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Regional Economic Integration

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Regional Economic Integration

Case for a Regional Export Credit Agency for Asia

edited by
Rahul Sen



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Foreword

As an institution dedicated to the study of socio-political and economic trends, ISEAS has been monitoring the growing impulse, among countries in the region, towards regional co-operation and integration.

In this light, ISEAS was particularly interested in the proposal made by Mr T.C. Venkat Subramanian, Chairman and Chief Executive Officer, Export-Import Bank of India, on the establishment of a Regional Export Credit Agency in Asia (RECAA) at the ASEAN-India Forum on 9–10 February 2004. Taking the proposal further, ISEAS organized a workshop on the same issue. The deliberations at the Workshop underscored the need for the establishment of a body to facilitate trade flows among countries in the region. The proposal is now being studied by the concerned multilateral fora in Asia.

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Introduction

Regional co-operation is becoming increasingly important in today's economy. Complexities surround the diverse set of nations and regions with factors like the hardening of the multilateral trading rules and the creation of the World Trade Organization (WTO) and unity through a consistent philosophy has been considered far from simple. However, recognizing the potential for greater regional co-operation for development, there has been an array of regional co-operation initiatives with the most institutionally advanced of the regional groupings being the European Union (EU) and the Americas having several regional common markets including Mercosur, the Andean Community, Caribbean Community and Common Market (CARICOM) and the North American Free Trade Agreement (NAFTA). Other regional initiatives include Southern African Development Community (SADC), Common Market for Eastern and Southern Africa (COMESA) in Africa; ASEAN Free Trade Area (AFTA), SAARC Free Trade Area (SAFTA) in Asia. Interest in the regional option has attracted new attention in the Asia and Pacific region in the wake of the financial crisis. This is a reflection of the perception that the distinctive features of the region's approach to growth and economic learning need to be captured when tailoring support packages to meet the requirements of the region. In Europe, institution building has promoted co-operation through encouraging the harmonization of policies and institutions, creating a

zone of monetary and financial stability, and leading to a measure of political integration. In Asia, however, the motivations for regional co-operation are different from Europe's and are in their infancy.

Regional Trade Agreements (RTAs) have been in intense discussions in the recent years. According to some estimates, there are currently 285 RTAs in existence. All countries in the developing world, with the sole exception of Mongolia, are involved in some form of RTA or other.

Considering the mixed objectives (political, security and economic considerations) with which the RTAs emerge, there will be an increasing number of such agreements, irrespective of the efficiency of multilateral trading systems. In fact, such regional or preferential liberalization would lead to further liberalization through the process of 'competitive liberalization'. Under the competitive liberalization strategy, while the developed countries will have the objectives of protecting their investment interests, and new market access, the developing countries will have the overall objective of attracting infrastructure investment, which could contribute to their economic growth.

Globalization is seen as one of the most important factors in shaping the economic development. Participating in the global economy provides immense opportunities and has a major bearing on *trade, capital flows, the global environment, decentralization and urban development* and would require nations to seek a dynamic equilibrium at international, regional and sub-regional level. This has been shown by the success of countries with an *outward-oriented strategy*. By contrast, inward-looking development strategies lead to slower growth.

Asia is a vibrant economic region of the world. The region has made tremendous progress in the last four decades. In 1964, the per capita income of Asia was US\$95, lagging behind Africa (US\$150) and Latin America (US\$550). Today, after sustained growth over the years ably assisted by regional multilateral agencies like Asian Development Bank (ADB), Asia stands on top among the developing world. Asia now accounts for 24 per cent of global Gross Domestic Product (GDP), 60 per cent of total global forex reserves and accounts for 55 per cent of world population (consumers).

However, the share of Asia in global trade is not commensurate with its inherent economic strengths. The share of Asia in global trade has moved up from 15 per cent in 1980 to 26 per cent in 2003, primarily due to aggressive growth in exports and imports in China. The intra-regional trade amongst Asian countries have increased from 9 per cent (of global trade) in 1988 to 11 per cent in 2003. The growth again is partly due to the import boom witnessed in China which benefited a number of Asian countries in their export performance.

Role of ECAs

Export Credit Agencies (ECAs) or Exim Banks play a vital role particularly in Asia in promoting and facilitating their countries' international trade. Exim Banks support their countries' exports through a variety of financing programmes like Supplier's Credit, Buyer's Credit, and Lines of Credit in order to help their exporters to meet the global competition effectively and ensuring that their exporters do not lose out

due to uncompetitive financing packages. Exporters from AAA rated OECD countries are backed by their ECAs or Exim Banks with very attractive credit packages while bidding for large global contracts. Exim Banks in the developing world are unable to match such credit packages as their cost of funds are much higher compared to their counterparts in the OECD block. In the Asian region, except Japan Bank for International Cooperation (JBIC), which is an amalgamation of Japan Exim Bank and OECF (erstwhile concessional funding arm of Japanese Government), other Exim Banks are comparatively weaker in their abilities to match ECAs from OECD group.

An interesting paradox is that the developing countries in Asia invest their forex reserves in AAA rated banks and institutions in OECD countries earning marginal returns, while Exim Banks from these developing countries borrow from these OECD markets at much higher rates of interest to finance their exports. This situation can be rectified if there are strong AAA rated institutions in Asia where such forex reserves could at least be partially parked and from whom borrowings could be raised by such Exim Banks for financing their countries' exports. Such an arrangement will ensure that Asian forex reserves are recycled to support further development activities within the region.

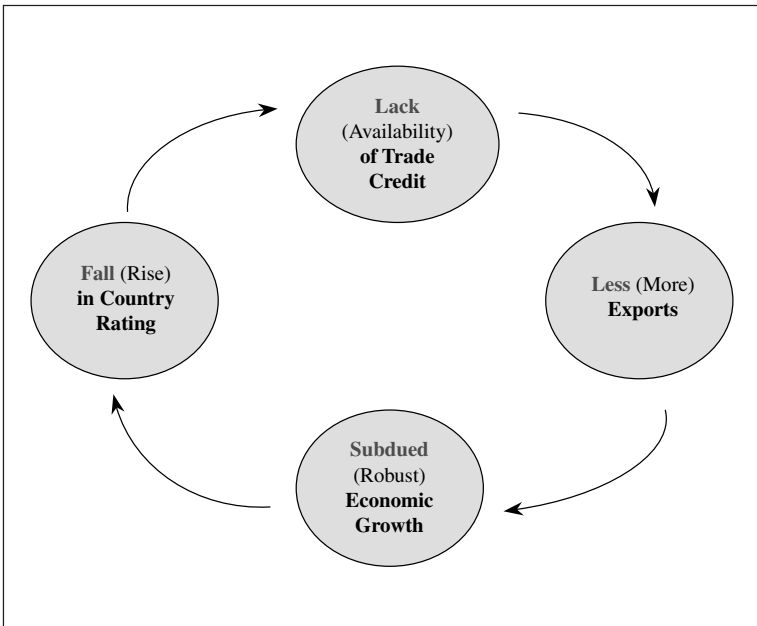
Another aspect of Asian region is that number of countries in the region have relatively less developed economies and need substantial investment for industrial infrastructure, which could partly come from relatively better developed economies within the region by way of export credits to finance import of individual projects by these weaker economies. Most ECAs will not be wishing to support any export transactions to these countries as their

economic parameters may not be acceptable commercially. Without support, these economies will fall deeper into economic inactivity creating a vicious circle. If there is a regional multilateral agency that can provide credit enhancement to such weaker economies, development activities will increase. Trade promotes investment and the vicious circle can be turned into a virtuous circle.

The factors that have influenced decline in trade finance in recent times include:

- The interaction between perceived risks and the leveraged positions of banks

The Vicious (*Virtuous*) Circle



- Lack of insurance
- Herd behaviour among trade finance providers
- Change in the banking sector

Asian ECA Forum

Trade facilitation constitutes an important element of the strategy to enhance bilateral trade and investment relations. Towards this end, co-operation in financial services assumes a pivotal role in facilitating financial exchanges among participating countries. Further, regional co-operation is becoming increasingly important in today's economy. In such an environment, co-operation among ECAs is vital for the successful completion of an international project.

With a view to enhance co-operation and forge a stronger link among its member institutions, the first meeting of Asian ECAs was held in India, at the initiative of the Export-Import Bank of India (Exim India) in 1996, which led to the formation of the Asian ECA Forum. Members comprise ECAs from India, China, Japan, Indonesia, Korea, Malaysia, Thailand, and Philippines. These are the eight countries in Asia, which have Exim Banks, playing their typical role of promoting international trade and investment of their countries. All the eight Exim Banks are fully owned by their sovereign governments. The Annual Meetings deliberate upon measures to foster long-term relationship within the Asian ECAs Community, share experience and strengthen financial co-operation to promote intra-regional trade and investment.

The task of the Asian ECA Forum is to enhance co-operation and forge a stronger link among its member

institutions, thereby fostering a long-term relationship within the Asian ECAs community. The Annual Meetings serve as a forum for discussing a wide range of issues focused on fostering common understanding as well as exchanging and sharing information. Together, the endeavour is to meet the challenges faced as an export credit agency in Asia and explore possible areas for further regional co-operation.

The first two meetings of Asian ECAs took place in Bangalore and Mumbai, India, both in 1996, hosted by Exim India. The discussions focused on formalising an annual meeting and developing a common agenda. Substantial progress has been made over the past eight years since these two meetings in India, with the support and active participation of the member ECAs. The periodicity of the meeting was made annual and each member ECA decided to host the Annual Meeting by rotation. The Annual Meetings were held in member countries to discuss a wide range of topics. Specific topics covered at each meeting were decided in advance and reviewed during the time leading up to the meeting, in addition to any further ideas that emerged in the course of the year. Despite a relatively short history, each meeting proved to be a valuable opportunity with participants having learned a great deal from sharing each other's experience and engaging in active dialogue. A concrete step towards regional co-operation emerged at the Seoul meeting (2001) where member ECAs decided to work on the concept of 'Multilateral Letter of Credit Confirmation Facility'. The concept was firmed up and the member ECAs signed a multilateral agreement in Kuala Lumpur (2002). Member ECAs further consolidated the arrangement by signing bilateral agreements with other

ECAs. Exim India signed with Exim Malaysia and Exim Thailand at Manila, Philippines (2003) and is in the process of signing with other Exim Banks.

A step further in this direction will be to explore the possibility of setting up a regional ECA (Exim Bank) with the support of regional multilateral agency like Asian Development Bank. This concept has found general favour among the member ECAs.

The Need & Role

Regional ECA can facilitate regional economic integration through increased intra-regional trade in Asia. There may be some legitimate doubts expressed as to why a Regional Export Credit Agency for Asia (RECAA) is required and whether it will be conflicting with country level ECAs. To understand this contention there is need to consider certain key aspects of the Asian economies as a prelude to the concept.

Asian economies are significantly dependent on each other for international trade. While Asian economies are major recipients of FDI among developing countries, intra-Asian FDI flow is modest. Further, there is a distinct decline in export growth rates and investment inflows of the less developed economies of Asia in recent years and International Credit Ratings are not sufficiently investment friendly. Another factor is that majority of Asian countries are low to middle income countries, which creates difficulty in accessing international finance and often availability, rather than cost of finance, acts as a constraint.

Objective of a Regional Export Credit Agency for Asia (RECAA)

The objective of RECAA will be to improve access to trade finance for Asian economies, through *credit enhancement* and *risk mitigation* measures and thereby, contribute to enhance intra-regional and extra-regional trade & investment. RECAA will seek to achieve its above objective by positioning itself as a regional supra national with high credit rating (AA-minimum). RECAA will be a Refinancing/Rediscounting/Reinsurance institution and not a Direct Financier. RECAA would complement rather than duplicate or supplant existing multilateral, regional, sub-regional and national institutions, which would increase the level of intra and extra Asian trade and investment.

Some Recent Developments

At a recent conference in Singapore, organized by the Institute of South East Asian Studies (ISEAS) Singapore, I was a luncheon speaker on the topic “Avenues for co-operation in Financial Services between India and ASEAN”. While outlining various avenues for co-operation, the undersigned mentioned the concept of a Regional Export Credit Agency for Asia as a viable vehicle for promoting intra-regional trade and investment amongst Asian countries and that such an institution can be strategically located in a vibrant financial centre like Singapore that can contribute to closer co-operation in financial services among national and international banks and institutions. Encouraged by the response from the participants at the conference, a brain

storming session was organized by ISEAS a few weeks later, at which leading international banks based in Singapore deliberated with experts from ISEAS and Exim Bank of India, bringing in new ideas and suggestions.

Exim Bank of India subsequently made a presentation at the 10th Annual Meeting of Asian ECAs at Beijing, P.R. China on 11 May 2004 at which heads of all participating ECAs (China, Japan, India, Korea, Philippines, Thailand, Indonesia, Malaysia and Australia) and senior officials of the co-financing division of Asian Development Bank and an official of International Monetary Fund, Washington, U.S.A. were also present. ADB, while generally welcoming the concept, suggested that as a first step, the Bank (ADB) could consider introducing 'Regional Export Credit and Finance Scheme' that will partially achieve the intended objectives of the regional export credit agency. ADB made a presentation on the concept with the help of a consultant, engaged for developing the above programme.

Subsequently, during the recent Annual Meeting of the ADB at Jeju Island (Korea) in May 2004, the co-financing division of the ADB organized a seminar on the subject (Guarantee Products and Risk Sharing Partnerships) at which a panel of international speakers including the undersigned deliberated on the various aspects of the proposed ADB Facility and interacted with the audience, comprising international bankers, insurance experts, ADB officials amongst others. There was a general consensus that there is need for level playing field among the ECAs, the proposed ADB facility is a step in the right direction and that with Basel II norms prescribing capital adequacy for country exposure, there may be reluctance on the part of commercial banks to take exposure on weaker economies. ADB officials

indicated that they would examine the various suggestions and comments of the participants at the conference and would deliberate on the concept further with select group of experts to chalk out future course of action.

* * *

It is worth recalling that the Governor of the Asian Development Bank (ADB), during his inaugural speech at the recent Annual Meeting (May 2004), drew attention to the pioneering role played by ADB since its establishment in 1966 in the development and transformation of Asian economies from weakness to strength, from laxity to vibrancy. Every Asian country had or still has a development financial institution (DFI) and ADB's role and operation did not conflict with the national DFI. In the same way, a regional export credit agency, if established with ADB's support and participation, will not conflict with the national ECAs but will only be complimentary and source of strength.

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(Note: The views expressed in the Introduction are of the author and not of the institution to which he belongs.)