Chapter 2: Transaction cost of Trade Facilitation

2.1 Performance in trade facilitation indicators

The trade facilitation performance can be measured with respect to trade facilitation indicators (TFI). Stakeholders' surveys were conducted by MoC&I, DGFT and by C&AG for this audit. They indicate room for improvement in trade facilitation procedures[3], viz. appeal procedures; fees and charges; formalities in documentation; formalities in automation; formalities in procedures; as well as in governance and impartiality.

On similar lines, Business confidence index (BCI) reports of NCAER[4] were relied upon by Ministry of Commerce & Industry (MoC&I) for business facilitation and boosting of India's Manufacturing Exports. Other similar reports from RBI, Planning Commission and studies commissioned by MoC&I and World Development Indicators have been used for decision support in trade facilitation policy.

2.2 Gains through trade facilitation

Due to poor facilitation the impact on the transaction cost has been estimated to the tune of ₹ 42,000 crore (US$ 6-7 billion) according to the Strategic Plan of Department of Commerce (2020).

Another report by the Peterson Institute for International Economics (PIIE 2013) estimate that significant trade facilitation could increase global GDP by almost $1 trillion (Appendix 4). This has been used in World Development Indicators which has been relied upon by second Task Force on Transaction Costs.

2.3 Transaction costs analysis

Transaction cost in international trade comprised (i) non-neutralised Taxes and duties, (ii) differential cost of credit at International and Domestic Rate, (iii) differential cost of tariff at International and Domestic Rate and ground level transaction cost due to delays and charges in Customs, Ports, Issuance of license, Banks, Refunds etc.

Indirect costs to trade involved (a) additional costs incurred due to procedural delays, e.g. time for customs clearance and cargo handling. These costs are related to the market life of products, (b) lack of predictability in the application or interpretation of regulations and formalities and (c) Lost business opportunities.

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[3] Other international report on Trade Facilitation Indicators: The Potential Impact of Trade Facilitation on Developing Countries' Trade" (OECD Trade Policy Paper No 144, 2013) for 107 countries outside the OECD area.
[4] National Council of Applied Economic Research

FTP 2004-09 announced in August 2004 had two basic objectives to double the percentage share of India's trade in the next five years and to generate employment. Towards achieving these objectives the major measurable taken in FTP was to simplify procedural complexities and reduction of the transaction cost. In this backdrop DoC commissioned FIEO to estimate incidence of cost disability to exporters, and ASSOCHAM to survey the impact of taxes, infrastructure, FTP, procedures etc on exports. RBI also published a report based on the survey on impact of Trade Related Measures on Transaction Costs of Exports (May 2006).

DoC had regularly constituted committees (2005, 2009 and 2013) and task forces to address the issue of high transaction cost in India and suggest measures to reduce transaction cost and time, impacting the country's Foreign Trade transactions. These studies were concomitant with the FTPs.

2.4 Reports on Transaction Cost

A survey was commissioned (March 2005) by DoC through ASSOCHAM[5] to study the impact of taxes and levies, infrastructure, foreign trade policy, inverted duty structure, sectoral policies and export related procedures on trade.

The survey found that the average aggregate impact felt by exporters was 13.24 per cent of the freight on board (fob) value of exports. A significant observation from the report was that the fiscals impacted exporters the most out of the three key components of export process, with incidence felt between 4.73-5.72 per cent i.e., around 5.22 per cent of the fob value of exports. Infrastructure came second impacting the exporters, on an average in the range of 3.80 - 4.80 per cent i.e., around 4.30 percent of the fob value of exports. Export procedures affected exporters to the tune of 3.72 per cent of the fob value of exports.

Audit observed that ten important exporting sectors were identified for analysis. The export/import data of the products were reported by analyzing their variance.

Another study relied upon by DoC of FIEO[6] calculated the incidence of cost disability to Indian exporters varying from 19 to 22 per cent on FOB value of exports. The report stated that there may be variations depending upon the product type, manufacturing processes, labour involvement, geographical location etc.

The first Task Force on Transaction Cost claimed that the implementation of 23 identified issues relating to four Ministries have mitigated the transaction cost to about ₹ 2,100 crore.

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[5] the Associated Chambers of Commerce and Industry

[6] Federation of Indian Exporting Organizations, cost disability incidence estimates, 2005.

A task force on 'Transaction Costs in Exports' was constituted in 2009 by MoC because FTP (2009-14), Outcome Budget of DoC continued to highlight transaction cost as a major concern and the World Development Indicators were not very encouraging. The task force was to look into various issues affecting the competitiveness of Indian exports and initiate a set of "executable" remedial measures towards reducing latencies and costs associated with trading across borders. The report had two outcomes, first to identify the gamut of issues involved and the relevant cost associated with each issue and secondly, from the list of issues so identified, executes and delivers to the trade the maximum benefit possible. It was a survey based report and had not reflected on the performance of the 2005 report.

The committee had made 44 recommendations pertaining to seven ministries, out of which 32 recommendations were agreed upon. Out of the 32 recommendations, 21 recommendations were reported to have been implemented in the task force report published in 2011.

However it was noted in audit that all the recommendations are yet to be implemented by the related departments viz., upgradation of the plant quarantine laboratory and online facility for issuance of phyto-sanitary certificates by Agriculture Ministry, offline software for filing advance authorization and EPCG applications on DGFT server and online status holder application facility by Commerce Ministry, relaxation of the eligibility criteria for ACP clients and single factory stuffing permission by customs (Revenue Department).

The transaction cost was estimated at 8 to 10 per cent of the value of exports. This amounted to approximately ₹ 1,50,000 crore.

Strategic Plan, DoC (2020) envisaged strategic initiative of reducing transaction cost with suitable monitoring system put in place as a follow up of the recommendation of the 1st task force.

The 2nd Task force on 'Reduction in Transaction Costs in Exports' was constituted in 2013 to examine and identify such difficulties that the exporters face and make actionable recommendation to reduce or eliminate them. The report was published in July 2014. A major departure in the approach of the Second Task force compared to the earlier task force was not to attempt any monetization of the gain from mitigation of the issues highlighted in the Report. It was a feedback survey based report. The report had stated 46 recommendations pertaining to nine ministries and seven separate recommendations relating to Land Border crossing and certain other miscellaneous issues.

Audit observed that FTP 2009-14 was extended beyond its tenure. FTP 2014-18 may take into account the requirements of the trade facilitation measures adopted by DoC and provide a framework to align all trade related policies.