

A REVIEW OF THE EUROPEAN COMMISSION'S PLANS FOR AN ELECTRONIC CUSTOMS ENVIRONMENT

Peter Wilmott

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Abstract

Success in international trade is an essential component in the current European Union (EU) 'Lisbon agenda' which aims to make the EU 'the most competitive and dynamic knowledge-based economy in the world'. The performance of customs administrations is very much a determining factor in the success or failure of the EU strategy, but there are reasons to believe that the current vision of creating a paperless customs environment in Europe is insufficiently ambitious, flawed at a practical level, and inadequately resourced and managed. The extension and rationalisation of reform plans need to be advanced by taking full account of the nature of modern supply chains or, more importantly, their potential for further development. Further, there is a need to advance the processes for increasing the political priority and momentum afforded to the customs reform project. Without significant remodelling the current blueprint for EU customs in the 21st century will fail to deliver key Lisbon agenda goals and will risk surrendering Europe's competitive edge in international trade to nations that have more aggressive customs strategies.

Introduction

The ability of European Union (EU) companies to compete in today's global markets depends to a crucial extent on increasing the efficiency and reducing the cost of border regulation covering the movement of goods into, out of and across the EU. Without efficient, modernised border controls, European companies face unnecessarily high transaction costs when in competition with emerging economies like China and India.

Europe's 'Lisbon agenda' aims to make the EU 'the most competitive and dynamic knowledge-based economy in the world'. Success in international trade is an essential component of this strategy, and the performance of our customs administrations is a determining factor in its success or failure. Despite brave words from Brussels, there are reasons to believe that the current customs vision for the EU is neither sufficiently ambitious nor adequately resourced and managed.

Although the EU is a customs union, with common tariffs based on a common commercial policy, its administration is in the hands of the customs authorities of individual Member States, whose practices differ substantially. Moreover, traders are still not able to treat the union as a genuine single customs territory and cannot, for example, declare goods in any Member State of their choice without having their own agent or representative there. This complexity militates against efficiency in the 21st century trading environment.

The European Commission is currently tackling this and other obstacles to the operation of the customs union through changes to the European Customs Code and the Multi-Annual Strategic Plan (MASP), which sets out the steps needed to implement its vision for creating a paperless Customs environment in Europe. But the MASP in particular is a complex jigsaw of some 20 IT projects and sub-projects, and it is managed in a fragmented and under-resourced way. It is not due for completion until 2012, with considerable risks of slippage. Companies in Europe simply cannot wait that long for customs modernisation to take effect.

It is not too late to make the changes needed for the radical shift towards a world class and competitive customs infrastructure for Europe. But achieving this calls for clarity of thought and openness of mind on the part of both the decision takers in Brussels and the Member States and the business community that depends on them. The starting point is to set out an alternative vision of what that infrastructure should look like and how we should build it.

The costs of compliance and benefits of trade facilitation

Much has been written about the costs of bureaucracy in international trade. Authoritative estimates are hard to come by, but a common thread running through the literature is the scale and importance of those costs. It is suggested, for example, that three quarters of all trade delays result from administrative hurdles such as customs and other clearance procedures, and the OECD has calculated that the cost of these hurdles can amount to as much as 15% of the value of goods traded. It further claims that a 1% reduction in costs would trigger worldwide gains of over US\$40 billion.² Border-related delays cause uncertainty over delivery dates, which impact on the reputation of business and depress trade; each additional day a product is delayed prior to shipping reduces the export trade of that country by more than 1%. And there is a larger impact on time-sensitive agricultural goods where a day's delay reduces the relative value of country's exports of such products by 7% on average. It is not the purpose of this paper to review or challenge any such estimates. Nor does it base any recommendations on particular sets of figures. But research of this kind does underline the relevance to global growth and prosperity of an unencumbered trade machine and points up the importance of removing unnecessary obstacles to efficiency.

An alternative vision

Legally the EU has a single customs territory. Therefore traders should be able to treat it as such and, for customs purposes, behave no differently in the larger EU than they would in their home member state. The internal market has sought to harmonise a large number of disparate rules and regulations affecting the way markets work in the Community, sweeping aside national restrictions and border-based procedures. Taken to its logical conclusion, this means that the unitary nature of the customs territory should be capable of being replicated for all other processes that require administrative interventions because goods movements (or related services, like transport) involve crossing internal EU frontiers. However, the *raison d'être* of customs procedures is to maintain control over and collect duties payable, as necessary and appropriate, on international trade, that is, trade between the EU and countries in the rest of the world.

Given the essentially outward-looking nature of the EU's customs union, it could be argued that it is not the purpose of customs reform to change the way the EU's internal market works. It is unreasonable though to attempt to divorce customs rules and their operation on the one hand from single market measures on the other that either promote or impede progress towards the competitive society that the EU has set as its goal. Artificial distinctions are therefore unhelpful and measures designed to streamline internal market processes so that businesses can engage in international trade at the lowest possible compliance cost and the highest possible level of competitive efficiency should not be ruled

out simply because they fall outside the formal remit of the services responsible in Brussels for the customs union. This is especially true of issues arising on the indirect taxation front which risk negating efficiency gains promised by customs reform. It is curious to note, for example, that work on designing a system to control the movement within the internal market of goods liable to excise duties still cannot be aligned fully on very similar customs control processes. Similarly, attempts to integrate VAT controls and certification into the new export procedures do not appear to be as straightforward and successful as logically they should be (VAT and customs are handled by the same Directorate General in the Commission).

These considerations make it possible to draw up a list of the features that – *as a minimum* – the EU's customs union and single market should embody in its procedures for handling international trade. More concretely, traders established in any of the EU's Member States should be able to do the following:

- Complete all customs formalities from the establishment or establishments that they choose, located in accordance with business needs rather than administrative constraints.
- Deal with only one customs administration, in respect of all customs operations wherever located in the EU's customs territory (an exception might be the case where a business has multiple establishments and chooses to allocate customs operations among them for purely commercial reasons, in which case more than one administration could be involved).
- Be able to organise their manufacturing, sales, distribution, accounting, after-sales and related services without having to worry about differences in customs treatment from one Member State or the implications of the present 'compartmentalisation' of the customs union by national and often conflicting regulatory requirements.
- Comply with all administrative requirements by submitting relevant data once and once only (that is, without being obliged to resubmit or re-key the same data to meet the requirements of different administrations).
- Expect the same rules and standards to apply to the customs treatment of their goods, wherever the goods or the related customs operations take place; be subject to identical regimes for selection for examination, for the punishment of irregularities or offences and for the settlement of customs or other debts that may arise from their operations.
- Expect controls and other formalities for which administrations other than customs are competent to be carried out in ways fully compatible and coordinated with the EU's customs procedures – this includes the application of risk management and selection techniques and the performance of documentary or physical checks on the goods.
- Interact with all competent border agencies through an up-to-date, transparent and low-cost IT infrastructure.
- Have full access to all laws, regulations, guidelines and advice relevant to their customs and related operations, wherever published within the EU.

As an example of the insufficiency of the MASP, the Single Window component of the reform program – necessary to deliver the fourth point of the list above – is barely more than a vague promise, without a concrete timetable, work plan, user requirement or technical specification. It hardly seems right for Europe to content itself with a vision that amounts to little more than a highly overdue technical upgrade to a system conceived in the mid-twentieth century and resting on principles that in many cases go back to the nineteenth.

This paper therefore puts forward the following more radical suggestions for key components of a twenty-first century customs system fit for the largest economic bloc in the modern world.

Going beyond the basic vision

There are few signs that the EU's vision really understands or takes into account the nature of modern supply chains or, more importantly, their potential for further development. In particular, a forward-looking strategy must be based on the fact that the companies accounting for the bulk of international trade have as great an interest as the traditional border agencies in complying fully and accurately with regulations affecting international trade. Governance is a complex matter for modern corporations. They have to obey a vast number of rules emanating from often poorly-coordinated government agencies in a range of countries, and then account for their compliance to shareholders, auditors, city commentators and politicians. Failure can result in severe damage to their reputation, loss of market share, loss of investor confidence and ultimately bankruptcy, take-over or some other dramatic or catastrophic event. Despite the prevailing cynicism over corporate behaviour, these factors weigh heavily with responsible companies.

It follows that customs administrations and their fellow border agencies could do worse than base their controls on the internal pressures to conform that exist within firms rather than on external measures. In other words, let companies assess their own liabilities, make their own duty and tax payments, and submit to periodic audits of the records that they maintain internally to demonstrate full compliance. This approach is followed by many countries for the control of value added tax, by some for the administration of other indirect and even direct taxes, and even by a few for ensuring compliance with customs rules on import duties and quotas.

It would be possible to apply the same approach to compliance with other rules. Security controls, however controversial the suggestion might appear, could be managed in a similar way, as could other regimes aimed at protecting society from threats to its health, well-being and general integrity. The prize would be simpler and less disruptive processes for companies, which would be able to internalise government rules and manage compliance with them in ways fully compatible with their commercial procedures. And for governments it would mean getting away from transaction processing, in which every customs declaration, for example, stood alone and was treated, to a greater or lesser extent, independently of its commercial context. Customs IT infrastructure would instead be orientated more towards discovering cases of non-compliance in the course of routine or extraordinary audits, and could be based on the concept of remote and fully automated examination of companies' own IT processes (this would require agreement between private and public sectors on data protection and security, and would have to set limits to administrative 'fishing expeditions'; nevertheless, such agreement should be attainable if the benefits were great enough).

This principle would make it possible for trade to flow freely with the minimum of delay and disruption at the EU's borders. Although some Member States have so-called simplified procedures that achieve a comparable objective, they are relatively unsophisticated and do not on the whole involve agencies other than customs. Their existence, however, suggests that this paper's proposal builds on existing fact rather than future conjecture.

A further advantage of this approach would be the incentive it gave to companies to maintain compliance at a high level. Once the appropriate systems had been installed, any move back to more traditional control methods would be little less than a disaster for the company concerned. So the sanction of removing permission to manage its own compliance would be viewed by companies as a serious matter indeed.

Some argue that procedures should only be introduced if they are capable of being used by all firms, big or small. Yet their lower frequency of trade activity can already disqualify SMEs from taking advantage of simplified procedures (and potentially Authorised Economic Operator [AEO] status) since they have less international trade activity, tend to have fewer specialised personnel, weaker capital reserves and less of a track record to demonstrate their legitimate intentions. Such variable geometry would no doubt continue to apply if the suggestion put forward in this paper was followed. However, the efficiency gains inherent in the new approach – for both companies and administrations – would be likely to offset such objections of principle. And there would be scope for intermediaries and other supply chain members to collaborate to accommodate SMEs, by operating systems that could perhaps be beyond the reach of members individually.

Looking beyond Europe's borders, there would be significant advantages in adopting a 'joined-up' approach to customs control, involving a collaborative relationship with the companies and administrations at the other end of supply chains starting or finishing in Europe. One embodiment of this principle could be the use of export declarations in the country of consignment as the basis for import information in the country of destination. If combined with the new approach to compliance set out above, this would mean that export declarations (or their equivalent in in-house company compliance systems) would be made available immediately to the partners in the supply chain responsible for import compliance on arrival at destination. Similar arrangements would apply to data used to check for compliance with security-related controls. In short, customs administrations would begin to use the supply chain as an integrated data source rather than a disparate and uncoordinated set of unrelated commercial transactions. Work has begun on such concepts in the World Customs Organization and elsewhere, but so far concrete results are thin on the ground. Building such a concept into the EU's vision of a paperless customs environment would give these projects a major boost.

With initiatives of this kind as basic building blocks, the EU could investigate the advantages of setting up and using commercial entities as 'third party certifiers' of compliance within the supply chain. This could take two routes, each compatible with the other. First, work now begun on the ISO 27000 series of security standards could embrace supply chain security practices. Second, any individual supply chain could see its security bolstered – and its acceptability to border and security agencies enhanced – by the involvement of independent certifiers in checking the integrity of transactions and processes in the supply chain. The current major reform of customs legislation and practices represents a real opportunity to create and exploit new concepts of supply chain security. Even if work is under way, it does not yet seem that its potential benefits and operational consequences are integrated into the vision of a paperless environment as seen by the European Commission and the Member States. Such integration is urgently needed if security controls are not to constitute as big a brake on economic competitiveness in the twenty-first century as traditional controls and inefficiencies did in the twentieth.

Feasibility

There is some overlap between this alternative vision and the program laid down in the MASP. This is hardly surprising, since both need to be coherent and self-contained if they are to be credible. But the vision set out here contains key components that the MASP omits ('self assessment' and 'joined-up controls', for instance) and calls for others that are in the MASP to be given greater or different priority. An approach based on a higher level of ambition that nonetheless retains most of the MASP's foundations must therefore be both realistic and feasible, provided there is sufficient political will to drive the agenda forward in the name of EU competitiveness. It would not require the abandonment of the Commission's current strategy, but it provides a basis for rationalising its components, changing some of the timing, improving its management and filling the gaps.

Political will

This paper should not be construed as in any way impugning the intentions or integrity of all those who have contributed to the development of the vision of paperless trading advanced by the Commission or have helped to agree and begin implementing the vision's components. On the contrary, it applauds the clarity of the initial vision and the commitment of the small band of officials charged in Brussels with its implementation. It is also right to believe that Member States generally welcome the customs reform project and support its goals. However, there does appear to be a major disconnect between those charged with the political management of the process in Brussels and the reality of customs administrations' reporting lines and budgetary responsibilities on the ground. The stark fact remains that it is Finance Ministers that ultimately drive customs activities in the Member States, but Brussels policy debates on customs reform do not generally involve Finance Ministers. For example, the Council's policy debate on the customs code

that took place in the Competitiveness Council on 4 December 2006 involved trade, industry, energy and European ministers. The UK was represented by a Minister of State for Energy. Notwithstanding the doctrine of the unity of the Council within the EU's institutions, it is hard to believe that customs reform will be driven forward as an active priority so long as Finance Ministers do not take charge of the political agenda.

It follows that, without disenfranchising the Competitiveness Council, business needs to see fuller involvement of customs administrations' direct bosses if belief in the success of the MASP and its wider reform program is to become widespread. This can be organised without difficulty, by setting up either special sessions within the Economic Council on Financial Affairs (ECOFIN Council) or by holding occasional joint sessions of the Competitiveness and ECOFIN Councils.

Demonstration of political will and belief in the importance of customs reform as a major contribution to the Lisbon agenda and the creation of a competitive customs platform in Europe would then energise both the European Parliament, a key partner in the development and adoption of customs policy, and national political figures, both in governments and in parliaments at national level.

It is therefore essential that Europe's Finance Ministers take direct control of the reform process in close association with the Ministers responsible for delivering the Lisbon Strategy.

Adequate tools for the job

The Directorate-General charged with customs reform in the European Commission (DG TAXUD) appears unable to allocate the resources needed to this important reform program. Evidence takes the form of a lack of detailed preparation (for example, no user requirements for key MASP components), difficulties in reaching out to business and other stakeholder groups in the Member States (the relative infrequency and cursory nature of some if not all consultative meetings organised by TAXUD), and a visible failure to lead from the front in persuading Member States to do the right thing and do things right. Some policy stances too (for example, the handing-off of responsibility for IT systems, or the reluctance to tackle work on the Single Window component) may be motivated by budgetary concerns at the centre.

The Commission and Member States need therefore to agree on additional resources for customs reform, as a matter of urgency, at both EU and national level. They should also recognise the importance of using proper project management techniques to push through change, in place of the ad hoc and frankly amateur arrangements currently in place.

Involving other border agencies

Success in key aspects of the MASP will depend on drawing non-customs border agencies into the process. For this to happen, there needs to be some convergence of expectations at the practical level and will at the political level. In other words, border agencies must acknowledge that customs reform will work in their favour, and their political masters must begin to understand the advantages that will flow from a joined-up approach to implementation of controls. Mechanisms are needed to make this happen, as inter-agency cooperation can so easily founder on the rocks of mistrust and suspicion, born out of ignorance and misunderstandings. The realities of turf wars have to be accepted and dealt with too, rather than – as sometimes happens – swept under the carpet.

The project therefore requires early and effective engagement with all border agencies and their respective political masters – whether at national or EU level – in order to produce the seamless approach to change that is a pre-requisite for success.

Revising the vision

There is nothing wrong with re-visiting the original paperless trading vision, in order to update it and adapt it to changing circumstances. This process would, it is contended, have the support of the European business community if it seemed likely to lead to more useful and beneficial projects that could be implemented sooner and in a more orderly fashion.

No re-launch of the strategy would be likely to succeed anyway if it could not energise Europe's business leaders and attract widespread support and, dare it be said, enthusiasm. Engaging CEOs of large companies in the progress of customs reform in Europe is vital in making the right changes happen. And drawing them in should be relatively simple, given appropriate political will and a compelling new vision.

However, this proposition expects the initiative for a re-launched strategy to come from Brussels, and calls on the Commission to direct its services to work in this sense.

Conclusions

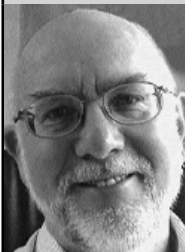
It is fashionable in some quarters to believe that bureaucrats cannot get practical things right and that politicians cannot lead in what seem to be largely technical subjects. This paper suggests that a successful and efficient customs union lies at the very heart of the European Union. But Europe has not so far succeeded in building one, and the present customs reform program may represent its last chance to do so for a very long time. The Commission's initial ideas were brilliantly simple and compelling. In other words, TAXUD has proved that it knows its stuff and can paint the big picture of customs reform in all its compelling detail. Europe's political leaders do not jib at getting embroiled in technical debate in other policy areas – a rapid glance at most Council agendas will demonstrate that. But for some reason they do not regard customs as important or worthy of their full attention. That can change, since the politics of customs reform is attractive and just waiting to be discovered.

Politics is the art of the possible. What this paper advocates is possible, and politically attractive. More than that, it is essential if Europe is to keep our place at the top of the international trading community.

Endnotes

- ¹ See www.sitpro.org.uk. For more details of SITPRO's activities in this area, please contact the secretary of its Strategic Advisory Group on Europe, Graham Bartlett (graham.bartlett@sitpro.org.uk).
- ² OECD Policy Brief October 2005, 'The costs and benefits of trade facilitation', at: <http://www.oecd.org/dataoecd/58/25/35459690.pdf>.

Peter Wilmott



Peter Wilmott is Director, Ad Valorem International Limited, a UK company that advises companies, trade bodies and customs administrations on customs reform. He has held positions as Director, GlobalLink Border Solutions Limited; non-executive Director, SITPRO Limited; and First Vice-President, Office du Développement par l'Automatisation et la Simplification du Commerce Extérieur. His continuing involvement at SITPRO enables him to continue his work on WTO trade facilitations negotiations and EU customs reform.