Policy tool

#7 Trade finance

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Support the diffusion of climate-related technologies and equipment by facilitating and increasing trade finance, such as loans and guarantees.

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What is trade finance?

Trade finance comprises credit facilities used by importers and exporters to facilitate international trade. These instruments bridge risks and the time gap between when the exporter wants to receive payment for producing and shipping goods and when the importer receives them, making it easier for importers and exporters to engage in international trade transactions.

How can trade finance help mitigate and adapt to climate change, especially in developing economies?

For global merchandise trade flows of over USD 25 trillion annually to flow smoothly, there needs to be a well-functioning trade finance market serving the needs of traders, especially those in developing economies where requests for trade finance are more likely to get rejected. Indeed, some 60-80 per cent of world trade relies on trade finance, such as trade credit and insurance/guarantees, mainly of a short-term nature. International supply chains rely on sophisticated supply-chain financing operations, which optimize payment flows throughout the chain of suppliers, including for SMEs.

In general, the supply of trade finance meets demand in only a few regions of the world. Recent WTO-International Finance Corporation studies on West Africa and the Mekong regions reveal that available trade finance benefits mainly well-established importers and exporters, leaving many SMEs and women-led businesses unserved. No more than 25 per cent of these economies' trade is supported by trade finance. The studies show that raising this trade coverage from 25 per cent to 40 per cent would increase annual trade flows by 8 per cent on average, resulting in an increase of 80 per cent of trade flows in ten years (WTO and IFC, 2022; WTO and IFC, 2023).

At the same time, important efforts have been undertaken to explore "greening trade finance" (see box), not least in the context of the OECD Arrangement on Officially Supported Export Credits. In October 2021, participants in the OECD Arrangement agreed to end export credit and tied aid support for unabated coal-fired power plants (i.e. coal power without carbon capture utilization and storage) (OECD, 2022b). In March 2023, they also agreed in principle to expand the scope of green or climate-friendly projects eligible for longer repayment terms, as permitted under the OECD's Climate Change Sector Understanding, which sets out to provide adequate financial terms to projects identified as significantly contributing to climate change mitigation. The expanded scope now covers environmentally sustainable energy production, $C0_2$ capture storage and transportation, and the transmission, distribution and storage of energy. Also covered are clean hydrogen and ammonia, low-emissions manufacturing, zero and low-emissions transport and clean energy minerals and ores.

While information on the specific trade finance gap between demand and supply for climate-related goods is still limited, it is probably of a similar nature to the overall trade finance gap and should be closed to

Trade finance for climate projects: the case of the Asian Development Bank

The Asian Development Bank (ADB) Trade and Supply Chain Finance Program aims to close the trade finance gap, which widened to an estimated USD 2.5 trillion in 2022. Since 2009, the Program has provided USD 67 billion to support trade through guarantees, loans and knowledge support. In light of the ADB's commitment to making regional trade and supply chains greener and more resilient, it also supports transactions that contribute to achieving economies' global climate action goals. For example, the ADB worked with Basisbank to help Panex, a producer in Georgia of innovative thermal building panels that reduce energy waste. The ADB provided USD 2 million to Panex to help it import energy-efficient raw materials and to export its products to Armenia and Azerbaijan. Buildings are responsible for about 40 per cent of global energy consumption. ADB's partnership with Basisbank and Panex is helping to reduce GHGs in Georgia and neighbouring countries.

increase trade in products and technologies needed for the transition to a low-carbon economy and for climate change adaptation.

Projects essential to decarbonize economies, such as the construction of renewable energy generation plants, depend on importing affordable inputs from manufacturers in other economies. The same applies in climate change adaptation, where international trade is crucial for many developing economies to obtain drought-resistant crop varieties or products needed to adapt urban infrastructure so that it can withstand flash floods or extreme heat.

International trade plays a crucial role, therefore, in ensuring that the supply of products required for climate action reaches those most in need in a timely and affordable fashion. Without sufficient flows of trade finance to facilitate the importation of key inputs, many climate-related projects may be delayed or cancelled.

What could be done to improve trade finance flows for climate-related products and projects and align them with wider climate action policy plans?

Banks report that common barriers to trade finance availability include the difficulty of borrowers to meet the requirements of banks providing trade finance, insufficient collateral of borrowers for the high perceived risk and shortages of low-cost funding.

To breach the trade finance gap, it is important that relevant parties – including private banks (which account for most of the trade finance market), export credit agencies, and regional development banks – enhance their existing efforts to mobilize resources to increase trade finance programmes. One way they can do so is to join forces to develop risk-sharing frameworks that support trade in the products underpinning the energy transition and climate change adaptation projects. For example, the European Bank for Reconstruction and Development has partnered with financial institutions to promote international trade transactions that disseminate green technologies in their markets.

Efforts at the multilateral, regional and national levels could aim to pool resources, wherever possible, and to develop risk-sharing mechanisms that take some of the risk away from the private sector, including by way of encouraging co-financing between the various providers of trade finance. The flow of trade finance can also be enhanced by building the capacity of local lenders, strengthening banking relationships, improving access for SMEs and women-led businesses, and aiding decision-making through better quality data. These measures require coordinated action by financial institutions, national policymakers, regulators and international organizations.

Climate finance is increasingly intertwined with Aid for Trade financing, notably in renewable energy infrastructure. This is an area where Aid for Trade and various key stakeholders can play a catalytic role by helping to mobilize finance for green infrastructure and by helping the private sector take advantage of opportunities in the low-carbon economy (WTO, 2022b).

Moreover, technical assistance provided by regional or multilateral development agencies can focus on providing developing economies with trade finance facilitation programmes to enhance their financial institutions' trade finance departments. The WTO Secretariat and the International Finance Corporation are already working with small traders and financial institutions at the local level to improve understanding of the ecosystem of trade finance and to enhance access to trade finance training programmes in emerging markets, mainly in Africa.