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## An analysis on supporting programs of procuring goods for export in Korea

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### I. Introduction

Recently Export competitiveness of Korea has decreased, even though the nation's total export volume increased, due to uprising of BRICs<sup>1)</sup> and other

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1) BRICs mean Brazil, Russia, India and China.

competitors. This brings an attention on the way how to improve the competitiveness. Among possible various solutions, we would like to investigate current trade supporting programme in Korea and suggest some method for further utilization.

There are currently 3 programs in Korea which is led by the Government side ; Trade Financing Program, Trade Tax Program, and Trade Insurance Program.

First, Trade Financing Program is a fund to support exporter to manufacture goods or buy raw materials or buy finished goods for export in cash or under local L/C.<sup>2)</sup> Second, Trade Tax Program is kind of drawback<sup>3)</sup> of customs duty. Last, Trade Insurance Program is kind of a risk management program to cover credit risk and price fluctuations of raw materials before manufacturing or shipment. These are organized to support exporters but it seems that the exporters are not well recognized the advantage of those supporting programs.

This paper will analyze the supporting programs mentioned above and will suggest better use of the programs in respect of procuring goods for export.

## II. Trade Financing Program

### 1. Trade Financing Program

#### (1) A meaning of Trade Financing Program

Trade Financing Program is a short term<sup>4)</sup> finance program to improve export of goods and service in Korea by extending KRW loan in order to buy

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2) a kind of back to back LC which is used only for local transaction for export, designed by Bank of Korea (BOK) allowing several benefits including low interest rate and commission

3) a refund of tax which was levied at the time of import

4) normally it is up to 180days

raw material or finished goods for export. Trade Financing Program can be used as the short cut for exporters in domestic industry to take loan from Foreign Exchange Bank<sup>5)</sup> to improve export competitiveness.<sup>6)</sup>

Trade Financing Program started in 1961 February as a part of export financing by Korean Monetary Board. In 1994, the detailed rule<sup>7)</sup> including booking procedures for execution of the trade financing KRW loan was set up by BOK<sup>8)</sup>. This program is mainly for ease of procuring or producing of goods for export by using low interest bearing loans. It has following features ;

First, it is a kind of advance financing system. Exporter may take a short term loan from Foreign Exchange Bank before production and then repay the loan upon receipt of export proceeds.

Second, it is a systematic network supports in view of loans for total exporting process allowing advances at each level of production, buying raw material and finished goods where necessary .

Third, as it is policy lending program<sup>9)</sup> follow-up control are needed for Foreign Exchange Bank to review capacity of production and export needs of the exporter which would like to get finance.

Fourth, it can be available for non-30 largest group companies<sup>10)</sup> at much lower interest compared to normal working capital loan<sup>11)</sup>.

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5) a bank which have license for foreign exchange but now it represents all the Korean banks as all of them have license for the foreign exchange.

6) Korea Banking Institute, Trade Financing, 8th ed., Korea Banking Institute, (2006), p. 16.

7) the ruled has been revised several times since 1994 with latest revision in 2006

8) As trade financing progarm is related to liquidity of KRW, BOK as central bank in Korea is in the middle of the financing program

9) Government led beneficial loan program to exporters

10) also it is not available for bankrupt or insolvent companies

11) BOK trade financing rate is currently about 2.5%~3.5% p.a while normal working capital loan at 5%~ 10% according to borrower's credit status

## **(2) Objects and Methods of Trade Financing Program**

Trade Financing Program is for exporters and importers (some times importers who procure goods for reexport) which make sales contract by payments of D/P or D/A, or L/C and for companies providing raw materials and finished goods under Local L/C.<sup>12)</sup>

Trade Financing Programs are extended for purpose of production,<sup>13)</sup> procurement of raw materials<sup>14)</sup> and finished goods.<sup>15)</sup> Also there are four ways in executing the BOK trade financing according to LC received or not. Exporters should take only one method to enjoy the BOK trade finance. This means that multiple choice is prohibited.

The four ways are :

First, BOK trade loan is subject to exporter's documentary credit, sales contract or Local L/C where loan for production, raw material or finished goods are available. Second, BOK trade loan is subject to actual export volume achieved in preceding year with regardless of L/C received. Third, BOK trade loan is subject to an export volume not exceeding USD50,000,000 where the loan is extended without regard of loan purpose. Fourth, BOK trade loan is subject to actual export volume in a specific period of time with regardless of L/C received.

## **(3) Amount and advance time of Trade Financing Program**

The BOK trade loan by L/C standard is according to average exchange rate made in the previous month. This means that the LC amount in foreign currency is converted into local currency, which is KRW. The average rate during the previous month is also applied to comprehensive loan and

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12) See Trade Financing and handling procedures by and under the regulations for loan of the Bank of Korea, Art. 5, Chap 2.

13) production fund is for manufacturing or processing of goods for export and exclude materials required under FOB basis.

14) raw material fund is available of importing or manufactured materials for export.

15) finished goods funds is for buying finished goods by Local L/C.

draft/local LC as well. .

A short term loan by actual export is available not exceeding amount of maximum limit

However in case a draft is denominated in KRW, the same KRW will be accepted.<sup>16)</sup>

With regard to advance time of BOK trade loan, it is available according to the nature of fund required ;

First, loan for production is available by one lump sum draw down or in partial as soon the limit of loan is set. Second, loan for raw material is available when shipping documents are arrived or when payments are made under local LC. Last, loan for finished good is available under payment of Local L/C.

## 2. Local L/C Program

### (1) Meaning of Local L/C

The payment of Local L/C is in favor of a domestic supplier under Master L/C,<sup>17)</sup> where the end supplier is to provide raw materials or finished goods to the beneficiary of master LC. Local L/C is not allowed for international trade but available only for between domestic businesses in Korea.

Local L/C provides a safe payment because the local L/C issuing bank undertakes to pay the second supplier on behalf of the first supplier, mostly being beneficiary of the master L/C. Also the second beneficiary can take VAT draw back even though it is transacted domestically in Korea under the government's tax exemption policy.

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16) See Trade Financing and handling procedures by and under the regulations for loan of the Bank of Korea, Art. 9, Chap 2.

17) a LC provided to the middle man or first supplier who is obtaining goods through second supplier On the back of this master LC, the first supplier often provide another LC to the second supplier. This second LC is called baby LC as this is followed by the master LC.

In summary, it is good way not only to promote export but protect domestic industry with actual domestic procurement along with VAT draw back.

## **(2) Terms of Local L/C**

Local L/C is available for exporters who want to buy finished goods or raw materials processed in Korea or come from abroad for export, respectively.<sup>18)</sup> Under Local L/C system the second beneficiary, being the beneficiary of local L/C, could apply another Local L/C to buy raw materials and finished goods for export.<sup>19)</sup> However, there are rules to apply Local L/C as follows.

First, Local L/C is available only under irrevocable Master L/C. Second, amount of Local L/C should be denominated in USD or KRW equivalent to the amount of Master L/C. Third, delivery date and validity of Local L/C must be within the shipment and validity of Master L/C in order to meet the supply condition of master contract.<sup>20)</sup> Fourth, validity of Local L/C might be added up to 10 days from actual delivery date but within the time of shipment date of the Master L/C. Fifth, shipping documents may be presented within 5 banking days from the date of receipt of goods but could be extended for 7 banking days where an applicant and a beneficiary are located in a long distance. Sixth, sight draft shall be drawn on the applicant of issuing bank. Finally, the condition of local L/C shall not be against on condition of negotiation of Master which gives favour for easy negotiation..<sup>21)</sup>

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18) See Trade Financing and handling procedures by and under the regulations for loan of the Bank of Korea, Art. 12, Chap 3.

19) See Trade Financing and handling procedures by and under the regulations for loan of the Bank of Korea, Art. 12, Chap 3.

20) the shipment deadline of master contract is reflected in the master L/C.

21) See Trade Financing and handling procedures by and under the regulations for loan of the Bank of Korea, Art. 14, Chap 3.

**(3) Present status of using Local L/C**

The use of local L/C has been decreased to KRW323billion in 2007 from KRW519 billion in 2003. The reason for this sharp decrease is that increase of other programs such as Purchase Confirmation<sup>22)</sup> have replaced handsome Local L/C .<sup>23)</sup>

< Table - 1 > Local L/C Negotiation Scale

(Unit : KRW billion, outstanding as of end of the year)

|                 | 2003 | 2004 | 2005 | 2006 | 2007 |
|-----------------|------|------|------|------|------|
| Commercial Bank | 430  | 315  | 300  | 263  | 272  |
| Special Bank    | 89   | 62   | 47   | 55   | 51   |
| Total           | 519  | 377  | 357  | 318  | 323  |

Source: Shin Sang-Chul, "How to Financing for Exporting SMZs?(Focused on Local L/C)", Korea Small Business Institute(KOSBI), 2009,12

The avoidance of using Local L/C means that SME<sup>24)</sup> has turned to use Purchase Confirmation. This is because there is cost <sup>25)</sup>for local L/C while there is just simple fee<sup>26)</sup> for issuance of Purchase Confirmation. Purchase Confirmation, however, does not give BOK trade loan and payment safety to the second supplier, being the actual provider of raw materials or goods, while a VAT draw back is allowed same.

Below is another statistics<sup>27)</sup> showing both decrease of number and amount of local L/C during 2003 ~ 2007. We can find that the number of Local L/C

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22) another bank's certificate showing that the fist beneficiary purchase materials/goods from a local supplier for export purpose.

23) Shin Sang- Chul, "How to Financing for Exporting SMZs?(Focused on Local L/C)", Korea Small Business Institute(KOSBI), (2009), pp. 42-43.

24) Small and Medium Enterprise

25) 0.15% p,q for normal credit rated applicant

26) like KRW20,000 which much more cost saving compared to local L/C issuance.

27) KFTC(Korea Financial Telecommunications & Clearings Institute)

has been decreased by one third over the last 5 years time.

< Table - 2 > Local Credit Number and amount

(Unit : Thousand Number, billion Amount)

|               | 2003  | 2004 | 2005 | 2006 | 2007 |
|---------------|-------|------|------|------|------|
| <b>Number</b> | 1,017 | 515  | 449  | 384  | 334  |
| <b>Amount</b> | 274   | 365  | 301  | 267  | 271  |

Source: Shin Sang Chul, "How to Financing for Exporting SMZs?(Focused on Local L/C)", Korea Small Business Institute(KOSBI), 2009.12

### 3. Suggestion for the Trade Finance Program

#### (1) Problems

BOK trade loan is actually beneficial in respect of low pricing <sup>28)</sup>to exporters who are manufacturing goods or procuring raw materials/finished goods for export in respect of low pricing. But the program leaves a room for improvement as follows.

First, BOK trade loan is executed through commercial banks which evaluate the exporter's credit. This means that low credit rated exporter is not able to enjoy the low interest trade financing. The local commercial banks are just gate way <sup>29)</sup>to run the government led trade financing and do not like to take any credit risk. And therefore the local banks ask some security from the exporters who fall below the credit standard.

Second, BOK trade loan is executed in KRW which is Korean currency and therefore the exporters shall take foreign exchange risk because the exporters get the loan in KRW but they settle later the loan with export proceeds which are in foreign currency. This means that if there is, for

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28) ie, about 4% lower than normal working capital loan

29) The local banks lend some money at favorable interest to exporters who are within the BOK trade loan programme and then the local banks get rediscount from BOK at much lower interest for the money they extended.



example, some KRW appreciation against USD at the time of loan settlement the exporter shall get extra fund.

Third, according to the BOK guideline for local LC, exporter may draw sight draft drawn on applicant rather than the issuing bank. This is a practice when UCP400 was prevailing. Now UCP<sup>30)</sup> says that the draft shall be drawn on the issuing bank.

Fourth, BOK guideline is so complicated to the extent that a few days' training is required to understand the program. Therefore SME are not well familiar with this favour and this goes same to the junior bankers.

## **(2) Suggestion**

This paper suggests BOK trade loan is be revised for the following area.

First, BOK includes USD, among other foreign currencies, as part of trade loan. This is because BOK reserves huge USD and therefore could utilize some USD for the rediscount. With this USD trade loan, the exporters could avoid foreign exchange risk whilst saving cost for foreign exchange hedge. In addition, this may create more USD reservation for BOK as the nation will see more trade surplus if export is promoted with this USD trade loan initiative.

Second, the BOK trade loan is distributed to other financial institution or trade promote agencies such as SBC,<sup>31)</sup> KOTRA,<sup>32)</sup> KITA.<sup>33)</sup> SBC have separate fund to help financially unhealthy SME with low interest but there a limit. KOTRA and KITA seems to create some fund for SME exporters. Then BOK may support these organizations with rediscount system. This will be of much help to infant or financially weak SME which have a lot of export opportunities.

Third, BOK guideline need to be simplified with plain wordings so that

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30) UCP500 and UCP600 point out this clearly.

31) Small Business Corporation, a government entity which supports SME.

32) Korea Trade and Investment Promotion Corporation

33) Korea International Trade Association

exporters and bankers avoid unnecessary misunderstanding. Also the guideline need to be aligned with up to dated international standard such as UCP600.

### III. Trade Tax Program

#### 1. Meaning of customs drawback

Customs Drawback is a system under which customs duties and other taxes levied on imported raw materials can be refunded when they are used for making export goods.

The drawback system is one of several export supporting measures employed by the Korea Customs Service to increase international competitiveness of exports. It alleviates the burden of tariff levied on raw materials for the production of export goods.<sup>34)</sup> This means that Customs pay back the whole or part of the amount of import tariff when exporter satisfy requirements of customs.

There are several drawback of customs. One is draw back of duty overpaid or erroneously paid<sup>35)</sup>, second one is drawback for breached goods<sup>36)</sup>, third one is drawback for loss or damage declaration of stored goods<sup>37)</sup> and fourth one is drawback in accordance with The Special Act for Drawback.<sup>38)</sup> This

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34) see [www. customs.go.kr](http://www.customs.go.kr)

35) Custom drawback of over payment of tariff caused of misunderstood of doing business or else.

36) drawback of perished goods at bonded area is happened when arrival of falsely goods of buyer shipback to the seller is needed, when declared importing goods are perished or damaged under storage and when reservation or cancel of collecting tax to the reserved or falsely goods. By these reasons effect of import has gone customs drawback is applied.

37) After acceptance of payment of tariff or import declaration due to perishment or damage of the goods the whole or the part of customs drawback is available.

38) its original title is drawback of Act Special Cases concerning the drawback of

paper treats the fourth one where The Special Act for Drawback is applied.

## 2. Application of customs drawback

Customs drawback is applied not only for exports processed by the Customs in accordance with the "Korea Customs Act" but also for special cases of transactions eligible for drawback<sup>39)</sup>, domestic sales or construction supplies paid in foreign currencies<sup>40)</sup>, goods or raw materials supplied to bonded areas including bonded factories, bonded sales shop including duty-free shop, and companies residing in Free Trade Zones(FTZ).

Application of customs drawback is available when declaration of export is made and approved of shipment by online network of Customs. Also the trade might be object of selling under foreign exchange.<sup>41)</sup>

Customs drawback is applied to the whole raw material for export only for once in a year. Even dividing application of customs drawback is also available when total trade can be divided into each categories of declaration.

Export of manufactured or processed goods are to be made within 2 years after declaration of export and application of customs drawback may be available within 2 years after those declaration.

## 3. Calculation of Drawback Amount

The drawback amount is, in principle, the sum of customs duties and internal taxes levied on each imported raw material used to produce export goods. It can be calculated in two ways: one is Individual Drawback and the

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Customs duties, etc. Levied on Raw materials for Export. but generally called "The Special Act for Drawback".

39) It means supplies for vessels and air crafts plying between Korea and foreign nations.

40) It means construction supplies for US forces, foreign embassies, consulates or legations in Korea paid in foreign currency.

41) see The Special Act for Drawback, Art. 4(2) or 4(4).

other is Simplified Fixed Drawback.<sup>42)</sup>

Individual drawback is the sum of individual tariff levied on each imported raw material used to manufacture export goods. And Simplified Fixed Drawback is calculated that under a specific sum of money(a table of fixed rate of drawback) is regarded as tax payment.

The goal of customs drawback is pay back amount of tariff already paid when export is made. It is reasonable that customs drawback is calculated according to Individual drawback. However it is important to pay back exactly the amount of import tax as well to support exporter with easy way of Customs Drawback. Extending of Simplified Fixed Drawback is essential to realize in supporting export program even with some deviations.

### **1) Calculation of Simplified Fixed Drawback**

Simplified Fixed Drawback is for small business to support and simplify the process of Drawback with SEMs below the annual drawback amount of KRW 600 million for last 2 years. Drawback might be calculated under a specific amount of payment by a payment of tariff.

Simplified Fixed Drawback is calculated in accordance with HS Code that amount of Customs drawback to actual export (FOB/KRW1,000) is settled under considering the variations of tariff rate or foreign exchange rate.

As mentioned above Simplified Fixed Drawback is available only for SEMs below the annual drawback amount of KRW 600 million for last 2 years. However over or lack drawback can be occurred because it comes from the base of average drawback rate for the last one year under specific HS Code.

Therefore it comes to exporter's option whether to apply Simplified Fixed Drawback. When the exporters expect to receive over drawback using a domestic raw materials, they would prefer Simplified Fixed Drawback. But when exporters a less refund, they may avoid Simplified Fixed Drawback.

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42) see [www.customs.go.kr](http://www.customs.go.kr)

## 2) Calculation of Individual drawback

Each customs drawback is applied to the amount of import tariff of raw materials for export. Drawback is made after confirmation of each material.<sup>43)</sup>

It is better to calculate the amount of import tariff but needs a bundles of documents complicated and takes too much time to calculate.<sup>44)</sup>

Most of drawback is applied now under Each Customs Refund and to general goods not available fixed rate refund.

## 4. Actual Running Result of customs drawback

Actual result of customs drawback is increased by 15% or KRW323,440 million in 2009 compared to 2008. Each customs drawback is about 93.7%, and Simplified Fixed Drawback of fixed rate drawback is about only for 6.2% <See Figure 3>

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43) The following documents and conditions are required to be eligible for individual drawback:

- i Description, size and quantity of raw materials used to manufacture export goods should be specified (Specification of Yield Ratio)
- ii A certificate of tax payment of each raw material described on the Specification of Yield Ratio(Import declaration certificate or certificate of tax payment of fundamental raw materials or certificate of import declaration partition) (see [www.customs.go.kr](http://www.customs.go.kr))
- iii Documents proving export or equivalent (Export declaration certificate or procurement confirmation)

44) Individual Drawback Yield Ratio

- i The yield amount is the quantity of raw materials used to manufacture export goods, and it is composed of net quantity and wasted quantity. Net quantity is the portion that composes the final product and wasted quantity is the portion that is lost in the manufacturing process. The yield ratio is the sum of net quantity and wasted quantity, and it becomes the basis for drawback amount.
- ii There are two yield ratio systems used to calculate the drawback: one is Self-management yield ratio and the other is Standard yield ratio. Since Jan. 1, 2000 only Self-management yield ratio has been accepted for drawback.
- iii Self-management yield ratio is calculated by the company applying for drawback itself, using one of the methods accepted by the KCS. (see [www.customs.go.kr](http://www.customs.go.kr))

It is easy to use of Simplified Fixed Drawback of fixed rate drawback but seems only a few exporter apply for the program.

The amount of import tariff is about KRW9,167billion in 2009 and drawback is made in ratio of KRW8.9 per a USD.

10,582 cases were used as actual using result of Simplified Fixed Drawback of fixed rate drawback in 2008. 32% of total exporter, 105,835 cases were applied and 6.7% or d KRW189billion was drawbacked. It was increased by about 29.3%.

According to the Authority, 3,735 cases were applied to Simplified Fixed Drawback. It seems that Simplified Fixed Drawback was extended to exporters with export goods worth from KRW0.4billion to KRW0.6billion.

< Figure - 3 > Actual Result of customs drawback

(Unit : KRW100million)

|                                  | 2005   | 2006   | 2007   | 2008   | 2009   |
|----------------------------------|--------|--------|--------|--------|--------|
| <b>Custom Income</b>             | 63,177 | 68,584 | 74,107 | 87,751 | 91,691 |
| <b>Amount of Drawback</b>        | 23,384 | 24,429 | 24,360 | 28,162 | 32,344 |
| <b>Simplified Fixed Drawback</b> | 1,292  | 1,250  | 1,463  | 1,892  | 2,010  |
| <b>Individual Drawback</b>       | 22,091 | 23,179 | 22,987 | 26,270 | 30,334 |

Source : Korea Custom Service

< Table - 4 > Announcement of Simplified Fixed Drawback Table and Actual Frequency of use

(Unit : amount, KRW100Million)

| year | item  |         |        |                    |
|------|-------|---------|--------|--------------------|
|      |       | number  | amount | number of business |
| 2006 | 3,250 | 101,620 | 1,250  | 9,765              |
| 2007 | 3,654 | 98,024  | 1,463  | 9,640              |
| 2008 | 3,735 | 105,835 | 1,832  | 10,582             |

Source : 「customs yearbook」 2009

## IV. Trade Insurance Program

### 1. Meaning and function of Trade Insurance

#### (1) Meaning of Trade Insurance

Trade Insurance covers commercial risk<sup>45)</sup>, credit risk and political risk<sup>46)</sup> beyond control of parties. It helps promotion of export by way of public insurance system. It further protects export marketing risk.

Trade Insurance began from 1969 in Korea and it was concentered with establishment of Korea Export Insurance Corporation in 1992 by the Government. Korea Export Insurance Corporation was renamed as K-sure in July 2010 to cover import risk in addition to various export risks as above illustrated.<sup>47)</sup>

Especially, the import insurance system was introduced to help financially unhealthy importers who import strategically important items to Korea. The insurance covers losses arising from breach of contract by foreign exporters or foreign exporters' default of repayment of prepayment made earlier by Korean buyer.<sup>48)</sup>

#### (2) Efficiency of Trade Insurance

Trade Insurance has various effects to exporters. First, it eliminate

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45) such as non-recovery of export proceeds and in the case export itself being impossible due to importer's poor credit, bankruptcy, refusal to pay export proceeds, etc.

46) such as war, revolution, limitations imposed on importation and foreign currency exchange, declaration of moratorium, etc in importing country

47) see [www.K-sure.org.kr](http://www.K-sure.org.kr)

48) Korea Export Insurance Corporation(KEIC) has been seeking to amend the Export Insurance Act since January 2009. this effect was proved to be effective with the approval of bill to revise the Act at the National Assembly in March 2010, enabling K-Sure to be reborn as " Korea Trade Insurance Corporation " effective July 2010. (see [www.K-sure.or.kr](http://www.K-sure.or.kr))

uncertainty of exports beyond the exporters' control such as buyer's commercial risk<sup>49)</sup> and importing country's political risk etc. This means that the trade insurance covers risks in addition to cargo insurance which is covered by commercial insurance companies. Second, it helps the exporters in getting financing from banks by way of guarantee which is given to banks which extend pre-shipment financing or post-shipment financing. Third, it helps the exporters by offering low rate of insurance premium,<sup>50)</sup> which means that the exporter's financial burden is reduced while they are covered a wide range of export risk.

## 2. Actual status of Trade Insurance

Since 1992 use of Trade Insurance has grown up steadily. It amounted to KRW 164,960billion in 2009 and until Sep 2010 KRW143,262billion.

< Table - 6 > Actual status of Trade Insurance

(unit : KRW100million)

|                                     | 2006           | 2007           | 2008             | 2009             | 2010(9)          |
|-------------------------------------|----------------|----------------|------------------|------------------|------------------|
| Short-term <sup>51)</sup>           | 607,065        | 652,644        | 947,120          | 1,443,997        | 1,256,242        |
| Medium and Long Term <sup>52)</sup> | 45,597         | 82,247         | 190,005          | 131,841          | 103,613          |
| Credit Guarantee                    | 11,315         | 11,591         | 15,625           | 59,637           | 49,375           |
| Foreign Exchange Risk               | 162,708        | 169,793        | 145,267          | 14,128           | 18,789           |
| <b>total</b>                        | <b>826,685</b> | <b>916,275</b> | <b>1,298,017</b> | <b>1,649,603</b> | <b>1,432,621</b> |

49) In Letter of Credit transaction it covers the issuing bank's credit risk as well

50) the possible low rate is owing to K-Sure's status as non-commercial government entity.

51) Short term insurance consists of short term export insurance, farming and fishing export insurance, cultural export insurance, over sea marketing insurance, and others.

52) Mid-long term insurance is consists of mid-long term export insurance, export guarantee insurance, foreign investment insurance, foreign guarantee insurance and



Source : Korea Trade Insurance Corporation, 「Trade Insurance」, each of the monthlies.

### **3. Trade Insurance Program for procuring Export Goods**

Trade Insurance Programs can be divided into short term (within 2 year period) insurance and over 2 year mid-long term (over 2 year period) according to insurance taking period. There are about 15 variety of insurances provided by K-Sure. Among them this paper put attention on insurance at pre-shipment side and stage of procuring goods for export.

#### **1) at the stage of Pre-shipment**

The exporter may face losses due to political risk or importer's bankruptcy that might occur during the production stage of goods with payment overdue exceeding two years.

Medium and Long-term Export Credit Insurance (Pre-Shipment) is a scheme to actively support exporters by covering his losses caused by export failure not due to exporters' default.<sup>53)</sup> If exporter could not go on business under mid-long term contract or could not get paid from the importer it might be covered by K-sure.

#### **2) at the stage of procuring raw materials and manufacturing goods for export**

##### **(1) Pre-shipment Export Credit Guarantee**

It is essential that small business exporter take export credit guarantee<sup>54)</sup> before pre-shipment at the stage of procuring raw materials and manufacturing goods for export to loan a export fund from bankers. K-sure

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others.

53) There is possibility of credit risk or other contingencies in international trade of manufacturing vessel or plant because of its peculiar large scale of business.

54) It is operated for providing pre-shipment fund and for after delivery for collecting proceeds by K-sure.

issues certificates of export credit guarantee and guaranty against bankers with exporter equally.

Generally after making sales contract exporters usually loan export fund as trade financing to procure raw materials and manufacturing goods.

However as trade financing always demand a security or guarantee small exporters hardly provide such a security or guarantee. In such case after confirmation of exporter's credit K-sure may afford trade insurance to small exporters against bankers.

Therefore banker also eliminate uncertainty of credit or commercial risks and take a stable coverage from K-sure.

#### (2) Insurance for market fluctuation of raw materials

Insurance for market fluctuation of raw materials is available at stage of procuring raw materials for export and compensate for the loss incurred to exporters and in case of fall in prices for example copper, aluminum or nickel. On the other hand K-sure take back the profit from exporters if the price goes up.

It is available for small or large exporters who import raw materials directly from abroad and process. It operates even for a small quantity.<sup>55)</sup> It is especially helpful and of good service to small exporters without banking experiences.

### **4. Suggestion for the use of Trade Insurance**

K-sure led trade insurance is virtually beneficial to SME exporters who are lack of information about buyer and importing country along with weak financials. For wider use of trade insurance, following is suggested.

First, insurance guarantee for pre-shipment and post shipment financing is currently provided to banks which are extending KRW loans. The insurance

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55) ie, less than a M/T(Metric Ton)

guarantee is needed to cover foreign currency denominated loan.

Second, import insurance are limited for Korean buyer's advance payment only. It is suggested that the K-sure import insurance further cover issuance of LC for import of those products. Currently K-sure insurance related to import LC opening is available for import of raw materials for re-export only.

## V. Conclusion

There are 3 initiative trade supporting programs in Korea named Trade Finance Program, Trade Tax Program and Trade Insurance Program. These are all good and beneficial to SME exporters which procure goods for exports. Among them Trade Finance Program and Trade Insurance Program is most workable to financially weak SME exporters in view of low interest lending and wide range of risk covering.

The nation's trade dependence ratio<sup>56)</sup> exceed 90% and therefore Korea's economy can not go on without trade composed of import and export activities. There is a concern on the high ratio of trade dependence but it is true that there is no alternative to escape from this dependency for Korea. This means that the nation must develop ways to promote exports with competitiveness.

Currently big companies such as Jaebul companies are in front line attributing to more than 70% of total exports. This is a high ratio and therefore some measures to support SME exporters are to developed continuously. This paper looked in to SEM exporters supporting programs and suggested a few methods to help further initial staged or financially weak SME exporters. Among them USD loan based BOK trade finance and insurance guarantee for foreign currency (including USD) denominated loan is strongly

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56)  $(\text{Import} + \text{Export amount}) / \text{GNI}$ . This ratio once jumped to 100% in 2010

suggested. With regard to Trade Tax Program, this paper has little suggestion about its improvement and leaves a room for further study later.

It is understood that most SME exporters know the existence of those 3 trade program but they appear not to utilize those benefits full. Financing is a blood for a company's survival and further growth. Therefore it is recommended that trade training organizations such as universities, KITA, SBC organize classes for right use of those benefits. Also SME exporters should have wisdom in utilizing those programs in a mixed way, for example, combined use of Trade Insurance and Trade Loan in seeking for effective and cost saving solution.

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## ABSTRACT

### **An Analysis on Supporting Programs of Procuring Goods for Export in Korea**

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To promote the nation's exports, in Korea several government led programs are alive for procuring and manufacturing goods for export. The trade supporting programs are consisted of Trade Financing Program, Trade Tax Program, and Trade Insurance. The programs are summarized ;

First, Trade Financing Program is available to exporters of procuring raw materials and finished goods for export. It is extended with exceptionally low interests from the Korean commercial banks. Second, Trade Tax Program provides whole or part of customs drawback to exporters. customs drawback is` made when exporters meet requirements of Customs for export. Third, Trade Insurance Program cover risks of uncertainty which is beyond the exporters' capacity at low insurance premium

It is suggested that the exporters have deep knowledge of these three programs to their ends. Especially Trade Financing Program and Trade Insurance Program can be a combined work for the financially weak SMEs.

Further, there are rooms for these programs to develop to enhance the competitiveness of SME exporters.

Key Words : Trade Supporting Programs, K-Sure, SEM exporters