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CONSIDERATION OF GUIDELINES ON KEY SECTORS FOR TRADE EFFICIENCY: BANKING AND INSURANCE

Finance and insurance issues in relation to trade efficiency

Report prepared by the UNCTAD secretariat on the basis of a study by a consultant*

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EXECUTIVE SUMMARY

(i) The availability of modern trade-related finance, payment and risk management products is a critical element in the expansion of international trade within the developing world. This paper evaluates the market for trade-related financial services and identifies potential opportunities for Trade Points to improve their clients' access to modern finance and insurance products.

(ii) Section I reviews policy considerations for Governments seeking to improve the domestic environment for trade finance and insurance providers. The discussion focuses on three specific policy areas that have a significant impact on trade efficiency in financial services, including:

- The effect of regulatory barriers to foreign financial services firms.
- The need to harmonize finance-related trade laws and regulations in order to improve the provision of crossborder financial services.
- The impact of poorly designed or administered foreign exchange controls on the utilization of modern financing and risk management techniques.

(iii) Section II presents several approaches through which the Trade Points can facilitate the distribution of trade-related financial products. The primary recommendation concerns the development of a financial services referral function within each Trade Point. The proposed advisory function would be supported by a comprehensive computer database which catalogues the capabilities of relevant financial service providers.

(iv) Section III reviews the major financing, payment and risk management mechanisms currently utilized in international trade. UNCTAD consultants have identified several opportunities to introduce or more effectively deliver key financial products through the Trade Points. Each of these opportunities is summarized along with guidelines and implementation considerations for the Trade Points.

(v) In section IV the potential role of the Trade Points in investment promotion, both inward and external, is evaluated. Details are presented concerning a new effort, led by the Multilateral Investment Guarantee Agency, to link investment promotion organizations via a specialized communications network.

(vi) The benefits to Trade Point clients of incorporating modern trade finance, payment and risk management instruments into the Trade Point service offerings include: (1) reduced financing costs, (2) more rapid payments, (3) mitigation of financial and credit risks, and (4) the ability to compete

more effectively in world markets by offering more favourable terms to their customers.

INTRODUCTION

1. One of the chief impediments to increased international trade is inadequate access to competitively-priced trade finance and insurance products. This problem is particularly acute for small and medium-sized enterprises (SMEs) in developing and transitional economies. However, SME managers in the United States and other industrialized countries also cite the unavailability of trade finance and inefficiencies in the provision of financial services as key obstacles to further trade development.

2. Trade inefficiency in financial services can have a significant impact on the ability of SMEs to participate in international trade or to compete effectively with exporters from other countries. For example, in many markets the ability to offer extended payment terms to customers is a key factor in the buying decision. Also, inadequate payment and clearing mechanisms can prolong the payment cycle and increase the capital requirements associated with a given trade transaction. Smaller exporters which must finance foreign trade transactions through internal resources, due to the lack of available trade finance, will be less able to price their products competitively or fund future export growth.

3. There are a number of factors that contribute to supply constraints or ineffective service delivery in the financial services market, especially within developing and transitional economies. These include:

- General unavailability of financial capital or insurance capacity.

- High cost of service delivery, commonly the result of inadequacies in telecommunication systems, information on trading counterparties (e.g., credit data) and other elements of the financial market infrastructure.

- Regulatory constraints (e.g., exchange controls) or State monopolies of certain financial products.

- Lack of access to necessary financial market expertise and information system technology.

4. Trade-related finance and insurance can be viewed as a "tool-box" of financing and risk management techniques, each designed to perform a specific task within a transaction. By distributing or facilitating access to the broad spectrum of trade finance and insurance products, the Trade Points can ensure that their clients have the financial tools required to compete effectively in the international market-place.

5. This report examines potential opportunities to increase efficiency in the provision of trade-related financial services, focusing at two levels:

- Section I discusses policy initiatives which Governments can undertake to remove regulatory barriers, develop their financial sector infrastructure and better integrate their financial markets with those of their trading partners.

- Section II discusses mechanisms through which the Trade Points can better inform their trading clients about available finance and insurance alternatives, and facilitate the provision of financial products through the Trade Points. Section III reviews trade finance, payment and risk management techniques in common use today. This analysis mainly considers private sector alternatives, although certain programmes offered by State-run and multilateral agencies are also addressed. This section also presents summary details of several opportunities to introduce or more effectively deliver certain products through the Trade Points. These include products that are otherwise unavailable or inefficiently delivered in many developing and transitional economies.

6. A separate analysis in section IV reviews potential mechanisms through which the Trade Points can facilitate foreign direct investment.

I. THE ROLE OF GOVERNMENT IN PROMOTING TRADE EFFICIENCY IN FINANCIAL SERVICES

A. Background

7. At several levels, Governments have a significant impact, both direct and indirect, on the availability and quality of trade-related financial services. This influence extends from the influence of monetary policies on access to credit through the effect of educational programmes on the capabilities of indigenous financial professionals. This analysis will focus on three particular policy areas that directly affect the provision of trade-related finance and insurance products:

- Regulation of financial institutions, particularly barriers to entry imposed on foreign financial services providers.

- Integration of international standards and agreements into the domestic legal infrastructure.

- Foreign exchange restrictions and the impact of poorly designed or administered control procedures.

8. The implications of unduly restrictive policies on trade efficiency are evaluated as well as the beneficial effects of free trade in financial services. The general conclusion is that the development of a free market for financial services will facilitate increased international trade in goods and services, through improvements in the products and levels of service provided by the trade finance community.

B. Regulation of trade-related financial activities

9. In most countries the banking and insurance industries have traditionally been heavily regulated by government. Due to the critical role that financial

institutions play in a nation's economy, regulation and supervision of these institutions is a key aspect of public policy. Many countries that are seeking to protect emerging domestic institutions or maintain strong control over their financial industry have imposed restrictions on the local activities of foreign financial institutions. These controls over trade-related financial services have taken many forms, including:

- Limitations or outright bans on subsidiaries or branches of foreign financial institutions, including insurers. In most of these cases, financial institutions are only allowed to maintain representative offices, which cannot directly engage in financial transactions. For example, Governments in several transitional economies have restricted the number of foreign bank branches and subsidiaries in order to protect their fledgling banking industries.

- Prohibitions on foreign banks or insurers doing business with locally-owned companies. This policy has cut off many otherwise creditworthy companies from access to the international financial markets.

- Requirements for traders to insure overseas shipments with an indigenous insurance company.

10. Concerning the latter issue, the International Union of Marine Insurance has identified over 60 countries imposing restrictive measures affecting the freedom of transport insurance. These include: (1) restrictions on indigenous exporters or importers insuring overseas shipments, (2) prohibition of exports on an f.o.b. basis or imports on a c.i.f basis, and (3) special taxes and currency restrictions affecting premium payments (AIMU, 1992). Insurance brokers estimate that marine rates in some of these countries are as much as 20 per cent above prevailing rates in the international insurance market, which is keenly competitive.

11. Governments in many developing and transitional economies have realized the limits of these policies. The negative consequences include:

- Limitations on access to private debt markets overseas, particularly where sovereign debt capacity has been exhausted.

- Retarded development of the indigenous financial industry due to the absence of regional or international competition.

- Reduced ability of indigenous exporters to compete internationally due to financial constraints.

12. As a result, many countries are now beginning to open their financial markets to international competition. For example, China has recently permitted several foreign insurance companies to establish local subsidiaries and sell policies to Chinese insureds. Egypt has relaxed regulations restricting foreign banks from providing services to Egyptian companies.

Also, many of the transitional economies in Eastern Europe, such as Hungary and Poland, have allowed foreign investment in privatized insurers and in new insurance ventures. A more detailed analysis of existing regulatory obstacles in selected countries is currently being planned by the Special Programme for Trade Efficiency (SPTE).

13. Over the last decade, there has been a strong trend towards the globalization of financial services providers. This suggests a growing acceptance that many trade-related financial products are most efficiently provided by transnational financial institutions. This is particularly true in the case of credit insurance, where the liberalization of financial services regulations in the European Union (EU) is creating greater trade efficiency. Until the late 1980s credit insurers were either government-sponsored schemes (for export insurance only) or private insurers restricted to underwriting in their home market and perhaps one or two neighbouring countries. This was not an effective industry structure owing to the following factors:

- Underwriting volumes and results were very sensitive to local economic conditions, with limited opportunity for geographic diversification.

- Credit underwriters were often distant from the markets they analysed, with little local support in the buyer's country.

- The limited size of the individual national markets made it difficult to achieve the scale economies required to support needed investments in computer and telecommunications technology.

14. The European Commission, recognizing the unique economic characteristics of credit insurance, formulated a separate directive as part of the 1992 Single Market reforms which effectively allowed a credit insurer domiciled in a member State to offer credit insurance throughout the EU. The European credit insurance market is at present forming into smaller groups of well-capitalized regional insurers. With operations in several countries, they are now better able to monitor the solvency of foreign buyers. Leveraging upon their increased capacity and market knowledge, they are also developing underwriting operations in many underserved foreign markets, such as the United States. In addition, as stronger private market insurers emerge, Governments are reducing their expenditures on the State-sponsored export credit insurance programmes or privatizing them outright, as was the case in the United Kingdom.

15. At the time this report was prepared, the financial services negotiations within the latest GATT round were not fully completed. Many of the initiatives being discussed in this context would significantly reduce the barriers to free trade in financial services and improve trade efficiency in the provision of finance and insurance products.

Guidelines

16. Government policy-making in the area of financial services regulation should, at the very least, consider the unique structural aspects of the market for trade-related financial services. Market access restrictions should be eliminated for financial products that cannot be effectively delivered by a solely domestic provider, such as credit insurance. Policy makers should also evaluate the indirect impact of protectionist restrictions, particularly on the competitiveness of local exporters.

17. Trade Points should also evaluate the new opportunities arising from the GATT Uruguay Round of multilateral trade negotiations, once a final agreement on the financial services component has been successfully concluded.

C. Harmonization of trade-related financial laws with international standards

18. Although there have been many multilateral efforts to harmonize laws and regulations affecting international financial transactions and procedures, significant variations continue to persist from country to country. These inconsistencies and the legal uncertainties they give rise to have proven to be a major impediment to the broader use of modern financing and payment methods, particularly in the developing world. The rules, Incoterms and uniform customs and practice developed by the International Chamber of Commerce have helped to standardize many procedures and contract terminology relating to traditional finance and payment techniques, such as collections and documentary credits. Efforts are also being made to develop a legal framework to accommodate paperless transactions, particularly title documents such as bills of lading. However, many of these recent efforts are proceeding very slowly.

19. An illustration of the problem is the Convention on International Factoring, which was approved at a diplomatic conference in May 1978 by delegates from 55 countries. Work on the Convention had begun 15 years earlier under the auspices of the Institute for the Unification of Private International Law (UNIDROIT). The Convention addresses the assignment of current and future crossborder receivables under a factoring or invoice discounting contract and the transfer of the exporter's rights under the contract of sale, among other issues. Unfortunately, only France and Italy have ratified the Convention to date, although the United States and Hungary are expected to vote on this issue in the near future.

20. In the area of insurance, a controversy continues over the rules concerning shipowners' liabilities with respect to cargo that is lost or damaged while on board. Issues surrounding the allocation of losses between the carrier and the cargo owner were initially addressed in the so-called "Hague Rules" of 1924. Updates to these rules were agreed at a conference at Visby, Sweden, and went into effect in 1977. However, at a subsequent conference held at Hamburg, Germany*, in 1978, a significant set of revisions, known as the "Hamburg Rules" was devised. However, many countries have refused to ratify this latter convention. Unfortunately, no solution to this impasse has been found in subsequent years.

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* Federal Republic of Germany at the time.

Guidelines

21. Governments should review their current laws and regulations affecting trade finance, insurance and international payments to ensure that they are consistent with accepted international practices. In particular, governments should consider ratifying and implementing the following conventions, which seek to further harmonize international trade finance law:

- The Convention on International Factoring, described above.

- The Convention on International Financial Leasing, which was agreed at the same conference as the International Factoring Convention, and has likewise not been ratified by a sufficient number of countries to bring it into force.

- The United Nations Convention on International Bills of Exchange and Promissory Notes, which addresses payment instruments used in international trade. The United States and several Latin American countries are considering ratification, which would bring this Convention into force.

Finance-related documents should also be incorporated into the national aligned systems, where relevant.

D. Foreign exchange controls

22. Many developing nations utilize exchange controls in order to manage more closely their country's foreign exchange reserves, which are frequently a constrained resource. Trade-related restrictions typically require that exporters repatriate and exchange into local currency all or a portion of their foreign exchange earnings from overseas sales. Other restrictions include limitations on the length of payment terms for imports or exports. These typically extend to prepayments for imports as well, with a maximum period stipulated between payment and the physical importation of goods. Commercial banks, customs authorities or central/foreign trade banks are normally responsible for administering exchange control procedures.

23. Many exchange control regulations currently in effect predate modern trade finance and payment procedures and thus make the use of more efficient mechanisms unduly complex or impractical. For example, some countries still mandate the use of documentary credits for export transactions. In many cases minimum value thresholds have not been updated and thus have been effectively reduced by inflation.

Guidelines

24. Governments should evaluate carefully existing exchange control regulations to ensure that they do not inhibit the use of current financing and payment techniques. In particular, control procedures that address non-bank providers of export finance, such as factors and invoice discounters, should be developed, as appropriate. Exporters should be allowed to use a

portion of foreign exchange earnings to purchase modern financial products (e.g., credit insurance) which enhance their competitiveness but are not available locally.

II. THE ROLE OF TRADE POINTS IN INCREASING THE EFFICIENCY AND AVAILABILITY OF TRADE-RELATED FINANCIAL SERVICES

A. Overview and policy considerations

25. The Trade Point Programme offers several unique opportunities to channel modern trade finance and insurance products into many traditionally underserved markets. The development of the Trade Point Network can have a catalytic effect on the provision of trade-related financial services, particularly to SMEs using the Trade Points. Successful Trade Points in developing or transitional economies will become the locus for a significant volume of trade activity. The achievement of sufficient transaction volumes, combined with the telecommunications and information-gathering capabilities envisaged for the Trade Points, will lower service delivery costs. This will make it feasible for domestic and foreign providers to offer a wider array of financial products to Trade Point clients.

26. There are three major avenues though which Trade Points can facilitate more efficient access to trade-related finance and insurance products. They are as follows:

(1) **Developing a financial services referral capability** within each Trade Point, supported by a comprehensive database of domestic and foreign financial service providers. A more detailed description of this proposed referral capability is presented in section II.B below.

(2) **Recruiting specific financial service providers** into the Local Trade Efficiency Associations (hereafter referred to as "LTEAs"), accompanied by a physical or "virtual" presence in the relevant Trade Points. These institutions should be encouraged to develop or adapt finance and insurance products that address the needs of the Trade Point clientele (particularly SMEs). They should also exert leverage upon the communications and information resources of the Trade Point Network. This relationship would ideally be on a non-exclusive basis or with exclusivity restricted to specific co-developed products.

(3) **Acting as an agent or broker**, on a non-exclusive basis, for domestic or foreign financial institutions that offer products or services not easily obtainable in the local financial markets. There are a number of international financial services providers, particularly in the areas of foreign buyer credit information, factoring services and credit insurance, who have an interest in expanding their market coverage but lack the necessary local distribution channels. This is particularly true in those developing countries that do not offer the market potential necessary to justify the establishment of a local subsidiary. The telecommunications capabilities and transaction flows within the Trade

Points would make it feasible in many instances for the Association or a member company to establish such an agency/broker capability.

Specialized services with limited demand, such as forfaiting or leasing, may be more appropriately facilitated through the aforementioned referral service.

27. The balance of this section discusses the development of a financial services referral service. Section III reviews the various categories of trade-related financial services products and describes how they might be enhanced and distributed through the Trade Point Network.

B. Considerations for a financial services referral service

28. A common problem faced by exporters involves selecting the appropriate mix of trade finance and insurance products that most cost-effectively addresses their international trade requirements. Smaller exporters frequently do not have the requisite in-house expertise and require external advice. In many cases their banks do not have this expertise either or else specialize in particular trade finance products, which potentially compromises the independence of their advice.

1. Guidelines

29. To support export clients effectively, particularly SMEs, the Trade Points should be able to provide comprehensive information on available finance, payment and risk management alternatives. This financial advisory function would ideally be staffed by a trained adviser who can analyse the client's export business and recommend appropriate financing and insurance alternatives. The advisory function should be supported by an extensive database addressing the capabilities of available financial services providers.

2. Implementation considerations

30. The Trade Point financial advisers can either be seconded from participating financial institutions or recruited from the local financial community. Training programmes, which provide an overview of the various financing, payment and risk management techniques in common use, can also be utilized to ensure that the advisers are working from a common base of knowledge. A key issue for the LTEAs to consider is how to maintain the independence of the Trade Point financial advisory function. Although financial institutions selected to participate in the LTEA should be recommended in those situations where they can provide the requisite capabilities, the advisory function should also have the flexibility to recommend alternatives, as appropriate. This is particularly important when the most effective solution for the Trade Point client is not available from a LTEA member. The database described below would support the identification of the most appropriate finance and insurance mechanisms. The ability to provide independent financial advice can be a key selling point in marketing Trade Point services.

31. The computerized database supporting the financial advisory function should contain detailed information on qualified financial service providers. For example, information regarding commercial banks should include:

- Name, size and domicile of the institution.
- Location of institution and overseas branches or subsidiaries that provide trade-related services, including contact information.
- Types of exporters served (e.g., pre-exporter, new-to-export, new-to-market, and old-to-market).
- Geographical markets where the institution has had risk exposures or has provided services (particularly where the institution has specialist capabilities).
- Industries for which the institution has provided services (particularly areas of specialization).
- Types of finance, payment and risk management products which the institution has experience with or prefers.
- Preferred client size, or minimum standard.
- Preferred transaction size and tenor, or minimum standard.
- Experience with government or multilateral agency guarantee or insurance programmes.
- Special services targeted to SMEs.
- Special Trade Point-related programmes or involvement in a LTEA.
- Credit information services.
- Other services available.
- Other relevant information.

The database should also be capable of cataloguing comments from the Trade Points concerning their past experience with a given institution.

32. The initial priority should be to develop a database for providers of financing, payment services, credit insurance and credit information. Cargo insurance is normally sold through independent brokers who have already developed their own internal databases of insurers.

33. A possible model for this database has been developed by the Bankers' Association for Foreign Trade (BAFT), which is an multinational trade association based in Washington, D.C. The BAFT database, which contains most of the information described above for over 200 international banks, is used

to support the Association's Access To Export Capital (AXCAP) Programme. AXCAP is a referral service, established this year by BAFT, for United States exporters seeking trade-related financial services. The development of the referral service and database was partially financed by USAID and the United States Department of Commerce.

34. The AXCAP service has already been extensively utilized, particularly by United States-based SMEs, which have historically had difficulty obtaining adequate trade finance services within the American banking system. BAFT reports that they have provided advice to several hundred exporters in the first two months of the programme's operation. A similar level of demand can be expected in many developing countries as well.

35. BAFT management has indicated informally that they would be willing to discuss future collaboration with UNCTAD to expand the database further and make it available to the Trade Point Network.

36. The Bangkok Trade Point Development Centre is also working with ESCAP countries to develop a finance referral capability.

37. The next section addresses specific products which can be more effectively distributed through the Trade Point Network.

III. REVIEW OF TRADE-RELATED FINANCIAL PRODUCTS AND DISTRIBUTION ALTERNATIVES

A. Overview

38. This section reviews current developments in the market for trade-related financial services. It also discusses specific opportunities for the Trade Point Network or individual LTEAs to facilitate increased access and more efficient delivery of these products to their clients. For purposes of this analysis, trade-related financial services have been grouped into the following six categories, although some products cross more than one category:

- Credit and related information on trading counterparties.
- Financing services, both with and without credit intermediation.
- Documentary credit/collections/payments services.
- Credit insurance products.
- Non-credit financial risk management services.
- Cargo/marine insurance.

39. The analysis of each product category includes guidelines for Trade Point management. Further details are presented for several specific product distribution opportunities identified in the research phase of this study. These should be considered for a pilot implementation programme involving

selected Trade Points. The evaluation includes an assessment of implementation considerations, including costs, "user friendliness", portability, infrastructure requirements and security, as appropriate.

40. Within the above context, the analysis also addresses, where appropriate, the following issues:

- Trade finance and insurance problems facing SMEs.

- Opportunities to utilize technology-based solutions to promote greater trade efficiency in the provision of financial services.

- The potential role of multinational financial institutions in supporting the Trade Point network with technology, finance and expertise.

- Opportunities to make better use of existing national and multilateral trade finance, guarantee and insurance programmes, particularly in support of SMEs.

B. Credit and related information on trading counterparties

41. The availability of accurate and objective information regarding the creditworthiness of firms in developing countries and countries in transition is a major requirement for increased international trade. Currently, such information is difficult and expensive to obtain and disseminate. As a result, firms exporting to or among developing economies have traditionally had to rely on costly external guarantees, such as letters of credit (L/Cs), rather than trading on an open account basis. Table 1 below shows the disparity in payment terms offered by United States exporters in 1989 for shipments to various regions of the world. The significant reliance on confirmed L/Cs for exports to developing countries reflects the lack of the information needed to justify extending unsecured credit terms as well as the concern felt by many exporters over buyers' creditworthiness.

Table 1

PAYMENT TERMS UTILIZED BY UNITED STATES EXPORTERS - BY REGION OF EXPORT DESTINATION, 1989 (percentages)

Region of export destination	Open account	Sight draft	Time draft	Unconfirmed L/C	Confirmed L/C
EU	65%	16%	18%	0%	1%
Other Europe	52	11	9	6	22
Latin America	3	9	11	1	76
Africa	-0-	-0-	-0-	-0-	-0-
Middle East	6	10	15	-0-	69
Asian LDCs	10	15	12	14	49

Source: World Bank Report (Schilling, 1992).

42. Credit information is currently available from two major sources:

- Banks obtain buyer credit information for their clients from financial institutions in the buyer's country with whom they have a correspondent relationship. This has been a fairly unstructured service, usually provided as an accommodation for clients rather than a major fee-earning service.

- Credit reporting agencies sell information which they collect on companies in their market. Financial information on a given company is obtained through questionnaires directed to the company management, payments information collected from other firms doing business with the target company as well as regulatory filings and other public disclosures as provided for under local law. In some countries this information is available from on-line databases, but most providers of credit information fax written reports to their clients.

43. The provision of credit information in industrialized economies is dominated by a few companies with extensive international networks. Dun & Bradstreet is the industry leader in terms of overall volume. Other major firms include TRW, Intrum Justitia and Graydon International. The latter company is owned by a consortium of European credit insurers. Most countries have at least two indigenous credit reporting agencies, except in parts of Africa, Eastern Europe and the former Soviet Union. However, the actual level of market coverage varies greatly from country to country. There are also a number of banks and private companies that provide analyses of payment conditions in various developing countries and countries in transition. These services assist exporters and financiers in assessing the political risks of non-payment.

1. Guidelines

44. Trade Points should be able to facilitate access to foreign credit information, either by bringing a member company of a credit reporting network into the LTEA or by acting as a distributor for overseas credit reporting agencies.

2. Implementation considerations

45. Several representative credit reporting agencies have been interviewed as part of this initial study. At least one international network sells credit reports at a discount to a trade association of credit managers, which then sells them at a small mark-up to association members. This particular company is also able to transmit reports via e-mail. A similar arrangement for the Trade Point Network should be evaluated, as the Trade Points offer significant distribution potential as well as the requisite telecommunications capabilities. It would be advantageous for interested LTEAs to negotiate as a

group with information providers, in order to extract the maximum leverage from their combined distribution capabilities.

46. The resale of externally-sourced credit information would be relatively straightforward, assuming that the participating Trade Points have e-mail access. Little additional investment is required except for the development of a local marketing and delivery capability.

47. The collection and distribution of credit-related information on local buyers through the Trade Point Network may also be a viable option for certain Trade Points. The development of a credit reporting function could be a commercial opportunity for the Trade Point or a LTEA member company in those countries where this capability is lacking. Such a capability would also contribute to the development of the local trading and financial market infrastructure. However, this is a much more complex undertaking and would involve a significantly greater investment than the resale alternative described above. A Trade Point entering this business would need to hire and train a staff (at least 2-3 individuals) to gather information on local companies for overseas clients as well as develop supporting information systems and telecommunications capabilities. The feasibility of this concept depends upon the anticipated level of foreign demand as well as the capabilities and competitiveness of existing local providers. Therefore proposals to establish an internal credit reporting capability should be evaluated by individual LTEAs on a case-by-case basis.

C. Financing products

48. Trade finance has evolved considerably since the Renaissance era, when bankers in Italian city-States such as Florence, Genoa and Venice developed the antecedents of traditional trade finance mechanisms, such as letters of credit and acceptance financing. Although the modern variants of these instruments are still utilized in many trade finance transactions today, a number of other financing and risk management techniques have been developed to meet the unique requirements of certain industry sectors or to address capital shortages in developing countries. The increasing availability of modern telecommunications, computing power, risk management tools and information enables trade financiers to tailor financing transactions to the specific needs of the trading counterparties. Thus the possible combinations of funding and risk management techniques available today number in the thousands.

49. This analysis therefore will focus on the major trade finance mechanisms that are particularly useful in facilitating North-South as well as South-South trade. Some financing techniques involve funding only, while others, such as factoring, incorporate both financing and credit intermediation. These techniques are divided into three broad categories:

- Pre-shipment export financing.

- Short-term post-shipment export financing.

- Structured finance techniques, particularly those used in medium- and long-term export financing.

50. The analysis will also consider the role of external funding mechanisms, such as rediscount facilities and secondary markets. Considerations for financing small and micro-enterprises are also discussed. This evaluation focuses largely on private sector financial services providers; however, there are also approximately 90 national export credit agencies (ECAs) in the world which provide various types of pre- and post-shipment finance (including direct loans). Many also offer guarantees and credit insurance. Although certain of these programmes are noted below, a comprehensive review of the specific financing facilities offered by each country is outside the scope of this analysis. However, Trade Points should be aware of the programmes offered by their national ECA.

51. Several specific opportunities to utilize the Trade Point Network in facilitating the delivery of modern trade finance instruments, particularly in developing and transitional economies, are identified.

1. Pre-shipment export financing

52. This type of financing provides the working capital required to produce or inventory goods for export. Some enterprises can generate this working capital from internal resources or have a bank overdraft facility for this purpose. For firms that require further external resources, several financing mechanisms have been developed. Usually backed by various forms of collateral or guarantees, they include but are not limited to the following:

- Loans secured by a L/C from the buyer and a pledge of the exporter's assets. This can be very expensive for SMEs, for frequently the assets which must be pledged will greatly exceed the loan amount, even with the L/C as additional collateral.

- Many countries operate programmes to provide pre-export finance guarantees so as to facilitate borrowing by providing a collateral substitute. These programmes exist in several developing countries with more advanced financial systems, such as the Republic of Korea, the Philippines, India and Indonesia.

- Some countries have established specific programmes to provide hard currency funds required to purchase foreign-sourced production inputs. The World Bank has assisted in the establishment of several revolving funds during the 1980s. Facilities developed in countries such as Mexico, Costa Rica and Zimbabwe offer short-term pre-shipment finance in hard currency.

- There are a number of specialized finance houses and trading companies who offer pre-shipment finance but actually take a lien on (or title to) the production inputs purchased, in lieu of other collateral. Where title is taken, the exporter in effect acts as an agent for the financier until the goods are shipped. Frequently a separate post-shipment financing mechanism is then utilized and the financier is repaid for the inputs plus a mark-up. This technique is used in many countries for products ranging from agricultural commodities to personal computers.

- In many countries indirect exporters play a major role in the export economy. These enterprises can include component producers for firms that export an assembled final product or producers of finished goods which are later exported by trading companies. As many of these firms are SMEs, they also frequently require pre-shipment financing but may not have access to the facilities described previously. Several countries, such as Mexico and Malaysia, have therefore developed domestic letter of credit systems which facilitate the use of a technique known as back-to-back letters of credit. Under this mechanism, a direct exporter issues domestic or import (for foreign-sourced inputs) L/Cs to its suppliers, backed by a confirmed L/C from the ultimate buyer. The domestic indirect exporter can then obtain a pre-shipment loan backed by the domestic L/C.

53. A key obstacle facing SMEs in obtaining access to these facilities is gaining the trust of the lender or guarantor involved. Moral hazards aside, many SMEs seeking finance have not yet established a track record for delivering export orders in accordance with the contract terms. Although these financing transactions are self-liquidating, the lack of adequate information or trust increases the level of perceived risk to the financial intermediary. The Trade Points, in their role as export counsellors to the SME, can help to increase the comfort level of the financial institutions involved.

(a) Guidelines

54. Trade Points should be positioned to advise clients on the pre-shipment financing facilities available in their country or region. In addition, Trade Points can develop support programmes to assist exporters in structuring and delivering on their contractual commitments, so that participating financial institutions can offer pre-shipment finance without assuming undue risks.

55. The individual LTEAs should also work with national and multilateral agencies to draw up finance and guarantee programmes, such as pre-shipment finance guarantees or domestic letters of credit, which are appropriate to their clients' needs and the capabilities of the domestic financial system. These types of pre-shipment financial support have been implemented successfully in developing countries and economies in transition. However, most have been implemented by government institutions, which have the necessary financial resources, access to external finance and ability to modify the legal infrastructure.

(b) Implementation considerations

56. Several financial intermediaries which offer specialized types of pre-shipment financing have been identified in the initial research for this report. Also, the World Bank has been extensively involved in establishing pre-export finance facilities and domestic L/C systems on a national basis.

2. Short-term post-shipment export financing

57. Short-term post-shipment financing generally involves transactions with payment terms of 180 days or less although certain financing techniques can be applied to trade on more extended terms. These mechanisms usually involve discounting invoices or bills of exchange that have been guaranteed by a bank (acceptances).

58. However, many commercial banks in developing countries lack the capital resources for adequately backing their letters of credit or acceptances. In these cases third party guarantees, such as credit insurance or a L/C confirmation from a well-capitalized bank, are required to support a financing transaction. Many countries, particularly in Africa, do not have an adequate banking system to support any of these techniques. In these cases, alternative mechanisms such as barter and countertrade must be employed. These are described later in this section.

3. Acceptance financing or bill discounting

59. Acceptance financing (or bill discounting) is one of the most frequently utilized types of trade finance. This technique involves the creation of a banker's acceptance, which is a term bill of exchange (or usance bill) drawn by the importer on a bank (frequently under a L/C), which has been accepted as the bank's commitment to pay the exporter a stated sum at a specified future date. The exporter can then discount the acceptance with his bank to obtain funds. Most commercial banks already offer some form of acceptance financing or bill discounting facility to their clients.

60. Although these transactions are self-liquidating, a major problem which many banks encounter is the lack of available capital, particularly if there is no secondary acceptance market where banks can resell these instruments to raise cash. Many central banks operate rediscounting facilities to purchase acceptances and inject liquidity into the banking system.

61. There is also a growing number of regional finance programmes that are designed to provide loans and rediscounting facilities in support of international trade. Perhaps the most successful programme is BLADEX, which is based in Panama and provides financing and rediscount facilities throughout Latin America. Other regional programmes include the Inter-Arab Trade Facility, which is operated by the Arab Monetary Fund, and several trade financing mechanisms operated by the Islamic Development Bank (IDB). The IDB facilities provide export and import financing in accordance with Islamic banking principles.

62. A private sector investment fund is also being established in London to provide short- and medium-term funding (up to three years) for trade finance transactions arranged by other financial institutions.

Guidelines

63. The individual LTEAs should include commercial banks capable of offering post-shipment trade finance. These institutions should have access to national or regional refinancing facilities to ensure that adequate liquidity is available to finance routine transactions facilitated by the Trade Points. The LTEAs should also participate in local and regional efforts to develop new financing and rediscounting programmes, particularly in support of SMEs.

4. Factoring and invoice discounting

64. Factoring has emerged as an effective method of financing and credit risk intermediation for exporters in developing countries and economies in transition. Modern factoring first developed in the United States as a means of financing domestic trade, particularly in the textile and garment industries. Since the 1960s the factoring industry has expanded internationally, with a fourfold growth in factoring volume in the decade from 1982 to 1992. Today there are over 750 factors in more than 40 countries, accounting for a total volume of $264 billion, of which 5.6 per cent, or $15 billion, represents crossborder transactions.

65. The term factoring actually encompasses a package of services that can be accessed individually or in combination. These typically include:

- Evaluation of buyer creditworthiness;
- Credit intermediation, with up to 100 per cent of the risks assumed by the factor;
- Collection services, including follow-up on past-due receivables;
- Accounts receivable ledger administration;
- Financing through cash advances against accounts receivable.

66. The latter service, when utilized alone, is often referred to as invoice discounting or confidential receivables finance. Banks will also provide invoice discounting services, particularly when the overseas credit risk is mitigated through an export credit insurance policy.

67. A major advantage of factoring is that it allows the exporter to quote open account payment terms for buyers which have been approved by the factoring house. In many industrialized countries trade is normally conducted under open account terms, as is illustrated in table 1 for trade between the United States and the European Union. In order to compete effectively, a firm exporting to these countries must either assume the credit risk itself or lay off the risk through a credit insurer or factoring house. Firms trading with developing countries can also gain an element of competitive advantage by offering similar terms, thus saving the importer the expense and administrative effort of opening an L/C.

68. The international factoring industry is dominated by a small number of firms and factoring networks, principally Factors Chain International

(FCI), International Factors Group, Heller International and Lombard NatWest Commercial Services. For example, FCI consists of approximately 100 independent factoring houses in nearly 40 countries, representing about 50 per cent of total industry volume.

69. Banks have recognized the special role of factoring and have been active in acquiring factors and consolidating the industry within the industrialized economies. For example, in the United States and the United Kingdom virtually all the major factoring houses are now subsidiaries of commercial banks. Also, over half of the FCI member companies in developing countries and economies in transition are either commercial banks or have banks among their major shareholders.

70. In a factoring relationship, the exporter typically assigns his trade receivable to a local factor (known as an export factor), who advances funds against invoices presented. The export factor reassigns the receivables to a factor in the buyer's country (an import factor), who assumes the credit risk and collection responsibilities. The import factor collects the receivable and remits the funds to the export factor, less his fee.

71. The cost of full export factoring services usually comprises two elements: (1) the financing cost, which is normally the factor's cost of funds plus a margin, and (2) a service charge covering the credit intermediation and collection services. For example, Lombard NatWest advertises service charges in the 1-3 per cent range, depending on the buyer's location.

72. Factoring is a particularly useful source of finance for SMEs that have some experience in exporting and generate a significant level of export turnover. For example, Lombard NatWest considers an annual export (or import) turnover of at least US$ 750,000 as a minimum threshold. Factors in developing countries frequently have lower requirements. Factors generally prefer not to handle one-off transactions.

73. The factoring industry has been particularly active in incorporating telecommunications technology and EDI into their operations. Factors Chain International (FCI) has had an EDI system (FACT) in place for several years to facilitate inter-factor communications. They have also formed a working group (EWG), under WEEB-MD4 of the UN/ECE's Working Party 4, to develop specialized messaging formats for the factoring industry. FCI is now developing a new system using EDIFACT standards, known as EDIFACToring, which is designed to facilitate data communications among factors, sellers, buyers and banks. This system is currently in the implementation phase. Lombard NatWest has also developed proprietary systems, which support EDI capabilities between the company and its clients.

(a) Guidelines

74. Trade Points should facilitate access to export factoring services for their export clients. Support for new exporters in mastering international

trade procedures and building export volume will help them to achieve the thresholds required to access factoring services.

(b) Implementation considerations

75. Facilitation of factoring and invoice discounting services can be accomplished in several ways:

- Recruiting an existing factor into the Trade Point, preferably one that has access to an international network of correspondents or branch offices. The Trade Points could play a significant role in supporting the dissemination of the EDI technologies being pioneered by organizations such as FCI, particularly within developing countries. This would be the simplest solution from an implementation standpoint.

- One of the financial institutions participating in the LTEA can establish a factoring capability. The financial institution should develop overseas correspondents, either by joining an existing network or by forming bilateral relationships with factors in target markets. In this way they can lay off the overseas credit risk and obtain collection services. Factoring networks such as FCI have as part of their mission the development of factors in markets not adequately served at present. Individual factors, such as Lombard NatWest, frequently accept business from overseas banks which are factoring invoices involving buyers in the EU. Also, certain multilateral agencies, such as the IFC, have provided technical assistance and capital to several factoring start-ups in developing countries and economies in transition.

- A third alternative, assuming that the development of an indigenous factor is not feasible at present, is for the Trade Points to act as brokers or agents in distributing overseas collection services. Import factors will offer collection services and bad debt protection to overseas exporters but typically will not advance funds abroad because of the exporter performance risks involved.

- Finally, banks participating in the Trade Point can offer invoice discounting services for transactions covered by an export credit insurance policy, underwritten by a local insurer or one located in the buyer's region. This is a technique commonly used by banks in the EU, where credit insurance is readily available. There are several issues to consider in setting up such a facility, including: (1) acceptance of insurer's security by the financing bank, (2) the ability of the insurer, if based overseas, to underwrite in the exporter's country, and (3) policy language which permits assignment of claims to the financing bank.

76. Requirements for the implementation of a factoring capability include: (1) adequate telecommunications, (2) software and training, which are both available, and (3) an appropriate legal infrastructure. The legal

structure should allow, among other things, for the assignment of current and future receivables under a factoring contract as well as the transfer of the exporter's rights under the contract of sale. Ratification and implementation of the International Factoring Convention discussed previously would be useful.

5. Structured finance techniques

77. Trade financiers have adapted many of the securitization and financial engineering techniques first pioneered in the corporate finance industry for use in structuring trade transactions. These are frequently used to finance trade involving developing countries or economies in transition, particularly for high-value exports and construction projects where longer repayment terms are desired. A significant amount of medium- and long-term finance is also facilitated through guarantees provided by export credit agencies in the seller's country. In addition, age-old trading techniques, such as barter and countertrade, have been updated through the use of modern risk management instruments.

78. This analysis will focus on forfaiting, countertrade and leasing, which are mechanisms commonly used today, particularly for capital goods exports. There are a variety of other techniques available, but many of them are more appropriate for situations requiring long-term project finance.

(a) Forfaiting

79. Forfaiting was extensively used in financing East-West trade during the Cold War era but is widely used today to finance exports, particularly capital equipment, to and among developing countries and economies in transition.

80. A typical transaction involves the delivery of goods by the exporter in return for bills of exchange or promissory notes from the importer. Usually these are drawn in a series with semi-annual maturities, the total number of bills/notes being dependent on the amount borrowed and the credit period. Maturities can range from 3 months to 5 years. These bills/notes are frequently guaranteed by the importer's bank or another third party, either through a "Per Aval" endorsement or a separate letter of guarantee. The exporter then discounts these bills/notes (without recourse) with the forfaitor, who will either hold them to maturity or sell them in the informal secondary market that exists for this type of security. Institutions that make a market in forfaited notes are generally located in Europe and include international banks and specialized investors.

81. Advantages of forfaiting include reasonable interest rates (usually a spread above LIBOR appropriate to the maturity structure of the transaction) and the ability to lay off political, transfer, credit and documentary risks.

(i) Guidelines

82. Trade Points should be able to refer clients to qualified forfaitors and assist client importers in obtaining the requisite guarantees. As forfaiting transactions are tailored to the specific requirements of the trading

counterparties, the telecommunications capabilities of the Trade Points can be invaluable in facilitating the flow of information.

(ii) Implementation considerations

83. Representatives of several forfaiting houses have been interviewed as part of this initial study. Although many forfaitors have branch offices in developing countries, most are based in the United Kingdom and continental Europe. Consequently they are continually seeking institutions in developing countries and economies in transition which can refer business.

(b) Barter and countertrade

84. Barter and countertrade are estimated to comprise over 10 per cent of world trade today, and are particularly common in transactions involving developing countries and economies in transition. Countertrade differs from barter in that part of the transaction involves a cash payment. These transactions are usually much more complex today due to the use of various techniques to minimize the risks to one or both of the counterparties or the countertrade intermediary, if one is involved. The risks relate to the timely delivery of goods promised, quality of goods delivered, and pricing. Some of the techniques developed to facilitate barter and countertrade include:

- External performance guarantees on one or both counterparties, which can be issued by a bank or take the form of an insurance policy. For example, some Lloyd's syndicates underwrite policies covering non-delivery risks. Also, inspection agencies are frequently used to ensure that the quantity and quality of goods are consistent with the contractual agreement.

- Barter by L/C involves the exchange of L/Cs between the counterparties, with the release of funds from the sale of the bartered goods being contingent upon shipment of the primary goods.

- Escrow accounts are used to hold funds arising from the sale of bartered goods until payments are due to the primary goods exporter. The account is usually managed by a bank which acts strictly in accordance with the terms of the countertrade agreement. This mechanism is particularly useful as it can be used repeatedly over time and can be accessed by several exporters dealing with one counterparty.

85. Countertrade brokers play a very important role in finding buyers for the goods offered in the exchange and in arranging the risk management mechanisms. They are usually compensated on a commission basis.

86. New techniques to facilitate countertrade are being refined in the transitional economies of Eastern Europe and the former Soviet Union. These include:

- Buy-back transactions, in which one company exports equipment and technical assistance to another, taking products produced by the equipment as payment and selling them at a mark-up.

- Internal switch trade, where a local hard currency exporter finances cash purchases on behalf of another company, which pays the exporter with its own goods.

Guidelines

87. Trade Points should recruit qualified countertrade brokers into the LTEAs, if justified by potential trade volumes. Otherwise, the Trade Points

should be able to refer clients to qualified countertrade brokers and financial institutions which specialize in facilitating countertrade transactions.

(c) Leasing

88. Crossborder leasing is a form of financing that is increasingly utilized, particularly for equipment exports between developed countries. Although the more visible examples of crossborder leasing in developing countries or economies in transition involve high value items such as aircraft, leasing of smaller equipment is becoming more common.

89. The use of leasing can enhance an exporter's competitiveness in several ways:

- Leases provide a means of offering extended credit terms, thus helping the buyer to conserve working capital. The nature of the credit risk assumed differs from a direct sale in that the exporter or financial intermediary writing the lease retains title to the assets.

- Operating leases can be booked in most countries as off-balance-sheet liabilities, which may be useful if the importer has exhausted its borrowing capacity.

- The exporter or financial intermediary may be able to take advantage of tax incentives and accelerated depreciation provisions to increase their margins or offer a lower rental rate to the importer. This can be particularly significant if the exporter is in a higher tax regime.

90. Many countries, however, do not have well-developed leasing laws. Moreover, international tax and accounting issues can increase the complexity of the financing transaction. The issue of longer-term credit risk must also be addressed. Frequently a local bank guarantee is required to support the leasing contract.

Guidelines

91. Trade Points should determine the potential demand for lease financing services based upon the local volume of capital equipment exports. The current legal framework in the local market and potential target markets should be evaluated to determine if crossborder leasing is feasible. Local financial institutions with a leasing capability or international leasing specialists should be included in the financial services referral service.

6. Financing considerations for small and micro-enterprises

92. The availability of external financial resources can be particularly important for small and micro-enterprises, which frequently need external finance in order to purchase the domestic or foreign-sourced inputs to

manufacture the export product. However, many small businesses do not have the resources or easy access to overdraft lines because of insufficient net worth. Many countries have special small or micro-enterprise loan programmes. The experience of such programmes sponsored by USAID has shown that, given the costs of administration and monitoring, the most successful small loan programmes are not those that support specific activities, such as exporting or new product development. Instead, loan facilities that simply provide discretionary working capital to small and micro-enterprises have proved to be the most viable in the long term.

D. Documentary credit/collection/payment services

93. The application of documentary credit, collection and payment techniques is addressed concurrently in this section as financial institutions frequently utilize common information systems and telecommunications networks in delivering these services.

94. Documentary credits (also referred to as "L/Cs") are the form of credit risk intermediation most frequently offered by banks to facilitate trade transactions. The insurance-based forms of credit risk intermediation, export credit and political risk insurance, are addressed in section E. below. The collection and payment mechanisms described below can be used with either type of credit risk management technique.

95. Under the documentary credit process the issuing bank will make payment (immediately or at an agreed future date), upon the presentation of title, shipping and related documents completed in accordance with the specific terms set forth in the letter of credit. The exporter is thus insulated from buyer credit risks as the issuing bank is providing a guarantee of payment. However, many banks in developing countries and economies in transition have insufficient capital, so their perceived ability to back L/Cs is sometimes questionable. Confirmation of an L/C by a another financial institution is an additional source of security; however, many banks in industrialized countries are reluctant to assume these risks.

96. Documentary collection refers to the process of delivering title, shipping and related documents for the goods exported to the importer in exchange for a written undertaking to make payment, such as a bill of exchange or promissory note. This service is normally provided by commercial banks. The level of credit risk assumed is greater than under documentary credit terms, as no bank guarantee is involved. However, the credit risk exposure is less than under straight open account terms.

97. Payment services refers to the process of transmitting funds from the importer's bank account to that of the exporter. This is usually performed by a commercial bank and there are many potential mechanisms for effecting this transfer.

98. The documentary credit process has been described by many as expensive and cumbersome. Since the banks deal only with documents and are potentially liable if the terms of the L/C are not observed strictly, small errors or

variations in the documents presented usually result in rejection by the issuing banks. SITPRO has noted that in the United Kingdom an estimated 50 per cent of documents presented under L/Cs contain errors that result in settlement delays, frequently for more than two weeks. The physical transmittal of documents to the importing country is another source of collection problems, with documents that are misdirected or late in arriving a frequent occurrence. SITPRO has also noted that the terminology and documentation requirements stipulated in many L/Cs, particularly from developing countries, are often out-of-date or incorrectly applied, thus giving rise to further delays. However, the documentary credit is still widely used, particularly in Asia.

99. The balance of this section describes initiatives to streamline these processes through the application of modern information and telecommunications technology. Current developments in payment and clearing systems are also evaluated, including relevant SWIFT initiatives.

1. Trade banking systems

100. The banking industry is attempting to deal with the problems inherent in the documentary credit and collections processes through the application of modern information management systems and EDI. Several banks and software vendors now offer integrated trade banking systems which automate many clerical tasks. These systems also help to minimize the amount of information that must be re-keyed from one computer system to another, which is a leading cause of documentation errors.

101. These systems typically contain application modules that address the full range of trade banking services, including:

- Documentary credit issuance/advising/confirmation/negotiation.

- Export and import collections.

- Bills financing.

- Creation and administration of banker's acceptances.

- Other loans and advances.

- Reimbursements to and from correspondent banks.

- Funds transfer.

102. Many trade banking applications, such as Hong Kong Shanghai Bank's Hexagon system and Citibank's Citibanking system, now feature remote access capabilities. Exporters and importers can thus access the bank via modem to open L/Cs or review their account status. These systems also are able to interface directly with communications systems such as SWIFT, so that L/C advices can be transmitted directly to the advising bank's computer system,

thus eliminating further sources of error. Security features can include data encryption and the use of private communication networks.

103. In addition, several institutions and software developers are implementing systems that utilize EDI or imaging technologies to transmit

electronic copies of collection documents. These systems facilitate timely inspection and analysis before the physical documents are presented to the importer. For example:

- Citibank is currently implementing an in-house imaging-based system that will allow it to consolidate its trade document processing functions into four regional centres around the world. These centres will handle all document examination and transaction accounting operations while the local branches facilitate the physical presentation of documents.

- Complex Systems, Inc., a New York-based trade finance software developer, has introduced a system that will allow banks (or their branches) and clients using the same software to exchange collection documents electronically. In addition, the importer can transmit the underlying logic of the document bundle stipulated under the terms of the L/C. Thus the exporter will have, in effect, a detailed checklist of the L/C requirements.

104. Although these developments will reduce settlement delays, fully paperless settlement of documentary transactions still lacks the necessary legal framework, particularly with respect to the acceptance of title documents in electronic form.

(a) Guidelines

105. Financial institutions associated with the Trade Points should consider the implementation of modern trade banking systems as a means of increasing the efficiency of service delivery and reducing transaction costs. Institutions should also review current documentary credit/collection procedures and contract terminology to ensure that they are up to date and conform to international standards.

106. UNCTAD and the Trade Point Network also should follow closely the initiative of the World Trade Centers Association (WTCA) to create a new EDI-based collection/payment/financing system to serve Trade Centre clients. This initiative, which is still in the design stage, is an attempt to re-engineer the traditional trade finance mechanisms described above. The WTCA has also indicated an interest in collaborating with UNCTAD in developing this technology.

(b) Implementation considerations

107. Trade banking systems can be purchased from certain international banks as well as specialized software vendors. A major vendor estimated that the installed cost of a minicomputer-based system ranges from US$ 120,000 to $1 million, depending upon the configuration. Many of these systems also have PC-based remote access software which can be sold or given to clients to facilitate data communication. Some systems marketed by large international banks also offer the opportunity to use the bank's international telecommunications systems to facilitate messaging with overseas

correspondents. This is a useful feature if the purchasing bank is not a SWIFT member.

108. Alternatively, several international banks offer "private label" services, wherein the transaction processing and administrative tasks are handled by the servicing bank. The purchasing bank markets the service under its own name and is connected to the servicing bank's operations centre and information systems. The cost of these services is normally volume based.

2. Payment and clearing systems

109. The settlement of financial obligations arising from foreign trade can be handled by a number of methods, which are reviewed below.

110. Many payments are effected through the correspondent banking accounts of the financial institutions involved in the transaction. In the simplest case, where the importer's bank has an account with the exporter's bank, instructions are sent (usually through SWIFT) to debit the account and transfer the proceeds to the exporter's account. Frequently, intermediate correspondents are utilized where a direct relationship does not exist between the two banks. Many large international banks specialize in facilitating (clearing) such payments between foreign countries and their home markets (or payments in their home currency). For example, Chase Manhattan in Frankfurt is a major clearing bank for dollar-based payments. In addition, many of these banks, such as Citibank and American Express Bank, have internal payment handling systems which can facilitate the rapid transmission of international remittances through their branch networks. For small transactions the transmission of instructions or payment instruments still frequently takes place by airmail or courier.

111. Payments also can be made by the importer's bank though an international clearing and payments system. Many of the largest banks utilize the Clearing House Interbank System (CHIPS) system to clear dollar-based obligations among themselves. The developing world has a number of regional clearing and payment networks, including:

- Latin American Integration Association Payments and Reciprocal Credit System (ALADI). This is the only one with an automated clearing system in place.

- The Asian Clearing Union (ACU)

- The West African Clearing House (WACH)

- The Central African Clearing House (CAFCH)

- The Preferential Trade Area Clearing Arrangement (PTA) (East and West Africa)

- The Central American Clearing House (CACH)

- The Caribbean Community Multilateral Clearing Facility (CMCF).

112. Unfortunately, many of these clearing houses are not automated and suffer long settlement delays as a result of arrearages by member countries (Ritter, 1992).

113. There are a number of initiatives under way to create new specialized payment systems, particularly in Europe. Examples include:

- TIPA, which links cooperative banks.

- IBOS, which connects a group of European commercial banks.

- Eurogiro, which is a network service post office and giro banks.

- Visa International, which links ATMs across Europe.

114. New clearing and payment systems are emerging in developing countries and economies in transition as well. Examples include:

- MEGALINK, which is a consortium of 75 banks in 6 Asian countries, is developing systems to facilitate trade payments and link ATMs.

- A consortium of Russian and East European banks as well as Sao Paulo Bank have announced plans to create an ecu netting system linked through SWIFT. They are receiving support from the EBRD as well.

115. However, none of these systems is sufficiently global to serve the entire Trade Point Network, as it is currently envisaged. They represent the first steps in a process that is very likely to result in a network of regional payment systems and clearing houses. UNCTAD and the relevant LTEAs within the Trade Point Network should closely monitor or participate in these initiatives, as appropriate.

116. Further details regarding SWIFT-related developments are presented below, as this messaging system is the major communications medium for interbank data communications.

3. SWIFT developments

117. The primary means by which banks exchange transaction-related instructions internationally are via telex, fax and SWIFT (Society for Worldwide Interbank Financial Telecommunications). In addition, many international banks have implemented private phone and data networks to facilitate inter-branch communications worldwide.

118. SWIFT is the major interbank messaging system in use today. From the network's inception in 1977, SWIFT membership has grown to over 3,600 institutions in almost 100 countries. SWIFT members utilize a standard

set of messaging formats, transmitted over a secure packet-switching network, to exchange transaction-related messages and information.

119. Set-up costs for new members are significant, ranging from US$ 100,000 upwards depending on the configuration and location. Variable costs, however, can be much lower than for telex or other communications modes.

120. Initially, payment messages handled by SWIFT involved instructions relating to single transactions (e.g., trade payments), which were handled through the correspondent banking accounts of the institutions involved. However, SWIFT has since extended its activities into the following areas:

- The Interbank File Transfer Service facilitates the transfer of bulk payments data, usually multiple low-value remittances as well as administrative information, which traditionally is sent by fax.

- The ECU Netting Service is used mainly by European banks to net their ecu-denominated liabilities.

- ACCORD is a confirmation matching system for foreign exchange and money market trading.

- The PREMIUM service has a message copying feature which facilitates the use of the SWIFT network in automated clearing-house applications. France is currently using SWIFT as the transfer mechanism within its national settlement system for high-value payments.

121. SWIFT is also in the pilot stages of an international financial EDI project to facilitate the direct collection of domestic and crossborder trade payments (non-L/C). This will occur through direct debit instructions issued by the seller's information system. These messages contain remittance advice information, which will be transmitted to the buyer's information systems at the time their account is debited. This approach will require all transaction participants to make modifications to their information systems. At present, it is only feasible between counterparties that have substantial trade transaction volumes. However, it is an initiative which UNCTAD and the Trade Point Network should closely monitor.

122. Another SWIFT initiative in the design stage is a mass payments facility, which is intended to facilitate crossborder payments between banks and automated clearinghouses (ACHs) as well as ACH to ACH payments. Although this initiative is in its early stages, UNCTAD and the Trade Point Network should also closely follow its development. The successful implementation of these capabilities, combined with its current ACH technologies, would present significant new opportunities to enhance payment systems in the developing world.

Guidelines

123. As the Trade Point Network is still in its early development, consideration of a proprietary payments system is premature. However, UNCTAD, the LTEAs and affiliated financial institutions should seek to participate in national and regional efforts, both public and private, to develop or enhance payment and clearing systems. In particular, they should seek to ensure that the development process for new systems addresses the following issues:

- The EDI capabilities should be designed under EDIFACT standards.

- The system design should facilitate linkages to other national and regional clearing systems. Moreover, mechanisms to finance short-term deficits by member countries should be incorporated to prevent settlement delays.

- Developments in documentary credit/collections techniques should be reflected in the system design.

124. If a significant volume of inter-Trade Point trade does materialize, more rapid payments could be facilitated, if necessary, by involving an international bank with a proprietary express payments system in the relevant Trade Points.

E. Credit insurance products

125. Credit insurance, the insuring of sellers against insolvency or default by their domestic and/or overseas buyers, is commonly utilized in Europe and Japan to protect trade transactions. It is also increasingly used in other developed and developing markets. This product is typically purchased by: (1) firms desiring to protect their domestic and export trade against credit risk, and (2) financial intermediaries who are financing domestic and international trade but wish to limit their credit risk exposure. It is one of the primary credit intermediation techniques utilized in international trade and is a frequently used alternative to documentary credits, particularly when open account payment terms are preferred.

126. This insurance is generally underwritten on a whole turnover basis, wherein all of the insured's domestic and/or overseas sales are covered in exchange for an annual premium based upon sales volume. The insurer will restrict his exposure by setting a limit on the insured receivables outstanding from a given buyer at any one time. In addition, the majority of policies issued cover only transactions involving payment terms of 180 days or less.

127. Credit insurance covers only the commercial risks in a transaction; however, in many cases an export credit policy is combined with political risk cover, which insures against certain government actions (e.g., foreign exchange controls) that may prevent the buyer from making payment.

128. The benefits of using credit insurance are that it normally allows the exporter to sell on open account terms, thus avoiding the costs and complexity associated with documentary credits. Many banks will accept a credit insurance policy as security for trade finance as long as the policy is issued by a well-capitalized insurer.

129. As noted previously, the credit insurance industry, particularly in the industrialized countries, is undergoing a restructuring as a result of regulatory liberalization and the competitive opportunities offered by modern communications technologies. In developing countries most credit insurers are

State-controlled companies. However, several new private and multilateral credit insurers are emerging in the developing world. These include:

- The Islamic Corporation for the Insurance of Investment and Export Credit, which is being formed by the Islamic Development Bank to insure trade and investment between Muslim countries in accordance with Islamic Law.

- Global Trade Insurance, a subsidiary of the People's Insurance Company of Singapore, which is the first private market credit insurance underwriter in Asia. This company insures Asian trade with Europe and the Americas as well as exports from these markets into south-east Asia.

- The new African Export-Import Bank, which is exploring the development of a credit insurance subsidiary.

130. Credit insurance is normally distributed through direct sales by the credit insurers or through specialist brokers. However, in many developing countries the distribution of private market credit insurance is conducted through general insurance brokers or trade banks. Service levels, particularly to SMEs, are frequently uneven due to the lack of product expertise in the local market.

1. Guidelines

131. The Trade Points should facilitate the availability of credit insurance to their clients through the development of a brokerage or underwriting capability within the Trade Point or a LTEA member company.

132. Export credit insurance services should be targeted at experienced exporters who sell on a frequent basis to a fairly regular group of overseas customers and who wish to switch from documentary credits to open account terms of payment without incurring significant additional credit risk. It is also useful when selling to markets, such as Western Europe, where L/Cs are not commonly demanded and their use may influence the purchase decision.

2. Implementation considerations

133. Discussions have been held with several private market credit insurers concerning possible distribution of their products through the Trade Point Network. One insurer in particular has extensive experience in working with banks and insurers in developing countries to distribute or co-underwrite credit insurance. Due to regulatory and financial considerations, it will be necessary to address the marketing of credit insurance on a country-by-country basis.

134. There are several distribution approaches which the Trade Points can consider. These include:

- Recruit a qualified credit insurance broker or a local State-owned/private credit insurance underwriter into the LTEA. If a local underwriter is involved, the Trade Point should seek to develop new-to-export policies for SMEs. These policies should also involve intensive export counselling services by the Trade Point to mitigate the additional risks to the insurer stemming from exporter inexperience. New-to-export policies are used in many developed countries to assist SMEs in trading abroad on open account terms without assuming excessive credit risks.

- The Local Trade Efficiency Association could act as an agent/broker for one or more credit insurers. The telecommunications capabilities of the Trade Point would be very useful for exchanging administrative information with a foreign insurer and facilitating the rapid approval of new buyers under the policy. If the insurer is domiciled overseas, there may be regulatory issues that have to be addressed before the insurer can offer a policy to a domestic exporter. Brokerage fees for credit insurance can range up to 15 per cent of premium paid.

- It is also possible for a qualified insurer affiliated with the Trade Point to develop a credit insurance capability without a massive investment in personnel and systems. One particular European credit insurer has been establishing co-underwriting programmes with property/casualty insurers in several developing countries. Under this mechanism the indigenous insurer, which could be a licensed insurance subsidiary of a commercial bank, markets the product and issues a policy in accordance with local regulations. The European insurer conducts the underwriting analysis and must approve all foreign buyers (usually in OECD countries) which are to be covered under a given policy. The indigenous insurer also automatically reinsures up to 90 per cent of the risks assumed by the European insurer and handles local marketing and administration. Thus the local insurer can gradually gain the expertise to assume additional underwriting responsibilities. There are also a number of regulatory and foreign exchange issues which must be addressed in implementing this type of programme, particularly in licensing and reinsurance.

135. The above approaches permit the Trade Point to offer a broader range of credit risk intermediation products as an alternative to documentary credits.

F. Non-credit financial risk management services

136. This section evaluates financial risk management techniques in use today, except for those which directly address credit risk and the insurance of goods while in transit to the importer. Credit risk management products offered by banks are discussed in section D above while credit insurance products are evaluated in section E. Cargo/marine insurance issues are addressed in section G.

137. The use of modern financial risk management techniques is quite commonplace in private sector companies within industrialized economies and is utilized increasingly by State-run and private enterprises in developing countries. However, there are serious structural barriers that prevent them from being used in many countries or in being applied to trade among developing countries.

138. Numerous risk management instruments and techniques are available today, covering a range of widely-traded financial instruments, currencies, commodities and precious metals. Instruments which should be particularly relevant to Trade Point clients include:

- Commodity and precious metal futures, options and swap contracts. These allow exporters to hedge against future fluctuations in the price of the underlying commodity. Products for which derivative instruments are widely traded include oil, gold, corn, wheat, coffee, livestock, lumber, sugar, copper, cocoa, cotton, silver and platinum. Most of these instruments are exchange traded; however, many financial institutions and trading firms will arrange bespoke contracts.

- Currency-based derivative instruments including forward contracts, futures, options, swaps and related techniques. Once limited to short-term maturities, traders can now hedge currency exposures on trade and financial transactions for up to several years. Many of these instruments are exchange traded; for example, the Philadelphia Stock Exchange specializes in foreign currency options. However, the majority of contracts are arranged on a bespoke basis by financial institutions and traders.

- Financial instrument and interest rate derivatives include forward rate agreements, futures, options, swaps and a range of related techniques. The exchange-traded contracts are usually based on widely traded debt and equity securities as well as major market indexes. Examples include United States government bonds and the Nikkei Index. These are commonly used to hedge interest rate and equity market exposures. Many exporters and importers use interest rate swaps and related instruments to fix or reduce their costs of borrowing when financing a major trade transaction or construction project.

139. A recent World Bank report cited estimates that more than 25 per cent of the funds raised in 1989 by 16 developing countries on the international capital markets utilized some type of risk management instrument (Claessens, 1993). The report also noted that some United States exchanges specializing in livestock and currencies have estimated that 15-25 per cent of the foreign participation in their markets comes from developing countries. Examples cited include Eurodollar futures (Chile), oil price hedging (Mexico), currency options (India, Indonesia and Turkey), loans with oil options (Algeria).

140. Some developing countries and economies in transition have established indigenous exchanges for trade currency and commodity instruments. For example, the Budapest Commodities Exchange began offering currency futures in March 1993 and facilitates trading in a number of other currency-based derivative instruments.

141. Potential barriers to the increased use of financial risk management services include:

- Creditworthiness of the firms purchasing risk management instruments.

- Upfront costs or premiums.

- Domestic structural barriers, such as national marketing boards or exchange controls.

- Government intervention or risk assumption where market alternatives are available.

- Lack of liquidity in hedges involving developing country currencies or lack of appropriate market-traded instruments.

142. In May 1993 UNCTAD convened a meeting of a group of experts in Geneva to explore approaches to promoting the increased use of commodity futures contracts. The participants identified many regulatory and technical barriers to the utilization of these instruments and developed proposals to dismantle many of the obstacles. One of the major impediments cited was an insufficient understanding of the function and use of derivative instruments among Governments and potential users in developing countries. Improved training and advisory services, including those provided by UNCTAD, were among the recommendations arising from the second session of the expert group in September.

Guidelines

143. Local Trade Efficiency Associations (LTEAs) should determine the financial risk management needs of their clientele and develop seminars or training programmes to explain the relevant techniques. For example, UNCTAD has sponsored training programmes in the use of commodity futures. If potential demand is adequate, the LTEAs should also facilitate access to risk management services by their clients. These services could either be provided through affiliated financial institutions (e.g. forward contracts in foreign currencies) or by qualified foreign institutions/brokers identified through the financial services referral function.

144. Local Trade Efficiency Associations should also consider lobbying their national governments if legal/regulatory barriers are impeding the utilization of modern financial risk management tools.

G. Cargo/Marine insurance

145. Cargo and marine insurance is one of the oldest, most regulated and most tradition-bound sectors of the insurance industry. It is also a relatively small part of the industry and thus has not been the target of the technological innovations that are affecting other insurance lines. The distribution of cargo and marine insurance is largely broker driven, while

underwriting considerations focus on the maintenance rating of the ship and the safety record of its operators.

146. Coverage can vary between "minimum cover" policies and "all risks" policies, at the discretion of the insured. Insurance can be purchased for a specific shipment or cover all shipments for a set time period (open cover policy). Lloyd's insurance market has had a great deal of influence on the development of specific policy language and terms.

147. The property/casualty insurance industry has begun to develop telecommunications networks, such as RINET in Europe, to facilitate the exchange of claims-related and administrative information between direct insurers and reinsurers. Marine/cargo insurance underwriters do not yet participate to any significant degree in these networks, relying instead on telephone, fax and telex. Moreover, in many countries insurance documents are not included in the aligned system of documents.

148. A major obstacle to the further modernization of the cargo/marine insurance industry is the continued existence of regulatory barriers to international competition, as noted previously. Without regulatory reform, there are limited opportunities for Trade Points in developing countries and economies in transition to increase trade efficiency in the provision of cargo/marine insurance services.

Guidelines

149. Local Trade Efficiency Associations should recruit at least one marine insurance broker or underwriter into the Trade Point in order to facilitate easy access to insurance services. A full range of insurance alternatives should be available, although the open cover policy is the most efficient from an administrative point of view.

150. Local Trade Efficiency Associations should also consider lobbying their national Government to permit an easing of local-sourcing requirements for trade-related insurance and to work for the harmonization of international procedural conventions in marine insurance.

IV. FACILITATING FOREIGN DIRECT INVESTMENT THROUGH THE TRADE POINT NETWORK

151. The facilitation of foreign direct investment in developing countries and economies in transition is currently being addressed at several levels, including the following:

- On a national basis within industrialized economies by various organizations such as development finance institutions (DFIs), investment promotion agencies (IPAs), development cooperation organizations, government ministries, chambers of commerce and trade associations. Some countries, such as the United States and Japan, have several agencies that have investment promotion in developing countries as a major component of their mission. These agencies frequently rely on their embassy commercial departments or the host Government to perform information collection and administrative tasks within the countries targeted for investment.

- At the multilateral level through the various agencies and organizations which are currently assisting developing countries, including: (1) the United Nations, through UNIDO and the International Trade Centre UNCTAD/GATT, (2) The World Bank Group, particularly the IFC and MIGA, and (3) the European Union, through the Centre for the Development of Industry and the International Investment Partners. Although many of these organizations have local offices in developing countries they also rely on host country Governments and business associations for information on investment opportunities.

- In a limited number of developing countries through ministries for foreign economic relations and international cooperation agencies. Examples include the Agency for International Cooperation and Development in Russia and Malaysia's Industrial Development Agency. There are also inward investment promotion programmes in many developing countries, such as Egypt, Ghana, Hungary, Indonesia, the Philippines and Thailand. However, many of these programmes are in their early stages and most suffer from a lack of adequate resources to address their tasks assigned to them.

152. The services most commonly offered by these organizations (collectively referred to in the subsequent discussion as "IPAs") include:

- Information on investment conditions in foreign countries as well as relevant laws and regulations. These services can also include data on specific direct investment opportunities or host country initiatives to attract foreign investment. For example, the Overseas Private Investment Corporation in the United States operates an Opportunity Bank where investment proposals from over 100 developing countries have been registered.

- Matchmaking programmes, which are generally designed to inform potential investors or technology providers about opportunities in developing countries within their industry or area of expertise.

- Investment missions and conferences that bring together potential partners, either physically or through video-conferencing.

- Programmes to promote investment opportunities within specific industry sectors, which combine elements of the latter two services on a more targeted basis. This is an increasingly popular service because of its high perceived cost-effectiveness.

- Subsidy programmes to support feasibility studies on potential investment projects. Many of the organizations operating these programmes also provide other financial and technical support, including (1) project preparation services, (2) subsidies for expatriate managers or training/apprenticeship programmes conducted for local nationals, (3) loan or equity capital, and (4) political risk insurance (FIAS, 1991).

153. Although this plethora of organizations and programmes plays an important role in facilitating foreign direct investment, the lack of coordination among these institutions inevitably leads to certain inefficiencies, including the following:

- Obtaining information on investment opportunities can be difficult due to resource constraints at the local level. The approaches to qualifying investment proposals as well as the content and format of investment information provided to IPAs are generally not standardized.

- Broadcasting specific developing country investment opportunities to all of the appropriate IPAs can require a significant administrative effort.

- Many investors, even seasoned multinational corporations, experience difficulties in identifying and accessing the appropriate programmes and services.

154. Trade Points in developing countries and economies in transition can play a useful role in addressing the former two areas of inefficiency, that is, identifying promising investment opportunities and liaising with the appropriate IPAs. Many Trade Point clients, particularly SMEs, are looking for foreign partners to provide finance, expertise or technology. Trade Points in developed economies can steer inexperienced firms to the appropriate national or multilateral IPA.

155. In addition, many Trade Point users may be seeking joint venture partners to distribute their products abroad, particularly if after-sales service is a major consideration. This area is frequently not a high priority for IPAs although some trade promotion organizations offer matchmaking services.

1. Guidelines

156. The Local Trade Efficiency Association should first consider whether to provide services in this area. Unlike trade facilitation, many of the benefits to the Association members will be derivative and realized over a longer period, as the export volume of local joint ventures increases. There may also be some limited opportunities to earn fees by providing local support or consulting services to IPAs, particularly if the host Government is unable to field the appropriate resources.

157. The Trade Point Network should attempt to facilitate the efficient flow of information within the investment promotion community rather than duplicate existing programmes. This can be accomplished at several levels:

- Providing local resources to identify and qualify investment proposals and direct them to the appropriate IPAs, particularly those that maintain formal investment opportunity databases.

- Collaborating with IPAs in promoting and conducting investment missions, particularly those focusing on an industry sector that is well represented within the Trade Point's clientele. Many IPAs rely on host Governments or business organizations for local support in organizing these missions.

- Participating in the establishment of common approaches and standards that address the qualification of investment proposals as well as the information content of messages that communicate these opportunities to the IPA community.

- Participating in the development of a network and database(s) to collect and disseminate information on investment opportunities in a more cost-effective manner. In particular, UNCTAD and the LTEAs should consider participating in the initiative described below to create an IPA Electronic Network linking the investment promotion community.

2. Implementation considerations

158. A possible framework for the development of an investment promotion capability is the IPA Electronic Network, which is being spearheaded by the Multilateral Investment Guarantee Agency (MIGA), a member of the World Bank Group. The project is currently in the organizational stage and several institutions, including UNCTAD, have been invited to participate in its development. It is envisaged that the Network will eventually include investment promotion organizations, chambers of commerce, trade associations, DFIs, investment advisers, consultants, information and telecommunications providers, and the media.

159. In the initial phase, the participating organizations will develop directories and bulletin boards that facilitate the exchange of information and experiences, the advertising of relevant services, and the showcasing of upcoming events and opportunities. After the Network is fully operational, MIGA expects that it will include "global databases on actual and prospective foreign and domestic investors, the business operating conditions and investment opportunities in developing and transitional countries, and global market conditions and opportunities in selected industries and sectors". The IPA Network will use the INTERNET as its telecommunications medium.

160. The association of institutions involved in developing this network will also provide an excellent forum for addressing issues relating to the harmonization of information requirements, message formats and qualification methodologies, which were raised above.

V. CONCLUSION

161. A key requirement for the continued development of international trade among developing countries and economies in transition will be the creation of a financial environment in these countries in which modern financing and insurance techniques can be freely utilized, regardless of the directions of

trade. This should be viewed as a long-term process, with effort required on many fronts - legal, regulatory, financial, educational and technological. However, the international and multifunctional capabilities of the Trade Point Network offer an excellent platform from which to address these issues.

162. This paper presents a menu of options which the Trade Points can consider in their continuing efforts to provide their clients with a full range of financing and insurance alternatives. The next step in the process is for selected LTEAs to choose particular options to be implemented on a pilot basis, with support from the UNCTAD secretariat. The results of these pilot projects will then be presented at the United Nations International Symposium on Trade Efficiency (UNISTE) along with detailed guidelines for the other Trade Points to follow if they choose to undertake similar initiatives. In this way these and other financial techniques and mechanisms can be propagated throughout the Trade Point Network without the need to "re-invent the wheel" in each individual case.

Appendix A

LIST OF ORGANIZATIONS CONTACTED FOR THIS STUDY

American Institute of Marine Underwriters

Arthur J. Gallagher Intermediaries, Inc.

Bankers' Association for Foreign Trade

Bank of New York

Berry, Palmer & Lyle, Ltd. (Lloyd's Brokers)

BIS Banking Systems

CIT Group

Citibank

Complex Systems, Inc.

Development Alternatives, Inc.

European Capital

Factors Chain International

First Washington Associates, Ltd.

GJ Sullivan, Inc.

Global Trade Insurance Management Pte Ltd.

Graydon America

Hungarian International Bank

International Bank for Reconstruction and Development

Justitia International

Lombard NatWest Commercial Services

Samuel Montagu & Co. Ltd. (Midland Bank)

Multilateral Investment Guarantee Agency

National Westminster Bank

Opal Trade Corporation

Overseas Private Investment Corporation
SITPRO

SWIFT

Trade Point - Bangkok

Trade Point - Cairo

Trade Point - Cartagena

Trade Point - Manila

Trade Point - Santiago

Trade Point - Tunis

UNCTAD

US Agency for International Development

US Chamber of Commerce

US Department of State - Legal Affairs

WFS Group, Ltd.

World Trade Centers Association

Appendix B

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