

International Trade - An Unintended Casualty of Financial Regulation

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Abstract

As with many small open economies imports into Trinidad and Tobago are often facilitated via trade financing. Using data from a combination of sources, the demand for trade financing and the impact of this instrument on imports is investigated. An examination of information from the World Bank Enterprise Survey suggests that for Trinidad and Tobago the demand for trade financing depends on the age and the size of the firms. A closer look at the relationship between imports and trade financing, utilizing both domestic commercial bank data and Berne Union data, indicates a lag between the trade financing contract and the receipt of the goods of approximately 3 quarters. Using the Berne Union trade financing data suggests that a 1 per cent increase in the short term export credit exposure results in a 0.5 per cent increase in imports. The literature notes that derisking and Basel III initiatives will result in, at a minimum, an increase in trade financing, and that there may be a reduction of the availability of the instrument. Should any of these occur it may hamper the ability of Trinidad and Tobago to import goods for consumption and for use in inputs for the manufacturing sector.

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1. Introduction

During the financial crisis of 2008/2009 global trade flows contracted sharply, however while there has been some recovery, growth in international trade has remained relatively stagnant. For Trinidad and Tobago the heavy reliance on the energy sector saw trade export values declining in more recent years, also on the import side there has been a great deal of fluctuations. While the falling or stagnant growth in trade is a factor of the slowdown of the global economy, there are other potential deterrents which are not as easily apparent. These obstacles have to do with changes in the financial sector landscape, more specifically the specter of derisking and the Basel III regulations. As advanced economies implemented stricter rules and larger fines for the breaches of financial sector regulations commercial banks have begun a process which is called derisking. The Financial Action Task Force (FATF) has defined de-risking as “the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid, rather than manage, risk in line with the FATF’s risk-based approach”. According to the Bank for International Settlements (BIS) "Basel III" is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector. These measures aim to: improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source; improve risk management and governance; and strengthen banks' transparency and disclosures. The withdrawal of trade financing services has been noted in Asia as, Buckley, Arner and Stanley (2014) reported that since 2008 trade financing from Eurozone and Swiss banks had declined from 38 per cent to 19 per cent of the emerging Asia-Pacific economies trade credit. The reason behind the withdrawal was to improve their capital ratios. Buckley, Arner and Stanley (2014) also noted that this action was accompanied by a rise in trade finance pricing.

Both derisking and the implementation of Basel III have the potential to impact trade financing. While the importance of trade financing is well known in the literature, research on the topic has been limited by the availability of data to assess its impact on trade. Trinidad and Tobago is an open economy with a level of trade openness (exports+imports as % of GDP) of 86 in 2014 (World Bank data). However much of this is related to the energy sector, as the energy sector accounts on average for around 80 per cent of the country’s exports. In the case of imports the country has a large distribution sector, with a food import bill that has grown significantly over the years. While trade in the energy sector is conducted on the basis of long negotiated contracts, trade in the other sectors can be more fluid. This paper firstly seeks to assess the use of trade financing in the Trinidad and Tobago scenario and then seeks to project what would occur if derisking/Basel III affected trade financing in Trinidad and Tobago.

2. Literature Review

In the business of international trade there is often a time lag between the export of a good and the payment for the merchandise. Trade financing is a medium by which uncertainty and information asymmetry are reduced. Klapper and Randall (2011) noted other reasons given in the literature for the availability of trade credit including as a form of price discrimination and as a substitute for bank credit. There are several trade credit instruments available which can be categorized as (i) open account – where the shipment takes place before payment; (ii) cash-in-advance – where exporters receive payments prior to shipping; (iii) letters of credit– where a financial institution guarantees payment once all the terms and conditions specified are met and (iv) cash against documents. According to the literature letters of credit is one of the more widely used methods of payments, though for the banks letters of credit tends to represent off balance sheet items. Each of these financial instruments comes with its own set of risks. It is estimated that some 80–90 per cent of trade transactions globally are supported by some form of credit financing (Buckley, Arner and Stanley, 2014).

Table 1: Methods for Payment in International Transactions and the Risk for Traders

Method of Payment	Definition	Applicability	Risk	Pros	Cons
Open account	The goods are shipped and delivered before payment is due, typically 30, 60 or 90 days.	Recommended for use in (a) low risk trading relationship or markets and (b) in competitive markets to win customers with the use of one or more appropriate trade financing techniques	Substantial risk to the exporter because the buyer could default on payment obligations after the shipment of the goods.	Boost competitiveness in the global market. Help establish and maintain a successful trade relationship.	Significant exposure to the risk of non-payment. Additional costs associated with risk mitigation measures.
Letter of credit	A commitment by a bank on the behalf of the importer that payment will be made to the beneficiary (exporter) provided that the terms and conditions	Recommended for use in higher-risk situations or new or less-established trade relationships when the exporter is satisfied with the	Risk is spread between exporter and imported, provided that all terms and conditions in the L/C are adhered to.	Payments made after shipments. A variety of payments, financing and risk mitigation options available.	A labour intensive process. Relatively expensive methods in terms of transaction costs.

Method of Payment	Definition	Applicability	Risk	Pros	Cons
	stated in the L/C have been met.	creditworthiness of the importer's bank.			
Cash against documents	Exporter entrusts the collection of payment to the exporter's bank, which sends documents to the importers bank, along with instructions for payments.	Recommended for use in established trade relationships in stable export market and for transactions involving ocean shipping.	Riskier for exporters though CAD term are convenient to pay and cheaper than L/C to the importer.	Bank assistance in obtaining payment. The process is simple, fast and less costly than L/C.	Bank's role is limited and they do not guarantee payment. Banks do not verify the accuracy of the documents.
Cash-in advance	Payment prior to the transfer of ownership of the goods	Recommended for use in high-risk trade relationships or export markets, appropriate for small export transactions	Exporters is exposed to virtually no risk as the burden of risk is placed almost completely on the importer	Payment before shipment. Eliminates risk of non-payment	May lose customers to competitors over payment terms. No additional earnings through financing operations.

Source: ITA 2002.

At present there is a growing body of literature on the demand for and impact of trade financing, and the impact of changes in the financial landscape. The literature encompasses several themes. More recent studies use information from the Berne Union on export credit insurance to employ a gravity type model to examine the impact of factors such as economic growth, distance, openness and export credit on imports. Some authors are able to use data which directly link firms to the use of the trade financing and thus are able to examine the impact of firm characteristics. Due to the changing landscape of financial regulation there are studies conducted primarily by financial institutions which seek to identify the impact of trade finances.

Auboin and Engemann (2013) using Berne Union data on export credit insurance for the period of 2005-2011 find that the volume of insured trade credit is strongly correlated with the overall economic and financial conditions, with the volume of trade credit significantly determined by the level of liquidity and national income. They also find that trade credit is a significant determinant of imports, real GDP and the relative prices of foreign and domestic goods are also important determinants of imports. Brandi

and Schmitz (2015) in looking at the effect of export credit insurance (Berne Union) on the trade flows of industrialized, emerging and developing economies find that over the period 2005-2013, a one per cent increase in commitments results in an increase of 0.27-0.54 per cent in total imports in the following year. They also found that the more open the economy the less reliant trading partners were on export credit. In addition the stage of development was also important for the need for trade credit, with the import flows to non-OECD, lower and middle-income and developing countries being heavily supported by a higher flow of trade credit insurance.

Coupey-Soubeyran and Héricourt (2011) look at the determinants of the demand for trade credit among some 1100 firms in the Middle East and North African Region using information from the World Bank's survey on enterprises in developing countries. They find that when firms, face difficulty in accessing bank credit that the demand for trade credit increases. The non-financial aspects of firms such as age and size have little effect in the need for trade credit.

Chor and Manova (2012) examined US imports from 2006-2009, they found that countries with higher interbank rates and tighter credit markets exported less during the financial crisis of 2008/2009. The authors further noted that in sectors that needed extensive external financing, having limited access to trade credits or have few collateralizable assets the contraction of exports was more pronounced. Türkcan (2015) examined Turkey's trade with 206 countries over the period 2002-2012. He found in the first instance that most of Turkey's exports are financed via the open account method (shipment takes place before the payment is due) while imports are brought in under the cash-in-advance method. Türkcan (2015) found that after the 2008 global recession both exporters and importers used the cash-in advance method more intensively. Muûls (2015) looked at Belgian manufacturing firms over 1999-2007, and found the firms were more likely to be exporting or importing if they have lower credit constraints as well as if they have better credit ratings.

African Development Bank (2014) sought to understand the trade finance market by conducting a survey which covered 276 banks across 45 African countries on their trade finance activities in 2011 and 2012. The key findings were (1) the value of bank-intermediated trade finance was estimated to be roughly from US\$ 330- 350 billion or around one-third of total African trade; (2) unmet demand for trade finance is estimated at between US\$110-120 billion based on the estimated rejection/approval rates; (3) while the average trade finance default rates are low in Africa (4 per cent) it is higher than the world average of less than 1 per cent; and (4) the average price for the issuance of letters of credit is between 0.6 per cent and 1 per cent.

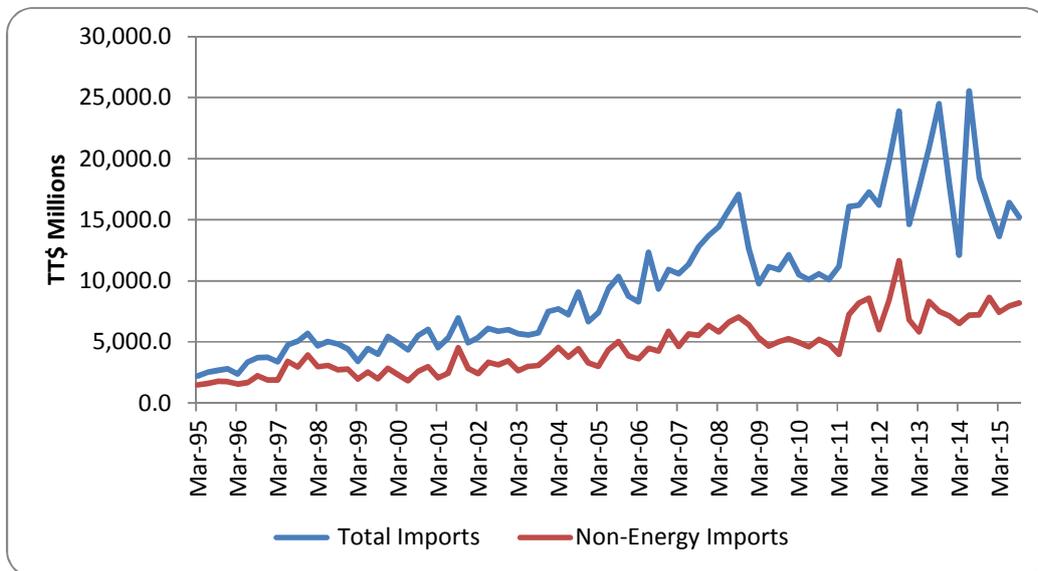
The International Chamber of Commerce conducts on an annual basis a survey on the availability of trade financing globally. In its 2015 report it is noted that there has been a shortfall in the availability of trade financing globally. The most significant impediment to trade financing has been the introduction and enforcement of anti-money laundering/know your customer (AML/KYC) regulations – which is one of the key drivers of derisking. Basel regulatory requirements ranked fifth in the list impediments.

Auboin and Blengini (2014) found that the initial Basel III proposal placed a 100 per cent leverage tax on non-leveraged activities such as letters of credit, which has the potential to reduce their attractiveness relative to higher-risk assets. Serena and Vasishtha (2015) using data from 10 countries over the period 2001Q1 to 2012Q4 found that global financial conditions as measured by the VIX index, a “financial conditions index,” and a measure of dollar funding costs significantly affects trade finance. In addition trade finance depends positively on the growth in global imports and country specifics such as trade flow and domestic banks funding availability. However they also find that the short-term nature of trade financing leaves it vulnerable to negative shocks in the global economy particular if such shocks emanate from the banking sector. The authors note though that trade finance is not more sensitive to global financial conditions than other loans to non-bank entities.

3. International Trade and Trade Finance in Trinidad and Tobago

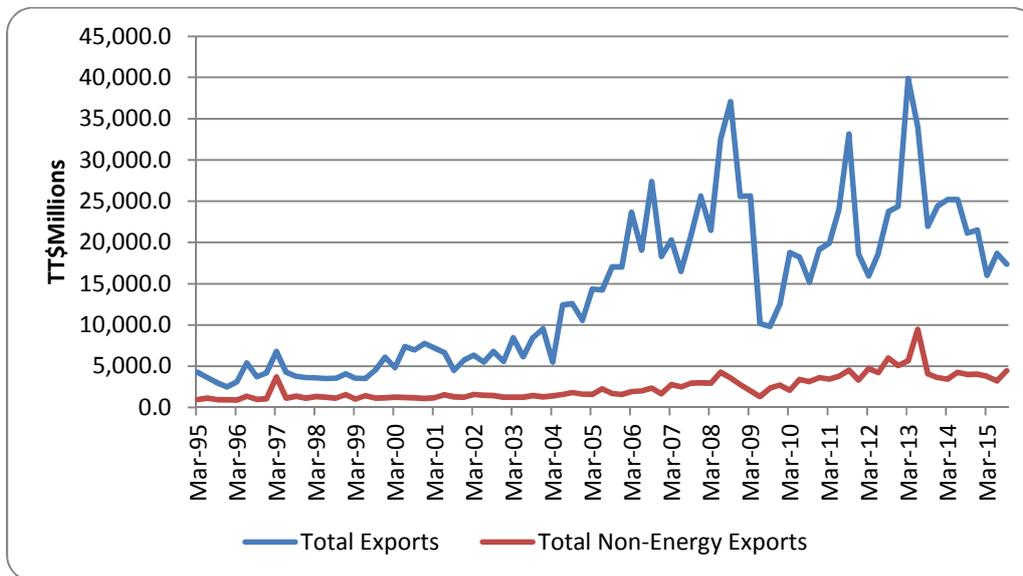
Trinidad and Tobago as mentioned earlier is an open economy with much of its exports concentrated in energy sector exports of crude oil, liquefied natural gas and petrochemicals. There is a broader range of goods that are imported with interest to the government and the public at large being the size of food imports.

Chart 1: Trinidad and Tobago Imports



Source: Central Statistical Office of Trinidad and Tobago.

Chart 2: Trinidad and Tobago Exports



Source: Central Statistical Office of Trinidad and Tobago.

There has been no published work conducted on trade credits in Trinidad and Tobago, this is likely due to the lack of available data on the topic. To undertake the analysis trade financing data was sourced from several different institutions and datasets.

a. The demand for trade financing

To firstly understand the demand for trade financing or credit, information was sourced from the World Bank enterprise survey of firms in Trinidad and Tobago. This survey was conducted in Trinidad and Tobago in 2011, for 370 companies which included manufacturing firms, retail and services companies and, the figures reveal that while 99.9 per cent of the firms surveyed had a savings or checking account only 53.7 per cent had a bank loan or a line of credit, and 29.2 per cent of firms indicated that access to finance was a major constraint.

Wignaraja and Jinjarak (2015) in looking at the financing of SMEs in Asia use the enterprise survey data in their investigation. To check whether the characteristics of the firm influence their demand for financing, the following equation is estimated:

$$P(L, T, F, gA) = f(F, A, S, F, S) \quad (1)$$

To generate the probability that the firms has a line of trade financing available the question asking about the percentage of inputs/materials that are paid for after delivery is translated into binary figure (1 –positive per cent, 0 - nil). The age of the firm is derived from the year of establishment of the firm, and the size of the firm is measured by the number of permanent employees). The database segregates the firms into three sectors – manufacturing, retail and other services. Given the binary dependent variable a probit model is employed in the analysis. The results of this investigation suggest that the typical firm characteristics such as age and size play a role in the availability of trade financing. In the case of size, the larger the firm the more likely it is to pay its supplier after delivery of the goods. To check the importance of age both the actual age of the firm and age squared are used. While age is significant the signs of the coefficients suggest a U shaped relationship between age and the supplier being paid after delivery of the goods. The one important factor that appears to determine access to trade financing is the sector that the firm is in.

The database also provides information on whether inputs/materials are paid for before delivery or are paid for on delivery, as well as the availability of a line of credit (not specific to trade purposes). While the age of the firm does not impact either the availability of a line of credit or the supplier being paid on delivery, it is significant on the supplier being paid before delivery. The size of the firm is also important in having a line of credit and being paid before delivery. However the sector the firm operates in is mostly insignificant.

Table 2: Demand for Trade Credits

	Supplier paid after delivery	Supplier paid before delivery	Supplier paid on delivery	Line of Credit
Age	-0.005*	0.010***	-0.002	0.008
Age2	0.00006*	-0.0009**	0.00002	-0.00005
Number of full time employees	0.001**	0.001**	0.0002	0.002***
Manufacturing Sector	0.120**	0.060	0.107*	0.025
Retail Sector	0.291***	-0.081	0.004	0.148

Marginal effects reported

While the data from the World Bank enterprise survey indicated that approximately 70 per cent of the firms have some form of trade financing, it is difficult to assess the per cent of firms that applied for trade financing and was rejected. According to DiCaprio et al (2015) only 8 per cent of requests for trade financing originating from the Americas was rejected.

b. The demand for letters of credit from domestic commercial banks

To facilitate trade, and in particular imports of goods, there is the need for the use of trade financing facilities. In Trinidad and Tobago, many of the commercial banks offer this service for a fee. In the case of facilitating imports the basic fee for the issuance of a letter of credit tends to be under 1 per cent of the value of the goods. In the case of exports, the charges tend to be fixed or a small per cent. This sum seems to be in line with that charged in other region. AfDB (2014) reveals that in 2011-2012 the average fee for the issuance of letters of credit by African banks was between 0.6 and 1 per cent.

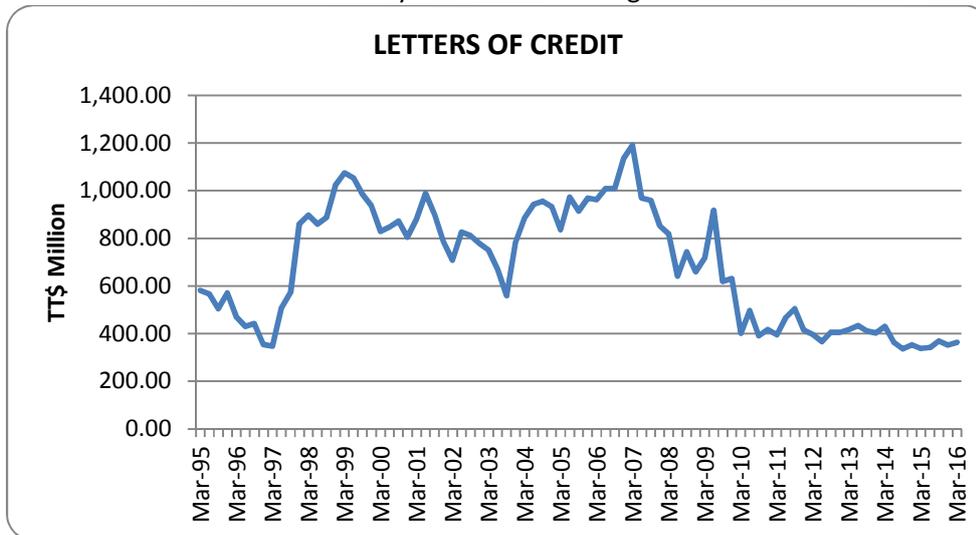
Table 3: Trade Financing Fees

Letters of Credit Outward - Import	Summary
(a) Issuance Fee	0.25-0.90% for the first 3 months
(b) Amendments	\$60-\$115
Letters of Credit Inwards - Export	
(a) Confirmation Commission	\$100-\$115
(b) Advising Commission	\$75-\$150
(c) Amendments	\$75-\$125

Source: The Central Bank of Trinidad and Tobago

The data available on the letters of credit is broken down into several categories: commercial letters of credit, performance standby letters of credit; financial standby letters of credit and documentary letters of credit. The data suggests that in the early years, pre-2000 the documentary letters of credit was the primary instrument used, however more recently the financial standby letters of credit have gained more prominence. It is not surprising that there was a slump in the use of letters of credit in 2008/2009 period as the global financial crisis was accompanied by a slowdown in trade as evidenced by both a fall in the trade values and in the number of swift messages. While global trade has somewhat mildly recovered recently, the letters of credit for Trinidad and Tobago remained relatively stagnated since 2010.

Chart 3: Letters of Credit Issued by Trinidad and Tobago Commercial Banks



Source: Central Bank of Trinidad and Tobago.

Trinidad and Tobago’s level of imports has continued to rise over the decades, however in the more recent years there has been great fluctuations perhaps related to the imports of items related to the energy sector and for the non-energy sector perhaps related to the difficulties in obtaining foreign exchange to facilitate the purchases.

To test the relationship trade financing and imports the paper follows the literature by estimating the following equation:

$$\log(M_t) = \beta_0 + \beta_1 \log(T_{t-1}) + \beta_2 \log(g_{t-1}) + \beta_3 \log(r_{t-1}) + \varepsilon_t \quad (2)$$

Where:

TF represents the letters of credit granted

GDP represents the QGDP index

Reer is the measure of the countries relative price of foreign and domestic gross domestic product

M is the value of imports.

Data is sourced from the reports made by the commercial banks on the value of the letters of credit issued. This data unfortunately does not explicitly disaggregate whether the letters of credit are issues for imports, exports, domestic companies or foreign companies. However the data does indicate if the letters of credit are issued in foreign currency and a disaggregation between resident and non-resident

customers. The bulk of the data suggests that the letters of credit are primarily issued to resident customers in foreign currency. For the purpose of this exercise it is assumed that this represents letters of credit to facilitate imports. The import data was sourced from the Central Statistical Office, Trinidad and Tobago while primarily an exporter of energy products also imports goods for the facilitation of the energy sector as well as crude oil for the use in the local refinery, Petrotrin. Thus for the purpose of this analysis what only what are deemed non energy products is used. Trinidad and Tobago does not at this time produce a quarterly nominal GDP figure, as a result the quarterly index of gross domestic product was used. As an alternative the annual GDP figures were disaggregated using the denton methodology, and in general the results remained the same. The quarterly real effective exchange is calculated by the Trinidad and Tobago Central Bank.

Table 4: Impact of Trade Financing on Imports

Dependent Variable	lnTF(-3)	Lngdp (-1)	Ln reer(-1)	c	R ²
Total non-energy import	-0.266***	1.287***	0.103	-3.600***	0.8407
Food Import	-0.133**	0.882***	1.126***	-7.400***	0.9085
Beverage Import	-0.349*	1.557***	-0.772	-14.505***	0.6736
Crude Material Import	-0.805***	2.313***	-1.144	-8.642***	0.5645
Fats and Oils Import	-0.394**	1.391***	0.448	-11.362***	0.6314
Manufacturing Import	-0.156*	1.344***	-0.399	-5.219***	0.7863
Machinery Import	-0.290**	1.227***	-0.228	-2.968*	0.6995
Miscellaneous Manufacturing imports	-0.152**	1.244***	0.467*	-8.826	0.8789
Miscellaneous Imports	0.597**	-1.244**	2.847***	-0.051	0.1059

Note for crude material imports the lag on the trade financing variable is one; for manufacturing imports the lag is 4; for machinery imports the lag is 2; for miscellaneous manufacturing imports the lag is 5, and for miscellaneous imports the lag is 1.

In testing the relationship between trade and financing and non-imports, the investigation finds in general that the real effective exchange rate is an insignificant determination of imports. This could be due to the lack of volatility in the exchange rate over the period as well as the inelastic demand for merchandise goods. As expected the level/growth of the country's gross domestic product significantly impacts its level of imports. In a closer look at trade financing the results indicates, in the first instance,

that the lag between the trade financing recorded and the imports appears to be longer than the typical one period lag used by several studies. In the case of total non-energy, the influence of trade credits on the level of imports only become significant after a three period lag. BIS (2014) noted that in India and Mexico, average maturities for trade finance instruments were six and 12 months respectively. In the literature the lag on the trade financing coefficient is often one period, signifying that the letters of credit are often 90 days in length. Notably however the sign of the coefficient of the trade financing variable is negative, indicating that as imports increased that the need for letters of credit declined. This could be due to several factors including the development of a good relationship between the importer and supplier, the alternative sourcing of trade financing, a decline in banks approval of trade financing and demands for payment of cash advance. In 2014 and 2015 there were media reports indicating that Trinidad and Tobago importers were having difficulties paying their foreign suppliers due to difficulties in accessing foreign exchange and that suppliers had reduced the time to pay the bills which may have further reduced the demand for letters of credit.

While the information on letters of credit are not disaggregated sectorally, an attempt was made to assess the importance of this financial measure for different types of goods. The non-energy import data was further disaggregated into the one digit SITC classification. Using the same model the results reveal a general consistency of the results, though notably the lag required for the letters of credit variable differed among the groups. For example while food, beverages, oils and fats had a lag of 3 periods, crude material was significant at one lag, while manufactured goods was 4 lags. It was only in the case of manufactured items was the relationship between imports and the letters of credit a positive one.

Using information from the Central Bank's database of foreign direct investment finds that in 2015 firms from the energy sector, inclusive of the petrochemical sector; the assembly type and related Industries; and the chemicals and non-metallic minerals sector were the primary beneficiaries from trade credits from unaffiliated companies.

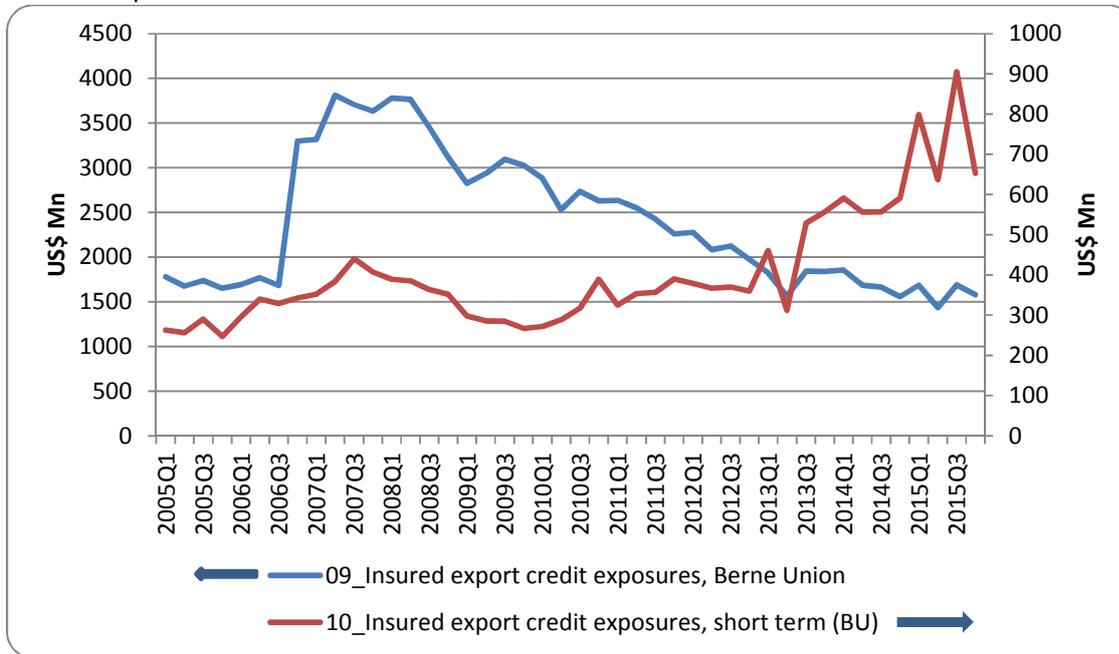
c. The demand for letters of credit from international financial institutions

In recent years information on export credits by destination country has become available from the Berne Union, which is a group of private and state export credit insurers². The insured export credits are composed of long, medium and short term credits and represent the actual insurance which is used to cover actual loans. The data reveal that while the value of the total export credit exposures to Trinidad and Tobago has been on a downward trajectory since around 2008, the value of short-term credits, which are more closely aligned with trade financing, has been trending upwards since 2009 though during 2015 there was significant volatility in the stock of outstanding short term export credit. It is

² <http://www.berneunion.org/about-the-berne-union/berne-union-members/>

important to note that no Trinidad and Tobago company is reported as a member of the Berne Union, so there is no overlap with the trade credits offered by the commercial banks in Trinidad and Tobago.

Chart 4: Export Credits



Source: World Bank (2016)

Using the Berne Union data equation (2) is re-estimated, however in this instance the relationship between trade financing and both total imports and total non-energy imports are checked as it is possible that energy companies sending product to Trinidad and Tobago, eg from Barbados, Russia, Gabon, etc, may have obtained export financing.

Table 5: Impact of Export Credit Insurance on Imports

	Total Imports	Total Non-Energy Imports
Ln TF (-3)	0.500**	0.553***
Ln gdp (-1)	0.808	0.898**
Ln reer (-1)	0.448	0.209
c	-5.595	-6.529
R ²	0.4437	0.5626

Using the equations the results indicate that as with the commercial bank data the effective exchange rate has little impact on the level of imports, surprisingly however GDP also have little significant impact,

this may have to do with the shortened time span (2005-2015) or the inelasticity of the import demand. Like the commercial banking data, trade credits only become significant after a 3 period lag. However unlike the results using the commercial bank trade credits, in this case the Berne Union trade financing data has a positive relationship with the level of imports. The coefficient suggests that a 1 per cent increase in the short term export credit exposure results in a 0.5 per cent increase in imports. The results suggest that in this case export credits obtained from other jurisdictions assist in the Trinidad and Tobago companies being able to import goods. Brandi and Schmitz (2015) found that a 1 per cent increase in export credit insurance resulted in an increase in total imports of between 0.27-0.54 per cent, while Auboin and Engemann (2013) found that a 1 per cent increase in export credit resulted in a 0.4 per cent increase in imports.

4. Possible Impact of Changing Financial Regulations

Derisking is of increasing concern to the Caribbean region. In the case of Trinidad and Tobago the available data suggest that trade credits are increasing sought from financial institutions outside of Trinidad and Tobago. One recent example of the impact of derisking is the case of Barclay PLC closing accounts that have a Jamaican address; and then in January 2016 the entire British Barclay export finance team was made redundant. If this were to happen to accounts of businesses with a Trinidad and Tobago address there is the possibility of companies becoming unable to import goods, or having to resort to more costly means – e.g. paying immediately using credit cards. On the other hand the Berne Union data may also suggest that exporters of the goods are taking out trade financing products to ensure that they get paid. In this case the effects of derisking may be limited by the availability of the products and the costs which may go up if more banks leave this segment of the market for what is perceived as more profitable ventures.

In addition to the issue of derisking and its potential impact on trade finance, the implementation of the Basel III framework can have implications for trade financing. Since discussions began on Basel III, financial service providers have noted the possible negative implication of the standards on trade financing. Ensuing discussions and consultations have resulted in amendments in the framework on one-year maturity floor, counterparty credit risk measures and the leverage ratio. The committee has agreed to waive the one-year maturity floor for certain trade finance instruments under the advanced internal ratings-based approach for credit risk and the sovereign floor for certain trade finance-related claims on banks using the standardized approach for credit risk. However even with these changes there are some in the international community that still are of the opinion that Basel III still represents a risk to trade financing. Thieffry (2011) noted that the implementation of Basel III could increase the cost of trade finance by as much as 40 per cent.

Table 6: Basel III Treatment of Trade Finance.

Issue	Basel III recommendations
One-year maturity floor	one-year maturity floor for self-liquidating trade finance instruments (including both issued and confirmed self-liquidating letters of credit (L/Cs)) with an original maturity of less than one year is waived. Other trade finance transactions can also be exempted, subject to national discretion.
Sovereign floor	waive the sovereign floor for short-term self-liquidating L/Cs under the option 2 treatment.
Credit conversion factor (CCF)	under the Standardised Approach, a 20% CCF is applied to L/Cs .
Leverage ratio	apply a 20% CCF to short-term contingent trade finance assets (short-term self-liquidating trade letters of credit arising from the movement of goods (eg documentary credits collateralised by the underlying shipment)).
Liquidity Coverage Ratio (LCR)	the LCR was defined as the ratio of the "stock of high-quality liquid assets" to "total net cash outflows over the next 30 calendar days". The revised specification of the LCR (January 2013) includes guidance to indicate that a low outflow rate (0–5%) is expected to apply to contingent trade finance exposures.

Source: BIS (2014)

These new regulations whether because of Basel III or derisking have the potential to raise the cost of finance, which is likely to be passed on to the consumer thus contributing to inflation. In addition there is the possibility, regarding Basel III, that commercial banks move away from the low risk trade credit instrument (letters of credit have a default rate of under 0.1 per cent (ICC, 2015)) towards more profitable but higher risk instruments. As an alternative to increasing the trade finance rates, financial institutions may limit the availability of the financial instrument. Any of these options can result in a reduction of imports. In addition to affecting imports, the loss of trade finance can affect production and employment where firms depend on imports as inputs into the production process.

5. Conclusion

The paper represents a first attempt to examine the trade financing in Trinidad and Tobago in general, and the potential impact of the changing financial regulation landscape. The findings suggest that in Trinidad and Tobago age and size of firms as well as sector are key determinants in whether or not the firm has trade financing. Using data from the Trinidad and Tobago commercial banks indicates while trade financing is a significant determinant of imports, its relationship is a negative one. Indicating perhaps that as imports increase and suppliers become more confident in the ability of the importers to pay that intra-firm credit is extended. Using the Berne Union data it was found that trade financing is important in facilitating imports, however in this case the relationship is a positive one. This suggests that exporting companies are increasing coverage from on their side for the possibility of a default on payments. This may also explain the negative relationship from the domestic side. One common finding from both the domestic commercial bank financing and Berne Union financing is that the lag between imports and trade financing is on average three quarters. Further it is believed that the implementation of Basel III and derisking may raise the cost of trade financing and possibly limit the abilities of businesses to import goods.

An overall conclusion is that for a more in-depth and through investigation to be conducted more data is needed. One piece of information that is missing from the analysis is the sector to which the trade credits are attached. This may be available from the documents submitted by importers to the customs officials. A possible alternative is to seek access to more granular detail from SWIFT as it pertains to trade financing for Trinidad and Tobago. In addition, there is no notion of how many firms applied for trade financing and were rejected. Following some of the banks in Asia and Africa the Central Bank of Trinidad and Tobago could undertake a survey of the commercial banks to find out about the rejection rates, and which sectors apply for and receive trade financing. In addition the default rates for letters of credit need to be known as well as the reasons for the rejection. While Trinidad and Tobago has an export-import bank the data collected is not easily separable in trade financing instruments, therefore a revision of the data collected is needed to understand the importance of this facility to non-energy exports.

In regards to the impact of the changing overarching global financial legislation it is likely that the cost of trade financing will increase. The impact of this will depend on the size of the increase and its transmission to the inflation rate. One suggestion to deal with these issues comes from a Commonwealth Secretariat (2013) report which puts forth the idea that an examination of how risk pooling and risk mitigation in the provision of trade finance can be promoted within and across the Commonwealth needs to be undertaken. Buckley, Warner and Stanley (2014) in looking at the potential impact of Basel III on Trade Finance in East Asia proposed the creation of a ring-fenced liquidity pool for trade finance, the development of co-financing among the various providers, both public and private, and the establishment of a regional trade finance database. For the CARICOM region similar ideas may be considered.

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