

Export Transaction Cost

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What is Export Transaction Cost ?

There are different non-price factors that are not related with physical process of production of goods such as administrative processes, government rules and regulations, infrastructural bottlenecks etc. for which an exporter employs its own resources either in terms of 'time' or in terms of 'money' before the actual shipments of export items. The multiplicity of rules and regulations, rule-bound administrative procedures and practices, inadequate infrastructural facilities and appropriate institutional support adversely affect the export promotion efforts. These non-price factors, often referred to as "transaction costs", impede the impetus given to export growth even when other trade policy issues have been addressed by the Government. In the internationally competitive world, export promotion is highly price-sensitive and therefore any addition to it by way of transaction costs has to be addressed by the trade policy reforms.

These costs usually begin with an individual firm's imports of inputs required for exports and stretch till the export remittances are received through the banking channels. Inadequate infrastructure is the principal source of transaction costs for most Indian export industries. Though Export Processing Zones (EPZs) have been set up to provide necessary infrastructure and a unit located in EPZ enjoys several price and non-price incentives like tax-holiday, special import licences etc. to enhance its exports but these units are not operating to their potential primarily due to the very same infrastructural bottlenecks which were supposed to have been removed by the setting up of an EPZ.

It is stated that if a negotiation is free of transaction costs, then the resource allocation is efficient, but in real world such costless negotiation is practically impossible and, therefore, third party (notably the State') intervention in the multilateral negotiation is justified if the attendant transaction costs are minimal.

The basic problem with transaction costs is that some of the factors responsible for such costs are difficult to quantify and warrant more qualitative than quantitative treatment.

The principal objective of transaction costs analysis is to optimise all such costs, as beyond a critical level they tend to shrink the volume of transactions. Increasing costs of transaction tend to adversely affect the efficiency of transaction, partly in terms of resources and partly in terms of suppression of exchanges.

Activities, which cause Transaction Costs

In the field of exports and imports, transaction costs arise out of stringent rules and regulations, complex administrative processes and dishonesty of administrative personnel. Therefore, in a regime conducive to exports, efforts need to be taken to reduce the complexities involved in export transaction processes. Along with price-related measures, such efforts provide incentives to exporters to improve the export supply.

With the economic liberalisation in 1991, trade reform measures were announced primarily focused on price-related incentives for Indian exports and imports and less on removal of complexities in norms and procedures. However, of late the emphasis has been on simplification of rules and regulations, minimisation of paperwork, and transparency in implementation; especially on removing the infrastructural bottlenecks.

EXIM Bank in its study has classified the 'procedural complexities' presumed to have been stemmed from the following qualitative factors :

- (a) Complex administrative processes;
- (b) Bureaucratic approach of public agents;
- (c) Procedural delays in clearing imported inputs for exports at the customs;
- (d) Multiplicity of rules and regulations;
- (e) Stringent but inefficient implementation processes;
- (f) Information constraints regarding credit availability and export remittances;
- (g) Infrastructural bottlenecks related to transportation and communication;
- (h) Institutional factors which intensify rent-seeking activities in an economy; and
- (i) Political environment as it affects any change in policy stances and other related parameters concerning the factors listed above.

While factors (a) and (b) are inter-dependent due to multiplicity of rules and regulations and hence, multiplicity of paperwork results from the administrative processes which are not simple and transparent; factor (c) could be explained in terms of factor (e) which, in turn, is partly attributable to factors (a) and (d). Factors (a), (c), (d) and (e) could be clubbed together as they cause time constraint in export transactions which have also been referred to as "procedural delays". Institutional factors and political environment prevailing in the exporting country - enlisted as factors (h) and (i), have a major bearing on all the other factors.

An export transaction process is divided into several gradual steps starting with the imports of inputs for exports and culminating with receiving export remittances



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from abroad. The following steps are taken by those involved in processes of exports from India :

- (i) Obtaining different export-import codes and registrations;
- (ii) Obtaining different licences;
- (iii) Revalidation of export licences;
- (iv) Issuance of Export House/Trading House certificates;
- (v) Obtaining various refunds like duty drawbacks etc.;
- (vi) Getting remittances through banks;
- (vii) Custom clearances;
- (viii) Final dispatch of export consignments

The EXIM Bank in its Study found that the selected industries encounter problems connected to imports for exports, getting refunds from the Government under Duty Drawback and similar schemes, getting remittances from banks as well as in licensing processes.

Engineering Products

Engineering goods have been one of the major components of manufactured export items of India. Engineering exports have registered an annual average growth of 14.42% during last ten years. While there was a drop in exports during 1998-99 and 2001-02 due to depressed global demand, engineering exports have increased by 233 per cent during last 10 years and have increased by 135 per cent during last five years. Share of engineering exports in total export from India hovered between 12 to 16 per cent during the said period.

Indian engineering exports amounted to US\$ 10.6 billion during 2003-04 with a share of 16% in total export from the country. Major items under engineering goods exports include machinery and instruments, transport equipment, iron and steel and manufactures of metals. An export target of US\$ 12 billion has been fixed for the year 2004-05 for export of engineering goods and services.

According to the EXIM Bank study, most of the Engineering exporters' problems were on account of procedural delays and unlawful harassment and most of the additional time taken at different steps of

the engineering firms' export transaction was due to delay in getting various refunds from the Government of India. As per the perception of these firms, if procedural complexities are eliminated then their export sales could go up by 10 per cent of their present export earnings which is equal to the incidence of transaction costs incurred by them.

It is interesting to note that the incidence of transaction costs is higher in the case of more capital intensive and traditional items like engineering; whereas textiles industries, which are more labour intensive, suffer less from such costs. One reason may be that requirements of capital goods imports are higher in the more capital-intensive industries.

The study found that there exists considerable need for further simplification of procedural complexities involved in export transactions. Another area, which required to be highlighted, is the delay in getting various refunds. Although it was observed that such delays have reduced, they still constitute an important part of the overall transaction costs incurred.

EXIM Bank in its study has highlighted the following :

- 81% of the firms reported of facing procedural complexities, as compared with 93% under the previous study. Further, 53% of the firms reported delays due to avoidable harassment caused by public agents, as compared with 80% previously. However, majority of the firms reported procedural delays to be occasional. Further, for 78% of the firms interviewed, the delays related mainly to importing inputs, with 64% identifying the delays to be occasional.
- Refunds – Of the 18 firms interviewed, 7 firms reported the time taken to obtain various refunds. Out of these 7 firms, 5 firms reported no delays in obtaining refunds. However, other firms reported a time period of 180-240 days in getting refunds. As per the previous study, the actual time period taken for getting various refunds was reported to be as high as 365 days. It can be seen that although the time

period for getting refunds has reduced, there is still considerable degree of difference within the firms as far as duty refunds are concerned.

- Customs clearances – As far as clearances from the customs authorities are concerned, 70% of the firms interviewed reported of customs clearances within 5 days. Among the other firms, however, the maximum time reported for such clearances was 20 days.
- Banks – The firms interviewed reported that time taken for receiving remittances through banks vary between 2 to 25 days. However, over 75% of the firms reported of actual time taken for such receipts to be at most 10 days.
- Licences – 8 firms reported of obtaining export-import codes, and that the time taken to obtain such codes range between 2-30 days. As regards obtaining various licences, the time taken vary between 2 to 30 days. However, around 70% of the firms interviewed reported that actual time taken to be less than 15 days, as compared with the actual time taken of 30 days under the previous survey. Similarly, in the case of revalidation of export licences, while most of the firms reported a time of 2-15 days, one firm reported a time taken of 60 days.
- Transportation – Firms interviewed in the engineering goods sector did not report any notable delay caused by transportation bottlenecks. However, it was reported that firm occasionally need to undertake high air freight costs in order to meet urgent demands. Freight costs as a percentage of export earnings vary across firms. Around 45% of the firms reported it to be between 0.5% to 5%, however a maximum of 20% freight cost was also reported.
- Transaction Costs – Although delays due to procedural complexities are primarily occasional in the engineering goods sector, they still contribute to overall transaction costs. For 60% of the firms interviewed, transaction costs as a percentage of total export earnings constituted less than 5%. However, the maximum incidence of transaction costs, as reported by one firm, is 15% of total export earnings.



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The EXIM bank study indicates that in the engineering sector there has been the wide divergence in the various steps of export transaction within the sector. Diversity in case of duty refunds and revalidation of export licences was found to be high.

High Powered Committee on Transaction Costs of Indian Exports

Considering the importance of the subject, a "High Powered Committee on Transaction Costs of Indian Exports (HPC)" was set up by the Government in 1999 to identify transaction costs and to suggest measures/steps to reduce such costs on India's exports.

The terms of the Committee included :

- (i) to examine the transaction costs incurred by exporters in terms of additional time and resources invested in non-production factors arising out of the procedural complexities and obstacles associated with both administrative process and procedural bottlenecks in relation to foreign trade licensing, customs clearances, and refunds of duty drawback;
- (ii) to examine the transaction costs in terms of additional time and money incurred due to infrastructure constraints at ports, airports, inland container depots, warehousing, inland transportation, etc.;
- (iii) to examine the administrative procedures, conditionalities and problems faced by the exporters in getting timely, adequate and competitive export finance including working capital from banks and other institutions; and
- (iv) to suggest measures and make concrete recommendations for reduction of such transaction costs and improving the implementation processes.

The Committee made a number of suggestions and recommendations aimed at reducing and rationalizing the procedural complexities in order to mitigate delays, multiplicity of rules and regulations, infrastructural bottlenecks to facilitate and

promote India's exports. The Committee was of the view that :

- The exercise of reducing transaction costs of Indian exports should be a continuous process of periodic dialogues between various trade bodies, Government departments/ Ministries, agencies, Export Promotion Councils, etc.
- There should be a standing institutional monitoring and review mechanism in all the concerned Government departments, and that the High Powered Committee should be converted into a High Powered Standing Committee which would serve the dual purpose of instilling confidence in the exporting community, as well as monitor the reduction of transaction costs.

The recommendations of the Committee can be broadly categorized as those concerning :

(i) Central Board of Excise and Customs

- The instructions which are issued by CBEC should be very clear and precise and should not leave any scope for more than one interpretation; the implementation of the instructions of the CBEC should be uniform and without variance throughout the country, and there should be a system of centralized instructions made applicable to all Customs Houses.
- Duty Drawback claims on the Electronic Data Interchange (EDI) system should be cleared within 3 working days, and in manual cases within 5 days.
- Customs House Agents (CHAs)/ Exporters should be allowed and encouraged to transmit data electronically through computer connectivity, which would reduce the waiting period at the service counters.
- There should be a proper standby arrangement for immediately switching over to the manual system in case of breakdown of

the EDI system; and there should be an intensive training/awareness programme for CHAs/their employees and exporters.

(ii) Directorate General of Foreign Trade

- Issuance of a provisional registration number automatically across the counter to the exporter and issuance of permanent IEC number after a fortnight.
- For issuance of Advance licence and the Special Import Licence, there should be a verification counter to check various required documents according to a checklist and once accepted there should be a single stage coordinated processing, which should not take more than a week's time.
- DGFT should ensure that DEPB licences are issued within 5 working days in manual cases, and within 2 working days where computerization is in place.

(iii) Ministry of Civil Aviation

- As regards the cooling period for export consignment, except for the items, which are considered, to be relevant from the security angle, the cooling period may be waived.

(iv) Reserve Bank of India

- The Committee was inclined to agree with the instructions issued by RBI in February 1999, and felt that the new monitoring, evaluation and review mechanism should reduce the processing time for sanctions/renewals of export credit substantially.

(v) Department of Economic Affairs

- The Committee recommended that an inter-ministerial standing group to be called High Powered Standing Committee (HPSC), under the Chairmanship of the Finance Secretary, to be set up to resolve the issues relating to cooperation between various Government Departments/Agencies like Department of Revenue,

Ministry of Commerce and Industry, National Informatics Centre, Reserve Bank of India, Ministry of Surface Transport and Ministry of Civil Aviation, etc. The HPSC could meet every three months to coordinate the measures taken to reduce 'Transaction Costs of Indian Exports'.

(vi) Multi-agency and Departments

(a) Procedures

- EDI system should be made operational on priority basis, so that payment of Excise rebate/refund can be made automatically when the export is complete.
- Single Common Document - A single common document be evolved in order to meet the requirements of various departments/agencies.

(b) Computer-related

- Data based Monitoring System on EDI - The Committee felt that it is essential to install a stagewise data monitoring system, with inter-departmental/agency compatibility, which is not only workable but would also enable the user to pin-point the exact stage and time of the processing of the export consignments from the moment of filing of the export document till the closure of Export General Manifest (EGM).
- Connectivity between various agencies at the airports/ports - Matching of software through modification and adjustment, keeping the inter-departmental/agency compatibility in view and in consultation with NIC, with connectivity between various departments to be established.
- On-line connectivity should be established between DGFT and the Customs on a priority basis so that the need for verification of DEPB is obviated.

(c) Others

- The number of documents should be reduced to the minimum possible.
- Good officers/staff to be identified, training officers and staff to expose them to new and better concept of management and human interaction.
- Ombudsman - The Ministry of Commerce and Industry may list out the areas where intervention and mediation may be required. The Department of Revenue would then set up a mechanism for immediate redressal of grievances in these areas and submit an action taken report to the High Powered Standing Committee (HPSC).

An inter-ministerial expert group consisting of representative of concerned Ministries/Departments should be set up and entrusted with the task of recommending integration between various agencies. The High Powered Committee was later converted in a High Powered Standing Committee on reduction of Transaction Costs of Indian Exports, which monitors and reviews the progress of the operational initiatives undertaken with a view to reduce transaction costs and facilitate export growth.

Importance of Trade Facilitation

Reduction in transaction costs through trade facilitation can bring enormous gains to trade, and as such are necessary and important for the development of global trade. In addition, the reduction of other types of barriers has brought border-crossing costs to business, such as waiting time and Customs procedures into new focus. The need for trade facilitation is underlined further by the plethora of the procedures that have to be gone through while importing or exporting.

Modern supply chain management techniques and the rapid spread of information technologies and e-commerce have progressively increased the use of just-in-time techniques by manufacturing

industry and encouraged the growth of integrated global supply, production and distribution systems. In this environment, where manufacturers rely on the uninterrupted reception of the necessary components to meet production contingencies, business cannot afford to have imported or exported goods tied up for long periods because of unnecessary or over-complicated trade procedures and requirements.

The rules and regulations that govern tariffs and non-tariff measures have become increasingly complicated over time. Preferential trade agreements have added to this complexity a proliferation of rules of origin. Threats to national security have also increased in recent times. All these factors add up to make the process of exports and imports far more difficult than they used be half a century ago.

In view of the above, it is imperative that this challenge be met, i.e. to make trade as transparent and quick as possible to harmonize global supply chains and production process while ensuring that Governments are able to efficiently administer customs and safeguard national health and security.

The scope of Trade Facilitation is very broad and touches upon several areas. While some of these falls directly under initiatives that need to be taken by the Government, others involve a partnership between private stakeholders and Government initiatives.

The main indicators of trade facilitation and the areas of reform required in them have been identified by CII in a study as :

- Port Logistics
 - Cargo Dwell time
 - Warehousing facilities (including refrigerated warehouses for perishables)
 - Rail and road links from hinterland to ports
- Customs Procedures
 - Electronic Data Interface (EDI)
 - Signature less, Internet based process for filing customs related documents
 - Trust based systems



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- Post clearance audit
- Pre-Shipment Inspection Agreements (PSI)
- Risk analysis and assessment
- Standards Harmonization
 - Reform of domestic Standards setting and monitoring authorities
 - Moving towards regional and global convergence on standards
 - Mutual Recognitions Agreements on standards
- Business Mobility
 - Movement of Professionals and transparent visa systems
 - Adequate Financial systems including Banking, Insurance and Clearance mechanism
- Trade Information and E-business facilities
 - Proper channels and access to market information, legal systems and standards and regulations
 - Availability of information electronically through the internet
 - E-business infrastructure to enable to business-to-business contacts
- Administrative Transparency and Professionalism
 - Simple and transparent procedures for export and import
 - Non-discriminatory approach to enforcement based on risk assessment techniques
 - Public - Private cooperation and information sharing to improve enforcement and compliance.

Trade Facilitation : Current Status in India

Despite trade liberalization of 1991, the administrative procedures associated with trade are perhaps the most complex in India. The CII study states that in order to export, one needs to obtain 258 signatures, make 118 copies of the same information, keypunching of which takes 22 hours and involves dealing with a multitude of GOI agencies separately.

Cargo Dwell Time and Port/Airport Logistics

The current performance of India's Ports and Airports are far below global norms, and remain an impediment to India's greater integration with the world economy. Reforms are also urgently needed in India's customs and regulatory practices that remain inefficient relative to International norms despite improvements in the recent past.

India has problems in other fronts also, most notably in Trade Information and enquiry point. As of now there is no officially designated inquiry point for trade dealing with the Indian market.

A major step towards trade facilitation in order to reduce transaction costs in India was taken with the recommendations of the Task Force on Indirect Taxes (December, 2002). Some of the most important recommendations that were accepted by the Government of India, were as follows :

- Customs clearance procedures should be based upon trust and be uniformly applied to all importers and exporters of all goods
- The verification of declaration through pre-clearances examination, where necessary, should be based on intelligence and Risk Assessment techniques
- Use of Post Clearance audit.
- Online filing of electronic declarations
- Establishment of warehouses by shipping/airlines/couriers/freight forwarders etc. within the port/airport area to reduce dwell time
- High-level Inter-Ministerial Committee may be set up under the Chairmanship, CBEC to resolve inter-agency issues
- A permanent Trade Facilitation Committee should be constituted at each Port/Airport/ICD/CFS comprising senior representatives of all agencies including Customs House Agents (CHA's) under the Chairmanship of the Commissioner of Customs.

While noticeable progress has been made towards the reduction of transaction costs, it is recognized that fuller attention is required to expedite implementation of the recommendations, and this is necessary to make India a world-class global player.

Suggestions

The following suggestions represent the views expressed by the exporting community :

- The EDI system in the concerned agencies should be fully operationalised and integrated with one another so that the entire documentation process could be made under the system and human interface is minimised
- Interest rates on packing credit and bank commission should be reduced
- Government agencies should act as trade facilitators rather than controllers or regulators
- The Chambers and Export Councils should be encouraged to take up issues with the Government on a regular basis
- Incentives should be devised for product development and better marketing facilities
- The various procedures and requirement of compliance of stringent rules and regulations involved in an export transaction should be further simplified
- Necessary Labour Law reforms must be carried out
- Infrastructural needs of the exporters, especially on a cluster basis, must be urgently addressed
- There is a need to bring about transparency and accountability in the concerned officials
- There is a dire need to introduce audit based controls
- Self assessment should be encouraged and examination of goods should be reduced to a minimum while introducing risk assessment techniques
- Urgent steps need to be taken to reduce the dwell time for clearance of cargo.