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TRADE AND INTERNATIONAL POLICY

## Rights of Passage: The Economic Effects of Raising the *de minimis* Threshold in Canada

by

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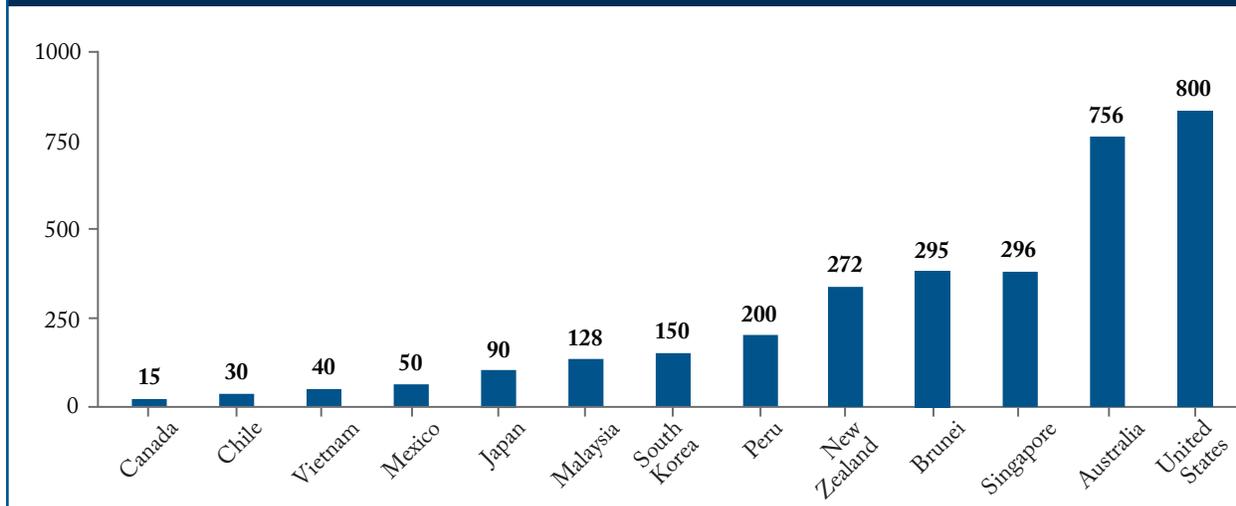
- With Ottawa considering raising the threshold for duty-free imports into Canada, it is timely to assess the economic costs and benefits of such a move. At issue is the so-called *de minimis* threshold (DMT), which is a valuation ceiling for imports, below which no duty or tax is charged and the clearance procedures are minimal.
- Currently, Canada's DMT of C\$20 is among the lowest in the world, and indeed the lowest of any industrialized country.
- We model the economic effects of increasing the DMT in Canada to various levels, namely C\$80, C\$100, and C\$200. We consider the costs and benefits of increasing the DMT for three stakeholders: (i) the Government of Canada; (ii) Canadian consumers; and (iii) Canadian businesses, in particular small- and medium-sized businesses.
- In sum, our results indicate that increasing the DMT in Canada would be fiscally neutral or positive for Ottawa, depending on how the government deploys its cost savings. The effects are clearly positive for consumers and businesses, particularly small- and medium-sized businesses because the cost savings for smaller entities is disproportionately large.
- The sum of the total direct economic effect on the three stakeholder groups is clearly positive: between C\$202 million and C\$648 million.

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### De Minimis Values across Countries (US\$)



Source: "GEA overview of de minimis regimes worldwide," Global Express Association, April 2016. All figures in USD.

With the dramatic increase in internet-based shopping (or "e-tailing"), duties and taxes collected on small individual items imported by mail bring additional revenue for governments. What is gained in revenue, however, often fails to outweigh the high costs of customs procedures and assessment. This is particularly so for shipments whose value, while small, still exceeds the *de minimis* threshold ("DMT") for inbound goods by mail. The DMT is a valuation ceiling for imports, below which no duty or tax is charged and the clearance procedures are minimal.<sup>1</sup> Indeed, this paper will show that a relatively low DMT is a money-losing endeavor.

Canada's DMT of C\$20 (US\$15) is among the lowest in the world,<sup>2</sup> and the lowest of any industrialized country. It was last updated decades ago and has not been adjusted, even for inflation, since. The Canadian Government is reportedly contemplating raising its DMT, which has stimulated an active policy discussion in Canada about the potential economic effects.<sup>3</sup>

1 The International Chamber of Commerce Customs Guidelines #11 defines "*de minimis*" as a valuation ceiling for goods, including documents and trade samples, below which no duty or tax is charged and clearance procedures, including data requirements, are minimal. For further information, see: <http://tfig.unece.org/contents/de-minimis.htm>.

2 The *de minimis* threshold in Canada is set by the Government of Canada through the *Postal Imports Remission Order* and the *Courier Imports Remission Order*. Separately, we note that in February 2016 the US Congress approved an increase in DMT from US\$200 to US\$800. See Sec. 601 of *Trade Facilitation and Trade Enforcement Act of 2015* (H.R.1907); available online at <https://www.congress.gov/bill/114th-congress/house-bill/1907>.

3 See, "Government mulls waiving taxes and duties on smaller-value online purchases," *Ottawa Citizen*, Jan.13, 2016, available at <http://ottawacitizen.com/news/politics/government-mulls-waiving-taxes-and-duties-on-smaller-value-online-purchases>; "Canadians are burdened with antiquated customs paperwork for imports as low as \$20," *Financial Post*, Oct. 28, 2015, available at <http://goo.gl/nu4ECI>; "Low duty minimums cause pain for online retailers," *The Globe and Mail*, Oct. 1, 2015, available at <http://goo.gl/eIQOdO>; "Price gap help: Tax cuts for cross-border orders could pay off," *CBC News*, Dec. 18, 2014, available at <http://goo.gl/8ePR1e>

## Canadian Stakeholders

From the point of view of domestic stakeholders, there are conflicting positions over the ideal DMT level:

- *Customs authorities* in importing countries may have a preference for higher DMT levels, which would free up resources and increase their ability to focus on high-risk shipments, including prohibited or dangerous items, and large-scale trademark or copyright violations.
- *Domestic import-competing businesses* (mainly retailers) tend to favor low (strict) DMTs and claim that generous exemptions at the border would put them at a disadvantage vis-à-vis foreign sellers, since domestic firms may have to charge sales or value-added taxes even for small items while foreign sellers are exempted.
- *Importers and foreign “e-tailers”* favor high DMTs because of the relatively high transaction costs (fees, delays, official procedures) in connection with the importation of low-value items. These groups see low DMTs as a barrier to trade, and claim that the high transaction costs and the high costs of product returns have an overall “chilling effect” on imports writ large; that is, a reluctance of domestic consumers to purchase internationally out of concern for any real or potential transaction costs they may incur when purchasing small-value items from abroad.
- *Many small businesses* tend to favor higher DMTs, which facilitate lower fees, less paper work, less delay, and easier product returns. Small businesses that engage in cross-border trade for supplies, intermediate inputs, and direct business-to-consumer commerce are at a material competitive disadvantage relative to the US competition because they incur duties, tax paperwork, brokerage fees, and delays for imports over \$20 while their US competition enjoys relatively hassle-free imports up to \$800.
- *Express courier service providers* charged with the logistics of inbound parcels complain about the burdensome administrative tasks for low-value parcels, which often require significant resources that are outside their core business.<sup>4</sup>
- *Consumer groups* also point out that a low DMT disadvantages those consumers that live far away from the border, because duties and charges are typically only levied on inbound parcels, while cross-border commuters that carry imported goods with them are exempted.
- *For large businesses*, the issue is less that of transaction costs of small-value items, but rather the backlog that a low DMT creates at the border for large-scale imports.<sup>5</sup>

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4 Express courier positions have been noted in “Economic Competitiveness and Border Efficiency through Simplified Processing of Low-Value Shipments,” Global Express Association, January 2016; and *Express Delivery Services: Competitive Conditions Facing U.S.-based Firms in Foreign Markets*, Inv. No. 332-456, USITC Publication 3678, April 2004, USITC. Similar concerns were expressed in our informational interviews with express couriers.

5 See for example, “Low duty minimums cause pain for online retailers,” *The Globe and Mail*, Oct. 1, 2015, available at <http://www.theglobeandmail.com/report-on-business/small-business/sb-managing/low-duty-minimums-cause-pain-for-online-retailers/article26352022/>: “Both the Canadian and Ontario Chambers of Commerce said that the low *de minimis* level is taking up too many resources at the border and is slowing down the process. For domestic manufacturers, according to the Ontario Chamber, that means clogging the manufacturing supply chain.”

### *Estimating the Impact of a Change in the DMT*

We estimate the economic effects of increasing the DMT in Canada to various levels, namely C\$80, C\$100, and C\$200. Our model captures direct channels of economic costs and benefits accruing to key stakeholders, as the economy moves from the “actual” (the situation with the current DMT of C\$20) to a series of scenarios in which the DMT is increased to higher levels.

We consider the costs and benefits of increasing the DMT for three stakeholders: (i) the Government of Canada; (ii) Canadian consumers; and (iii) Canadian businesses, in particular small- and medium-sized businesses. We do not consider the indirect effects on Canadian retailers, large companies and courier providers that would emerge from additional small imported shipments by mail under a higher DMT. We note, however, that the inclusion of indirect effects would likely increase the overall economic benefits of raising the DMT and therefore the results reported here are likely an underestimate of the total economic effects.<sup>6</sup>

With an increase in the DMT, government agencies, such as Canada Post and the Canada Border Services Agency (“CBSA”), would no longer expend resources to assess the low-value parcels. The net government budget effect largely depends on what the government decides to do with the freed-up resources. We consider two options. In Option 1, Ottawa redirects the freed-up resources towards increasing the assessment rate on higher-value parcels. In Option 2, Ottawa realizes its cost-savings internally and redeploys priorities. We model each policy option.

Consumers would be affected via three important channels: (i) duties and taxes; (ii) brokerage fees; and (iii) importation delays (or time to import). As the DMT increases, consumers save money by foregoing duties, sales taxes, or brokerage fees for parcels above C\$20 and below the new DMT. Additionally, they no longer endure costly delays in transit times due to time-consuming import assessment procedures. While consumers experience a net gain from higher DMT levels, the magnitude of the effect depends on how the government decides to deal with freed-up resources flowing from the higher DMT. The net gain for Canadian consumers is greater in Option 2 in which the assessment rate on higher value parcels remains constant.

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6 The dynamics of indirect effects of an increase in the DMT are outside the scope of this paper. Such an analysis, however, would potentially identify the following four economic factors: (i) a small but positive sales effect for Canadian businesses, as consumers save from duties and taxes, and the cost savings is realized as a small income effect, which results in a slight increase in disposable income; (ii) an efficiency gain for the overall economy, as Canadians are no longer expending a relatively large amount of resources to collect a small amount of revenue; (iii) trade diversion of consumption towards foreign retailers, as consumers no longer pay taxes and duties on low-value inbound parcels they divert their purchases in that range from domestic to foreign retailers; and (iv) complementarity between online and traditional sales, which reflects evidence that as consumers spend more they use multiple channels such as online and physical stores (see “Demystifying the online shopper: 10 myths of multichannel retailing,” PwC, January 2013). To the extent that ecommerce grows as a result of a higher DMT, Canadian retailers that offer online purchasing would likely experience increased sales as well. Overall, these results likely sum to a net positive for Canadian retailers and the Canadian economy, although the magnitude is indeed an empirical issue.

Businesses would be affected directly through the following channels: (i) duties; (ii) brokerage fees; (iii) paperwork time, and (iv) time to import. As the DMT increases, businesses will forgo duties and brokerage fees for those parcels above C\$20 and below the new DMT, and they no longer endure costly delays in transit times due to time-consuming import assessment procedures. Businesses experience cost savings in the form of lower transaction costs, as they no longer have to spend time and money on the paperwork in connection with low-value parcels in order to claim their input tax credit.

We note that small- and medium-sized businesses (SMBs) are likely to experience larger effects on the margin because they have fewer resources than large firms to expend on administrative tasks, and face a disproportionately high cost of compliance with import procedures and low-value parcels, including the high cost of product returns.<sup>7</sup> While SMBs would benefit from any increase in DMT, the magnitude of the effect depends on how Ottawa redirects the freed-up resources. As with consumers, businesses are better off in Option 2, where Ottawa realizes its cost-savings internally, than in Option 1, where it uses the savings to increase the assessment rate on higher-value packages.

Compared to previous attempts to quantify the economic effects of increasing the DMT, our study stands out in three important respects.<sup>8</sup>

- First, we were granted access to data on inbound parcels into Canada. These data provide the most informative look to date. Specifically, we benefited from private business data generated by the leading express courier service providers (DHL, FedEx and UPS), and transactional level data provided by eBay, Inc. Access to this confidential data enabled a more informative and data-driven analysis, which is important because two critical factors in a DMT analysis are (i) the split between inbound parcels handled by the postal service and express courier services, and (ii) the distribution of consignment values of inbound parcels.<sup>9</sup>
- Second, we offer a transparent modeling approach to estimate the direct economic effects of a change in the DMT. The results from previous studies in the literature are largely governed by a set of rigid assumptions that do not necessarily align with available data. We model those issues explicitly with flexible parameters and allow sensitivity analysis around key assumptions. For instance, the economic effects of a change of DMT depend

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7 Regulatory costs per employee have been estimated to be at least 36 percent higher in small firms than in medium and large firms (see Crain et al., “The impact of regulatory costs on small firms,” for the U.S. Small Business Administration, September 2010). Also, it has been shown that large firms can more easily overcome fixed trade costs (see Chaney, “Distorted gravity: the intensive and extensive margins of international trade,” *American Economic Review*, 98:4, 2008.)

8 See “De Minimis Thresholds in APEC”, ITS, May 2012; and “The Government Fiscal Impact of Raising De Minimis Thresholds in Canada,” The Conference Board of Canada, November 2014.

9 There are two major streams of inbound parcels: Canada Post and express couriers. Data on inbound parcels through Canada Post and consignment values were collected from publicly available sources and expert interviews. The confidential eBay data were useful as a plausibility check for the publicly available data. Regarding data on inbound parcels through express couriers and the distribution of consignments, these were kindly provided to us by the Global Express Association, which is the global trade association of the express delivery industry.

on initial assessment rates and assessment costs, among other factors.<sup>10</sup> Our preferred set of results is based on what we consider to be the most reasonable and robust parameter values in light of existing research, available information, and interviews we have conducted with industry specialists. Our model, however, is programmed in a flexible manner that allows us to test for the sensitivity of the model results to modifications of any (combination of) policy parameters. We have conducted this sensitivity analysis and the results are reported in the appendix to the accompanying technical paper ([https://www.cdhowe.org/sites/default/files/Technical%20paper%20e-brief\\_de%20Minimus.pdf](https://www.cdhowe.org/sites/default/files/Technical%20paper%20e-brief_de%20Minimus.pdf)).

- Third, contrary to some of the existing literature, our model is transparent with respect to data used, assumptions made, and calculations performed. We are also able to report results for each individual key stakeholder group. This could be particularly relevant for Canadian policymakers that are concerned about balanced budgets and the fiscal neutrality of new policies, or for industries and associations whose members would be affected.

Tables (1) and (2) below summarize our results. We find that an increase of the DMT in Canada will be fiscally neutral or even positive for the federal government. Depending on how Ottawa realizes its cost savings, the net effects of even a modest increase of the DMT from C\$20 to C\$80 on government revenue is between a loss of C\$3.8 million and a gain of C\$127 million. Given the C\$1.7 billion annual budget of CBSA, we would characterize these budget effects as being between fiscally neutral and a very small gain.<sup>11</sup> The effects on consumers and SMBs are positive in each policy option. The sum of the total direct economic effects on the three stakeholder groups is clearly positive: between C\$202 million and C\$648 million.

The first two rows of Table 2 illustrate that relatively low DMTs can be a costly endeavor for governments. For instance, by holding the DMT at \$20 instead of \$80, the government collects \$39 million in additional revenues, but at a cost of \$166 million.

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10 Examples for parameters whose values are private information to the government and its agencies include: (i) the assessment rate, *i.e.*, the rate with which inbound parcels are assessed for tax and duty; (ii) the “slippage” rate, *i.e.*, the degree to which high-value parcels take more time to assess than low-value parcels; (iii) the delivery delay faced by buyers if an inbound parcel is assessed by customs officials; and (iv) the total cost of assessing parcel and collecting the taxes and duties.

11 “Canada Border Services Agency 2014-15: Report on Plans and Priorities,” see Budgetary Financial Resources Table, p.12.

**Table 1. Economic Effects of Raising the *de minimis* Threshold (DMT) in Canada under Option 1 (assessment rate increase for higher-value parcels)**

<b>Option 1: Economic effects to key stakeholders (C\$ millions)</b>			
	<b>\$80 DMT</b>	<b>\$100 DMT</b>	<b>\$200 DMT</b>
<b>Government</b>			
Revenue forgone	\$39	\$52	\$117
Additional revenue	\$34	\$30	\$48
<b>TOTAL - Government</b>	<b>-\$4</b>	<b>-\$22</b>	<b>-\$68</b>
<b>Consumers</b>			
Duty and tax revenue net effect	\$3	\$20	\$64
Brokerage fee net effect	\$106	\$130	\$188
Import time net effect	-\$6	-\$4	\$5
<b>TOTAL - Consumers</b>	<b>\$104</b>	<b>\$146</b>	<b>\$257</b>
<b>Business</b>			
Duty revenue net effect	\$1	\$2	\$4
Brokerage fee net effect	\$89	\$103	\$143
Paperwork time net effect	\$14	\$17	\$24
Import time net effect	-\$1	-\$1	\$1
<b>TOTAL - Business</b>	<b>\$102</b>	<b>\$121</b>	<b>\$172</b>
<b>Total Direct Economic Effects</b>	<b>\$202</b>	<b>\$245</b>	<b>\$361</b>

Source: Authors' calculations. Results reflect the initial benchmark assumptions.

Note: In Option 1, the government redirects freed-up resources that were expended on low-value parcels to higher-value parcels. Revenues are forgone from low-value parcels while additional revenues are generated from the increased assessment rates on higher value parcels.

**Table 2. Economic Effects of Raising the *de minimis* Threshold (DMT) in Canada under Option 2 (no redeployment of freed-up resources)**

<b>Option 2: Economic effects to key stakeholders (C\$ millions)</b>			
	<b>\$80 DMT</b>	<b>\$100 DMT</b>	<b>\$200 DMT</b>
<b>Government</b>			
Revenue forgone	\$39	\$52	\$117
Cost saving	\$166	\$190	\$278
<b>TOTAL - Government</b>	<b>\$127</b>	<b>\$138</b>	<b>\$161</b>
<b>Consumers</b>			
Duty and tax revenue net effect	\$37	\$50	\$112
Brokerage fee net effect	\$116	\$137	\$191
Import time net effect	\$3	\$3	\$10
<b>TOTAL - Consumers</b>	<b>\$156</b>	<b>\$190</b>	<b>\$313</b>
<b>Business</b>			
Duty revenue net effect	\$2	\$2	\$4
Brokerage fee net effect	\$91	\$105	\$143
Paperwork time net effect	\$15	\$17	\$24
Import time net effect	\$1	\$1	\$2
<b>TOTAL - Business</b>	<b>\$108</b>	<b>\$125</b>	<b>\$174</b>
<b>Total Direct Economic Effects</b>	<b>\$391</b>	<b>\$453</b>	<b>\$648</b>

Source: Authors' calculations. Results reflect the initial benchmark assumptions.

Note: In Option 2, the assessment rate on higher value parcels does not change, and the government realizes the cost savings internally, such as through a redeployment of government priorities, or a more efficient allocation of resources.

The model is generalized to consider a range of scenarios (we consider C\$80, 100 and 200), and includes key parameters, such as assessment rates and resource costs for *de minimis* assessments. For some parameters in the model, there are no publicly available data and in those cases we specify a range based on best available information.

We conducted sensitivity analysis around key parameters and found our main results are robust within a reasonable range of parameter values. We modified one parameter at a time, and report the results accordingly. The results remained fairly stable under both policy options and across the three DMT levels. We also presented a set of conservative parameter choices that yield minimum cost savings, and a set of aggressive parameter choices that yield more generous cost savings. These sensitivity analyses are reported in the appendix of the accompanying technical paper, and suggest the modeling results are fairly robust across all of the scenarios and parameter choices.

### *Conclusion*

In sum, our results indicate that increasing the DMT in Canada would be fiscally neutral or positive for Ottawa, depending on how the government realizes its cost savings. The effects are clearly positive for consumers and businesses, particularly small- and medium-sized businesses because the cost savings for smaller entities is disproportionately large. These results reflect the relative inefficiency of *de minimis* tax and duty assessments, and show that raising the DMT can alleviate these inefficiencies and yield benefits in terms of cost savings from a reduction in brokerage fees, costly import delays, and administrative costs for government, consumers and businesses. While identifying an ‘optimal’ DMT is outside the scope of this paper, these results clearly indicate that increasing the DMT from the current level of C\$20 is likely to yield a net economic benefit for Canada.

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