Abstract

In the aftermath of the Lehman Brothers collapse in September 2008, drop in the supply of trade finance, a critical engine for trade transactions, has become an acute concern for the development community. Banks were increasing pricing on trade finance transactions to cover increased funding costs and higher credit risks, and trade was dropping drastically in most countries, with global trade projected to decline in 2009 for the first time in decades. Yet, little was known about the real impact of the crisis on developing country’s capacity to export. The World Bank has commissioned a firm and bank survey on trade and trade finance developments in developing countries during the first quarter of 2009 to collect field information. In total, 425 firms and 78 banks were surveyed in 14 developing countries across five regions.

This paper summarizes the findings of the survey as well as discusses the type of policies governments and international organizations put in place to mitigate the impact of the crisis. In sum, the survey findings confirmed that the global financial crisis has constrained trade finance for exporters and importers in developing countries. But the impact varied by the firm size, sectoral activity, and countries’ integration into the global economy. In particular, SMEs were particularly affected, and export diversification was made more difficult, especially in low income countries. Nevertheless, drop in demand has emerged as the top concern of firms at the time when the survey was conducted in March–April 2009.
Trade and Trade Finance Developments in 14 Developing Countries Post September 2008—A World Bank Survey
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The consultants administered the survey questionnaires for firms and banks in 14 countries (Brazil, Chile, Egypt, Ghana, India, Indonesia, Kenya, Peru, the Philippines, Sierra Leone, South Africa, Turkey, Tunisia and Ukraine), collected the data and submitted reports to the World Bank about the trade trends and trade finance conditions in the above-mentioned countries.

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Executive Summary

In the aftermath of the Lehman Brothers collapse in September 2008, Pascal Lamy, Director General of the World Trade Organization, warned the international development community about the drop in the supply of trade finance, critical engine for trade transactions. These warning were supported by the increase in spreads, the spilling over of the financial crisis among both developed and developing countries, and by anecdotal stories reported by the press about developing country exporters constrained by trade finance. As of December 2008, trade finance deals were offered at 300-400 basis points over interbank refinance rates—two to three times more than the rate a year earlier. The cost of Letters of Credits was doubling or tripling for buyers in many countries, including China, Turkey, Pakistan, Argentina, and Bangladesh. At the same time, trade was dropping drastically in most countries in the Fall 2008. Exports and imports of forty-five countries that had reported trade data for January 2009 were uniformly weak, with an average drop of over 30 percent as compared to January 2008. Global trade of merchandise and services was projected to decline in 2009 for the first time in decades.

Yet, little was known about the magnitude of any potential shortage or ‘gap’ in trade finance, whether it was mainly demand or supply driven, the real impact on developing country exports, and the type of policies governments and international organizations should put in place to mitigate the impact. One of the reasons was the lack of data in this field. Banks rarely report trade credits volumes, and corporate lending is not globally collected. Selected data used to proxy trade finance trends indicated that trade finance flows was dropping. According to Dealogic,1 global trade finance contracted by about 40 percent in the last quarter of 2008 as compared to 2007. Data from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) on short-term trade finance messages sent between banks for letters of credits, guarantees and documentary collections showed a decline of 3.5 percent in October 2008 as compared to the same period in 2007. These early alarming signs were corroborated by historical evidence that trade finance tends to be highly vulnerable in times of crisis, as it was the case in East Asia in the late 1990s.

A critical question to the development community was to capture the impact of the crisis on developing countries in terms of availability of trade finance to their exporters and importers and the impact on trade flows. Several organizations have joined efforts to collect field data. The IMF-BAFT launched a survey of about 40 banks in developed and emerging markets in October and November 20082. Their results indicated that there has been a widespread increase in pricing of all trade finance instruments relative to banks’ costs of funds, but the quantity changes have been mixed. They also estimated that banks’ trade finance capacity constraints impact about 6-10 percent of developing country trade, implying a trade finance gap in the order of $100-300 billion.

The World Bank has sought to complement these efforts by conducting in March/April 2009 a firm and bank survey on trade and trade finance developments in developing countries since the beginning of the financial crisis. In total, 425 firms and 78 banks were

1 Dealogic is a leading provider of global investment banking analysis and systems and one of the few sources of information on trade finance developments.
surveyed in 14 developing countries across five regions\(^3\). In sum, the survey findings confirmed that the global financial crisis has constrained trade finance for exporters and importers in developing countries. Yet, drop in demand has emerged as the top concern of firms. The lack of export revenues was putting pressure on firms’ cash flow and, therefore, their capacity to fund their export and import transactions. The survey revealed some stylized facts at the firm, bank, and income levels.

At the firm level, firms that rely to a large extent on the banking system for trade finance have suffered from more risk averse and selective local banks. On the contrary, firms that mostly rely on inter-firm financing and self-financing have been mostly affected by the slowing global economy, the lack and cancellation of orders, delays in buyers’ payments, and shorter maturity imposed by suppliers. SMEs have been more affected than large firms because of a weaker capital base and bargaining power vis-à-vis global buyers as well banks. Also, SMEs have been more subject to high increases in the cost of trade finance instruments. A large number of SMEs operating in global supply-chains and/or in sectors that have been most affected by the slow global economy such as in the auto industry have reported as being constrained both through the banking system and the drop in export revenues and buyers’ liquidity. Moreover, firms indicated being constrained by the need to provide more guarantees and insurance in times of crisis mainly due to lack of affordable supply of these products.

At the regional level, the three low-income African countries where our survey was conducted (Ghana, Kenya, and Sierra Leone), seem to have been relatively more insulated by the financial crisis as of March-April 2009. Their primary trade finance constraints originate from more structural problems such as poorly developed banking system and trade finance institutions, and macroeconomic imbalances. Many of these exporters have traditionally relied on self-financing and cash-in-advance; therefore, they have also been affected by the drop in commodity prices and global demand from their main export market (US and the EU). The drop in their cash reserves has further constrained their trade finance. The financial crisis has also added strains on the domestic financial systems and is unfavorable to SMEs and new firms that are seeking to diversify away from commodity exports. In South Africa, as in other middle-income countries in the other regions, trade finance constraints did not seem to have a regional dimension, but rather dependent on the nature of the business relationship with clients and industry.

At the bank level, the drastic reduction in global financial liquidity and in the number of intermediary players has pushed banks in developing countries to become more cautious, risk averse and selective, tightening trade finance conditions. Interviews with banks confirmed the increase in pricing and drop in volume of trade credit. Yet, the drop in volume seems to reflect lack of demand due to the global recession rather than a consequence of the increase in pricing. Moreover, lack of liquidity in local currency did not appear to be an issue.

In terms of governments’ response, the survey revealed that most governments have taken actions to mitigate the impact of the financial crisis mainly through two channels: (i) Most

\(^3\) The 14 countries are: Indonesia and the Philippines in East Asia; Turkey and Ukraine in Europe and Central Asia; Brazil, Chile and Peru in Latin America, Egypt and Tunisia in Middle East and North Africa, India in South Asia; and Ghana, Kenya, Sierra Leone, and South Africa in Sub Saharan Africa.
governments sought to make available more liquidity in the financial system to alleviate pressure on domestic banks, or to secure trade credit lines to trading firms. In this perspective, government bodies such as publicly-owned Export Credit Agencies and/or Export Import Banks were instrumental. While it is still too early to assess the effectiveness of these measures, early reactions collected by the surveyors from exporters, importers, and bank indicate that either the additional liquidity has not yet translated into more lending by banks, or being not enough to compensate for the international credit lines; and (ii) Some governments put in place broad measures that aimed to support medium to long term exports and the competitiveness of domestic firms.
Introduction

In the aftermath of the Lehman Brothers collapse in September 2008, Pascal Lamy, Director General of the World Trade Organization, warned the international development community about the drop in the supply of trade finance, a critical engine for trade transactions. These warnings were supported by the increase in spreads, the spilling of the financial crisis among both developed and developing countries, and by anecdotal stories reported by the press about developing country exporters constrained by trade finance. Tight credit conditions were driving up spreads for trade credits in many countries, especially in emerging markets. Banks were increasing pricing on all trade finance transactions to cover increased funding costs and higher credit risks. At the same time, trade was dropping drastically in most countries, and global trade was projected to decline in 2009 for the first time in decades.

Yet, little was known about the magnitude of any potential shortage or ‘gap’ in trade finance, whether it was mainly demand or supply driven, the real impact on developing country exports, and the type of policies governments and international organizations should put in place to mitigate the impact. To improve information on the impact of the crisis on developing countries, the World Bank has conducted a firm and bank survey on trade and trade finance developments in developing countries during the first quarter of 2009. In total, 425 firms and 78 banks were surveyed in 14 developing countries across five regions.4 (See Annex 1 for more information on the sample).

The objective of the surveys was to collect field information on how exporters, importers, and banks in developing countries are being affected by the crisis. The analysis has proved to be very insightful, in particular in terms of who is being the most affected and why, as well as what are some of the long term constraints that policy makers should address to better support firms.5 In addition to the firm and bank surveys, the surveyors collected information on governments’ policy actions put in place to mitigate the impact of financial crisis and global recession on trade finance and trade flows.

The remainder of the paper is organized as follows: Section I reports on trade developments globally and in the countries where the survey was conducted. Section II highlights some key findings from the survey at the firm level. Section III focuses on results from the bank surveys. Section IV reports on the governments’ actions to support trade and trade finance.

I. Trade developments since September 2008

According to the World Bank projections as of June 2009, the global economy will contract at an annualized rate of 3 percent and trade in goods and services will shrink by

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4 The 14 countries are: Indonesia and the Philippines in East Asia; Turkey and Ukraine in Europe and Central Asia; Brazil, Chile and Peru in Latin America, Egypt and Tunisia in the Middle East and North Africa, India in South Asia; and Ghana, Kenya, Sierra Leone, and South Africa in Sub Saharan Africa.

5 However, the surveys do not to allow for a comprehensive and robust analysis of the firms’ constraints, and therefore, interpretation of the results should be cautious, including when drawing some generalization and policy recommendations.
9.7 percent in 2009 in an unprecedented synchronized way. A rebound is projected for 2010. The slowdown is relatively uniform across all regions suggesting that the drop in demand is the primary cause. While the global downturn started in developed economies, developing countries were also being affected. The Latin America region is projected to post the severest decline in trade in 2009, while the rebound will be driven by East and South Asia. These projections are in line with a review of the impact of historical global downturns on trade flows by Freund (2009) indicating that the elasticity of global trade volumes to real world GDP has increased gradually from around 2 in the 1960s to above 3 nowadays. This is a result of the increased vertical specialization that characterizes trade and the large proportion of trade occurring within global value chains. According to Yi (2009), the consequence of the global integration is that each $1 of exports contains more imports than previously, so that a decline in GDP has a magnified effect on world trade. The positive side is that trade tends to rebound very rapidly when the outlook brightens. Trade in services is proving to be more resilient. Monthly U.S. trade in goods declined by 33 percent in value terms between July 2008 and February 2009; trade in services declined by only 10 percent during the same period. This trend is also observed for other developed countries and developing countries. The resilience of services trade is mostly a reflection of relatively robust demand for business-related professional services (e.g., insurance, telecommunications) and technical services (e.g., legal and IT outsourcing). The value of trade in services such as transportation of goods and people and tourism has fallen in line with the merchandise average, but business process outsourcing is still registering positive growth rates (albeit much lower than pre-crisis). It also reflects the fact that the demand for services is less cyclical than demand for goods and not subjected to the decline in inventory supplies. Services trade has also been less dependent on trade finance than trade in goods.

A. Drop in merchandise exports preceded decline of imports

Among the surveyed countries, the World Bank estimates that the Philippines, Ukraine and Turkey would be the most affected, while low-income countries in Africa, mostly commodity exporters, would be more resilient and post positive export growth in 2009 (Figure 1). Monthly data available up to March 2009 for nine out of the 14 surveyed countries confirm that trade plunged starting in the last quarter of 2008 and continued to decrease in the first months of 2009 (Figure 2). Interestingly, the drop in trade in most of these countries has been driven by a sharp decline in exports as demand from developed countries dried up abruptly in the last quarter of 2008. Also, in commodity exporter countries, exports and imports tend to be less synchronized as imports traditionally include consumer and intermediate goods and inputs for the domestic economy, and for which the local demand has not been affected in the early phase of the financial crisis. However, exports have been affected by the recession in developed countries. As a result, exports dropped by 10 percent on average across these nine countries, while imports increased by 7 percent on average, during the last quarter of 2008. As a result, some countries have reported an alarming squeeze in their current account and foreign exchange reserves that was constraining their trade finance capacity.
B. **The crisis has affected trade in different ways**

While most countries have been severely affected, the impact of the decline has been relatively severe in countries that are integrated and dependent on trade with developed countries, where demand has sharply contracted. In our sample, those countries include Indonesia, the Philippines, South Africa, Tunisia and Turkey. The increased fragmentation of the production that took place in the last two decades has led to the increase in the elasticity of global trade volumes to real world GDP from around 2 in the 1960s to above 3 in recent years. The higher elasticity means that trade would drop faster
as output declined but also translates to a more rapid recovery as the recession ends (Freund 2009)\(^6\).

Trade in certain sectors and products have been more affected than others. Exports of durable goods have been most affected. Specifically, disaggregated monthly data for the U.S. and Japan show that some industries are harder hit such as mineral products, transportation equipment, metals, and stone and glass, while others such as have seen an increase in trade. In Brazil, most sectors faced export revenue reductions in January 2009, but the automotive sector has been particularly hit. Exports from lean retailing industries such as Textile and Clothing were also affected, in particular in countries where this sector represents a large part of export revenues such as in Indonesia, Tunisia, and Turkey. Trade of non-durable consumer goods such as cell phones, food and tobacco products have declined least, as demand for these products is less likely to be put off as long.

Commodity exporters such as Sierra Leone, Kenya and Peru have mainly suffered from the drop in commodity prices. A number of commodity prices from agricultural products to minerals and energy have abruptly dropped in the second half of 2008, after reaching a peak in previous months. In Sierra Leone, diamond and rutile exports (79 percent of exports) reduced by 50 percent and 20 percent respectively. For Peru, commodity exports (minerals, fish oil/meal and coffee) dropped 20 percent in the last quarter of 2008 compared to the same period in 2007. Ghanaian exports have remained strong with the price of its traditional exports such as Cocoa, Gold and Timber continued to increase.

Exports of services have generally proven to be more resilient (Mattoo and Brochert 2009). The resilience of services trade is mostly a reflection of relatively robust demand for business-related professional (e.g., insurance, telecommunications) and technical services (e.g., legal and IT outsourcing). The value of trade in services such as transportation of goods and people and tourism has fallen in line with the merchandise average, but business process outsourcing is still registering positive growth rates (albeit much lower than pre-crisis)\(^7\).

\textbf{C. Firms report that the drop in exports is mainly due to lack of new orders and lack of finance from buyers}

Two-thirds of the respondents declared that their exports dropped sharply between September 2008 and March 2009, in particular firms in India, Indonesia, Peru, Tunisia, and Turkey (Figure 3). The picture is more balance in the other countries where about the same number of firms have experienced either a drop or an increase in their exports. Similarly, 71 percent of respondents have reported a decrease in their imports since September 2008. This spans firms from different size and sectors. The survey indicates that large firms have reported a decline in their imports to a larger extent than to SMEs, most likely reflecting their capacity to cut on imports and rely on larger inventories in times of gloomy economical prospects. On the contrary, SMEs seem to have been more affected than large firms with regard to exports as they tend to rely on fewer clients and


\(^7\) In Egypt, services exports dropped due mainly to a drop in Suez Canal receipts and a contraction in tourism revenues, affected by the decline in the number of tourist nights on the back of the worsening global economic conditions.
markets, often integrated with buyers in rich countries, and therefore more sensitive to demand.

A majority of firms declared that lack of new orders and/or cancelled orders explained the drop in their exports, indifferently from the size of the firm (Figure 4). Firms in Tunisia and Turkey particularly emphasized the effect of a slower economy in the EU, their main export market. This has translated into less orders but also lack of finance offered by buyers. Indeed, a large number of firms from the above two countries as well as the Philippines have reported lack of finance, mainly from the buyer, to constrain their exports. This illustrates the case of firms for which trade finance constraints are not directly related to lack of financing from the banking system since they traditionally rely on self-financing and/or financing from the buyers. They are affected by a weaker global demand and uncertainty on future prospects. These firms will likely recover more quickly as the economy picks up even if the banking system is not yet fully rehabilitated.

**Figure 3: Most firms reported a drop in their exports and imports between September 2008 and March 2009**

- 63% of firms reported a drop in exports
- 71% of firms reported a drop in imports

**Figure 4: Lack of finance and cancellation of orders are the main reasons for decline in exports**

- No new orders: 51%
- Canceled orders: 18%
- Lack of finance on buyer’s part: 25%
- Lack of finance on company’s part: 7%

Number of respondents: 190
Despite the abrupt drop in exports, 55 percent of firms have not changed and did not foresee changes to their destination for exports or origin of imports. Main reasons for not changing export destination or import origin for most firms are threefold: (i) Firms are still assessing the impact of the financial crisis; (ii) Companies still rely on existing clientele for business; and (iii) Companies prioritize profitability and remaining competitive over shifting business strategies to explore new markets. Still, some firms that are highly integrated in supply chains and relying on very few markets have reported or expect a substitution for destination of exports. Some Philippines firms have declared they are shifting from the U.S, South America, and EU markets to mainly China and Taiwan. Firms in Turkey expect to export more to China, and regionally to Algeria, Egypt, UAE and Qatar, while they expect exports to U.S. and EU markets to decline. In Egypt, surveyed firms indicated a slight substitution from the U.S. and the EU to China, and Arab and African countries. Moreover, some of these firms that have been relying extensively on the export market might explore new opportunities on the domestic markets.

II. Firms’ perspective on scarcity of trade finance: Who is affected and why?

Along with the rapid decline in trade and the reported freeze of trade finance, a critical question has emerged for policy makers in developing countries and development organizations about the extent to which exporters and importers in developing countries are being constrained by the trade finance freeze. The hypothesis is that the financial crisis may have reduced the supply of trade finance, and that the lack of it may deepen and prolong the recession, halting the economic growth of emerging economies and many poor countries already vulnerable. The trade finance “gap” was estimated using various methodologies (e.g., bank surveys, and drop in trade flows combined with an estimation of trade financed by trade finance instruments) and there seems to be a global convergence towards a “gap” of $250 billion. In this perspective, the World Bank survey of 425 exporters and importers in 14 developing countries conducted six months after the beginning of the crisis sheds some light on the firms’ assessment of the crisis and the origin of their constraints.

A. SMEs most affected by tightening trade finance; yet mainly worried about global demand

While most firms have reported a tightening in trade financing since September 2008, SMEs were the most affected. The most often cited constraints relate to the increase in cost of trade financing instruments, banks’ more stringent selectivity and guarantee requirements, and delays in payments from buyers. SMEs are more vulnerable due generally to their low credit standing (low capability to provide collateral) and the tenuousness of their remaining viable in the face of the sharp and possibly prolonged

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9 New firms are also affected as reported by banks – see section III reporting finding from the banks survey
decline in demand. Large corporations often rely more greatly on self-financing and retained earnings. Also in times of crisis, banks have been reported to follow a ‘flight-to-quality’ strategy and offer better lending rates to large corporations which often are better capitalized and likely to be more resilient to a drop in demand.

- In Chile, bank interviews indicated that large firms that traditionally financed internationally have turned toward the domestic banks, crowding out domestic SMEs.
- In Indonesia, SMEs reported that the cost of trade finance has become more expensive than for larger firms.
- In Peru, interest rates for larger companies have increased twice as much as for SMEs.
- In the Philippines, multinational banks remained focused on larger domestic firms and multinational companies located in the country. Little credit exposure is made to local, and, much less, smaller exporters. Moreover, the domestic banks maintained their trade credit lines with large, reputable exporters, while smaller exporters have been experiencing a reduction or even winding down of their trade credit lines. Larger firms have also access to lower interest rates, capital markets and greater assets to support their lending operations.

Even firms that have not been relying extensively on the banking system for trade finance have also been affected. These firms usually use open account with self-financing, cash in advance and accounts payable. The scarcity of trade finance originated from the slower demand from their export markets and the consequent drop in revenues, delays in payment terms by buyers, and shortening payment terms by suppliers. This has in turn squeezed the capital base of exporters and importers, their working capital and capacity to self-finance their transactions. It is typically firms that are integrated in global supply-chains with a zero-sum game between different segments of the value-chain: firms lower in the supply chain are more affected as a result of reduced access to credit by final suppliers/customers.

- In Indonesia where most firms in the sample produce consumer products and are assemblers of different semi-finished products to be final products, the impact has been large. Exporters were experiencing an increase of up to 37 days in their cash flow cycle.
- In India, 60 percent of firms’ cash-to-cash cycle time has increased from 15 to 90 days post September 2008; and 80 percent of firms reported overdue payment ranging from 5 to 70 percent of their sales.
- Firms in Turkey also complained about overdue payment, in particular when using a direct method of payment rather than safer method of payments such as Letters of Credit (LCs). This may lead some firms to prefer safer methods of payments, provided that banks are willing to work with them.

Yet, most firms highlighted that the drop in global demand was their top concern and that trade finance was not a major binding constraint. They noted that they could still handle these tightening conditions. These reports will be corroborated by the banks survey results in Section III as trade finance volumes have reportedly increased despite higher pricing in countries where trade flows have been somewhat sustained such as in Kenya and Ghana.
Lack of trade finance might have been an acute problem in the aftermath of Lehman Brothers’ collapse when spreads picked up and trade finance instruments froze, but less so at the time when the survey was conducted (March-April 2009). It also made the ability of firms to diversify their export market more difficult at a time when demand from their main market has declined abruptly. The pressure might reemerge when the global economy picks up and the trade credit still tight.

About a third of firms surveyed signaled that pre-export financing has been a major obstacle for exports (Figure 5). A quarter of the respondents declared it has become more of an obstacle since September 2008. The main issues raised by respondents are the cost of pre-export financing and refusal of banks to lend. In particular, firms mentioned higher down payments, more collateral required and higher interest rates. Exporters in Peru, Ghana, South Africa, the Philippines, and Kenya, seem to be the most constrained for a variety of reasons related to the method of payment used, industry and firm’s size.

- In the case of commodity exporters in Peru and Ghana, using formalized method of payment (e.g., LCs) to fund pre-export financing, the issue is stricter bank selection criteria. In Peru, surveyed firms report that the problem is the higher cost in a range of 2% - 5%.

- For SMEs, with weaker capital base, and firms in global supply chains producing consumer goods such as in the Philippines and South Africa, using self-financing and buyer down payment, the issue is the drop in orders and payment delays that are constraining exporters’ cash-flows and importers’ liquidity. Also, turning to the banks in such instances is not always an alternative as banks prefer to work with existing clients. Indonesian firms seeking new markets have been constrained by the need to find information about these new markets and buyers, but also by the fact that banks would not lend them working capital for pre-shipment finance.

**Figure 5: Access to pre-export financing has been a problem for commodity exporters in Kenya, Ghana and Peru**

(% of firms declaring access to pre-export financing an obstacle)
B. Banks are requiring more guarantees and insurance while firms usually find them unnecessary and expensive

While a majority of respondents declared traditionally not using export guarantees or trade credit insurance (Figure 6), surveyed firms highlighted that banks were requiring more of them as buyers’ banks were defaulting in some countries, and firms delaying payments and being at risk of insolvency. The predominant firms’ explanation for traditionally not using export guarantees is the presence of an established business relationship with the client not justifying the use of such an instrument. This is particularly the case for exporters with established clients, either commodity exporters or those in supply chains. The second most important reason is the cost of export guarantees, followed by poor services and limited coverage (Figure 7). For Kenyan exporters, although the African Trade Insurance Agency (Box 1) has been in existence for a number of years, it has so far limited its coverage to political risk insurance. Only recently, the agency has started to provide commercial risk insurance. It is also reportedly under-capitalized and understaffed for an institution with a regional dimension.

Figure 6: Most firms report not using guarantees or trade credit insurance…

![Figure 6: Chart showing the percentage of firms not using guarantees or trade credit insurance in different countries.]

Number of respondents: 294
Yet, where specialized institutions offer wider services such as in Tunisia, Peru, Turkey, and South Africa, a large number of firms declared using export guarantees or trade credit insurance. In South Africa, the Credit Guarantee Insurance Corporation provides both guarantees and insurance services for short term credits, and the Export Credit Insurance Corporation that provides only insurance services for medium to long term credits. In Tunisia, two large institutions, SOTUGAR and COTUNACE, provide a wide variety of services and coverage. Such commercial insurance cover is widely viewed as necessary to support more robust trade finance operations.

Surveyed firms reported that providing guarantees and insurance in times of crisis is more difficult. In Chile, all firms reported that insurance companies have reduced their coverage as a result of the crisis. Foreign companies were the first ones to react (they noted the effects of the crisis on their customer portfolio), but by the beginning of 2009 all Chilean insurance companies had already reacted in a similar way. Insurance fees have not changed much because they are usually long term conditions; nevertheless, companies believe that these might increase in future negotiations as a consequence of the crisis. Most interviewees indicate that no specific countries have been vetoed and that in general insurance companies maintain coverage for existing customers, but that it is harder to obtain insurance for new customers. In Eastern Africa, pressure on the ATI to expand has increased as demand for insurance has recently amplified as a consequence of the tightening their lending requirements by banks. Respondents in the Philippines, Kenya, India and Peru noted that they would like their respective governments to provide more guarantees, as well as political and commercial risk insurance for export transactions. In response to the crisis, some governments have also increased the coverage and the capital of publicly-owned guarantee and insurance agencies as in Tunisia (more in Section IV on governments’ response to the crisis).
Surveyed firms in LICs (all three in Africa: Ghana, Kenya, and Sierra Leone) seem to have been less directly affected by the financial turmoil and rather struggle with long standing domestic issues and decline in commodity prices.

i. Firms have traditionally relied little on traditional trade finance instruments for export finance because either the local banking sector and institutions are poorly developed to start with, or banks find it difficult to find creditworthy customers. For example in Sierra Leone, commercial banks have traditionally have often preferred to take a conservative attitude to the granting of credit and invest in government Treasury Bills/Bonds. In Ghana, most institutions providing export finance tend to be undercapitalized. They have limited sources of raising deposits and fail to develop the working strategy at raising the right level of funding, be it capital or deposits.

ii. Most firms surveyed in these countries are commodity exporters with established buyers and secured credit lines or relying on self-financing. In Ghana, traditional exports of Cocoa, Gold and Timber that represent three-quarters of the country’s exports are mostly financed through offshore syndicated working capital borrowing and medium-term loans from international banks. In March 2008, Ghana Cocoa Board was able to secure a three-year medium term loan deal of US$200 million from the Royal Bank of Scotland and Ghana International Bank. Cocoa prices have also gone up so corporate revenues have not been affected yet.

Box 1: The African Trade Insurance Agency (ATI)

ATI is an African Regional International Financial Institution established in 2001 by African States at the initiative of COMESA and with the financial and technical support of The World Bank Group. Its mandate consists of facilitating, encouraging and developing the provision of, or the support for, insurance, including co-insurance and reinsurance, guarantees and other financial instruments and services for the purposes of promoting trade, investment and other productive activities in Africa in supplement to those that may be offered by the public and private sector, or in cooperation with the public and private sector. Any exporter domiciled in one of the ATI Member States and exporting to a buyer outside Africa is eligible for credit insurance by ATI covering short term trade receivables usually not exceeding 120 days. The products are distributed via a web of brokers. The risk is mitigated through re-insurance services of various international organizations on a 60/40 basis (60% of the risk is to remain with ATI).

ATI has recently been restructured to provide not only political risk cover for the countries of Eastern Africa but also commercial risk cover (up to 90%) to exporters on their receivables from anywhere in the world. The trade credit insurance product has been launched a year ago but has only recently become operational. The means of ATI in terms of manpower are still relatively small given the number of countries covered.
In Sierra Leone, no formal arrangements for export financing exist. For diamond and rutile/bauxite exporters in Sierra Leone relying mainly on self financing, the trade finance crush originates from a drop in commodity prices - diamond prices have fallen on the international market by between 30% and 50% since September 2008. This has led to the squeezing of exporters’ revenues and foreign exchange reserves.

iii. Moreover, the turmoil in the trade credit market seems to be relatively less of a priority for policy makers in these economies dealing with from serious macroeconomic imbalances that have been undermining the business environment for many years. In Ghana, as at the end of 2008, fiscal deficit stood at US$2,131 million, about 15% of GDP which is the highest over the past 10 years. Inflation as at the end of January was 19.5%. In Kenya, many banks have stopped lending and tightened their lending criteria because of the sharp economic slowdown Kenya is facing due to the serious drought the country is facing and the resulting low food production and high food prices.

D. Despite the crisis, firms have not changed their method of payments toward safer instruments

One of the objectives of the survey was to test the hypothesis that given the drop in global demand and the uncertainty prevailing in the banking system, firms would switch towards more formalized methods of payments such as letters of credits and documentary collection. According to the survey results, most firms have not changed their payment requirements with trading partners essentially because the key factor determining the type of payment is the nature of business relationship (Figures 8 and 9). Firms are also equally sensitive to the good standing of the buyer’s bank and the country of operation. Only six percent of the respondents declared that they would change their method of payment because of the increased pricing of trade finance instruments.

About two-thirds of surveyed exporters and importers reported that their preferred method of payment is open account and cash in advance/pre-payment. This pattern is particularly pronounced for firms surveyed in Tunisia, Turkey and Indonesia, which are highly integrated in global supply-chains and work with recurrent clients. Trustworthiness and a sound business relationship are prevalent. Moreover, SMEs reported using more cash in advance/pre-payment than large firms do. Since this is one of the riskiest methods of payment, the heavier reliance of SMEs on this method probably reflects their weaker bargaining position versus large firms. Of course, the pattern varies across countries.
Figure 8: Majority of respondents declared they have not changed their methods of payments which depends mostly on the nature of the business relationship.

![Key Factors Determining Type of Payment](image)

Figure 9: Majority of firms are not changing their method of payment for trade transactions.

![Number of respondents: 264](image)

While the crisis has led some firms to choose more formalized and secured transactions such as LCs and documentary collection to avoid delays in payments that are highest with direct method of payment, the survey does not reveal an obvious shift towards more secured trade finance instruments. Many factors might explain this result.
First, the shortfall in trade finance and drop in trade volumes have been relatively sudden and of a larger magnitude than anyone would have expected a few months earlier. This contributed to increase the degree of business uncertainty and might have led to a “wait and see mode” attitude as reported by some firms.

Second, in a world where lean retailing and fragmentation of production prevail, buyers are the drivers. As a consequence, it seems that the crisis has not reversed the secular trend of moving away from L/Cs to open accounts. Firms are rather concerned about keeping their clients and not taking the risk to jeopardize a long-term relationship based on trust. Exporters in Egypt reported that it is still preferable to use open account to facilitate transactions and get deals. SMEs doing business with large firms also find it difficult to request for L/Cs. Some interviewed Indian sellers, largely small and dispersed, reported that they do not have a lot of bargaining power with large buyers, so it is difficult to ask for L/Cs, let alone cash-in-advance. In the Philippines, firms reported to continue to prefer avoiding these formal transactions with banks that tend to be demanding and costly and choose alternative sources of financing such as through family members.

Third, some local banks in developing countries have somewhat lost confidence in L/Cs issued by buyers’ banks, often in rich countries, as a result of the inability of buyers to pay what they ordered. Thus, the “sanctity” of the L/Cs has diminished. Finally, the slow global economy and drop in global trade volume have translated into a drop in the use of all trade finance instruments (L/Cs and short-term loans) as reported by most banks interviewed (see next section). Therefore, any drop in L/Cs should be interpreted with caution.

III. Banks’ perspective on scarcity of trade finance: Weak demand and heightened risk aversion

The World Bank survey also included interviews of a total of 78 banks and financial institutions in 13 developing countries (excl. Indonesia) to assess any changes and trends in trade credit volumes post-September 2008. This is particularly useful in light of the absence of data on trade finance. Comprehensive statistical compilation of flows is difficult to extract from balance of payments due to the high cost of information, technology needed, and the difficulty to guarantee a high level of accuracy to very short term capital movements. From the countries surveyed, only two of them (Brazil, and Turkey) had macro trade finance data available overt time as described below. Moreover, a large part of trade finance transactions takes place between buyers and suppliers which are not required to report their transactions. Against this background, the bank surveys aimed to produce qualitative results and were conducted through phone or in-person interviews. The bank questionnaire covers bank lending activities and practices pertaining to trade loans, trade credits, and short and medium-term financing for export and import transactions from September 2008 to April

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10 At present, the only available and reliable source of statistics comes from the Berne Union database, which provides data on the amount of business of export credit agencies.
2009. Overall trends from the survey indicate that trade finance has been noticeably constrained post-September 2008 as illustrated by increased pricing of trade loans and short-term financing, shortened payment terms, requests for more guarantees, and tightened counterparty bank requirements. This general trend applies to the majority of the banks across the 13 countries.

A. Pricing of trade loans increased but not a binding constraint

The majority of surveyed banks indicate that the pricing of trade loans and credits have gone up since the 4th quarter of 2008. The survey findings show an array of factors affects the pricing of trade loans and credits, with some variation depending on the bank’s country of origin, the bank’s exposure to international financial markets, its cash reserve ratio and capital requirements and the demands and profile of its clientele. Most banks have cited the increase in cost of funds as causing the increase in local pricing of trade finance instruments.

- In Brazil, the ACC\textsuperscript{11} interest rates, traditionally considered “cheap money” for Brazilian standards, are priced on the basis of the London Interbank Offered Rate (Libor) plus a spread rate, normally amounting to 5% to 8% for the exporting company. On September 17\textsuperscript{th}, the day after Lehman Brothers crashed, interest rates began a rising trend from 5.6% to 13.7% in October 3\textsuperscript{rd} – the worst day of the series (Figure 10). But by the end of January, the pressure seemed to have eased with the rate settling at round 9% – albeit in the presence of volatility.

![Figure 10: Brazil’s ACC Annual Interest Rates](image)

- In Chile, the banking sector suffered from the notorious spread increase in the operations to obtain resources from foreign Banks. Between September and October the spread over Libor for 180-day operations increased by around 150 basis points, according to our interviewees. Financing options for terms longer than or equal to 360 days all but disappeared. By November, spreads began decreasing but they continued to be significantly higher than before September 2008, as of February 2009 (Figure 11). Reports of spread increases are not particular to Chile but rather widespread as indicated in the rest of the section.

\textsuperscript{11} The “Adiantamento de Contrato de Câmbio” (ACC) is one of the most important exports suppliers credit modality used in Brazil. Basically, it is an anticipation of financial resources related to export contracts and it has the purpose of financing production of goods that are going to be exported.
Other banks have noted that increased capital requirements affected its pricing structure. Banks in India attributed increased pricing to higher capital requirements imposed by the Central Bank of India (RBI), with the majority of banks reporting that LC prices have risen by 10-30 percent and all banks reported that short-term financing has increased by 35 to 150 basis points above LIBOR. Finally, some banks such as in Egypt reported that they have resorted to rationing of credits as a safeguard lack of confidence and risk aversion after September 2008.

Yet, banks have not reported the increased pricing as a factor explaining the drop in volumes of trade finance. Factors that have reportedly contributed to the decline in volumes include (i) a drop in demand for trade loans and credits by firms due to the global economic recession; (ii) difficulty in finding creditworthy customers; (iii) and risk aversion for short-term loans in bank portfolios.

These reports are corroborated by more macro data available for Turkey and Brazil. In Brazil, export finance volume started falling as of October 2008. The average volume of export pre-payment, one of the most important suppliers credit modality used in Brazil, dropped an alarming 42 percent in comparison with the monthly average volume of 2007. In January 2009, the worst month of the historical series, pre-payment reached only $1.5 billion, representing a fall of 63 percent in comparison with January 2008 and 60 percent compared to the average volume of 2007. In Turkey, value of letters of credit issued by the Turkish banking sector declined by 25 percent between September and December 2008. Similarly, export credits provided by the Turkish banking sector decreased by 13 percent during the same period, putting a halt to a positive trend since 2004 (Figures 12 and 13).
The demand effect seems to explain to a larger extent the drop in banks’ volumes of trade loans. In Ghana where exports of cocoa kept up, banks reported an increase in the volume of letters of credit and short-term financing for the period September-December 2008 versus comparable period in 2007 despite an increase in the cost of financing for both instruments. Similarly, in Kenya where both imports and exports increased, trade credit increased in 2008 despite an increase in lending rates making trade credits to the private sector more expensive.

**B. Banks reported not lacking liquidity but implementing more stringent lending requirements**

*Very few surveyed banks have reported lack of liquidity in local currency as constraining their supply of trade finance.* Banks in Sierra Leone have traditionally been liquid but not providing export finance because of a scarcity of creditworthy customers, among other things. The banking systems in most of the other countries, in particular in Chile, Egypt, Kenya, South Africa and Tunisia, also appear as well-capitalized in local currency and have not experienced liquidity constraints since the onset of the crisis\(^{12}\). In contrast, some banks have reported more difficulty accessing liquidity in foreign currencies which have become more scarce and expensive as a consequence of the liquidity crunch in western banks in a first stage, and the drop in export revenues. Banks had more difficulties financing large import transactions such as big purchases of equipments or large investments by public companies as reported by Tunisian banks.

\(^{12}\) The relatively secured position of the Chilean Banks seems to be the consequence of a delayed impact of the crisis and the macro position of Chile. The banking sector in Chile has become strongly capitalized, highly regulated, and fairly concentrated after the dramatic crisis of 1982. Furthermore, in Chile, while the banking sector and the private corporations are net debtors from the rest of the world, the Government and the Pension Funds are net creditors.
Sierra Leone has started feeling a severe shortage of foreign exchange due to several factors including the drop in export earnings and personal remittances.

However, the majority of banks reported that they have tightened counterparty bank criteria, excluding certain banks and countries in lending portfolios. They are requesting for additional insurance and confirmation from banks, conducting detailed due diligence to pre-select counterparties, being more restrictive and risk averse towards new markets, new clients and new products, and adding additional safeguards to loans via guarantees and higher confirmation fees. With lack of liquidity in local currency not being reported as a major constraint, risk aversion in the banking system with regard to client firms may translate a risk mitigation strategy in case the crisis prevails or worsens.

Bank interviews also corroborate the reports by firms discuss earlier with regard to the banks’ criteria for tightening. Interviewed banks confirm that they are more likely to impose stringent conditions on SMEs than larger firms and for firms operating in industries that are the most affected by the crisis:

- In Chile, larger firms that have previously relied on foreign capital have turned back to domestic financial markets, causing a “flight to quality” scenario, crowding-out SMEs and new firms by making lending criteria more restrictive.
- Banks in the Philippines indicated that lending decisions have become more stringent for some exporters in certain industries such as garment, furniture and electronics. Some banks have refused lending to some exporters while other banks have significantly tightened lending criteria such as requiring more collateral.

The perception of geographical risk by banks has changed post-September 2008. Surveyed banks have tightened criteria for risky banks from countries that have been directly affected by the crisis, such as the U.S.A, the EU, China and Iceland. However, some banks have also added an array of banks in other countries due to political and commercial risk considerations. For instance, the list of countries that banks in Turkey have tightened or restrict lending to include India, U.S., Italy, Korea, Russia, Kazakhstan, Ukraine, Hungary, the Baltic Countries, Pakistan, India, the UAE, Bangladesh, Algeria and Libya. Similarly, some banks in Chile have tightened operations with counterparty banks from wide-ranging locations including Russia, Ecuador, Venezuela, Argentina and other countries in Eastern Europe. This is in contrast to firms’ ‘wait-and-see’ mode in terms of changing geographical destination and origin for exports/imports as described in the previous section.

IV. Governments’ actions to mitigate the impact of the financial crisis

Notwithstanding the impact of the crisis on firms and banks, many governments have quickly sought to mitigate the potential impact of the crisis on their domestic economy and export sector. Therefore, one of the objectives of this survey was to collect information on measures taken by governments to mitigate the impact of the financial crisis on trade and trade finance. Our findings reveal that all governments of countries where the survey took place enacted or planned to implement supporting policies, albeit in
varying degrees and forms. These include various combinations of short-term solutions to provide immediate relief to firms and banks, and of long-term adjustment strategies to bolster countries’ export competitiveness. The main actions taken by governments can be grouped in two categories: (i) to increase banks’ liquidity to alleviate liquidity pressure including for trade finance; (ii) to enhance the long-term competitiveness of the country’s exports by developing and expanding export promotion programs (Annex 2 summarizes the government actions taken by the 14 countries surveyed as of April 2009).

A. Governments have implemented measures to alleviate constraints on liquidity and trade finance in particular, notably through ECAs or equivalent government agencies

As soon as reports about western banks lacking liquidity has spurred many governments of developing countries to inject preemptively liquidity into the financial system to encourage alleviate the financial pressure on firms and support trade-related lending. Most governments of the surveyed countries have often implemented a combination of measures to lower lending rates and extend maturities for borrowers, to provide new lines of credit for pre- and post-shipment transactions to ensure that trade financing and working capital needs are met, and to expand export guarantee and insurance programs for risk mitigation. The list below illustrates some of the broad measures implemented by the various governments to increase banks’ liquidity:

- Some governments initiated interest rate adjustments to encourage bank lending. The Egyptian Government reduced overnight deposit lending rates; the Turkish Central Bank increased its discount limits; and the Indian Government extended interest rate ceilings for export credit.
- Some governments such as India, the Philippines, and Peru coordinated with domestic banks to reschedule debt payments for firms. The Indonesian Central Bank took the initiative to re-open its facility for private banks to rediscount their exports LCs.
- Governments such as of Tunisia and Kenya required banks to lower their cash reserve capital requirements to generate additional lending capabilities. The Tunisian Central Bank decreased the rate of compulsory reserves in January 2009 to make available to the banking system additional liquidity of about TD250 million, and lowered its rate from 5.25 to 4.5% to help reduce the cost of financing for companies (as of February 2009).

ECAs have been instrumental to governments to channel trade finance to firms. In addition to the above broad measures, some governments’ actions directly targeted the reportedly lack of trade finance available to firms. Interestingly, while some governments have tried to achieve this objective by establishing rediscount and refinance facilities to increase liquidity for trade loans and export credit, many have implemented direct measures through the established ECAs or Ex-Im Banks. When public, these entities typically serve as channels for the government to issue trade credits, loans, and guarantees and insurance to the private sector. In many of the surveyed countries, public ECAs and Ex-Im Banks served as the “providers of last resort” for trade finance as in Brazil, India, the Philippines, South Africa and Turkey. ECAs and Ex-Im Banks were used by national governments to channel new lines of trade credits and loans.
The Brazilian government established new credit lines via the National Bank for Economic and Social Development (BNDES) to provide pre-export and export finance;

The Indian government established a refinance facility of RS 50Bn for the Ex-Im Bank of India and extended interest rate ceilings for export credit;

In Tunisia, the government has injected capital to a quasi-government entity, CONTUNACE, to increase its capital base by 6 million Dinars;

The South African government proposed the introduction of a pre-shipment facility for select industries;

In Turkey, the government has expanded Export-Import Bank of Turkey’s export credit and insurance facilities.

**Other public entities have also been instrumental.** Some other governments intervened through government-owned or supported development banks that serve as sources of “second-floor” financing to direct trade finance to private lenders and borrowers. The Chilean government has leveraged its fiscal surplus and has tried to permanently assure a reasonable level of liquidity and foreign currency to favor the normal performance of the banking system, notably through CORFO, the economic development agency providing business financing. As early as October 2008, CORFO announced new credit lines of “Second Floor” financing exclusively dedicated to satisfying working capital needs and to providing funds to non-banks factoring agencies. The government also injected liquidity into the Credit Insurance Programs for exporters and added significant funds to FOGAPE, a program managed by the Banco Estado (the only State Bank in Chile), which provides default insurance for credit given to small companies. All programs conceptually continue to rely on the decision of private banks regarding to whom to lend, something that is valued positively by interviewed firms. Moral hazard is diminished in that always insurance is partial, and therefore, a private credit risk evaluation has to take place anyway. The policy objectives of these public measures were designed to help viable firms to maintain financing access by tackling commercial credit shortage in general and not only trade finance scarcity. Policies do not differentiate between firms that trade internationally or locally. However, the government also has strengthened the existing tools that favor credit access to small companies and export companies in particular.

In the absence of formal government’s entities that offer trade finance instruments, some governments decided to set them up or make them into law, and use other public bodies. In Indonesia, the government passed legislation in December 2008 to transform an existing government agency into an official Export-Import Bank that would provide funding and insurance for trade finance. In Ukraine, the parliament passed a law that granted the Ukreximbank the status of official export credit agency and supports plans to establish a government export insurance company, "Ukrainian Export Insurance Company". In Sierra Leone, the government has recently established the Sierra Leone Investment and Export Promotion Agency (SLIEPA), which has the responsibility of providing export finance and export credit guarantees.

**Development organizations’ trade credit lines are also an alternative resource to increase liquidity for trade finance.** A last group of countries have sought to increase domestic banks’ offer of trade finance by requesting new lines of credit from international and regional development banks. This is particularly the case in LICs where banks have
already established such credit lines. In Sierra Leone and Kenya, large public banks have benefitted from the confirming lines of credit issued by the World Bank private arm, the International Finance Corporation (IFC), and covering the political risk of the country of the issuing bank, as well as the risk of the bank itself. In Sierra Leone, the two government-owned banks, Sierra Leone Commercial Bank Ltd and Rokel Commercial Bank Ltd, both have IFC LC confirmation lines of US$1 million which have been fully utilized. Banks are now seeking to increase them to US$3 million13. The new Nigerian banks established in Sierra Leone are more familiar with LCs financing than the local banks and have confirmation lines from their parent banks, which are already being utilized to some degree. In Kenya, the IFC is experiencing an increased demand since the international corresponding banks have been pulling out. The IFC is also investigating the possibility to provide confirming lines to a number of new banks in the Kenyan market (currently only six banks out of 46 financial institutions benefit from these confirmation lines).

B. Some governments have implemented broader measures that aim at improving the competitiveness of the domestic economy and promoting exports

Some governments have taken the crisis as an opportunity to spur and/or institute programs and policies that promote the competitiveness of their domestic sector and exports. Such measures range from establishing new industrial sites and export promotion agencies to initiatives that aim to help firms promote their products overseas more effectively. Export promotion measures have reportedly been undertaken by the governments of Egypt, the Philippines, Sierra Leone and Tunisia.

- In Egypt, the government has allocated funds to develop new industrial sites and establish programs geared for export promotion.
- In Sierra Leone, the government has revamped the Sierra Leone Investment and Export Promotion Agency (SLIEPA) to provide export finance as well as export promotion for domestic firms14.
- In the Philippines, the government plans to provide a subsidy of P1 billion to the Export Development Fund to fund priority projects that will facilitate exports.
- The Tunisian government has introduced a number of measures to support exporters experiencing a reduction in their activity to mitigate the social impact of crisis in terms of unemployment and benefits, as well as a reform program to boost the competitiveness of the economy in the long term (Box 2).

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13 Some private banks have access to IFC LCs confirmation lines but have reportedly not utilized them yet.
14 The Sierra Leone government is also considering the option of setting up the Sierra Leone Produce Marketing Company to improve the quality of Sierra Leone’s cocoa and coffee exports.
To mitigate the impact of the crisis, the Tunisian government introduced a number of measures to secure the recovery of eligible* export companies in difficulty by improving their cash flow and lowering their financial costs. These measures did not include support to local banks as the government considers that they have not been affected by the crisis. Banks were rather instructed to be more flexible with companies affected by the crisis, to try to reschedule their outstanding commitments and to avoid their closure.

**Some of the measures targeted at firms in difficulty**

1. Support by the State of 50% of the contribution to social security during the appeal period to reduce working time due to the slowdown in their activity.
2. Support by the State of the contribution to social security when technical workers are unemployed because of the reduction in business in foreign markets.
3. Support by the State of 50% of the cost of insurance of export and the encouragement of “Compagnie Tunisienne pour l'assurance du commerce extérieur” (COTUNACE) to carry out the reinsurance of risks. Furthermore, the State increases the COTUNACE capital by 6 million dinars (MDT) in addition to the MDT by stockholders.
4. Support by the State of two interest rate points for exporters rescheduling their debt.
5. Allow credit institutions to deduct the ordinary and compound interest rates and interest on arrears which these institutions have foregone under the rescheduling operation in the property tax on companies.
6. Reduced refund time for tax credits and accelerated release of companies' claims in respect of public procurement.
7. Enlarging the access to FAMEX 2, the Export Market Access Fund, to include 200 new companies during the 2009, in addition to the 800 current beneficiaries.
8. Enable anti-dumping mechanisms and implement a specific program to reduce parallel trade.
9. Increased budget for fairs and exhibitions and to intensify campaigns to promote tourism.

**In addition, the Tunisian government has engaged in an ambitious reform program supported by a World Bank lending project to enhance the competitiveness of the economy:**

1. Reduce the number of MFN tariff bands from 9 to 5 by 2011 with the objective to reach an average MFN rate of 15%.
2. Streamline the non-tariff measures and import control techniques.
3. Implement the Single Window in the main port by 2011.
4. Put in place an information system to fight against counterfeit.
5. Elaborate a strategy to promote services exports, notably health care services, ICT, and professional services.
6. Reduce the VAT refund time for exporters to 7 days
7. A number of measures to modernize the financial sector and improve the business environment.

*Eligibility criteria: Proof of a real decline of activity; Proof of non-payment by customers; Having suffered cancellations of orders; and having received a request for significant drop in orders that were already planned. In addition, measures 1 and 2 are available for totally exporting companies only.*

Source: Consultant’s report and World Bank 2009
In their efforts to mitigate the impact of the crisis and support exports, many governments have benefitted from the financial support and the technical assistance provided by development organizations such as the World Bank Group (WBG) and regional development banks as well as the International Monetary Fund. The WBG has expanded the liquidity of local banks through the existing Global Trade Finance Program, and the set-up of the Global Trade Liquidity Program. Most of the activities aimed at increasing lines of credits available for SMEs and supporting the capitalization of EXIM banks. Some activities have a regional dimension such as the strengthening of the Africa Trade Insurance Agency to facilitate the provision of insurance, including coinsurance and reinsurance, guarantees and other financial instruments and services for regional integration. In addition, the WBG expanded its lending and assistance to support the export competitiveness of developing countries (Annex 3 for more details on these programs and activities).

C. Success of policy measures to increase liquidity and promote exports is still difficult to establish

Since most of the actions to increase liquidity available to firms only took effect during the 4th quarter of 2008 or 1st quarter of 2009, their impact on banks’ trade credit and firms’ liquidity could not be captured at the time of the survey. However, information collected during the firm and bank interviews gives some indication on the perception and the early impact of these actions. In Chile, while banks and firms positively valued the government response to the crisis as being well intended and generally well designed, they think the amounts will be far below of what it may be needed to cope with the situation. In Kenya, the central bank initiative to reduce the cash reserve ratio from 6% to 5% effective since December 2008 had still not have major effects on the banking sector lending since the cash ratio of the banks has not decreased considerably. On the contrary, the excess reserves of the banks increased by almost 2.5 times, meaning that the government actions mainly shifted liquidity from obligatory to excess reserves. Interest rates also did not go down. The high inflation rates and the economic slowdown to only 2.2 percent in 2008 have resulted in risk-averse lending practices by banks since they are fearing companies to fail and a substantial increase of non-performing loans in their portfolios. Interviewed firms in Kenya and Sierra Leone noted that they would like the IFC to expand existing credit lines and/or explore ways to assist their countries in obtaining more trade finance.

One possible explanation to the lack of response to policy measures that aim to increase the liquidity of the financial system to provide working capital and trade financing during the crisis is that lending decisions depend first of all on whether banks allocate available credits and loans to trade finance portfolios vis-à-vis other loan portfolios. Secondly, lending is contingent on counterpart criteria pertaining to firm size, industry focus and the country for export destination and/or import origination. As mentioned previously, many surveyed banks indicate that they have tightened counterpart criteria for specific countries due to political or commercial risks, have become more discriminatory towards SME borrowers that have shorter credit histories, and have curtailed lending to specific sectors deemed more affected by a contraction in global demand. Therefore, whatever the liquidity position of banks, since lending decisions are not solely dependent on liquidity
but also banks’ perception and valuation of risks, liquidity boosting policies may or may not translate into increased lending for trade transactions.

A recent paper by the World Bank highlights the possible rationales for governments’ intervention in support of trade finance such as when markets are undergoing a temporary adjustment process with real costs for trading companies and for the economy as a whole. The government intervention can speed up the adjustment process or compensates the short-term losers. It is also justifiable in terms of the inherent potential multiplier effects given the importance of credit chains and the propagation effects of these chains, the complementary nature of trade finance with other forms of firm financing such as investment and working capital. The paper also cautions against the notion of a large trade finance “gap” leading to the need to inject liquidity in the international financial system. A number of reasons might explain why bank might restrict the supply of trade finance more than other forms of bank credit such as a temporary inability of the market to properly calculate risk, a collapse of interbank trust and a hoarding for cash, raising the risk of interbank strategic default, banks’ urgent need to recapitalize, and supply and demand failing to meet as prices to supply trade finance went too high (World Bank 200915).

Similarly, the ultimate success of export promotion measures is difficult to ascertain in the short term, and survey interviews did not indicate whether these policies are particularly effective at addressing trade finance constraints. In Tunisia, only 62 firms in difficulty were eligible for the government contribution to social security charges as of April 2009, of which only five benefited from the banks two interest point discount when rescheduling their debt. It is argued that the government’s plan might be unrealistic because the overall cost of support has not been announced, and there is no dedicated fund to deal with the crisis, not a guarantee fund for banks dealing with firms affected by the crisis. Therefore, banks would tend to reject applications for funding. Respondents from Ukraine’s banking industry indicated that the lack of predictability and transparency in its country’s trade and economic policies complicated bank operations and funding allocation decisions.

In sum, this section sheds light on the usefulness of Export Credit Agencies (ECAs) or Export-Import Banks (Ex-Im Banks) and other governments’ bodies in times of trade financial crises. Had not these institutions been there, the policy response would have probably been less easy and quick to set-up. For LICs, the use of lines of trade credit by publicly-owned banks and extended by development banks has emerged as another alternative to increase the liquidity for firms.

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Conclusion

Looking forward, the recovery of the global economy and the fiscal stimulus packages put in place by many governments will ease the pressure on firms’ export revenues and trade finance capacity. However, trade credit may remain tight for a longer period and constrain some trade transactions. Notwithstanding the developments of the crisis, this survey raises some longer-term issues that deserve special attention from policy makers and international organizations, in particular:

(i) What kind of mechanisms should economies have to make sure that trade finance funds remain available for firms when private banks default or become risk averse? While this crisis is exceptional in terms of its size, financial crises have occurred more often at the country or regional level, and hindered temporarily the channeling of trade finance through the banking system. Therefore, should governments establish ECAs and ExIm banks to channel directly increased funds to viable traders? While these might be useful to channel liquidity during crises, they might be too costly to set up and administer in normal times. They can also create distortions in the trade finance market as they would generate moral hazard behavior.

(ii) How to alleviate the trade finance constraints in low-income countries even in normal times? These countries suffer from poorly developed financial systems, which are constraining SMEs and firms trying to diversify away from commodity exports. Many economies also suffer from lack of private or government export credit guarantee and insurance programs to support private banks in their decision to lend to exporters. IFC confirmation lines are being used by some banks, but it seems that there is scope to increase the number of banks covered and the size of the confirmation lines.
This report reflects the results obtained from a survey of 425 firms in 14 developing countries of different income level across six regions (Figure 14). The same questionnaire developed by the World Bank was used by local consultants in these countries. It covers firms’ trade developments and prospects, their method and source of payment for pre-export, import and export finance. The survey was conducted in March/April 2009 and covered the period from September to December 2008/first quarter of 2009 versus comparable periods in 2007. The objective was to highlight changes since the onset of the global financial crisis in the 4th Quarter of 2008. In all these countries, the surveyors targeted a large number of exporters and importers from different industries and of different size. Questionnaires were sent by email and made available online. However, given time constraints and the low level of spontaneous response, most questionnaires were administered directly or via phone interview by the surveyors. As a result, the sample of firms surveyed in each country is not homogeneous across countries, and interpretation and comparison of results across countries need to be conducted carefully.

The Regions that are most represented in the sample are East Asia (32 percent) and Sub-Saharan Africa (24 percent). Almost two-thirds of firms are based in Low Middle Income countries (Figure 15). Overall, 75 percent of the firms in the sample declared that they were not part of a global supply chain. However the proportion in each country varies (Figure 16). More firms are part of a supply chain in Tunisia, Chile and Peru. On the contrary, very few firms surveyed in Ghana, Kenya and Sierra Leone are part of such a network. Similarly, 77 percent of the firms in the sample declared they are not partially or fully owned by multinational firms, except for two outliers, Chile and Peru (and to some extent India) where most firms surveyed is partially or fully owned by a multinational firm. Finally, most firms are SMEs except in Brazil, Turkey, India and Chile where the sample is dominated by large firms (Figures 17 and 18).
Figure 15: Firm Representation by Region and Income

Figure 16: Number of Firms that are Part of a Global Supply Chain (by Countries and by No. of Firms)
Figure 17: Percentage of Firms Partially or Fully Owned by a Multinational Firm

Figure 18: Breakdown of Sample Firms (SMEs Versus Large Firms)
Bank survey

The World Bank survey included interviews with 78 banks and financial institutions in 13 developing countries (excl. Indonesia) to assess any changes and trends post-September 2008 (See Figure 19). The bank surveys aimed to produce qualitative results and were conducted through phone or in-person interviews. The bank questionnaire covers bank lending activities and practices pertaining to trade loans (including Letters of Credit), trade credits, and short and medium-term financing for export and import transactions from September 2008 to April 2009.

Figure 19: Sample of Banks Surveyed (76)
### ANNEX 2 - Government Actions during the Crisis

<table>
<thead>
<tr>
<th>Type of Support:</th>
<th>Country</th>
<th>Government Action(s) and Plan(s):</th>
</tr>
</thead>
</table>
| ➢ Trade Finance | Brazil  | • Established an international line of credit for exports and prioritized lending in trade-related foreign currency operations.  
• Provided financing via the National Bank for Economic and Social Development (or BNDES); BNDES will provide R$19Bn in credit lines, R$10Bn for pre-shipment lines of credit and US$4Bn for trade finance.  
• Established a joint U.S.-Brazil Central Bank swap line for dollar-real for US$30Bn | |
| ➢ Trade Finance | Chile   | • Established new lines of financing and insurance through Corporación de Fomento de la Producción (Production Promoting Corporation) or CORFO, the government agency that provides financial support to the private sector.  
• In October 2008, CORFO announced a new US$200M line of “second floor” financing for working capital needs, another US$100M “second floor” line for non-bank factoring agencies, a US$500M in long-term loans to finance investments and US$50M for its guarantee fund for exporters.  
• In January 2009, the Government announced a US$4Bn ‘Plan for Fiscal Incentives’ that includes the creation of a new CORFO Fund of US$50M to cover default insurance for SME credits.  
• The Government added an additional US$130M for a program managed by Bankco Estado, the State Bank, to provide default insurance for SME credits. | |
| ➢ Export Promotion | Egypt   | • In December 2008, the Government introduced reductions in import tariffs and sales tax rebates for importers.  
• In Q1-2009, the Central Bank cut overnight deposit and lending rates by 150 bp to 10% and 12%, respectively. It also counted loans to SME’s as part of reserve requirement holdings of commercial banks.  
• The Government has allocated funds to develop new industrial sites and special programs for export promotion. | |
| ➢ Bank Support/Liquidity | Ghana  | • The Government has recently established requirements that commercial banks raise their capital reserves from GH¢7 million to GH¢60 million by 2010 in order to boost liquidity for trade financing. | |
| ➢ Trade Finance | India   | The Reserve Bank of India (the Central Bank) has implemented the following measures:  
• Interest rate ceiling on rupee credit has been extended to the end of Q1-09  
• Interest rates ceiling on import and export credit (foreign currency denominated) were increased  
• Interest rate for post-shipment rupee export credit was extended;  
• Limit of Export Credit Refinance facility has been increased from 15% to 50% to provide additional liquidity support to banks;  
• Increase in period of entitlement for both pre- and post-shipment credit at a concessional rate;  
• Established a refinance facility of RS 50Bn for the EXIM Bank of India;  
• Interest subsidy has been extended for pre and post-shipment export credit (in rupees) for textiles, handicrafts, carpets, leather, gems and jewelry, marine products and specifically for SMEs. | |
| ➢ Trade Finance | Indonesia | • The Government passed a bill to establish an Export-Import Bank in December 2008 that aims to transform an existing institution (Bank Ekspor Indonesia) into an Export-Import Bank (Exim) which would provide funding and insurance for trade finance.  
• The Government is planning to put in place a Rediscout Facility at the Bank of Indonesia to handle L/C-based trade receivables and provide liquidity.  
• The Government has plans to recapitalize PT. (Persero) Asuransi Ekspor Indonesia (ASEI), the country’s export credit guarantee and insurance agency, with Rp 1.5 trillion and its Export-Import Bank with Rp 3 trillion.  
• The Government has established requirement for exporters across the board to use L/Cs. This measure is aimed to mitigate buyer and non-payments risks, but could also increase trade finance costs, especially for those exporters that operate with open accounts. | |
| ➢ Bank Support/Liquidity | Kenya   | The Central Bank reduced the cash reserve ratio from 6% to 5% in December 2008 to increase liquidity. | |
| ➢ Trade Finance | Peru    | • Passed a US$3Bn stimulus plan in January 2009 to support local infrastructure and to address the crisis.  
• The national development bank (called COFIDE), the Central Bank, the Superintendence of Banks and Insurances and the main state-owned bank (Banco de la Nacion) have coordinated to reschedule debt payments for firms;  
• A credit line of US$400M from the Banco de la Nacion to COFIDE has been authorized for mortgage and other credit lines.  
• Expanded insurance coverage to US$6M for SME exporters through SEPYMEX (a COFIDE program to promote SMEs through export insurance coverage for pre-shipment financing).  
• Increased the drawback to non-traditional exports, from 5% to 8%. | |
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<tr>
<th>Type of Support:</th>
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| Export Promotion | The Philippines | - The Central Bank of the Philippines (BSP) expanded its rediscount window to increase loans for banks by raising the total amount available from P40Bn to P60Bn; increasing the value of loans to rediscounted loan papers from 80% to 90%; lowering interest rates charged on rediscounting; and setting at below-market rates or 0.5% below the reverse repurchase agreement rate.  
- The Government passed an amendment to the Magna Carta for SME Law, requiring banks to allocate up to 10% of their loan portfolio to SMEs.  
- The Philippines Export-Import Agency (Philexport) plans to expand its guarantee capacity by increasing its Tier 2 capital (via subordinated debt issue) to P1.4 Bn, but this expansion is still awaiting the National Government’s approval.  
- The Government plans to provide a subsidy of P1 Bn to the Export Development Fund (EDF) in May 2009 to facilitate exporters. The EDF is managed by the Export Development Council, of which Philexport is a main pillar. |
| Export Promotion | Sierra Leone | - The Government has revamped the Sierra Leone Investment and Export Promotion Agency (SLIEPA), a government agency that promotes exports and inward investment that has also been tasked to provide export finance and export credit guarantees.  
- The Government is considering the option of setting up the Sierra Leone Produce Marketing Company to regulate and improve the quality of its cocoa and coffee exports. |
| Regulatory Reform | South Africa | - The Financial Services Board of South Africa has initiated a pending legislation on tightening regulations for hedge fund for risk mitigation purposes.  
- The Government articulated in a policy document, “Framework for South Africa’s Response to the International Economic Crisis”, its plan to provide a pre-shipment facility for selected sectors. |
| Export Promotion | Tunisia | - The Government has implemented a series of measures under a December 30 2008 law to support exporting companies, and includes measures such as providing 50% of insurance cost and improves cash flow for working capital, rescheduling debt payments for companies and support for rescheduling of credits for exporters.  
- The Government increased capital in COTUNACE (the quasi-government export credit and guarantee entity) by 6M dinars.  
- The Government has undertaken 11 “curative measures” that include providing state budget to promote domestic exports at trade fair and exhibits, assisting firms with working capital requirements and providing guidance and support to SMEs and new firms.  
- The Central Bank of Tunisia has lowered capital requirements in January 2009 to encourage more liquidity in the banking system, decreased the interest rate from 5.25 to 4.5% to reduce the cost of financing, increased the allocation of state budget for public projects, and established facilities for deposits and loans to meet bank liquidity needs. |
| Bank Support/Liquidity | Turkey | - The Export-Import Bank of Turkey’s facilities have been expanded from TL1.5Bn to TL2Bn, including an expansion of the scope of its export credit and insurance portfolios, increased its credit limit and value of insurance and guarantees, lowered its short-term TL-denominated export credit lending rate, increased export credit lending rate for USD-denominated short-term export credits and extended the maturities of short-term export credits.  
- The Government has also initiated a new credit program, managed by the Export-Import Bank, to promote exporters in international trade fairs.  
- The Export-Import Bank and the Central Bank of Turkey implemented administrative changes to improve exporters’ access of the Central Bank’s discount facility.  
- The Central Bank’s discount limits have been increased from US$350M in 2008 to US$1Bn in Q1-2009. |
| Bank Support/Liquidity | Ukraine | - The Parliament passed a “Draft Law on export insurance and crediting” in August 2008 that granted the Ukreximbank the status of official export credit agency. This law is also in support of plans to establish the “Ukrainian Export Insurance Company”, a state insurance company. |
Global actions

The WBG supports the G-20 commitment from governments and multilateral institutions to provide US$250 billion in the coming years to bolster trade finance. In particular:

- The **Global Trade Finance Program (GTFP)** has been doubled to US$3 billion over a three-year period to provide additional guarantees to mitigate risks in trade transactions with local banks in emerging markets.

- The **Global Trade Liquidity Program (GTLP)** is expected to contribute up to US$50 billion over a 3-year period to channel trade finance liquidity to developing countries.

- The World Bank has also launched a US$40 million **Trade Facilitation Facility (TFF)** to support developing country priorities to improve trade facilitation systems, including infrastructure, institutions, services, procedures and regulatory systems. Developing countries need to continue to improve their trade competitiveness through trade facilitation and other behind-the-border reforms to be competitive and to reap the benefits of the eventual global economic recovery. World Bank Trade-Related Lending has more than doubled from US$1.4 billion in FY08 to US$3.4 billion in FY09, driven by projects in the Europe and Central Asia and Africa regions, in support of trade facilitation, regional integration, and export competitiveness.

Support provided to surveyed countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Type of support</th>
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<tr>
<td>India</td>
<td>The World Bank has established a US$120 million line of credit for SMEs and a small guarantee fund. This project was scheduled to close in June 2009, but as a response to the crisis, the Bank recently negotiated additional financing of US$400 million to extend the original project by four years.</td>
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<td>Indonesia</td>
<td>The World Bank is considering a US$200 million trade finance project that will: (1) recapitalize the Indonesian EXIM bank and provide a backstop facility to enhance underwriting capacity of the country's Export Insurance Agency; (2) set-up marketing schemes for emerging exporters and pre-shipment guarantees that will help diversify the export base and trade finance instruments. Preparations for the project are estimated to start mid-2009. In addition, the World Bank has approved a US$2 billion Public Expenditure Support Facility Development Policy Lending in March, 2009, which will help establish a re-discount window for trade finance through the Central Bank (Bank Indonesia) and create an Export Financing Agency.</td>
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| Kenya   | - The World Bank is preparing a US$65 million Regional Trade Facilitation Project that aims to strengthen the Africa Trade Insurance Agency (ATI) to facilitate the provision of insurance, including coinsurance and reinsurance, guarantees and other financial instruments and services for regional integration, trade, and investment. As a member of ATI, Kenya will benefit from this project.  
- The IFC’s Global Trade Finance Facility offers lines of credit to Kenyan banks (6 issuing banks currently used this facility and is exploring possibilities of providing |

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<th>Country</th>
<th>Description</th>
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<td>Sierra Leone</td>
<td>The IFC has provided US$1 million of LC confirmation lines to two largest local banks and these lines are fully utilized; the banks are requesting the IFC to increase this to US$3 million.</td>
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<td>Turkey</td>
<td>The World Bank is implementing a US$300 million loan with Turkish Exim bank and another US$300 million loan with the local development bank (TSKB) to finance working capital and investment for exporters. The Bank also implemented a US$200 million SME credit line, including for exporters’ working capital or trade finance, and an additional SME credit line of US$500 million is confirmed for FY10.</td>
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<tr>
<td>Tunisia</td>
<td>The World Bank is supporting a US$40 million Export Development Project that includes: (1) the Export Market Access Fund, a matching grant program that provides co-financing to firms, and (2) a Pre-shipment Export Finance Guarantees Facility.</td>
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<td>Ukraine</td>
<td>The World Bank is implementing a US$150 million export development project with Ukraine Eximbank (Ukrexim) and discussion are underway with Ukrexim bank for a follow-up Export Development project later in 2009. Additionally, a US$250 million Export Development 3 or EDP2 AF to augment financing support for exporters has also been confirmed for FY10 (starting in July 2009). IFC’s Global Trade Finance Program (GTFP) was launched in Ukraine in October 2005, and increased its program by US$500 million to US$1.5 billion in October 2008 and to US$3 billion in December 2008.</td>
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*Source: World Bank and consultants’ survey reports*