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BUSINESS TIMES

Revitalising export finance for export growth

By Verite Research

Since the turn of the century, Sri Lanka's exports have fared poorly. The share of exports to GDP has steadily declined from 33 per cent to 15 per cent during 2000-2014, and exports have stagnated at around US\$10 billion since 2011. Ricardo Hausmann, a Harvard economist who spoke at the Sri Lanka Economic Forum in January of this year, highlighted that diversification of export markets and products is critical to generate



A garment factory

sustained and inclusive economic growth in Sri Lanka. Further, the new government has assured that exports will remain a priority in their development strategy. This article draws attention to the role of Export finance in reviving export growth. It looks at inhibiting factors in the current Export finance environment and provides recommendations to overcome these constraints.

Diversification: Key to a thriving export sector

The lack of growth in exports is due to three main factors. First, Sri Lanka's export revenue depends heavily on a few products; apparel and tea alone account for over 50 per cent of total export value. These sectors are highly labour intensive, which we no longer have a

comparative advantage in comparison to competing countries such as Bangladesh and Vietnam. Second, Sri Lanka exports to a few markets; over 50 per cent of exports from Sri Lanka go to the EU and USA and growth in import demand from these markets have been stagnating for a significant period of time. Third, Sri Lanka depends heavily on a few large exporters to generate most of the export revenue. Small and medium enterprises contribute to a mere 4.4 per cent of total export turnover, whereas the average is around 40 per cent in Asia.

Diversifying exports is easier said than done

As global trade becomes more competitive, buyers are increasingly demanding payment terms more favourable to them, and the ability of exporters to agree to such payment terms is a deciding factor in securing export orders. However, such payments carry a considerable degree of credit and payment risks. Consequently, exporters prefer to continue trading with buyers they have already traded with rather than run the risks associated with new buyers and markets. This is especially true in the case of SME exporters whose access to finance is even more restricted. Export finance can enable exporters to accept such unfavourable payment terms by providing insurance, guarantee or financing arrangements that will help mitigate such risks.

Export finance provides insurance, guarantee or financing arrangements which will enable exporters to agree to defer payment over a period of time. It facilitates international payments, helps mitigate risks, meets export working capital requirements and helps build capacity, competitiveness and expand markets. Export finance can play an important role in addressing key problems faced by the export sector; it can help secure export orders by enabling exporters to offer competitive payment terms to buyers, it can facilitate increased participation of Small and Medium Enterprises (SMEs) in international trade and also incentivise exporters to diversify into developing country markets.

Currents constraints to a robust export finance sector

There are three critical demand and supply side constraints that prevent export finance from playing a more proactive role in facilitating and promoting exports in Sri Lanka.

1) Lack of credible, updated and timely information

Lack of credible, updated and timely information about foreign buyers and markets result in the over-estimation of risks involved. This pushes up the costs of transactions which in turn results in export finance instruments being overpriced. This has a negative impact on the supply of export finance instruments.

Another information asymmetry that prevails in Sri Lanka is the lack of information on the uses and benefits of export finance instruments. This affects demand as exporters are unaware of the financing options available to them.

2) Institutional deficiency

Institutions that facilitate and promote the use of export finance in Sri Lanka are of two types. First, institutions that directly provide export finance and second, institutions that facilitate and promote the availability and utilisation of export finance. Currently there are two defined deficiencies in their institutional framework; i) limitations in skills, capacity and expertise and ii) low level of policy focus, government support and initiative to facilitate export finance. This has a negative impact on the supply of export finance.

3) Current low and static export structure

The export sector is static. Most of the export revenue is generated by a few established products that are exported to a few low risk markets by a few large exporters with longstanding relationships with their buyers. This limits the demand for export finance instruments.

The above constraints have resulted in a limited portfolio and utilisation on export finance in Sri Lanka. The issues are clearly inter-connected and steps taken to address them should focus on both constraints simultaneously.

Revitalising export finance

Three key interventions that can help promote the availability and utilisation of export finance in Sri Lanka;

1) Introduce new and innovative export finance solutions

Innovative export finance instruments can revive and boost the export sector. For example, Value Chain Financing by NDB empowered cinnamon growers, exporters and related manufacturers, thrusting the Ceylon Cinnamon brand into the global arena. Other countries use innovative instruments that are customised to target SMEs to initiate and facilitate their exports.

2) Improving access to reliable, updated information and lower cost

Research by the International Finance Corporation (IFC) confirms that lending is higher and credit risk is lower in countries where lenders share information, regardless of the private or public nature of the information sharing mechanism. Further, maintaining and sharing information on a centralised electronic platform of information reduces the cost of

information and improves ease of access for stakeholders such as exporters, buyers, banks and other lending institutions.

3) Improving capacity, efficiency and credibility of institutions

Improved access to export finance instruments and information need to be accompanied by greater awareness and marketing. Enhancing the credibility of Export finance agencies and improving their working relationship with financial institutions is crucial for the export finance sector to run smoothly.

Achieving Targets: Cannot play it safe anymore

The government has discussed and recognised the importance of reviving exports. They have set tall targets of increasing the total export value to \$50 billion by 2020. This target seems unrealistic given that the export sector has been stagnating at \$10 billion for the past few years. If the government is to move in the direction of the achieving its target, it is going to have to move on from discussions to concrete action.

Sri Lanka has grown complacent with regards to exports. The conditions that sustained the sector's few products and few markets are fast disappearing and future growth must be propelled by new products and markets. A strong export finance environment can provide the nudge the sector needs.

(Verité Research is an interdisciplinary think-tank based in Colombo that provides strategic analysis to high level decision-makers in economics, law, politics and media. Comments are welcome at publications@veriteresearch.org <<mailto:publications@veriteresearch.org>>)