International Financing Through Letters of Credit in Trade for Export Activities

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Abstract

International trade plays a pivotal role in sustaining global economic integration, with the Letter of Credit (L/C) serving as a critical legal and financial instrument to ensure payment security in cross-border transactions. This study aims to analyze the legal position of exporters in L/C arrangements within Indonesia's regulatory framework and to identify the challenges arising from discrepancies between national regulations and international standards, particularly the Uniform Customs and Practice for Documentary Credits (UCP 600). Using a normative juridical method with a statutory and conceptual approach, this research reveals that although L/C provides payment assurance and mitigates financial risks, inconsistencies in interpretation and implementation among banks and regulatory bodies create legal uncertainty for exporters. Furthermore, L/C does not guarantee the quality or condition of the goods delivered, requiring complementary contractual safeguards. The study concludes that stronger legal protection and harmonization between Indonesian regulations and international norms are essential to enhance the reliability, efficiency, and fairness of L/C mechanisms in global trade.

I. Introduction

Ekspor represents a fundamental driver of the Indonesian economy, enabling the nation to leverage its comparative advantages within the global market (Kumar, 2024). However, cross-border transactions inherently carry significant payment risks due to differing legal systems, currency variations, and the absence of established trust between distant trading partners (Riza, 2016). To mitigate this counterparty risk, the Letter of Credit (L/C) has become the dominant payment instrument in Indonesian export practice (Nezhad et al., 2024). In theory, the L/C mechanism is designed to provide a secure payment guarantee from a bank to the exporter upon the successful presentation of complying documents. This financial tool is crucial for fostering confidence and facilitating international trade by ensuring that exporters receive payment as long as they fulfill their documentary obligations. The reliance on L/Cs underscores their perceived role as a cornerstone of secure international trade finance. Consequently, Indonesian exporters frequently depend on this instrument to navigate the complexities of global markets. The theoretical security it offers is a key reason for its widespread adoption across various export sectors. Therefore, understanding its operational framework is essential for all parties involved in export activities. Ultimately, the L/C system is intended to create a balanced and secure trading environment for both exporters and importers.

Despite its theoretical promise of security, the practical implementation of the L/C mechanism in Indonesia is significantly hampered by a fragmented regulatory landscape. The legal framework governing L/Cs is scattered across various governmental regulations, central bank instruments, and international soft law, creating a complex and often contradictory environment for practitioners. Specifically, the applicable rules are dispersed between Government Regulation No. 1 of 1982, several regulations issued by Bank Indonesia, and the international standard known as the Uniform Customs and Practice for Documentary Credits (UCP 600) (Setiawan, 2017). A critical challenge arises

from the fact that while Bank Indonesia mandates the use of UCP 600, the hierarchical and operational relationship between these international rules and Indonesia's national legal system is not clearly defined (Utama et al., 2024). This lack of integration means that there is no single, authoritative source of law for L/C transactions, leading to jurisdictional ambiguities. The coexistence of national and international rules without a clear framework for reconciliation is a primary source of legal uncertainty. This regulatory patchwork complicates compliance for banks and businesses alike, as they must navigate multiple, sometimes conflicting, sets of guidelines. The absence of a comprehensive and unified legal directive undermines the very legal certainty that the L/C instrument is meant to provide. This situation highlights a significant disconnect between policy intention and practical implementation in the realm of trade finance.

The direct consequence of this regulatory fragmentation is inconsistent implementation by commercial banks, which frequently leads to legal uncertainty and disputes, with exporters often bearing the brunt of the resulting financial risks and losses (Alsharu et al., 2024). This regulatory disharmony reflects a deeper confusion and a wide range of divergent interpretations among banks regarding the application of UCP 600 within the confines of Indonesian national law (Lee, 2020). These inconsistencies can manifest in varying standards for document examination, differing interpretations of key terms, and unpredictable responses to discrepancies, which directly impact the exporter's ability to receive payment. The resulting legal ambiguities create a fertile ground for conflicts not only between exporters and their banks but also between the banks themselves involved in the L/C process. This environment of unpredictability forces exporters to operate in a high-risk climate, contrary to the payment security that L/Cs are designed to ensure. The frequent disputes and need for clarifications from Bank Indonesia indicate a systemic problem within the trade finance ecosystem. This situation poses a significant barrier to establishing a reliable, efficient, and trustworthy international

payment system for Indonesian exports. Therefore, resolving this normative gap is not merely an academic exercise but a practical necessity for enhancing Indonesia's export competitiveness. The current state of affairs ultimately disadvantages the very actors that the system is supposed to protect.

Existing academic literature has predominantly focused on the economic utility of L/Cs or the technical management of documentary compliance and associated risks. While these studies provide valuable insights into the functional aspects of L/Cs, they often overlook the critical dimension of legal-normative analysis. Few studies have explicitly and systematically mapped the normative gap that exists between specific Indonesian national provisions and the international standards of UCP 600. This gap in research is particularly evident from the perspective of legal protection for exporters, who are the primary beneficiaries and users of this financial instrument. The lack of a focused study from this viewpoint leaves a crucial area of inquiry unaddressed within the broader discourse on international trade finance. This article seeks to fill this identified void by concentrating specifically on the legal challenges faced by exporters. The contribution of this research lies in its explicit aim to bridge this scholarly gap and provide a clearer understanding of the legal landscape. By doing so, it will offer a more holistic view of the challenges within Indonesia's L/C system. Therefore, this study positions itself to provide novel insights that are both academically rigorous and practically relevant for policymakers and practitioners.

Consequently, this study is structured to systematically address these issues by first conducting a thorough review of the fragmented legal framework for L/Cs in Indonesia. Following this, the article will perform a critical analysis of the compatibility between this domestic legal framework and the international standards set forth in UCP 600. The analysis will identify and elaborate on the specific points of disharmony and their practical implications for exporters. Based on this analysis, the research will then propose concrete

measures for regulatory harmonization to enhance legal certainty. The ultimate goal is to contribute towards the development of a more robust, predictable, and secure L/C transaction system. This structured approach ensures a comprehensive examination of the problem from identification to the proposal of solutions. The findings are expected to be valuable for regulators, bankers, and exporters in streamlining L/C practices. Thus, the article aims to not only diagnose the problem but also to prescribe actionable recommendations for reform. This end-to-end analysis will provide a significant contribution to improving the legal infrastructure supporting Indonesian exports.

2. Research Method

This research adopts a normative juridical design employing statutory and conceptual approaches. The study focuses on examining the consistency and harmony of Indonesia's regulatory framework governing the use of Letters of Credit (L/C) in export transactions. A normative juridical design was chosen because the main issue concerns the coherence and hierarchy of written rules, rather than empirical disputes between private parties. The primary legal materials consist of Government Regulation No. 1 of 1982 on Export, Import, and Foreign Exchange Traffic, relevant Bank Indonesia instruments, and UCP 600 as the international standard for documentary credits. The secondary legal materials include scholarly articles, books, doctrines, and journals discussing international trade law and documentary credit mechanisms. All materials were analyzed through descriptive and comparative techniques to identify overlaps, regulatory gaps, and disharmonies between Indonesia's national provisions and UCP 600. The exporter, acting as the beneficiary under the L/C, serves as the principal unit of analysis, as this position reflects the practical and legal implications of regulatory inconsistencies (Wea et al., 2024).

3. Results and Discussion

The Legal Position of Exporters Under Indonesian L/C Regulations

Our analysis reveals that the central problem in Indonesia's L/C ecosystem does not lie in UCP 600 itself but in the fragmented and inconsistent manner in which it is internalized into Indonesian banking operations and national regulations. While L/Cs are theoretically designed to provide secure payment guarantees for exporters, the Indonesian regulatory framework creates significant legal ambiguities that undermine this security. The legal foundation for L/C transactions is scattered across multiple instruments, including Government Regulation No. 1 of 1982 concerning the Implementation of Exports, Imports, and Foreign Exchange Traffic, various Bank Indonesia regulations, and the internationally recognized UCP 600 standards (Setiawan, 2017). This regulatory fragmentation creates a complex legal environment where exporters must navigate conflicting requirements and interpretations. The absence of a comprehensive, unified legal directive specifically governing L/C implementation means that exporters lack predictable and uniform protection across different banking institutions. This situation is particularly problematic given that L/Cs are meant to provide payment certainty regardless of the parties' familiarity with each other (Raspita & Apriyanto, 2024). The current regulatory patchwork fails to establish clear hierarchical relationships between international standards and national laws, leaving exporters vulnerable to inconsistent application of L/C principles across different Indonesian banks.

Points of Divergence Between Indonesian Banking Practice and UCP 600

The implementation of UCP 600 in Indonesian banking practice reveals significant points of divergence that directly impact exporter protection. Indonesian commercial banks exhibit varying interpretations and applications of key UCP 600 provisions, particularly regarding documentary compliance and payment procedures. For instance, different banks may apply substantially different standards when examining documents, with some rejecting payments due to minor discrepancies that are not clearly regulated in

Indonesian legal instruments. A concrete illustration of this problem can be observed in the handling of document discrepancies: Bank A might reject documents for a 2-day delay in presentation, while Bank B considers the same delay acceptable if the exporter provides a reasonable explanation. This inconsistency stems from the lack of detailed operational guidelines from Bank Indonesia that would harmonize UCP 600 application across the banking sector (Utama et al., 2024). Furthermore, the relationship between UCP 600's strict compliance principle and Indonesian contract law provisions under the Civil Code creates legal uncertainty, as exporters face unpredictable outcomes when disputes arise. The absence of standardized documentary examination procedures means that exporters cannot rely on consistent treatment of their documents across different banks, even when dealing with identical L/C terms and conditions. This regulatory gap forces exporters to navigate a labyrinth of bank-specific interpretations, fundamentally undermining the payment security that L/Cs are supposed to provide.

Implications for Legal Certainty and Export Competitiveness

The regulatory fragmentation and inconsistent banking practices have profound implications for legal certainty and Indonesia's export competitiveness. Exporters operating under this uncertain legal environment face increased transaction costs, delayed payments, and heightened litigation risks, which ultimately diminish Indonesia's competitive advantage in international markets. The theoretical advantages of L/Cs—including payment assurance, immediate document negotiation, and risk mitigation (Susanto & Susilowardani, 2024)—are significantly compromised in practice due to the lack of regulatory harmonization. This situation creates a paradoxical environment where the instrument designed to provide maximum security instead generates additional legal uncertainties. The current framework fails to adequately protect exporters because banking interpretations vary significantly, and there is no authoritative mechanism to

resolve these differences promptly. Consequently, Indonesian exporters face disadvantages compared to competitors from jurisdictions with more harmonized L/C regulations. The frequent disputes and need for clarifications from Bank Indonesia indicate a systemic failure in the legal infrastructure supporting export activities. This regulatory environment not only affects individual exporters but also impacts Indonesia's broader economic interests by creating barriers to efficient international

4. Conclusion

The Letter of Credit (L/C) offers substantial protection for exporters, including payment assurance, risk mitigation, and expedited document transfer. Financial institutions play a pivotal role in minimizing the risk of non-payment, as the payments are guaranteed by the bank that issues the L/C and can be secured upon the shipment of goods. Furthermore, the L/C safeguards exporters against currency transfer limitations and facilitates advance payments or interest-free credit.

However, there are several drawbacks associated with the use of Letters of Credit (L/C). These include the absence of a guarantee for the importer that the goods shipped are in accordance with the order, the bank's focus on documents rather than the actual goods, the time required for document processing, and the bank fees involved in managing the L/C. Despite these limitations, Letters of Credit continue to serve as a crucial instrument in international trade, offering security and certainty for both exporters and importers.

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