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Can Trade Finance Attract Commercial Banks?

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For the period 1997-99, the Chase Manhattan Bank was the largest single provider of US Export-Import Bank guaranteed credits, which totaled some $6 billion. So this chapter comments on the potential role of an institution such as Chase in the provision of Ex-Im related credits. To begin, it would be useful to provide a broad description of how Chase views its opportunities in global financial markets.

Chase and the Global Financial Markets

The principal fact is that securitization is a dominant trend in global financial markets. In the past, private-sector cross-border finance typically took the form of bank loans. Today, and for the foreseeable future, the growth of long-term cross-border capital flows more likely will be in the form of bonds, equities, or direct investments.

In this context, Chase is pursuing a universal-bank model for business development. In practical terms, Chase intends to play a major role as a cross-border intermediary of bonds and equities—in addition to its position as the largest arranger by far of syndicated bank loans. Moreover, Chase participates directly in the process of cross-border direct investment, through its Chase Capital Partners arm. Of course, Chase remains committed to maintaining its already dominant role in the foreign

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exchange and derivatives markets, while building up its already leading-market position in payments processing, cash management, and securities custody operations.

This listing is not intended to represent an advertisement for Chase, although I would not be disappointed if you are impressed by the scope of our operations. Chase is dedicated to a highly varied mix of cross-border financial roles. It considers one of its key comparative advantages to be its ubiquitous contacts with principal corporations, private investors, governments, and public entities of all kinds around the world. It has deep international roots and a unique international infrastructure.

At the same time, Chase's focus is on its role as a financial *intermediary*. It possesses core competencies in credit assessment, in risk management, and in cash management. But today it syndicates the loans that it originates, just as with primary issues of bonds and equities. In other words, all its primary issuance activities must be able to pass a market test, in that even loans that it originates must be marketable.

Chase has a very large balance sheet, encompassing some $400 billion in assets. This gives it the financial heft to deal at a scale that few other institutions can match. But this strength does not weaken its internal financial discipline. Indeed, through the strict application of shareholder value-added analysis—in which individual businesses must cover their capital costs as well as their operating costs—the threshold today is higher than it was under the operating-revenue focus typical in the past.

Chase—like its principal competitors—is a very different institution compared with even a few years ago. Its scope is broader, while the internally generated pressure for liquidity, profitability, and risk control is relentless. At the same time, the goal of earning maximum returns for shareholders is paramount.

Chase and Ex-Im Bank

Turning to the US Export-Import Bank itself, and the role that it does and should play: First, we need to be realistic. Ex-Im Bank activity cannot single-handedly turn around the US trade deficit. The current record deficit that has emerged in the past few years more than anything reflects macroeconomic factors: principally, an unprecedented US investment boom, together with economic growth that has been considerably faster than in its principal trading partners. In fact, Ex-Im Bank cannot significantly shape the broad flow of US external trade. Its loans and guarantees directly affect only about 2 percent of US exports.

Ex-Im Bank cannot stabilize foreign markets on its own either. Its efforts in this regard are swamped by the potential actions of the International Monetary Fund, the World Bank, and other official international financial institutions. According to Ex-Im Bank's own words, its mission

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instead is to "facilitate US exports by providing financing in order to level the playing field for American exporters facing unfair foreign financing competition and bridge export financial shortfalls caused by market failures."

What Ex-Im Bank can do is to extend credit in support of the US government's objectives—including the promotion of economic development and economic liberalization. For example, Ex-Im deliberately has taken on risks in the past few years in Asia—amid financial crisis—and in sub-Saharan Africa, Russia, and the Newly Independent States of the former Soviet Union. This is a valuable role, but it needs to be recognized that it is not a commercial role.

In fact, Ex-Im routinely ventures into areas where commercial lenders otherwise will not go. There are good reasons for this reluctance. Banks cannot easily price loans in a way that accurately reflects the high degree of political, legal, and financial risk that is common in countries that are just starting on the path to a market economy. Absent Ex-Im guarantees, there would be few banks or other investors interested in holding these credits. Of course, this is not a static situation. Ex-Im, along with the World Bank and other multilateral lenders, can encourage these countries to improve their legal systems and their disclosure requirements so that private institutions and entities may become more willing to lend. Nonetheless, a bottom-line measure of Ex-Im's success is that Chase would not be making these loans at all—at virtually any price—without Ex-Im participation.

A growing proportion of Ex-Im's credits go to private borrowers. In 1999, 55 percent of Ex-Im credit went to private entities, up from 22 percent in 1990. Why, some would ask, will private-sector banks not lend money to sound private-sector companies? Many of the ventures that Ex-Im finances are perfectly sensible from an economic standpoint, but will generate only local currency revenues. As we learned again during the 1997 Thai crisis and the 1998 Russian crisis, local firms without the ability to generate foreign-currency revenues are potentially risky credits to banks that lend in dollars, even though their basic business plans may be sound.

Ex-Im guarantees make it possible for institutions such as Chase to finance these worthwhile activities. Of course, Ex-Im itself finances or guarantees only a portion of the covered loans. Private lenders remain at risk for the remainder. Many private lenders believe the presence of the US government as a creditor substantially increases the likelihood of repayment of total credit.

But banks account for a declining share of emerging-market net finance. Although net flows from banks to emerging markets currently are close to zero, nonbank sources extended a net $32.4 billion in credit to emerging-market borrowers in 1999. This raises the question of whether Ex-Im should be in the business of guaranteeing bonds as well as loans. It is an

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interesting idea, but one that may not be of much practical importance. The World Bank already has this authority and has guaranteed bonds issued to finance several ventures—particularly power projects—in emerging-market economies. Borrowers, however, have not rushed to use this facility, because it has proven to be a cumbersome, time-consuming way for them to raise money.

A major part of Ex-Im's business is providing guarantees that often are offered in competition with foreign export credit agencies. Chase is a major player in the market for aircraft lending, for example, an activity that attracts credit guarantees from various European countries. These guarantees are often used in transactions in emerging-market countries. In many cases, the private credit markets would be unwilling to finance such transactions absent Ex-Im guarantees. Either the manufacturer would have to provide credit directly—not easily done in the case of very expensive products such as commercial jets—or the sale would not occur.

Much of the tension among various export finance agencies over "leveling the playing field" reflects the uneasy fit between today's commercial and political realities. In a world of relatively open markets for goods, services, and capital, firms' activities are increasingly international and multinational in character. Export credit agencies need to look for cooperative—rather than competitive—modes of operation. This prospect, however, sits uneasily with their national mandates, and clouds the concept of a level playing field. Still, the effective melding of commercial and political realities is imperative if the export finance system is going to move successfully into the twenty-first century.

Conclusion

The answer to the question "Can trade finance attract commercial banks?" is "Yes, but. . . ." Banks have, and will continue to have, an interest in profitable trade finance activities. But much of what Ex-Im Bank does is not particularly attractive to banks that devote increasing attention to weighing the risks that they take against the profits they hope to earn. Without Ex-Im as a partner, the banks would find that many of those risks are not commercially attractive. Ex-Im Bank's activity quite properly is justified by public policy goals, and it should not be held accountable to commercial risk standards.

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