Mohamed Khaider University, Biskra

Faculty of Economics, Commerce and Management Sciences

Commerce Department

Module: English
Branch: Finance and International Trade
Level: First year Master

Lecture 02: Trade Finance Gap

Learning Objectives

After teaching this Lecture the Students should be able to:

- *Understand the Trade Finance Goals*

- *Define the Trade Finance Gap*

- *Identify the solutions of Trade Finance Gap*

1- Trade Finance Goals

Figure 1: Trade Finance Essential to Sustainable Development Goals

Source: ADB Trade Finance Program, inspired by United Nations. Sustainable Development Goals Knowledge Platform. https://sustainabledevelopment.un.org.

2-Defining the Trade Finance Gap

The Trade Finance Gap refers to the difference between the demand for trade finance and the availability of trade finance facilities. It represents the unmet need for financing for international trade transactions.

3-Key aspects of the Trade Finance Gap:

. **Demand for trade finance**: The need for financing to facilitate international trade transactions, including imports and exports.

. **Availability of trade finance**: The supply of financing facilities, such as letters of credit, factoring, and forfaiting, offered by banks and other financial institutions.

. **Shortfall**: The gap between the demand for trade finance and the availability of trade finance facilities.

4-Causes of the Trade Finance Gap:

. **Risk aversion**: Banks and financial institutions may be reluctant to provide trade finance due to perceived risks, such as country risk, credit risk, and regulatory risk.

. **Regulatory requirements**: Stricter regulatory requirements, such as anti-money laundering (AML) and know-your-customer (KYC) regulations, can increase the cost and complexity of providing trade finance.

. **Liquidity constraints**: Banks and financial institutions may face liquidity constraints, making it difficult for them to provide trade finance facilities.

. **Limited access to finance**: Small and medium-sized enterprises (SMEs) and companies in emerging markets may face challenges in accessing trade finance facilities due to limited credit history, collateral, or other factors.

5-Consequences of the Trade Finance Gap:

. **Reduced trade volumes**: The lack of trade finance can lead to reduced trade volumes, as companies may not be able to access the financing needed to facilitate international trade transactions.

. **Increased costs**: Companies may need to rely on more expensive financing options or pay higher fees for trade finance facilities, increasing their costs and reducing their competitiveness.

. **Economic impact**: The trade finance gap can have a broader economic impact, as reduced trade volumes and increased costs can affect economic growth, employment, and development.

6- Why is there such a large trade finance gap in developing countries?

In some nations, there is a significant disparity between supply and demand. The Asian Development Bank estimates that the global trade finance gap—the portion of requested trade finance that is denied—stands at approximately $1.5 trillion. Developing countries in Asia and Africa account for half of this shortfall, with small and medium-sized enterprises (SMEs) being the most affected. According to the World Economic Forum, this gap could expand to $2.5 trillion by 2025 as supply chains shift from China to less developed nations. This not only creates a substantial barrier between SMEs and global markets, despite their readiness to participate, but also hinders trade from fully contributing to economic growth, development, and job creation

7-Why is there such a large trade finance gap in developing countries?

In industrialized nations, trade finance is often overlooked because importers and exporters benefit from well-established financial sectors. However, in developing countries, securing trade finance is more challenging, with requests more likely to be denied for several reasons. Businesses that lack collateral or comprehensive financial records struggle to prove their creditworthiness, while local traders may have access only to a limited and highly selective financial industry. Additionally, many developing nations face a shortage of expertise and knowledge required to navigate trade finance instruments effectively.

Compounding these challenges, the 2008–09 global financial crisis led international banks to reduce their correspondent banking relationships, which are essential for processing cross-border payments and guarantees. Over 200,000 such relationships have disappeared since the crisis, significantly impacting trade finance flows in regions such as Africa, the Caribbean, Central and Eastern Europe, and the Pacific Islands. The financial sector has become even more concentrated due to new regulations aimed at combating money laundering, preventing terrorist financing, and enforcing trade and financial sanctions.

8-Least developed countries are hardest hit

The situation in the least developed countries is particularly severe. In Africa, over 50% of trade finance requests are rejected, contributing to an annual trade finance gap exceeding $100 billion—equivalent to one-third of the region's total market value. With limited alternatives to bank financing, traders often abandon transactions once their requests are denied. Many international banks have withdrawn support for cross-continental trade with Africa due to concerns over regulatory penalties, making it increasingly difficult for local banks to secure US dollars for clearing trade transactions.

Cambodia's Trade Integration Strategy 2019–2023 highlights a similar issue, with SMEs accounting for 90% of exports. Due to the lack of trade finance, exporters are forced to pay for inputs upfront, while local lending practices require land as collateral. This effectively excludes businesses without land or cash from accessing the financing they need, a challenge faced by many other economies as well.

9-Solutions to address the Trade Finance Gap:

. **Alternative financing options**: Alternative financing options, such as fintech companies, can provide innovative trade finance solutions to address the gap.

. **Risk mitigation**: Risk mitigation techniques, such as credit insurance and guarantees, can help reduce the risks associated with trade finance and increase the availability of financing facilities.

. **Regulatory reforms**: Regulatory reforms can help reduce the complexity and cost of providing trade finance facilities, making it easier for banks and financial institutions to provide financing.

. **Capacity building**: Capacity building programs can help banks and financial institutions in emerging markets develop the skills and expertise needed to provide trade finance facilities.