CHAPTER ONE

IMPORT PROCEDURE

What is foreign trade?

The trade of every country can be divided into two parts

1. internal/home trade
2. international/foreign trade

Internal trade- purchase and sale of goods with in a country is known as the internal trade. Internal trade is always with in the boundary of a country. It is also known as domestic/home trade.

International trade- may be defined as the trade between different countries. Purchase from and sale of goods and services out side the country is called international trade/foreign trade.

Foreign trade plays an important role in accelerating the process of economic growth of a country.

Foreign trade can be divided in to the following three categories

i. Import trade-when goods are purchased from a foreign country, it is called import trade.
ii. Export trade-when goods are sold to other countries
iii. Enter port trade-sometimes goods are imported from one country with the purpose of exporting them to some other countries

Difference between home trade and foreign trade

1. Meaning- home trade means purchase and sale of good with in a country. Foreign trade means purchase from and sale of goods and services outside the country
2. Different currencies- home trade involves the use of only one currency i.e. the domestic currency. International trade involves the use of two different currencies, the local and a foreign country currencies

3. Exchange and control- with in a country, there is a free flow of goods and services. there is no free flows of goods and services from one country to another
4. Politically different- home trade takes place with in the same political unit. International trade takes place between different political units.
5. Transportation costs- domestic trade involves less transportation cost. Foreign trade involves comparatively greater transportation cost
6. Risk- in home trade the amount of risk is comparatively less. In foreign trade there is a greater risk.

Import- export procedures in Ethiopia

Export-import trade encompasses both national and international rule and regulations. This makes it a difficult and complicated venture to handle. This is because of the distance involved and the divergent socio-economic conditions and rules that prevail in different countries.

The Exporting process

Exporting from Ethiopia requires an export license from the Ministry of Trade and Industry. The process involves three critical functions: feasibility analysis, planning foreign market entry and implementation .Exporting involves a considerable investment of financial, managerial, and production resources. Therefore, an objective analysis is necessary before making the decision to export. It is important to consider the following questions:

i) Analysis of domestic performance

- Why is the business successful in the domestic market?
- What is the current domestic market share of the product?

ii) Firm's commitment and desire to export

- What are the firm's objectives for exporting?
- At what level in the firm's hierarchy is the exporting department located?
- Which members of the firm's staff will be involved in the export process?

- Is there a need to in increase the size of the firm's staff?
- What international experience does the firm (or any of its employees) have?
- What level of involvement in the export process is the firm will to have?
- How much risk is the firm willing to take?

iii) Competitive analysis

- What makes the firm's products or services competitive in a foreign market?
- What makes the products or services unique?
- What are the overall competitive advantages (e.g. technological advancements, patents, skills)?

iv) Finding out about target foreign markets

- What market segments are being used?
- How much inventory will be necessary to sell overseas?
- How is the firm's competition performing in international markets?
- Will the product be restricted due to tariffs, quotas or other non-tariff barriers?
- Does the product conflict with culture, traditions or beliefs of customers abroad?
- Will patent/ trade mark protection abroad be essential for the product?
- What product labeling requirements must be met?
- What sort of environmental regulations need to be adhered to?

The import /Export process is not a smooth process, it calls for a series of decisions from both parties (importer/exporter) some of these decisions include:

- Market analysis
- Licenses
- Negotiations between the seller (Exporter) and buyer (Importer) on product specification, price, mode of shipment.
- Agreement on terms of sale (trade terms)

- Settlement of payments
- Inspection of goods
- Customs clearance

a) Market Analysis

Market research is vital to the success of import /export business. Is your product suitable? You must be able to sell enough of the product or service to justify undertaking the import /export project.

The following are check lists of research items for importers:

Importer check list:

- ✓ Is there already a market for the product?
- ✓ What is the market price?
- ✓ What is the sales volume for the product?
- ✓ Who has market share, and what are the shares?
- ✓ Market size & characteristics?
- ✓ Distribution channels being used?
- ✓ Cost of importation?

After completion of the research if the research output is promising, the importer or the exporter pushes the processes further.

b) Negotiations between the importer and exporter

Initial quotations may be forwarded from the importer to the exporter. Initial quotes begin with request for quotation "from the importer to exporter". **A Performa invoice** is often the document used to respond to a request for pricing information. The Performa invoice, a normal invoice document visibly marked "Performa" is the method used most often to initiate negotiations, its purpose is to describe in advance certain items & details. If the importer agrees on the Performa invoice, he/she will send a purchase order. But, before order securing import license and export license and terms of sale precedes.

c) Securing Import license and Export license

As an exporter you should secure appropriate export license for your product. Although the responsibility of securing import licenses may rest with the importer, the exporter does not want to ship goods until it is certain that all import

regulations have been met. Goods arriving without proper documentation can be denied entry and returned to the supplier.

d) Terms of sale (International trade terms (Incoterms)

- International trade terms indicate how the buyer (importer) and seller (exporter) divide risks and obligations and, therefore, the costs of specific kinds of international trade transactions. When quoting prices it is important to make them meaningful.

Reasons for Foreign Purchasing

The reasons for sourcing abroad are many and vary with the specific commodity needed. Buyers who have turned abroad for a large portion of their purchases cite the following reasons:

1) **Cost /price benefits**- most studies show that ability of a foreign vendor to deliver product at a lower overall cost is a key reason to buy abroad. Total landed costs, including the cost of transportation for thousands of miles in some case, are often lower than domestic suppliers.
2) **Quality**- Higher quality on some items, if not on all items due to:
    - Better technological know-how
    - Newer and better capital equipment
    - Better quality control systems
    - Motivation of the workforce to accept the zero defects concept.

Foreign vendors have displayed great flexibility in adapting their manufacturing methods to special requirements, their products particularly machinery are often far advanced over their domestic counterparts; and the quality of many products is often superior to that of higher-priced domestic items. It has often been stated that price is the initial motivator for offshore sourcing, and high quality is a bonus that keeps them returning.

3) **Unavailability of items domestically**:

- Complete unavailability due to absence of skilled manpower and raw materials.
- Materials may be available, but not in sufficient quantity.
- Even if some goods may be available they may not be of the right quality.

4) Faster Delivery and Continuity of Supply

Increase worldwide demand for goods made it imperative that new sources of supply be developed; this availability of goods in the world market shows continuity of supply. Faster delivery depends on technical and financial capacity of foreign vendors.

5) Better Technical Service:- if the foreign vendor has a well organized distribution network in the buying country, better supply of parts, warranty services and technical advice may be available than from domestic suppliers.

6) Technology- Increasingly, as firms domestically and overseas specialize, technological know-how in specific lines varies particularly in the case of capita equipment foreign vendors may be far advanced technologically than domestic sources.

7) Relative Ease of communication: - the development of almost instantaneous communication and rapid transportation anywhere in the world has helped promote international trade.

8) Competitive Clout: - competition tends to pressure the domestic supplier to become more efficient, to long term benefit of both that vendor and the buyer. Some countries use imports or the threat of imports as a lever to pressure concession from domestic suppliers.

9) Marketing Tool (market entry):- To sell domestically made products in certain foreign countries, it may be necessary to agree to purchase agreed on dollar amounts from vendors in those countries. This is what we call a counter-trade. Moreover, most multinational corporations accept some responsibility for the economic development of the nations in which they operate.

Example- A computer firm whishing to sell its products in Brazil must also buy from Brazil.

Methods of Identifying Import sources

How does the prospective importer identify import sources? In number of ways:

a) If similar imported products are already in the market, go to a retailer that sells them and examine the product label to see where it is made
b) If the product is not being imported, you should contact all the sources of supplier information.
c) Accidental importing also takes place, when you visit a foreign country look for products that may have a market at home.

Difficulties and problems in Export Marketing

Export marketing is restricted to some extent due to certain difficulties or drawbacks such as:

- **Difficulties of Distance**:- export markets are spread over long distance. Naturally, the exporter will find difficulty in catering to long distance markets. Longer the distance, the more will be the transport goods to the customers.
- **High Risk and Uncertainties**: export marketing is subject to high risk and uncertainties. The risks may be both political and commercial. The political risks involve government instability, war, civil disturbances, etc. The commercial risks involve insolvency of the buyer, protracted default on the part of the buyer, and so on. However, it is possible to overcome some of these risks through purchasing insurance policy from insurance companies.
- **Diverse Languages, Customs and Traditions**: - the export markets differ in languages, customs, and traditions. The exporter may not be able to cope up with these diversities. Therefore, the exporter has to be selective. He/She should deal in only such markets where he/she can easily handle or overcome such differences or diversities.

- **Different Currencies, Weights and Measure**: Different countries in the world have their own system of weights and measures. Some countries may measure in pounds, and others in kilograms, or in some other measure. Again, every country has its own currency. Each currency has different exchange rates. The currencies of some countries subject to heavy fluctuations in exchange rates.
- **Customs Formalities**: - There are a number of custom formalities in the export of goods from one country to another. Again, there are Customs formalities for the buyer, i.e., Customs formalities of the importing country.
- **Foreign Exchange Regulation**: Export marketing is subject to foreign exchange regulations. For instance, in Ethiopia, the exporters have to give declaration to the National Bank of Ethiopia (NBE) that they will realize the full value of exports within a period of six months.
- **Problems for Non-members of Trading Blocks**:- the countries, which are not the members of powerful trading block like NAFTA, EEC, ASEAN, etc.., do face problems while dealing with the member countries of the trading communities. The trading communities try to eliminate or if possible reduce trade barriers on the member nations. However, they impose common external trade barriers on non-member nations.
- **Double-faced Competition**: - exporters in the international markets have to face strong challenges from the two-faced competition. The competition is more severe and acute in international market. There are direct competitions from similar products and indirect completions from substitute products.
- **Trade Barriers**: Export trade is subject to a number of tariff and non-tariff barriers. Various importing countries do impose a variety of taxes and other formalities. This creates difficulty for the smooth flow of goods and services among countries. However, efforts are now being made at WTO (world trade organization) to reduce and simplify a number of trade barriers.
- **Documentation Formalities**: - there are a number of documents to be prepared in export trade. In Ethiopia, for example, there are more than 15 documents that are compulsory needed to facilitate Customs export formalities

Parties that facilitate the importing of commodity

There are several participants in facilitation of international trade, especially when the goods are shipped by sea. The following parties are among the active participants of international trade:

1) **Commercial banks-** virtually all direct transactions between purchasingfirm in local country and exporting firm in other countries are handled by commercial banks which have international bank division. In Ethiopian for instance, both government and private banks such as CBE, CBB, DBE, Dashen, Awash, Absyina, Hibret, Buna, and Birhan etc effect and/or receive payments on behalf of their customers. Involvement of banks on both side to regulate the transfer of money for goods sold on Letter of credit (L/C)
    - The bank in the side of the buyer (applicant) is called the issuing/ opening Bank.
    - The bank in the side of the seller (Beneficiary) is called the Advising or Confirming Bank.

The export credits guarantee department (i.e. Bank) provides insurance against risk on commercial basis. Cover can be provided to related risks such as:

- The insolvency of the buyer.
- The failure of the buyer to pay for the goods which he/she has accepted.
- A buyer default on a contract before acceptance of the goods but after they have been shipped.
- The imposition of import restriction.
- Civil disturbance in the importing countries.

Generally banks provide a security for means of payment to a designated beneficiary who could be exporter and /or seller who found at far away from the importer and/ or buyer.

2) **Ports**: - ports are an area where ships are loaded with and/ or discharged of cargo. It is also include the usual places where ships wait for their turn. There are two types of Ports:
    - **Ports of Shipment**: - A place where export products will be loaded fro exporting country to transship into importing country.

- **Ports of Destination**: - A place where imported products will be unloaded to enter into importing country.

3) Freight Forwarder (Customs Clearing Agent)

For the smooth flows of custom clearing activities in Ethiopian, Customs Authority, freight forwarders or Customs Clearing Agent (CCA) play critical roles.

Freight forwarding: - means the representation of a consignor or consignee locally or internationally in fulfilling customs, port and other formalities for import and export cargo at port including the transportation and delivery of same

Freight forwarder: - means a person who is licensed to carry out freight forwarding. In other words, freight forwarder refers to a service provider working from his/her premises and taking care of a range of operations relating to his/her clients' goods: transshipment, handling, storage and various commercial and administrative formalities. He/she is generally also called a Customs Broker.

The functions of the Freight Forwarder

The functions of the freight forwarder include the following:

- Port clearance
- Customs clearance
- consolidation
- Warehousing and delivery services
- Cargo handling equipment services
- Transport services, where the freight forwarders provides such services himself/herself
- Transport the cargo using other transporters, where himself/herself or cargo owner do not have transport services
- Fumigation services
- Packing services
- Preparation and issuance of relevant documents
- Compliance with foreign trade regulation and letter of credit instructions
- Choices of the most suitable carrier and conclusion of the contract of carriage

- Follow up movement of cargo
- Consultancy services in freight forwarding

How to become a freight forwarder in Ethiopia

To obtain a Clearing License from Ministry of Trade and Industry (MOTI), a certificate of proficiency after attending a training course and taking an examination at Ethiopian Customs Authority (ECuA). Previously all importers could clear their own goods. Nowadays Customs deal exclusively with clearing agents.

When an importer employs a clearing agent he/she in effect gives up the right to deal directly with Customs. The importer may be unable to approach Customs directly in event of a dispute concerning the authenticity of documents relating to values, or the nature and correct tariff classification of specialized goods, and negotiations may be left in the hands of and agent who is not familiar with the origin of the documents or the nature of the goods. With regard to Government importers, they have to use Marine Transit Services Enterprise (MTI) as a clearing agent, but private importers are free to choose.

To use the service of clearing agent, the importer completes a Clearing instruction and supplies the necessary documents:

- Exporter's commercial Invoice.
- Original Bill of Lading endorsed to the agent.
- Insurance certificate and debit note
- Certificate of origin
- Forex permit
- Packing list and;
- Ocean Freight invoices

4) Shipping Agency

Shipping Agency means the representation of an owner, chatterer or operator of a ship in canvassing and booking cargo or passenger and providing services to the ship inland and at port as necessary and includes the coordination of stevedoring and shore handling services.

The functions of the shipping Agency

The functions of the shipping agency include the following:

- Contact various ship owners and obtain advance information of sailing schedule of cargo discharging and loading vessels.
- Prepare daily fleet position and distribute to shippers and importers
- Provide cargo canvassing, booking and coordination services.
- Organize the arrival and departure arrangements of ships and ensure that the country's foreign trade cargo be transported by sea-worthy vessels.
- Follow that export goods have arrived at port before arrival of loading vessel and ascertain that the goods are properly loaded.
- Notify importers of the arrival of their goods to effect delivery.
- Assist the appropriate bodies in order to avoid or minimize congestion of port and delay or services.
- Assist in chartering sea-worthy ships.
- Collect freight; prepare statement of account and disbursement account.
- Coordinate stevedoring and provide cargo super-intendancy services'
- Provide or arrange ships husbandry services like provision of food, water, ete.., to the ship.
- Provide crew change and repatriation services
- Issue Bill of Lading (B/L), delivery order and prepare other shipping documents
- Facilitation settlement of claim by cargo owners.
- Provide protective agency service; and
- Monitor movements' of containers..

6. Insurance companies

Whether foreign purchasing firm or foreign supplier use the services of a freight forwarder or arrange for the delivery of the goods on its own, it must insure the cargo to be imported or exported. Transport companies will only assume limited liability if the firm's goods are damaged or lost. Among varies types of insurance policies, marine insurance covers not only ocean cargo but air cargo and connecting land transportation. Generally, the policy will be special cargo indicating that only the one shipment is covered or open cargo which will cover all shipments made by exporter. The latter is generally caused by exporters who frequently shipment in large volume.

7. National bank/ central bank

National or central bank of the country is responsible to control over foreign exchange. According to Prof. Kent, Exchange control may be defined as government action to regulate exchange rate and to restrict the use of the means of international payment. It means to put legal restrictions on the business which involves foreign exchange and its sale and purchase in the national market, when such business is undertaken by the individuals. It is method to keep the fluctuations away from the economy in order to foster the speed of economic development. It becomes apparent that foreign currency is to be checked up by the governmental authority to avoid any crisis. However; control of foreign Exchange does not imply the abolition of the use of foreign currency by the traders. It rather means to channelize the flow of Exchange so that it may not cross the lines marked for it. In a wide sense, the term Exchange Control refers to all those dominant activities of government which are intended to influence the rate of exchange or the business connected with foreign exchange. But in a narrow sense, the exchange control refers to those restrictions which are imposed by the government on foreign business.

Following are the characteristics of exchange control

- All sorts of foreign exchange transactions are centralized under the direction of the central Bank of the country. In case of Ethiopia it is under the direction of the National Bank of Ethiopia (NBE).
- The whole of foreign exchange is deposited in central bank which gives the exporters domestic currency in turn.
- The importers get foreign currency from the central bank of their country
- The government fix priorities for distribution of foreign exchange
- Imports get automatically a result of exchange control
- The government holds its monopoly on foreign business as a whole

8. Customs Authority

Custom authority of an importing country is responsible for regulate and control that no goods are interred into the country without paying duties and taxes. In addition, the authority is judicially given vested power to implement laws and

international convention related to its objective and controls the importation of prohibited or restricted goods.

9. International transport / carriers All modes of transportation take part in the movement of goods depending on the nature of commodities and availability of infrastructure.There are four ways to transport cargos from one country to another. These are:

- **Truck:** a popular option for shipments in most of countries. It can be used when delivering the goods from a foreign port of entry to another country. Options include general carriers, specific commodity carriers, and private carriers. Costs are based on truckload and less than truckload quantities.
- **Rail:** another common option when transporting goods. It is also used frequently used to transport goods to a port for shipping overseas and when the good arrive at the foreign port of entry and must carry on to another destination. It is more popular than transporting by truck in many countries as the roads are not always in good condition. Costs are the carload a full carload will be cheaper than a particular carload.
- **Air:** the most costly of all transport methods. There are also length and weight restrictions for air freight. However, the higher costs may be offset by faster delivery, lower insurance and warehousing costs, and better inventory control.
- **Ship:** large items bulk commodities and item that do not require fast delivery can be shipped economically by sea. However, there are minimum weights requirements for ocean freight, which may be three to four times greater than air requirements. With ocean freight, importer or exporter goods are shipped in 20 foot and 40 foot containers or in crates. The container charge will be less if they are able to fill one completely. If they do not have a full container load, one can lower one's cost by "piggy-backing" (i.e., consolidating) on to another partial shipment.

Import procedures: the international practice

The international practice of import procedure involves four sub-faces: pre-import, legal dimensions of import, retirement of import documents, and customs clearance

It includes the following major and sub-procedures:

Stage I:Pre-import Sub-Procedure:-this includes the following steps:

1. **Selecting the commodity or identification of need**;- an importer should select the commodity for import after considering various commercial factors as well as legal considerations including the regulations contained in the Import-Export trade policy. Imports may be made freely except to the extent they are regulated by the provision of the policy. Prohibited goods cannot be imported at all. Import of restricted items is permitted through licensing only.
2. **Receipt of list items to be procured (PR)**
3. **Preparation of specification**
4. **Preparation of bid document**
5. **Obtaining of overseas Suppliers**: - imports can be made from any country of the world except countries with which Ethiopia get into trade and/or political disputes.
6. **Sending the biding document to oversee supplier for comments**
7. **Receiving final bid document with comment from oversee suppliers**
8. **Announcing through media**
9. **Issuance of biding document**
10. **Plotting period(submission of bid)**
11. **Closing biding**
12. **Opening of bid**
13. **Preliminary evaluation (i.e. VAT** registration certificate, trade license, bid security or bid bond**)**.
14. **Technical or detail evaluation**
15. **Financial evaluation**: - successful completion of an import transaction mainly depends upon the capability of the overseas supplier to fulfill his/her respective contract. Therefore, it is advisable to verify the creditworthiness of the overseas supplier and his/her capacity to fulfill the contract through confidential reports about him/her from the banks and Ethiopian embassies abroad.
16. **Approval of bid evaluation and report by tender committee**
17. **Award notification for the winner supplier**
18. **Preparation of contract**
19. **Receipt of fresh pro-forma invoice**

20. **Negotiating and signing on the contract**
21. **Receipt of performance bond (10% of the total award price)**

Stage II: fulfilling legal Documents for sub Import procedure

This procedure includes the following steps:

1. Request for bank/import permit
2. Receive bank permit from national bank
3. Request for HS code (harmonized system code) from clearing agents
4. Receipt of HS code
5. Request of insurance policy
6. receipt of insurance policy
7. Issuing of eligible legal documents to issuing bank
8. Issuing performance invoice to applicant bank
9. Presentation of HS code for issuing bank
10. Issuing of foreign exchange permit to issuing bank
11. issuing of insurance to applicant bank
12. Submitting of application of letter of credit
13. Final receipt of approved LC number

Stage III. Arranging and submission of shipping document or Retirement of Import Documents Sub-procedure

This includes the following:

1. arrangement of items made by supplier
2. loading and unloading
3. preparation of shipping documents (obtaining of shipping document)
4. presentation of shipping document to the advise bank
5. requesting for bill of exchange
6. sending shipping document to the issuing bank
7. receipt of shipping from (DHL or TNT)
8. issuing of shipping documents to the buyer

Stage IV Customs Clearance Sub-procedure

In this regard, all goods imported to Ethiopia have to pass through the Customs Clearance after they cross the Ethiopian border. The imported goods are examined,

appraised, assessed, evaluated and then allowed to be taken out of Customs Station for use by the importer. The procedure for Customs clearance in general for goods imported in Ethiopia is discussed as follows:

1. applying for custom clearance by fulfilling ECDF
2. submission of all required documents together with a copy of ECDF
3. verification of documents by the custom officer or checking the truthfulness
4. customs inspection of goods in the presence of the agent
5. custom valuation of the declared goods or giving value in terms of money
6. customs calculation of taxes fees and duties
7. Inspection of clearing goods in custom
8. authorization of their release or release of goods from custom

Contract considerations for importers

A contract is a legally binding agreement between the parties identified in the agreement to fulfill all the terms and conditions outlined in the agreement. Contracts can be many types purchasing contract, sales contracts, partnership agreements, trade agreements and intellectual properties agreements. A purchasing contract is a contract between the buyer and a supplier who is promising to sell his/her products and/or services. Where as, a sale contract is a contract between the seller and a customer that the seller are promising to sell his/her products and/or services to the customer. The customer in return is obliged to pay for the products/services bought.

Importers frequently attempt to control their import transactions and protect their interests by using a purchase order subject to terms and conditions expressed on the back of the purchase order or by using a payment term subject to various performance requirements.

According to Margaret M. Gatti both these methods present potential problems for the importer and do not achieve the importer’s objective unless importers are conscious about related risks associated with them.

1. Risks related to purchase order (PO)

An Ethiopian importer, for instance, imports certain cargo from US and places purchase order typically bear only the importers signature and designate Ethiopian law as the governing law, i.e., the law which will be used to interpret the PO in the event of dispute. Ethiopian law, however, is generally based on the uniform commercial code (UCC) and under the UCC; a contract dealing with the sale of goods must be in writing and must be signed by both parties if it is intended to bind both parties. While the ideal situation with regard to an exporter is accept the importer's PO in a separate document which refers to the importer's PO and which bears the exporter's signature. There are exceptions; a PO signed only by the importer or not referenced in an acceptance signed by the exporter does not bind the exporter.

Further more, the selection of Ethiopian law does not necessarily mean that Ethiopian law will be applied. The Ethiopia is not a signatory to the United Nation's Convention on contract for the International Sale of Goods (CISG). Under these provisions of the CISG, the CISG automatically applies in transactions between parties located in countries which are signatories to the CISG; unless the parties specifically state that the CISG does not apply. Consequently, a PO which declares Ethiopian law to be the governing law and does not override the applications of the CISG will not prevent the CISG from being brought to bear in the case of a controversy.

The application of the CISG does not produce wholly undesirable results for the importer, however. In fact, with regards to a PO signed only by the importer, the CISG produces a more favorable result than the UCC. The CISG does not subject to sales contracts to any requirements with regard to form. Thus, the PO signed only by the importer and the terms and conditions found on the back of the PO will bind the exporter accepts the PO. The only instance when this result will not be achieved is when the exporter responds to the importer's PO and states terms and conditions which materially alter the PO and its terms and condition. CISG views such a response from the exporter as the exporter's rejections of the importers terms and conditions and the offer of new terms and conditions. In this case, therefore neither the PO and its terms and conditions nor the exporter's counter offer will bind either party. The importer should keep in mind, however, that the CISG does not require a written document to bind parties to a

transaction. Therefore, the importer and exporter could in fact be bound to one another in a transaction via oral contract. The importer should also aware of the fact that the CISG establishes rights and obligations for the importer and exporter and these rights and obligations will be give effect in a transaction, unless they are specifically altered or excluded in an agreement between the parties.

2. Risks related to payment

Payment terms are frequently linked to performance requirements established by either the importer or the exporter.

Letters of credit are laden with performance requirements established by the importer. An importer prescribes such requirements in an application of an L/C. in issuing the L/C in favor of the exporter; the importer's bank makes the importer's performance requirements known to the exporter and promises to pay the exporter if and when the exporter complies with the importer's performance requirements.

Documentary collection/Bill of Exchange/Draft, on the other hand generally laden with performance requirements established by the exporter. The exporter requirements are prescribed in the collection letter which the exporter forwards to his/her bank. The exporter's bank makes the importer aware of the exporter's requirements and requires the importer to perform accordingly in order to receive the title documents to the exported product.

The performance requirements that are attached to L/C and documentary collection revolve around making and receiving payment. Other issues are not covered. Thus, importers who rely solely on payment terms to control their import transactions and protect their interests do not accomplish their objectives. Importers who combine the use of payment terms with a PO subject to terms and conditions are in a better position, but they still cannot be certain that their objectives will be achieved.

Conclude a purchase agreement: a resolution for the risks

Thus, importers are more likely to succeed in controlling their import transactions and protecting their interests when they enter in to a formal purchase agreement

with their exporters. Purchase agreements should deal with product related issues, procedural matters, dispute resolution mechanics and legal issues.

a. product related issues include:
   i. product specifics: description of product, quantity of product, quality of product
   ii. purchase price: currency, amount, explanation of what is included in purchase price, validity period of purchase price
   iii. packing, marking and labeling requirements, governmental requirements, and importer specific requirements
   iv. product shipment: port of shipment, timing of shipment, method of shipment, special handling requirements during shipment, insurance of product during shipment,
   v. Product delivery and acceptance: port of delivery, timing of delivery, process for the importer acceptances of the product, process for signaling non-acceptance by importer, exporter's responsibility with regard to non-acceptance by importer, remedies available to the importer in the event of non-acceptance.
   vi. Product warranty and servicing: warranty specifies, servicing procedures,
   vii. Product indemnities related to buyer's use or buyer's resale
b. procedural matters include
   i. order placement procedure
   ii. inspections right and inspection mechanics
   iii. payment for product method timing currency and routing
   iv. documentation requirements, exporter country requirements, importer country requirements and importer specific requirements;
   v. responsibility for costs and expenses
c. dispute resolution mechanism include:
   i. dispute resolution method: conciliation, mediation, arbitration, or litigation
   ii. dispute resolution forum
   iii. law to be applied during dispute resolution
   iv. language to be used during dispute resolution
d. legal issues include
   i. definitions of non-performance

ii. excuse for non-performance
iii. results of non-performance
iv. purchase agreement construction: amendment and severability

The purchase agreement drafted by the importer can be either an individual purchase agreement intended to govern a specific transaction or it can be a master purchase agreement intended to govern repetitive import transactions. No matter which form the purchase agreement takes, however, it should state full details. This is because terms which are omitted or undefined will be added, defined or deleted in accord with the practice of the agreements governing law. While both the UCC and the CISG interpret agreements in context, i.e, by looking at what the parties have written, by examining the parties conduct and by reviewing general customs and usage, it is still always safer for the importer to prescribe al details in the purchase agreement, rather than risk the application of unintended details or the deletion of intended details. The purchase agreement should be given both an effective date and expiration date and it should be signed by both parties.

While there are no agreements that a purchase agreement will be acknowledged or given effect by an exporter's country, it offer's importers the surest means available to control their import transactions and protect their interests.

INTERNATIONAL TRADE TERMS (INCOTERMS)

DEFINITION OF INCOTERMS

International commercial terms can also be read as incoterms. Incoterms are shipping terms which contain rules and regulation that clarify the costs, risks, obligations of buyer and seller in international commercial transaction. Based on the terms used agreed by the involving parties such as port, airport, ship owners, custom authorities and other governmental or any responsible bodies can easily determine the responsible party for the cargo in transit. Incoterms are invaluable and cost saving tool. The exporter and the importer need not under go a lengthy negotiation about the conditions of each transaction once they have agreed on a

single commercial term like FOB; they can sell and buy of FOB with out discussing who will be responsible for the freight, cargo insurance risks and other costs.

The Incoterms was first published in 1936; Incoterms 1936 and it is revised periodically to keep up with changes in the international trade needs. The complete definition of each term is available from the current publication Incoterms 2010. The new Incoterms 2010 rules were revised by the International Chamber of Commerce and will become effective January 1, 2011. Four terms were eliminated (DAF, DEQ, DES, DDU) and two were added: Delivered at Place (DAP) and Delivered at Terminal (DAT). The modifications affect obligations, risk transfer, and cost sharing for the seller and buyer, resulting in better clarification and application of the eleven (11) Incoterms, and consistent with the way global trade is actually conducted since the last update in 2000. Incoterms agreements are grouped into fourtypes based on types of contract arrangements:

- Origin
- Main carriage paid
- Main carriage unpaid
- Arrival/destination

Strengths and weaknesses of Incoterms

The international commercial terms are assumed to have the following strong sides, or merits for the business unit, or any individuals or organizations engaged in import export trade. These are:

- They are universally applicable
- They serve as a guidelines, standards that eliminates misunderstanding among parties involved in a given transportation contract.
- They are applicable to any types of goods

- They are useful in determining the title of goods, risk and obligations of parties
- They provides basis to arbitration and reconciliation or conflict resolution

However:

- Incoterms don't apply to contracts for service
- Incoterms do not determine how title of the goods will be transferred
- Incoterms don't protect either part from risk of loss.
- They don't cover for goods before and after delivery

Types of Incoterms

Based on the area of applicability we have two types of incoterms. These are:

1. **Uni-modal incoterms**: - are those that are applied only to one type of mode of transportation which means only for water transportation.
   E.g. FAS, FOB, CFR, CIF & DES

2. **Multi-modal incoterms**: - are incoterms that applicable to more than one mode of transportation. They may be applicable to all modes of transportation.
   E.g. Ex-work DEQ, FCA, CPT, DAF, DDP, DDU

Based on the first letter or acronyms, Incoterms 2000 has been classified into group E, group F, group C and group D

a) Group E

- **EX – work**

In this context **Ex** means from, work means factory or warehouse, which is the seller's premise. Ex-work, applies to goods available only at the sellers premises. Buyer is responsible for loading the goods on truck or container at the seller's premises, and for the subsequent costs and risks.

In practice it is not uncommon that the seller loads the goods on truck or container at the seller's premises with out charging loading fee. While using ex-work it is advisable to indicate the named place seller's premise in quotation often the acronym ex-work.

E.g. Ex-work Addis Ababa FOM & plastic Factory

The term EXW is commonly used between manufacturer, seller and export trader, buyer & the export trader resells on other trade terms to the foreign buyers. Some manufacturer may use the term ex factory, which means the same as ex-work.

b) Group F

- **FCA (Free carrier at named place of origin)**

The delivery of goods on truck, rail, car or container at the specified point (depot) of departure, which is usually the seller's premises, or a named rail road station or a named cargo terminal or into the custody of the carrier, at sellers expense. The point (depot) at origin may or may not be a customs clearance center. Therefore the buyer is responsible for the main carriage (freight, cargo insurance and other costs & risks).

In the air shipment, technically speaking, a goods placed in the custody of an air carrier is considered as delivery on board the plane. In practice, many importers and exporters still use the FOB in the air shipment. In the export quotation, indicate the point of departure loading after the acronym. E.g. FCA (Nazareth soap Factory, Nazareth)

- **FAS (Free Alongside ship named port of origin)**

Goods are placed in the dock shed or at the side of the ship on the dock or lighter with in reach of its loading equipment so that they can be loaded on the ship the ship at seller's expense. Buyer is responsible for the loading fee, main carriage / freight; cargo insurance & other costs and other risks. The term FAS is popular in the break-bulk shipments and with the importing countries using their own vessels.

- **FOB (Free on Board named port of origin)**

Free on board transportation involves two aspects based on the where title ownership is to be transferred to the buyer or importer, Accordingly when the parties agreed to use FOB origin title ownership will be transferred when the goods delivered to the common carrier at the shipping point. In Relation to transfer of title

of ownership responsibilities of costs, risks and insurances will be transferred to the buyer at the named point of port. On the other hand, FOB destination requires the seller to deliver the goods with full responsibility of the costs, risks, freights and insurances coverage's. Titles of the goods will be transferred to the buyer at the named point of destination or some times the buyer's country premises

C) Group C

- **CFR - COST AND FREIGHT (... named port of destination)**

"Cost and Freight" means that the seller must pay the costs and freight necessary to bring the goods to the named port of destination but the risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time the goods have been delivered on board the vessel, is transferred from the seller to the buyer when the goods pass the ship's rail in the port of shipment.

The CFR term requires the seller to clear the goods for export.

This term can only be used for waterway transport.

CIF - COST, INSURANCE AND FREIGHT (... named port of destination)

"Cost, Insurance and Freight" means that the seller has the same obligations as under CFR but with the addition that he has to procure marine insurance against the buyer's risk of loss of or damage to the goods during the carriage. The seller contracts for insurance and pays the insurance premium.

The buyer should note that under the CIF term the seller is only required to obtain insurance on minimum coverage. The CIF term requires the seller to clear the goods for export. This term can only be used for sea and inland waterway transport.

- **CPT - CARRIAGE PAID TO (... named place of destination)**

"Carriage paid to... "Means that the seller pays the freight for the carriage of the goods to the named destination. The risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time

the goods have been delivered to the carrier, is transferred from the seller to the buyer when the goods have been delivered into the custody of the carrier.

"Carrier" means any person who, in a contract of carriage, undertakes to perform or to procure the performance of' carriage, by rail, road, sea, air, inland waterway or by a combination of such modes.

If subsequent carriers are used for the carriage to the agreed destination, the risk passes when the goods have been delivered to the first carrier.

The CPT term requires the seller to clear the goods for export.

This term may be used for any mode of transport including multimodal transport

- **CIP - CARRIAGE AND INSURANCE PAID TO (... named place of destination)**

  "Carriage and insurance paid to..." means that the seller has the same obligations as under CPT but with the addition that the seller has to procure cargo insurance against the buyer's risk of loss of or damage to the goods during the carriage. The seller contracts for insurance and pays the insurance premium.

  The buyer should note that under the CIP term the seller is only required to obtain insurance on minimum coverage. The CIP term requires the seller to clear the goods for export. This term may be used for any mode of transport including multimodal transport. .

Group D

DAT - Delivered at Terminal: Seller bears cost, risk and responsibility until goods are unloaded (delivered) at named quay, warehouse, yard, or terminal at destination. Demurrage or detention charges may apply to seller. Seller clears goods for export, not import. DAT replaces DEQ, DES.

DAP - Delivered at Place: Seller bears cost, risk and responsibility for goods until made available to buyer at named place of destination. Seller clears goods for export, not import. DAP replaces DAF, DDU.

- **DDP (Delivery Duty paid)**

The seller is responsible for most of the expenses, which include the cargo insurance, import customs clearance, and payment of customs duties and taxes at the buyers end and the delivery of goods to the final point at destination, which is often the project site or buyer's premises. The seller may opt not to insure the goods at his/her own risks.

Cost factors in importing and exporting goods

As per our decision in the previous section, you can imagine various types of costs that could be incurred either by importer or exporter in the process of producing the product, packing, transporting, insurance coverage, loading and unloading, and customs duty and taxes. The following are some of the factors related to cost

1. materials, labor and overhead custom packing inspection fees, licensing fees and royalties
2. buying agents and traders markups
3. bank charges and commissions overseas agents commissions freight forwarder charges documentation charges insurance premiums, export license fees certification fees, consular fees and advertising
4. road freight charge (cartage, drayage) and/or rail freight, routing costs uninsured damage theft and pilferages handling charges and demurrage
5. brokerage fees and export levies etc

Compulsory import documents for respective Bank and custom clearing

The following documentations are compulsory in importing goods from abroad to Ethiopia.

Purchase contract. Purchase or sales contract refers to a document that indicates the agreement between exporter and importer on various terms and conditions that will put the parties well off after the trade transactions are over between them. Generally, all trade transactions are invariably quoted on the basis of detailed documentation and written agreements signed by both, the importer and exporter. However, a fairly large part of Ethiopia's imports-exports carried out without the backing of written contracts. This is especially true in the case of export of products

from small scale and cottage industries like handicrafts, gift articles, homemade food ingredients, etc. however, it should be noted that absence of written contract does not mean that there is no contract at all. There has to be a contract if exporters are to be made. There exists, in such cases, what is known as a constructed contract. A constructed contract is one where the existence of a contract can be inferred from relevant documents, via, telex messages, pro-forma invoice, commercial invoice or letter of credit. The exporter must, however, make sure that all the information on which agreement is required are available on any or all these documents.

1. **Trade/business license**. The importer or purchaser has to produce a copy of the trade license certified issued from ministry of trade and industry. It must be, of course, renewed every year.
2. **Import license**. Import license is required when the purchaser wants to import items categorized under restricted import. Such permits are obtained from government institutions which have a vested power to give the permit.
3. **VAT Registration and TIN certificates**. Importers whose annual sales are greater than birr 500,000 suppose to produce a copy of VAT Registration Certificate when they start to L/C opening process to their respective client issuing bank.
4. **Purchase order** when terms have been agreed, the importer will place purchase Order and in turn obtain pro-forma invoice by fax. Importers are sure of obtaining foreign Exchange (FOREX) and do not have to wait for a FOREX allocation before ordering. Orders are placed by telephone, fax, and e-mail. Importer s sometimes starts to process transactions for regular customers after initial enquiries without waiting for the formal order.
5. **Pro-forma invoice**. A temporary commercial invoice prepared and sent by an exporter to the importer. It contains almost the same particulars as commercial or final invoice. Its purpose is to help the importer in getting an import license in his/her own country, if the import of such commodities requires that and in opening the letter of credit in favor of the exporter in his/her own country. The exporter should cultivate a habit of sending a pro-forma invoice, even if it is not demanded.
6. **Cargo insurance policy/ Debit Note**. It is most important to have insurance cover against loss or damage that may occur during shipment. The purchase contract with the importer must clearly state who is responsible for arranging

the insurance at all stages from the time the merchandise leaves the exporters premises or warehouse until the importer takes possession. The insurance certificate must contain the same details as the policy with the slight difference that it will carry a shortened version of the provisions of the policy under which it is issued and should be signed by the policyholder. The particular's include the name and signature of insurer, name of assured endorsement of the assured when applicable so that the rights to claim may be transferred description of the risk covered description of the consignment sum or sums to be insured and place where claims are payable together with the name of the agent to whom claims may be directed. In this regards if the importer is responsible the insurance expense, the insurance expense, he/she has to produce underwriting debit note along with the L/C application form. It implies that the responsible party has paid the premium charge and gets insurance coverage in case accidents.

Basically, the insurance policy/certificate must embrace the following relative to the processing of the international consignment and cover the risk detailed in the credit arrangements.

The types of marine insurance are

- ✓ Be in a completed form,
- ✓ be in transferable form,
- ✓ be dated on or before the date of the document evidencing dispatch for example, B/L, and
- ✓ Be expressed in the currency as that of the credit.

An insurer undertakes to indemnify the marine insurance policy holder against losses caused due to perils of the sea. Here perils of the sea include:

- ✓ Sinking of the ship
- ✓ Damage to the ship and cargo due to dashing of the waves
- ✓ Dashing of the ships on the rock
- ✓ Fire explosion on the ship
- ✓ Spoilage of cargo due to sea water
- ✓ Destruction of the ship and cargo by the crew or captain of the ship
- ✓ Piracy and such other risk

Note marine insurance cover not only ocean cargo but air cargo and connecting land transportation. Generally, the policy will be special cargo indicating that only the one shipment is covered or open cargo which will cover all shipments made by an exporter. The latter is generally used by exporters who frequently ship in large volume.

7. **Foreign Exchange (FOREX) permits**. Importers no longer bid in the FOREX auction. The commercial banks now participate on their behalf. Commercial bank can obtain FOREX from NBE FOREX auction which are held every week. On Fridays NBE advertises the amount available through television radio and news papers and bids have to be in by 4 PM. Only commercial banks and investors can bid. Minimum bid level is USD 500,000.00the importer applies for FOREX permit at the commercial bank with application form (Foreign Exchange Application for Import), pro-forma invoice and import (trade) license. The import license may be needed every time although FOREX applications are frequent. There may be slight variations in commercial bank procedures, e.g. one bank asks to see original Trading License and then keep photo copy. The importer has to produce a certificate from NBE that there are no unclear FOREX commitments.
8. **Letter of Credit (L/C) Application Form**. If the foreign purchaser and supplier are agreed and/or if they are obliged by the trade regulation of the respective country that the mode of payment has to be L/C, the importer has to open L/C on his/her client Issuing Bank on behalf of the beneficiary. Thus, the importer has to correctly fill the prescribed L/C application form as per their agreement on both the purchase Order and purchase contract. Any discrepancies made while completing the application form may result in amendments of the L/C which entail the importer to pay additional charge. The application form usually accompanied by documents such as Purchase order, purchase contract pro-forma invoice insurance certificate VAT registration certificate/insurance Debit Note, etc.
9. **Customer Debit Note/ L/C Settlement advice**. Debit note is issued to importer by the issuing bank that signifies payment for an imported cargo i.e., L/C settlement. In fact, structurally they are very much like invoice, though they have a different meaning. Invoice always depicts sales, while Debit Notes on the other hand are used deducting money from customers account.

10. **Commercial Invoice and/or manufacturer Invoice**. It stands for billing for the goods and services. It includes a description of merchandise, price, FOB origin, and name and address of buyer and seller. The buyer and seller information must correspond exactly to the description in letter of credit. Unless the L/C specifically states otherwise, a generic description of the merchandise is usually acceptable in the other accompanying documents.
11. **Consular Invoice.** The consular invoice is a specific invoice issued by the consul of the importing country. Many importing countries, mainly less developed countries, have already phased out this invoice. It is used for customs clearance and other purposes as such any errors or omissions on the invoice may cause problems and fines at the customs in the importing country. Consular invoice is a form of non-tariff barrier. The format of consular invoice form varies greatly but it contains essentially the same data as in the commercial invoice and packing list. The invoice form is either in the language of the importing country or bilingual of exporting country.
12. **Packing list/packing Note**. The exporter or his/her Agent prepares the packing list to facilitate the foreign buyer to check the shipment. It contains the detailed description of the goods packed in each case, their gross and net weight, etc. the difference a packing note and packing list is that the packing note contains that particular's of the contents of an individual pack, while the packing list is consolidated statement of the contents of a number of cases or packs.
13. **Certificates of origin/country of origin**. The certificate of origin is a document certifying the country in which the product was manufactured, and in certain cases may include such information as the local material and labor contents of the product. Some importing countries require a certificate of origin to establish whether or not preferential duty rate is applicable.
14. **Inspection certificate/inspection report/report of findings.**
15. **Bill of lading**. A B/L is a document issued by the ship owner or by the master or other agent on his/her behalf which states that certain goods have been shipped on a particular ship and which purports to set out the terms on which such goods have been delivered to, and received by the ship. It is often referred to as one of the most important documents in maritime trade. It is a document which evidence a contract of carriage by sea and the taking over or loading of the goods by the carrier, and by which the carrier undertakes to deliver the goods

against surrender of the document. A document evidencing the receipt of goods for shipment and issued by a freight carrier engaged in the business of forwarding or transporting goods. The documents evidence the control of goods. They also serve as a receipt for the merchandise shipped and as evidence of the carrier's obligation to transport the goods to their proper destination. In general bill of lading has three major functions. These are evidence of receipt of goods (i.e., receipt as to the quantity, to the condition and to loading marks) as evidence of the contract of carriage and as a document of title.

Clean Vs Foul Bill of lading

The clean bill of lading bears an indication that the goods were received without damages irregularities or short shipment usually the words "apparent good order and condition", "clean on board" or the like are indicated on the bill of lading. Where as, the foul bill of lading –unclear B/L, Dirty B/L------, is the opposite of the clean bill of lading. It bears an indication that the were received with damages, irregularities or short shipment, usually the words "unclean on board" or the like are indicated on the bill of lading, for example, "insufficient packing", "missing safety seal" and "one carton short".

Short form Vs long form bill of lading

In short form B/L or Blank back B/L is a type of B/L where the terms and conditions of carriage on the reverse or back of the B/L are omitted instead they are listed on a document other than the B/L. unless otherwise stipulated in the L/C, a short form B/L is acceptable. The short form B/L saves the cost of printing (i.e., no printing on the back of the B/L) and if the terms and conditions of carriage change, there is no need to reprint the B/L form. Long form B/L, on the other hand, the terms and conditions of carriage are printed on the reverse or back of the B/L. the Long form B/L is commonly used in international shipping.

Received Vs on Board Bills of lading

Received bill of lading does not prove that the goods have been shipped. It only acknowledges that the goods have been received by the carrier for shipment. Therefore, the goods have been shipped, as evidenced by the pre-shipment wording or the on board notation (e.g., “on board” or “laden on board” or “shipped on board”) on the B/L. on board where as is shipped BL which proves the title to the goods is conferred directly to a party named in the LC or the importer usually as such the title to the goods is not transferable to another party by endorsement.

Straight Vs Order Bills of lading

Straight B/L is a non-negotiable B/L which the title to the goods is conferred directly to a party named in the L/C (the importer usually), as such the title to the goods is not transferable to another party by endorsement. In other words, the B/L is not negotiable. The L/C calls for a straight B/L usually by using such words, “consigned to (the named party)” or “issued in the name of (the third party)”. The named party can obtain the goods directly from the carrier at destination. Therefore, unless the cash payment has been received by the exporter or the buyer’s integrity is unquestionable, the use of straight B/L is risky. Order B/L, on the other hand is negotiable bill of lading which the title to the good conferred to the order of shipper or to the order of a named party in the letter of credit (the issuing bank usually). The purpose of an order B/L is to protect the interest of the shipper or named party to the title to the goods. The title to the goods is transferable to another party by endorsement, usually on the reverse or back of the B/L by the title holder of the B/L. if the endorsement of the B/L is required in the L/C, all the originals must be endorsed. The L/C may calls for an Order B/L that is:

- To order blank endorsed or to order of shipper and blank endorsed
- To order of shipper and endorsed to order of named party
- To order of [the named party (other than shipper)]

16. **Freight invoice/receipt**. When a movement of freight is initiated by the receipt of shipping instructions or bill of lading a charge for the transportation is generated and sent as an invoice. This document implies the amount of money paid to shipping company.

17. **Dock receipt /shipping instruction**. The dock receipt is also shipping note when signed by the receiving clerk (cargo checker) at the container terminal or dock is a proof of the delivery of goods.
18. **Warranty of Title**. A warranty by a seller to a buyer of goods that states that the title being conveyed is good and that the transfer is rightful. This is a method of certifying clear title to the product transfer. It is generally issued to the purchaser and issuing bank expressing an agreement to indemnify and hold both parties harmless.
19. **Customs clearing agency agreement/power of attorney**. According to Ethiopian custom law, an importer shall not have a direct contract with custom authority. Rather he/she shall be represented by customs clearing broker who play an intermediary role between the importer and customs office. Thus, they required to conclude a contract that confirm the principal or importer give an attorney to the agent or custom broker and handing over all the necessary documents to clear the cargo from customs stations.
20. **Custom declaration form (CDF).** In many countries, imports/export shipments valued below a minimum requirement may not require a formal customs declaration. The purposes of CDF are to verify and regulate in/out going cargo and to collect the statistical data (of the product, quantity, value, and destination) for import/export references.

    The format of CDF varies from country to country. The form typically contains the information found in the commercial invoice and bill if lading/air bill. In addition, the form may include

    - The business license number and/or tax account number and/or import permit or license number of the importer
    - The business license of the manufacturer from whom the export trader buys the export goods
    - The commodity code or category of the goods
    - The country of destination and its country code or a numeric country code may be assigned to each importing country by customs of the exporting country for compiling statistics
    - The name, address and code or license number of the customs broker or forwarder

- ❖ The customs charges

21. **Customs invoice.** The customs invoice is used in lieu of the commercial invoice in a few importing countries for customs purposes but the importer often needs a commercial invoice too. The custom invoice can be in the form called the certificate value. The invoice varies in format but they contain essentially the same data as in the commercial invoice and packing list. The invoice itself certified by the exporter. The blank customs invoice is available from the customs broker and specialized printer.
22. **Investment or duty free permit.** Countries compete for attracting investor in to their country by extending duty free privileges. Such privileges are also given to local investors, NGOs, ministry organizations and commissions.

    E.g. exemption from import duties and taxes on capital goods such as machineries, equipments and spare parts up to fifteen percent of the capital invested, provided this goods are locally. Exemption from payment of import duties on raw materials used for production of export commodities.

23. **A certificate of Health**. A certificate of health is usually required when agricultural or animal products are imported or exported. The certificate is issued and signed by the health authority in the supplier's country. It states that the county's health requirement should be satisfied at the time of shipment. For example if the products are imported from Canada, the issuing authority will be the ministry of agriculture based in Canada.

Important terminologies:

- Cargo clearance- the process of clearing cargo through customs at sea port or inland clearance depot.
- Cargo declaration- document on arrival and departure providing information required by public authorities relating to the cargo.
- Cargo booking service- the process of shipper/agent using the cargo reservation service thereby ensuring space/capacity is allocated to consignment on a particular schedule.
- Discharge- the unloading of a vehicle, vessel, aircraft or barge/landing of cargo.

- Shipper-person or firm with cargo to transport.
- Dry-dock- dock in which ships may be repaired or built, the water being pumped out as required.
- Bunker port- a port, which is available for bunkering ships (bunkers-the quantity of fuel on board vessel)
- Stevedores- Dockers engaged on cargo/baggage transshipment.
- Quay-the location in sea port at which cargo arrives or departs.
- Port of registry- home port of a vessel at which place the vessel is registered

CHAPTER TWO

Letter of Credit (L/C) / Documentary Credit

2.1 Meaning of Letter of Credit (L/C)

Letters of Credit (L/C) have been used for centuries to facilitate payment in international trade. Their use will continue to increase as the global economy evolves. L/C used in international transactions is governed by the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits (ICC-UCP). The general provisions and definitions of the International Chamber of Commerce are binding on all parties.

A L/C is a payment term generally used for international sales transactions. It is basically a mechanism, which allows importers/buyers to offer secure terms of payment to exporters/sellers in which a bank (or more than one bank) gets involved. The technical term for L/C is 'Documentary Credit'. At the very outset one must understand is that L/C deal in documents, not goods. The idea in an international trade transaction is to shift the risk from the actual buyer to a bank. Thus, an L/C (as it is commonly referred to) is a payment undertaking given by a bank to the seller and is issued on behalf of the Applicant i.e. the Buyer. The Buyer is the Applicant and the Seller is the Beneficiary. The Bank that issues the L/C is

referred to as the Issuing Bank which is generally in the country of the Buyer. The Bank that Advises the L/C to the Seller is called the Advising Bank which is generally in the country of the Seller. The specified bank makes the payment upon the successful presentation of the required documents by the seller within the specified time frame. Note that the Bank scrutinizes the documents and not the 'goods' for making payment. Thus, the process works both in favor of buyer and the seller. The Seller gets assured that if documents are presented on time and in the way that they have been requested on the L/C the payment will be made and Buyer on the other hand is assured that the bank will thoroughly examine these presented documents and, ensure that they meet the terms and conditions stipulated in the L/C.

To put in a nut shell, a L/C is a contractual agreement between banks, known as the Issuing bank, on behalf of one of its customers/clients, authorizing another bank, known as the Advising/confirming bank, to make payment to the beneficiary. In this regard, the elements of a L/C

- ✓ A payment undertaking given by a bank (Issuing Bank)
- ✓ On behalf of a Buyer (Applicant)
- ✓ To pay a Seller (Beneficiary) for a given amount of money
- ✓ On presentation of specified documents representing the supply of goods
- ✓ Within specified time limits
- ✓ Documents must conform to terms and conditions set out in the L/C
- ✓ Documents to be presented at a specified place

2.1.1 Parties Involved and their Respective Responsibilities under L/C

The Buyer, the Beneficiary, the Issuing Bank, the Confirming Bank/ Advising/Notifying/ Negotiating Bank are the parties involved in a specific L/C term of payment. The following discussion presents you the brief description of each of the parties involved and their respective responsibilities.

1. The Buyer

The buyer refers to a person who is the importer, applies to the bank for the opening of a L/C. The bank may or may not require the buyer to secure the L/C by providing sufficient deposits to protect its own interests. It depends on the confidence that the bank has over the buyer applying for the L/C.

The respective responsibilities include:

- ➢ Knowing the exporter or getting a status reports (truck records) on him/her.
- ➢ Making sure the terms of the L/C application form are consistent with, the underlying purchase contract.
- ➢ The terms of the L/C must be "Capable of Performance" by the exporter, if they are not, amendments will have to be made, which could prove expensive.
- ➢ Ensuring that the instructions to the Issuing Bank are clear and brief especially the description of the goods.

- Recognize that Irrevocable L/C does not have options once entered into. They must be paid for, unless cancelled,

2. The Beneficiary

The beneficiary is entitled to payment as long as he/she can provide the documentary evidence required by an L/C. The L/C is a distinct and separate transaction from the contract on which it is based. All parties deal in documents and not in goods. The Issuing Bank is not liable for performance of the underlying contract between the buyer/importer and beneficiary/exporter. The Issuing Banks obligation to the buyer is to examine all documents to insure that they meet all the terms and conditions of the credit. Upon requesting demand for payment the beneficiary warrants that all conditions of the agreement have been complied with. If the beneficiary (seller) conforms to the L/C, the seller must be paid by the bank.

The responsibilities include:

- Making sure the terms and conditions on an L/C agrees with the underlying sales contract and is "Capable of Performance". If any provisions cannot be carried out, ask the importer to.' arrange for an amendment.
- Dispatching the goods.
- Preparing the documents exactly as called for in the L/C and presenting them to the Advising Bank within the time limit stipulated in the L/C.

3. Issuing Bank

The Issuing Bank refers to a bank which issues the L/C at the request of the Applicant. The Issuing Bank must be well known and acceptable to the seller. The buyer gives instructions regarding the terms and conditions of the L/C. The Issuing Bank's liability to pay and to be reimbursed from its customer becomes absolute upon the completion of the terms and conditions of the LIC. Under the provisions of the Uniform Customs and Practice (UCP) for Documentary Credits, the Issuing Bank is given a reasonable amount of time after receipt of the documents to honor the draft.

The responsibilities include:

- Ensuring that importers are aware of their obligations; providing guidance on application completion, import regulations and special documentation.
- 'Check the importer's credit limit, if he/she is granted with L/C facility.

4. Advising Bank / confirming Bank

An Advising Bank, usually a foreign correspondent bank of the Issuing Bank will advise the beneficiary. Generally, the beneficiary would want to use a local bank to insure that the L/C is valid. In addition, the Advising Bank would be responsible for sending the documents to the Issuing Bank. The Advising Bank has no other obligation under the L/C. If the Issuing Bank does not pay the beneficiary, the Advising Bank is not obligated to pay. The negotiating bank has to see that the documents negotiated conform strictly to the terms and conditions of the L/C.

The responsibilities include:

- Checking the authenticity of the Letter of Credit. If there is any doubt, the Issuing Bank should be contacted by tested telex.
- If requested to do so, confirming the Letter of Credit. This is normally done by adding a phrase such as "We confirm this Letter of Credit" signed by an authorized officer of the bank. If the Nominated Bank is not prepared to confirm (usually because of country risk), it must inform the Issuing Bank without delay. Unless the Issuing Bank has given instruction to the contrary, the Nominated Bank may then advise the L/C, making it clear to the beneficiary that it does so "Without engagement" on its part.
- The L/C is genuine and the signature of the officer signing the Letter on behalf of the Issuing Bank corresponds to the specimen signature in the possession of the Negotiating Bank.
- The period of its validity has not expired. The L/C is issued for specified period.
- The amount of the draft to be negotiated is with the same as the balance of the amount given in the L/C,
- The terms of the L/C are satisfied. If the Negotiating Bank fails to satisfy him/herse1fn respect of the terms of the L/C, he/she may have no claim against the bank which issued the L/C,
- The party whose bill the bank is asked to negotiate is the same as the one given in the L/C.

Note: It should be remembered that the Confirming Bank has no recourse to exporter where it will not be reimbursed by the Issuing Bank.

2.1.2 Characteristics of Letter of Credit

Letter of credit possesses four basic features that somehow differentiate from other types of international trade modes of payments. They are: negotiability; revocability; transfer and assignment; and it can be sight or time draft

a. Negotiability

Letter of credits are usually negotiable. The Issuing Bank is obligated to pay not only the beneficiary, but also any bank nominated by the beneficiary. Negotiable instruments are passed freely from one party to another almost in the same way as money. To be negotiable, the L/C must include an unconditional promise to pay, on demand or at a definite time. The Advising Bank becomes a holder in due course. As a holder in due course, the holder takes the L/C for value, in good faith, without notice of any claims against it. A holder in due course is treated favorably under the UCC,

The transaction is considered as a straight negotiation if the Issuing Bank's payment obligation extends only to the beneficiary of the credit. If a L/C is a straight negotiation it is referenced on its face by "we engage with you" or "available with

ourselves”. Under these conditions the promise does not pass to a purchaser of the draft as a holder in due course.

b. Revocability and Irrevocability

L/C may be either Revocable or Irrevocable. A revocable L/C may be revoked or modified for any reason, at any time by the Issuing Bank without notification. A revocable L/C cannot be confirmed. If a Correspondent Bank is engaged in a transaction that involves a revocable L/C, it serves as the Advising Bank.

Once the documents have been presented and meet the terms and conditions in the L/C, and draft is honored, the L/C can not be revoked. The revocable L/C is not a commonly used instrument. It is generally used to provide guidelines for shipment. If a L/C is revocable it would be referenced on its face.

The irrevocable L/C may not be revoked or amended without the agreement of the Issuing bank, the Confirming bank, and the Beneficiary. An irrevocable L/C from the Issuing Bank insures beneficiary that if the required documents are presented and the terms and conditions are complied with, payment will be made. If a letter of credit is irrevocable it is referenced a face.

c. Transferable and Assignable

The beneficiary has the right to transfer or assign the right to draw, under an L/C only when the credit states that it is transferable or assignable. Credits governed by the Uniform Commercial Code (Domestic) maybe transferred for unlimited number of times. Under the Uniform Custom and Practice for Documentary Credits (International) the credit may be transferred only once. However, even if the L/C specifies that it is nontransferable or non-assignable, the beneficiary may transfer their rights prior to performance of conditions of the credit.

d. Sight and Time Drafts

All L/C require the beneficiary to present a draft and specified documents in order to receive payment. A draft is a written order by which the party creating it, orders another party to pay money to a third party. A draft is also called a bill of exchange (B/Ex). There are two types of drafts: sight and time. A ‘sight draft’ is payable as soon as it is presented for payment. The bank is allowed a reasonable time to review the documents before making payment.

A ‘time draft’ is not payable until the lapse of a particular time period stated on the draft. The bank is required to accept the draft as soon as the documents comply

with credit terms. The Issuing Bank has a reasonable time to examine those documents. The Issuing Bank is obligated to accept drafts and pay them at maturity.

2.1.3 L/C Opening and Settling Procedure

1. Seller and Buyer conclude a sales and/or purchase contract, with method of payment usually by L/C (documentary credit) as the seller wants to guarantee payment.
2. Buyer applies to his/her Issuing Bank, usually in Buyer's country, for the opening L/C in favor of Seller (beneficiary).
3. Buyer's bank approves the credit risk of the buyer, issues and forwards the L/C to its correspondent bank (Advising or Confirming). The correspondent bank is usually located in the same geographical location as the seller (beneficiary). The correspondent bank will advise, and usually to confirm, the credit.
4. Advising bank, usually in Seller's country, will authenticate the L/C and forward the original L/C to the seller (beneficiary) informing about the terms and conditions of L/C.
5. If credit terms and conditions conform to sales and/or purchase contract, Seller prepares goods and documentation, and arranges delivery of goods to carrier.
6. Seller presents documents evidencing the shipment and draft (B/Ex) to paying/Accepting/Negotiating Bank named in the L/C (the Advising Bank usually), or any bank willing to negotiate under the terms of credit.
7. The Advising Bank examines the documents and draft for compliance with credit terms. If complied with, bank will pay, accept or negotiate. If the documents are correct, the Advising or Confirming Bank will claim the funds by:
    - Debiting the account of the Issuing Bank.
    - Waiting until the Issuing Bank remits, after receiving the documents
    - Reimburse on another bank as required in the credit.
8. Advising Bank sends the documents and draft to the Issuing Bank.
9. Issuing Bank examines the documents and draft for compliance with credit terms. If complied with, Seller's draft is honored (paid).
10. Documents release to Buyer after payment or on other terms agreed between the Issuing Bank and Buyer such as debiting the buyer's account.
11. Buyer surrenders B/L to carrier (in case of ocean freight) in exchange for the goods or the delivery order.

L/C may be opened either by means of airmail or by means of full-text cable (i.e. in SWIFT format). SWIFT stands for Society for Worldwide Interbank Financial Telecommunications.

2.1.4 Common Defects in Documentation under L/C

A discrepancy is an irregularity in the documents that causes them to be in Non-compliance to the L/C. Requirements setforth in the L/C cannot be waived or altered by the Issuing Bank without the express consent of the customer. The Beneficiary

should prepare and examine all documents carefully before presentation to the Paying Bank to avoid any delay in receipt of payment.

Commonly found discrepancies between the L/C and supporting documents include:

- L/C has expired before the presentation of draft (B/Ex).
- B/L evidences delivery prior to or after the date range stated in the credit.
- Charges included in the invoice which could be commercial and/or manufacturer not authorized in the credit.
- Inconsistent description of goods.
- Insurance document errors.
- Invoice amount not equal to draft amount.
- Ports of loading and destination not as specified in the L/C.
- Description of merchandise is not as stated in L/C.
- A document required by the L/C is not presented.
- Documents are inconsistent as to general information such as volume, quality, etc.
- Names of documents not exact as described in the L/C. Beneficiary information must exact.
- Manufacturer and/or Commercial Invoice or statement is not signed as stipulated in the L/C.

When a discrepancy is detected by the Advising/Negotiating Bank, a correction to the document may be allowed if it can be done quickly while remaining in the control of the bank. If time is not a factor, the exporter/beneficiary should request that the Advising/Negotiating Bank to return the documents for corrections.

If there is no enough time to make corrections, the exporter should request that the Advising/Negotiating Bank send the documents to the Issuing Bank on an approval basis or notify the Issuing Bank by wire, outline the discrepancies, and request authority to pay. Payment cannot be made until all parties have agreed to jointly waive the discrepancy.

2.1.5 Overcoming Potential Risks under L/C: from the perspective of supplier

1. Understand the Rules - UCP 500 / UCP 600

To maximize the chance for payment under a L/C, a seller/beneficiary and the foreign buyer/importer must know the rules of the game. The rules are codified in a publication sponsored by the International Chamber of Commerce (“ICC”), known as the Uniform Customs and Practice for Documentary Credits (UCP). It is a set of rules on the issuance and use of Letter of Credit.

Historically, the commercial parties, particularly banks, have developed the techniques and methods for international trade finance. This practice has been standardized by the UCP. The UCP is promulgated by the International Chamber of Commerce (ICC). The ICC has developed and molded the UCP by regular revisions.

The result is the most successful international attempt at unifying law ever, as the UCP has substantially universal effect.

A significant function of the ICC is the preparation and promotion of its uniform rules of practice. The ICC's aim is to provide a codification of international practice occasionally selecting the best practice after ample debate and consideration. The ICC rules of practice are designed by bankers and merchants and not by legislatures with political and local considerations. The rules accordingly demonstrate the needs, customs and practices of business. Because the rules are incorporated voluntarily into contracts, the rules are flexible while providing a stable base for international review, including judicial scrutiny. International revision is thus facilitated permitting the incorporation of the changing practices of the commercial parties. ICC, which was established in 1919, had as its primary objective facilitating the flow of international trade at a time when nationalism and protectionism threatened the easing of world trade. It was in that spirit that the UCP were first introduced — to alleviate the confusion caused by individual countries' promoting their own national rules on L/C practice. The aim was to create a set of contractual rules that would establish uniformity in practice, so that there would be less need to cope with often conflicting national regulations. The universal acceptance of the UCP by practitioners in countries with widely divergent economic and judicial systems is a testament to the rules' success.

The rules in the UCP 500 are drafted by and for the banking community. One of the major purposes is to protect the banks from liability in Letter of Credit transactions. The banks are providing a service - the financing of the transaction - and they expect to be protected from getting involved in disputes between the parties as to the terms of the contract of sale. For this reason, "the independence principle" is a very important concept in L/C transactions. This means that the L/C, and the documents required under the L/C for payment are completely independent from the underlying transaction between buyer and seller i.e., Purchase and/or sales contract concluded between them.

The bank is not concerned with whether the contract between buyer and seller is being performed according to its terms. The bank's only concern is whether the documents presented by the seller conform to the documents required under the L/C, and whether the documents are presented within the required time periods. The bank employees who examine documents presented under the L/C are essentially clerks. Their job is not to make judgment calls, but simply to see if the documents presented by the seller/beneficiary comply strictly with the documents required by the L/C. It is therefore very important to assist clients in understanding the rules, because a lack of knowledge will only work to their damage.

2. Choosing the reliable Issuing Bank

The exporter has to try to control the payment process from the outset. This means that when negotiating with the buyer, the seller should try to get the buyer to use a bank of the seller's choice to issue the L/C. the seller should find out from its own bank, preferably a bank with a substantial international presence, what corresponding bank it uses in the country of the buyer. If the buyer can have the L/C issued by that correspondent bank, the process can proceed more expeditiously.

At the very least, the seller should insist that the buyer use a bank that is well-known and highly regarded by the banking community. The seller's own bank can provide information on the financial status and reputation of the foreign bank. Since a major purposes served by a L/C is that the issuing bank assumes the risk of the buyers insolvency, if the bank itself is financially weak, the L/C may not serve its purpose.

3. Confirming the L/C

If the seller does not have a confidence **i**n the bank of the buyer's choice, or if there is any question about the political stability of the foreign country where the issuing bank is located, then the L/C should conformed by a local bank. When the local bank conform a L/C issued by a foreign bank, it takes upon itself the payment obligation. Thus, if a local bank confirmed an L/C, and subsequently, for political or economic reasons, the foreign bank could not reimburse the local bank, the local bank is obligated to pay the beneficiary under the L/C.

There is a charge for confirmation, which becomes more expensive in proportion to risk the local bank believes it is taking in confirming the L/C. There are some situations where the risk may appear so high that a local bank will not agree to confirm at all. If the bank is refuses to confirm because of political instability, advice the client to try to have the L/C issued outside the politically unstable area. The question of who pays the local, bank's confirmation charge is negotiable, but if not negotiated in advance, the bank will generally charge the beneficiary for this service.

4. Keeping Documents Simple

The seller should negotiate with the buyer prior to the issuance of the L/C exactly what documents must be presented to the bank for payment under the L/C. The most important from the seller's point of view is to have as few documents as possible, to have as simple a description as possible, and to be sure that all documents called for by the L/C can in fact be produced. Cases have occurred where one of the documents is a certificate supposed to be issued by the foreign government, which was simply never produced. Another problem can be created if the L/C requires a document to be signed by someone under the control of the buyer. The document may not be signed by the right person, or may not be signed at all.

Almost all L/C's require production of a Commercial Invoice and a transport Bill of lading With respect to the commercial invoice, the L/C will typically state the description of the goods which must be found in the invoice. If the goods are not described in exactly the same way, the seller may not be paid. In one case where payment was denied, the L/C required for the commercial invoice to describe the goods as "100% Acrylic Yarn". When the invoices were presented to the bank, they described the goods as "Imported Acrylic Yarn." Even though the packing list attached to the invoice described the goods as 100% Acrylic Yarn, the court upheld the bank's refusal to pay under the L/C because the documents did not strictly comply with the requirements of the L/C.

In many cases, even if the documents do not comply exactly, the buyer will agree to waive any discrepancies in the documents, and, if the bank agrees, the payment will occur. In the Acrylic Yarn case above, however, the buyer had gone into bankruptcy, and the trustee in bankruptcy would not agree to waive discrepancies. In another case, buyer and seller sought to amend the L/C to correct a discrepancy. The bank, however, was having never checked the financial status of its customer, the buyer, prior to issuing the L/C, and having learned in the meantime that its customer might not be able to reimburse the bank if it paid the L/C, refused to amend the L/C. The court held that the issuer bank had no duty to amend a L/C upon the request of a customer and a beneficiary.

These cases teach three important lessons. First, documents must be accurate. Second, if there is a mistake or a problem with the documents which the L/C requires to be presented, the seller/beneficiary should not ship goods until the L/C has been amended. The UCP 500 makes clear that no amendment can take place unless the Issuing Bank, the Confirming Bank, if any, and the seller, agree to it. UCP 500, Article 9(d). Unless the seller has written confirmation from the bank that the amendment to the L/C has been issued, and the confirming bank has accepted the amendment, he/she bears the risk that the L/C will not be paid.

Third, a prudent seller will not let the buyer take possession of the goods until he/she has been paid under the L/C. The reason should be obvious. If there are discrepancies in the documents preventing payment of the L/C, a buyer in possession of the goods has much less incentive to waive discrepancies so the seller can be paid. If the seller is not paid by the bank, the buyer still has a contractual obligation to pay for goods, but the difficulty of collection can make the price drop substantially, even assuming the buyer is solvent and can pay something. Particularly when the goods have been shipped to a foreign country, the attempt to collect payment can be quite costly. The buyer, knowing this, will undoubtedly attempt to negotiate a lower price, if he/she pays at all.

To keep goods out of the buyer's possession, the seller should be sure to have the marine B/L consigned to order of the bank. Since the marine B/L is a title document, a consignment to order of the bank gives the bank title to the goods until they have

been paid for by the buyer. Assuming proper payment, the bank transfers title to the buyer, who can then take the B/L and go pick up the goods. If payment is not made, the bank has an obligation to hold the documents for the seller, or return them to the seller if instructed to do so by the seller. The buyer should not be able to get the goods without the title document.

A buyer may ask the seller to have the B/L made out to order and blank endorsed, and to send one or more sets to the buyer within a few days of shipping the goods. This is like writing a blank check. It enables the buyer to pick up the goods, and thereby provides him/her with a disincentive to waive any discrepancies in documents the seller presents to the bank. Given the high failure rate of initial presentations of documents under an L/C, a seller needs to know he/she will have the buyer's cooperation will be more forthcoming if he/she cannot get possession of the goods until any problems with discrepancies have been resolved.

5. Meeting the deadlines

Every letter of credit has three important dates: (1) the date by which goods must be shipped, (2) the date by which documents must be presented, and (3) the expiry date for the L/C. the seller should make sure that each of these dates can be met, and should allow a large margin for error. After the L/C has been issued, if the seller learns that the date for shipping goods can not be met , he/she should not ship any goods until he obtains an amendment to the L/C permitting later shipment. If an L/C which calls for transport documents does not contain a date by which documents must be presented, does this mean the seller can wait until the expiry date to present his/her documents? Not if he wants to be paid. Article 43 of the UCP 500 provides that if no time period after shipment is given in the credit for presentation of documents, banks will not accept documents presented to them later than 21 days after shipment. An exporter unfamiliar with the 21 day rule of the UCP 500 could easily miss this deadline.

The exporter should make sure that the expiry date of the L/C permits sufficient time to permit correction, if possible, of any mistakes in the documents. Under the UCP 500, once the documents are presented, the bank has a maximum of seven days to let the beneficiary know if there are any discrepancies. If discrepancies can be corrected, they must be corrected and sure that the expiry date allows enough time for errors to be rectified.

2.1.6 Benefits and Types of L/Cs

2.1.6.1 Benefits of L/Cs

L/C has multifaceted use for both the foreign purchaser/importer and exporter/supplier. The following section discusses the benefits enjoyed by both party.

A. Benefits to the Importer

Purchases without Cash: an importer can by means of a Letter of Credit purchase goods from foreign merchants who cannot know or rely upon his/her own standing; and such purchases can be made where the exporter demands cash on payment. In fact, the Issuing

Banker lends to the importer the advantage of his/her own credit and goodwill.

Guaranteed Shipment: shipment of goods cannot be delayed once a L/C is issued. Therefore, the importer is assured of the delivery of goods in time.

Payment after Satisfying Conditions: the exporter cannot obtain the cash under Letter of Credit without actually shipped the merchandise. The system of documentary bills provides for the honoring of bills only when there are according to certain conditions. **Overdraft Facility**: the importer may also get a L/C issued in favor of the exporter on the basis of overdraft facility extended to him/her by the Issuing Bank. Thus, the importer gets possession of goods without making actual payment.

Better terms of Trade: since in the case of a Letter of Credit, payment is assured, the importer is in a better position to negotiate the terms of trade with foreign suppliers which otherwise is not possible.

B. Benefits to the Beneficiary/Exporter

An L/C facilitates trade transactions between importer and exporter who are not known to each other as to their respective reputations and/or creditworthiness.

The major advantages derived by the exporter or beneficiary of a L/C are as follows:

- **Prevents Blockage of Finance**: the Letter of Credit received from the importer can be discounted with the Confirming Bank and money can be realized immediately. This prevents blockage of funds. At the same time, after fulfilling the required formalities the exporter gets immediate payment.
- **Prevents Bad Debts**, in the case of an L/C, the payment is guaranteed by the Issuing Bank and therefore, the risk of bad debts is less. A Confirmed Letter of Credit is more secured due to double guarantees from the Issuing Bank and the Confirming Bank.
- **Fulfillment of Import and Exchange Control Regulations**: the Letter of Credit is issued by the Issuing Bank after the importer complies with the import regulations and exchange control regulations in his/her country. Thus, after getting L/C unnecessary delays caused by import regulations can be avoided.
- **Importer's Obligation**: the importer may refuse to accept goods in the case of other methods of payment. But in the case of the L/C, the importer cannot do so because it is obligatory for him/her to accept goods and make payment once he/she gets the documents negotiate in his/her favor.

- **Helps to Procure Pre-shipment Finance**: an exporter can obtain pre-shipment finance from commercial banks on the strength of a Letter of Credit issued by the importer's bank in his/her favor.

2.1.6.2 Types of L/C

There are different types of Letter of Credit. Common types of the L/Cs are briefly discussed as follows:

1. Revocable and Irrevocable L/C: Revocable Letter of Credit can be withdrawn, cancelled or modified by the Issuing Bank at any time without the prior consent of the beneficiary. However, the Issuing Bank has to give a notice to the exporter after revoking the Letter of Credit. Since, Revocable L/C is very risky; exporters do not accept such L/C. Where as, Irrevocable L/C cannot be withdrawn, cancelled or modified without the prior consent of the beneficiary or the other parties involved in the transaction such as Confirming Bank. Exporters, normally, prefer an irrecoverable L/C.

2. **Confirmed and Unconfirmed L/C**: in the case of a Confirmed L/C an exporter has an additional guarantee from a local bank, in addition to the one given by the Issuing Bank.

Thus, the Confirmed L/C carries guarantee from two banks, i.e., the Issuing Bank and the Confirming Bank. Unconfirmed L/C is one, which is not supplemented by additional guarantee from a bank in exporter's country.

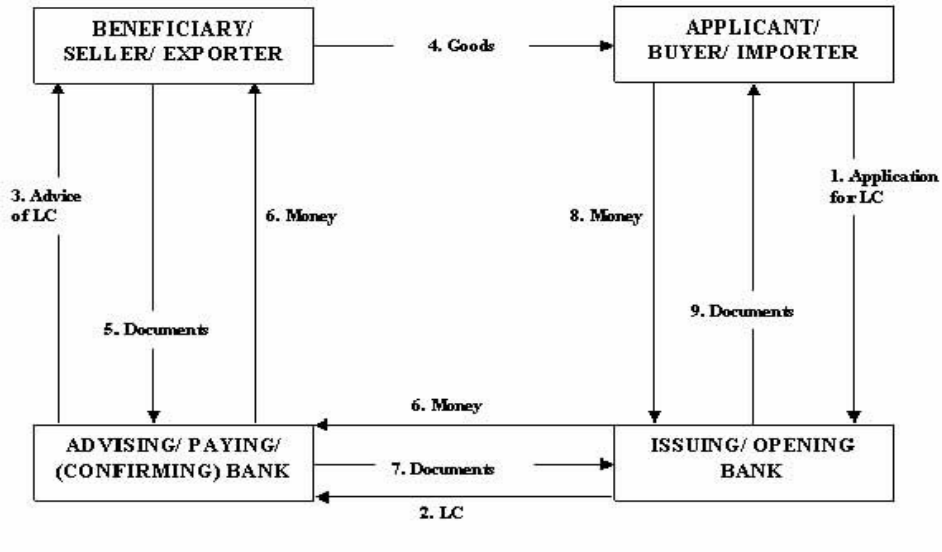
3. Transferable and Non-transferable L/C: a Transferable L/C is required when the beneficiary (first beneficiary) acts a trader only and orders the respective goods from so called "sub-supplier' (second beneficiary), who ships the goods covered under the L/C directly to the applicant or the party specified in the L/C. However, the Issuing Bank must be informed about such transfer. The first beneficiary of the L/C, in this case, assures his/her contractual payment obligation to the second beneficiary by transferring the L/C in full or in part to the second beneficiary without investing his/her own capital or using his/her own credit facility. There is no contractual relationship between the applicant and the second beneficiary, although the second beneficiary ships the goods directly to the applicant. This applicant must, therefore, trust that the beneficiary will transfer the L/C to a reliable party only. A Non-transferable L/C, on the other hand, cannot be transferred to a third party. Usually, all L/Cs are non transferable, unless and until so stated in them.

4. Clean and Restricted L/C: when the Issuing Bank does not put any condition regarding the negotiation of export documents, the L/C is referred to as a Clean L/C. When the Issuing Bank puts a condition regarding the negotiation of export documents through a specific bank, the L/C is referred to as a Restricted LIC.

5. Red-Clause and Green-Clause L/C: a 'Red Clause' L/C is one which authorizes the exporter to obtain pre-shipment finance from his/her bank. Such finance is guaranteed by the Issuing Bank and is generally printed or typed in red ink. Hence, such L/C is known as a 'Red Clause' L/C. A 'Green Clause' L/C, in addition to permitting pre-shipment finance, provides the storage facilities to the exporter at the port of shipment. Such facilities are extended by the Issuing Bank and is generally printed or typed in green ink. Hence, such Letter of Credit is known as a 'Green Clauses' L/C.

6. Revolving and non- revolving letter of credit: revolving letter of credit serves for more than transactions especially when there is long term relation ship between buyer and seller. It is not subject to exhaustion. It renewed automatically for the same amount and the same period once it is authorized. Non revolving letter of credit: when it impossible to use letter of credit for more than one transaction, it is issued for a fixed amount and for a fixed period of time. In this case, an exporter has a right to draw bill of specified amount with in stipulated time.

2.1.7 The circular flows /the relation ship between parties involved in letter of credit



There is contractual relation ship between buyer and seller and also the flow of goods from the seller to buyer.

2.2 Other Modes of Payments (Alternative to L/C)

Most sales/purchase agreements stipulate, in some manner, that certain collection of documents must be submitted in advance by the exporter to the buyer or its bank in order to generate payment once the goods have been received. The main

documents, just to refresh your mind, include commercial invoices (the exporter's bill of sale), consular invoices (required by some foreign countries), certificates of origin (attesting to the origin of the exported goods), import licenses (some countries require importers to obtain these for restricted items), inspection certificates (health or sanitary certificates are required by many countries for animals, animal products, plants, and other agricultural products), and dock and insurance receipts.

2.2.1 Documentary Collections / Bill of Exchange (B/Ex) / Draft

What do you understand by bill of exchange or draft?

A draft is a written order by an exporter instructing an importer/agent to pay a specified amount at a specified time.

The exporter issues a B/Ex which is an unconditional request for payment on demand or at a specified time and other documents which transfer ownership to the foreign buyer. The exporter instructs the bank to transfer ownership upon full payment. The banks, in this case, act as intermediaries. If payment is not made the document of title, usually the B/L is held by the foreign buyer's bank until instructions for payment by the buyer are provided. This is riskier than the Letter of Credit b/c the bank will not guarantee a bill of exchange. Therefore, the exporter assumes responsibility for the shipment and risks of non-payment. Documentary collection will be used as a method of payment if the buyer is not willing to open documentary credit (L/C) or to provide a bank guarantee, and competition does not allow the seller to insist on a documentary or a hank guarantee; import regulations of a certain country require it, and if the solvency of the buyer no longer allows delivery against Open Account, thus the seller wishes to retain disposition over the goods until payment is made.

2.2.1.1 Types of Documentary Collections

i. Documents against Acceptance (D/A)

If the draft is payable at later date (time draft) the instruction specify that the documents will be released to the importer up on an acceptance of the draft. When a draft is drawn Documents against Acceptance (D/A), credit is extended to the importer on the basis of his/her acceptance of the draft calling for payment within a specified time and usually at a specified place. Acceptance means that, the importer formally agrees to pay the amount specified by the draft on the due date. The specified time may be expressed as a certain number of days after sight (time draft), which means after the day that the draft is first presented to the consignee.

The specified time may be expressed as a certain number of days after date (date draft), which means that the date on which the draft is drawn serves as the beginning day of term (i.e., length of time before payments due) of the draft. Date drafts are preferred to time drafts because they indicate the exact date of the maturity of the draft depending upon the arrangements made, the drawee of a draft may be permitted to examine the merchandise before accepting the draft.

ii. Sight Draft/Documents against Payment (DAP)/Cash against Document (CAD)

If the draft is payable on sight then the instruction letter specifies that the documents will be released to the importer up on payment of the draft. Here the importer must make payment for the face value of the draft before receiving the documents conveying title to the merchandise. This occurs when the importer first sees the draft. Sometimes, with instruction from the drawer, the importer may be given a certain limited period within which to make payment. In the mean time the merchandise remains in the name of and in the hands of the collecting agency, which is usually a bank. It should not be assumed, however, that the drawee must make immediate payment. It is the custom, in most foreign countries for the drawee of the draft to make credit arrangements with his/her own bank, at point of destination, to advance the funds with which to pay the full face of the draft or some part of the draft against delivery to the importer of a proportionate amount of the merchandise.

iii. Clean Drafts versus Documentary Drafts in the Documentary Collections

Clean Draft: in a clean draft, no shipping documents are attached to the draft sent to the Remitting Bank. The documents are sent together with the goods, directly to the buyer. Therefore, unless the credibility of the buyer is unquestionable, using a clean draft in the shipment of goods is risky. The clean draft is more often drawn for the collection of payment for the services, not goods.

Documentary Draft: in a documentary draft, the shipping documents are attached to the draft sent to the Remitting Bank. The buyer will be able to receive the shipping documents from the Collecting Bank only after he/she has accepted the draft for payment later or after he/she has paid the draft.

2.2.1.2 The Parties in the Documentary Collection

There are four parties involved in documentary collections. These are:

1. *Drawer*: the drawer is the party who issues the draft and to whom the payment is made. The drawer is the seller (the exporter) and the payee of the draft. The payee could be another party rather than the exporter, or could be the bona fide holder (the bearer) of the draft.

2. ***Drawee*:** the drawee is the party who owes the money or agrees to make the payment and to whom the draft is addressed (made out). The drawee is the buyer (the importer), the acceptor and the payer of the draft in a documentary collection. In a letter of credit the drawee most often is the Advising Bank or Confirming Bank or the Issuing Bank, which are the acceptor and the payer of the draft.

3***. Remitting Bank***: is the exporter's bank to whom the exporter sends the draft, shipping documents and documentary collection instructions, and who subsequently relays them to the collecting bank in a documentary collection is called the remitting bank. The term Remitting Bank as used under a L/C may refer to a nominated bank from whom the issuing bank or the confirming bank, if any, receives the shipping documents.

4***. Collecting Bank (Presenting Bank):*** the bank in the importer's country (the importer's bank usually) involved in processing the collection---presents the draft to the importer for payment or acceptance, and thereafter releases the shipping documents to the importer in accordance with the instructions of the exporter---is called the Collecting Bank or the Presenting Bank.

2.2.2 Consignment

The goods are shipped to a foreign distributor who sells them on behalf of the exporter. The exporter retains title to the goods until they are sold, at which point payment is sent to the exporter. The exporter has the greatest risk and least control over the goods with this method. Additionally, receiving payment may take quite a while. When consignment method is used, payment is usually made by means of a clean draft, which is a type of cheque drawn by the consignor (by the exporter) to which no documents are attached. Payment typically occurs after the products have been resold by the buyer (importer). This is a convenient way for the importer to make payment. Timing and procedures for payment will depend on the prior arrangements made between the importer and exporter. The exporter may draw a clean draft (no documents are attached) on the importer for the value of a particular shipment or shipments. Actual remittance (payment) is made by cheque, bank draft, or wire transfer. It iswise to consider risk insurance with international consignment sales. The contract should clarify who is responsible for property risk insurance that will cover the merchandise until it is sold and payment is received. In addition, it may be necessary to conduct a credit check on the foreign distributor.

2.2.3 Cash on Delivery (COD)

Cash on Delivery transactions are not frequently used in export trade except in connection with air transport. Numerous airlines have facilities at their terminals for

making delivery of merchandise against cash payments by the consignee. Where these facilities are available, a convenient method is afforded shippers for collecting payment.

2.2.4 Cash with Order (Cash in Advance) - Telegraphic Transfer (TT)

The buyer bears the highest possible risk since he/she has no guarantee that he/she will receive the goods ordered. Receiving payment by cash in advance of the shipment might seem ideal. In this situation, the exporter is relieved of collection problems and has immediate use of the money. A wire transfer is commonly used and has the advantage of being almost immediate. Payment by cheque may result in a collection delay of up to six weeks. Therefore, this method may defeat the original intention of receiving payment before shipment.

2.2.5 Open Account

The exporter ships the goods as soon as the order is received and then invoices the purchaser for payment within a certain amount of time say for instance 30 days. It allows the buyer receive goods without being obliged to pay or to accept a draft immediately. It is at the buyer's sole discretion to fix the payment date and to effect payment at a time chosen by him/her. All risks including transfer and transportation risk goes to the seller. The seller's risk of receiving payment is further increased because no exact date of payment is stipulated.

This term of payment requires a high degree of confidence in the buyer's ability to pay and willingness to fulfill this/her obligations. At present, it is not application the Ethiopian banking system.

Sample Form For Requesting A Letter Of Credit

Dear International Buyer:

We are providing the following instructions as a guideline to be used when opening a letter of credit to us. Because a letter of credit is a very critical document, please verify that the information is accurate and complete, without any mistakes which can create a discrepancy and lead to our subsequent request for an amendment, and delay the shipment.

Regarding your purchase order number [ ] dated [ ], please ask your bank to open an irrevocable, at sight, commercial letter of credit according to the following terms and conditions.

Beneficiary Name

[ ]

Beneficiary Address

[ ]

Requested Advising Bank Name

[ ]

Requested Advising Bank Address

Telephone Fax Swift

In the amount of US$

The letter of credit must be payable at the counters of name of bank or it must be negotiable and payable at the counters of a bank in city near the seller .

The letter of credit must be in the possession of the Advising Bank and received by us days before the agreed upon shipment date.

Shipment will occur days after an acceptable letter of credit is in the possession of the Advising Bank.

Shipment terms are:

Incoterms 2000 destination

Partial shipments are permitted.

Latest shipment date is ☐. Latest expiration date is ☐.

Documentary requirements are:

1. Signed commercial invoice ☐ originals and ☐ copies
2. Packing list ☐ originals and ☐ copies
3. ☐
4. ☐

Documents are to be presented within ☐ days from the shipping date.

All bank charges will be paid by the Applicant.

CHAPTER THREE

Ethiopian Import Bank and Customs Clearing Procedures and Practices

3.1 Definitions of Important Terminologies and Concepts

To have full understanding about the definition of customs clearance, it is better to define some of the jargons associated with it. These are the following:

1. **Customs clearance"** means a process of fulfilling customs' formalities for import and export cargo on behalf of consignor or consignee with in customs station. Or it is a process of action done by the authorized customs official in fulfilling customs' formalities form import or export of goods/merchandise on behalf of consignor or consignee within the office of customs. Customs formalities means any customs operations carried out in connection with importation, exportation or transit of goods from the time of arrival at the customs port until released from the customs control. It is also in the operations materials must be out by the person concerned and by the customs in order to comply with the statutory or regulatory provisions which the customs are responsible for enforcing in connection with the control of persons at the customs frontier and the clearance of baggage, goods and means of transport at importation,

exportation and in transit. These formalities may include those relating to veterinary, immigration, currency and licensing regulations. Or in short we can define Cargo clearanceas the process of clearing cargo through customs at sea port or inland clearance depot.

2. Port clearance-means a process of fulfilling port's formalities for import and export cargo on behalf of consignor or consignee within port area until the import cargo is brought out from the port or the export cargo is loaded on to the ship. Port of registry- home port of a vessel at which place the vessel is registered
3. Cargo declaration- document on arrival and departure providing information required by public authorities relating to the cargo.

4. ACYCUDA^{++} :- a computer system followed by Ethiopian customs authority to automate customs revenue calculation and prepare different statistics.
5. customs Approved route: is any road, railway, waterway, and other route like pipeline, which in accordance with the customs provisions of a state, must be used for the importation, exportations, customs transit, etc,. Of the goods.
6. Discharge- the unloading of a vehicle, vessel, aircraft or barge/landing of cargo.
7. Shipper-person or firm with cargo to transport.
8. Dry-dock- dock in which ships may be repaired or built, the water being pumped out as required.
9. Bunker port- a port, which is available for bunkering ships (bunkers-the quantity of fuel on board vessel)
10. Stevedores- Dockers engaged on cargo/baggage transshipment.
11. Quay-the location in sea port at which cargo arrives or departs
12. Customs Transit: - is customs procedures by which goods are transported under the customs control from one customs office to the other. The customs transit operation is the transport of goods from an office of departure to an office of destination under customs transit. Goods carried under customs transit shall not be subjected to the payment of duties and taxes provided the conditions laid down by the customs are complied with and any security required has been furnished.
13. *Customs Declaration Annex Form (CDAF)* is a document that enables authorized exporter to export products to other foreign countries or authorized importer to import products to Ethiopia. The permit has a limited period of time that the exporter and or importer should be able to utilize before the expiry date. If not utilized before the expiry date, the declaration will be returned immediately to the Exchange Controller National Bank of Ethiopia, or to the authorized bank which issued.

Government of Ethiopia has started to pave the way towards modernizing the Ethiopian Customs Authority. This allows choosing one of the customs clearance tools to be introduced in order to improve government finance and to strengthen the economy of the country through increased efficiency in the foreign trade environment. The Government of Ethiopia has selected ACYCUDA^{++} system for the computerization of their customs revenue calculation and statistics, gathering their process and as the base tool to achieve the objectives. Government has made dry ports (e.g. mojo dry port) with modern facility and implemented computerized procedures at a major customs point to facilitate customs clearance.

Customs law, regulations and other government notifications made provisions and procedures to clear the export and import cargo and to facilitate trade. It does not only simplify and promote international trade, but also regulates unauthorized, illegal and movement of contraband items. This procedure can be considered as an instrument for anti-dumping and unwanted import

3.2 Harmonized System (HS)

The Harmonized System Codes (HS Code) is a standard issued by the World Customs Organization (WCO) to unify the classification of the goods. HS refers to an ideal system of internationally identifying goods for tariff purposes. These are six digit codes for identifying different products across the world. The country using these HS codes can suffix additional digits to the existing six digits according to their needs.One can use HS code to search the *tariff for imported goods* at the customs website; or one can enter the key word of the goods (for example steel for hot trolled steel sheets) and locate the correct tariff and *HS* Code. By using this link you can get the tariffs rate assigned to each product and the correct HSC of the products http://www.erca.gov.et/search.phpAll goods that we can see, feel, use, buy etc, are coded in customs.The coding will differentiate one commodity from another which means each commodity or group of items will have a separate code from another.This coding makes customs clearance easy.The coding of items also helps customs officer to compile data of imports and exports.The arrangement of the codes and the goods in the customs tariff is systematic and progressive and because of this, the tariff is sometimes called the nomenclature-***which means the systematic naming of goods in the tariff.*** It is nomenclature because goods are systematically and progressively arranged from raw materials, semi-finished products, then

finished products.The internationally harmonized commodity description and coding system in short (HS) is a multipurpose six-digit nomenclature.

3.3 L/C Opening and Settling Procedures: Ethiopian Commercial Banks' Practices

The following are typical Letter of Credit Transaction steps of a confirmed irrevocable letter of credit practiced by commercial banks of Ethiopian.

1. Buyer and seller must conclude a purchase/sales contract by specifying L/C as a mode of payment
2. After the exporter and buyer agree on the terms of a sale, the buyer arranges for its bank to open a letter of credit that specifies the documents needed for payment. The buyer determines which documents will be required.
3. The Buyer's Bank issues, or opens, its irrevocable letter of credit includes all instructions to the seller relating to the shipment.
4. The Buyer's Bank sends its irrevocable letter of credit to an Exporter’s Bank and requests confirmation. The Exporter may request that a particular local bank be the Confirming Bank, or the Foreign Bank may select a correspondent bank in the Exporter’s country.
5. The Confirming Bank prepares a letter of confirmation to forward to the Exporter along with the irrevocable letter of credit.
6. The Exporter reviews carefully all conditions in the letter of credit. The Exporter's freight forwarder is contacted to make sure that the shipping date can be met. If the exporter cannot comply with one or more of the conditions, the customer is alerted at once.
7. The Exporter arranges the goods for shipment and the forward/deliver the goods to the appropriate port or airport.
8. When the goods are loaded, the exporter/Freight Forwarder completes the necessary documentation.
9. The Exporter (or the Freight Forwarder) presents the documents, evidencing full compliance with the letter of credit terms, to the Confirming Bank.
10. The Confirming Bank reviews the documents. If they are in order, the documents are sent to the Buyer's Bank for review and then transmitted to the Buyer.
11. The Buyer (or the Buyer's Agent) uses the documents to claim the goods.
12. A draft, which accompanies the letter of credit, is paid by the Buyer's Bank at the time specified or, if a time draft, may be discounted to the Confirming Bank at an earlier date.

3.4 Import Customs Clearance Procedures: ECuA Practices

These procedures have been taken out of**The Re-establishment and Modernization of Customs Authority Proclamation No. 60/1997 or 60/1989** (according to the Ethiopian calendar - EC) and its amendment **Proclamation No. 368/2003 or 368/1995 EC**

However, it's advisable that a reader gets these documents for a comprehensive understanding of the existing proclamations and regulations.

1st. Lodgment of Customs declaration

2nd. Supporting Documents of Customs Declaration

3rd. Verification of Documents and Examination of Goods

4th. Examination at the request of Importer

5th. Delivery of Goods

Lodgment of Customs Declaration

Except exempted by directives all goods entered in accordance with Article 17 of the proclamation shall forthwith lodged for clearance in aspect copies of customs declaration.Goods exempted form clearance shall be determined by directives issued by the Customs Board. Where customs clearing agent applies for hold function and fulfils supporting documents pre lodgment of customs declaration may be allowed for and five days before the arrival of the goods at customs port. However, if the goods do not arrive within the five days, a new declaration shall be lodged at the time of arrival of the goods.The Authority may allow goods to be cleared urgently due to their nature or the reason they are required for. The details and the reasons that justify this procedure shall be prescribed in the directives issued by the authority.All information supplied in the customs declaration shall be filled and signed by the customs clearing agent.Any imported goods registered for home consumption shall be identified and declared in Customs declaration.Goods entered for an outright exports or temporary export shall be declared in Customs declaration.Customs declaration accepted by the entry reception shall immediately be registered for the accomplishment of customs formalities.Customs declaration may be lodged orally, by bodily action or electronically. The ministry may issue directives as to the goods and conditions of lodging Customs declaration orally, by bodily action or electronically.

Supporting Documents of Customs Declaration

On the lodgment of customs declaration and declaration of facts the following original documents in support shall be supplied to customs in a number of copies fixed by the Authority:Transportation document, commercial invoice, Bank permit, Packing list, Certificate of origin, and other necessary documents to be prescribed in the directives issued by the Authority. Transportation document that is required in support of export goods shall be a document that is used as evidence for the transpiration of goods up to the customs port of exit.The Authority may require any document to be presented in an Amharic translation made by official translators.***Customs declaration shall be acceptable*** where the necessary documents which are prescribed under this Article are presented and approved by the customs officer.

Verification of Documents and Examination of Goods

The proper customs officer shall verify documents and examine goods to assure the accuracy of information supplied in the document.The owner of the goods or his authorized agent shall attend during examination of the goods. Where the owner or his agent fails to appear at the time of examination, the proper Customs Officer shall open and examine the goods in the presence of relevant officials.Procedure of goods examination shall be prescribed by directives issued by the Authority.

Examination at the request of Importer

If any importer or his agent believes that the goods have suffered damage, short or pilfered in route may request for prior examination of the goods before the lodgment of goods declaration.Where the request made in accordance and its reason are justified by the Authority; goods examination may be carried out upon payment of service charge. Customs declaration shall, therefore, be filled in accordance with the examination report.Service charges for prior examination of goods shall be prescribed by directives issued by the Authority

Delivery of Goods

All goods listed in customs declaration shall be removed from the warehouse by the owner or his agent immediately upon the accomplishment of customs formalities.Goods which are not removed from the warehouse with in the period specified in sub-Article (3) of Article 43 of the proclamation shall be sold or disposed otherwise as deemed abandoned to the customs.

3.5 objectives, Duties & responsibility of Ethiopian custom Authority

As it is promulgated in Federal *NegaritGazeta*Proclamation no.60/1997 issued on its 3rd year No. 18 February 15th 1997, the Ethiopian Customs

Authority (ECuA) is given judicial responsibility by the House of Representative to fulfill the following three major objectives:

- Collect duties and taxes on goods imported or exported.
- Implement laws and international conventions related to its objectives.
- Control the importation or exportation of prohibited or restricted goods.

In order to achieve the aforementioned objectives, the Ethiopian Customs Authority (ECuA) has specific duties and responsibilities. These are:

- To assess the duty paying values, collect duties and taxes, collect license and service charges.
- To examine documents of importers or exporters so as to enforce Customs law.
- To establish Customs Stations in any Customs port, frontier post and Transit routes.
- To approve the place for the deposit of import and export goods, establish warehouses, give license for those who establish Customs warehouse, supervise the proper handling of deposited goods, suspend or revoke warehouse license.
- To prevent and control the importation or exportation of goods in contraband.
- To search any goods and means of transport entered into or departing from Ethiopia through Customs ports, Frontier posts and other customs stations.
- Under the authority given by and supervision of the authority of the attorney general, to investigate customs offences, institute criminal proceeding, and follow up the case in court.
- To collect, organize and disseminate import and export data.
- To carry out studies as to the levying, assessment and collection of customs duties, devise ways of combating and repression of contraband activity and implement same up on approval.
- To sell or dispose otherwise goods without owner, abandoned, or forfeited.
- To issue or revoke customs clearing license.
- To prepare forms and brochures necessary for customs activity.
- To prepare and implement systems for the assessment, and collection of duties, financial accounting and other related activities.
- To arrange for trainings and workshops to upgrade the efficiency of Customs officers.
- To own property, enter into contract, sue and be sued in its own name.

3.6 Control of ECuA over Imported/Exported Goods

1) For the implementation of the objectives of Customs the following goods shall be under the supervision and control of Customs:
    A. Imported goods from the time they get at customs port until the completion of customs formalities and received by importer.
    B. Goods under drawback procedure from the time of drawback claim until exportation. The term ‘drawback’, here in, is used in the customs regulations in the sense of allowing a person or a business to drawback or to get a refund of, subject to some conditions on import duties paid earlier. For instance if duty is paid on raw materials used in the production of commodities while imported is refunded back upon exportation of the processed commodity.
    C. Goods, entered into customs warehouse until removed from the warehouse.
    D. Goods of export from the time they entered into Customs port until the completion of customs formalities and be exported.
    E. Goods in transit, from the time their movement is allowed until the completion of transit procedure.
    F. Goods found without owner, abandoned, forfeited or contraband goods until they are sold or disposed otherwise.
2) Without prior authorization no one is allowed to enter into customs warehouse in which goods are deposited or; open or do any acts on those goods controlled and supervised by Customs.
3) The Authority shall be responsible for the damage on goods under its control and supervision caused by its employees while discharging their official duties.

3.6 Types of Customs Clearance Payments

Unless exempted by law, items imported into Ethiopia are subject to a number of taxes. Government levies five kinds of taxes on import items. These taxes are assigned priority levels and are calculated in a sequential order. These taxes, in their sequential order, are customs duty, excise tax, VAT, surtax and withholding tax. Taxes on imported goods are collected by the Ethiopian Revenues and Customs Authority (ERCA). These taxes provide considerable revenue to the government. According to the report issued July 2009 by Planning Directorate of ERCA, these taxes provided revenue of 11.8 billion Birr.

1. Customs Duty and its Rates

The first of the five taxes levied on import items is customs duty. The term customs duty denotes taxes imposed on goods entering or leaving the

country. ERCA collects customs duty only on import items as no tax on export is levied. The government waived taxes on export items on purpose-just to encourage export. However, there is a 150 percent export tax particularly on certain hides and skins of animals.

Customs duty provides significant revenue to the government. ERCA collects Customs duty based on the rules stipulated in the customs proclamation No. 622/2009 and other regulation and directives.Customs duty has 6 bands or groups of rates which are applied to imported goods. These bands of rates are 0%, 5%, 10% 20%, 30% and 35%. From these bands of rates one can see that the minimum customs duty rate is 0(zero) while the maximum is 35 percent of the CIF(Cost + Insurance + Freight) value of an imported item. According to the Customs Tariff (Amendment volume 1, 1996 edition), the maximum customs duty rate used to be 60 % of the CIF value of an imported item. However, since then the government has taken steps towards reducing customs duty rate in order to support inward investment and the broad business community. Such steps were taken in 2000 and 2002 where the maximum customs duty rate was reduced to 40 and then 35 percent of the CIF. The long run government's aim is to reduce this figure to near zero (0).

To calculate the customs duty, the CIF is multiplied by tariff rate applicable to each imported item. ERCA collects customs duty on a great variety of goods which can be classified into two categories. The classification is based on the primary purpose of the imported goods. Those import items used for productive purpose, items to be re-exported and for public use are classified in category one while import items for all other (nonproductive) purpose are classified in category two.

Category 1. Accordingly, raw materials, semi finished goods, producers goods, and import items for public use such as minibuses, buses etc fall under category one. Raw materials can be processed or unprocessed materials that would be used as industrial or agricultural input while producers' goods are goods such as capital goods and others imported by business organization for productive purposes. To encourage business organizations involved in activities such as producing goods and services, special privileges are granted to them including the exemption of customs duty and other taxes. As a result, raw material, and producers goods are largely zero (0) rated although there is up to a 10 percent customs duty rate applied to some of them. For example the importation of agricultural production inputs such as a tractor is charged with 10 percent customs duty rate. The importation of raw material and producers goods are highly encouraged for they promote domestically produced goods which replace imported goods and helps to save cash flow out of the country.

Generally speaking, the more the imported goods are to be used for productive purpose, the more would get the customs duty rate near to zero.Semi finished goods are also classified under category one. These goods are imported into the country for further processing and their importation is encouraged next to raw materials and producers goods. ERCA charges semi finished goods at a 10 and 20 percent customs duty rate.

Category 2. Imported goods which are classified in category two are items such as consumer or finished goods imported for personal use or for a nonproductive purpose. Consumer goods may also be sub classified into durable and nondurable goods. Durable consumer goods are goods like automobiles, furniture that have an expected useful life of three or more years. Nondurable goods such as foods, gasoline, articles of clothing etc that are depleted or discarded relatively soon. The highest customs duty rates are usually applied to consumer goods. For example, an automobile is heavily taxed at a 35 percent customs duty rate on the grounds that it is imported for personal use while ambulances which are primarily used for public use is imported free of customs duty and other taxes. The general principle in setting customs rate in Ethiopia is that the more the imported item is to be used solely for personal use the higher the rate of customs duty and other taxes.Full information on rates of customs duty on each item to be imported can be obtained from the Ethiopian Customs Tariff prepared based on the harmonized commodity description and coding system (H-S).

Export Tax

Customs duty and other taxes on export items are waived purposely to encourage export. However, the government levies export tax on specific semi-prepared hides and skins of animals. This export tax includes taxes on wet blue skin of an ox, wet blue hides of sheep and goat, and pickled hide of a sheep. The tax is 150 percent of the selling price of the hides and skins to be exported. This tax is introduced on January 1, 2010 by a directive no. 25/2009 issued by Ministry of Finance and Economic Development. The government imposed export tax on these items as a method to curb the exportation of the items, and to increase domestic leather products such as shoes, purses, ready-made garments etc.

Preferential Tariffs

Ethiopia is a member of the Common Market for Eastern and Southern Africa (COMESA) and it administers preferential tariffs that favor trade with member countries of COMESA: The table below describe the special customs tariff rates applicable to goods produced in and imported from COMESA member countries as against the

regular customs tariff rate which is applicable to goods produced in and imported from non member countries.

s. no	Regular customs tariff rate%	COMESA Tariff Rate%
1	5	4.5
2	10	9
3	20	18
4	30	27
5	35	31.5

2. Excise Tax

Excise tax is the second of the five taxes levied on import items and it is one of the most well known forms of tax in Ethiopia. It is a tax levied on selected goods such as luxury goods and basic goods which are demand inelastic i.e. goods that shows no change at all in quantity demanded when price goes up or down. Moreover, excise tax is also applied to goods which are considered as hazardous to health and that may cause social problems. Additionally, the government uses excise tax as a revenue-producing device. In Ethiopia, both the federal and regional governments collect excise tax. ERCA is responsible for collecting excise tax for the Federal government and collects excise tax levied on locally produced and imported items into the country.The minimum excise tax rate applied to excisable goods is 10% while the maximum is 100%. Excise tax has 10 bands or groups of rates at which excise can be charged. These band rates are 10%, 20%, 30%, 33%, 40%, 50%, 60%, 75%, 80% and 100%. These rates are used to calculate the payable excise tax.

Who must pay excise tax?Excise tax on when ever the goods which are subjective for excise taxes are imported from a foreign countries the importer is responsible to pay excise tax or when such goods are locally produced the manufactures/producer of such good is responsible to make effective payment to the custom authority. Or the excise tax on goods locally produced is paid by the producer whereas excise tax on imported items is paid by the importer.Each taxpayer is

liable to compute his or her tax liability/the amount of money he or she owes. The base of calculation for goods locally produced is the cost of production multiplied by its excise tax rate. However, the cost of production means direct labor and raw material cost incurred in the production process, cost of indirect inputs and overhead costs, but does not include depreciation costs of machineries.

In calculating excise tax payable on textile and textile products locally produced in a factory and vehicles assembled locally, the tax paid on import of inputs that are used to produce such goods shall be deducted.Likewise, cost + insurance + freight (CIF) + customs duty multiplied by excise tax rate is the base of computation for goods imported into the country.Excise tax on imported items is paid at the time of clearing those goods from customs area. According to sub article 2(a) of article 6 of the proclamation 307/2009, excise tax on locally produced goods is to be paid, not later than 30 days from the date of production. However this provision is amended by the directive No 18/2009, which allows for the excise tax to be paid within 30 days of the next month following production.

3. Value Added Tax (VAT)

VAT is the third of the five taxes to be levied on import items. In Ethiopia, VAT is levied at a flat percentage rate. To the exclusion of goods detailed in article 8 of the proclamation No. 285/2002 and goods exempted from VAT by the directive issued by the Ministry of Finance and Economic Development, VAT is levied on every imported item. Importers are liable to pay 15 percent of the sum of cost, insurance, freight, customs duty and excise tax.

4. Surtax

Surtax is the fourth of the five taxes imposed on import items. Surtax was introduced in the Ethiopian tax system on April 9, 2007. The council of Ministers issued a regulation to levy 10 percent surtax on imported goods. The imposition of surtax was necessitate to build the financial capacity of the government for interventions to solve the rise in the cost of living which is affecting consumers with low and medium income level. The government has been exerting effort to make grain available at a low price for urban dwellers with medium and low income level until the market is stabilized. Hence, the government required additional budget to pay for the subsidy and this is financed by surtax on import items. Necessary care has been taken so that the imposition of surtax over the imported goods wouldn't result in a rise in the cost of living and in the cost of goods for investment.Ten percent of the sum of cost, insurance, freight, customs duty, excise tax, and VAT is the base of computation for surtax on all goods imported into the country.

However, the following items and services are exempted from payment of surtax. Fertilizer, Petroleum and lubricants, Motor vehicles for freight and passenger and other special purpose motor vehicles, Air craft, spacecraft and part thereof , capital (investment goods) and some medicines, raw materials and other goods which are already decided by law to be tax free.

5. Withholding tax

Withholding tax is the last tax on import items and was introduced in Ethiopia on December 30, 2000. Proclamation No 227/2001 introduced withholding tax. Later on, this proclamation was replaced by income tax proclamation No 286/2002 and the Council of Ministers Income Tax Regulation No 78/2002. The latter proclamation made effective a withholding tax of 3 percent on import items and a 2 percent on payments made in return for the purchase of goods and services.

Withholding tax on imports

Income tax is collected on the import of goods for commercial use and the collected amount is treated as a tax which is withheld and is creditable against the taxpayers' income tax liability for the year. Therefore, withholding tax is not a tax in the traditional sense.The amount collected on imported goods shall be three percent of the sum of cost, insurance and freight (CIF value). If the amount of income tax collected on the imported goods results in underpayment of business income tax due for the year, as determined at the time of declaration of income tax, the tax payer is required to pay the difference with the declaration. If the amount represents an overpayment of income tax due for the year, the tax authority shall, after ensuring the accuracy of the books and records, refund the taxpayer the amount overpaid within three months. The tax authority does this pursuant to article no. 76 of the proclamation no. 286/2002. According to this article, refund to the taxpayer is made after compensating for other taxes he/she owes the tax authority.

Goods imported by the following individuals and firms are exempted from the 3 percent withholding tax imposed on commercial import items. The individuals and firms that enjoy such privilege include:

- Nonprofit and nongovernmental organizations and associations, subject to the provision of registration certificate issued by Ministry of Justice or an authorized body.
- Privileged individuals to import their personal effects free of duty pursuant to the directive issued by ERCA
- Individuals and organizations allowed to import duty-free items pursuant to category two of the customs tariff.

- International organizations, foreign diplomat, consular missionaries, and their members who, in line with diplomatic and other international agreements, are exempted from profit tax
- Individuals and organizations who are exempted from income tax by federal and regional investment authority. However these Individuals and organizations are subject to provide evidence that authenticate privileges of such a kind
- Raw materials and capital inputs like spare parts used by individuals and organizations licensed to engage in the activities of production are exempted from a three percent withholding tax provided that the inputs are not directly used for commercial purpose. However an industry owner, as read in the proclamation no.286/2002, shall pay a two percent withholding tax when the item produced using the foregoing inputs is made available for sale in the market.
- Capital goods imported into the country for the establishment or development of industry or power generation or transportation facilities. However, the importer is subject to provide evidence, from the Ethiopian Investment Authority or from concerned bodies, that authenticates the imported items are capital goods and are not to be directly used for commercial purpose,
- Gift items, advertising items, sample of goods,
- Individuals and organization engaged in the activities of mining and petroleum for they are governed pursuant to a special tax law.

Exemplary way to calculate customs duty and other taxes on an automobile imported for personal use

Consider a typical example: an importer brought in an automobile with 1300 cc for personal use. So the importer is liable to pay 35% custom duty rate and 30% excise tax rate. How do you think the total customs duty and other taxes can be calculated? To determine customs duty and other taxes on the automobile the importer may use the following seven key steps. The first step is to identify the duty paying value of the automobile. The duty paying value of any import item is the actual total cost of the goods i.e. cost + insurance + freight. Cost stands for the transaction value (purchase price of the good) and other related costs. Insurance represents the money

or premium that for insurance coverage. Freight is money paid for the transportation of cargo (good) from port of shipment up to port of destination.

- Once the duty paying value of the imported item is calculated, the next step is to calculate customs duty payable on the automobile. Suppose the duty paying value of the imported item is 60,000 birr, the importer is liable to pay customs duty of 21000 birr. This figure is obtained by multiplying customs duty rate with the duty paying value of the imported item i.e. 60,000 x 35% .
- Having calculated customs duty next is the third step used to reflect how excise tax is calculated. In this step, the importer multiplies the sum of duty paying value and customs duty by excise tax rate (60,000 + 21,000) x 30%. This gives the importer 24,300 birr which is the payable excise tax.
- The fourth step shows the way value added tax is calculated. In this step, the importer multiplies the sum of duty paying value, customs duty, excise tax by value added tax (60,000 + 21,000 + 24,300) x 15%which is VAT rate. The result of this calculation is 15, 795 birr which is VAT to be paid on the automobile.
- The fifth step, to calculate surtax, involves multiplying the sum of duty paying value, customs duty, excise tax, VAT, by surtax rate (60,000 + 21,000 + 24,300 + 15,795) X 10% which is surtax rate. Accordingly the payable surtax is 12,109.5 birr. 5%.
- The sixth step is to calculate withholding tax. In this step, the importer multiplies the duty paying value by withholding tax

rate i.e. 60,000 x 3%. The result is 1800 birr which is the withholding tax to be paid. The last step involves adding the payable customs duty, excise tax, value added tax, surtax, and withholding tax to arrive at the figure of the total payable customs duty and other taxes. Accordingly the calculation results in a sum of 75,000.5 birr i.e. 21,000 + 24300 + 15,795 +12,109.5 + 1800.

- **The formula for calculating customs duty and other taxes:**
- **DPV =Cost + Insurance + Freight**
- **DPV x CUDU =A**
- **(DPV + A) x EXTA= B**
- **(DPV + A + B) x VAT=C**
- **(DPV + A + B + C) x SURTAX =D**
- **DPV x WHT = E**
- **Total payable = A + B + C + D + E**
- ……
- **Where DPV= Duty Paying Value**
- **CUDU= Customs Duty Rate**
- **EXTA = Excise Tax Rate**
- **SURTAX= Surtax**
- **WHT = Withholding Tax**

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