

**THE USE OF TRADE FINANCE INSTRUMENTS TO MITIGATE RISKS IN  
FOREIGN TRADE****Shuhrat Atxamovich Babadjanov**

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**Abstract.** This paper analyzes the main risks associated with foreign trade operations and highlights the role of trade finance instruments in mitigating these risks. Particular attention is given to instruments such as letters of credit, bank guarantees, factoring, forfeiting, and export credit insurance. The study shows that these tools enhance transaction security, reduce counterparty and payment risks, and contribute to the stability of foreign economic activity. It is concluded that expanding the use of trade finance instruments is essential for strengthening foreign economic security and improving the resilience of trade operations under global uncertainty.

**Keywords.** foreign trade, trade finance instruments, letter of credit, bank guarantee, factoring, forfeiting, export insurance, commercial risk, currency risk, risk management

**1.Introduction**

Foreign trade is a critical factor for sustainable economic growth. However, it is accompanied by high levels of commercial, currency, and country risk. The contemporary global economy is characterized by deepening uncertainty in international trade and the global economy, stemming from the onset of a restructuring of the conventional world order. Despite the persistent inertia of current globalization processes, external economic risks associated with sanctions and restrictions in international trade are intensifying. In such conditions, trade finance instruments are becoming a primary mechanism for ensuring the stability of foreign economic relations and an essential tool for mitigating trade risks.

The International Chamber of Commerce (ICC) maintains one of the most important global data registries for trade and supply chain finance. By 2025, it will have accumulated over 25.7 trillion US dollars in aggregated transactions to assess risks and other indicators in this

sector. This makes the ICC one of the primary sources for analyzing risk profiles and trade finance trends.

The Global Trade Finance Gap study conducted by the Asian Development Bank (ADB) showed that the global trade finance deficit remained at \$2.5 trillion in 2025. This reflects the gap between the demand for trade finance and the actual availability of such instruments.[1]

The rapid expansion of foreign trade volumes in Uzbekistan in recent years has further increased the practical relevance of this issue. In 2022, the republic's foreign trade turnover amounted to \$50.0 billion, reaching \$62.6 billion in 2023 and \$65.9 billion in 2024. During this period, the volume of exports increased from \$19.3 billion to \$26.9 billion. [2]

Trade finance instruments are used precisely to redistribute these risks, reinforce them with bank guarantees, increase trust between counterparties, and reduce liquidity shortages. According to the ADB's 2025 Global Trade Finance Gap Survey, the global trade finance gap remains at \$2.5 trillion. [3] This indicates a significant gap between the needs of trade deals and the actual supply of financing.

## 2. Methodology

The study utilized the following methods:

1. Utilizing the comparative-institutional analysis method, the primary instruments of trade finance—documentary letter of credit, bank guarantee, documentary collection, factoring, forfeiting, and export credit insurance—were compared based on their functional purpose and risk mitigation mechanisms.

2. Foreign trade data for 2022–2024 from the Statistics Agency under the President of the Republic of Uzbekistan were summarized using the descriptive-statistical method.

3. Based on a legal-doctrinal analysis, the normative-legal acts regulating export support, pre-export financing, subsidies, fund mechanisms, and trade development institutions for the period of 2020–2025 were systematized. Presidential decrees and resolutions from the Lex.uz database served as the primary source.

4. The global trends and risk profile of trade finance were assessed based on materials from international organizations such as the ADB, ICC, and EBRD.

A limitation of the research is the absence of unified, consolidated open statistics specifically on trade finance instruments in the context of Uzbekistan; therefore, the conclusions are drawn partially from foreign trade statistics and normative-legal frameworks.

## 3. Analysis and Results

Tashmuhamedova (2019) focuses on improving tax management and the organizational efficiency of public tax service employees. The author argues that effective tax administration is not only a fiscal instrument but also an important component of economic security. Improved tax control, professional development of tax employees, digitalization of tax procedures and transparent interaction with taxpayers contribute to budget stability and reduce informal economic activity.[12]

Burkhanov et al. (2024) examine the financial security of joint-stock companies in Uzbekistan. Their research is important because it connects corporate financial stability with broader economic security. The authors stress that liquidity, solvency, profitability, capital structure and risk management indicators should be systematically assessed to determine the financial security level of enterprises. This study expands the understanding of economic security from the macroeconomic level to the corporate governance level.[13]

Khodiev et al. (2019) analyze methods for evaluating the efficiency of production capacity utilization in textile enterprises. Their work demonstrates that optimal management of production capacities improves competitiveness, cost efficiency and industrial sustainability. The study is particularly significant for textile enterprises, where effective use of resources, modernization of equipment and rational production planning are key factors of long-term development. [14]

According to a report by the Asian Development Bank (ADB), the gap between global demand and supply in trade finance was estimated at \$2.5 trillion in 2023—a figure that remains at the level of previous years despite efforts by banks and international institutions to expand financing capacity. Such a deficit limits the opportunities for small and medium-sized enterprises and affects countries' ability to join global supply chains, especially during periods of economic uncertainty. International data confirms that trade finance instruments generally have a low credit risk. Data from the International Chamber of Commerce (ICC) shows that even amid global crises, default rates on trade finance products remain consistently low, reflecting their reliability as a financial mechanism. Although systematic national statistics on trade finance operations are not available in Uzbekistan, data from international sources allows for conclusions to be drawn about the main trends.

As a country actively seeking to expand exports and participate in global supply chains, Uzbekistan faces challenges to its external economic security. These challenges include various risks, ranging from currency risks to payment uncertainty.

Generally, foreign trade operations are exposed to a number of specific risks. Among them, the following can be highlighted: (Figure 1).



**Figure 1. Specific Risks in Foreign Trade Operations**

The effective management of these risks is a key factor in the sustainable development of foreign economic activity. To identify these risks, we must first analyze the dynamics of foreign trade in Uzbekistan and study them over the years. The table below presents the main indicators of Uzbekistan's foreign trade for 2022–2024. (Table 1)

Table 1

**Dynamics of Foreign Trade in Uzbekistan [15]**

Year	Foreign trade turnover, billion USD	Exports, billion USD	Imports, billion USD	Balance, billion USD
2022	50.0	19.3	30.7	-11.4
2023	62.6	24.4	38.1	-13.7
2024	65.9	26.9	39.0	-12.0

These dynamics lead to two important conclusions. First, the volume of foreign trade is expanding rapidly, which increases the economic significance of payment and counterparty risks in trade operations. Second, a negative foreign trade balance persists; consequently, mechanisms for financing imports and guaranteeing export revenues are becoming increasingly relevant.

The analysis shows that the role of instruments in mitigating foreign trade risks is not uniform; rather, they serve different risk segments: (Table 2).

Table 2.

### Comparative Description of Trade Finance Instruments

Instrument	Primary risk mitigated	Practical advantage	Key limitation
Documentary letter of credit	Payment and counterparty risk	High reliability due to bank obligation	Relatively high cost, complex documentation
Bank Guarantee	Risk of contract non-performance	Covers advance, tender, and performance risk	Does not cover all political risks
Documentary Collection	Risk of payment delay or refusal	Low cost	The bank does not guarantee payment
Factoring	Accounts receivable and liquidity risk	Accelerates working capital turnover	Involves commission and discount costs
Forfaiting	Long-term credit and country risk	Possibility of full risk transfer	Not suitable for all transactions
Export Insurance	Political and commercial risk	Increases bank and investor confidence	Additional insurance cost

According to ADB data, the global trade finance gap remained at \$2.5 trillion in 2025. This means that access to trade finance is insufficient, especially for SMEs.

The experience of the EBRD Trade Facilitation Programme shows that international bank guarantees and trade loan mechanisms are effective for emerging markets. As of the end of 2024, more than 130 issuing banks and over 800 confirming banks participated in the TFP, with a total transaction value exceeding 41 billion euros.<sup>1</sup> ICC materials confirm that trade finance

<sup>1</sup> <https://www.adb.org/publications/adb-global-trade-finance-gap-survey>

products, especially letters of credit and guarantees, historically fall into the category of low-default assets within the banking system.

Based on the data and analysis presented above, **we have analyzed the application level of trade finance instruments in Uzbekistan and their effectiveness in mitigating foreign trade risks (Table 3).**

Table 3

**Application Level of Trade Finance Instruments in Uzbekistan and Their Effectiveness in Mitigating Foreign Trade Risks**

<b>Instrument</b>	<b>Application Level in Uzbekistan</b>	<b>Risk Mitigation Effectiveness</b>	<b>Application Features</b>
<b>Letter of Credit</b>	High	Very High	This is one of the most widely used instruments in foreign trade operations. As the bank assumes the payment obligation in favor of the exporter, it significantly reduces counterparty and payment risks and increases the security of export-import operations.
<b>Bank Guarantee</b>	Medium	High	It is mainly used to ensure the fulfillment of contractual obligations, participate in tenders, and guarantee advance payments. This instrument reduces risks associated with contract non-performance but does not fully control the payment process.
<b>Factoring</b>	Low	Medium	It increases the liquidity of exporting enterprises and reduces the risk of working capital shortages by financing accounts receivable. However, this instrument is not yet widely developed in Uzbekistan.
<b>Forfaiting</b>	Very Low	High	It serves to mitigate credit and country risks by selling debt obligations at a

			discount in long-term export deals. In practice, it is mainly used in large-scale international trade operations.
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As this table shows, the documentary letter of credit is the most widely used trade finance instrument in Uzbekistan's foreign trade operations. This instrument is considered the most effective tool for reducing counterparty and payment risks, as the payment obligation is guaranteed by the bank. Modern trade finance instruments, such as factoring and forfaiting, are not yet sufficiently developed, and their practical application remains largely limited to major export operations.

The most important normative-legal acts adopted in recent years have also provided an impetus for monitoring and improvement in this area. In particular, **Decree No. PF-6091 of October 21, 2020**, — "On Further Strengthening Financial Support for Export Activities," **Decree No. PF-97 of April 6, 2022**, — "On Additional Measures to Support Foreign Trade Participants," **Decree No. PF-150 of June 9, 2022**, — "On Additional Measures for the Further Improvement of the Activities of the State Fund for the Support of Entrepreneurship," **Resolution No. PQ-126 of March 14, 2024**, — "On Measures to Further Enhance the Role of Business Associations in the Development of Foreign Trade and Regional Industry," **Decree No. PF-229 of December 27, 2023**, — "On the Next Measures to Ensure Equal Conditions and a Fair Competitive Environment for Entrepreneurs," and many other decrees and resolutions serve as clear examples.

An analysis of these documents shows that Uzbekistan's trade finance infrastructure has been gradually reinforced since 2020: first, the resource base was expanded, then the fund's mechanisms were deepened, and by 2024, the focus shifted toward institutional consolidation and alignment with the WTO.

At the same time, the choice of a specific instrument depends on the level of trust between the parties, country-specific conditions, the transaction amount, and the company's risk management strategy. Thus, the timely and widespread use of these instruments serves to increase the stability of foreign trade, strengthen the balance of payments, and reduce the economy's vulnerability to external shocks.

#### 4. Discussion

The results show that the role of trade finance instruments in foreign economic security is significant in three areas.

First, these instruments resolve the issue of trust between exporters and importers at the micro-level. With a letter of credit or a bank guarantee, counterparty risk is transferred to the banking system, increasing the likelihood of the transaction's execution. The experience of the ICC and the EBRD confirms exactly this.

Second, they create a risk-sharing mechanism for the banking system and export infrastructure at the meso-level. The availability of fund, insurance, subsidy, and refinancing mechanisms encourages banks to finance more export transactions. The regulatory evolution in Uzbekistan from 2020 to 2024 shows a convergence towards this model.

Third, they increase economic resilience to external shocks at the macro-level. As foreign trade turnover grows, payment risk, currency risk, and logistics risk also increase in absolute terms. Therefore, export growth cannot be sustainable without trade finance instruments.

At the same time, two problems persist in Uzbekistan's practice. First, there is a lack of separate, open statistics on trade finance instruments. Second, the cost of these instruments, documentation requirements, and bank risk appetite remain constraints for SMEs. These problems are consistent with the global financing gap noted by the ADB.

### **5. Conclusion**

According to the research results, trade finance instruments are not merely a banking technique for reducing foreign trade risks, but also an important element of foreign economic security policy.

Trade finance instruments are crucial for mitigating risks in foreign trade activities and ensuring the stability of international commercial operations. Their application helps protect the interests of transaction participants, improves payment discipline, and promotes the development of international trade in general. In the context of increasing global risks, the importance of trade finance is growing, which requires its further improvement and adaptation to the changing global economy. Expanding the use of trade finance instruments will make it possible to reduce foreign trade risks, increase the stability of export flows, and strengthen Uzbekistan's foreign economic security.

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