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International Trade, Risk and the Role of Banks*

Friederike Niepmann and Tim Schmidt-Eisenlohr[†]

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Abstract

International trade exposes exporters and importers to substantial risks. To mitigate these risks, firms can buy special trade finance products from banks. Based on unique data with global coverage, this paper explores under which conditions and to what extent firms use these products. 15 percent or \$2.5 trillion of world exports are settled with letters of credit and documentary collections. Letters of credit are employed the most for exports to countries with intermediate contract enforcement, and they are used for riskier destinations than documentary collections. The 2007/2008 financial crisis affected firms' payment choices, pushing them to use more letters of credit. These patterns follow naturally from a model of payment contracts in international trade.

Keywords: trade finance, multinational banks, risk, letter of credit

JEL-Codes: F21, F23, F34, G21

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