



Prof. Dr. Manfred Turban

**Trade Risks and Risk Management in  
a Changing World Trading System**

**Development of risks and risk  
management in international  
trade relations**

**mtr-9**

# Structural Changes in World Trade and Trade Relations

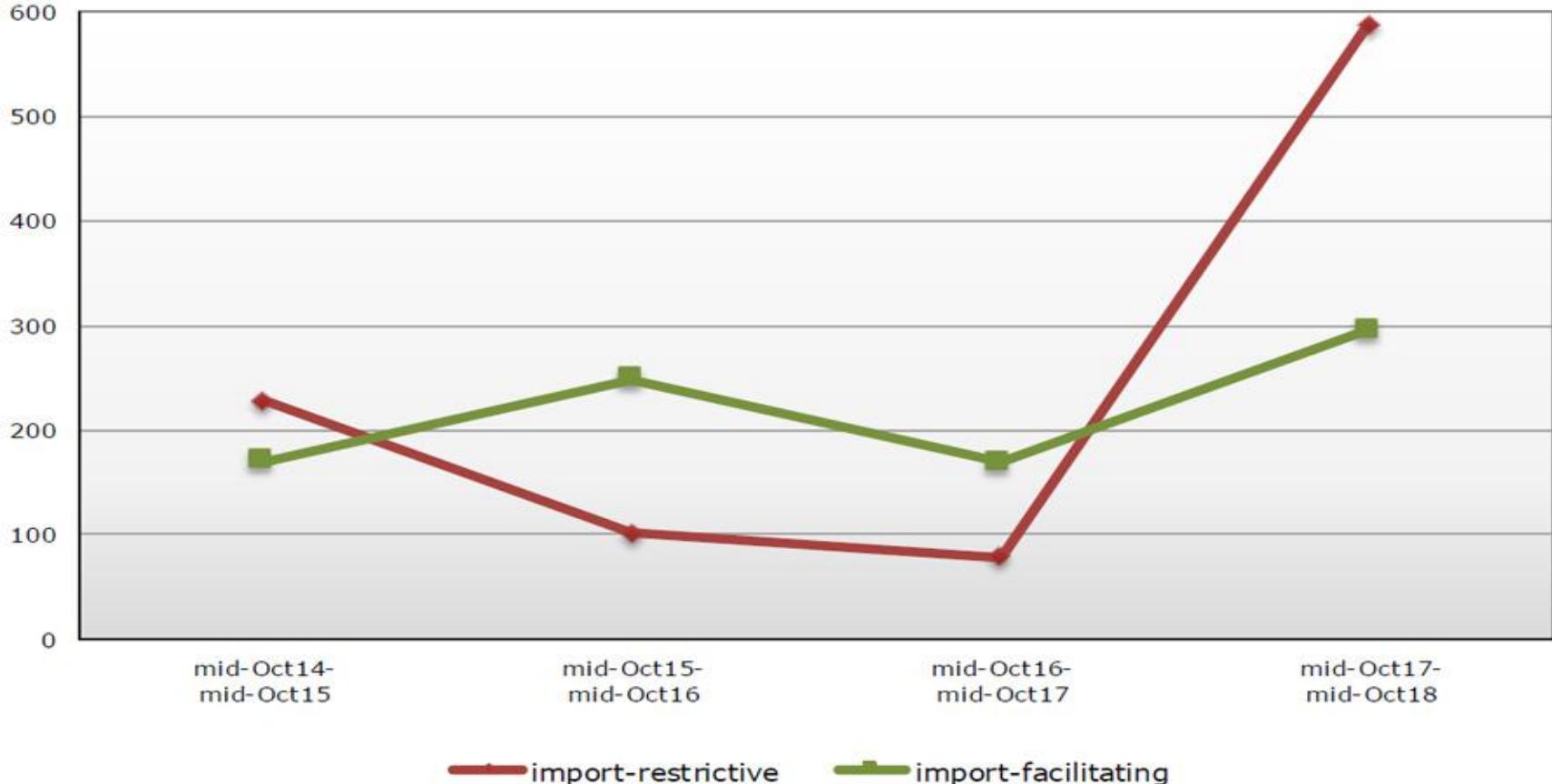
**Development of world economy** experienced a new wave of globalization (since end WW2)

- **Far-reaching structural changes in international trade and international business**
  - expansion of international trade in goods
  - increase of international trade volume of commercial services
  - Surge of foreign direct investments / emergence of MNEs / international production
  - Strong increase of global value chains (GVC)
- **Shifts of production and trade and changed relationship between the main trading countries**
  - Share of emerging and developing economies in trade increased at the expense of advanced economies
- **Drivers of globalization lost momentum after the world economic crises of 2008/09**
  - Significant signs of stagnation with all forms of economic globalization
  - Development of few forms of protectionism since 2010

## Crisis of the World Trading System and Frictions in PTA

- **Rule-based World Trading System** of GATT and WTO as **backbone of surge in international trade**
  - Development of international trade triggered by lowering customs, lifting trade barriers and liberalizing trade
  - Regularly adaptation of rules to changing needs
  - Increasing participation after foundation of WTO in 1994 (emerging and developing countries as members)
- **Crisis of world trading system after failure of Doha Round**
  - Emergence of conflicting issues / common guidelines no longer to be found
  - Manifestation of frictions
  - No further development of the system of rules
  - Development of regional approaches in trade liberalization
  - Negative attitude to the multilateral trading system by leading trading nations
- **Wave of Protectionism**
  - Distributional conflicts with respect to gains of trade
  - Conflicts within PTA and economic blocs (EU with currency and sovereign debt crisis and Brexit)

### Trade-restrictive and Trade-facilitating measures reported (in billion USD) Source: Report from WTO Director General Of 11-12-2018)



Note: These figures represent the trade coverage of the measures (i.e. annual imports of the products concerned from economies affected by the measures) and not the impact of the trade measures. These are estimates based on 2013 to 2017 import data. Liberalization associated with the 2015 Expansion of the WTO's Information Technology Agreement is not included in these figures.

Source: WTO Secretariat.

# Development of Risk Structure and Challenges for International Trade Business Management

## Advantages of the rule-based multilateral trading system for trading firms

- Rules provide a reliable legal framework for international trade relations to all members
- Firms of member countries have equal access to trade advantages
- Firms are protected against arbitrary rise of tariffs and non-tariff-barriers
- Firms have access to the national treatment principle to exports
- Dispute settlement system gives possibility of legal recourse
- Favorable framework for the set-up of international value chains
- **Achievements in international trade relations increasingly at stake**
- **Companies are confronted with changing risk profiles**

## Risk management in international trade

- **Traditional focus on short-term business risks**

## Emergence of new types of short- and medium-term business risks in international trade

- Recourse to duties in manufactured trade
- Introduction of non-tariff trade barriers
- Increase of Protectionist measures
- Increasing number of sanctions
- **Outright tariff war developing in 2018/19**

## Development of Risk Structure and Challenges for International Trade Business Management

### Short-, medium- and long-term business risks: political and country risks

- Related to a bundle of reasons:
  - General disintegration of the rule-based world trading system
  - Conflicts between states because of non-accepted distribution effects of trade developments
  - Conflicts between states because of export duties and biased practices in public procurement
  - Growing instability of world trading order
  - Economic instability in specific parts of the world economy
  - Monetary instability in several countries
  - General protectionist tendencies
  - Conflicts with respect to property rights

# Strategic Considerations in International Risk Management

## Political and country risks in trade necessitate short-term reactions and s strategic management on the firm level

- Immediate effects
- Effect on cost structure
- Varying impact of risk factors

## Basic elements of strategic approach

- Evaluation of the character of risk and impact on the firm as first step
- Preventive measures and preventive action including emergency plans
- Development of a general strategy to handle possible risks

# Political risks in short-term operative risk management

## Coping systematically with short-term business risks

- Evaluation of character of specific risks
- Evaluation of impact on the firm
- Evaluation of the possibilities of risk prevention
- Cost-benefit analysis of risk prevention
- Evaluation of instruments of risk prevention
- General risk prevention concept

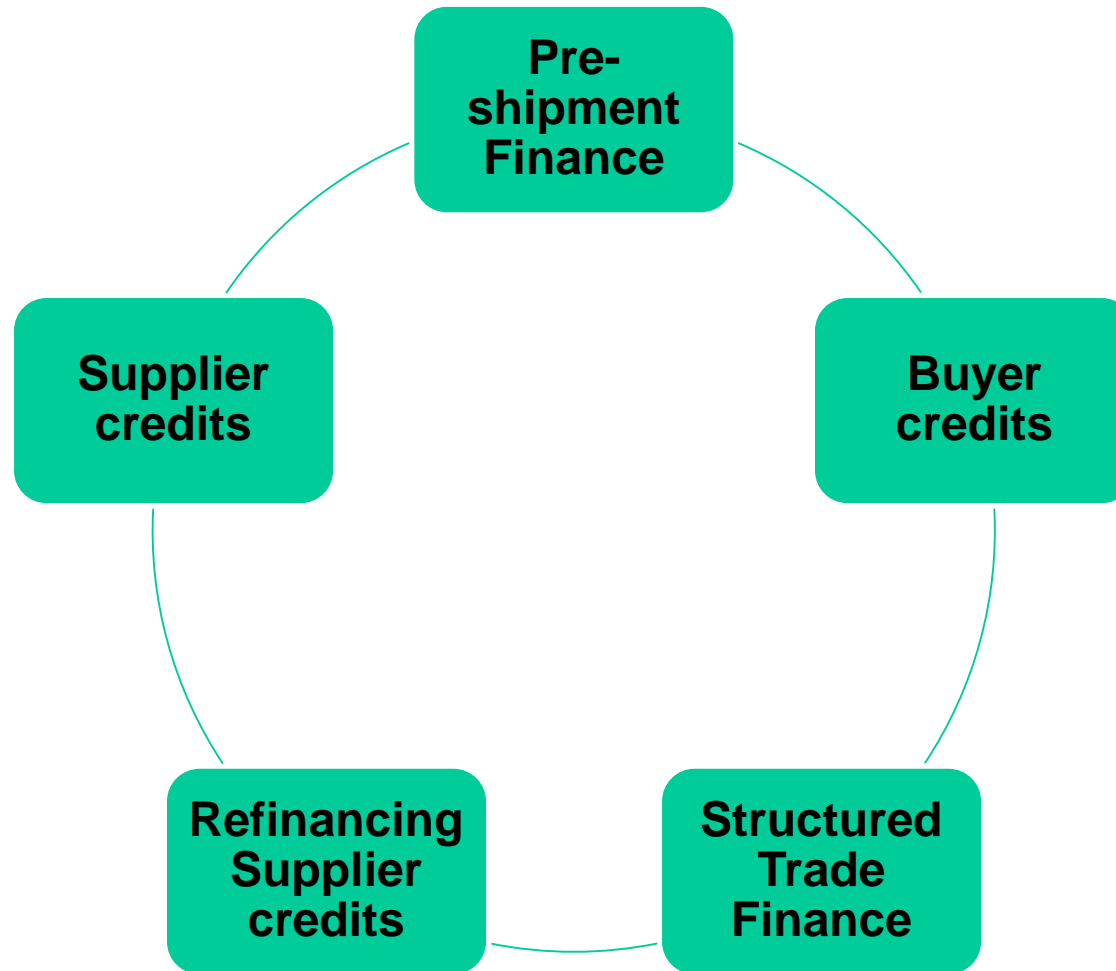


# Traditional short-term risk management by trade-firms

## Traditional risk-management focusing short-term risk

- **Risk management based on Trade practices directed to covering commercial risks**
  - Trade terms (terms of delivery; terms of payment)
  - Political and country risks addressed only to a limited extent
- Terms of delivery address only specific aspects
- Terms of payment provide cover of country risks when credit institutes from both countries concerned share liability
  - “L/C confirmed”
  - Insurance bonds and guarantees confirmed by both countries or third country
- **Risk-Management tools in Trade Finance**
- Operative tools provide possibilities to cover political and country risks
  - Advance payment by banks against documents
  - Supplier credits
  - Refinancing supplier credits
  - Additional confirmation by credit institute of second country
  - Export factoring
  - Forfaiting
  - Credit institutes take over “all risks” (factor, forfaiting banks)
  - Buyer credits: credit accorded to buyer, seller receives cash

# Types of International Trade Finance



## Traditional short-term risk management by trade-firms

### Credit and Investment Insurance

- Political and country risks mainly covered by government based forms of ECA (Export Credit Agencies)
  - Use of **ECA backed Buyer credits** enabling the seller to receive cash payments
  - Use of **Lines of Credit backed by ECA insurance**
  - **Government-based risk insurance of FDI**

### Risk Cover and Cost

- Cover of political risks related to the political situation of the country of export destination
- Risks resulting from customs conflicts, trade barriers and import restrictions usually not included
- Securitizing risks incurs economic burden

# Political Risks and Medium and Long-term Strategic Risk Management

## Medium-and long-term strategic risk management to reconsider and reevaluate strategic directions of firms

- Impact of new political risks on business models or strategic directions of firms
  - Assessment and evaluation of political risk impacts
    - Strategic focus on reduction of the probability of risk occurrence
    - Strategic focus an exclusion of occurrence of risk
  - Impacts on business model: reevaluation of Own Business Model compelling if lasting negative changes occur
    - Evaluation of specific vulnerability
    - Consideration of options of adaptation of business model
- **Types of Strategic Options of Firms**
  - **Intensification of flexibility of operation**
    - Trading firm in advantageous position if
      - high capability in adaptation to new frameworks and trading conditions
      - Business model and cost-structure enable profitability also with shrinking sales
    - Flexibility of business model in risk management
      - High flexibility with impact on cost structures
      - Diversification or restructuring of country portfolio leading to risk mitigation
      - Country-related location and supply strategies

## Political Risks and Medium and Long-term Strategic Risk Management

- Increased flexibility to be able to react better to economic shocks
    - Monitoring and improving sales country risk portfolio
    - creating flexibility relative to locations of processing
    - reluctance concerning capital intense FDI
    - creating flexibility relative to types of international value chains
  - Strategic approaches on the firm level
    - incorporation of further elements of flexibility in business model
    - development of flexible strategies with respect to international value chains
    - adjustments of the portfolio of country markets under risk aspects
      - *reduction of dependency from export markets*
      - *enhanced flexibility of the location strategy with respect to procurement and production*
- **Enhanced Spread of Risks:** reduction of probability of risk occurrence (portfolio strategy)
- **Strategies in political risk management** focus *reduction of potential damage*.
  - Strategies by taking recourse to **specific business models with risk sharing options**
    - forms of *structured finance to share trade risks or to eliminate country risks (cross-border leasing, cross-border joint ventures)*
    - cooperation in sectors like equipment and construction with multilateral and regional development banks: Multilateral and regional development banks with participating in projects as lender or guarantor
- Political and country risks of firms only in part to be covered by classical risk management,
- Adaptation of trade risks necessary

## Sources

Grath, Anders (2016), The Handbook of International Trade and Finance, London (4ed.)

Helpman, Elhanan (2011), Understanding Global Trade, Cambridge

Seyoum, Belay (2014), Export-Import Theory, Practices, and Procedures, New York–London–Oxford (3ed.)