

What Does It Cost to Trade Cross-Border?

How higher de minimis increases trade potential for micro & small enterprises through lower costs

CUTS has conducted a study exploring the challenges faced by MSEs in trading internationally and using e-platforms. Additionally, it investigates the impact of de minimis threshold/exemptions on exports of MSEs in selected countries and forecasts the increase in their exports if de minimis threshold is increased.

Background

It is well-known that trade costs have a substantial impact on exports, both volumes and destinations, and they have, for most countries' Micro and Small Enterprises (MSEs), been unsurmountable. Customs duty, local taxes (like excise and VAT), and customs clearance are examples of such costs that significantly impede MSEs' ability to export.

A *de minimis* regime can lower these costs for MSEs in respect of their low value export consignments. *De minimis* refers to the minimum value of goods, below which no duties and taxes are collected and streamlined border clearance is provided. This type of regime may in particular

be relevant for online cross-border transactions as these consignments (especially business to consumer, B2C) often are low value. In this context, it should be reminded how online commerce presents MSEs with an opportunity to expand geographically and serve customers on a global basis.

The internet, technology and online platforms allow them to internationalise without the need to invest in a physical network. It is worth emphasising that online commerce is perhaps the only way for MSEs to participate in world trade as independent operators and entails those serving customers remotely (no physical presence in the destination markets). This

necessarily means that they are sensitive to any costs that add to the costs of remotely serving customers (such as delivery delays, delivery costs, trust building, preference of buying domestically, no physical location for customer service). This is the context for analysing *de minimis* as a method for reducing market entry costs.

Although a *de minimis* regime conceptually provides facilitated customs clearance and exemptions from customs duty and local taxes on small value trade consignments; in reality, countries design their regimes differently. A majority of countries (e.g. India) apply *de minimis* only on customs duty and procedures; and then also only for gift/sample items and excluding local taxes.

Some countries, including those of the European Union (EU), used to cover both local taxes and customs duty and procedures under *de minimis*, but have recently excluded VAT from its scope in relation to distance selling. Additionally, the value threshold of *de minimis* on customs duty vary from zero in Saudi Arabia and Bahrain to US\$1000 or more in Azerbaijan and Georgia. Further, *de minimis* thresholds have largely been constant for many years in most countries except a few, like Philippines and the US.

The Research

Scopes and thresholds of *de minimis* vary. It is, therefore, insufficient to merely assess whether *de minimis* has an impact on MSE exporting, it should also be examined how different forms of *de minimis* affects these exports. This study attempts to examine how higher and more widely covered (inclusion of both customs duty and local taxes) *de minimis* regime can lead to integration of MSEs in global trade through promoting their exports.

It is important to note that there is a mammoth limitation of data availability for estimating these relationships and potential effects. The definition of MSEs varies from country to country and there are discrepancies in how, and whether, countries report export values by enterprise size. A list of the importing and exporting countries forming part of this study as well as the methodology is provided in the Appendix.

Research Findings

The initial observations suggest that *de minimis* has an impact on MSE exporting, although a marginal one. This marginal impact may be explained by how: *de minimis* value threshold is considerably low in many countries; many countries have excluded VAT and local tax from the scope of their *de minimis* regime; many countries do not permit benefits of *de minimis* to commercial exports; and few exporters are aware of this incentive.

The paper assesses the relevance of the value threshold and the scope:

What impact may differently designed *de minimis* regimes have on MSE exports?

The study has examined the impact of *de minimis* on MSE exports in two groups of countries: one where VAT is part of the scope of *de minimis* and another where it is not. The study finds that the impact on MSE exporting is greater where the scope of a *de minimis* regime includes VAT. For instance, increasing the customs duty *de minimis* threshold by US\$1 may lead to an increase of approximately US\$5mn in average MSE exports of the selected countries, whereas increasing the VAT *de minimis* threshold by the same amount may lead to an increase of more than US\$115mn in average MSE exports of the selected countries, *ceteris paribus*.

What impact may an increase of the *de minimis* threshold have on MSE exports?

The study has examined the impact of increasing the *de minimis* threshold on customs duty to US\$200 and the threshold on VAT to US\$30 on MSE exports in selected countries. The findings suggest that a very modest rise in *de minimis* threshold value may result in a significant increase in MSE exports. However, the *de minimis* impact on MSE exports would be lesser in the case of countries where VAT is excluded from the *de minimis* scope. For instance, the estimates suggest that this modest rise in value thresholds may increase MSE exports with as much as 96 per cent (in comparison, the increase would be about

55 per cent for the group of countries with mixed *de minimis* scope), *ceteris paribus*.

These observations suggest that both the scope and the threshold have a meaningful impact on MSE exports and that VAT *de minimis* has a greater positive impact on MSE exports than customs duty *de minimis*.

The paper offers these early-stage research observations with the hope of elevating the issue of costs in the destination market as a barrier for the internationalisation of independent internet-enabled MSEs. This paper will encourage debate and further research into trade facilitation, specific to this new category of exporters.

Appendix

The availability of data has limited this research to 13 exporting countries and 53 importing countries. Therefore, the study examines the relationship between MSE exports of 13 countries to 53 cross-border destinations.

Data on exports of MSEs has been taken from the Organisation for Economic Co-operation and Development (OECD) database for the year 2015, which is the latest available; while data on *de minimis* have been taken from various sources including Global Express Association and trade.gov.

List of Exporting and Importing Countries Selected for the Analysis

List of Exporting Countries		List of Importing Countries			
1	Austria	1	Argentina	28	Latvia
2	Cyprus	2	Australia	29	Lithuania
3	Germany	3	Austria	30	Luxembourg
4	Korea	4	Belgium	31	Malaysia
5	Lithuania	5	Brazil	32	Malta
6	Mexico	6	Bulgaria	33	Mexico
7	Netherlands	7	Canada	34	Morocco
8	Poland	8	Chile	35	Netherlands
9	Portugal	9	China	36	Norway
10	Romania	10	Croatia	37	Poland
11	Slovenia	11	Cyprus	38	Portugal

List of Exporting Countries		List of Importing Countries			
12	Spain	12	Denmark	39	Qatar
13	UK	13	Estonia	40	Romania
		14	Finland	41	Russian Federation
		15	France	42	Singapore
		16	Germany	43	Slovenia
		17	Greece	44	Spain
		18	Hungary	45	Sweden
		19	Iceland	46	Switzerland
		20	India	47	Taiwan, Province of China
		21	Indonesia	48	Thailand
		22	Ireland	49	Turkey
		23	Islamic Republic of Iran	50	Ukraine
		24	Israel	51	UK
		25	Italy	52	US
		26	Japan	53	Vietnam
		27	Korea		

In order to examine the impact of *de minimis* (exemption from customs duty as well as VAT) on exports of MSEs, the following function has been estimated in a single point cross-section dataset:
 $Exports_{ij} = f(x_j, \mu; \beta)$

Here, $Exports_{ij}$ are exports of MSEs from country i to country j , x_j is vector of determinants, i.e. threshold of *de minimis* for customs duty and VAT in importing country j , μ is the error term and β is the vectors of the parameters to be estimated. This estimation has been assuming a linear relationship between MSEs exports and *de minimis* threshold.

The specific equation for estimating the possible impact of changes in *de minimis* on exports of MSEs is as follows:

$$Exports_{ij} = \beta_0 + \beta_1 x_j + \mu \text{-----} (1)$$

Here, equation (1) has been estimated in following three models, aimed at distilling the impact of customs *de minimis* and VAT *de minimis*, as follows:

Model (1) - when *de minimis* regime of importing countries covers only customs duty
 $Exports_{ij} = \beta_0 + \beta_1(\text{customs de minimis of importing country})_j + \mu$

Model (2) - when *de minimis* regime of importing countries covers both customs duty as well as local taxes (VAT)
 $Exports_{ij} = \beta_0 + \beta_1(\text{customs de minimis of importing country})_j + \beta_2(\text{VAT de minimis of importing country})_j + \mu$

Model (3) - when *de minimis* regime of importing countries covers customs duty and whether or not local taxes, here if an importing country provides *de minimis* on VAT its threshold value has been taken, and if an importing country does not provide *de minimis* on VAT, its value has been taken as zero.

$$Exports_{ij} = \beta_0 + \beta_1(\text{customs de minimis of importing country})_j + \beta_2(\text{VAT de minimis of importing country})_j + \mu$$

Hypothesis:

H₀: There is no significant impact of *de minimis* exemption on exports of MSEs.

H₁: There is a significant impact of *de minimis* exemption on exports of MSEs.

Table 1: Summary Statistics of Variables in Equation (1)

	Obs.	Mean	Std. Dev.	Min.	Max.
Model-1					
MSEs Exports (US\$m)	297	438.62	1328.87	0.05	12939.50
Importer <i>De Minimis</i> (US\$)	297	132.57	199.44	5.198	822
Model-2					
MSEs Exports (US\$m)	341	960.42	2569.90	0.03	31230.55
Importer <i>De Minimis</i> (US\$)	341	158.34	30.12	25	166.30
Importer VAT (US\$)	341	23.77	1.82	16.63	24.39
Model-3					
MSEs Exports (US\$m)	638	717.51	2100.84	0.028	31230.55
Importer <i>De Minimis</i> (US\$)	638	146.34	138.32	5.20	822
Importer VAT (US\$)	638	12.71	11.94	0	24.39

Table 2: Regression Results of Equation (1)

Dependent Variable-Exports of MSEs Estimation Method- Ordinary Least Square	Model (1)	Model (2)*	Model (3)*
<i>Constant</i>	468.42* (5.17)	-2578.023* (-4.24)	432.1196* (4.80)
<i>Importer De Minimis (Customs duty)</i>	-0.2248 (-1.08)	4.9758* (4.18)	-0.0791 (-0.37)
<i>Importer De Minimis (VAT)</i>		115.7058* (4.56)	23.3719* (3.44)
Obs.	297	341	638
F-Statistics	1.16	12.21	6.60
R/Adj. R-Squared	0.0011	0.0117	0.0175

Source: Author's own estimates

- Figures in parentheses are t ratios.

Significance: *1 per cent

Table 3: Forecasted Exports of MSEs Based on Equation (1)

	Model (1)	Model (2)	Model (3)
Number of exporting countries	13	13	13
Number of importing countries	25	28	53
Actual total MSEs exports in 2015 (US\$bn)	130.27	327.50	457.77
Forecasted total MSEs exports (US\$bn) if customs and VAT <i>de minimis</i> of importing countries are US\$200 and US\$30, respectively	Not possible as Model (1) does not reflect any significant relationship of MSEs exports and customs <i>de minimis</i> of importing countries	644.10	712.94
Projected increase in exports (US\$bn)	NA	316.60 i.e. 96.67 per cent	255.17, i.e. 55.74 per cent

Note: The projected figures of MSE exports may seem to be inflationary. This may be due to the un-accounting of various factors affecting exports, which is highly difficult due to account for data limitations. However, the results clearly point to the relevance of de minimis and the difference in impact due to scope.

This Briefing Paper has been prepared by Sanjay Kumar Mangla of and for CUTS as part of the project entitled, 'Internationalisation of Micro and Small Enterprises through E-Commerce: *Assessing the Impact of De Minimis*'.

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