

Financing World Trade

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The international financial system has grown and evolved immensely over the past two decades. In the late 1950's the Eurocurrency market was only beginning to emerge, for all practical purposes there was no Eurobond market, and extensions of commercial credits were limited to the old commercial banking function of short term trade financing. All of that has changed. Total deposits in the Eurodollar market today are in excess of \$400 billion. The international bond market last year underwrote a record volume of new long term financing. And commercial banks have become increasingly innovative in responding to international demands for credit.

It is not coincidental that international trade has flourished side-by-side with the explosive growth on the financial side. In fact, it has been the growth in trade more than anything else that has accounted for the evolution of the financial mechanism. Just in the four years 1973 to 1977, total world trade increased by one-half, from about \$1 $\frac{1}{3}$ trillion, exports and imports combined, to more than \$2 trillion.' Most of the \$2 trillion of world trade required financing in one form or another.

Unfortunately, the available data on financing international trade are extremely sparse and incomplete. It may be asserted, as I have, that almost all trade requires some type of financing, but it is impossible to prove the point statistically. The concern of this symposium is trade in agricultural products, and I can assure you that statistics in that area are virtually nonexistent. Therefore my comments today will be more of a general nature. Whatever numbers are mentioned, as they have been above, will be round numbers that I am confident are in the ball park but that should not be analyzed too closely.

The forms that credit flows take in financing international trade are varied, but generally they may be broken down into three categories: (1) True trade financing; (2) Project financing; and (3) Balance of payments financing. A purist might take the position that only the first category, trade financing, should be discussed at this symposium, since the other two forms of financing involve circumstances other than trade. Generally I would agree with that proposition except for the fact that it is impossible to draw a clear line between trade finance, project financing, and balance of payments financing. Moreover, and of equal importance, the fact is that

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the data are not available to draw the distinction, so that I cannot draw it even if I would.

"True" Trade Financing

Those of you who remember your first college course in money and banking might recall that our present banking system was based upon a need to finance trade, primarily international trade. When the Federal Reserve Act was written, shortly before World War I, the intention was to design a central bank patterned after the Bank of England, and to encourage the growth of a commercial banking system along the lines of the British system. The principal financial instrument in this system was to be "bankers bills" or, as we know them today, bankers acceptances. Bank credit extended against such bills was considered to be self-liquidating since it would be employed only in the production, transportation, or marketing of real goods. As goods changed hands, the bills would be liquidated. A good part of the Federal Reserve Act and Federal Reserve regulations as they exist to this day deal with bankers bills.

In their admiration for the British system, Senator Carter Glass and his associates in 1913 did not recognize that the thrust of growth and therefore of credit extensions in this country was directed toward internal growth of the United States rather than to external growth as in Britain. Therefore, the bankers acceptance market never became the center of our money market as had been intended, the execution of Federal Reserve policy developed along a path not comprehended in the original act, and the resulting banking system differs in many important respects from the pattern on which it was modeled, i.e., the British banking system.

Until the post-World War II period, however, bankers acceptances did continue to play an important role in financing the movement and storage of commodities, particularly agricultural commodities, both within the United States and in international trade. To that extent, the Federal Reserve Act and the "real bills" doctrine that it embodied continued to be a part of the banking system. But the growing restraints on trade in the 1920's and particularly the 1930's, and the disruption of normal trade during the war years of the 1940's, held down both conventional international trade and the need for its financing. Therefore, my discussion today about the growing problems of financing international trade will deal only with the post-World War II years and, more particularly with the most recent four or five years.

As of the end of 1977, total short term debt owed U.S. banks by foreigners amounted to \$77 billion. In addition, the total of bankers acceptances outstanding amounted to \$25.6 billion. Both of these figures were alltime records. In most cases, these credits on the books of U.S. banks were a direct reflection of financing extended by the banks to support international trade. But it is clear that this volume of short term financing falls far short of what one would expect in view of the fact

that total international trade last year, as noted, came to \$2 trillion. The explanation is simple enough. Most important, the trade figures are global while the bank credit figures are only for the United States. Second, a fairly large part of world trade does not require financing at any stage. Third, "true" trade financing may involve a credit commitment of only a few days or a few weeks, so that any given volume of credits might turn over many times in the course of a year.

Even in the case of routine, short term trade financing, however, a number of problems arise that can and do affect the ability or willingness of the financial system to finance it. Most important is the practice among the developing countries, some Eastern European countries, and others, to impose obstacles to the repayment of trade credits. For example, it is a fairly common practice to require that all foreign exchange receipts from exports pass through the central bank and that foreign exchange payments for imports be approved specifically by the central bank. If a country is running a balance of payments deficit it might impound foreign exchange receipts and authorize their distribution to pay for imports only with a lag that would help to disguise underlying balance of payments deficits. In such cases, the lender financing the transaction is unsure of when he will be repaid. Moreover, there have been enough examples of moratoria on foreign claims to raise some questions as to whether or not payment will ever be received. Obviously, this circumstance discourages the financing of trade with countries following such policies and, by itself, is a deterrent to the growth of world trade.

As a general proposition, however, the ordinary month-by-month financing of trade does not encounter many obstacles and there has not been, to my knowledge, any situation in which the availability of financing was inadequate to provide for foreign trade needs. In dealing with the analysis of country risks in international lending it obviously is necessary to include all outstanding debt of a given country and prospective foreign exchange receipts in the analysis, including straight trade transactions of an essentially short term nature. But the need for a country to keep open the financing channels for critically needed imports and exports ordinarily is sufficient to guarantee that, whatever the country's policies might be in other regards, it will not interfere.

Project Financing

It might seem to be a fairly simple exercise to distinguish between trade and project financing. For example, credit extended to facilitate an international shipment of food and feed grains, where payments should be expected to be prompt, should be easily distinguishable from credit extended to finance the construction of a new plant facility that might take five years to complete. But this pattern of simplicity does not stand up in the complex welter of day-by-day events. As already noted, a country might find it necessary or expedient to delay payment on a straight foreign trade transaction simply because it has to ration its outlay of foreign ex-

change. On the other side, even an intermediate term project financing deal may be made up of many component parts, some of which partake more of ordinary trade than of term financing. For example, how does the delivery of a bulldozer to a construction site differ from the delivery of a grain shipment to a food warehouse. Each is a current trade transaction and each might be settled currently as a matter of course.

Having said this, it is nonetheless true that project financing is perceived to be different not only in terms but in kind from trade financing. An important reason for the distinction is that project financing more often than not involves the shipment of goods and supplies from a developed country to a developing country against a contract that calls for delayed payment. It is this kind of financing that has attracted considerable attention in recent years and considerable criticism of international bankers for extending themselves in risky credit situations. And it is here that the availability of credit to finance trade has been unsure. In fact, it has been the accumulation of this intermediate debt that, in many cases, has brought into question the total financial viability of a country even on short term trade credits.

As in the case of trade financing, there has been no evidence of a shortage of credit for project financing so long as the project itself appears to be an economic one. One important difference in financing techniques is that whereas trade financing is ordinarily handled by a single bank acting for its own account, project financing often, even usually, involves an amount of money too large for a single bank to do the financing by itself. In those cases, a group of banks in a single country might form a syndicate to do the financing or, increasingly more frequently, the financing might be handled in the form of an internationally syndicated loan. In the latter case, the leader or leaders of the syndicate may be commercial banks, but often the deal is put together by a merchant banking house or another financial market middleman.

The vastly increased availability of project financing in recent years has been of significant importance to many less developed countries in their efforts to promote economic growth. Prior to the emergence of the Eurodollar market as a major international financial institution, many of the projects that have been financed through syndicate loans probably would not have been financially feasible. While the growth and activities of the Eurodollar market have occasioned many expressions of concern, and while credit extended through that market along with other forms of credit creates a risk of the world becoming addicted to debt, it should also be recognized that the existence of the Eurodollar market has probably made a greater contribution to LDC development than any other single event.

Because of recent developments that have vastly increased the need for international finance, developments that I will discuss later, some countries have found themselves over-borrowed. In a few such cases, the private financial system has been reluctant to extend new credit. In other words, on the basis of a country risk analysis some of these countries did not appear to be good credit risks. In most

cases, the private lending syndicates have been able to work out an arrangement to restructure outstanding debt so as to avoid the default by the borrowing country. In such cases, the International Monetary Fund has sometimes been called in to supply additional credit and to impose stringent economic policy conditions upon the country, intended eventually to correct the underlying problem. In view of the amount of discussion there has been on the shakiness of some internationally syndicated loans, it is interesting to note that so far there has not been an actual default on a credit. It speaks well for the international financial system that it has been able to ride out the upheavals of recent years without serious adverse developments.

In wrapping up this discussion of project financing, I would like to repeat that both in fact and in theory it often is impossible to distinguish normal trade from project financing. When a lending syndicate analyzes the credit-worthiness of a given country, all types of debt outstanding are included in the analysis. Moreover, the analyst looks to the future behavior of exports and imports to determine the country's ability to service its debt. Were a country or one of its agencies to default on a credit, it would be not only longer term financing but short term trade financing as well that would be affected.

Balance of Payments Financing

It also is impossible to distinguish balance of payments financing from the other two types of financing I have discussed. In the jargon of commercial banking there is a phenomenon called the "evergreen loan." This is a loan that theoretically is cleared up at least once each year, but that in effect is a permanent loan on the books of the bank and a permanent component of working capital for the borrowing company. The analogy with international balance of payments financing is very direct. Realistically, when the government, agencies, or businesses of a country borrow, net, from external sources, that credit is going to finance the country's balance of payments. Reference has been made to the practice of some countries of rationing available foreign exchange so as to be able to schedule debt repayments in ways that will not adversely affect the country's credit standing. Reference has also been made to the restructuring of debt in a form that will make it easier for the borrowing country to service the debt. In both cases, the additional debt involved and/or the stretching out of repayment of old debt is part of the financing of the country's payments deficit.

Important developments in the last few years have distorted the balance of payments of countries all around the world, both developed and developing countries. These distortions have created very large new credit needs. Most important of the developments, of course, was the increase in international oil prices in late 1973 and early 1974. The quadrupling of oil prices at that time led to an income shift from oil consuming countries to oil producing and exporting countries. In spite of the fact that imports by the OPEC countries have increased enormously in the last

four years, the net trade surplus of the OPEC countries as a group is estimated to be still running upwards of \$30 billion.

The impact of OPEC surpluses upon the payments balances of oil importing countries has been most uneven. In general, the developed countries of Western Europe and Japan have been able to pay their oil bills. Similarly, many developing and semi-developed countries either were able to develop their own energy sources, to increase their exports of other products, or to restrain their imports of other products by enough to restore balance to their trade accounts. On the other side of the ledger, the United States in 1977 ran a trade deficit of more than \$30 billion, and many non-oil producing developing countries also ran sizeable trade deficits. All of this leads to the need for financing balance of payments deficits. In the case of the U.S. deficit, the financing took the form of accumulations of unwanted dollars in the central banks of the surplus countries. Less developed countries in many cases were financed indirectly from the surpluses of the OPEC nations. The OPEC surpluses did not flow directly to the deficit LDC's to assist in financing trade deficits, but instead flowed into the money market in this country and the Eurodollar market abroad, where private financial institutions accepted the rôle of intermediating between the surplus oil countries and the deficit non-oil developing countries.

The increase in oil prices has not been the only important influence on world balance of payments patterns. Prices of many materials produced by developing countries have been depressed, while prices of other products have soared. For example, high prices for coffee have benefited Brazil and other coffee exporters in Latin America and Africa. Meanwhile, prices of nonferrous metals, particularly copper, have been depressed and have seriously affected the trade accounts of the exporting countries. These and many other developments have imposed strains upon the financial markets to accommodate the necessary movement of funds from one country to another.

At the risk of repeating myself, it should be stressed again that at the time the credit is extended it usually is impossible to determine whether the credit is to finance a trade transaction, a balance of payments deficit, or a specific project. To employ a cliché, funds are fungible. Whatever the stated purpose of the credit, or whatever the sources of repayment, the results are reflected in a country's balance of payments accounts.

It is only when a situation is interpreted in terms of the availability of credit that significant differences amongst the stated reasons for the credit can arise. In most cases, there is an abundant availability of credit to finance trade transactions. And in most cases, there is ample money for project loans where the project is economically viable. However, when the borrowing is by a sovereign government, somewhat sterner criteria might be applied. For example, a financial institution that might be quite willing to finance imports of a given country and/or to participate in financing a project, might be reluctant to participate in a syndicate under-

writing a loan to that country that does not have a specific purpose. It is here that the financing of balance of payments distortions becomes less sure, and it is the public debt of a country outstanding in foreign hands that can lead to an overall debt picture that could even result in reluctance to finance basic trade transactions.

Conclusion

There is ample credit available to finance present and prospective international trade. There also is ample credit to finance longer term project investments and balance of payments deficits. Whether or not availability can be translated into actual access to credit funds depends importantly, however, upon the overall structure of a country's debt and the prospects for repayment of that debt.

Note

1/It may appear that combining imports and exports in this way involves double counting. In a trade balance sense that is true since an export offsets an import. Looked at from the point of view of financing trade, however, the concern should be total trade not just exports or imports.