Unit 3

TRADE

Unit Outcomes

At the end of this unit, students will be able to:

- **understand the concept of trade.**
- **recognize the concepts of domestic and foreign trades.**
- **realize the necessary conditions to act as a trader.**

Introduction

The growth of world trade offers tremendous potential for Ethiopian business organizations that are engaged in buying and selling goods and services in overseas markets. But success in the international trade requires better quality products, competitive price and increased productivity. There are different facets to international trade such as different currencies, trade terms, risks and ways of financing the deal, etc.

These complexities require imaginative trading strategies that address the challenges facing companies pursuing business opportunities overseas. Therefore, to undertake a successful business in the international market, there must be a good understanding of the required procedures and principles. The purpose of this unit is to give a brief explanation of foreign trade and its procedures. Additionally, in order to have a clear picture about foreign trade, there is a need for a brief discussion on domestic trade particularly transaction related issues.

Contents of the Unit

In order to be able to achieve the above objectives, you will learn the following topics:

- Definition of Trade
- Foreign Trade

3.1 Definition of Trade

- *How many of you in the class are interested to do business in your life? Why?*

Business people face the problem of finding a person who is willing and capable of buying products. This is a major problem of business because producers may not be in a position to get a person who has the need, interest and the power to buy a product. On the part of the buyer, the problem is getting the right producers which do have the necessary product features with regard to quality, quantity, price and other factors. Ideally, if you want to trade, you must find someone who has what you want and you must also have what he wants and the two of you agree on values and then it can be said transfer of exchange has taken place.

Trade is one of the major components of business which is mainly responsible for distribution and sales, Also traders perform the basic functions of transportation, facilitating payment, taking risk and providing information for facilitating trade. Trade solves this basic and fundamental problem of commerce. Thus, the literal meaning of trade can be stated as follows:

Trade is the business of buying, selling or exchanging goods, within a country or between countries.

3.1.1 Trade

Trade can be sub-divided, firstly, on the **basis of operation**. Accordingly, we find internal trade and international trade. Secondly, the classification can also be based on the **unit of sale**. Thus, we find wholesale trade and retail trade which are explained briefly.

i) Internal Trade: Internal trade, also known as home trade, consists of buying and selling of goods and services within the boundaries of a country. Payments are usually made in national currency or through the national banking system. The internal transportation system is utilized for the movement of goods. Large numbers of middlemen are not generally involved. Government regulations are not varied and rigid. Internal trade may be conducted on either of the wholesale or retail bases (see the explanation of wholesale and retail trade in the marketing unit).

ii) International Trade: International trade, also called foreign trade, refers to the exchange of goods and services between two or more countries. International trade may be further sub-divided into import, export and entrepot trade.

a) **Import Trade:** consists procuring of foreign goods for home consumption.

b) **Export Trade:** consists in the supply of domestic goods for foreign use. Ethiopia exports coffee, hides and skins, flowers, oil seeds and pulses to foreign countries mainly to western nations.

c) **Entrepot Trade:** involving the import of foreign goods for re-exporting them to foreign consumers and making a profit in deal. For instance, United Emirates is a major re-exporter of many of the products of far eastern and western countries to the African market including Ethiopia.

3.1.2 Aids to Trade

Trade cannot prosper unless it is supported by an infrastructure. Various auxiliary services are important to facilitate trade. The exchange process is not always smooth. There is long distance between sellers and buyers. There is risk of loss during transit. There is time gap between production and demand. Customers may not get information about the product, price and cost. All those activities which help trade in overcoming these problems are called **aids to trade**. A brief discussion about these activities is given below even though some of them are covered in detail in the marketing part.

1. **Banking**: Banking provides a means through which payments for purchasing and selling of goods can be made. It pools resources from individuals in the form of savings and deposits and make them available to those who can use theses resources profitably.
2. **Transportation:** As stated earlier in marketing part of this textbook, transportation ensures a smooth and uninterrupted flow of goods from producers to wholesalers, to retailers, to customers.
3. **Insurance:** It provides a cover against the loss of goods in the process of transit and storage.
4. **Warehousing:** As stated earlier, warehousing creates time utility. It maintains goods in perfect condition until they are required by customers.
5. **Advertising:** Advertising provides information to customers and other middlemen.
6. **Packaging and packing:** They protect goods from damage during transportation.

3.1.3 Inland Transactions

What are Transactions? Transactions are the occurrence of events or of conditions which result in exchange of goods and services. As stated in marketing unit, when the exchange takes place, it takes the form of transaction. When this happens, we say a trade of value takes place. For transaction, there must be at least two things of value, agreed upon conditions, a time of agreement and a place of agreement. All business transactions are carried out by four groups of people, namely: the producers, the wholesalers, dealers or merchants, the retail dealers or shop-keepers and the consumers.

The business transactions need some important documents (papers) or letters. These papers are very useful for facilitating exchange of goods and services. They are (a) the enquiry, (b) the quotation, (c) the order, (d) the invoice, and (e) the document of payment for the goods.

The Enquiry: it is letter sent by the buyer to the seller asking for the price of goods that he/she thinks of buying. In other words, it is a request for information and should state types of goods, at what prices goods can be obtained, and terms of delivery and payment. A letter of enquiry states definitely the requirements, the approximate quantity, whether the seller should pay certain costs (e.g. carrying i.e. transportation).

Quotations: It is an offer to sell certain goods at a price under conditions that are clearly stated. The quotation contains conditions in such points like;

- Subject to acceptance within 7 days of the date of quotation;
- The quantity, quality, price, terms of delivery and payment including sample of the product;
- The quotation should be numbered and a copy of it is kept on file.

Activity: 1

- **Explain the difference between enquiry and quotation.**

The Order/Indent: Order is the document sent by the buyer to the seller for the supply of goods. The order must contain full particulars of the goods required with terms of delivery and payment. The order may be written as a letter or in printed form like quotations. The order must clearly state the terms and conditions under which goods will be acceptable and payment may be effected. However, some sellers will state their own terms and conditions instead of accepting that of the buyers.

The Invoice (Executing the Order): After the order is received from the buyer, the seller prepares a document known as an invoice. Every organization is unique and it has its own procedures depending on its needs and resources.

The Document of Payment for the Goods (The Payment)

Buyers should pay sellers for the goods or services by using various means of payment. These documents of payments are cash, cheque, promissory note, etc.

A diagram showing all of the five documents in buying transactions between sellers and buyers are given in the following diagram.

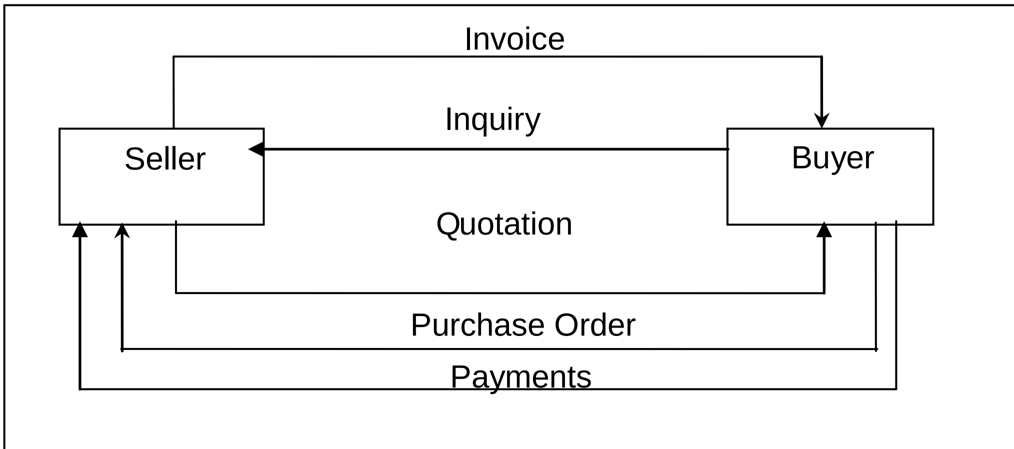

Fig. 3.1 Flow of Transaction Documents

Rights of Traders

The business documents stated earlier are business contracts between buyers and sellers. However, businesses often give their standard terms and conditions of business (T&C's) low priority until a dispute arises. Nine times out of ten it is too late to do anything about it at this stage. Often T&C's are out of date, inappropriate, ambiguous, unlawful, or, (as in many cases), non-existent.

The first thing to note about terms and conditions (T&Cs) is the difference between business-to-business (B2B) trading relationships and business-to-consumer (B2C) relationships. In B2B traders have a lot more freedom to agree whatever they want than with B2C relationship. Irrespective of what the T&C's say, in B2C relationships consumer law will override to protect certain consumer rights, and imply certain others if traders are silent about them. It is for this reason that it is very important to tailor the T&Cs to the customer base to afford the maximum protection, whilst making sure that traders don't overreach. If traders trade in both B2B and B2C markets, they may even want to have a different set for each. To protect themselves from possible problems, traders should consider at least two issues: **timing and Proper Notice.**

Timing: Classic bad example is T&Cs on the back of the invoice. As invoices are characteristically delivered after the contract has been made, the terms are generally unenforceable. Ensure your T&Cs are brought to your customer's attention at the earliest opportunity. Consider setting out your terms in your brochures, catalogues or other marketing material, and certainly on your order/quotation forms and acknowledgement of order (if applicable).

You must be able to demonstrate that you have done enough to draw the consumer's attention to the T and Cs. Accordingly, a consumer should be required to acknowledge that he or she has read and agrees to the terms as part of the purchasing process. However, laws to protect consumers' rights are rarely enforced in developing countries because of weak capacity in law enforcement and non-existence of organized groups to protect the rights of consumers by taking the issues to the court.

Capabilities of a Trader

Consider any successful businessman. Often in the beginning, success came by simply working harder, putting in more hours, taking on more personally. Doing what ever it takes. But, this may not lead the trader to permanent success.

Compare a professional athlete with a trader. For a professional athlete, losing is not an option. Unfortunately, in trading, losing is mandatory. Losing the right way is what matters, proper amount on appropriate trades. Once a trade has stopped, it is a loss and the trader moves on. The trader knows that what matters is process that delivers winners over a period of times. What is significant is not what happens on one trade. To the athlete, losing is not acceptable. It must be avoided at all costs at all levels.

So what is helpful for a trader? Learning the whole process of trading is most important. Learning from those who have been through (beginning to an end) it, or having the ability to learn and adapt quickly as traders go. Having the mindset of having a plan, being able to adjust that plan in the proper way at the proper time, and carrying out the plan until the results are reached. Then, constantly evaluating the process, eliminating mistakes and being mindful of the need to change and be flexible.

Unfortunately, it may be difficult to get traders with such extraordinary qualities with businessmen in developing countries like ours given our tradition. But, we expect such people to emerge in the future.

Activity: 2

- **Explain the difference between the purchase order and invoice**
- **Explain the major documents involved in domestic transactions.**

3.2 Foreign Trade

- ***Why Ethiopian is involved in foreign trade? What if there is not foreign trade?***

As stated earlier, foreign trade is a trade, which one-country carries on with another country, which is beyond the national boundaries. Foreign trade encompasses all business activities that involve exchanges across national boundaries. Thus, a firm is engaged in foreign trade when it buys some portion of its input from, or sells some portion of its output to, an organization located in a foreign country.

3.2.1 Absolute and Comparative Advantage

Some countries are better equipped than others to produce particular goods or services. The reason may be a country's natural resources, its labour supply, or even customs or a historical accident. Such a country would be best off if it could specialize in the production of such products, because it can produce them most efficiently. The country could use what it needed of these products and then trade the surplus for products that could not produce efficiently by its own. For Example, Saudi Arabia has, thus, specialized in the production of crude oil and petroleum products; South Africa, in diamonds; and Australia, in wool. Each of these countries is said to have an absolute advantage with regard to a particular product. **An absolute advantage is the ability to produce a specific product more efficiently than any other nation**.

One country may have an absolute advantage with regard to several products, whereas another country may have no absolute advantage at all. Yet, it is still worthwhile for these two countries to specialize and trade with each other.

To see why this is so, imagine you are the president of a successful manufacturing firm, and you can accurately type ninety words per minute. Your assistant can type eighty words per minute but would run the business poorly. You, thus, have an absolute advantage over your assistant in both typing and managing. But you cannot afford to type your own letters because your time is better spent in managing the business. That is, you have a comparative advantage in managing. **A comparative advantage is the ability of a nation to produce a specific product more efficiently than any other product.**

Your assistant, on the other hand, has a comparative advantage in typing because he or she can do that better than managing the business. So you spend your time managing, and you leave the typing to your assistant. Overall, the business is run as efficiently as possible, because you are each working in accordance with your own comparative advantage.

The same is true for nations. Goods and services are produced more efficiently when each country specializes in the products for which it has a comparative advantage. Moreover, by definition, every country has a comparative advantage in some products. However, countries want to produce each and every product for self-sufficiency strategies and needs. As a result, they restrict importation of many items to their markets and at the same time they encourage export of their products to other countries to generate hard currency. For example, Ethiopia levies no export customs duty except on coffee. But there is import customs duty almost on all products to be imported to Ethiopia.

Activity 3

- **Explain the concepts of absolute and comparative advantages and give examples for your explanation.**

3.2.2 Trade Restrictions

As it will be discussed later in this unit, countries restrict either the import of specific products or on trade with particular countries. The measures may be imposition of high customs duties, economic embargo, quantity limit and restriction of hard currency available for import. Some of the commonly used trade restrictions are explained as follows:

1. **Customs Duties:** These are taxes levied by the government on imports and exports. Note that customs duties are different from excise tax, which is the tax levied on domestic products. The two types of tariffs are **revenue tariffs** and **protective tariffs**; both have the effect of raising the price of the product in the importing nations, but for different reasons. Revenue tariffs are imposed solely to generate income for the government. Protective tariffs, on the other hand, are imposed to protect a domestic industry from competition by keeping the price of competing imports high or higher than the price of similar domestic products.

   Customs duties are levied in the following ways;

   a) **Ad valorem:** The tax is calculated on the value of the goods imported or exported. On the imports, it is the value of the goods at the port of entry, which is the C.I.F. value (C.I.F.), Cost, Insurance and Freight. On the exports, it is the value of the goods at the port of origin.

   b) **Specific:** This shows that tax is levied on the quantity of the goods imported or exported such as 100 Birr per ton for some type of goods.

2) **Additional taxes and non-tariff barriers.** There are also some additional taxes other than the usual customs duties that are discussed below briefly.

a) **Customs Surcharge**: This is an additional duty of so much percent on all customs duties. It enables the government to raise the charges without changing the ordinary rates as changing the ordinary rates frequently is expensive. It is certain percentage of the customs duty. When the government faces financial problems in certain extraordinary problems like war, it levies customs surcharge to increase its revenue to finance the problem.

b. **Other Taxes:** Barriers can be tax or non-tax barriers. These are taxes levied by the local authorities, such as port authorities or municipalities on all imports and exports that are stated as certain percentages of customs duties.

c. **Non-tariff barriers:** A non-tariff barrier is non-tax measure imposed by a government to favour domestic over foreign suppliers. Non-tariff barriers create obstacles to the marketing of foreign goods in a country and increase costs for exporters. The following are a few examples of government-imposed non-tariff barriers:

- An **import quota** is a limit on the amount of a particular good that may be imported into a country during a given period of time. The limit may be set in terms of either quantity or value of the goods. This system has been very common during the previous government for certain items such as automobiles.
- An **embargo** is a complete halt to trading with a particular nation or in a particular product. The embargo is used most often as a political weapon rather than economic reasons.
- A **foreign-exchange control** is a restriction on the amount of a particular foreign currency that can be purchased or sold. By limiting the amount of foreign currency importers can obtain, a government limits the amount of goods importers can purchase with that currency. This has the effect of limiting imports from the country whose foreign exchange is being controlled.
- A nation can increase or decrease the value of its money relative to the currency of other nations. **Currency devaluation** is the reduction of the value of a nation's currency relative to the currencies of other countries. Devaluation increases the cost of foreign goods, while it decreases the cost of domestic goods to foreign firms. Ethiopia has reduced the value of Birr from Birr2.07 in 1991 to Birr 5 around 2000 and now (2010) the value of $1 is between Birr 13 and Birr 14 as of writing this material it is between Birr 16 and Birr 17..

- **Bureaucratic red tape (excessive procedure)** is subtler than the other forms of non-tariff barriers. Due to the excessive procedures designed for controlling purposes, bureaucratic procedures can frustrate many importers and exporters.

Activity: 4

- **Explain the difference between ad valorem and specific methods of levying customs duties.**
- **List at least three major types of items that can be exported by Ethiopia.**
- **Visit your nearest bank and ask its role in the foreign trade.**

Reasons for Trade Restrictions

As to the need for or against trade restrictions, there are two groups that advocate their own reasons. There are a number of justifications for each groups of advocates. As stated earlier, various reasons are advanced for trade restrictions either on the import of specific products or on trade with particular countries. Political considerations are usually involved in trade embargoes. Other frequently cited reasons for restricting trade include the following:

- ***To equalize a nation's balance of payments***. This may be considered necessary to restore confidence in the country's monetary system and in its ability to repay its debts. A nation's **balance of payments** is the total flow of money into the country minus the total flow of money out of the country, over some period of time. This concept is different from **balance of trade** i.e., balance of trade is the total value of its exports minus the total value of its imports, over some period of time.
- ***To protect new or weak industries.*** A new, or infant, industry may not be strong enough to withstand foreign competition. Temporary trade restrictions may be used to give it a chance to grow and become self-sufficient.
- ***To protect national security.*** Restrictions in this category generally apply to technological products that must be kept out of the hands of potential enemies. For example, strategic and defence-related goods such as sophisticated intelligence communication equipment and mass destructive weapons may not be exported to unfriendly nations by the developed nations of the west particularly of the USA.
- ***To protect the health of citizens.*** Products may be embargoed because they are dangerous or unhealthy (for example, farm products contaminated with insecticides).

- ***To retaliate for another nation's trade restrictions.*** A country whose exports are highly taxed by another country may respond by imposing tariffs on imports from that country.
- ***To protect domestic jobs.*** By restricting imports, a nation can protect jobs in domestic industries. However, protecting these jobs can be expensive.

Reasons Against Trade Restrictions

According to the advocates of this group, trade restrictions have immediate and long-term economic consequences both within the restricting nation and world-trade patterns. These include the followings.

- ***Higher prices for consumers.*** Higher prices may result from the imposition of tariffs or the elimination of foreign competition, as described above.
- ***Restriction of consumer's choices.*** Again this is a direct result of the elimination of some foreign products from the marketplace and of the artificially high prices that importers must charge for products that are still imported.
- ***Misallocation of international resources***. The protection of weak industries results in the inefficient use of limited resources. The economies of both the restricting nation and other nations eventually suffer because of this waste.
- ‡ ***Loss of jobs.*** The restriction of imports by one nation must lead to cut backs and the loss of jobs in the export -oriented industries of other nations.

Activity: 5

- **Are you in favour of trade restrictions or against it? Why?**

3.2.3 Nature of Foreign Trade

As it has been discussed earlier, foreign trade is different from domestic trade in many ways. However, the basic features of foreign trade are (i) it is always on wholesale basis and (ii) it requires special procedure because of a number of reasons.

Reasons for Special Procedure in Foreign Trade

The reasons for the need to follow special procedures in the foreign trade are many and varied. But the basic reasons are listed as follows:

1. Each country is a distinct political and economic unit with its own currency, laws and tax systems. These actually create obstacles in the way of free movement of goods and payment for the same.
2. Different countries have different languages and customs. Therefore, there is a need for studying the foreign market before entering foreign trade. The most

important skill in a foreign country is language that the native can speak it fluently at the age of three.

3. The need for financial resources because of the long interval between the time when the goods are dispatched from one country and received by the importer in another country.
4. Because of the long distance between the country supplying the goods and the country receiving them, goods are exposed to greater risks.
5. The existences of trade barriers such as tariff and import restrictions which are other important factors in foreign trade. Trade barriers are discussed in the ensuing topics of this unit. Because of the reasons mentioned above and other reasons stated below, foreign trade requires documents.

Activity: 6

- **Why exporters / importers follow special procedures?**

3.2.4 Documents and Special Terminologies

Due to the involvement of many parties and the need for special procedure in the foreign trade, there are a number of documents with special terminologies. One to succeed in the foreign trade, he has to be familiar to certain terminologies and documents and their definitions are given in this part of the textbook. .

i) Mate's receipt: When goods are taken up by a steamer, the exporter or his transit agent will hand over to the captain of the ship a copy of the customs declaration as well as a copy of the shipping order. The mate of the ship then issues a Receipt called **Mate's receipt**'. This receipt is termed '**clean**' when it does not contain any adverse remarks regarding the condition of packing at the time the goods are received on board the steamer. It may be noted that it is not in the interest of the exporter to have '**foul**' mate's receipt.

ii) Transport or shipping Documents. There are different transportation documents.

a) Bill of Lading (B/L): It is an official receipt of the shipping company acknowledging receipt of goods on board the steamer and contains the terms and conditions on, which it has agreed to carry the goods to the port of destination. In fact, it is a receipt for the goods shipped and serves as an evidence of the contract of carriage.

It is also a document of title to the goods and transferable by endorsement and delivery. When the goods are sold under an arrangement where the importer agrees to pay the freight, then, the Bill of Exchange is taken out without payment of freight and is marked **'freight forward' or 'freight to be paid'**. In such cases, the freight becomes payable by the importer at the port of destination. It is also a guide to carrier's staff in handling the shipment.

This document may be issued in two forms: the Straight Bill of Lading and the Order Bill of Lading. The **straight Bill of Lading** is a bill that provides for delivery only to the party named in the Bill of Lading and to no one else. In this case, the carrier or his agent must be certain that the party receiving the goods is actually the party named in the bill. On the other hand, the **Order Bill of Lading** is a negotiable instrument which provides for delivery to a named party or his order (anyone he may designate) by endorsement of the Bill of Lading. Goods transported under negotiable Bill of Lading are not to be released by the transport company until the bills of lading have been surrendered bearing the endorsement of the party claiming the goods.

b) Special Types of Bill of Lading. Different types of Bill of Lading are also common such as ocean bill of lading, inland bill of lading, airway bill and postal parcel receipt that are discussed below:

Ocean Bill of Lading: This is a document that covers the movement of goods by sea and may be issued in either straight or order form. Steamship companies issue such bills of lading in sets consisting of one or more originals and bearing a clause that says that the cargo will be released upon presentation of one of the originals, thus, making valueless the remaining originals of the complete set. It has been the most common practice to issue ocean bills in sets of three originals. However, there is a trend in international trade to issue one or more original bills of lading. See Annex A in this unit for Bill of Lading document.

Inland Bills of Lading: These are issued by railroad lines or truck lines and can also be drawn in either straight or order form. Unlike ocean carriers, the inland carrier never issues more than one originals of such bills.

Airway Bill: is a receipt for goods carried by air and often referred to as an "Air consignment Note". Airway bill is generally issued by air carriers for merchandise to be delivered to a party at some named destination. See the sample Airway Bill in Annex B at the end of this unit.

Parcel Post Receipts: which are issued by the postal service and are non-negotiable and merchandise is deliverable to the addressee only. It is a post office receipt for goods dispatched by mail. The receipt is evidence of dispatch only.

iii) Insurance policy Certificate: The exporter arranges for the insurance of the goods against the usual perils of the sea. He gets the insurance policy against payment of premium, which is usually, a percentage of the insured value (10% to 20% above the invoice value covering the probable duty payable or the imports and other incidental expenses involved).

The terms of contract between the importer and the exporter should define the responsibilities for arranging insurance coverage whilst the goods are in transit and what risks are to be covered. See Annex C for sample Insurance Certificate.

iv) Certificate of Origin: This is a document which states the country (countries) of origin of goods. It enables the importer to get advantage of special treatment. Due to special trade agreements between countries, goods sent from friendly country to another generally receive preferential treatment in import duties. For example, European Union provides customs duty exemptions to Ethiopian commodities. The supplier should complete it and may have to be authenticated by a chamber of commerce or other authorized body in the exporter's country. The certificate should include the name and address of the exporter, the manufacturer (if different), the importer, a description of the goods and the signature and the seal of the authorising organization.

v) Consular Invoice: It is a document of verification of customs duties given by the trade consul of the importing country residing in the exporting country. The consular invoice along with other documents will be sent by the exporter to the importer. The purpose of the document is to facilitate the calculation of the custom duties by the authorities of the importing country without taking more time.

vi) Certificate of Health: Agricultural and animal products may require a certificate stating that they comply to the importing country's health regulations. This certificate must be authorized and signed by the health authority in the exporter's country.

Vii) Pack List: Where there are several packages in one consignment, an invoice is usually accompanied by a packing list which details the contents of the package and may also show their weights and measurements.

Activity: 7

- **Identify the different documents used in foreign trade and explain the purpose of each one.**

3.2.5 Foreign Inquiries and Quotations

Both enquiries and quotations should contain full details of the goods required, their description, catalogue number or trade, size, weight, or other distinguishing features as well as the quantity, the time and method of delivery, packing and packing size, the firm period of price, delivery place and date.

The quotations also include the price and terms of sale. In case of first enquiry, it is usual to make some investigation regarding the financial position of the client. It can be done by means of a banker's reference if the bank's name is supplied by the enquirer or by means of a trade reference or inquiry with some firm(s) who had business dealing with the potential supplier. The documents should also specify the terms of shipment and payment.

Price Terms (Terms of Shipments)

The following are payment terms which are given by International Chamber of Commerce (ICC). These are listed in the order of decreasing cost and responsibility to the seller (exporter) or alternatively in order of increasing cost and responsibility to the buyer (importer).

1. **DDP- Delivered Duty Paid (at Named Place Of Destination)**
   All costs of shipment of the goods, including duty, are paid up to the point of delivery at the named place in the country of importation. The buyer is responsible only for accepting delivery and all obligations are those of the seller.
2. **DDU- Delivered Duty Unpaid (at named place of destination)**
   The buyer is accepting the risk associated with the goods failing to clear customs. However, seller pays the taxes and the export duty.
3. **DEQ- Delivered EX Quay (duty paid at named port of destination)**
   Costs of delivery, duty to be paid, to the named port of destination are borne by the seller. All obligations subsequent to Customs clearance are the responsibility of the buyer.
4. **DES- Delivered Ex Ship (at named port of destination)**
   The seller is responsible for costs of delivery on board of the vessel, at the named port of destination. The buyer assumes all risks and responsibilities including duty, from a point immediately prior to importation.
5. **DAF- Delivered at Frontier (at named place)**
   The seller is responsible to make the goods available at the frontier with all subsequent costs, including duty, being the obligation of the buyer. This term applies to all modes of transport but most commonly used for goods being carried by road and rail.

6. CIP- Carriage and Insurance Paid (to named place of destination)

Costs of carriage and insurance of the goods to the named destination are the responsibility of the seller. The buyer becomes responsible for all costs and risks, including duty, from the named place of destination up to his/her own address. This term applies to all modes of transport.

7. CIF- Cost, Insurance and Freight (at named port of destination)

The seller is responsible for cost of goods, freight and marine insurance to named port of destination. The buyer is responsible for all costs, including duty, subsequent to delivery on board at the port of destination. This term applies to sea or inland waterway transport only.

8. CFR- Cost and Freight (at named port of destination)

The same as that of the CIF except the buyer is responsible for marine insurance.

9. FOB- Free on Board (at named port of shipment)

The seller's responsibilities are to include all costs of delivery until goods are delivered over the ship's rail at the named port of shipment. The buyer is, therefore, responsible for all costs subsequent to loading on board. This term applies to sea or inland waterway transport only.

10. FAS – Free Alongside Ship (at named port of shipment)

The seller is obliged to deliver goods alongside the vessel on the quay or to a lighter at the name port of shipment. The buyer is, therefore, responsible for clearing the goods for export and all subsequent costs, charges and insurance. This term applies to sea or inland waterway transport only.

11. FCA - Free Carrier (at named place)

The seller is responsible for delivery of goods, cleared for export, into the charge of the carrier nominated by the importer at the named place, usually on inland clearance depot. The buyer is responsible for all risks and costs including the costs associated with the appointment of carrier. Often the seller will assist with this appointment but with the buyer's risk and expense. This term applies to all modes of transport.

12. EXW – Ex Works (at named place)

The seller is responsible for making the goods available to the buyer at the seller's own premises. The buyer is therefore accepting full responsibility for transportation of the goods and has maximum liability. The sellers quoting these terms have minimal time and cost implications but may be making their goods less competitive as the buyer will need to calculate all additional transportation costs in addition to the contract price.

Activity: 8

- **Explain the difference between domestic and foreign quotations and purchase orders.**

3.2.6 Foreign Terms of Payment

- *What differences can you see when one pays to a foreign company and a domestic company?*

A variety of payment methods are used in international trade transactions, which have their own advantages or disadvantages. The common terms of payment are (a) Letter of Credit, (b) Advance payment, (c) Open Account, (d) Payment on Collection Basis (such as Bill of Exchange) and (e) Consignment Sales which are discussed very briefly.

1. **Letter of Credit:** The letter of Credit typically is issued by the importer's bank, that is, the issuing bank. The issuing bank's L/C signifies that the bank agrees to pay the importer's obligation to an exporter resulting from a sales agreement; contingent on receiving documentation proving that shipment was made. In return for the L/C, the importer warranties that he or she will pay the bank the sales amount and any fees.

The L/C is crucial to exporters if a foreign customer is not well known or if the customer's credit is suspect for any reason. The L/C substitutes the issuing bank's credit and reputation for those of the importer.

The issuing bank sends the L/C covering the amount of the sale to the exporter's bank (called the paying bank) in the exporter's country. The paying bank, in turn, sends the L/C to the exporter. When shipment is made, the exporter presents its sight or time draft along with proof- of-shipment documents to its (paying) bank. The exporter's bank then pays the seller, debits the account of the importer's bank, and sends the shipping documents and the draft on to the importer's bank. Upon receipt of the documents and draft; alternatively, with a time draft, the importer's account is debited on maturity) and conveys the documents, representing title to the goods to the importer. The following diagram shows the above description in schematic model.

As shown in Figure 3.2, based on an agreement by an American computer manufacturer (exporter) to sell computer equipment to an Ethiopian buyer (importer), illustrates the transactions.

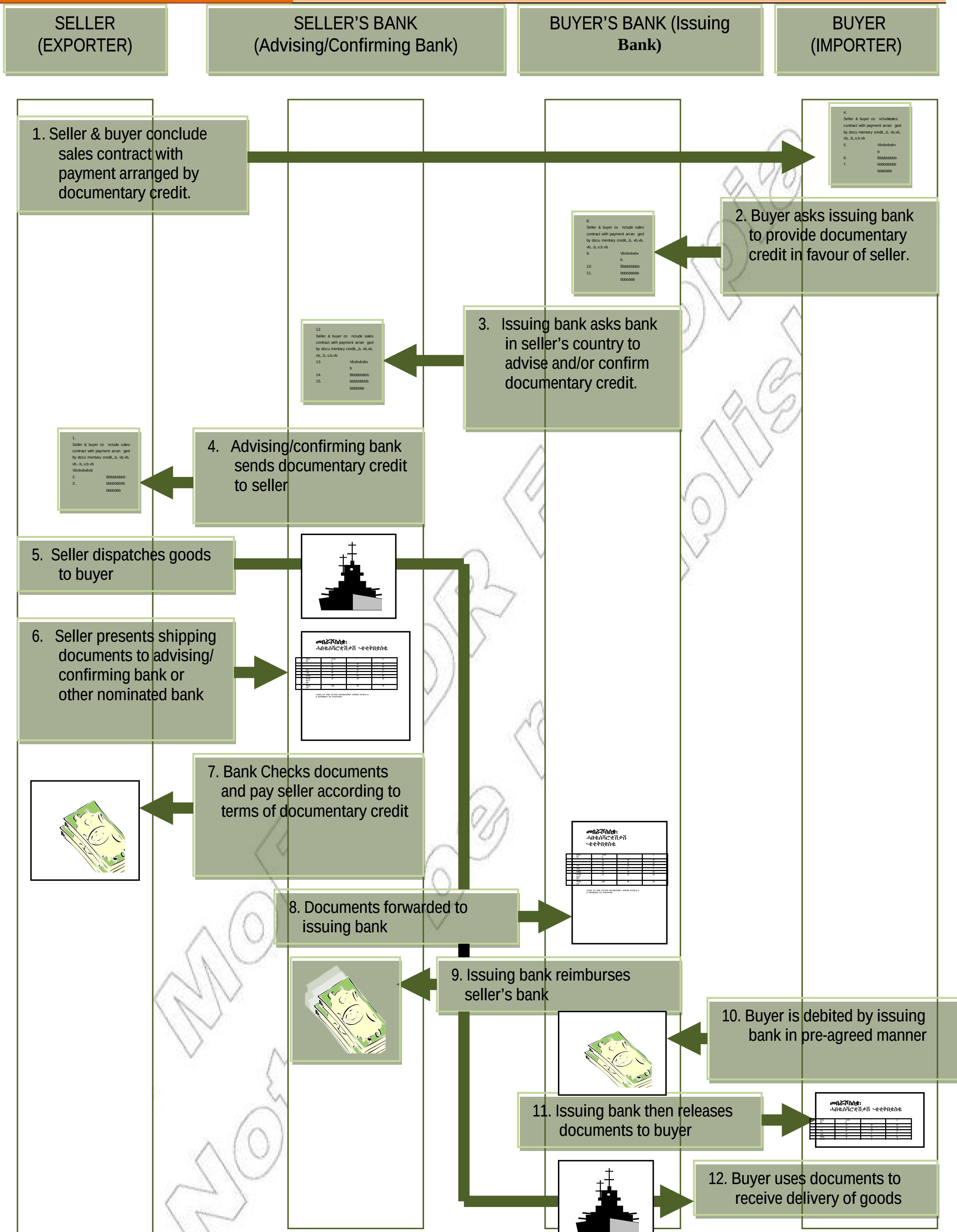

Figure 3.2 A typical path of letter of credit

L/C may be confirmed or unconfirmed and revocable or irrevocable. Confirmed irrevocable L/Cs bear the guarantee of payment by both the issuing and confirming (paying) banks. An unconfirmed irrevocable L/C bears the guarantee of the issuing bank only, and a revocable L/C carries only importer's promise to pay and does not carry either bank's guarantee.

The Letter of Credit must specify the value of the credit, the time limit for submitting documents, (which in turn limits the time for shipment), mode of dispatch, i.e., by road, rail, sea, air or parcel post: whether partial shipment are allowed, etc.

2. **Advance payment (cash in advance)**: In this method, the buyer makes advance payment. This method often is used when the buyer is unknown to the seller. The method places the financing burden entirely on the buyer; once the buyer has made the cash payment, he/she has no assurance that the seller will fulfil his obligations.
3. **Open account:** Instead of either receiving funds prior to shipment (cash in advance or at the time of shipment (irrevocable letter of credit), the exporter may be requested to ship on open account terms.
   - The exporter who agrees under this method of payment will ship the goods without receiving of a bank assurance of payment, but will get paid under the usual payment terms of the buyer usually not more than 180 days following the invoice date.
   - Payment on open account offers the least security to an exporter.

4. **Payment on Collection Basis**:
   - Payment on collection basis is the most widely used payment method in the purchase and sale of goods and services in foreign market.
   - The bank acts only as an agent of the exporter -- its power and responsibilities are limited accordingly.
   - Under this arrangement, the seller forwards financial and commercial documents through his bank (remitting bank) to the buyer's bank (collecting bank).
   - The seller includes with the documents the draft drawn on the buyer for collection. To initiate a trade collection, the exporter will draw a draft (also called "Bill of Exchange") on the buyer who will honour the draft when it is presented to him (pay it or accept if it is a term draft) after the importer's order has been shipped. One of the methods of payment on collection basis is the bill of exchange.

Bill of Exchange: Bill of Exchange is defined as an unconditional order in writing, addressed by one person (the drawer) to another (the drawee), signed by the drawer requesting the persons to whom it is addressed to pay on demand or at a fixed or determinable future time a certain sum in money to or to the order of a specified person or to the bearer (the payee). To be negotiable, the draft (draft is the alternative name for Bill of Exchange) must

- Be drawn by the beneficiaries on parties specified in the credit.
- Be signed by the drawer.
- Contain an unconditional order to pay a certain sum in money.
- Be payable on demand or at a definite time (tenor).
- Be payable to the drawer properly endorsed.
- Not exceeding the credit amount or remaining balance of the credit.

There are three types of arrangement for collection of bill of exchange which are discussed below:

- **Sight Draft Collections:** Under a sight draft arrangement, documents forwarded through the seller's bank to the buyer's bank overseas only can be released to the buyer upon payment of the draft. A sight draft offers more protection than a time draft, especially when the exporter is selling to a foreign buyer for the first time or when the credit worthiness of the customer is unknown. This payment method has advantages to both the buyer and the seller.

- **Time Draft Collection:** Using this method, the seller draws a draft on the buyer payable on a specified due date or a certain number of days after sight or after bill of exchange date. The time draft and documents are forwarded through the seller's bank to the buyer's bank overseas with instructions to deliver documents against acceptance only. A time draft exposes the exporter to more risk than a sight draft because the buyer is in possession of the merchandise, without paying, from the date of acceptance. The seller must be certain that the buyer is capable of paying on the maturity date and that the political and economic conditions of the country are stable enough to ensure that payment will be made without significant delay. To accept the draft, the buyer signs across the face of the draft and indicates the date accepted.

- **Clean Draft Collection:** Under this payment method, the seller presents only his/her draft to the bank for collection; the shipping and other documents are sent directly to the buyer. This method lacks the protection of a documentary collection.

5. **Consignment Sales**: The goods may be shipped "on consignment" whereby the buyer receives the goods but makes payment to the seller only if and as the goods are sold by the buyer. However, ownership (title) of any unsold goods remains with the shipper.

The payment mechanism adopted depends on a number of factors, which are usually taken into account when the underlying commercial contract is negotiated. Factors include:

- The amount of trust that the exporter and importer have in each other.
- The credit worthiness of the buyer.
- The bargaining power of the respective parties.
  Conditions imposed by a third party, e.g. credit insurer
- Import/export regulations (in certain countries). However, the most commonly used payment used in Ethiopia is letter of credit which is criticized to be very cumbersome.

In the foreign terms of payment, there are more risks for the seller of goods than for the buyer.

Some of the main risks in international trade are:

1. **Country Risk:** depends on the political, economic, legal and social stability of the country that are engaged in trade.
2. **Importer Risk:** The common risks are; non-payment of invoices, delayed payment of invoices and insolvency of buyer.
3. **Industry risk:** include demands of particular products, recession in particular industry, competitive products/pricing.
4. **Foreign exchange:** risk includes fluctuation in exchange rates affect pricing and profit.
5. **Exporter Risk:** Problems in producing correct documentation, failure to supply goods in accordance with the sales contract.
6. **Transportation risks:** are risk associated with the mode of transport, e.g. Marine risks, storage facilities in ports.

   Many of these risks can be insured against or mitigated through the payment mechanism. However, reducing your own risks may result in your counter parties having to accept a greater degree of risk and may increase costs of both parties which had an impact upon competitiveness.

Activity: 9

- **Identify and briefly explain the five methods of payment in foreign trade.**
- **Explain the role of banks in foreign trade.**

3.2.7 A Note on Customs Duty Estimation Procedure in Ethiopia

As stated earlier Governments encourage exports but discourage imports. One means of discouraging imports is levying customs duties. The method of estimation of customs cost (customs estimate) of commodities in Ethiopia is based on general principles of customs estimate according to world practice and shall apply to commodities imported to customs territory of Ethiopia. The procedure for customs duty estimation is explained very briefly here:

1. The merchant must get quotations from the exporter.
2. The importer has to open Letter of Credit in favour of the foreign exporter. In order to establish a Letter of Credit, the buyer first sends a request to his banker so that the bank will give assurance for payment of a specified sum of money to the supplier. The bank in turn makes arrangement with their agents or the suppliers' bank.
3. The customs Authority, based on the request of the importer to import goods, carries out pre-shipment inspection of goods at the exporter's country. The inspection includes, among other things, standards, quality, prices and conformance as to the regulations of the country.
4. The importer files declaration copy to the customs authority along with shipping documents. These include Bill of Lading, Invoices, Freight Sheet for freight paid by the consigner, packing list, Certificate of Origin, Insurance Certificate if insured by the consigner and the like. The declaring person at the customs Authority of Ethiopia declares the customs cost. The importer has to deposit the customs duty in the specified account.
5. The Customs Authority transfers orders to the port authority to allow movement of goods to the specified bonded warehouse of the customs authority. Currently, the order can be communicated online to the port authorities using its own Wide Area Network or hardcopy as the case may be.
6. Examination of goods is carried as to whether the goods imported conform to the items indicated in the purchase order or in the clear report finding of the pre-shipment inspection report.
7. Document scrutiny for proper tariff rate, nature of goods and other issues will be the next step.
8. Discrepancy report may be produced by the Customs Authority if there is any discrepancy between what has been delivered and declared in the declaration file. Additional customs duty payment or refund of the difference between the actual and deposit amount can be effected using the customs notification copy.

For the purpose of customs estimation, Customs Authority uses the concept of entry regime. According to the entry regime, goods are classified as (1) dutiable goods that requires dutiable import declarations for payment of customs duty, (2) Duty free import declarations for diplomats, students returning from their study leaves abroad, International Organizations in which Ethiopia is a member, etc. and in such cases there is no payment of customs duty; (3) Duty Relief Import Declarations that include Investment Import Declarations, Government Import Declarations, NGOs, Temporary imports such as for exhibitions and foreigners working in major projects in Ethiopia. Government offices may not pay customs duty but the Ministry of Finance may deduct the equivalent amount from their annual budgets. Group (4) is the duty drawback category. If an importer imports certain goods to further process and export the finished goods, the customs authority refunds the customs duty paid earlier for the semi-finished goods/raw materials/finished components imported. But this fact must be communicated to the Ethiopian Customs Authority.

3.2.8 Methods of Entering International Trade

A firm that has decided to enter international markets can do so in several ways.

1. **Licensing** is a contractual agreement in which one firm permits another to produce and market its product and to use its brand name in return for a royalty or other compensation. Licensing is especially advantageous for small manufacturers wanting to launch a well-known domestic brand internationally.
2. **Exporting:** A firm may also manufacture its products in its home country and export them for sale in foreign markets.
3. **Joint ventures:** A joint venture is a partnership formed to achieve a specific goal or to operate for a specific period of time. A joint venture with an established firm in a foreign country provides immediate market knowledge and access, reduced risk and control over product attributes.
4. **Totally Owned Facilities:** At a still deeper level of involvement in international business, a firm may develop totally owned facilities, that is, its own production and marketing facilities in one or more foreign nations.
5. **Strategic Alliances:** Strategic alliances, the newest form of international business structure, are partnerships formed to create competitive advantage on a worldwide basis. They are very similar to joint ventures. For example, the automobile and computer industries are working together in strategic alliances.
6. **Trading Companies:** provide a link between buyers and sellers in different countries. Trading company buys in one country at the lowest prices consistent with quality and sells to buyers in another country.

7. **Counter trade:** Counter trade is essentially an international barter transaction in which goods and services exchanged for different goods and services**.**
8. **Multinational Firms:** A multinational enterprise is a firm that operates on a worldwide scale without ties to any specific nation or region. The multinational firm represents the highest level of involvement in international business. It is equally "at home" in most countries of the world. In fact, as far as the operations of the multinational enterprise are concerned, national boundaries exist only on maps. It is, however, organized under the laws of its home country.

Activity: 10

- **Why there is limited foreign investment in Ethiopia?**
- **Developing countries like Ethiopia are facing capital outflow to developed nations. What are the basic causes for this new reality?**
- **Explain the role of international trade to the development of nations.**

Summary

Trade is the business of buying and selling or exchanging goods and services, with in a country or between countries. Trade can be subdivided, firstly, on the basis of operation as internal trade and international trade. Secondly, trade can be classified according to the unit of sale as wholesale trade and retail trade.

Transactions are the occurrence of events or conditions which result in exchange of goods and services. The producers, wholesalers, retailers, and consumers or customers carry out transactions. The business transactions require documents including enquiry, quotation, purchase order, invoice and document of payment.

The bases for foreign trade are the traditional theories of Economics, namely absolute and comparative advantages. Foreign trade is undertaken always on the wholesale basis and it requires the involvement of many parties. Because of political, distance, legal, customs, language and other features, foreign trade requires special procedure to be followed. Foreign inquiries and quotations must contain full details and particulars of goods such as descriptions, catalogue number, size, weight and other distinguishing features and the quantity, the time and method of delivery, packing and packing size, the firm period of price and other details.

The common terms of payment in the foreign trade are letter of credit, cash in advance, open account, bills of collection and consignment. They do have different degrees of risk for the exporter and importer. There are also different ways of entering into the international trade ranging from licensing to multinational firms.

Review Questions

Part I. Choose the best answer from the given alternatives.

1. The highest risk for the exporter is in
   a. Letter of credit　　c. Advance payment
   b. Bill of exchange　　d. Consignment sales
2. If Somalia exports Ethiopian coffee to the international trade such business is known as
   a. Wholesale trade　　c. Export trade　　e. extrepot trade
   b. Retail trade　　d. import trade
3. The payment terms that forces the buyer to bear the maximum responsibility is
   a. DDU　　b. DES　　c. DAF　　d. EXW　　e. FOB
4. Which one of the following is not part of trade?
   a. Banking　　c. Advertising　　e. Transportation
   b. Insurance　　d. Inland trade
5. The most secure for the importer of a foreign trade is
   a. Letter of credit　　c. Consignment sales　　e. None
   b. Open account　　d. Bill of exchange

Part II. Define and explain the following key terms.

a. Trade
b. Foreign trade
c. Enquiry
d. Quotation
e. Invoice
f. Postal order
g. Money order
h. Cheque
i. Bill of Exchange
j. Franco
k. C.I.F
l. Letter of Credit
m. Open account
n. Customs duties
o. Certificate of Origin
p. Irrevocable Letter of Credit
q. Issuing Bank
r. Paying Bank

Part III. Answer the following questions.

1. Why countries encourage export and discourage import trade?
2. Mention the reasons against import restrictions.
3. What is the difference between domestic trade and foreign trade?
4. What is the difference between comparative and absolute theories of trade?
5. Distinguish ad valorem from specific types of customs duty levying methods.
6. What is the difference between Straight Bill of Lading and Order Bill of Lading.
7. Mention any three methods of entering into foreign trade.
8. What is the difference between open account and advance payment methods of payment in foreign trade?
9. Explain the entry regimes as to the Ethiopian context

PART IV. Group Work Form group of five students and write the history of trade in Ethiopia by referring different sources and present it to the class.

Annex A: Sample Bill Of Lading

BILL OF LADING FOR COMBINED TRANSPORT AND PORT TO PORT SHIPMENTS

Shipper
CHERSONI ANTONIO
VIA CANCELLO 542
CANCELLO SCALO (CE) - ITALY
P.IVA 00326040615

Custom Ref.

B/L No THRUSERV07

Shipper's Ref.

F/Agent's Ref.

Reference No.

THROUGH TRANSPORT B/L

Consignee
TO ORDER OF
BANK
INTERNATIONAL DIVISION
ADDIS ABABA - ETHIOPIA

COPY NOT NEGOTIABLE

E.S.L.

የኢትዮጵያ ፡ ንግድ ፡ መርከብ ፡ ኮርፖሬሽን ።

THE ETHIOPIAN SHIPPING LINES CORPORATION

አዲስ ፡ አበባ ።

ADDIS ABABA

Notify Party and Address (leave blank if stated above)
XYZ COMPANY
TEL.09228070
ADDIS ABABA - ETHIOPIA

Pre-Carriage by*	Place of Receipt by Pre-Carrier*
Vessel: JOLLY BIANCO 253	Port of Loading: NAPOLI
Port of Discharge: DJIBOUTI	Place of Delivery by On-Carrier*

Pre Carriage Payable at

On Carriage Payable at

Marks and Nos.	Container No.	Number and kind of packages; Description of Goods	Gross Wt. (Kg)	Measurement
		PARTICULARS OF GOODS ARE THOSE DECLARED BY SHIPPER	KOS : 9.240	
FIAT 682 N4 CHASSIS: 075206		1 UNIT USED DUMP TRUCK YEAR OF MANIFACTURE 1977 ORIGIN OF GOODS ITALY FREIGHT PAYABLE AT DESTINATION TRANSIT TO ETHIOPIA FINAL DESTINATION: A.A. RAIL WAY CUSTOM WAREHOUSE A.A.ETHIOPIA		
PAL / PAL		FREIGHT COLLECT		

Freight and charges
Interest shall be payable at 2% above Bank lending rate at place of payment, per annum, shall be paid on any freight and charges remaining unpaid after due date of payment.

Received, in apparent good order and condition unless otherwise stated, the Goods or Containers or other packages said to contain Goods herein mentioned to be transported subject always to the exceptions, limitations, provisions, conditions and liberties contained herein and whether written, printed or stamped on the front or reverse hereof, from the place of receipt or the port of loading, whichever applicable, to the port of discharge or the place of delivery, whichever applicable.

All agreements or freight engagements for shipment of the Goods are superseded by this Bill of Lading.

In Witness whereof the Master or Agents have affirmed to the number of original Bills of Lading one of which being accomplished the other (s) to be void.

....For the Carrier

issued at Genoa date 15 Oct 2001

Freight payable at

Number of original Bs/L
3/THREE

(CONTINUED ON REVERSE SIDE)

Goods of a dangerous or damaging nature must not be tendered for shipment unless written notice of their nature and the name and address of the sender have been previously given to the Carrier, Master or Agent of the vessel and the nature is distinctly marked on the outside of the package or packages as required by statute under heavy Penalties. A special stowage order giving consent to shipment must also be obtained from the Carrier, Master or Agent of the vessel. Shippers will be liable for all consequential damage and expense if all the foregoing provisions are not complied with.

* Applicable only when document used for combined transport

Annex B: Domestic Bill of Exchange (Foreign is also the same except some units such as $)

(a) %,// 2) (;&+$1*

Addis Ababa, 10 Oct. 2001 (b) $0281 7Birr. 125,000.00 (g)

At 60 Days After Sight (f) 3$< $$,167 7+

72 7(+ 25'(5 of Ourselves (h)

7+(680 2) One Hundred Twenty Five thousand Birr (g)

)25 9$/8(Received

72)25 $1' 21+$/() 2) (C)

(c) International Buyers Limited Addis Ababa Exporters Limited

(e) 12th Floor,

Dembel City Center, Addis Ababa la

Addis Ababa

______________________ (sign)

Sosina Tesfaye (d)

Managing Director

A bill contains:

a) The name of the form -Bill of Exchange

b) Date -10 Oct. 2001

c) The Receiver - International Buyers Limited

d) The signer - Sosina Tesfaye

e) The address of the receiver - Dembel City Center, Addis Ababa

f) Terms of the date - 60 Days

g) The amount - One Hundred Twenty Five Thousand Birr