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## POLICY TO IMPROVE EFFICIENCY OF FTA APPLICATION FOR KOREA'S SMALL AND MEDIUM ENTERPRISES AND LESSONS FOR OTHER COUNTRIES

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### Abstract

*Free Trade Agreements (FTAs) play an important role in the current global economic context, helping countries promote trade and investment, enhance competitiveness, ensure economic security, and promote sustainable economic development. However, not every country has been successful in taking advantage of the benefits of FTAs. One of the reasons for that is the weak capacity of domestic enterprises, especially small and medium enterprises. Korea has had very practical and effective policies to help increase approach to FTAs for these enterprises.*

**Keywords:** SMEs, Korea, policy

## I. INTRODUCTION

Since 2004, South Korea signed its first free trade agreement (FTA) with Chile. Since then, South Korea has expanded its economic footprint on the world stage by regularly signing FTAs. To date, there have been 21 FTAs with 59 countries in effect. The GDP of these countries alone accounts for 85% of the world's gross domestic product (GDP). Additionally, FTAs between the Philippines, Ecuador, the United Arab Emirates (UAE) and the Gulf Cooperation Council (GCC) have also been signed and are about to come into effect. Thanks to that, Korea has become the

country with the second largest FTA network in the world after Singapore. However, Korean small and medium enterprises are still facing many difficulties in accessing FTAs, which is why the effectiveness of FTAs for Korea is not as high as expected.

## II. CONTENT

### I. Situation of FTA utilization by Korean SMEs

According to the Ministry of SMEs and Startups of Korea, SMEs account for 99% of the number of enterprises, 83% of total

employment, and 34% of Korea's export value. FTAs can provide SMEs with various opportunities to expand internationally. However, according to Park Tae-ho, Director of the Gwangjang Institute of International Trade: "It is unfortunate that although the Government has tried to expand the export of small and medium enterprises through the FTA network, the effectiveness is somewhat insufficient compared to large companies." According to a survey conducted under the mandate of the Asian Development Bank, only about 10% of Korean companies are specifically aware of the content of FTA agreements in areas related to their businesses. This means that most small and medium-sized enterprises only have general awareness and do not meet the standards to be able to specifically apply FTA terms for their business operations.

In 2012, the Korea Federation of Small and Medium Enterprises conducted a survey of over 300 small and medium enterprises with 10 or more employees and exporting to countries that implement it. The results showed that, regarding the actual effectiveness of the FTA, 34.4% of respondents said they felt it and 39.3% of respondents said they did not feel it. The most common reason for assessing that the FTA effect was ineffective or negative was due to "increased competition in the export market" at 26.4%, followed by "due to inability to take advantage of preferential FTA tariff rates" at 25.4%. The most common reasons for not taking advantage of FTA preferential tax rates were "because there is no or very small difference compared to the general tax rate" at 40.3%, "because the origin standards of each FTA are different, it is difficult to apply", and "because it is difficult to issue certificates of origin" at 33.5%.

Also according to a press release from the Korea Federation of Small and Medium Enterprises in 2017, 4.4% of SMEs responded that they had "difficulties" in taking advantage of FTAs, and the most difficult thing when using FTAs was "preparing documents to prove origin, such as collecting origin confirmation for raw materials." This was very high at 50.5%.

Therefore, Korea has implemented many policies to support small and medium enterprises (SMEs) to take advantage of Free Trade Agreements (FTAs).

## **2. Korean policies to support small and medium enterprises**

### *2.1. Financial and credit support policy*

Small and medium-sized enterprises face many difficulties in capital, so in order to support enterprises with guaranteed financial resources to serve innovation activities, the Government provides direct and indirect financial support to enterprises. Korea has established a financial support system for small and medium-sized enterprises through a credit guarantee system. The Korean credit guarantee system is divided into three funds: Korea Credit Guarantee Fund (KODIT), Korea Technology Credit Guarantee Fund (KOTEC) and 16 local credit guarantee funds. This reduces risk for banks and financial institutions, thereby expanding access to capital for small businesses. Having a credit guarantee increases the ability to borrow capital, helping SMEs have financial resources to expand production and invest in product research and development.

Korea provides preferential loans through the Korea Development Bank (KDB), including the "K-Startup Grand Challenge" program that provides financial support to SMEs engaged in export projects. The Small and Medium Enterprise Support Agency (SMBA) credit

guarantee program helps SMEs reduce risks when participating in exports. According to the SMBA report, the credit guarantee rate for SMEs increased by 15% in 2021.

### *2.2. Strengthen training, consulting and providing information on FTAs for small and medium enterprises*

The Korean government has established FTA Support Centers nationwide to provide detailed information on FTA provisions, rules of origin, and market opportunities. According to the Ministry of Trade, Industry and Energy (MOTIE), SMEs are provided free support on how to certify rules of origin, helping them qualify for tariff preferences from the FTA with the EU. FTA guidance documents and seminars are held regularly, attracting thousands of businesses to participate.

The Korea Trade and Investment Organization (KOTRA) regularly organizes training courses on EU technical standards in areas such as textiles, electronics, and food. In 2022, more than 1,500 businesses participated in these courses.

The Korean government through KOTRA (Korea Trade Organization) provides free market research reports to SMEs. In 2021, KOTRA issued more than 300 reports on potential markets, helping small and medium-sized enterprises access export markets quickly and effectively.

### *2.3. The government is increasing support for small and medium-sized enterprises to participate in trade fairs and events.*

To promote exports and economic growth, the Korean government has implemented many measures to support small and medium-sized enterprises (SMEs) to participate in international trade fairs and events. These supports not only help SMEs increase their access to global markets but also enhance their international competitiveness. The Korean government provides subsidies and financial support to SMEs to reduce the cost of participating in international trade fairs. These grants may include booth rental costs, product shipping, and promotional costs. Organizations such as the Korea Trade-Investment Promotion Agency (KOTRA) provide funds to support small and medium-sized enterprises in participating in international trade events and fairs, thereby helping them reach potential customers and build relationships with international partners. In 2019, about 1,200 SMEs received support to participate in international fairs. In addition, SMBA has organized annual business networking events, with thousands of SMEs participating to find partners.

### *2.4. Tax incentives for small and medium enterprises*

Under the revised corporate tax law in 2020, exporting SMEs are entitled to a 50% reduction in corporate income tax for the first three years. Small and medium-sized enterprises in Korea enjoy lower corporate income tax rates than large enterprises. Specifically, the tax rate for SMEs with revenue under 50 billion KRW (about 42 million USD) is 10% for income under 200 million KRW (about 167,000 USD), and 20% for income from 200 million KRW to 20 billion KRW. Newly established SMEs can enjoy tax exemption or low tax rates for a certain period of time, helping them overcome the initial difficulties and focus on development. The Korean government also applies a policy of exempting import taxes on raw materials for export production, helping to reduce costs for SMEs.

### *2.5. Government support for research and development*

The Korean government has implemented many policies and programs to support research and development (R&D), especially

in the fields of science and technology, innovation and the development of strategic industries. The "Creative Research Program" provides funds for SMEs to engage in research and development of new products. In 2020, about 2,000 SMEs received funding from this program. In addition, businesses conducting research and development activities will enjoy tax incentives and tax reductions on R&D expenses. This encourages businesses, especially small and medium enterprises (SMEs), to invest in innovation and technology development.

Korea strengthens cooperation between government, business and research institutes: There are several national research institutes, including the Korea Institute of Science and Technology (KIST) and the Korea Advanced Institute of Science and Technology (KAIST), which receive financial support from the government to promote research in strategic areas. These institutes also work closely with businesses in developing new technologies. These policies help promote innovation, develop new technologies and enhance the competitiveness of Korean businesses, especially in high-tech and strategic manufacturing sectors.

#### *2.6. South Korea strengthens construction of logistics infrastructure*

South Korea is one of the pioneering countries in building modern logistics infrastructure and developing efficient supply chains. The Korean government has implemented many strong policies to support the national logistics system, thereby facilitating businesses, especially small and medium-sized enterprises (SMEs), in optimizing supply chains and increasing international trade efficiency. The strong development of seaports, airports, and high-speed railway systems has helped reduce transportation time and logistics costs for businesses. South Korea is also one of the leading countries in applying technology to logistics. Technologies such as Internet of Things (IoT), Blockchain, and Big Data have been integrated into logistics systems to track, monitor, and optimize the supply chain. This helps businesses, especially SMEs, save time and costs, as well as improve transparency and safety in freight transport.

#### *3. Lessons achieved*

Korea's support policies not only help SMEs overcome challenges in expanding exports but also create favorable conditions for them to make the most of benefits from FTAs. Through this, we can achieve lessons for countries, especially developing countries, to promote domestic small and medium enterprises to make good use of the opportunities brought by FTAs:

First is to create a flexible and effective financial support mechanism: It is necessary to provide complete and timely information about FTAs and the market: Countries need to create effective financial support mechanisms, not only through bank loans but also through credit guarantee policies, business support funds, or grants for innovation projects. In particular, providing low-interest or no-interest loans to SMEs can help small businesses weather difficult times, thereby creating long-term growth momentum.

Second is: Strengthen training and consulting for SMEs: The government's provision of free or low-cost training and consulting programs to SMEs not only helps businesses improve their professional and management skills but also helps them develop more effective business strategies. Furthermore, the government can also provide advisory services on supply chains, market access and intellectual property protection.

Third is: create international connection opportunities for SMEs: Through organizing fairs, exhibitions, trade events and international trade events, SMEs can participate in these events to find partners and expand their markets. This helps SMEs grow rapidly and go beyond the limits of the domestic market.

Fourth is: Apply tax incentives for small and medium enterprises. This will encourage small and medium enterprises to research and develop new technology applications. In particular, it is necessary to clearly stipulate policies on tax exemption, reduction and refund for small and medium enterprises, depending on business conditions, scale and type of business.

Fifth, support research and encourage technological innovation. The government can provide cooperation programs with research institutes, universities and large companies to transfer technology and enhance competitiveness for SMEs, thereby helping them adopt new technologies and improve production capacity.

Sixth, ensure infrastructure and logistics development. It is important to recognize the importance of logistics infrastructure in promoting trade and economy. This not only improves domestic transportation capacity but also facilitates international export and import of goods. An efficient logistics system can help reduce transportation costs, increase productivity and delivery times, thereby enhancing the competitiveness of businesses.

### **III. CONCLUSION**

Lessons from Korea's SME support policy can be applied to many different countries, helping them build a favorable business environment and sustainable economic development. By promoting the development of SMEs, countries not only increase their export potential but also create more jobs and promote inclusive and sustainable economic growth.

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