COSTS AND BENEFITS OF TRADE FACILITATION

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I. INTRODUCTION

Tariff liberalisation has made considerable progress since the end of World War II. Once the results of the Uruguay Round are fully implemented, the tariffs of developed countries on industrial goods will have fallen to a trade-weighted average of 3.9%, while those of developing countries will be at 12.3%. While serious efforts are warranted to reduce tariffs further -- particularly in high-tariff sectors such as agriculture and textiles -- attention is increasingly focusing on the need for liberalisation of non-tariff measures. Among such measures, it is widely thought that procedures relating to the international delivery of goods are one of the major bottlenecks. The Doha Development Agenda, agreed to in late 2001 launching a major new effort at multilateral trade liberalisation, has identified trade facilitation as an area in which negotiations should begin in 2003, after consensus is reached on negotiating modalities.

It is in this context that OECD is interested in trade facilitation. While other organisations have long experience conducting important technical work relevant for TF, OECD undertakes analysis to deepen understanding of today's major trade policy issues and to support policy makers. OECD is an intergovernmental organisation with a broad mandate for policy co-operation in the whole range of economic and social policy areas. One of the Organisation's major objectives is the *expansion of world trade for the benefit of all and support of a strong multilateral trading system*.

In light of current interest in TF and its identification by the Doha Development Agenda as an area in which negotiations should begin next year, the present paper will try to deepen understanding of the issue and its implications by:

- Defining what we mean by *trade facilitation* and *trade transaction costs*:
- Examining what can be said about the nature, level and effects *of trade transaction costs and the benefits of TF*, both qualitatively and quantitatively;
- Finally, commenting on some of the directions in which this points and that deserve further reflection and research, touching in particular on ways to reduce excessive customs-related transaction costs, so as to achieve the benefits of trade facilitation; and on capacity building.

II. DEFINITIONS

A. Trade facilitation

Trade facilitation has been on the WTO's agenda since the 1st WTO Ministerial in Singapore in 1996. The WTO website explains it as "the simplification and harmonisation of international trade procedures … for collecting, presenting, communicating and processing data required for the movement of goods in international trade". A slightly different focus emerges from the Doha Declaration which, in looking forward to future negotiations, refers to "expediting the movement, release and clearance of goods, including goods in transit". In any case, it should be noted that in different contexts, such as APEC and the World Bank, there is a tendency to use the term in much broader context, including TBT issues, competition policy, government procurement and transparency in general.

B. Trade transaction costs

Most attempts to look seriously at the costs and benefits of trade facilitation have in fact focused on *trade transaction costs*. These are seen to involve:

Direct costs:

- *Compliance costs* related to supplying information and documents required for the movement of goods or related means of payment.

- *Charges for trade-related services* (e.g. trade insurance, port management); these may be affected by government policies, e.g. limiting entry or restricting operations and competition.

Indirect costs:

- Procedural delays, e.g. time for customs clearance and cargo handling. These costs are related to the market life of products (spoilage of agricultural products; product cycles for technology-intensive products, etc.).

- Lack of predictability in the nature, application or interpretation of regulations, formalities and contracts. This derives from factors such as the lack of transparency of arbitrary interpretations.

- Lost business opportunities: Although difficult to calculate, these may be significant since delays in one country may have negative effects along the whole global production chain. Suppliers of trade-related services may also see their business reduced.

III. COSTS AND BENEFITS OF TRADE FACILITATION: QUALITATIVE ANALYSIS

The above definitions can help think more precisely about the components of trade facilitation and their impacts. Certain general observations can be made before looking at costs and benefits for the economy and for the public sector.

It should be recognised that there will always be transaction costs and that they will generally be higher for international trade than for domestic transactions. The benefits of trade facilitation are typically seen as equivalent to trade transaction costs that can be saved -- in other words, they will be smaller than total trade transaction costs because there is part of these costs that is unavoidable. Nevertheless, even if avoidable costs are small, they can represent a significant bias against trade. Moreover, the savings that might be achieving by reducing or eliminating such avoidable transaction costs can have a big impact, due to the dynamic effects of supply chain linkages. Although trade facilitation measures will typically entail some costs (e.g. for training and for implementing new procedures, equipment (especially for information technology) and even infrastructure, it can be assumed that the overall net effects of trade facilitation over time will be positive.

A. For the economy

From the perspective of a national economy and, by extension, of the *economic actors (business, e*xcessive transaction costs represent economic rents to the domestic sector. As with NTBs in general, inefficient procedures are equivalent to a trade tax, providing a bias against foreign economic activity. In contrast, more efficient procedures and lower transaction costs provide significant benefits to the economy in both static and dynamic ways by:

- Increasing trade in good and services;
- promoting competition, thus enhancing efficiency in the use of resources, encouraging technology transfer and the realisation of productivity gains;
- Increasing the incentive for international investment, contributing to economic growth and higher living standards.

In assessing the validity of this analysis, account should be taken of the arguments that have recent been raised questioning the benefits of economic globalisation. Does trade always bring the benefits claimed, or are they overtaken by socially and economically undesirable side effects? Does trade contribute to development? Is it compatible with other national objectives, such as environment, health and safety?

These questions are serious and deserve to be seriously answered; but they go well beyond the scope of the present paper. From a macroeconomic and medium-to-long term perspective, the answer is liberal trade is most likely to produce the best results for the economy and for economic actors. But even if there turns out to be some validity to the questions, inefficient trade procedures have no redeeming value: they represent a discriminatory tax on foreign economic activity and are a *deadweight loss*. Their elimination, and replacement by efficient regulations and procedures, can only be a positive-sum game.

B. For the public sector

A different perspective on costs and benefits of trade facilitation emerges with respect to the public sector. Here, trade transactions entail costs due to the need to operate customs and other trade-related public services. The basic costs here are unavoidable and (as already mentioned) any changes in these services could entail additional costs (although they may be mainly short-term).

Trade facilitation can nevertheless bring benefits to the public sector through more efficient implementation of customs and related regulations. This could involve, for example, a reduction in paperwork or in numbers of customs officials in ports of entry. Greater efficiency may also reduce possibilities for traders to avoid fees (including through arbitrary collection and possible corruption) and thus increase public revenue collected from customs procedures and from tariffs. It could also reduce the cost of new procedures that may be felt necessary, e.g. to respond to security concerns.

IV. QUANTITATIVE ANALYSIS OF COSTS AND BENEFITS

So far the analysis of costs and benefits has been descriptive and based on the logic of classical theory concerning markets and trade. To try to support this by actual measurable experience, we should consider first what methodologies are available for empirical measurement?

A. Methodologies

The most basic approach for attempting to analyze the costs and benefits of trade facilitation comes through ***inventories of business complaints***, listing particular procedures considered excessively costly or inefficient. Such inventories are a useful starting point for understanding the scope of the issue but they may not provide any usable quantitative information about costs and benefits. Moreover, any systematic analysis needs to go beyond anecdotal information.

A fuller and more systematic picture of administrative and procedural barriers can be provided by ***detailed firm-level surveys***. In this case it is possible to take account of a wide range of pertinent factors, such as particular cost elements; special characteristics of each country; product life (which provides an indication of sensitivity to delays); the size of international trade business (this is more indicative of sensitivity to trade facilitation than the size of a firm); and the extent of intra-firm trade (which can be instrumental in reducing transaction costs).

In order to be generally useful, surveys need to have extensive coverage. They must also provide accurate information collected systematically across companies and countries. It is thus usually necessary to combine written questionnaires with interviews. This tends to make the approach time-consuming and costly -- which in practice limits the possibilities for adopting it and, when it is adopted, requires its application within only limited parameters.

Box: Developing a template for assessing costs and benefits

OECD is co-operating with an important project being undertaken by SITPRO of the UK to devise a template or methodology for measuring and comparing the regulatory costs of international trade. This is based on identifying the requirements imposed on importers or exporters that entail costs, and what those costs are.

Methodology: To confirm the elements of a template by conducting systematic interviews with a limited range of companies in a number of markets.

Initial results: Expected in late 2002.

A third approach to empirical measurement is through ***modeling trade and welfare effects.*** So far, significant data problems have limited work along these lines.

However, there have been some interesting efforts to use computable general equilibrium models, in particular Global Trade Analysis Project (GTAP) models, e.g. to quantify the impact of automating customs procedures or to assess the cost of delays in particular countries.

B. <u>Results of quantitative work</u>

Having now reviewed briefly the available methodologies, what can we say about the results of quantitative work on trade facilitation? First, it is disappointing the extent to which most existing studies are based on unclear data and methodologies. Many times they rely on past work whose basis is questionable. Those that seem most valid have limited their focus to particular costs in specific circumstances, generally drawing on limited surveys. The results are diverse and reflect the restricted scope and parameters of their studies. Nevertheless, some interesting results have been obtained, e.g.

- Compliance costs in intra-EC trade estimated at 1.5% (Cecchini);
- Each day saved in shipping time can be equivalent to a tariff reduction of 0.8% (Hummels);
- Customs automisation can lower the price of traded goods by 0.2% (Mitsubishi Research Institute).

In contrast, a few studies exist that provide overall estimates, e.g.:

- Trade transaction costs are frequently estimated to be in the range of 7-10 % of world trade value (basis unclear); customs compliance costs would be somewhat less.

- Benefits of trade facilitation typically seen as 1-5 % of the value of total world trade (1994 Coumbus Ministerial Declaration on Trade Efficiency cited the figure of 2.5%).

Recent work raises the question whether these figures are misleadingly high.
The figures that emerge from different analyses depend on the measures that are considered and the actual changes that are implemented. Even if estimates of costs and benefits may be too high, this probably will not significantly alter the overall conclusion about the value of trade facilitation. Apparently small benefits (less than 1% of the value of world trade) will still have significant trade and welfare impacts, due to supply chain linkages within the globalised economy.

An important outcome of work conducted to date has been to show the asymmetrical effects of trade procedures and trade facilitation on SMEs and on enterprises in developing countries. This is because small-value consignments tend to attract a disproportionately high cost burden, due to the fixed costs that must be paid in any case. In addition, well-trained human resources to carry out and implement necessary procedures efficiently may be at a premium for small firms and developing countries.

V. EMERGING REFLECTIONS THAT MERIT FURTHER RESEARCH

The analysis sketched out above leads to several observations relating to the need for further research and reflection.

First, more empirical research is clearly needed to understand the nature and major components of the problem.

Next, the potential benefits of trade facilitation can only be realised if effective means are adopted to reduce excessive trade transaction costs. In this light, what policies or approaches will be the most effective for firms and governments? As already indicated, benefits of trade facilitation are typically seen as equivalent to the "trade transaction costs" that can be saved. In most cases these costs will be reduced but not eliminated.

Three approaches available to the ***private sector*** have shown particular promise in securing the benefits of more efficient trade procedures:

- Exploiting economies of scale: e.g. greater efficiency can often be achieved by grouping trade transactions, especially for low-risk shipments;
- Making use of Information and communications technology, including through the integration of information systems for logistical, financial, fiscal data, etc.;
- Making use of global logistic chain supply services, e.g. involving international express carriers and similar services to draw full efficiency benefits from globalised production and marketing.

From the viewpoint of governments, effective ***national and multilateral policy*** approaches include:

- Simplifying and harmonising customs procedures, e.g. so as to reduce filing frequency by using risk assessment techniques and audit-based controls;
- Benchmarking and definition of minimum standards;
- Ensuring effective dispute mediation mechanisms.

Finally, reflections on approaches to trade facilitation such as those above inevitably lead to the issue of ***capacity building***. On the one hand, SMEs and firms in developing countries may be particularly susceptible to certain costs, especially indirect costs such as the lack of predictability and lost business opportunities, which may lock them into low growth. On the other hand, cost savings approaches, as identified here, are likely to be more accessible for larger firms, especially firms that trade more, since they are in a better position to take advantage, and to do so more rapidly, than smaller firms (SMEs or firms from developing countries).

Nevertheless, because trade transaction costs are relatively greater, the benefits of trade facilitation are likely to be relatively greater as well. Special efforts therefore seem warranted to help these firms obtain the capacity and adopt methods that will effectively realise these benefits. For example, this would include facilitating the use by developing countries of:

- risk assessment techniques that could improve efficiency by underpin more selective control of imports and exports;
- greater separation of documentation from the physical movement of consignments; and

- greater separation of release and clearance procedures.

VI. CONCLUSIONS

There exists a significant volume of business complaints and compelling qualitative arguments for addressing trade facilitation, both at the national and multilateral level. Nevertheless, available studies and information on the costs of inefficient trade procedures and the benefits of trade facilitation are frankly disappointing. Quantitative information is patchy, imprecise and unconvincing. Partly because we are talking about the sum of a large number of relatively small costs, it is hard to generalise about the overall level of costs and benefits. But it should be recognised that even if these costs and benefits turn out to be fairly small in percentage terms, they can still have big effects through global supply chain linkages.

There is clearly great potential for further empirical research and modeling in this area, including through work on methodologies, to demonstrate the importance of the trade facilitation agenda. In pursuing such work, it will be important to pay special attention to the weaker members of the international economy to ensure that, through capacity building, they also are able to reap significant benefit from trade facilitation.