Can a South African Export Credit Agency Navigate Domestic and Global Headwinds?

Palesa Shipalana, Cyril Prinsloo and Zinhle Ngidi

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Abbreviations and Acronyms

AfDB	African Development Bank
Afreximbank	African Export-Import Bank
BEE	Black Economic Empowerment
BRICS	Brazil, Russia, India, China and South Africa
CCB	China Construction Bank
CEXIM	Export-Import Bank of China
CGIC	Credit Guarantee Insurance Corporation
CPFP	Capital Projects Feasibility Programme
DFI	development finance institutions
dti	Department of Trade and Industry
ECA	export credit agency
ECIC	Export Credit Insurance Corporation
Exim	export-import bank
GFC	global financial crises
ICC	International Chamber of Commerce
IDC	Industrial Development Corporation
IFC	International Finance Corporation
IMU	Interest Make-up
IPAP	Industrial Policy Action Plan
JIBAR	Johannesburg Interbank Accepted Rate
LC	Letter of Credit
LIBOR	London interbank offered rate
MLT	medium- and long-term
MNC	multinational corporation
OECD	Organisation for Economic Co-operation and Development
SACEEC	South African Capital Equipment Export Council
SADC	Southern African Development Community
SME	small and medium enterprises
TFTA	Tripartite Free Trade Area

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1. Introduction

More than a third of countries globally rely on an export credit agency (ECA) to promote domestic economic growth. ECAs, typically public institutions that offer concessional trade finance services to companies, aim to engender economic growth by facilitating exports and in turn increase domestic employment and production.

South African public entities, in line with the country's industrialisation and trade policies, provide a range of financial, risk and guarantee-services to exporters through institutions such as the Export Credit Insurance Corporation (ECIC) and the Industrial Development Corporation (IDC). In addition, a host of financial and non-financial service providers cater for market needs. In December 2017, South Africa, represented by the ECIC, became a shareholder of the African Export-Import Bank (Afreximbank) to expand its range of services to exporters. While this conglomeration of trade finance institutions offers South African firms a suite of trade financing services, various ministries within the economic cluster, including the National Treasury and the Department of Trade and Industry, have considered creating an amalgamated, fully fledged ECA for South Africa over the past two decades.

The domestic environment in South Africa has however, changed drastically over the past two decades. Unlike the windfall years before the global financial crises (GFC) when economic growth in South Africa topped 5% between 2005 and 2007[1], sluggish global growth in the post-GFC period, combined with the global commodity price downturn and domestic political turbulence, the country now finds itself in a heavily constrained fiscal position. This will limit its ability to set up a South African ECA. At the same time, the country boasts a robust and healthy private banking and financial sector that can be co-opted, alongside the IDC and the ECIC, to achieve national objectives.

Significant changes have also occurred within the global ECA-milieu that will impact on the South African government's ambitions. The Organisation for Economic Co-operation and Development's (OECD) 'gentleman's agreement' that regulated the biggest ECAs for nearly four decades, is failing to regulate emerging ECAs from non-OECD countries, which are drastically distorting the global trade financing market. At the same time, the GFC led to a liquidity crises and risk averseness among financial institutions, limiting trade finance especially in developing countries. The subsequent implementation of Basel III regulations imposes tighter capital and liquidity requirements and leverage ratios on financial institutions in an effort to address the regulatory gaps that led to the GFC, further constraining the availability of trade finance.[2]

This paper maps out South Africa's current trade finance market with the aim of assessing the demand for, and feasibility of South Africa establishing its own ECA. It also explores global developments within the ECA milieu which influence the operations and efficiency of not only existing financial service providers in South Africa, but also the mooted South African ECA.

[1] IMF, 'World Economic Outlook Database', http://www.imf.org/external/pubs/ft/weo/2018/01/weodata/index.aspx, accessed 5 June 2018.

[2] Basel III is a set of regulatory measures implemented by the Bank for International Settlements after the GFC aimed at regulation, supervision and risk management of banks. For more information, see: BIS, 'Basel III: international regulatory framework for banks', https://www.bis.org/bcbs/basel3.htm.

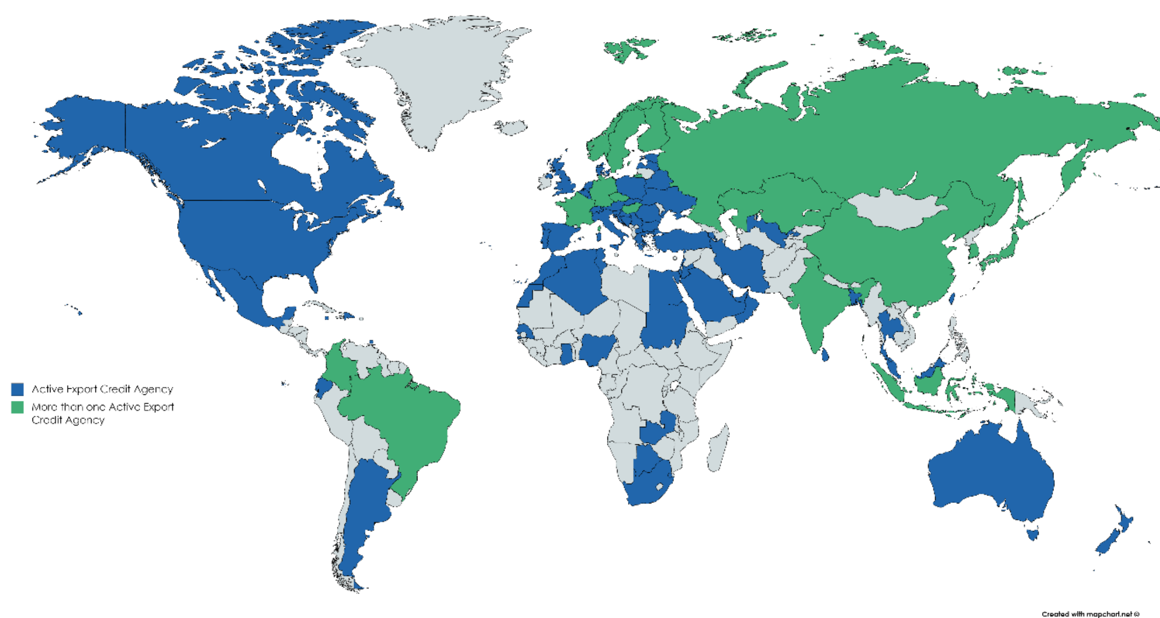
2. What is an ECA?

As South Africa looks to set up its own ECA, it is worthwhile to take cognisance of different configurations of ECAs across the globe. The following section highlights various characteristics and types of ECAs, as well as their main objectives.

2.1. Characteristics

Since the United Kingdom first established its export credit agency (ECA) in 1919, there has been a proliferation of ECAs (also referred to as 'export-imports banks') across the globe, now totalling more than 96 (see figure 1).[3] While no two ECAs are alike, their basic mandates of engendering economic growth by promoting domestic production and facilitating exports, is a common attribute. Like other development finance institutions (DFI), ECAs tend to be publicly owned (with paid in capital from governments typically one of their biggest sources of financing)[4], offering concessional and developmentally- orientated financing. While some ECAs are inward-focused, offering support only to domestic companies, outward-focused ECAs can provide part of, or the full range of their services to entities outside their national borders.[5] In almost all cases, there is a close alignment between ECA activities and national trade and industrial policies.

Figure 1 – List of Active Export Credit Agencies



Source: Export-import Bank of the United States (US Exim), 'Report to the US Congress on Global Export Credit Competition', https://www.exim.gov/sites/default/files/reports/EXIM-Competitiveness-Report_June2017.pdf, accessed 28 February 2018.

What sets ECAs apart from other DFIs are their service offerings, typically consisting of three core services: providing credit, insurance and guarantees for traders. Typically, there are three types of ECAs – those who only provide cover (e.g. insurance and guarantees) relying on private financiers to

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4 Balraj and Rajpurohit RS, 'Financial Comparison of Export Credit Agencies / Export-import Banks of India, China, USA, Russia, South Africa and Australia', http://mujournal.mewaruniversity.in/JIR%202-3/10.pdf, accessed 28 February 2018.

5 Export-import Bank of the United States (US Exim), 'Report to the US Congress on Global Export Credit Competition', https://www.exim.gov/sites/default/files/reports/EXIM-Competitiveness-Report_June2017.pdf, accessed 28 February 2018.

provide financing; those who engage in direct lending; and those who engage in both.[6] The following table offers a brief overview of each of these core services:

Table 1 – Core Services Typically offered by ECAs

Service	Description
Credit	Credit services typically involve direct loans to domestic or international, private or public, sovereign or non-sovereign entities looking to procure goods or services from a domestic company. Some ECAs also provide working capital finance to firms from its country.
Insurance	Insurance offered by ECAs typically cover risks associated with trading (economic or commercial, payment, forex, transportation and political risk).
Guarantees	Guarantees are typically extended by ECAs to private financiers should a buyer default on payment.
Source: Akhtar SI, Carpenter DH, Driessen GA and Taylor J, 'Export-import Bank: Frequently Asked Questions', https://fas.org/sgp/crs/misc/R43671.pdf, accessed 28 February 2018.	

By offering these core services, ECAs assist companies by managing different types of risks (economic or commercial, payment, forex, transportation and political risk) and ensuring access to credit or working capital when exporting their goods.[7] At times, private financial service providers would be unwilling to offer such services due to perceived high risk (e.g. in markets that are viewed as particularly risky, typically emerging markets) or offer such services at very expensive, uncompetitive rates.[8] It is in this context that ECAs can play an important role.

Typically, ECAs can cover a wide range of sectors, ranging from consumer goods; capital equipment and infrastructure development. They also have bespoke product offerings for different time-frames, as dictated by the needs of different industries and sectors. The following table is illustrative:

Table 2 – Typical Terms Offered by ECAs

	Short (Months)	Medium	Long
Credit	12 months	1 – 7 years	7+ years
Insurance	180 days	5 years	
Guarantees	12 months	1 – 7 years	7+ years
Source: Akhtar SI, Carpenter DH, Driessen GA and Taylor J, 'Export-import Bank: Frequently Asked Questions', https://fas.org/sgp/crs/misc/R43671.pdf, accessed 28 February 2018.			

[6] US Exim, *op. cit.*
[7] Balraj and Rajpurohit RS, *op. cit.*
[8] *Ibid.*

ECAs do not necessarily operate independently from other DFIs, but rather, offer specialised services. For example, when large infrastructure procurement projects are underway, ECAs alongside other DFIs can provide countries with an attractive offering by bundling export of goods and services which are serviced by different DFIs. China has been praised for the close cooperation that it has achieved between Sinosure (which provides trade insurance), the Export-Import Bank of China (CEXIM, providing concessional credit) and the China Development Bank (CDB, offering financing for large scale infrastructure projects). These Chinese DFIs cooperate to combine tied, untied, concessional and investment financing to increase their flexibility and offerings to countries.[9] While many countries aspire to achieve such levels of cooperation, others have struggled – this was identified as a particular challenge by South African policymakers interviewed for this paper.[10]

Box 1 - West and East – Different ECAs

Generally, there is a distinction between 'Western' ECAs, such as those from the US or EU and 'Asian' ECAs from Japan, China, Korea and India. The primary difference between them resides in the scope of their activities. Whereas Western ECAs focus primarily on supporting *exports,* Asian ECAs focus on supporting *exporters.* Asian ECAs, by focussing their efforts on 'national champions' or strategic objectives (e.g. the Belt and Road Initiative in the case of Chinese ECAs), try to be more strategic about the support they offer which allow them to maximise economic benefits accruing to the country. In addition, typically in Asian markets, private financiers have played a small role in financing trade activities, whereas the opposite is true in Western markets.

Source: Export-import Bank of the United States (US Exim), 'Report to the US Congress on Global Export Credit Competition', https://www.exim.gov/sites/default/files/reports/EXIM-Competitiveness-Report_June2017.pdf, accessed 28 February 2018.

2.2. Objectives

Proponents of ECAs champion the positive contribution made by these institutions, for the most part relating to their ability to facilitate economic growth, address market shortcomings, and support the participation of SMEs in global value chains.

ECAs are often employed strategically to gain international market share for domestic companies. The United States (US) EXIM, for example, subsidises transaction costs for US-based Boeing to assist it in providing a more competitive offering, ultimately luring business away from other international competitors such as European-based Airbus.[11] Various factors are considered when companies look at procurement of goods or services, including the quality, price and delivery terms. But financing can offer a competitive advantage too.[12]

As the trend of global decentralisation of production has increased – signified by the fragmentation and proliferation of production value chains across the globe – many ECAs have responded by providing working capital and supply chain financing. While both typically involve ECAs offering guarantees to private financiers based on companies' accounts receivable as collateral, the latter

[9] US Exim, *op. cit.*

[10] Personal Interview ECIC, 16 January 2018.

[11] Furth S, 'The Export-Import Bank: What the Scholarship Says', http://thf_media.s3.amazonaws.com/2014/pdf/BG2934.pdf, accessed 28 February 2018.

[12] Ghose S and Thakur S, 'An Analysis of the Growth of Exim Bank as India's Premier Export Financing Institution', http://www.researchersworld.com/ijms/vol2/issue1/Paper_06.pdf, accessed 28 February 2018.

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provides support to suppliers or consumers (even in other countries) across the value chain to facilitate the trading of goods between different centres of production.[13]

To maximise benefits, they typically have some form of local content requirement that companies must comply with to benefit from their concessional services and have strong mandates to promote financing for small and medium enterprises (SMEs) or marginalised businesses (e.g. women-owned). These latter organisations are widely considered to be key drivers of economic growth and job creation, but typically lack access to financial services.

The trade finance gap is felt more by SMEs than any other type of enterprise as their applications are most likely to be rejected by trade financiers or excluded from trade due to factors such as high pricing of trade finance solutions and requirements for extensive collateral which present indirect barriers to accessing trade finance. Globally, it is well known that SMEs play an important role in driving economic activity both in developed and in developing economies. It is estimated that SMEs contribute to more than 60% and 80% of total employment in developed and developing countries respectively.[14] Although there is consensus globally on the economic importance of SMEs, funding remains one of the key issues which impede the growth potential of such enterprises. Banks in particular tend to prioritise the top tier of the market, disproportionately extending trade finance to multinational companies (MNCs) and large corporates. Bank credit risk assessment methods focus heavily on financials of borrowing entities and collateral. These two aspects give MNCs and large corporations an unfair advantage over SMEs. Banks are also naturally more inclined to take on risk for a mature business which has a proven financial track record, tested operational practices and extensive assets that can be pledged as collateral, whereas credit worthiness is often a concern with SMEs.

ECAs are also useful in addressing market shortcomings. In the case of SMEs, private financial institutions are often unwilling to invest their resources in performing advanced levels of due diligence on deals that may be considered to yield low profits for the bank. SMEs usually also do not have the capacity to put in place the necessary structures to document financial and other regulatory information, making it difficult to do a thorough risk assessment. ECAs, by tailoring offerings to such companies, can aid in bridging these challenges.

In addition, ECAs also typically offer value-added services to SMEs. Knowledge products on new or different markets present a significant 'sunk cost' for companies, which can be a substantial deterrent for SMEs with smaller capacities to export. Instead, ECAs can carry such costs and benefit many companies. For example, the Indian Exim bank has expanded its scope to include activities such as importing technology, offering export product development services, export marketing, pre – and post-shipment financing and investing in production centres abroad.[15]

Evidence from the US Exim Bank suggests that Exim banks can also be used as countercyclical tools. For example, during the financial crises, when private finance was heavily constrained, companies could rely on the US Exim Bank to support their exports.[16]

However, beyond their alignment with industrial and trade policies to promote domestic objectives, ECAs also complement and enable the domestic foreign policies of their host countries. If an ECA,

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[13] US Exim, *op. cit.*

[14] Nyakundi K, 'An Analytical Review of the State of Trade Finance in Africa', https://d3n8a8pro7vhmx.cloudfront.net/eatradehub/pages/3623/attachments/original/1505906368/Trade_Finance_Working_Paper.pdf?1505906368, accessed 28 February 2018.

[15] Ghose S and Thakur S, *op. cit.*

[16] Freund C, 'The US Export-import Bank Stimulates Exports', https://piie.com/system/files/documents/pb16-23.pdf, accessed 28 February 2018.

typically mandated by its government, grants preferential financing options to companies from one country but are prohibited from offering the same service to companies from another country, it signifies clear economic diplomacy objectives.

2.3. Critiques

Despite the positive attributes of ECAs, their role is not regarded universally as beneficial. Debate around the value and viability of ECAs is dominated by researchers and analysts employing different econometric modelling approaches, factoring in different constants and variables and arriving at different conclusions. For example, one study suggests that 'for every dollar authorised by the US' EXIM results in $1.35 in greater exports. The multiplying factor is even greater for exports to Sub-Saharan Africa, resulting in about $1.80 in greater exports, signifying significant gains for the US economy.[17] Another study, based on a different set of constants and variables, argues, that 'beyond [a] wealth transfer from the many to the few is a net loss in economic surplus for the US economy'.[18]

Nowhere has this debate been more prominent than over the re-extension of the US EXIM in 2015. Those opposing the extension of the US EXIM's mandate based their claims on 3 broad arguments: the US EXIM services primarily large corporations and not SMEs or marginalised companies; the bank unduly benefits large corporations at the expense of tax payers; and, the US EXIM crowds out private sector financing or companies hoping to compete in a specific market. Specifically, the criticisms include the following:

- 'Boeing's Bank' – Many argue that ECAs only cater for large firms. Often large corporations constitute the biggest percentage of financing, but the smallest number of transactions. For example, roughly 75% of the US Exim's financing is geared towards large corporations such as Boeing, General Electric and John Deere, while they constitute less than 10% of all transactions.[19] Conscious of this criticism, other ECAs, like the Export-Import Bank of Korea, have programmes catering specifically for SMEs, such as their 'Hidden Champions Initiative' that looks to incubate 100 SMEs to increase their productivity and global competitiveness.[20]
- Corporate Profits – Critics of EXIMs argue that subsidies are employed to boost corporate profits, but despite overall welfare increased (e.g. due to a higher number of jobs), there is still an overall net loss for economies.[21] As a US Congressional report aptly notes, there is 'a limitation in demonstrating export and employment relations in trying to determine the opportunity cost of Exim Bank financing'.[22] This finding applies to all ECAs.
- Crowding Out – By providing subsidies, ECAs can exacerbate market shortcomings. While one side of the argument is that ECAs step in when there are no private financing alternatives (e.g. acting as the lender of last resort), the opposite can also be true: given the subsidised rates at which ECAs operate, private financiers cannot compete and hence have no interest in servicing some markets.[23] In addition, ECAs could also crowd out other companies in a sector or market if some receive subsidies and others do not.[24]

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[17] Freund C, *op. cit.*
[18] Beekman RL and Kench BT, 'Basic Economic of the Export-Import Bank of the United States', https://www.mercatus.org/system/files/Beekman-Ex-Im-Bank-Economics.pdf, accessed 28 February 2018.
[19] US Exim, *op. cit.*
[20] *Ibid.*
[21] Beekman RL and Kench BT, *op. cit.*
[22] Akhtar SI, Carpenter DH, Driessen GA and Taylor J, 'Export-import Bank: Frequently Asked Questions', https://fas.org/sgp/crs/misc/R43671.pdf, accessed 28 February 2018.
[23] Beekman RL and Kench BT, *op. cit.*
[24] Furth S, *op. cit.*

This analysis of advantages and disadvantages of ECAs should be assessed carefully by policy makers in South Africa considering the intention to establish a South African ECA. While the prospects of an ECA is alluring given its ability to support domestic industrial and trade policies, there are also opportunity costs that need to be carefully considered. And as the following section highlights, many of the core services offered by ECAs are already on offer in South Africa, albeit from diverse institutions. Indeed, it could also be argued that there are other, more pressing finance-related challenges that South African exporters face that should be prioritised instead of the establishment of a South Afreximbank.

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3. Does South Africa require an ECA? A stock-take of current South African financing facilities.

South Africa does not have a dedicated Exim Bank. It is widely believed that this is the result of the apartheid era when sanctions were imposed against South Africa severely restricting South Africa's export capacity. However, a host of public and private, financial and non-financial institutions have emerged that in part fulfil this role.

3.1. State-owned EXIM facilities in South Africa

Export Credit Insurance Corporation

The Export Credit and Foreign Investments Insurance Act (of 1957, as amended) made provision for the establishment of the Export Credit Insurance Corporation of South Africa (ECIC) in 2001. A registered financial service provider, it has the sole mandate of facilitating international trade by providing commercial and political risk insurance to domestic exporters of capital goods and services which in turn supports medium-to-long-term loans provided by the banking and financial sectors. ECIC is a wholly state-owned enterprise whose only shareholder is the Department of Trade and Industry (the dti). One of its key priorities, amongst others, is to promote African regional integration by increasing intra-Africa trade and supporting industrialisation through the creation of large regional markets that can ensure the development of deep and lasting regional value-chain partnerships. ECIC is also a member of the International Association of Export Credit Agencies (IAECA, or Berne Union as it is commonly known). This membership allows it to access industry data and benchmark itself against global best practice.

The ECIC's strategic focus is on emerging markets in Africa that are considered too risky for conventional insurers. It is critical for the ECIC to achieve access for South African exporters and investors to new markets and business opportunities in the rest of Africa given its desire to significantly increase South African export levels to the rest of the region above the 30% mark[25]. ECIC's insurance products are formulated to protect all parties involved in cross-border projects, from the institutions that provide financing, to the foreign buyers and the exporters. It is normal for a single project to be linked to multiple ECIC policies that cover both commercial and political risk.

The ECIC differentiates itself from other competitors by its appetite for insuring against political risk in Africa and underwriting large, long-term projects with flexible terms and conditions to suit project-specific needs and cash-flow profiles. One of the factors that discourages companies from participating in international trade deals is that trade finance repayments could become expensive over time rendering the export deals unprofitable. To be competitive, a buyer must believe that the pricing for a specific deal is favourable. The ECIC attempts to remedy this conundrum by providing interest rate support to lenders who are involved in financing a transaction which is insured by the ECIC. "The interest rate support is the Interest Make-up (IMU) scheme".[26]

In a transaction where the ECIC is insuring the exporter's commercial risk for instance, an IMU can be included where the ECIC will pay the lender an agreed rate to cover various costs which would otherwise not be covered in the interest rate charged by the bank to the exporter. Essentially, the lender would be able to break even, even though it will be charging the exporter less than what would have been charged if the IMU had not been in place. In this way, South African exporters are charged

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[25] In 2015, South Africa's exports to other African countries accounted for approximately 30% of total exports. Source: ECIC Integrated Report 2017, http://www.ecic.co.za/Portals/0/docs/annual-reports/ECIC-Integrated-Report-2017.pdf?ver=2017-09-01-135613-010, page 3, accessed 9 February 2018.

[26] ECIC, http://www.ecic.co.za/Solutions/Insurance-Solutions, accessed 14 February 2018.

lower rates for the trade finance facility. They, in turn, are able to pass on the savings to buyers ensuring their competitiveness outside the borders of the country. The IMU is not considered on a standalone basis. It is linked only to transactions which have been found to be eligible for ECIC insurance cover. Interest on the IMU is linked to the London Interbank Offered Rate (LIBOR[27]), which is used as the base rate, and a margin is added depending on the length of the repayment period of the trade loan. The longer the repayment period, the higher the variable rate that is added to the LIBOR.

ECIC's core products are:

- Five different **Performance Bond Insurance Schemes** (bid, performance, advanced payment, retention and reclamation bonds) which enable the ECIC to transact with banks and other financial institutions to increase the capacity of the South African market to issue bond facilities for export contracts.
- **Export Credit Insurance** is used for transactions involving capital goods and/or services outside South Africa and is provided to banks and suppliers. For project finance transactions, cover against political and commercial risk can be up to 100% and 95% of the loan amount, respectively; whilst the loan amount can be covered up to 100% for both political and commercial risk by corporate and sovereign borrowers or guarantors.
- **Investment Insurance is a political risk cover** used for acquisitions or equity contributions and shareholder loans for South African business entities investing in foreign countries.
- The Small and Medium Transactions programme has a pre-approved criterion catering for small transactions up to $10 million and medium-sized transactions between $10 million and $20 million.

In 2017/18, ECIC launched a new range of services that attracted project support valued at $479 million[28]:

- A new Master Risk Bond Policy which makes it easier for partner financial institutions to process transactions which are insured by the ECIC. It also contributes to increasing the volume of transactions that are processed and financed by these institutions.
- Insurance cover to non-South African registered banks and financial institutions, as well as foreign registered or domiciled companies that are willing to support South African exports or meet South African content requirements set by the ECIC.
- A needs-specific underwriting framework for black industrialists[29] to support their export-related business endeavours.

The ECIC aligns itself with the OECD Arrangement on Officially Supported Export Credits (OECD Agreement)[30] but chooses to adhere only to those standards, rules and regulations that are suitable to emerging market enterprises that do not impede its ability to be effective. Hence, ECIC uses the OECD's country credit rating. The OECD evaluates the risk of countries using a methodology agreed to

[27] LIBOR stands for London Interbank Offered Rate. This is a benchmark interest rate used by banks to lend money to one another in the international interbank market. Financial Times, http://lexicon.ft.com/Term?term=LIBOR

[28] ECIC Integrated Report 2017, http://www.ecic.co.za/Portals/0/docs/annual-reports/ECIC-Integrated-Report-2017.pdf?ver=2017-09-01-135613-010, page 23, accessed 9 February 2018.

[29] **the dti**, Black Industrialist Programme, http://www.dti.gov.za/economic_empowerment/Black_Industrialist.jsp, accessed 15 February 2018.

[30] The Organisation for Economic Coorperation and Development, The export credits arrangement text, http://www.oecd.org/tad/xcred/theexportcreditsarrangementtext.htm, Accessed 02 May 2018.

by parties to the OECD Arrangement[31] which classifies the credit risk profile of countries into seven categories depending on the level of risk. A rating of 1 is considered the lowest risk, while a rating of 7 depicts the highest risk category. Table 3 below shows the credit risk ranking of a selected number of emerging market and BRICS countries. India has the lowest score of 3 amongst the BRICS countries. South Africa, with the same score as Russia at 4 outperforms its African counterparts, Nigeria and Kenya, ranked at category level 6.

Table 3: Country Risk Classifications of selected Participants to the Arrangement on Officially Supported Export Credits – Select Countries

Country Name	Previous classification	Current prevailing classification
Angola	6	6
Bangladesh	5	5
Botswana	2	2
Brazil	5	5
China (People's Republic of)	2	2
Côte d'Ivoire	6	6
Argentina	6	6
Egypt	6	6
Ethiopia	7	7
Ghana	6	6
India	3	3
Kenya	6	6
Mauritius	3	3
Mexico	3	3
Morocco	3	3
Mozambique	7	7
Nigeria	6	6
Philippines	3	3
Russia	4	4
Saudi Arabia	2	2
South Africa	4	4
Tanzania	6	6
Thailand	3	3
Tunisia	5	5
Turkey	4	4
United Arab Emirates	2	2
Venezuela	7	7
Zimbabwe	7	7

Source: OECD[32], valid as of 27 October 2017

Overall, the ECIC is of the view that its transformation into an EXIM bank will support businesses with a wide range of clients, from those involved in large projects to assisting SMEs to break into the

[31] [ii] The Organization for Economic Cooperation and Development, "Arrangement on Officially Supported Export Credits", http://www.oecd.org/tad/xcred/crc.htm, Accessed 11 January 2018.
[32] The Organization for Economic Cooperation and Development, "Country Risk Classifications of the Participants to the Arrangement on Officially Supported Export Credits", http://www.oecd.org/trade/xcred/cre-crc-current-english.pdf, Accessed 11 January 2018.

international trade arena. The focus of the proposed EXIM bank will be on a sustainable and developmental return on investment allowing it to customise its offerings to SMEs and exercise its developmental role as a state-owned entity. This means that the proposed EXIM will not only focus on commercial returns as the priority, but also consider its development mandate. The ECIC proposes that the EXIM bank will advance money on loans below $10 million to smaller companies that require export loans and/or the development of new product ranges. It is envisaged that the impact and value creation of the EXIM bank will include opportunities to differentiate the ECIC from its competitors, improve its services to exporters and access a new customer base.[33] To this end, the ECIC is of the view that a competent and competitive workforce will be required to implement its strategic objectives as an EXIM bank which include value creation for clients, creating knowledge-sharing platforms and new products.[34]

As part of its political ambition to become a fully-fledged EXIM bank, the ECIC also intends to target domestic capital-intensive sectors with high export potential to cover its expansion. Boat building, which falls under the South African vessel construction industry is principally an export industry, with 90% of production dedicated to exports.[35] According to the ECIC,[36] the industry is now internationally competitive in respect of price, quality and durability after undergoing industrial restructuring. The industry has won several international awards for its highly acclaimed products.[37] It is understood that the ECIC commissioned independent research into the viability of forming an EXIM bank in South Africa. The study has not been made public, but its findings were submitted as a proposal to National Treasury supporting by the ECIC. Given the significant financial resources that will be required to action the proposal, it is currently not considered as a viable option by National Treasury. This has prompted the ECIC to buy a stake in the African Export-Import Bank (Afreximbank), a continental multilateral trade finance institution. With this shareholding, South Africa became the 47th African country to join the Afreximbank. This positions it well to become a key driver of trade across the continent. South African exporters, particularly SMMEs, will benefit from the expanded pool of structured trade finance facilities offered by Afreximbank. Afreximbank's shareholders include over 40 African government shareholders, the African Development Bank, international banks including Standard Chartered Bank, HSBC, Citibank and international export credit agencies such as the China Exim Bank and Exim India. Afreximbank regards South Africa's membership as critical for the attainment of its strategic goal of increasing its intra-African trade share from 15% to 22% given that South Africa accounts for about 35% of total intra-African trade.

Industrial Development Corporation

The IDC considers the International Financial Corporation (IFC), Afreximbank and the African Development Bank (AfDB) as its competitors although they all operate in different jurisdictions and have different developmental mandates. The IDC's risk appetite is higher than that of the banking sector which is more risk averse. For example, it is involved in mega projects in Sudan and Mozambique where banks find such markets to be too risky. Although it does have its own checks and

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[33] ECIC Integrated Report 2017, http://www.ecic.co.za/Portals/0/docs/annual-reports/ECIC-Integrated-Report-2017.pdf?ver=2017-09-01-135613-010, page 16, accessed 9 February 2018.
[34] ECIC Integrated Report 2017, http://www.ecic.co.za/Portals/0/docs/annual-reports/ECIC-Integrated-Report-2017.pdf?ver=2017-09-01-135613-010, page 16, accessed 9 February 2018.
[35] ECIC, Trade and Investment opportunities in Africa, Prospects and challenges for South African Exporters and Investors, file:///C:/Users/A0056768/AppData/Local/Microsoft/Windows/INetCache/Content.Outlook/O3H2C25C/Trade-and-Investment-opportunities-in-Africa.pdf, accessed 15 February 2018.
[36] ECIC, Trade and Investment opportunities in Africa, Prospects and challenges for South African Exporters and Investors, file:///C:/Users/A0056768/AppData/Local/Microsoft/Windows/INetCache/Content.Outlook/O3H2C25C/Trade-and-Investment-opportunities-in-Africa.pdf, accessed 15 February 2018.
[37] Afrexim Bank, https://afreximbank.com/south-africa-joins-afreximbank-as-a-shareholder/, accessed 15 February 2018.

balances to mitigate against such risky exposures. IDC is the lender of last resort in the South African trade finance market.

The IDC's[38] primary objective is the advancement of sustainable industrial development with a mandate spanning different sectors in South Africa and the rest of the African continent. On the back of this objective, the IDC, under its International Finance Division, advances long-term, medium-term and short-term trade finance solutions in the form of deal-specific single transaction funding or revolving credit facilities. Medium to long-term export credit finance (with payment terms between two and ten years) is offered to foreign buyers of South African capital goods and related services with disbursements by the IDC made directly to the exporter. The IDC offers this funding with the support of the South African Government's Export Credit Support Scheme which is administered by the ECIC. Up to 85% of the value of the export contract can be funded, provided that a minimum of 50% of South African content is attained. Facilities can be extended in South African Rand or US Dollars and prior to disbursement of funding from the IDC, foreign buyers must pay a minimum of 15% of the contract price. One of the key pre-requisites for the IDC's medium to long-term export credit finance is that the borrower must have ECIC credit insurance cover to insure against commercial and political risk. This condition accompanies the banks' requirement that cover by the Credit Guarantee Insurance Corporation of Africa (CGIC) is necessary for exports to countries that are considered to be high risk.

Borrowers must also be in possession of an exchange control approval by the South African Reserve Bank. "Exporters can choose to take exchange risk insurance cover, thereby mitigating their exposure to the exchange risk associated with the applicable export contract. This can be done by making use of the guaranteed rate of exchange mechanism, whereby certain US Dollar/ South African Rand exchange rates are set going forward".[39] Pricing for these facilities is in the form of various interest rates depending on the currency used for the facility. Rand denominated loans are priced utilising the Johannesburg Interbank Accepted Rate (JIBAR). US Dollar denominated loans on the other hand are priced using a fixed or a floating interest rate, the former being the applicable OECD Commercial Interest Reference Rate (CIRR) and the latter being the six-month LIBOR as a base rate.[40]

The IDC is able to arrange competitive medium-to-long term loan facilities for South African importers of capital equipment. It has credit line facilities available from several international banks in various countries. Where credit lines from a specific country do not exist, the IDC is able to arrange these on a case-by-case basis. Financing is usually extended in the currency of the supplier country with US dollar financing is available as an alternative. Repayment periods from two to ten years are available depending on the country of origin, value of the transaction and type of goods involved.

Alternatively, the IDC provides short-term and local bridging finance that is extended for periods of up to 12 months or on a revolving basis with annual renewals if the credit criteria are met by the borrower. They also provide guarantees which are one of the most popular trade finance solutions offered by the IDC. It is apparent that the IDC's offering is like that of banks and private non-banking trade finance providers in that its suite of facilities and conditions are comparable to other trade finance institutions. This includes that the assessment of risk and affordability of the borrower is common to that of others, security is required as is the case in the private sector and there is a specific set of pre-requisites which are considered across the board. The key differentiating factor is that the

[38] Industrial Development Corporation brochures for International Finance and Short-Term Credit Scheme.
[39] Industrial Development Corporation brochures for International Finance and Short-Term Credit Scheme.
[40] ECIC Integrated Report 2017, http://www.ecic.co.za/Portals/0/docs/annual-reports/ECIC-Integrated-Report-2017.pdf?ver=2017-09-01-135613-010, accessed 9 February 2018.

IDC's mandate is much broader as it is aligned with government's efforts to promote industrialisation while private entities pursue a profit motive with a view to minimise their risk exposure.

The IDC offers short-term bridging and export finance of up to 75% of the cost to execute contracts and up to 100% of the cost to execute local contracts. The borrower is required to have received a confirmed contract or order from its buyers to access short-term products. If the confirmed contract was not placed by a reputable, blue-chip or government entity, a Letter of Credit or a commercial Credit Guarantee Insurance Corporation (CGIC) short-term insurance policy is required[41].

Short-term export finance and local bridging finance is only available to the following:

- Entrepreneurs who have been awarded tenders by government or the private sector and/or contracts for providing products and services to reputable companies;
- Traders dealing in or exporting locally manufactured goods;
- Local manufacturers of goods for the local or export market;
- Importers of goods.

It currently takes about three months for the IDC to process a trade finance application which is frustrating to its clientele. To get around this, the IDC introduced a once-off fast-tracked loans and guarantee facility which enables funding to be approved within 11 days of receipt of the application. This working capital finance or guarantee facility assists borrowers to execute their order, contract or tender from the time an order is received and/or contract awarded until proceeds are received from a buyer. The main features of this once-off fast-tracked loans and guarantee facility are:

- It has a once-off facility that will apply to urgent awards, contracts or orders;
- It can be used for credit and or guarantee facilities;
- Funding eligibility for all exporters is up to 75% of the cost to execute a contract. Moreover, up to 100% of the cost to execute a contract can be provided where a Letter of Credit and/or insurance cover and Foreign Exchange cover can be obtained;
- Funding eligibility for all companies with a 1 year or more trading history is up to 100% of the cost to execute, and for start-ups cost up to 75% of the cost to execute the order;
- Pricing is based on the risk profile of the client;
- The facility is non-revolving (i.e. all repayments made to the IDC cannot be drawn again);
- Minimum loan value of R1 million and maximum value of R5 million per application.

SACEEC's Initiative on pre-shipment financing with the dti

The South African Capital Equipment Export Council (SACEEC)[42] represents the capital equipment sector, including consulting engineers involved in the financing of capital projects, but also capital equipment suppliers and suppliers of services to the capital project sector. SACEEC plays a facilitating role in assisting capital equipment sector companies to grow their business through exports. It has identified the need for globally competitive pre-shipment finance which is essential to enable South Africa's global competitiveness and to defend its local market share. SACEEC assessed the provision of

[41] Industrial Development Corporation brochures for International Finance and Short-Term Credit Scheme.
[42] South African Capital Equipment Export Council, http://www.saceec.com/sector-overview, accessed 8 February 2017.

pre-shipment finance in South Africa and raised concerns regarding the IDC's "short-term export finance" terms[43] that are summarised below[44]:

1) The applicant must be able to produce an acceptable confirmed export contract or export order;
2) Up to 75% of the cost to execute an export contract or purchasing order can be financed;
3) Applicants should comply with the required financing norms;
4) Start-up companies or micro companies do not qualify for finance;
5) Facility requirements should be more than R500 000;
6) Finance is available for a period of up to 180 days pre-shipment and 180 days post-shipment for specific export contracts;
7) Repayments are structured to suit the export order – usually it takes the form of a bullet payment on repayment by the importer;
8) Finance is only available for the actual cost to execute the export order;
9) Funds will be paid to the manufacturer directly to produce the goods or to import items necessary to complete the value chain;
10) Interest rates will be determined based on inherent investment risk of the applicant – the prime overdraft rate would form a basis for this rate;
11) Finance charges will include:
    a. an upfront flat raising fee of 0.25% on the facility amount;
    b. an advance fee of the higher of 0.1% of the value of the draw or R1000;
    c. other costs such as legal agreement fees, stamp duties, registration or securities etc.
12) Security includes post-shipment instruments to reduce the risk for the importer;
13) Exporters have to apply for EXIM Finance preferably before an export transaction is concluded;
14) A normal IDC risk assessment will be performed before a submission is made for consideration to IDC's management;
15) Each individual export contract has to be approved by the EXIM Finance before finance is made available;
16) Facilities are re-evaluated annually.

Of concern are items 2, 5, 9 and 10 in so far as they negatively impact on local business development and the enhancement of local competitiveness.

SACEEC, together with **the dti** and other industry stakeholders have tried to identify alternative structures to administer a pre-shipment programme that will offer a sustainable structure to alleviate major business constraints to growth; improve the current financing environment; increase competitiveness and increase the speed of sustainable job creation.

In general, pre-shipment finance provides exporters with working capital from the time of the receipt of an order up to the time of the shipment. Pre-shipment finance is an advance in the form of a loan overdraft or cash credit which means the bank will take into consideration a number of factors before making it available to an exporter. For example, the exporters' experience with the product is assessed, the security that is offered, the margin of interest is set, his/her honesty, integrity and capital

[43] South African Capital Equipment Export Council, Pre-Shipment Finance as a method of improving competitiveness, Proposal: Introduce Pre-Shipment Finance in selected sectors.
[44] South African Capital Equipment Export Council, Pre-Shipment Finance as a method of improving competitiveness, Proposal: Introduce Pre-Shipment Finance in selected sectors.

as a borrower are determined. In certain cases, a pre-shipment advance is made to finance expected receivables to be included in locally produced products.

Security is usually provided in the form of either a Letter of Credit; personal bond in the case of a party already known to the bank; a confirmed order as evidence of having received an order to export; and a relevant policy issued by the Export Credit Guarantee Corporation of that country. In cases where the exporter is well known to the bank and/or his/her past performance has been satisfactory, the bank is usually prepared to grant revolving pre-shipment credit in connection with successive deliveries. In practice it means that upon repayment of the first loan, the exporter is automatically granted a corresponding loan on the same terms. This procedure offers the advantage of saving time and costs as the original documents serve as a basis for extended credit.

Pre-shipment finance is generally used to cover the following costs:

- Cost of the production or purchase/procurement of goods;
- Packaging including any special packing/packaging;
- Costs of inspection or tests required by the customer;
- Domestic transport costs;
- Port, customs and shipping agent's charges;
- Freight and insurance charges; and
- Export duty if any.

The concessional rate of interest on pre-shipment finance is usually the LIBOR rate plus an agreed discounted rate. There are two specific advantages for using pre-shipment finance for exporters: the lower rate of interest and saving of conversion charges if credit is utilised to purchase imported inputs.

In particular, pre-shipment finance is important to small scale manufacturers and exporters who do not possess sufficient financial resources to meet the expenditure involved in the production of goods for export.

It is clear from the above that even though the framework of pre-shipment finance is used solely for export transactions, it is also ideal as a short-term remedy that could be used for both exports and local transactions. If used to finance local transactions as well, the industry will stop relying on government sponsored aid in future. The facility will however only reward those companies that are competitive and with a strong domestic customer base. The facility should also not cover those expenses that are unrelated to direct local production or manufacturing. SACEEC, together with industry stakeholders, therefore recommended the following modifications to the current IDC lending regime to create a facility that would unlock huge potential in the industry in the short-term and remedy some of the financial challenges currently being experienced:[45]

- Pre-shipment finance on all amounts, including amounts less than R500 000 which are the amounts generally required by micro and small businesses that **the dti** is trying to support. Alternatively, a subsidy on a 50/50 basis or a grant scheme to be used by the private sector to pay the IDC to perform the due diligence. This proposal is made on the basis that amounts less than R500 000 are below the margin where the cost of the due diligence has to be amortised with regard to a specific transaction which is also why the IDC is reluctant to consider such small amounts;
- Up to 85% of the cost to execute the order be financed;

[45] South African Capital Equipment Export Council, Pre-Shipment Finance as a method of improving competitiveness, Proposal: Introduce Pre-Shipment Finance in selected sectors.

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- A shorter due diligence period is used;
- A merger between ECIC's post-shipment facility and this newly proposed facility for pre-shipment finance in order to streamline due diligence processes;
- Interest rates that are in line with global norms, for instance LIBOR plus 2;
- Revolving credit be made available to deserving borrowers with secure customers;
- If a borrowing company is considered a higher risk than the disbursing organisation, the IDC should process the payments themselves to the suppliers;
- SACEEC be utilised to conduct pre-assessments of the company's performance and calibre before the in-depth due diligence commences which could speed up final approval;
- A review of the current "interest make-up" draw-down methodology which requires very little change and will therefore facilitate fast tracking of the implementation of the programme;
- For less secure orders, a collateral of an additional 25% of the value of the Letter of Credit can be expected from the applicant;
- The scheme be extended to local suppliers in the short-term and then be restricted to exporters until the current financial situation facing local suppliers improves.

In addition to the above, SACEEC also recommended a review of the availability of Stand-by Letters of Credit serving as bid bonds, performance bonds or payment guarantees to compliment the above recommended remedial action.

Capital Projects Feasibility Programme

The dti's Capital Projects Feasibility Programme (CPFP) is a "cost-sharing grant that contributes to the cost of feasibility studies likely to lead to projects that will increase local exports and stimulate the market for South African capital goods and services".[46] The programme facilitates feasibility studies that are likely to lead to high-impact projects which will stimulate value-adding economic activities in South Africa. Secondary to this, the programme aims to strengthen the international competitiveness of the South African capital goods sector[47] and allied industries, stimulate upstream and downstream linkages with SMMEs and Black Economic Empowerment (BEE) companies, attract high levels of domestic and foreign investments, create a long-term demand for South African capital goods and services, and stimulate project development in Africa and the Southern African Development Community (SADC). South African firms can access the grant which is capped at R8 million to a maximum of 50% of the total costs of the feasibility study for projects outside Africa and 55% of the total costs of the feasibility study for projects in Africa. Foreign firms can only access the grant if they partner with a South African firm and the application is submitted by the South African firm.

CPFP is a critical project preparation instrument in the dti and it should continue to support projects that have been prioritised by SADC, the Industrial Policy Action Plan (IPAP[48]) and the Tripartite Free Trade Area (TFTA) with the aim of coordinating and aligning financing models and activities. The dti's review of CPFP funded projects indicated a need to consider prioritisation and focus on projects that have a high potential to support South African exports based on proper pre-feasibility studies and buy-in from member states and/or institutions responsible for investment promotion.

[46] The Department of Trade and Industry, Financial Assistance, https://www.thedti.gov.za/financial_assistance/financial_incentive.jsp?id=4&subthemeid, Accessed on 12 February 2018
[47] Credit Guarantee Insurance Corporation of Africa, http://www.creditguarantee.co.za/, accessed 9 February 2018.
[48] Industrial policy Action Plan, https://www.thedti.gov.za/parliament/2017/IPAP_13June2017.pdf

As the preceding section illustrates and as summarised in the table below, public financial service providers offer the full range of trade financing facilities to South African exporters. However, some challenges, in particular relating to credit facilities and SMEs have been highlighted.

Table 4: Summary of Financial Services offered by public financial institutions in South Africa

	Export Credit Insurance Company	Industrial Development Corporation	African export-import bank
Credit		✔	✔
Insurance	✔		✔
Guarantees	✔		✔

3.2. Exim facilities: Banking Sector of South Africa

Trade finance is widely provided in South Africa by the banking sector which is dominated by four domestic banks (Standard Bank, FirstRand Bank, Nedbank and ABSA) and a few international banks. Non-banking financial institutions such as the IFC also participate in the market. This market is highly competitive with each bank offering flexible facilities that allow clients to structure their packages to suite each deal being financed. In addition, the import and export solutions available from the banking sector allow businesses to reach international markets and also protect their businesses from the risks associated with global transacting. It is standard practice for banks to assess the risk profile of borrowers using individualised risk assessments methods. In general, all banks provide the following facilities:

- Letter of Credit / Documentary Credit facilities;
- Documentary collections;
- Local and foreign guarantees;
- Business global accounts;
- Foreign exchange;
- Collateralised stock financing;
- Financing of inventory, receivables and materials in transit; and
- Logistics and equipment import finance.

Banks usually provide trade finance to big corporates that are well established with a good financial and performance record. For instance, the bulk of the trade finance clientele is made up of domestic listed companies and multi-national corporations. Borrowers are generally segmented according to their annual turnover. On average, the lowest segment has a cap of R10 million whilst the biggest segment has a minimum of R150 million and an uncapped maximum.

The big four banks dominate the guarantees market with a combined average monthly total of R156.2 million between 2014 and 2017. Graph 1 below shows that between 2014 and 2017, there were eight banks representing 97.37% of the guarantee issuances market share with Standard Bank having 23.94% of the market share followed by Nedbank at a close 21,61%. In Graph 2, which depicts the average monthly guarantee facilities issued per bank (in Rand), Standard Bank is leading the guarantee issuance market at R47.3 million followed by Nedbank at R42.8 million. In general, guarantee facilities are extended on a revolving basis for long-standing clients with risk reviewed annually.

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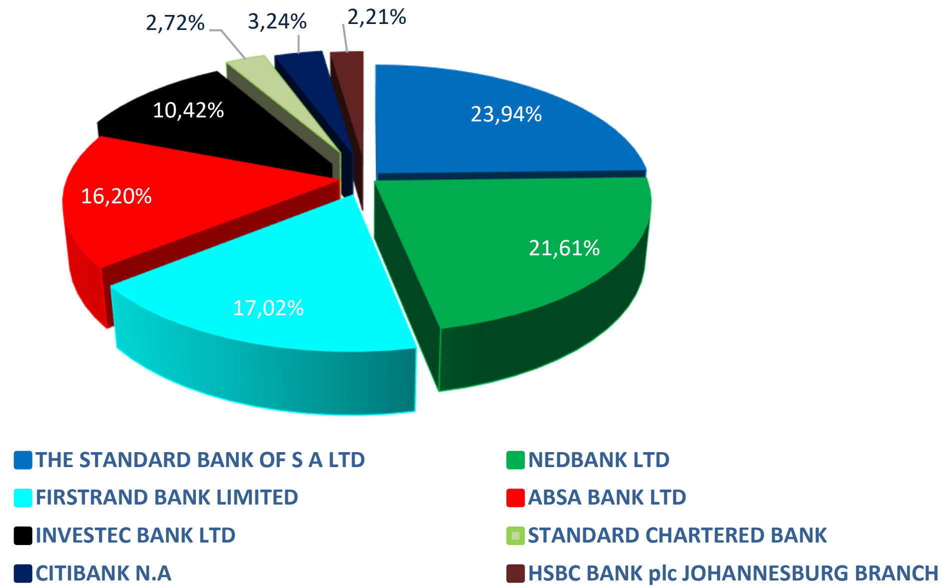
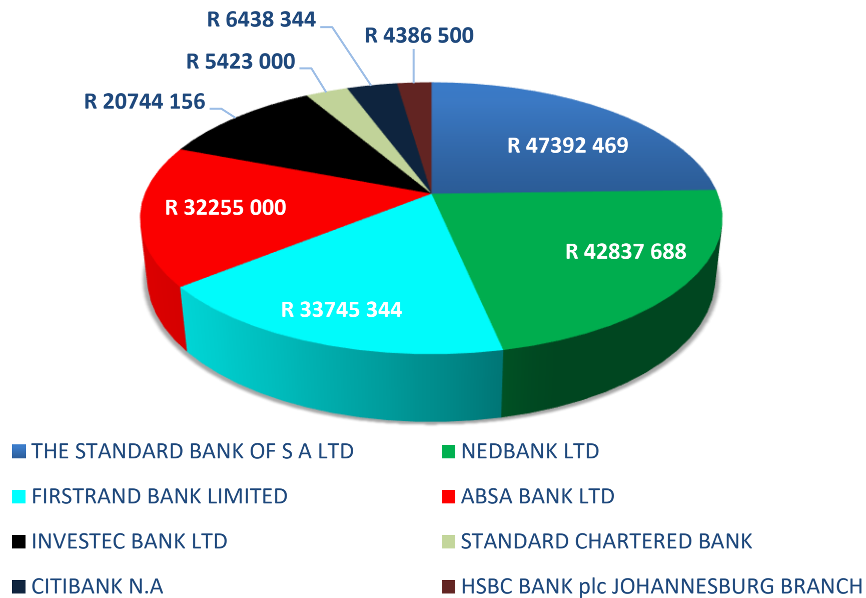
Graph 1: Average market share for Guarantee facilities extended between July 2014 and February 2017



Source: BA 900 data from SARB for Guarantees and Letters of Credit from Banks for the period of July 2014 to February 2017.

Graph 2: Average monthly Guarantee facilities - July 2014 to February 2017

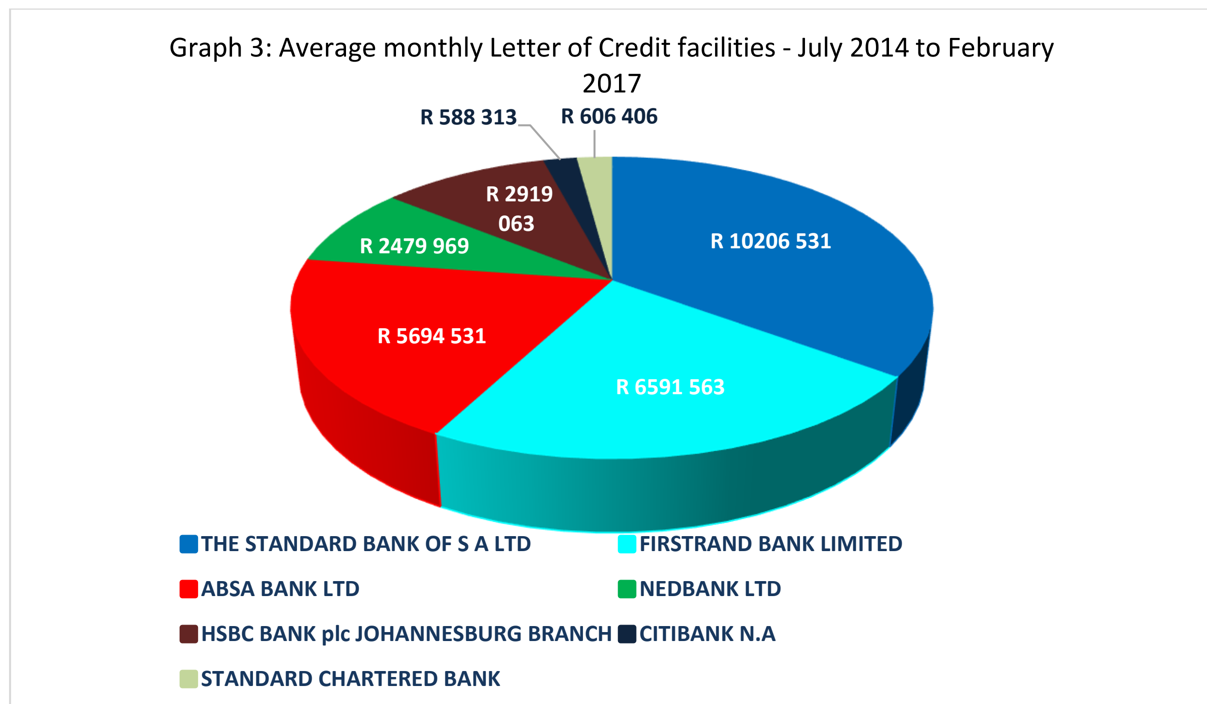


Source: BA 900 data from SARB for Guarantees and Letters of Credit from Banks for the period of July 2014 to February 2017.

There are currently seven banks representing 94.92% of the market for issuance of Letters of Credit. Compared to the guarantees market, the Letters of Credit market is much smaller with a combined average monthly total of R30.6 million between 2014 and 2017. There is a low issuance rate in the

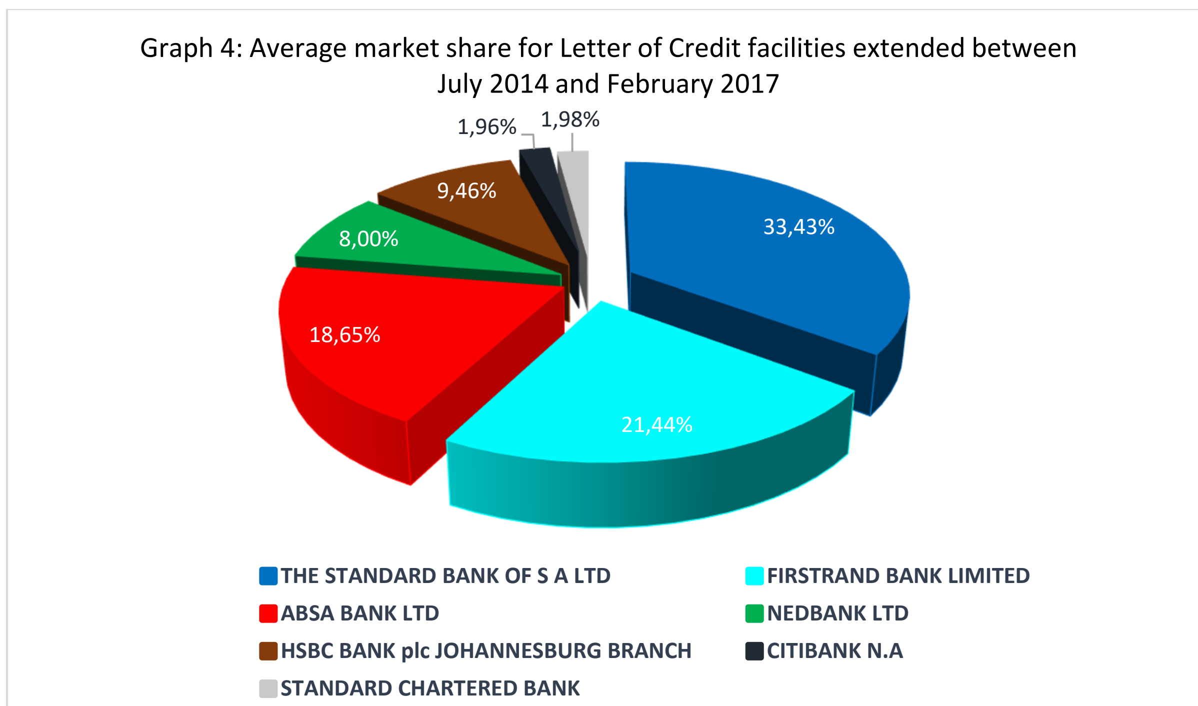
market due to their risky nature. Generally, Letters of Credit are linked to a specific transaction which means the bank must make payment on behalf of the exporter as soon as all contractual obligations are fulfilled. A guarantee requires the bank to make payment only in circumstances where the exporter, who has provided collateral to the bank, has failed to fulfil his/her contractual obligations. Additionally, Letters of Credit are generally used in international transactions, whereas the market for guarantees is much larger as they are also used domestically for risk mitigation in projects related to real estate and infrastructure development, amongst others.

Graph 3 below shows that Standard Bank issued the most Letters of Credit valued at a monthly average of R10.2 million followed by Nedbank at R6.5 million. Standard Bank dominates this market with a 33.43% market share followed by Nedbank with 21.44% (refer to Graph 4 below).



Graph 3: Average monthly Letter of Credit facilities - July 2014 to February 2017

Source: BA 900 data from SARB for Guarantees and Letters of Credit from Banks for the period of July 2014 to February 2017.



Source: BA 900 data from SARB for Guarantees and Letters of Credit from Banks for the period of July 2014 to February 2017.

3.3. Exim facilities: non-banking financial sector

International Finance Corporation

The World Bank's IFC Global Trade Finance Programme[49] which works with more than 275 banks across more than 90 countries is a small player in the South African trade finance market. It offers exporters guarantees for trade-related payment obligations made by financial institutions. The IFC has its own list of pre-approved banks that it works with. To apply, these banks contact the IFC's regional trade specialists for coverage and pricing which covers up to 100% of the trade facility amount. The IFC has different terms for guarantees starting from a maximum of three years for a standard guarantee up to five years for selected partners to support imports of equipment and capital goods.[50] It is worth noting that the IFC does not lend directly to SMEs as well as individual entrepreneurs. Although many of their investment clients are financial intermediaries that on-lend to smaller businesses. This is in stark contrast to the South African government's overarching developmental objective of creating an inclusive and transforming economy by broadening participation of SMEs and entrepreneurs.

The IFC's programme thus extends and complements the capacity of banks to deliver trade finance by providing risk mitigation on a per-transaction basis. The IFC, like most financial institutions offers the following Exim facilities: Import Letters of Credit, Standby Letters of Credit, guarantees which cover the payment obligation of the issuing bank for performance bonds; bid bonds; payment/advance

[49] World Bank's IFC Global Trade Finance Program, http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/financial+institutions/priorities/global+trade/gtfp, accessed 8 February 2018.

[50] IFC trade finance, http://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/financial+institutions/priorities/global+trade/gtfp, accessed 8 February 2018.

payment guarantees; and Promissory Notes for Trade with the IFC only covering the payment obligation of the issuing bank for pre-export financing or post-import financing extended by a participating Confirming Bank.

The qualify criteria for IFC funding, which is in line with what is being applied by the South African banking sector, require projects to have the following characteristics:[51] technically sound; in the private sector; from a developing IFC member state; environmentally and socially sound, satisfying the IFC's environmental and social standards as well as those of the host country; good prospects of being profitable (i.e. commercial viability); and benefit the local economy. It is accepted that this criterion is not a barrier to accessing trade finance. In particular, the latter two criteria are also aligned to the IDC's funding requirements.

China Construction Bank

The China Construction Bank (CCB)[52] in South Africa provides a full range of trade finance solutions similar to the banking and non-banking financial sectors mentioned above. CCB also allows its clients to design their own suitable trade structure, mitigate trade related risk, lessen foreign exchange exposure, accelerate cash flow, reduce transaction costs, and improve fund tracking and management abilities.

Credit Guarantee Insurance Corporation

The CGIC[53] specialises in providing domestic and international trade credit insurance. It is the largest private trade credit insurer in South Africa (note that ECIC is the largest public trade insurer). Unlike other providers of direct trade financing facilities, CGIC plays a trade facilitation role by providing products that reduce the risk taken by trade finance financiers and increasing the lender's likelihood of receiving funding. In the event that a company's debtors default on payments, CGIC pays the insurance policy holder (the exporter) the agreed percentage of each outstanding debt. Companies who obtain this facility enjoy the benefit of cover against loss of proceeds from local and foreign debtors. The insurance cover increases the banks' risk appetite to fund a company as the risk of working capital constraints and of defaults by the borrowing company due to non-payment from debtors is reduced by the trade credit insurance. CGIC's offering is similar to that of the ECIC, the main difference being that the ECIC has a mandate informed by the state while CGIC is run privately. However, the role played by institutions like the CGIC, ECIC, IFC and SACEEC is not that of direct funding for trade, instead, these institutions are instrumental in ensuring that the trade financiers offer more extensive credit facilities on more favourable terms to borrowers.

Figure 2 below shows that in 2014, the CGIC's biggest exporting clients were in the following sectors: Steel; Electronics, Building and electronics; Freight finance and food; IT and SMEs.

Figure 2: 2014 CGIC insurance risk exposure

[51] IFC qualifying criteria, http://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/solutions/how-to-apply-for-financing, accessed 8 February 2018.
[52] China Construction Bank, http://za.ccb.com/johannesburg/en/cpfw/20121213_3706871210.html, accessed 8 February 2018.
[53] Credit Guarantee Insurance Corporation of Africa, http://www.creditguarantee.co.za/, accessed 9 February 2018.

2014 insurance risk exposure per industry (%)

- Export
- Steel
- Electronics, timber, furniture, paper and packing
- Freight finance and food
- Building and electrical
- IT, pharmaceuticals and chemicals
- Small and medium enterprise cover (SMEC)
- Clothing, textiles, footware, motor, advertising and media
- Other/discontinued operations
- Bond and surety

2013 insurance risk exposure (%)

Source: CGIC annual report 2014

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4. International ECA Dynamics

Based on the variety of both public and private trade finance facilities that are available, the need for a South African ECA is arguably questionable. Nevertheless, should the country opt to proceed with the creation of an ECA, there are a host of international developments and factors that needs to be considered. These are also relevant for existing ECAs operating in South Africa – both public and private.

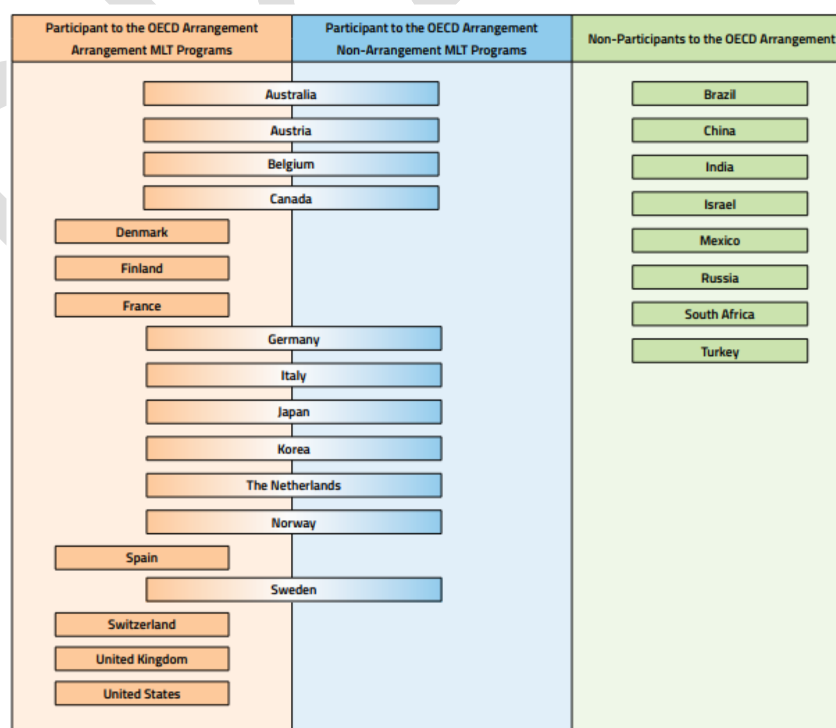
OECD Agreement

Despite the proclivity of any type of subsidy to heavily distort global supply and demand trends, as alluded to earlier, the global ECA-milieu have been relatively conflict-free throughout most of the 20th century. This was largely attributed to the OECD member states' 'gentleman agreement' that governed ECA activity since 1973 preventing a subsidy war, or 'race to the bottom'.

The primary objective of the OECD Agreement was to set parameters for financing (e.g. interest rates, risk fees, and repayment terms). According to the Agreement, for example, the US Exim cannot charge less than 1% interest from the price fixed by the US Treasury on securities of a comparable nature.[54] It also created rules specific to certain sectors (e.g. ships, aircraft, nuclear power plants, and renewable energy, among others) and dictated tied and untied credits.[55]

However, increasingly as countries outside this grouping and not party to this Agreement (see figure 3) have entered into the ECA market, the effectiveness of financing conducted under this agreement has declined. China, but also others outside this framework (such as the BRICS)[56] are significantly undermining the Agreement, by operating with different rules.

Figure 3: Major ECA countries by programme type



[54] Akhtar SI, Carpenter DH, Driessen GA and Taylor J, *op. cit.*

[55] Tied credits indicates a measure of national procurement is required for buyers to qualify for concessional financing, where 'untied' credit dictates no national procurement required.

[56] Brazil, Russia, India, China and South Africa

Source: Export-import Bank of the United States (US Exim), 'Report to the US Congress on Global Export Credit Competition', https://www.exim.gov/sites/default/files/reports/EXIM-Competitiveness-Report_June2017.pdf, accessed 28 February 2018.

Part and parcel of the 'tariff' war has also been a broadening of the scope of ECAs. While previously the ECA services of OECD countries were limited, they now have to compete with those outside this agreement – hence the increase in non-arrangement MLT programmes (see figure 3).[57] Japan and Korea, the first countries to be affected by China's aggressive ECAs programmes, have hence increased the scope of their ECAs by, for example, bundling untied aid with their loan programmes.[58] European ECAs have also followed suit. The shift of ECA operations outside the OECD Agreement began gradually from the 2000s onwards, but has since accelerated: in 2011 more than half of ECA activity was still done under the OECD Agreement, but by 2017, less than a third of activity was conducted under the Agreement.[59]

Combined, Medium and Long Term (MLT) trade finance from the BRICS in 2016 was $51 billion (of which China constituted $34 billion), representing nearly a quarter of total global trade-related support.[60] China in particular, with the largest ECA support globally (see figure 4), has taken a 'market-expansion' approach with its DFIs, rather than purely a 'market correcting' approach, in particular after President Xi Jinping introduced the Belt and Road Initiative (BRI).[61] What makes Chinese ECAs particularly competitive, is their ability to combine massive liquidity, low cost of government backed capital, low compliance and transparency and more preferential payment terms (e.g. repayment periods) than their global ECA counterparts.[62] China's ECA, the Export-Import Bank of China (CEXIM), alongside other Chinese DFIs, have a strategic focus on the BRI, driving the competitiveness of Chinese firms.[63] In 2016, more than 50% of CEXIM's MLT financing was provided to customers from BRI countries.[64]

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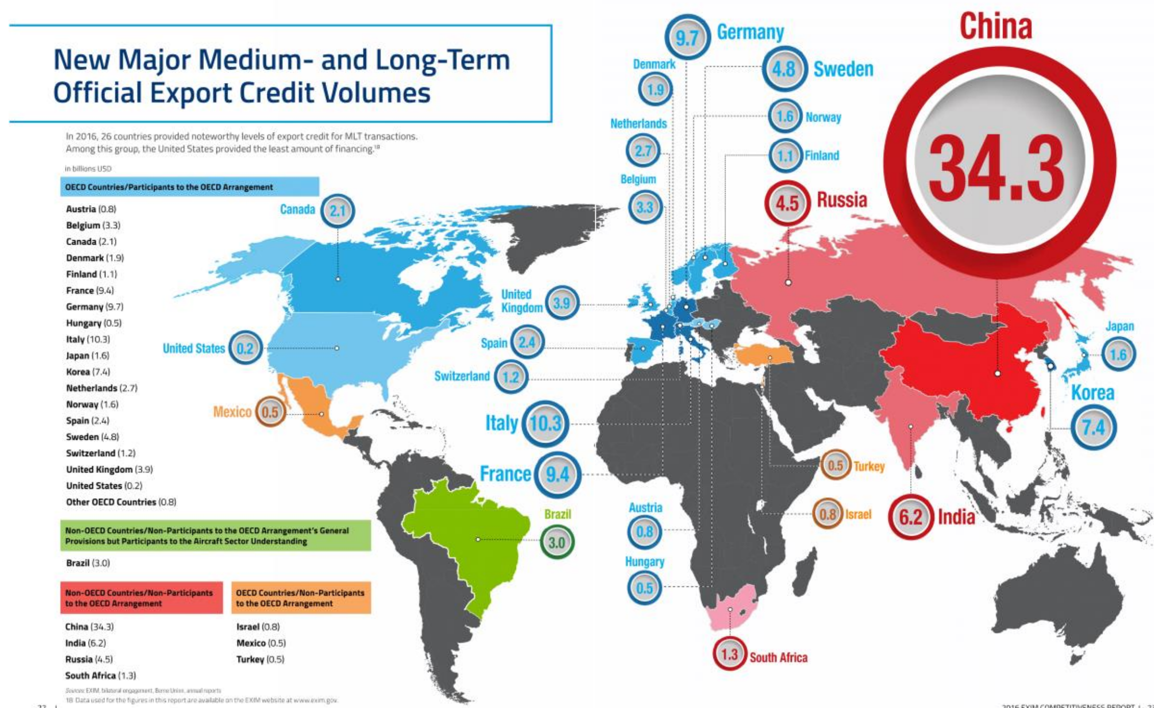
[57] US Exim, *op. cit.*
[58] *Ibid.*
[59] *Ibid.*

[61] *Ibid.*
[62] Lee H, Zhigang L and Coles T, 'Out of China: The Activities of China's export credit agencies and development banks in Africa', http://www.kwm.com/en/uk/knowledge/insights/out-of-china-the-activities-of-chinas-export-credit-agencies-and-development-banks-in-africa-20160101, accessed 28 February 2018.
[63] US Exim, *op. cit.*
[64] *Ibid.*

Figure 4: New Major Medium- and Long-Term Official Export Credit Volumes



Source: Export-import Bank of the United States (US Exim), 'Report to the US Congress on Global Export Credit Competition', https://www.exim.gov/sites/default/files/reports/EXIM-Competitiveness-Report_June2017.pdf, accessed 28 February 2018.

Global Financial Crises

More recently, the GFC has had a dramatic impact on trade finance broadly. With the contraction of global liquidity markets, many financial institutions withdrew their financing from especially emerging markets (who are perceived as riskier) to service their domestic constituency with their available capital.[65] At the same time, global trade growth also declined due to reduced production output globally and the commodity price bust. Global trade growth in 2016 was estimated around 1.5%, down from 7% before the GFC.[66] In response to these developments, ECAs have scaled up their support and services globally by expanding the size and type of support they offer, increasing their marketing efforts and geographical presence to expand their reach, and actively working towards a reduction of policy barriers that hinder their clients.[67]

Another consequence of the slow-down of trade volumes that has had a direct impact on the trade finance milieu, has been the creation of a 'buyer's' market – a situation where demand and supply is unbalanced, and buyers have the upper hand in dictating the quality, packaging, delivery schedules

[65] Nyakundi K, 'An Analytical Review of the State of Trade Finance in Africa', https://d3n8a8pro7vhmx.cloudfront.net/eatradehub/pages/3623/attachments/original/1505906368/Trade_Finance_Working_Paper.pdf?1505906368, accessed 28 February 2018.
[66] Nyakundi K, *op. cit.*
[67] US Exim, *op. cit.*

and terms of credit.[68] This makes things difficult in an environment where trade finance is limited, especially in developing countries.

Availability of inclusive trade financing is a critical factor in the promotion of global trade. The International Chamber of Commerce (ICC) report entitled "Rethinking Trade and Finance 2017" refers to trade finance as "the oil in the engine of international commerce",[69] in an attempt to focus stronger attention on the importance of trade finance. This is important as the evidence points to a substantial gap in trade finance globally.

The trade finance gap, which is defined as the difference between credit demand and credit supply, is one of the key challenges to global trade. According to the Asian Development Bank (ADB), the latest surveys pointed to a gap of $1.5 trillion in 2017, a reduction from $1.6 trillion in 2014 and $1.9 trillion in 2012.[70] The gap is highly prevalent in developing markets, particularly in Asia and the Pacific which alone accounted for 40% of the global gap in 2017. The reported trade finance gap in Africa was reduced from $120 billion in 2011 to $94 billion in 2014.[71] These figures indicate a positive trend in reducing the gap, however, it remains significant considering the importance of trade as a catalyst for economic development globally. It is concerning that banks do not have the capacity to materially reduce this gap because of various reasons, such as the mismatch between the availability of funds and liquidity, especially as banks have been pushing towards achievement of pre-financial crisis levels of liquidity.

Exacerbating the trade finance crisis in the post-GFC period has been the introduction of Basel III rules. The more stringent rules proposed in Basel III, with tighter capital and liquidity requirements and leverage ratios, which aim to promote greater global financial stability, also has the effect that financial institutions become more conservative in their lending. Given that trade finance is considered as non-investment grade risk financing, the pressure on private financial service providers to reduce long-term trade finance where their capital is captured, is growing.[72] In this context, the importance of ECAs (with more financing flexibility) are likely to increase, especially against the backdrop of IMF predictions that there will be an uptick in global trade in 2018.

Compounding the issue of the lower levels of global trade for ECAs across the world, is the fact that the global freight sector has been affected negatively by the slowdown in trade. Ship building and aircraft manufacturing, two sectors underpinning global freight services, are prominent sectors receiving support from ECAs. As excess capacity emerged following the slowdown in global trade, more bankruptcies have become apparent as fewer orders have come through.[73]

An international working group has been established to deal with the issue of the 'subsidies war', but also to consider other issues, including blended financing and tied/untied support. Even within the OECD Agreement, it took nearly two decades for members to agree on rules pertaining to the practice of blending financing with grants considering the massive competition issues this creates.[74]

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[68] Ghose S and Thakur S, *op. cit.*
[69] ICC publication – 2017 Rethinking Trade and Finance, https://iccwbo.org/publication/2017-rethinking-trade-finance/, page 17, accessed 12 February 2018.
[70] Asian Development Bank – 2017 trade Finance Gaps, Growth and Jobs Survey, https://www.adb.org/sites/default/files/publication/359631/adb-briefs-83.pdf, page 1.
[71] Nyakundi K, *op. cit.*
[72] US Exim, *op. cit.*
[73] US Exim, *op. cit.*
[74] *Ibid.*

5. Recommendations and Conclusion

South Africa has a vibrant and well-functioning trade finance market. Although fragmented, it is still efficient and accessible to anyone seeking EXIM facilities if the business can meet the minimum requirements. The lenders, mostly private sector financial institutions and state-owned entities, specifically the IDC and ECIC, ensure that the provision of trade finance in South Africa is in line with international standards, and that the market is highly competitive.

Support to SMMEs is considered a policy priority in South Africa, but they are not considered viable clients by the financial sector. Nonetheless, this is not a major hindrance as both public and private lenders in the market cater for them, for instance, ECIC and CCB.

Given this backdrop it is arguably unnecessary for South Africa to establish its own EXIM bank given that it already has full and effective trade finance services domestically which are also made available externally by its own lenders. Even if South Africa had a viable gap in the provision of EXIM facilities, its current fiscal constraints are not conducive to it investing in an EXIM bank that is state-owned. More so because the EXIM bank will have to enter into an already fiercely competitive trade finance market to compete with both international and local banks that are currently dominating the market. A fiscally constrained government should utilise its already scare resources on the provision of public goods where there has been market failure, and not where the private sector is already actively involved. The participation of the IDC and the ECIC in this regard is sufficient, especially with the former being the lender of last resort in this market.

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