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ILO report examines profits and drivers of forced labour

Over $150 billion in profits is generated yearly by the use of forced labour, which affects more than 20 million victims worldwide. A new report by the International Labour Organization (ILO) shines a light on the illegal economy of "this vast nation of men, women and children ... hidden behind a wall of coercion, threats and economic exploitation".

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Forced labour generates $150 billion profits per year, says ILO

An International Labour Organization (ILO) report delves into the facts and figures behind the "fundamentally evil but hugely profitable practice" of forced labour.

by Kanaga Raja

GENEVA: The total illegal profits generated by the use of forced labour worldwide amount to $150.2 billion per year, according to a new report by the International Labour Organization (ILO).

The report, titled "Profits and Poverty: The Economics of Forced Labour", said that more than one-third of the profits, amounting to $51.2 billion, resulted from forced economic exploitation, including nearly $8 billion generated in domestic work by employers who use threats and coercion to pay no or low wages.

Globally, said the ILO report, two-thirds of the profits from forced labour were generated by commercial sexual exploitation, amounting to an estimated $99 billion per year.

"In calculating the profits, it is assumed that wages and intermediate consumption make up about 30% of the total earnings of forced labour victims in commercial sexual exploitation," it added.

The profits from forced labour are highest in Asia ($51.8 billion) and Developed Economies ($46.9 billion), the ILO said, citing two reasons for this, namely, the high number of victims in Asia and the high profit per victim in Developed Economies.

In this regard, it found that annual profit per victim is highest in the Developed Economies ($34,800 per victim), followed by countries in the Middle East ($15,000 per victim), and lowest in the Asia-Pacific region ($5,000 per victim) and in Africa ($3,900 per victim).

According to the ILO, forced labour imposed by private agents for labour exploitation includes bonded labour, forced domestic work, forced labour of migrants in many economic sectors and work imposed in the context of slavery or vestiges of slavery. Forced illicit activities such as forced begging for gangs, for example, are also included in this category.

Forced labour imposed by private agents for sexual exploitation covers any commercial sexual activity, including pornography, exacted from the victim by fraud or force.

Forced labour imposed by the state covers all forms of work exacted by public authorities, military or paramilitary, compulsory participation in public works and forced prison labour (within the scope of ILO Conventions No. 29 and No. 105).

The ILO said that the estimate of the profits and the analysis of the causes of forced labour presented in the report are limited to labour and sexual exploitation extracted by private agents.

The ILO report cited income shocks and poverty as being the main economic factors that push individuals into forced labour, with other factors that give rise to risk and vulnerability being lack of education, illiteracy, gender and migration.

"This new report takes our understanding of trafficking, forced labour and modern slavery to a new level," said ILO Director-General Guy Ryder in an ILO press release.

"Forced labour is bad for business and development and especially for its victims. Our new report adds new urgency to our efforts to eradicate this fundamentally evil, but hugely profitable practice as soon as possible," he added.

Over 20 million victims

According to the ILO, its latest report had re-estimated the illegal profits made from the use of forced labour based on an updated methodology and data collected for its 2012 Global Estimate.

The new estimate is the aggregation of regional profit figures for three forms of forced labour, namely forced economic exploitation outside domestic work, forced domestic work and forced sexual exploitation, it said.

In the 2012 survey, the ILO had estimated that 20.9 million people are in forced labour globally, trafficked for labour and sexual exploitation or held in slavery-like conditions.

The vast majority of the 20.9 million

forced labourers – 18.7 million (90%) – are exploited in the private economy, by individuals or enterprises.

Of these, said the ILO, 4.5 million (22%) are victims of forced sexual exploitation, and 14.2 million (68%) are victims of forced labour exploitation, primarily in agriculture, construction, domestic work, manufacturing, mining and utilities.

The remaining 2.2 million (10%) are in state-imposed forms of forced labour, such as prisons, or in work imposed by military or paramilitary forces.

Women and girls represent the greater share of the total – 11.4 million (55%) – compared to 9.5 million (45%) men and boys. Adults are more affected than children – 15.4 million (74%) are aged 18 or older, with the number of children under the age of 18 estimated at 5.5 million (26%), it said.

According to the ILO, the Asia-Pacific region accounted by far for the largest number of forced labourers, at 11.7 million (56% of the global total), while the second highest number was found in Africa at 3.7 million (18%), followed by Latin America and the Caribbean with 1.8 million victims (9%).

The Developed Economies and European Union accounted for 1.5 million (7%), while countries of Central, South-Eastern and Eastern Europe (CSEE) and the Commonwealth of Independent States (CIS) have 1.6 million (7%). There are also an estimated 600,000 (3%) victims in the Middle East.

Of the total of 20.9 million people in forced labour, an estimated 9.1 million people (44%) moved either internally or internationally, while the majority, 11.8 million (56%), were subjected to forced labour within their place of origin or residence.

Profits from forced labour

Victims of forced labour exploitation, including domestic work, agriculture and other economic activities, generate an estimated $51 billion in profits per year. Out of those, the profits from forced labour in agriculture, including forestry and fishing, are estimated to be $9 billion per year. Profits for other economic activities are estimated at $34 billion per year, encompassing construction, manufacturing, mining and utilities.

The ILO also estimated that private households employing domestic workers under conditions of forced labour save about $8 billion annually by not paying or underpaying their workers. Based on information in the 2012 Global Database, it can be estimated that forced domestic workers are paid on average about 40% of the wage they should receive.

Profits per victim are highest in forced sexual exploitation, the report found, underlining that with a global average profit of $21,800 per year per victim, this sector is six times more profitable than all other forms of forced labour, and five times more profitable than forced labour exploitation outside domestic work.

It is also estimated that the profits made with the world's 10.7 million victims of non-domestic forced labour exploitation reach $43.4 billion per year, with an average annual profit of $4,000 per victim.

"This profit is estimated to be the result of the exploitation of victims in agriculture on the one hand, and industrial sectors (construction, manufacturing, mining and utilities) on the other."

The ILO said that forced labour profits in agriculture are lower than the sum of other sectors, but are quite significant in terms of the number of workers.

It is estimated that more than a third of the victims of forced labour in non-domestic sectors work in agriculture (including fishing and forestry), amounting to 3.5 million of the 10.7 million people in forced labour exploitation other than forced domestic work.

It is estimated that nearly $8 billion is literally stolen annually from the 3.4 million domestic workers in forced labour worldwide. The ILO said that this estimate is based on data collected by the ILO for the 2012 Global Estimate, which shows that domestic workers in forced labour are effectively deprived, on average, of 60% of their due wages. This amount of stolen wages, or profit, varies between $50 per month in Africa and more than $600 per month in Developed Economies.

The total annual profits made from forced sexual exploitation are estimated at $99 billion worldwide, with the profits being highest in Asia due to the large number of victims. However, the ILO said that annual profits per victim are highest in Developed Economies ($80,000) and the Middle East ($55,000), due to the high average price of sexual encounters.

In some concluding observations, the ILO report found that women and girls are generally less likely to be in forced labour irrespective of their age.

For instance, being female as opposed to male reduces the probability of a household member aged 5 or older being in forced labour by 0.21 percentage points (in the Niger) to 9.89 percentage points (in Guatemala).

With the exception of Guatemala where, surprisingly, the literate were more likely to be in forced labour (4.14 percentage points), the ILO said that being literate leads to a maximum 1.15-percentage-point decrease in the probability of household members being in forced labour.

"Put into perspective, the 21 million victims in forced labour and the more than $150 billion in illegal profits generated by their work exceeds the population and GDP of many countries or territories around the world," said the ILO.

"Yet this vast nation of men, women and children, along with its resources, remains virtually invisible, hidden behind a wall of coercion, threats and economic exploitation," it added.

The report indicated that while unscrupulous employers and criminals reap huge profits from the illegal exaction of forced labour, the losses incurred by the victims are also enormously significant.

"People in forced labour are often caught in a vicious cycle that condemns them to endless poverty. They may suffer personal trauma that will require years to overcome as they try to rebuild their lives."

Taking action

"There is a critical need to expand our current knowledge base on forced labour through standardized data collection methods across countries," said the ILO. Such standardization and regular data collection would enable the ILO and other international organizations to generate more reliable global figures, measure trends and better understand risk factors.

"The continued existence of forced labour is bad for its victims, for business and development. It is a practice that has no place in modern society and should be eradicated as a matter of priority," said the ILO.

"While progress is being made in reducing state-imposed forced labour, we must now focus on the socio-economic factors that make people vulnerable to forced labour in the private sector," said Beate Andrees, head of the

ILO's Special Action Programme to Combat Forced Labour, in the press release.

Andrees recommended a series of measures to reduce vulnerability to forced labour. These include bolstering social protection floors, investing in education and skills training, promoting a rights-based approach to migration, and supporting the organization of workers, including in sectors and industries vulnerable to forced labour.

"If we want to make a significant change in the lives of the 21 million men, women and children in forced labour, we need to take concrete and immediate action," said ILO Director-General Ryder.

"That means working with governments to strengthen law, policy and enforcement, with employers to strengthen their due diligence against forced labour, including in their supply chains, and with trade unions to represent and empower those at risk," he added. *(SUNS7808)* ❐

Low-wage workers butt heads with 21st-century capital

Calls in the US to raise the minimum wage are riding the wave of renewed international debate on economic inequality.

by Peter Costantini

SEATTLE: "Supersize my salary now!" The refrain rose over a busy street outside a McDonald's in downtown Seattle.

A young African-American mother carrying a little girl told the largely youthful crowd that she had walked off the job to join them because "we're getting tired of being pushed around". Her five-year-old took the microphone in both hands with a big grin and led a spirited chant: "We're fired up, can't take it no more!"

Green signs sported a hashtag, "Strike poverty 5-15-14 #Fast FoodGlobal", red T-shirts reasoned "Because the rent won't wait –15 now", and a blue banner exhorted "15 dollars an hour plus tips. Don't steal our wages."

A few hundred ethnically diverse demonstrators filled a sunny afternoon with demands that fast-food chains pay a living wage. Seattle City Council member Kshama Sawant said that workers in over 150 cities, including her hometown of Mumbai, India, had walked off their jobs that day.

Fast-food worker Sam Laloo spoke: "I believe in this movement because I'm trying to save enough to go to college and better myself. And I can't go to college because I don't make enough money. So it's a Catch-22."

According to the organizers, the protest was linked with fast-food worker actions in over 30 countries by coalitions of worker centres, labour unions, community groups and faith organizations.

This prosperous Pacific Northwest seaport, though, is the place in the US closest to actually raising the minimum wage for all workers to something approaching a living wage.

From the current Washington state minimum wage of $9.32 an hour – already the highest in the country – Seattle's mayor, city council and a majority of citizens according to some polls all support ratcheting up the wage over 60% to $15.

The debate now centres on how long the ramp-up period should be for different-size businesses and non-profits, whether benefits and tips will be included in the wage, and other implementation details.

Seattle would seem a promising test case for these efforts. Home to Boeing, Microsoft and Amazon, the metropolitan area boasts relatively low unemployment and burgeoning technology jobs with good salaries. The electorate votes heavily Democratic and organized labour wields some influence.

Nationally, President Barack Obama has proposed an increase in the federal minimum wage. Democrats introduced legislation in both houses of Congress to raise it from the current $7.25 an hour to $10.10 an hour over two years, and index it to inflation thereafter. Recent national polls show strong support for the raise, even among conservatives. But the proposal was filibustered by Senate Republicans, throwing the initiative back to states and localities.

From its establishment in 1938 through 1968, the national minimum wage roughly tracked inflation and productivity. But sporadic increases since then have failed to keep up with prices, leaving the current inflation-adjusted wage below its 1968 high.

Meanwhile, the standard has fallen far behind productivity growth: had it kept pace, by 2012 it would be nearly three times as high, $21.72 instead of $7.25.

To bypass the federal stalemate, state and local efforts to raise minimum wages have proliferated since the 1990s.

Twenty-six of the 50 states have raised or are raising their base wages above the federal level, with increases scheduled in eight states and the District of Columbia. More than 120 cities have also raised their benchmarks, and efforts are underway in San Francisco, Oakland, Los Angeles, San Diego, Chicago, New York and Portland, Maine.

The inequality threat

This resurgent movement to raise the floor of the labour market is surfing the zeitgeist of renewed international debate on economic inequality.

Capital in the Twenty-First Century, the chef d'oeuvre of French economist Thomas Piketty, has levitated to number one on the *New York Times* non-fiction bestseller list. Piketty documents "forces of divergence" in modern capitalism driving current levels of wealth concentration unequalled since the 1920s. To remedy some of the "potentially terrifying" consequences, he proposes a global tax on wealth.

Piketty is no prophet crying in the wilderness. Institutions as influential as the International Monetary Fund (IMF) and the US Federal Reserve Bank have joined the chorus.

IMF managing director Christine Lagarde has flagged growing income inequality as a threat to stability, and called for policies to reduce poverty and advance "inclusive" growth. Fed chair Janet Yellen has called "a huge rise" in income inequality "one of the most disturbing trends facing the nation".

Both the IMF and the Organization for Economic Co-operation and Development (OECD) have recently recognized that moderate minimum wage raises may be beneficial.

As a non-fiscal policy not requiring direct outlays by cash-strapped governments, minimum wage hikes have proven attractive even to some on the right.

The Economist magazine, a British champion of market hegemony, has swung from opposition to grudging acceptance that measured minimum wage increases can do more good than harm. Another business-friendly voice, the US news service Bloomberg, has editorialized in favour of raising the national minimum.

Conservative British Finance Minister George Osborne recently advocated an increase in the UK base wage. And centre-right Chancellor Angela Merkel approved Germany's first minimum wage legislation in April, setting the benchmark at €8.50 ($11.75) in 2015.

Increased costs

As the minimum wage in much of the US falls ever farther behind the economy, labour-market undertows have constrained increasingly older and more-educated workers to take low-wage jobs: In 2011, only 12% of workers making less than $10 an hour were under 20 years old and only 19.8% had not completed high school, a drop of roughly one-half for each measure since 1979; the proportion with at least some college education increased more than two-thirds to 43.2%.

Nevertheless, some politicians and business groups confront each proposed minimum wage increase with a chorus that it will destroy jobs. Historically, though, the predicted damage has yet to materialize. After decades of experience, rigorously empirical studies have consistently found no significant effects on employment due to minimum wage increases at national, state or local levels.

Increased costs to businesses have been absorbed mainly through very small price increases. Other means of reducing costs have included increased productivity through lower turnover and absenteeism, better organizational efficiency, compression of the wage scale, and sometimes slightly reduced average hours.

These trends held even for Santa Fe, New Mexico, after its 65% minimum

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World economy forecast to accelerate moderately

The UN has projected an upturn in the world economy over the next two years, although a downward revision has been made to the forecasts for developing and transition economies.

by Kanaga Raja

GENEVA: The world economy is expected to accelerate over the next two years, with updated growth rates of 2.8% in 2014 and 3.2% in 2015, the United Nations has reported.

In its mid-year update of the *World Economic Situation and Prospects 2014* report, the UN said that these updated growth rates are slightly lower than its earlier forecast made in January.

(In its January report, the UN had forecast the global economy to grow at a pace of 3.0% in 2014 and 3.3% in 2015. See *TWE* No. 562.)

According to its latest report, released on 21 May, a downward revision has been made mainly in the growth projections for developing economies and the economies in transition, as the situation in a number of countries in these two groups has somewhat deteriorated.

With the projected growth rates of 4.7% and 5.1% for 2014 and 2015 respectively, developing countries as a whole will continue to contribute a large proportion to global growth.

"However, this growth trajectory is lower by two percentage points than what the developing countries had registered for a number of years prior to the global financial crisis," said the UN, noting that the downward revision in the growth for the economies in transition is even more pronounced.

As demonstrated in the two recent episodes of financial turbulence in mid-2013 and early 2014, a number of developing countries are vulnerable not only to the international spillovers from the adjustments in monetary policies by major developed countries, but also to quite a few country-specific challenges, including structural imbalances, infrastructural bottlenecks, increased financial risks, incoherent macroeconomic management, as well as political tensions, said the report.

Growth in the developed economies is projected to be 2.0% and 2.4% for 2014 and 2015 respectively, about one percentage point higher than in the previous two years. For the first time since 2011, all major developed economies in North America, Europe and developed Asia are aligned together on the same upward growth trajectory, forming, hopefully, a virtuous cycle to reinforce their recovery, said the UN.

"Nevertheless, after five years of being mired in the aftermath of the financial crisis, these projected growth rates are insufficient to recuperate the output and job losses in most of these economies. They are still confronting a number of challenges, including the remaining fragilities in the euro area, the elevated unemployment rates in some of these economies and unsustainable public finances in the longer run," it added.

Trade and capital flows

Turning to international trade flows, the UN reported that world trade growth has been flat in the first quarter of 2014, but that some gradual improvement is expected over the course of the year as import demand in major developed countries continues to gradually increase.

Real exports are forecast to grow by 4.1% in 2014, almost twice as fast as in 2013, but still below the pre-crisis trend of double the global output growth. Further improvement is expected to continue into 2015, with export growth rising to 5.1%.

With respect to capital flows, the report said that as the United States Federal Reserve gradually scales back its monthly asset purchases, developing countries and economies in transition have seen a marked reduction in capital inflows in 2013 and early 2014, remaining exposed to sudden changes in financial market sentiment. However, the episode in early 2014 differed from the one in mid-2013 in several respects.

First, said the UN, the abrupt change in market sentiment was not triggered exclusively by a shift in views about the Fed's policy path, but by a combination of factors, including fears of a larger-than-expected slowdown in emerging economies. Second, the recent sell-off of emerging-market assets was mainly limited to equities, reflecting a flight to safety, with long-term US interest rates retreating. Third, the latest market correction was smaller and shorter in duration, with investors discriminating more among emerging economies.

In its outlook, the UN said that capital flows to emerging economies are projected to pick up slowly from the low levels seen in recent quarters, in line with the expected recovery in global growth. However, significant uncertainties and downside risks stem from the interaction between perceptions of the Fed's tightening path and the idiosyncratic weaknesses in some emerging markets.

Developed and transition economies

Highlighting economic trends by region, the report said that in the United States, the growth momentum built in the second half of 2013 weakened notably in the first quarter of 2014, mainly because of inclement weather, but growth is expected to pick up going forward, with GDP expected to grow by 2.5% and 3.2% in 2014 and 2015, respectively.

"Both private consumption and business investment are expected to increase at a stronger pace than in the past two years, along with a continued improvement in the labour market and the housing sector. Monetary policy is expected to remain highly accommodative during 2014 and into 2015, while fiscal policy will be less restrictive than in the previous year. The external conditions for the United States economy are expected to improve, but only slightly, as foreign demand from major trade partners is expected to remain relatively weak," said the report.

The Japanese economy expanded by 1.5% in 2013 and is projected to expand by 1.4% and 0.9% in 2014 and 2015, respectively. The fiscal stimulus package introduced in 2013 supported growth, but this stimulus is set to fade out. In April 2014, with an increase in the sales tax, the government has also provided for more expenditure through a supplementary budget, but the magnitude is not enough to fully offset the negative impact of higher taxes, said the report.

Western Europe emerged from recession in the second quarter of 2013, whereby in the EU-15, GDP is expected to grow by 1.5% in 2014 and 1.8% in 2015.

The report said that since the announcement of the European Central

Bank (ECB)'s Outright Monetary Transactions facility in September 2012, financial tensions in the region have subsided significantly and confidence has rebounded. Fiscal austerity programmes have lessened in intensity and balance sheet repair, while ongoing, is also less of a drag on activity.

"The recovery remains weak, with GDP still below its pre-crisis level," said the UN, adding that the weakness of the recovery is also a major factor behind the dire unemployment situation, in that in the EU-15, unemployment was 11.1% in 2013 and is only expected to stabilize in 2014, before coming down to 10.6% in 2015.

With regard to the new EU member states, the UN reported that the recovery in these economies is firming against the backdrop of stronger activity in the EU-15, a modest pick-up in domestic demand, less fiscal drag and a turnaround in the inventory cycle.

All countries in the region are expected to register positive growth in 2014, with the exception of Croatia. The aggregate GDP of the new EU member states is expected to grow by 2.4% in 2014 and by 2.9% in 2015.

According to the report, the CIS (Commonwealth of Independent States) region continues to face a challenging international environment and, in addition, many countries are confronted with domestic challenges and risks.

Several large CIS economies stagnated in early 2014, said the UN. Growth in the Russian Federation, which has a strong influence over the region, was already disappointing in 2013 and the conflict around Crimea and the possibility of economic sanctions targeting broader sectors of the Russian economy have led to a massive outflow of capital and further weakening of business and consumer confidence.

Depreciation of the currency in early 2014 added to inflation, undermining private consumption, and the resulting hike in the policy interest rates will further curb private investment, it added.

In 2014, growth in the Russian Federation is expected to be very low, despite fiscal expenditure on a number of infrastructure projects, while the economy of Ukraine is expected to shrink in 2014 because of the political crisis, weakness in private consumption, disruptions in trade flows and significant fiscal retrenchment. By contrast, economic expansion, driven by commodity exports, is expected to continue in Central Asian economies.

The aggregate GDP growth of the CIS and Georgia is expected to decelerate from 2.0% in 2013 to 1.6% in 2014, strengthening only modestly to 2.3% in 2015.

Developing economies

Among developing economies, Africa will continue to see solid growth of 4.2% this year, although political problems in a number of countries have led to a downward revision compared to the previous forecast, said the UN, citing the example of Libya where disruptions to oil output and exports will be a major drag on growth, underpinning a significantly lower growth rate for North Africa than previously forecast.

In 2015, overall growth (in this region) will accelerate to 5.1%, carried by some rebound in North Africa in view of a recovery of oil exports in Libya and stronger growth in South Africa underpinned by solid export demand and increasing consumption and investment.

"East Asia is expected to see robust growth as exports to developed countries strengthen and domestic demand in most economies remains firm. Economic activity in the region is projected to expand by 6.0% in both 2014 and 2015, the same pace as in 2013 and a marginal downward revision from the previous forecast."

China's growth rate is expected to moderate further over the next few years, with GDP projected to expand by 7.3% in 2014 and 7.1% in 2015, down from 7.7% in 2013, the report said, emphasizing that this lower growth trajectory is in line with the government's focus on raising the quality of development and economic restructuring.

The UN further said that Thailand is the only country in the region for which the short-term outlook has deteriorated sharply since the release of its earlier report in January – with the continuing political unrest taking an increasing toll on domestic demand, Thailand's GDP growth is projected to drop to about 2% in 2014.

"The slowdown in China and Thailand will likely be offset by a pick-up in growth in the region's most export-oriented economies, which benefit significantly from stronger demand in the United States and the European Union."

The report said that governments in this region are expected to maintain their current prudent fiscal policy stances, and that against the backdrop of improved global conditions, higher interest rates in the United States and a slight acceleration in domestic inflation, central banks may start tightening monetary policy in the latter part of the forecast period.

With regard to South Asia, the UN said that average economic growth here is projected to pick up gradually in the forecast period, after remaining near a two-decade low in 2013, with GDP estimated to expand by 4.6% in 2014 and 5.1% in 2015, up from 3.9% in 2013.

"The moderate recovery is expected to be underpinned by stronger consumption and investment in the context of enhanced macroeconomic stability. Several of the region's economies, including India, have seen lower inflation, stronger external balances and more stable currencies in recent quarters, conditions that are expected to support business and consumer confidence."

The strength of the recovery in South Asia will, however, be restricted by structural impediments, including energy and transport constraints, political unrest and violence, and a lack of economic policy reforms, it said.

India's economy is forecast to grow by 5% in 2014 and 5.5% in 2015, only slightly up from 4.8% in 2013, while the Islamic Republic of Iran is projected to see a return to mildly positive growth in 2014 as the partial lifting of sanctions will help non-oil exports. Economic growth is also expected to pick up slightly in Bangladesh and Pakistan, supported by increases in remittance inflows and a slowly improving investment climate, while Sri Lanka remains the region's fastest-growing economy, with annual growth forecast to stay above 7% in the outlook period.

Economic growth in Latin America and the Caribbean is expected to continue at a subdued pace in 2014, amidst increasing difficulties in some of the largest economies, with the region expected to grow moderately by 2.6% in 2014, although with significant heterogeneity across sub-regions.

Economic growth in Mexico and Central America is strengthening, benefiting from the pick-up in activity in the United States, with Mexico expected to grow by 3.2% in 2014, accelerating from growth of 1.1% last year.

By contrast, growth in South America is decelerating markedly from 3.2% in 2013 to 2.1% in 2014. Argentina is experiencing a noticeable slowdown, amidst decreasing business confidence and persistent inflation pressures, while Venezuela is likely to enter into recession, said the report. Brazil's economy continues to expand at a very moderate rate of 1.7% in 2014, with meagre prospects for investment demand and increasing pressure for fiscal consolidation. Other South American countries such as Bolivia, Colombia and Peru continue on a more solid growth path.

Meanwhile, growth in the Caribbean is expected to accelerate to 3.6% in 2014, and despite the continuing subdued growth, the unemployment rate is expected to remain relatively low.

According to the report, the least developed countries (LDCs) will see solid and accelerating growth in 2014-15, benefiting from favourable external demand conditions. In 2014, LDCs are expected to expand by 5.6%, a further increase from the rate of 4.8% and 5.3% achieved in 2012 and 2013, respectively.

Quantitative easing question

An important risk factor for global growth and financial stability remains the future adjustment in monetary policies by major developed countries, particularly quantitative easing (QE), said the report. Since its introduction after the eruption of the global financial crisis, QE has already created numerous forms of spillovers in the global economy.

For example, in earlier years, lower interest rates in developed countries underpinned capital flows to higher-yield markets especially in emerging economies, accompanied by upward pressure on exchange rates and pressure on the competitiveness of exports. Most recently, the prospect of a US exit from QE and higher interest rates led to capital outflows and a sharp depreciation of currencies in developing countries, as evidenced in mid-2013 and early 2014.

In the outlook, the UN said that as the QE of the United States is expected to be phased out in late 2014 and policy interest rates are expected to increase in mid-2015, this could lead to overshooting in long-term interest rates worldwide, selling off in global equity markets, outflows of capital from emerging economies, an increase in external financing costs for developing countries, and further depreciation of currencies for emerging economies.

"As a result, developing countries and economies in transition could face more painful adjustments and the moderate global growth could be derailed."

The withdrawal and unwinding of QE measures constitutes a major policy challenge in terms of the precise design and timing of individual actions. At the operational level, policymakers need to determine the magnitude and schedule of the reduction in asset purchases; decide on whether and at what pace to reduce their asset holdings; and tie this in with the future path of policy interest rates, said the report.

"To reduce the risks for global growth and financial stability, policymakers should pursue a clear communication strategy that provides concise guidance and effectively manages market expectations. In addition, policies explicitly need to take into account the risk of a premature withdrawal in the form of a more pronounced weakening of the economic recovery as well as the possibility that a delayed unwinding could drive up asset prices to unsustainable levels."

In developing countries, said the report, the challenge lies in dealing with the possible spillovers from the unwinding of QE in developed countries. This applies especially to those countries that are highly exposed to international capital markets and run large external imbalances financed by short-term external capital inflows.

In the euro area, it said that the systemic risks have subsided dramatically since the ECB announced its Outright Monetary Transactions in August 2012. Despite having never been deployed, its mere existence has broken the negative feedback loop between weak banks and weak government fiscal positions.

Nonetheless, significant fragilities remain, said the report, pointing out that the banking sector remains under stress, and that lending conditions remain heterogeneous across the region with overall credit to the private sector still declining.

In addition, said the report, the ECB and the European Banking Authority are currently performing a major Asset Quality Review and stress tests for a large sample of the region's banks. These are expected to find a need for significant recapitalization of some banks, with a question of who will pay for this.

If governments were to be required to finance a large portion of this recapitalization, the negative feedback loop could re-emerge, it added. *(SUNS7814)*❒

Defending consumers and public services against corporations

Opposition is growing across Europe to a planned trade pact with the US that critics fear would enshrine undue corporate privilege and undermine social and environmental standards.

by Julio Godoy

BERLIN: For many months, the Transatlantic Trade and Investment Partnership (TTIP) debates between the European Commission (EC) and the US government were a matter for insiders.

In July 2013, government officials and representatives of international corporations agreed behind closed doors that such a free trade agreement (FTA) would be a great step forward towards homogenizing social, environmental, health, industrial and labour standards across the Atlantic Ocean.

Until recently, only a handful of civil society organizations, mostly based in Brussels, questioned the wisdom of such an agreement and revealed the secret dealings of governments, in particular those referring to the so-called "investor protection clauses" and the downgrading of social and environmental standards in Europe, to the detriment of European consumers and parliaments.

But, under pressure from civil society groups, the EC agreed earlier this year to launch a process of public consultation on the TTIP. And, since early May, after demonstrations by numerous consumer, environmental protection and labour groups, the TTIP has become a theme debated across society. Criticism of the way the EC and the US government, in close cooperation with corporate lobbyist groups, have managed the secret negotiations is now general.

By early May, some 500,000 people in Germany alone had signed a petition against the TTIP, complaining that the agreement would "undermine democracy and the rule of law ... endanger our health ... and [would be] practically irreversible."

Even sectors of governments have become outspoken critics of the agreement. During a conference on the TTIP held in Berlin on 20 May, the German Minister of State for Culture and Media, Monika Gruetters, said "we Europeans have plenty to lose" if the FTA with the US were to forbid state subsidies for theatre, music, public radio and cinema production.

Gruetters even used a slogan typical of anti-globalization activists, by saying that "culture is not a commodity." That's why, Gruetters explained, European states subsidize cultural production, "to permit arts to be critical, complex [and] heterogeneous".

However, she said, for the US government such subsidies are "protectionist measures". To confirm this view, Gruetters quoted a "recent conversation" she had with the US ambassador to Berlin, John B. Emerson.

"State privileges for cultural production belong to the European self-conception," Gruetters insisted. "We oppose a new deregulation of culture [as demanded by the TTIP] because we are afraid we would lose our unique cultural landscape."

Investor protection clause

German Minister for Economic Affairs and Energy, Sigmar Gabriel, has also adopted the critical position of civil society groups against the investor protection clause that makes up the bulk of the TTIP. According to this clause, transnational corporations would be allowed to challenge national labour, health, environmental and other standards before non-governmental tribunals. The deliberations of such tribunals are secret and their verdicts are definitive and cannot be appealed against.

Pia Eberhardt, expert for trade and investment at the Corporate Europe Observatory (CEO), says that transnational companies around the world "are using such clauses contained in practically all FTAs to claim compensations for perfectly legitimate government policies to protect health, the environment and other public interests – because they claim these policies have the indirect effect of undermining corporate profits".

The Brussels-based CEO, an anti-lobbying watchdog organization, is one of the leading civil society groups questioning the TTIP. It has forced the European Commission to reveal secret protocols of the deliberations between European and US government officials, and has also shown that the EC most of the time adopts the positions presented by industrial lobbyists as its own.

A typical example of such corporate actions against states is the ongoing lawsuit that US tobacco company Philip Morris, based in Switzerland, launched in 2010 against Uruguay. Philip Morris is demanding $2 billion as compensation for alleged economic losses from Uruguay, claiming that the South American country's anti-smoking legislation devalues its cigarette trademarks and investments.

In a similar case, the oil and gas company Lone Pine Resources is suing the Canadian government for $250 million for, as the company's lawsuit puts it, the "arbitrary, capricious and illegal revocation of [Lone Pine Resources'] valuable right to mine for oil and gas under the Saint Lawrence River". In 2012, Quebec's regional government suspended fracking, the controversial method to exploit shale gas fields. According to Lone Pine Resources, the measure violates Chapter 11 of the North American Free Trade Agreement (NAFTA).

For civil society groups in Canada, such a lawsuit is "outrageous".

"Based on the principle of precaution, the Quebec government's response to the concerns of its population is appropriate and legitimate," said Martine Chatelain, president of Eau Secours!, the Quebec-based coalition for a responsible management of water. "No companies should be allowed to sue a State when it implements sovereign measures to protect water and the common goods for the sake of our ecosystems and the health of our peoples."

For Maritta Strasser, a leading activist behind the German petition against the TTIP, the investor protection clauses are "a tool to blackmail legitimate governments and parliaments".

Strasser's fears are well founded. As a former Canadian government official has been quoted as saying, "I've seen the letters from the New York and DC law firms coming up to the Canadian government on virtually every new environmental regulation and proposition in the last five years. They involved dry-cleaning chemicals, pharmaceuticals, pesticides, patent law. Virtually all of the new initiatives were targeted and most of them never saw the light of day."

For Eberhardt of CEO, the lawsuits against governments prove that FTAs "create two different systems of justice. One full of privileges for corporations, and another one for the rest of the society."

Many consumer groups are also concerned that the TTIP would facilitate the import into the European Union of US foodstuffs that otherwise would not satisfy present European health standards, such as genetically modified agricultural products, or hormone- or chemically-treated meat and poultry.

By now, even for German Economic Affairs Minister Gabriel, "it is inconceivable that an investor protection clause would annul German or European laws". Gabriel also opposes non-governmental tribunals ruling over conflicts between governments and corporations.

"Both the United States and Europe are democratic state structures that guarantee the rule of law," Gabriel said. There is no reason, then, "to allow special jurisdiction tribunals to rule over our laws and over our social, environmental and health standards".

He also demands that from now on the negotiations between the EU and the US government be "carried out in the most transparent way", adding that "if the European Commission believes that it can leave the national parliaments out of the negotiations, then the TTIP will be a sound failure".

This has not, however, dented European Trade Commissioner Karel de Gucht's interpretation of the negotiations. "The US government demands that the TTIP negotiations remain confidential and that the agreement contains an investor protection clause," he told the German ZDF public television channel.

The result is that most of the protocols of the negotiations continued to be classified, as demanded by the US government, and only private corporations and a restricted number of European government officials and members of the European Parliament have access to the documents. *(IPS)* ❐

Enhanced attention for trade finance

Trade finance – disruptions in which were said to have contributed to the slowdown in trade during the early stages of the global economic crisis – is the subject of a wide-ranging new study which surveys the trends and developments concerning this form of financing.

by Andrew Cornford

Trade finance has recently begun to receive enhanced attention outside the ranks of practitioners and other specialists. The new attention has various causes. Reduced availability and the increased cost of trade finance has been accorded an important role in the slowing of the growth of world trade during the earlier part of the current crisis. These changes in availability and cost in turn are attributed partly to new bank regulations, in particular Basel II. Moreover, somewhat belatedly, the trade-finance industry realized that its lobbying regarding new bank regulations needed to be supported by more systematic data and argumentation. Partly in response to the greater lobbying directed at Basel II and Basel III, the Basel Committee on Banking Supervision (BCBS) now appears more sensitive to the impact of bank regulation on trade finance, and has amended the rules of the Basel capital framework to meet some of the concerns expressed by the industry.

The Committee on the Global Financial System (CGFS), one of the bodies associated with the Bank for International Settlements in Basel, recently released a wide-ranging report of a study group on trade finance (CGFS, 2014). The report covers not only trends in the markets for trade finance, including developments during the current crisis, and the recent recourse to different forms and instruments of trade finance but also shortcomings of existing data, the impact of regulation, and the development by banks of new ways of supporting trade finance. Some topical subjects such as the provision of trade finance for global value chains and possible effects of fluctuations in the availability of trade finance on financial stability are addressed in the report. But there are also omissions concerning access for some developing countries to trade finance and the implications for trade finance of major trends in the regional distribution of global trade.

Trade finance since the crisis

Global trade decreased sharply in 2008-09. Between the fourth quarters of 2007 and 2008 goods exports declined by about 10%, and between the fourth quarter of 2008 and the second quarter of 2009 the decline accelerated to a pace of about 15%. Estimates of trade finance indicate that these declines were accompanied by contractions in trade finance of 1.9% and 7.5%.

The CGFS commentary on the role of trade finance during the early part of the crisis follows that of industry and International Monetary Fund (IMF) surveys published closer in time to the events. The decline in trade is viewed here as reflecting primarily aggregate demand and prices of traded goods. Movements in these variables would themselves have affected, but without fully explaining, observed changes in the amount of trade finance, i.e., bank products specifically linked to international trade transactions. Moreover – a point to which less attention is paid in the literature on the trade downturn – fluctuations in trade finance do not fully reflect those in total bank credit supporting international trade, which also includes inter-firm credit most importantly associated with open-account transactions where goods are shipped in advance of payment and the financing of working capital during the production of goods eventually moving in international trade (as explained in the box below).

Despite the inadequacies and definitional problems of available data concerning trade finance, the CGFS nonetheless concludes, "A general picture that emerges from the literature is that trade finance disruptions had a secondary but economically significant role in the sharp reduction in trade volumes in the quarters following the Lehman bankruptcy … But given the magnitude of the reduction in trade volumes, even a secondary role implies an economically significant impact on trade and economic activity" (CGFS, 2014: 23). Academic studies suggest that 15-20% of the decline in trade during the crisis was due to "credit shocks", the financing of working capital as well as trade finance proper being included under this heading. Statistical analysis carried out for the CGFS broadly agrees with this conclusion.

The less drastic slowdown in global trade in 2011-12 was also accompanied by parallel developments in trade finance. Major countries which experienced contractions in their trade during the period from the second quarter of 2011 until the second quarter of 2012 also witnessed stagnation or declines in trade finance – with especially large declines in both trade and trade finance in Germany, Italy and Spain. However, the intensification of the eurozone crisis in 2011 did not have spillover effects on global trade finance.

More detailed analysis of trade finance during the crisis is provided in reports of surveys conducted by the IMF and the industry. The crisis was associated with changes in trade finance which varied substantially amongst regions as well as with variations in the relative importance of different categories of trade finance. For example, data from surveys of a sample of banks conducted by the IMF and the Bankers' Association for Finance and Trade–International Financial Services Association (BAFT-IFSA) suggest that banks in Asian and Latin American developing countries were more likely than those in other regions to have increased the value of their trade finance in both 2008 and 2009, a clear majority of banks in one group of Asian countries (China, India, Indonesia, Malaysia, the Philippines, Thailand and Vietnam) actually increasing the value of their trade finance during this period (Asmundson et al., 2011: Appendix I). Moreover a survey by the International Chamber of Commerce (ICC) found a resurgence in the demand for traditional trade finance instruments, especially letters of credit (ICC Banking Commission, 2009: 34-35; ICC Banking Commission, 2010: 33).

These shifts in the value of trade finance no doubt reflect partly responses to the generalized increased risks during the crisis. But they are likely also to reflect shifts in trade shares during the crisis since there is wide variation among countries in their use of trade finance (CGFS, 2014: 9-12). Moreover data collected on a comparable basis also suggest reliance of the Asia-Pacific region on trade finance which is greater than its share of global trade would suggest. This region accounts for more than one half of letters of credit and overall exposures to trade finance, while the corresponding figure for Europe is one quarter and those for North America, Latin America, Africa and the Middle East 5-10%. In economies classified by the CGFS as emerging markets for which data are available, local banks account for the largest shares of bank financing in support of trade. In India, for example, in 2012 local banks (including foreign subsidiaries) provided about 80% of trade finance, and for Brazil the corresponding figure was about 70%.

Definitions and coverage of trade finance

The CGFS study devotes an appropriate amount of attention to the terminology of trade finance. This terminology is typically unfamiliar to non-specialists. Moreover, understanding the shortcomings of available data on trade finance requires a grasp of this terminology.

Frequently used terminology for payments and financing for international trade

Cash in advance. Here the seller receives payment before shipping the goods. Such transactions may be covered by a loan to, or the credit line of, the importer.

Open account. Goods are shipped to the buyer and title documents and the invoice calling for payment within a stipulated period of time are mailed separately. The lag between shipment and payment may require the extension of credit during the period involved. Such credit may be through a banker's acceptance under which the bank accepting a draft assumes the obligation of making the payment at maturity on behalf of the buyer.

Both cash in advance and open account may involve inter-firm trade credit between importers and exporters, of which the counterpart may be credit extended to the lender by a bank. Reliance on inter-firm credit in international trade is more common among firms with well-established commercial relations, among the constituent entities of multination enterprises, or at least where the buyers are in jurisdictions with reliable frameworks for the collection of receivables.

Documentary collections (which include **documents against payment** and **documents against acceptance**). The documents conferring title are released on payment, or on acceptance of a time draft which indicates a commitment to pay at an agreed future date. The lag between the release of documents and payment by the importer may be covered by the extension of credit to the exporter by a bank that is party to the transaction. In the case of documents against payment, where funds are remitted almost immediately, financing can be extended to the importer, allowing a delay in the reimbursement of funds to the bank effecting payment.

Letter of credit (L/C). A documentary or commercial letter of credit is an instrument typically issued by a bank on behalf of an importer in favour of an exporter, and represents a payment undertaking by the issuing bank to the exporter. An L/C constitutes a promise to make payment or to accept drafts (representing payment at an agreed future date) upon receipt of documents conforming exactly to the conditions set out in the letter of credit. The documents submitted typically include drafts, commercial invoices, packing lists, transport documentation (which may be a negotiable instrument), certificates of inspection, a certificate of insurance and, in general, any document required to evidence the exporter's compliance with L/C terms. A bank's commitment to pay is enforceable only when the exporter fulfils all the conditions specified in the L/C. The L/C can serve as the basis for an application for financing by the exporter during the period before payment is received from the importer. Security of payment under an L/C can be increased through confirmation by a bank other than that which originally opened or issued the L/C. Confirmation will usually be by a bank in the exporter's jurisdiction, and since the obligation to pay of the confirming bank is added to that of the issuer, it relieves the exporter of the risk of non-payment by the issuing bank in the importer's country.

In countries where there are restrictions on banks' extension of guarantees, stand-by letters of credit may be issued to serve much the same purpose. Here the demand for payment is usually based on a statement of default by the party from whom payment is due rather than the documents associated with the traditional commercial L/C.

The terms above refer to longstanding techniques of payments and financing classified under the heading of trade finance. The study of the CGFS also draws attention to some recent techniques which may or may not be classified in surveys or banks' returns as trade finance.

The **bank payment obligation (BPO)** is a payment method offering a level of security similar to that of a letter of credit. The BPO is an irrevocable undertaking on the part of an obligor bank (typically that of a buyer) to recipient bank (typically that of a seller) to pay a specified amount on an agreed date on condition of a successful matching of electronic data according to rules adopted by the ICC. The BPO greatly simplifies the informational requirements in comparison with those of the L/C.

Recently global supply or value chains have been attracting increased attention amongst those concerned with trade finance. The needs of enterprises involved in such chains can now be met through **supply chain finance (SCF)**. Under this heading banks provide technology and other services to facilitate payments and financing within such chains. The services within an SCF platform include typical elements of financing for international trade (such as pre-shipment and post-shipment financing, purchases and discounting of receivables, etc.) but not L/Cs. The objective of such a platform is to bring within a single unit of a bank financial services related to supply, storage, cross-border relations between sellers and buyers, distribution, and final sales to customers (Advisory Services International Inc. and SWIFT, 2013).

In statistical data on trade finance the transactions have traditionally been classified under the heading of arrangements which usually involve both payments and financing. Terms for typical payments and financing options are listed in the accompanying box. However, these data cover only part of the financing arrangements actually employed as part of international trade.

In practice much international trade is financed through unsecured credit lines available to companies of good standing from their banks, such facilities frequently being extended without collateral. The purpose for which such lines are used is not necessarily specified in the documentation covering short-term unsecured borrowing, which may be classified under "general corporate purposes" or "working capital". The borrowing firm may not be required to distinguish between those raw materials or finished goods purchased at home and those purchased abroad. For medium-term unsecured financing of this kind (used, for example, for buying equipment or for carrying longer-term receivables) there is usually a written agreement specifying the purpose and terms of the loan but not necessarily whether it will be used partly or wholly to finance imports or exports.

Thus, identification of trade financing in the form of multi-purpose or unsecured credit can be difficult. Indeed, the use of such facilities is rarely linked by lenders to trade finance, and is most likely to be managed in portfolios of commercial or corporate bankers as opposed to being recorded and managed as part of institutions' trade finance portfolios.

Indeed, generic facilities available to borrowers and used in support of their import and export activities are not, in the vast majority of cases, included in the specialized and more esoteric instruments referred to as trade finance nor are they classified under this heading. In industry parlance the term "trade finance" usually refers to financing which covers transactions with tenors up to 18 to 24 months. Transactions involving longer maturities are categorized as medium-term trade finance, and the financing of more complex transactions such as capital projects with time frames which may extend to many years is classified as project finance.

In the case of trade finance involving contingent liabilities [such as letters of credit (L/Cs)] the issuing institution faces exposure if the liability party fails to meet its financial obligation. Such contingent liabilities are counted among a bank's off-balance-sheet exposures and are thus included in the rules of the Basel capital framework.

Information on the costs of trade financing from private sources is not available on a uniform, systematic basis. This is partly due to the nature of trade finance, which comprises a variety of financing and payment structures designed to address a wide range of risks. Furthermore there is no industry-wide impetus or effort regarding publication of trade financing costs in a systematic or organized fashion.

As indicated by such data as are available, the costs and other terms of trade finance lending and the rates of interest on other categories of the financing of international trade are determined by risk premiums, the amount of banks' capital allocated to trade finance, and the way in which the trade financing is structured.

Data on trade finance

As the CGFS report notes, "There are no readily available data covering the global bank-intermediated trade finance market … This constrains the meaningfulness of simply aggregating available measures to arrive at a global stock of bank-intermediated trade finance and suggests instead an approach that treats each data source as providing a partial window into aspects of the bank-intermediated trade finance activity being conducted in that country or market segment" (CGFS, 2014: 5). The main data sources include surveys by industry bodies – sometimes in cooperation with official multilateral bodies – transactional data collected by industry bodies, and fragmentary information at a national level.

Surveys of trade finance in recent years by the ICC, the most important of the bodies conducting such surveys, contain both quantitative and qualitative information based on samples of banks. The ICC's samples have been increasing in size and in 2012 included 229 banks in 110 countries as compared with 2010 coverage of 161 banks in 75 countries (ICC, 2013a: 12). Even in the case of the institutions included in these surveys, the information does not cover all the financing which banks extend in support of trade transactions since it is based on data from the departments of banks specializing in trade finance and thus, for reasons explained above, misses such items as financing provided for inter-firm trade and working capital for trade transactions. Some of the earlier overall surveys of the ICC were conducted in cooperation with the IMF and BAFT-IFSA.

Data on trade finance provided by banks in emerging markets are available in the quarterly Emerging Markets Bank Lending Conditions Survey of the Institute of International Finance. This survey is addressed to senior loan officers, chief credit officers, credit risk officers or other senior officers in equivalent positions in banks based in emerging economies. The data are based on replies to questions as to changes in the willingness of the banks included in the surveys to supply international trade finance and as to changes in the demand for international trade finance from the banks' clients. The coverage of trade finance in these questionnaires is not specified.

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) provides the communications infrastructure through which the majority of documentary (commercial and stand-by) letters of credit and documentary collections instruments (and their related messaging and payment flows) are transmitted between financial institutions across the globe. SWIFT is a cooperative organization owned by banks which is designed to facilitate the exchange of payments and certain other financial messages between financial institutions throughout the world. A SWIFT payment message is only an instruction to transfer funds. Actual transfers are carried out through payment systems or correspondent banks, though issuance of a message does entail a liability to the disbursing bank (Stigum and Crescenzi, 2007: 854).

The principal source of aggregate data concerning export credit insurance is the International Union of Investment Insurers, better known as the Berne Union. Membership of this body includes the world's major private credit insurers and national export credit agencies.

Short-term (ST) insurance for trade transactions with repayment terms of one year or less is provided by both private and public members of the Berne Union. Data for such insurance from the Berne Union cover credit limits, i.e., the amounts which an insurer has committed itself to insure during a specified period, as well as covered exports, i.e., the value of trade covered by a credit insurance policy. The data also include claims paid and loss ratios, i.e., claims paid in relation to premium income which credit insurers use to measure credit quality retrospectively. Medium- and long-term (MLT) credit insurance with repayment terms of more than one year is mostly provided by official export agencies and usually covers particular transactions rather than trade transactions collectively up to a specified limit. Berne Union data do not include the relatively small amount of MLT credit insurance from private sources.

Terms and conditions associated with the extension of official credit insurance are available from the export credit agencies themselves and on a selective basis in specialist publications on trade finance.

The ICC Trade Register, an initiative started in cooperation with the Asian Development Bank, collects data from a number of banks considered to be global leaders in trade finance concerning the default and loss record on trade finance products. As of 2012, the coverage of the register was data on more than 15 million transactions provided by 21 banks (ICC, 2013a: 36).

The CGFS's own survey of its member countries indicated limited and heterogeneous coverage of statistics for trade finance. Only Brazil, India, Italy and Republic of Korea provide reasonably detailed data on a regular basis. For the majority of the member countries the coverage is limited to activities reflected in on-balance-sheet lending and thus excludes contingent liabilities such as L/Cs except to the extent that they are tied to or become actual loans.

Risks of trade finance

Regarding the appropriate treatment of trade finance in bank regulation, a major target of the industry's representations has been the rules of Basel II and Basel II.

At a general level the industry has drawn attention to the overemphasis of Basel II and Basel III on counterparty as opposed to product or performance risk. In the industry's view, this emphasis leads to the attribution of insufficient importance to the risk-mitigating factors of trade-finance instruments such as the self-liquidating character of many short-term trade-finance instruments, their collateralization, and the short maturity of a large part of such financing. Failure to take account of the risk-mitigating features of trade financing is held by the industry to be likely to raise capital requirements for, and thus costs of, trade finance for all but highly rated borrowers – from developed and developing countries.

Industry critics of Basel II and Basel III have also drawn attention to the procyclicality of the risk weights for credit risk under options of the Basel capital framework which permit banks to make their own estimates of the determinants of such risk. These determinants include the probability of default and loss given default, both of which are likely to increase during economic downturns, again without proper account being taken of the mitigating factors inherent in the instruments of trade finance.

The CGFS study notes that the data of the ICC Trade Register and earlier of the ICC-Asian Development Bank Trade Finance Default Register support the industry's position at least for the large banks included in these surveys (CGFS, 2014: 25-26). The average default rate for traditional short-term trade-finance products during 2008-11 was 0.02% and the economic loss rate – after account is taken of recoveries – 0.01%. Of special interest amongst the findings of the ICC-ADB Register was the first batch of data for nine international banks for 2008-09, the period which included the sharp crisis downturn in international trade: the incidence of default was even lower than during the entire period 2008-11 at 445 out of 2.8 million transactions (ICC Commission on Banking Technique and Practice, 2010: 6).

The coverage of trade finance in the ICC Trade Register until 2013 was limited to short-term instruments. For a smaller sample of 10 banks the coverage has now been expanded to medium- and long-term trade-finance products with backing in the form of insurance or guarantees from export credit agencies during the period 2006-11 (ICC, 2013b: 14 and 26-30). Since the maturities of transactions are subject to greater variation than for short-term trade-finance products, default rates are calculated on an annual basis (i.e., as annual transaction default rates). In the case of medium- and long-term products the annual transaction default rate during 2006-11 was a little greater than 1% – low but higher than for short-term products.

The ICC register covers only some of the forms in which credit is used to support international trade. As mentioned earlier, many financial facilities used to support internationally traded goods and services are not separately classified by banks under the distinct heading of trade finance. Instead they would be subsumed under different categories of borrower or exposure, and this would determine the estimation of their capital requirements for credit risk for Basel II and Basel III. Capital requirements estimated in this way may be procyclical in the same way as those for the credit risk of a bank's exposures to other categories of borrower.

Trade finance in the Basel capital framework

The principal but not the sole focus of the trade-finance industry's criticisms of bank regulation's effects on trade finance has been the capital framework of Basel II and Basel III. The Basel Committee has now revised the capital framework in ways which go a significant distance towards meeting these criticisms.

How has trade finance fitted into the framework of successive versions of the Basel capital framework? In view of the attention which the effects of the rules of Basel II and Basel III in relation to trade finance have recently received, the remarks below go somewhat beyond the account in the CGFS study with a brief description of the rules' evolution in successive versions of the Basel capital accord.

Under the original 1988 Basel capital accord or Basel I, the minimum regulatory capital for credit risks was to constitute 8% of banks' risk-weighted assets. The attribution of risk weights to banks' loans and other on- and off-balance-sheet positions followed a relatively simple scheme. Off-balance-sheet exposures were converted to their on-balance-sheet equivalents by multiplying them by credit conversion factors.

Where trade finance took the form of bank lending, the rules were subsumed under those for lending generally. Where trade finance took the form of off-balance-sheet exposures or contingent liabilities, it was covered by the system of credit conversion factors.

- Direct credit substitutes were attributed a credit conversion factor of 100%, that is to say they were treated in the same way as lending.
- Certain transaction-related contingent items (such as performance bonds and standby letters of credit) were attributed a credit conversion factor of 50% (corresponding to a capital requirement of 4% for an exposure to a non-financial firm).

● Short-term self-liquidating trade-related contingent liabilities such as L/Cs were attributed a credit conversion factor of 20% (corresponding to a capital requirement of 1.6% for a bank's exposure to a non-financial firm).

● Lending commitments (such as formal standby facilities and credit lines) were attributed a credit conversion factor of 50% or 0% according to whether the original maturity of the commitment was greater than or up to one year (corresponding to capital requirements of 4% for the bank's exposure in the first case and 0% in the second case).

In Basel II and Basel III, the frameworks currently being implemented in many countries, minimum regulatory capital requirements for credit risk are calculated according to two alternative approaches, the standardized and the internal ratings-based.

Under the simpler of the two, the standardized approach, the measurement of credit risk follows a system similar to that of Basel I but with a finer calibration of credit risk based on ratings provided by so-called external credit assessment institutions, expected in most cases to be credit rating agencies. In the light of recent revisions of the rules concerning exposures to trade finance (see below), one feature of the standardized approach as originally formulated in Basel II and Basel III deserves special attention.

Under one of the two options of Basel II and Basel III for the credit risk of a bank's exposures to other banks (Option 2), claims on banks not rated by a credit rating agency carry a risk weight of 50% (corresponding to a capital requirement of 4%) or, in the case of claims with an original maturity of up to three months, carry a risk weight of 20% (corresponding to a capital requirement of 1.6%).

Confirming banks may be chosen for the role of confirming L/Cs originally issued by banks in lower-income countries owing to their location in higher-income countries which increases the assurance to an exporter that payments due under an L/C will actually be made. However, in the original rules of Basel II and Basel III, application of these low risk weights was subject to a sovereign floor under which no claim on an unrated bank could receive a risk weight lower than that which applied to the claims of the country in which it was incorporated. This could have the consequence of nullifying the benefits of the lower risk weights for trade-financing transactions involving the claims (of confirming banks) on unrated banks in lower-income countries and thus raising the costs of such transactions.

Under the alternative internal ratings-based approach of Basel II and Basel III, for the major categories of exposure banks use their own rating systems to measure some or all of the four determinants of credit risk, namely the probability of default, loss given default, exposure at default, and the remaining effective maturity of the exposure.

● Under the foundation version of the internal ratings-based approach, banks estimate the determinants of default probability but rely on their supervisors for measures of the other determinants of credit risk.

● Under the advanced version, in addition to the probability of default, banks estimate the loss given default, the exposure at default, and the remaining maturity of the exposure (subject to a floor of one year and a ceiling of five years).

Regarding trade finance, the following features of the internal ratings-based approach merit particular attention:

● In the foundation version, the credit conversion factors used to estimate the exposure at default of off-balance-sheet exposures in the case of instruments which may be used as part of trade finance – the measurement of which is the responsibility of the bank's supervisor – follow closely the credit conversion factors of the standardized approach for converting off-balance-sheet exposures to their on-balance-sheet equivalents.

● In the advanced version, banks make their own estimates of these credit conversion factors subject to certain floors specified in the rules of Basel II and Basel III.

● In the case of both the foundation and the advanced versions of the internal ratings-based approach in the original version of Basel II and Basel III, the remaining effective maturity for trade-finance exposures was generally subject to a one-year floor – a floor which, through its effect on estimated credit risk, contributed to keeping the capital requirement for trade finance above a certain level. However, in the case of the advanced version, exceptions to this floor could be accorded to banks at supervisors' discretion. These "could be accounted for at their remaining maturity", even if this was less than one year.

In response to the highlighting by the financial crisis of the close connections between banks' liquidity risks and threats to their solvency (the target of Basel I and Basel II), rules for banks' management of liquidity risk, i.e., the risk that a bank will not be able to meet its obligations as they fall due, have been included in Basel III, the post-2009 version of the Basel capital framework. These rules include references to the instruments of trade finance.

The rules on liquidity management take the form of two standards, the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR).

Under the LCR, the ratio of a bank's high-quality, liquid assets to net cash outflows over a 30-day period should be at least 100%. Cumulative cash outflows are calculated by multiplying outstanding balances of different categories of the bank's liabilities by percentages reflecting the expected run-off over a 30-day horizon, and by multiplying its off-balance-sheet commitments and other contingent liabilities by factors reflecting expected rates of draw-down. The contingent liabilities include guarantees, letters of credit and other trade-finance instruments. The draw-down factors for such contingent liabilities are to be determined by national supervisors.

Under a bank's NSFR, the amount of a bank's longer-term stable sources of funding should be at least 100% of the stable funding required according to measures of the liquidity profiles of its assets and of potential liquidity calls due to contingent off-balance-sheet obligations over a one-year time horizon under conditions of extended stress.

Each category of a bank's stable funding (such as capital, preferred stock with a maturity of at least one year and the more stable categories of deposits) is multiplied by a factor reflecting its degree of stability. The required stable funding (RSF) is measured on the basis of supervisory assumptions, reflected in RSF factors, concerning the liquidity risk of the bank's assets, off-balance-sheet exposures and certain other commitments including guarantees, letters of credit and other trade-finance instruments. The inclusion of off-balance-sheet exposures and other contingent liabilities reflects the view that, in spite of their need for little immediate funding in normal times, they can cause significant drains of liquidity during periods of stress (which should be met by the establishment of reserves to meet such drains). For the contingent liabilities due to trade finance the RSF factors are left to national supervisory discretion.

The supervisory discretion regarding the treatment of trade-finance instruments in the LCR and the NSFR has the advantage of providing for flexibility which can take into account variations in national circumstances and in policy objectives. This can be important for emerging-market and other developing countries for which liquid assets may often be available only in more limited forms and amounts than for developed countries.

In Basel III the rules for capital requirements for risk-weighted assets are to be supplemented by an aggregate leverage ratio. Inclusion of the aggregate leverage ratio in Basel III is a response by the Basel Committee to the build-up of the excessive on- and off-balance-sheet leverage which helped to trigger the financial crisis but was not necessarily evident prior to the crisis in measures of leverage based on risk-weighted assets (such as those of Basel I and Basel II).

The aggregate leverage ratio sets a minimum level for banks' high-quality (so-called Tier 1) capital in relation to on- and off-balance-sheet positions (where the latter – the off-balance-sheet positions – include the contingent liabilities associated with trade finance). In the original version of Basel III, with only highly restricted exceptions, off-balance-sheet exposures in the ratio's denominator (including those associated with trade finance) had a credit conversion factor of 100% – and not the lower credit conversion factors allowed in the estimation of risk-weighted exposures for the minimum regulatory capital requirements for credit risk of Basel II and Basel III.

Major targets of the trade-finance industry's criticism of Basel II and Basel III, which the industry believed was supported by negative findings concerning their influence on the availability and cost of trade finance in the surveys of the ICC and the Bankers' Institute for Foreign Trade (now BAFT-IFSA), were (1) the way in which the risk-weighted capital requirements failed to take adequate account of the low credit risk of trade finance, and (2) the 100% credit conversion factor for trade finance in the denominator of the aggregate leverage ratio.

Revisions of the Basel capital framework

Two recent revisions in the rules of Basel III go some way towards meeting the trade-finance industry's criticisms.

The first, announced by the Basel Committee in October 2011, is directed at the rules for estimating the credit risk of trade finance (Basel Committee on Banking Supervision, 2011). The changes involve two waivers:

1. A waiver of the one-year floor for the maturity of issued and confirmed letters of credit for banks estimating risk weights on the basis of the advanced version of the internal ratings-based approach. As noted earlier, this waiver could already be accorded to a bank at its supervisor's discretion.

2. A waiver of the sovereign floor under which no claim on an unrated bank can receive a risk weight lower than that of the claims on the country in which it was incorporated. This is designed to lower the capital requirements for, and thus the costs of, confirming banks' trade-finance exposures to unrated banks in lower-income countries.

In January 2014 the BCBS specified credit conversion factors of less than 100% for trade-related contingencies and transaction-related guarantees included in the denominator of the aggregate leverage ratio (Basel Committee on Banking Supervision, 2014). Short-term self-liquidating L/Cs now have a credit conversion factor of 20% in the case of both the issuing bank and the confirming bank. Moreover, certain transaction-related contingent items (such as performance bonds, bid bonds and standby letters of credit, which are vehicles for guaranteeing performance related to particular transactions) have a credit conversion factor of 50%.

Further changes in Basel III, involving, for example, the rules for the management of liquidity, are currently under consideration. Even in its present form, the CGFS expresses the belief that through its contribution to bank resilience, Basel III will contribute to the resilience of trade-finance markets (CGFS, 2014: 30). However, the recent revisions are unlikely to fully meet the continuing concerns of the trade-finance industry concerning what it believes to be Basel III's attribution of excessive levels of risk to trade finance for the purpose of setting capital requirements.

New techniques of trade finance

Recently banks themselves have been increasing their use of techniques designed to enable their continued involvement in trade finance, while economizing on the use of their own capital. As the CGFS study notes (CGFS, 2014: 27), banks have historically sold loans financing international trade to other banks to adjust the risk profiles of their balance sheets. But several leading banks are now securitizing such loans through deployment of the "originate to distribute" model better known in the context of the securitization of mortgages. Such activity has so far been on a small scale to a great extent owing to non-bank investors' limited familiarity with trade finance.

For this purpose banks have deployed both outright and synthetic securitization.

In an outright securitization the trade-finance assets underlying the securitized assets are assembled by one or more banks and sold to a special purpose vehicle funded by commercial paper and other securities. The advantages to the bank are due to the lower credit risk, and thus lower regulatory capital requirements, of any consequent exposure to the special purpose vehicle in comparison to the trade finance itself. The cash from the sale can also be useful as a source of additional liquidity, assisting the bank in meeting regulatory rules on liquidity.

In a synthetic securitization investors take loss positions against a portion of a bank's trade-finance portfolio and receive a stream of payments (similar to insurance premiums) from the bank. Since the securitized assets remain on the bank's balance sheet, synthetic securitization of trade-finance assets can reduce its exposure to credit risk and thus its regulatory capital requirements but cannot be a source of liquidity from the sale of these assets.

Instability, trade patterns and access

The low-risk character of the traditional trade-finance instruments should protect them from instability except following serious economic downturns and shocks (CGFS, 2014: 21). Nevertheless, as noted at the beginning of this article, part of the sharp downturn in global trade in 2008 is attributed to "credit shocks" associated with trade finance. Furthermore the data on the contraction of identifiable trade finance during this episode may well underestimate the contribution to the trade downturn of the contraction of financing in support of trade not explicitly identified in surveys as trade finance.

The CGFS study considers that there is a continuing risk that trade finance can amplify financial shocks due to the effects on borrowers' creditworthiness and their access to foreign-currency financing. Moreover, in the case of supply chain finance, although the network of participating institutions were generally viewed by participants consulted for the CGFS as likely to prove resilient even in stressful conditions, the impact of cutbacks in bank financing "could be quite disruptive to the affected businesses" (CGFS, 2014: 20).

In a transactional-level econometric analysis matching French monthly trade data with ownership information for the period 2007-09 (which is not cited in the list of references of the CGFS study), the authors assessed the role of global value chains in fluctuations in trade in intermediate goods (Altomonte, Di Mauro, Ottaviano, Rungi and Vicard, 2012). They found that intra-group trade in intermediates reacted faster to the negative demand shock associated with a trade downturn, but also recovered faster, than arms-length trade between entities not belonging to the same group. This more rapid reaction time the authors attribute to a "bullwhip effect" due to the faster transmission of information and better management of inventories which is possible within a group. The analysis does not identify any independent role for trade financing here, although the authors acknowledge that intra-group financing may prove a particularly useful alternative to external financing in troubled conditions.

The CGFS study – understandably, in view of its membership – focuses largely on trade-finance issues such as problems or risks posed by such finance to global trade. However, it overlooks problems of lesser interest to developed and major emerging-market countries such as access to such financing for low-income countries, whose banks may have difficulty in establishing with banks in developed countries the correspondent relationships which are important for both trade finance and the facilitation of payments and settlement in international trade.

The CGFS study also does not discuss future trends in global trade which may have important future implications for its financing.

The CGFS study notes that, as in pricing and settlement, the dollar remains the predominant currency in trade finance. The ability of many banks to provide trade finance depends on their access to dollar funding (CGFS, 2014: 13-14). Thus in India 90% of import loans and much export financing is denominated in dollars, and even in China the proportion of trade-finance loans denominated in dollars is twice as great as that denominated in renminbi.

However, trade between major regions of emerging-market and developing countries has expanded faster than global trade since the 1990s (Pavoni, 2014). This trend seems likely to have implications both for currency denomination of payments and financing in international trade and for the leading role as arrangers of trade finance still played by multinational banks with their headquarters in developed countries (listed in Banker, 2014). Political developments such as the current crisis between NATO and Russia over Ukraine may even accelerate this process since sanctions affecting the access of major countries to trade finance from developed-country banks as well as to the main systems of payments and settlement of trade transactions are likely to lead the countries affected to establish – possibly long-term – alternatives as to both currencies and transactional infrastructure. ❒

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(continued from page 5)

wage hike in 2004, the biggest local raise. There, increased expenses against revenues averaged around 1% for all affected businesses.

The restaurant and hotel industries, which use more low-wage labour, had average cost increases of 3-4%. To cover these, a $10 meal would have had to rise to $10.35. In any case, the pertinent question is not whether any jobs are lost: it is whether affected workers end up better off after the increase.

Unlike the high-school-to-Social-Security factory jobs of a half-century ago, today's low-wage service jobs are notoriously volatile. Involuntary and voluntary turnover is often high, and weekly hours also frequently fluctuate.

From a worker's point of view, a "lost job" usually translates into days or weeks until the next job, not a life-changing loss.

After previous minimum wage increases, even if total hours worked yearly were reduced slightly for some workers, the size of the hourly raise would nearly always ensure that their total yearly income would be higher than before the increase.

Back at the Seattle rally, council member Sawant preached to the choir: "Because of our courage, our solidarity with each other, not because of the powers that be, we have brought things to this point where 15 can become a reality in Seattle and inspire the whole nation and the whole world." *(IPS)* ❒