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Editorial

The World Customs Organization's (WCO) theme for 2016 is the automation of customs procedures, its slogan for the year being 'Digital Customs: Progressive Engagement'. Given that international trade and its regulatory management has embraced – and in many cases pioneered – technological solutions for several decades, one may wonder why such a theme would be chosen for 2016. The reason lies in the exponential growth of information and communication technologies in recent years, both in terms of their complexity and scope of application. In particular, the global application of such technologies has expedited the implementation of a range of ambitious initiatives that form part of another WCO concept – Globally Networked Customs (GNC).

In practice, GNC facilitates the interconnectivity of customs administrations that is fundamental to the effective achievement of a variety of regional ambitions, including the European Union's customs modernisation initiatives that are set out in its Union Customs Code (UCC). For this reason, transitional rules have been established for certain provisions where the necessary electronic systems are not yet in place. The substantive provisions of the UCC, which come into effect on 1 May 2016, will have significant implications for many of our readers. We are therefore grateful to Hans-Michael Wolffgang and Kerstin Harden for providing a succinct overview of its provisions in their article 'The new European customs law' in this edition of the *World Customs Journal*. Also in this edition, Frank Altemöller examines a fundamental application of interconnectivity in the context of supply chain security – that of information exchange between states, and provides some interesting insights into a number of emerging issues.

Another landmark event whose effective implementation will rely heavily on the quality of regulatory interconnectivity is the recent signing of the Trans-Pacific Partnership Agreement (TPP) by its 12 member countries. While it has not yet entered into force, the scope of the Agreement is unparalleled, noting that the nations concerned represent about 40 per cent of the world's economy. A notable consequence of the proliferation of free trade agreements is the significant reduction in customs duties for the economies involved. As a result, there is an increasing focus on excise as an alternative source of government revenue, which in turn has led to an increasing level of research into the administration and impact of excise taxation. Welcome contributions to the body of knowledge in the current edition include Rob Preece's analysis of automobile excise tax reform in the ASEAN region, and the findings of an Indonesian case study undertaken by Ade Hidayat and Nasruddin Djoko Surjono.

Once again, on behalf of the Editorial team, I would like to thank both contributors and readers for their continued support of the Journal which now enters its tenth year of publication.

David Widdowson
Editor-in-Chief

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Section 1

Academic Contributions

The new European customs law

Hans-Michael Wolffgang and Kerstin Harden

Abstract

Profound economic and legal changes have made it necessary to reform European customs law. The Modernised European Customs Code (MCC) was outdated before it had even entered into force and was therefore recast as the Union Customs Code (UCC). It entered into force in October 2013 and will take effect from 1 May 2016. Besides structural changes, the UCC features substantive changes and amendments, particularly concerning the incurrence and extinguishment of the customs debt, the customs debtor, penalties, repayment and remission, customs procedures as well as the Authorised Economic Operator (AEO). This paper provides an overview of these changes.

1. Reasons for reform

The need to modernise European customs law has resulted from profound changes in the European Union (EU). The new economic reality coupled with changes to European law and the tasks performed by Customs led to regulatory demands that could not be met by specific amendments to existing legislation.

The Modernised Customs Code (MCC)[1] was intended to be the new edition of the Customs Code (CC) and entered into force on 24 June 2008. It was to apply to the whole territory of the Union by June 2014. However, some aspects of the MCC were overtaken by events and a new edition was needed even before it took effect. On 9 October 2013, the new Union Customs Code (UCC)[2] was published in the Official Journal of the European Union (OJEU) in the form of a Regulation. It will apply from 1 May 2016.

1.1 Changes to the economic environment

International trade has fundamentally changed in terms of economic operations. As a result of globalisation, its complexity has increased considerably. Along with increased interdependencies there has been a continuous rise in international trade and cargo movements, resulting in greater administrative burdens.[3] Modern channels of communication and highly developed information technology have accelerated the flows and consumption of goods. Clearing ever more goods, ever more quickly, presents economic participants and customs authorities with new logistical and technical challenges. In particular, the shift in the EU's external borders owing to eastern expansion has changed the economic environment in Europe. The threat of international terrorism has also made it necessary to optimise regulations designed to secure the supply chain, to create trust between Customs and trade as well as to improve customs controls.

1.2 Changes to Union law

The entry into force of the Lisbon Treaty heralded fundamental changes to the primary sources of European law. In this respect, Articles 290 and 291 of the Treaty on the Functioning of the European Union (TFEU), which grant the Commission the power to issue delegated acts and implementation acts, are of great importance for European customs law. The Customs Code had a Regulation establishing implementation provisions (CCIP) of general application. In future, however, it must be decided whether

the legal provisions concerned relate to delegation pursuant to Article 290 TFEU or implementation pursuant to Article 291 TFEU. This 'splitting exercise'[4] required the existing implementation Regulation to be divided into delegated or implementing acts. It also required the UCC to provide separate delegated powers and legal foundations in order to issue new acts.

Categorising the provisions in this way complicates the application of customs law since there are potentially three sources of information about certain provisions. Although the Commission's Delegated Act (UCC-DA)[5] and Implementing Act (UCC-IA)[6] largely follow the same structure, the correct legal basis in the UCC must first be identified in order to find the relevant rules.

During the transition period it will be even more difficult to apply the law. Member States do not currently have the IT infrastructure envisaged by the UCC and will only introduce the necessary electronic systems gradually over the next few years. Therefore, a transitional Regulation has been passed which permits the use of paper-based procedures until the computerised procedures are up and running.[7] It also contains provisions that will allow the UCC-DA to be amended again before it takes effect.

1.3 The changing role of Customs

Customs is no longer regarded as just the collector of import and export duties. The inexorable expansion of the multi-layered system of global trade based on numerous international agreements, together with the ever-greater need for security, has led to Customs being seen as a European security administration, which acts as the guardian of the EU's external borders.[8]

Against this background, Article 3 UCC sets forth the mission of customs authorities for the first time. It describes the role of Customs in monitoring and managing free trade and establishes four specific aims which are to guide the acts of customs authorities. On the one hand, Customs is to ensure the financial interests of the Union and the security and safety of the internal market whilst promoting cooperation with economic operators. This is clear from recital no. 16 of the UCC which describes Customs as the 'catalyst to the competitiveness of countries and companies'. Thereby, the customs authorities perform a leading role in the supply chain which combines supervisory and regulatory as well as mediatory and facilitative tasks. Article 3 UCC provides a framework for convergence and a point of alignment for the individual Member States, customs administrations and the Commission.[9]

1.4 Aims of modernisation

The renewed modernisation of customs law aims to further the objectives pursued by the MCC. These include, on the one hand, the facilitation of legitimate trade and, on the other, improved security and safety of the supply chain. The trade facilitation measures include the simplification and harmonisation of rules on customs debt, time limits and formalities.[10] There is a constant drive to improve efficiency, reduce costs and accelerate operations. For this reason, Article 6 (1) UCC imposes a general obligation to clear goods by way of electronic data-processing.

The other aim is to increase the security and safety of operations. This includes the prevention of illicit trade, comprehensive controls on trade flows as well as a common risk management framework.[11] Minimising potential risks and threats aims to protect the interests of the Union and its citizens as well as stakeholders in the supply chain. It soon becomes apparent that the aims pursued and the corresponding measures are sometimes contradictory or rule each other out. Customs authorities and economic operators also have competing interests. In practice, the aim is to reconcile them appropriately.

2. Changes and amendments in the UCC

2.1 Approach and structure

The UCC is divided into nine titles. It is more comprehensive than its predecessors, containing 281 articles as opposed to 253 (CC) or 188 (MCC). This is mainly due to the inclusion of powers for the Commission. As with existing customs law, the UCC can be conceptually divided into three parts: formal customs law (Titles IV-VIII), substantive customs law (Titles II, III and parts of Titles VI and VIII) as well as the general provisions in Titles I and IX.[12]

Title I contains the general rules of customs law and establishes the scope of the customs provisions. It extends the catalogue of definitions in Article 5 UCC, establishes the general rights and duties of economic operators[13] and regulates customs representation and penalties. Title I also introduces the principle of electronic data-processing (Art. 6 (1) UCC) and comprehensive monitoring by the customs authorities in respect of all authorisations (Art. 23 (5) UCC).

Title II establishes the basis for collecting duties. It regulates customs tariff, rules of origin[14] and the customs value[15] of goods.

In contrast to the CC, Title III regulates the customs debt and provision of security. This represents an important structural change since the law on customs debt is now placed before the rules on individual customs procedures. This organisation is logical because the rules on customs debt apply to all customs procedures.[16]

Title IV regulates the introduction of goods into the customs territory of the Union. The chapters contain procedural rules on the entry summary declaration, entry of goods into the customs territory of the Union, presentation and the temporary storage of goods.

Title V contains general provisions on the customs status of goods as well as release and disposal. It regulates the standard customs declaration and related simplifications.

The customs procedures are the subject of Titles VI and VII. The former covers release for free circulation and relief from import duty, whereas the latter deals with the special procedures of the UCC. First of all, it lays down general provisions for all procedures. Here, it is clear that the legislator has used the 'bracketing technique' to place the general rules before special ones. In future, it will be imperative to read the general part of the special procedures and then proceed to the more specialised provisions.

Title VIII regulates how goods are taken out of the customs territory of the Union and the final provisions of Title IX contain rules on the delegation of implementing powers, delegated legal acts, the committee procedure as well as IT developments.[17]

2.2 Incurrence of a customs debt in the UCC

Articles 77 to 88 UCC determine how the customs debt is incurred and cover both import and export duties.[18] An important change is that the UCC significantly reduces the grounds for the incurrence of a customs debt. The CC had more than six separate grounds that could, theoretically, give rise to a customs debt. By contrast, the UCC only has a few provisions determining when a customs debt is incurred. This change reflects the aim of restructuring and simplifying the law on customs debt that was already pursued by the MCC.[19]

2.2.1 Incurrence of a customs debt on import

There are two situations in which import duties can be incurred. On the one hand, there is the normal case of incurrence regulated by Article 77 UCC and, on the other, various cases of non-compliance found in Article 78 UCC. The special provisions of Article 78 UCC relating to non-originating goods only play a subordinate role in this respect.

Normal cases

Article 77 (1) UCC regulates the normal case in which import duties are incurred. Accordingly, a customs debt on import is incurred through the placing of non-Union goods liable to import duty under the procedure for release for free circulation, including under the end-use provisions or under the procedure for temporary admission with partial release from import duty.

With the exception of the new provisions on end-use, there are no substantive changes. In the German version, however, the 'release for free circulation' has been reformulated: 'Überführung' in Article 201 (1)(a) CC has been replaced by 'Überlassung' in Article 77 (1) UCC. The UCC does not provide a clear answer to the problem of when the customs debt is actually incurred. Consequently, the legislator has not resolved the debate surrounding the European Court of Justice's (ECJ) controversial decision in the *Wandel* case.[20]

Cases of non-compliance

Article 79 UCC groups together the grounds for the incurrence of a customs debt in the case of non-compliance. It contains all instances of non-compliance previously contained in Articles 202–205 CC. They are now based on standardised provisions relating to potential remedies, customs debtor and the grounds for extinguishment. This eliminates the unclear distinctions between the grounds for the incurrence of a customs debt in the CC.[21] Accordingly, Article 79 (1) UCC states that a customs debt will be incurred in the case of non-compliance with:

(a) obligations

(b) obligations concerning end-use and

(c) a condition governing the placing of non-Union goods under a customs procedure.

2.2.2 Incurrence of a customs debt on export

The rules governing the customs debt on export follow the same structure as those relating to the customs debt on import. As with the latter, a distinction is made between the normal cases in which a customs debt is incurred (Art. 81 UCC) and cases of non-compliance (Art. 82 UCC). The provisions largely correspond to Articles 209–211 CC. In this respect, export duties can arise when re-exporting non-Union goods as well since they also require a customs declaration to be lodged in accordance with Article 87 (1) UCC.

2.3 Extinguishment of the customs debt

Articles 124–126 UCC redesign the rules on the extinguishment of the customs debt.[22] Article 124 UCC lists the various cases of extinguishment in detail. These include cases where the goods are confiscated or seized, destroyed, or abandoned to the state or irretrievably lost.

The UCC does not adopt the remedies of Articles 204 and 206 CC in their original form. However, the legislator has incorporated them under the provisions on extinguishment and expanded them.

2.3.1 Extinguishment in the case of failures with no significant effect

The most interesting change is the liberal provision of Article 124 paragraph 1 (h) UCC. This case of extinguishment refers to the grounds for incurring a customs debt in Articles 79 and 82 UCC. Accordingly, a customs debt can be extinguished even in cases of non-compliance, provided that the failure does not have any significant effect on the operation of the customs procedure concerned and does not constitute an attempt at deception. A further criterion is that all the formalities necessary to regularise the situation of the goods must have been carried out. Once all the criteria have been met the reason why the customs debt was incurred is irrelevant for extinguishment.[23]

The Regulation's legal text reflects Article 859 CCIP with the exception of the condition that there be no gross negligence. This condition has not been transferred to the UCC-DA (in conjunction with Art. 126 UCC) either. In addition, Article 103 UCC-DA has significantly condensed the catalogue of failures which have no significant effect on the correct operation of a customs procedure. The attempt at deception now represents the limit and responds to the demand to reduce the consequences of the customs debtor's negligence to a minimum.[24]

However, the fact that Article 124 (1)(h) UCC only focuses on customs procedures is problematic. It means that the provision does not cover cases of non-compliance in Article 79 (1)(a) UCC involving the introduction and temporary storage of goods. One solution would be to apply it *mutatis mutandis* to all customs debts, regardless of whether the cases of non-compliance have taken place before or after the goods were placed under the customs procedure or even during the customs procedure itself.[25] In addition, the legislator expressly refers to temporary storage in Article 103 UCC-DA thereby indicating that it is also to be regarded as customs procedure within the meaning of Article 124 (1)(h) UCC.

2.3.2 Extinguishment where there is evidence that the goods have been taken out of the customs territory

Article 124 (1)(k) UCC tackles another problem encountered in case law by providing that a customs debt can also be extinguished if the customs debtor submits evidence that the goods have not been used or consumed, and have been taken out of the customs territory of the Union and there has been no attempt at deception.

This should provide a solution to the controversial cases of Article 204 (1) CC, at least concerning the incurrence of the customs debt. Hitherto, the judgements of the ECJ have not provided operators with a satisfactory solution.[26] In such cases, a customs debt was incurred owing to non-compliance in the form of a failure or removal despite evidence that the goods concerned had already been taken out of the customs territory of the Union and had not entered economic circulation at any time.

This provision in the UCC makes clear that the law on customs debt should not be punitive in nature (contrary to what judgements of the ECH have suggested). Rather, it places emphasis on the economic theory of customs. Accordingly, the incurrence of a customs debt depends on the goods entering the economic circulation of the EU. In future, cases of non-compliance will be addressed according to a separate catalogue of penalties (for example, fines). That said, it is still possible to detect the punitive nature of the law on customs debt here and there. Accordingly, the effect of Article 124 (4)–(6) UCC is that, under certain circumstances, the customs debt will not be completely extinguished for all customs debtors. In addition, Article 125 UCC draws attention to the fact that the Member States can, in principle, still apply penalties even if the customs debt has been extinguished in accordance with Article 124 (1) (h) UCC.

2.4 Customs debtor

Regarding a customs debtor subject to a claim, the UCC brings a number of significant changes and stricter regulation. Legal differences mean that a distinction must be made between the customs debtor in normal cases of the incurrence of a customs debt on import and the customs debtor in cases of non-compliance.

2.4.1 Customs debtors in normal cases

As with the CC, Article 79 (3) UCC first takes the declarant and the party represented (in the case of indirect representation) into consideration as potential customs debtors. However, according to Article 77 (3) sub-paragraph 2 UCC, all persons are deemed to be customs debtors who have provided false information required to draw up the declaration and who knew or should have known that such information was false. This provision is no longer optional but binding on all Member States. This change promises to considerably increase the number of potential customs debtors since, theoretically, any party involved in the customs procedure can provide false information. It remains to be seen how strictly the subjective element of non-compliance will be interpreted and evaluated in cases of doubt.

2.4.2 Customs debtor in cases of non-compliance

In the CC, the customs debtor in a case of non-compliance was always mentioned in paragraph 3 of the relevant grounds for the incurrence of a customs debt. In Article 79 UCC, these rules are spread over paragraphs 3 and 4 and provide a link to the three cases in Article 79 (1) UCC. As in the CC, the potential customs debtors are the persons subject to an obligation, the aware representative or the aware owner or buyer of the goods. What is new, however, is that the aware operator and the direct or indirect representative can also become the customs debtor in a case of non-compliance, provided the corresponding subjective criteria have been met. This change results in a considerably stricter regulation than Article 204 (3) CC. It means that, theoretically, all persons (for example, employees, warehouse workers, freight drivers or factory workers) who the party under the obligation has hired to satisfy their obligations under customs law are potential customs debtors.[27]

2.5 Penalties

The Commission originally intended to harmonise penalties throughout the customs union. However, this turned out to be a bone of contention during the legislative passage of the UCC. As a result, the UCC did not adopt any uniform rules for cases of non-compliance and related penalties. The question of competence alone is problematic since criminal sanctions and their enforcement are regulated by national laws.

2.5.1 Measures according to Article 42 UCC

Article 42 (2) UCC basically provides for the application of administrative penalties in two forms. On the one hand, there is the imposition of a pecuniary charge and, on the other, the revocation, suspension or amendment of an authorisation issued. In this connection, the penalties imposed by the Member States are to be ‘effective, proportionate and dissuasive’ (Art. 42 (1) UCC). This wording adopted by the legislator responds to the judgements of the ECJ which has consistently called for such a practice.[28]

2.5.2 Framework guidelines of the Commission

At the same time, Article 42 CC indicates that there will be 28 more or less different systems of penalties in the future which will presumably adopt their own approaches to the nature and gravity of the failures as well as the degree of punishment. In order to prevent the fragmentation of penalties and to protect the principle of equal competition within the internal market, the Commission submitted a proposal

for framework guidelines on 13 December 2013.[29] It aimed to unify national penalties for cases of non-compliance with customs laws throughout the Union. It remains to be seen whether the Commission will introduce another proposal. In any case, it is expected that there will be revisions, new editions and, in cases of doubt, a tightening up of the national penalty systems in order to achieve uniform treatment.

2.6 Repayment and remission

Articles 116–123 UCC regulate repayment and remission. The legal definitions previously contained in Article 235 CC have been integrated in the catalogue of definitions in Article 5 numbers 28 and 29 UCC and reduced to their bare essentials. As before, they refer to both total and partial amounts. Accordingly, 'repayment' means the refunding of an amount of import or export duty that has been paid, whereas 'remission' means the waiving of the obligation to pay an amount of import or export duty which has not been paid. Changes and new features introduced by the UCC are mainly to be found in the provisions regulating errors by the competent authorities and equity.

2.6.1 General provisions of Article 116 UCC

The general rule in Article 116 UCC provides five grounds for the repayment and remission of potential import and export duties which are defined in subsequent provisions. Listing them in advance serves to break down the four groups of cases that were strictly separated in Article 236–239 CC.[30] The five new grounds are:

(1) overcharged amounts of import or export duty (Art. 116 (1)(a) in conjunction with Article 117 UCC)

(2) defective goods or goods not complying with the terms of the contract (Art. 116 (1)(b) in connection with Art. 118 UCC)

(3) error by the competent authorities (Art. 116 (1)(c) in conjunction with Art. 119 UCC)

(4) equity (Art. 116 (1)(d) in conjunction with Art. 120 UCC)

(5) the repayment of duties in the case where the corresponding customs declaration is invalidated (Art. 116 (1) sub-para. 2 in conjunction with Art. 174 UCC).

The following paragraphs of Article 116 UCC contain more general provisions concerning the amount of duty to be repaid (para. 2), customs authorities acting on their own initiative (para. 4), no repayment or remission in the case of deception (para. 5), payment of interest (para. 6) and reinstatement of the customs debt (para. 7).

2.6.2 Error by the competent authorities

According to Article 119 UCC, repayment and remission are possible if the competent authorities have made an error owing to which the economic operator has paid too much duty. Paragraph 1 lays down the conditions that have to be fulfilled, namely that the debtor could not reasonably have detected that error and that they were acting in good faith.

What is striking is that there is no equivalent to Article 220 (2)(b) CC, which required compliance with all the provisions laid down by the legislation in force as regards the customs declaration. Accordingly, the declarant was obliged to furnish all particulars required by community law or by the supplementary provisions of the respective Member State in relation to the customs treatment in question.[31] In the UCC, the legislator has dispensed with this third requirement for claiming an error by the authorities since (owing to minor imprecisions), a precise application of this provision would result in this ground being excluded in most cases and Article 119 UCC would thereby have no effect.[32]

Furthermore, Article 119 (3) UCC includes statements on the preferential treatment of goods. In the CC, the counterpart to these provisions was found in the section concerning the entry into the accounts of the amount of the customs debt. Accordingly, the UCC unifies the procedural and administrative operations that were previously dealt with separately and now subsumes the situation where there is no subsequent entry in the accounts under the grounds for repayment and remission. Owing to the legal, formal and substantive unification achieved it will not be necessary in future to have several procedures running in parallel with different grounds for repayment in relation to the same case. In practice, this will relieve the procedural and administrative burden on all entities – from the customs debtor to the Commission.

2.6.3 Grounds of equity

The repayment and remission of customs duties is also possible on grounds of equity. According to Article 120 (1) UCC, this will be the case if there are special circumstances and no evidence of deception or obvious negligence. Article 239 (1) CC defined the special circumstances inadequately, which repeatedly gave rise to discussions on how to interpret this general provision in practice. Now, Article 120 (2) UCC has introduced a definition of special circumstances: namely, if the debtor is in an exceptional situation as compared with other operators engaged in the same business. Thereby, the legislator has followed the tenor of the judgements and principles of the ECJ, sometimes word-for-word.[33]

Article 120 UCC also departs from Article 239 CC, insofar as it permits repayment or remission only if special circumstances apply. Before, Article 239 paragraph 1 CC provided for individual cases of equity in addition to special circumstances that were established by the Commission's committee procedure and listed in Article 900 following CCIP as an open-ended catalogue of cases. The UCC dispenses with this power: neither Article 122 nor Article 123 UCC provide for an explicit delegation of power that would allow the Commission to retain the catalogue of cases. In practice, this could have far-reaching consequences regarding the number of applications and the time needed to process them.[34]

In this context, it is worth mentioning that the Commission's proposal for laying down a new edition of the CC originally gave it the power to specify the special circumstances of Article 120 UCC.[35] The fact that the proposal was not adopted in the edition of the UCC that had already entered into force suggests the omission was deliberate. However, it is possible that the courts will still have regard to the cases established in the CCIP, based on the definition of special circumstances and the ECJ's existing judgements.

2.7 Customs procedures

The earlier law provided for eight separate customs procedures[36] that could be divided into economic and non-economic procedures. By contrast, Article 5 no. 16 UCC basically provides for only three customs procedures:

(1) release for free circulation

(2) export

(3) the special procedures which, in turn, can be sub-divided into transit, storage, specific use and processing.

The aim of the reform was to restructure and simplify the dense and confusing procedural law.[37] Nevertheless, despite the restructuring and redesign, it was not intended to reduce the types of procedure to the detriment of economic operators.[38] The operators' freedom of choice in relation to the customs procedures is therefore retained by virtue of Article 150 UCC.

2.7.1 Release for free circulation

The procedure for the release of goods for free circulation is regulated in Article 201 UCC. Its contents reflect that of Article 79 CC. One change is that the wording of the German version replaces 'Überführung' with 'Überlassung'. This ensures that the German translation of the UCC reflects the English wording more closely[39] (although it is not expected to have any effect on the legal situation or procedure).

2.7.2 Special procedures

The special procedures are divided into four types that are each sub-divided into two groups. It is therefore obvious that the number of existing customs procedures has not been significantly reduced but merely re-structured.

Transit

Unlike the other customs procedures, the special procedure for transit (Art. 226–236 UCC) has not been significantly changed. The reason for this is that these provisions are based on international agreements and cannot be changed by the Union alone. As before, a distinction is made between external and internal transit with its respective sub-divisions. In future, however, reference will be made to the external or internal *Union* transit procedure.

Storage

The special procedure for storage is regulated in Articles 237–249 UCC and, in accordance with Article 210 (b) UCC, consists of customs warehousing and the free zone. In this, it departs from the MCC which still envisaged temporary storage as a separate customs procedure in Articles 151–152. Like the free warehouse, it is no longer an independent procedure and now only represents a situation under customs law.[40]

Another new feature relates to the different categories of customs warehouse used. Article 525 CCIP differentiated between a number of different types of public and private customs warehouses. By contrast, the UCC adopts a far more general distinction. The delegated acts divide a public warehouse into two types: type 1 (Art. 1 no. 32 UCC-DA) places the responsibility on the holder of both the authorisation and the procedure, whereas type II warehouses (Art. 1 no. 33 UCC-DA) only places responsibility on the holder of the procedure. Article 1 no. 11 UCC-IA establishes another public customs warehouse (type III), which is operated by the customs authorities. There are no further definitions or specifications provided in relation to private customs warehouses. However, private customs warehouses of type C and D will presumably continue to exist under the new legal regime.

The UCC's provisions on free zones are clearly stricter than before. Considering the customs security initiative in 2005, which extended all security-related provisions to free zones, this gives the impression that the free zone in European customs law has become obsolete since the available discretion and definitions are increasingly restricted.[41]

Specific Use

Specific use is regulated in terms of temporary admission and end-use.

Temporary admission is regulated in Articles 250–253 UCC. According to Article 250 (1) UCC, this procedure serves to grant total or partial relief to the re-export of non-Union goods used temporarily in the customs territory of the Union.

There are obvious changes: under exceptional circumstances, it is possible to extend the duration of this procedure from 24 months to ten years (Art. 251 (3), (4) UCC). Furthermore, the procedure can usually only be used by persons who are resident outside the Union. Any exceptions would have to be established by delegated acts but none are provided.

The end-use represents another form of the procedure relating to the use of goods and is regulated in Article 254 UCC. It enables goods to be released for free circulation under a duty exemption or at a reduced rate of duty on account of their specific use (Art. 254 (1) UCC).

Processing

The procedures relating to processing are regulated in Articles 255–263 UCC. As before, a distinction is made between inward and outward processing.

Inward processing

Under inward processing, non-Union goods are subject to processing operations in the customs territory of the Union without being subject to import duty or commercial policy measures. The available processing operations are defined in Article 5 no. 37 UCC as the working, processing, destruction, repair, and use of goods. In future, inward processing will only exist as a suspensive procedure. Besides including destruction in this section, the procedure for processing under customs control (previously regulated under Article 130 CC), has been merged with inward processing.[42]

Outward processing

The provisions on outward processing in Article 259 (1) UCC are the counterpart to those on inward processing. They relate to Union goods that are temporarily exported from the customs territory of the Union in order to undergo processing operations. On their re-importation, the goods may be granted total or partial relief from duties. The procedure has essentially remained the same. The only change is that the differential method has been dispensed with, leaving only the value-added method under Article 86 (5) UCC.

Rules on equivalent goods

Importantly, the rules on equivalent goods are no longer reserved for compensating products. The general provision in Article 233 UCC has extended them to cover all procedures apart from the transit procedure. This significantly increases the scope of this rule. In practice, this could cause fundamental problems with the import duty advantage referred to in Article 223 (3) UCC.[43]

2.7.3 Export

The third customs procedure in the UCC is export. The only change has been to the regulatory structure.[44] The obligation to lodge an export declaration corresponds to existing law and is subject to exceptions provided in the Commission's delegated or implementing acts. Article 245 UCC-UCC-DA provides more exceptions than the previously applicable Article 592a CCIP and now covers all cases.

2.8 The AEO concept in customs law

The provisions regulating the Authorised Economic Operator (AEO) are contained in Articles 38–41 UCC and have been considerably expanded compared to Article 5a CC. The UCC distinguishes between two types of AEO in the legal text itself whereas before the different types were listed in Article 14a (1) CCIP. Operators can apply for an authorisation for customs simplifications ('AEO-C', Art. 38 (2)(a) UCC), or an authorisation for security and safety ('AEO-S', Art. 38 (2)(b) UCC). The authorisations are not mutually exclusive and may be held at the same time ('AEO-F', Art. 38 (3) UCC).

2.8.1 Authorisation criteria

In order to obtain AEO status, the operator must apply for authorisation and meet the corresponding criteria (cf. Art. 38 (1), Art. 22ff. UCC). The authorisation issued is subject to monitoring by the customs authorities in accordance with Article 23 (5) UCC.[45] In this respect, Article 23 (2) UCC obliges operators to inform the customs authorities of any factor which may influence their AEO status.

In accordance with Article 38 (1) UCC, any economic operator established in the Union and who meets the criteria set out in Article 39 UCC can obtain the status of AEO. Article 38 (4) UCC ensures that the status is recognised by all Member States in the territory of the Union. The criteria determining the grant of AEO status are the same as those in Article 5a CC but defined more precisely with stricter wording. According to Article 39 UCC, the operator must meet the following criteria:

(a) the absence of any serious or repeated infringements of customs legislation and taxation rules, including no record of serious criminal offences relating to the economic activity of the applicant

(b) a high level of control of their operations by means of a system of managing records which allows appropriate customs controls

(c) proven financial solvency

(d) depending on the status, practical standards of competence or professional qualifications directly related to the activity carried out or evidence of appropriate safety or security standards.

The criterion relating to the practical standards of competence or professional qualifications is new and reveals the legislator's intention to guarantee the competence of the applicants and quality standards. Article 27 (1)(a) UCC-IA links the required competence to a minimum of three years of practical experience in customs matters or the application of a quality standard adopted by a European Standardisation body.

In future, evidence of professional qualifications will take the form of a certificate showing that the applicant has undergone successful training in customs legislation and customs-related activities (Art. 27 (1)(b) UCC-IA). Entities permitted to issue such certificates are customs authorities and certified educational establishments or professional or trade associations. The evidence must be provided by the applicant, the person in charge of customs matters or the customs representative. This new rule might have significant consequences in practice. On the one hand, it requires large groups of persons in companies to be regularly trained and educated; on the other, the educational establishments concerned are obliged to gain accreditation from the customs authorities or agencies recognised under national law.

2.8.2 Advantages

The UCC improves the advantages conferred by AEO status. Besides the advantages previously granted by Article 14b CCIP (for example, easier access to customs simplifications or a priority treatment for customs controls), the AEO is now granted exclusive advantages for the first time. These include self-assessment according to Article 185 (2) UCC, the authorisation to use a comprehensive guarantee with a reduced amount according to Article 95 (3) UCC, centralised clearance according to Article 179 (2) UCC and the waiver of the obligation for goods to be presented upon application in accordance with Article 182 (3)(a). The UCC thereby makes clear that, without AEO status, companies will no longer be able to take advantage of simplifications that considerably streamline and optimise company operations.

The advantages of AEO-S and AEO-C are differentiated more clearly than before. In future, holders of AEO-C may expect fewer benefits.[46] This can be seen in the UCC-DA which only grants advantages to holders of AEO-S status.[47] This is clear evidence that the EU wishes to establish AEO-S as the standard and suggests that AEO-C will gradually lose its significance. As a result, companies will be increasingly obliged to obtain AEO-S certification in future.

3. Conclusions and outlook

It is clear that European customs law will undergo substantive and structural change in future. The new concept enshrined in the UCC is therefore to be welcomed. As expected, the fundamental concepts and structures of the CC have not greatly changed: after all, they have been around for a long time and the intention of the revision was not to produce a completely new customs law. Rather, the aim was to adapt European customs law to the new legal, economic and security conditions.

A large number of changes relate to the UCC's structure. The wording of the Regulation and its systematic arrangement appear more precise, structured and coherent than before. This can be seen, in particular, from the use of the bracketing technique, the re-grouping of the provisions on customs debt and the inclusion of the powers to adopt delegated and implementing acts. These are the most obvious differences between the MCC and the UCC.

At a substantive level, the new concept of the UCC is largely seen in the reform of the law on customs debt and the simplification of the customs procedures. In places, the legislator also displays a clear tendency not only to harmonise European customs law but also to tighten it. Examples of this can be found in the provisions regulating the AEO, penalties and customs debtors.

Furthermore, the UCC reacts to problems, tendencies and developments in case law and customs practice, which have repeatedly arisen in relation to the CC. The UCC shows that the legislator has learned from experience and attempts to find answers to problems that have hitherto not been satisfactorily resolved. Examples include the attempt to simplify the grounds for incurring a customs debt, the emphasis placed on the economic theory of customs and mitigation of the consequences of negligent conduct. Thereby, the UCC takes into account new conditions and legal challenges. Unsurprisingly, it reflects the previous codes but also makes its own mark. The starting point of the UCC is promising and raises hopes that the customs authorities and economic operators will adopt an improved, more efficient and unified approach in future.

Notes

1 Regulation (EC) No. 450/2008 of the European Parliament and of the Council of 23 April 2008 laying down the Community Customs Code (Modernised Customs Code) [Official Journal of the European Union (OJEU) L145 of 04.06.2008].

2 Regulation (EU) No. 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast), [OJEU L 269 of 10.10.2013].

3 Lux, AW-Prax 2008, 283 (284).

4 Gellert, AW-Prax 2014, 72 (74).

5 Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code [OJEU L 343/1 of 29.12.2015]; [cited as 'Art. xx UCC-DA'].

6 Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code [O.J. L 343/558 of 29.12.2015]; [cited as 'Art. xx UCC-IA'].

7 Commission Delegated Regulation (EU) 2016/341 of 17 December 2015 supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council as regards transitional rules for certain provisions of the Union Customs Code where the relevant electronic systems are not yet operational and amending Delegated Regulation (EU) 2015/2446, [OJEU L 69/1 of 15.03.2016]

8 Kammerzell in: Witte/Henke/Kammerzell, Der UZK, p. 28.

9 Lux, ZfZ 2014, 178 (180); Lux/Larrieu, ZfZ 2006, 329 (335).

10 Recital No. 5 of Reg. (EU) 952/2013, [O.J. L 269/1 of 10.10.2013].

11 Recitals Nos 28 and 29 of Reg. (EU) 952/2013 [OJEU L 269/5 of 10.10. 2013].

12 Cf. also: Witte, AW-Prax 2014, 373 (374).

13 See Lux, ZfZ 2014, 178 (182ff.).

14 In this respect there are no notable changes in the UCC.

15 The most important change here is that it is no longer possible to use the first sale for the transaction value (cf. Art. 128 (1) IA). Furthermore, licence fees are separated from the contractual relationship between the buyer and seller (cf. Art. 136 (4) (c) IA), so that only the objective legal situation in the respective territory is decisive and not an inter pares consideration; see also *Rinnert*, ZfZ 2015, 142 (146f.).

16 Lux, ZfZ Sonderheft 2009, 1 (17).

17 Cf. the Work Programme on IT development in customs: Commission Implementing Decision of 29 April 2014 establishing the Work Programme for the Union Customs Code, 2014/255/EU, [OJEU L 134/46 of 07.05.2014] and Weerth, AW-Prax 2015, 235 (235f.).

18 See also: Lux, ZfZ 2014, 243 (243ff.).

19 Witte, AW-Prax 2013, 373 (377).

20 ECJ judgement of 01.02.2001, Case C-66/99 ('Wandel').

21 Recital no. 32 of Reg (EU) 952/2013, [OJEU L 269/5 of 10.10. 2013]

22 See also Witte, AW-Prax 2014, 229 (229ff.).

23 Witte, AW-Prax, 2013, 373 (378).

24 Recital no. 38 of Reg. (EU) 952/2013, [OJEU L 269/6 of 10.10. 2013]

25 Witte, AW Prax 2014, 197 (197).

26 ECJ judgement of 06.09.2012, Case C-262/10 ('Döhler Neuenkirchen'); judgement of 06.09.2012, Case C-28/11 ('Eurogate').

27 Witte in Witte/Henke/Kammerzell, Der UZK, p. 101.

28 For example, ECJ judgement of 7.12.2000, Case C-213/99 ('De Andrade'), at para. 19; judgement of 16.10.2003, Case C-91/02 ('Hannl/ Hofstetter'), para. 17; judgement of 26.10.1995 Case C-36/94 'Sieße'), para. 20.

29 Commission Document COM (2013) 884 final of 13.12.2013.

30 Lux, ZfZ Sonderheft 2009, 1 (20f.).

31 ECJ judgement of 23.5.1989, Case C-378/87 (Top Hit), paras. 22, 26; judgement of 27.6.1991, Case C-348/89 (Mecanarte), para. 28.

32 Gellert, AW Prax 2014, 72 (73).

33 ECJ judgement of 25.2.1999 Case C-86/97 (Trans-Ex-Import), para. 21; judgement of 7.9.1999 Case C-61/98 ('De Haan Beheer BV'), paras. 50-52.

34 Gellert, AW Prax 2014, 72 (73).

35 Commission Document COM (2012) 64 final, 2012/0027 of 20.02.2012, Art. 109 d), p. 118.

36 See also Witte, AW-Prax 2015, 77 (77ff.).

37 Recitals no. 46–51 of EU Reg. 952/2013, [OJEU L 269/6–7, 10.10.2013].

38 Recital no. 10 of EU Reg. 952/2013, [OJEU L 269/3, 10.10.2013].

39 Lux, ZfZ Sonderheft 2009, 1 (29).

40 Witte, AW-Prax 2013, 373 (374).

41 Recital no. 7 of EU Reg. 648/2005, [OJEU L 117/14 of 04.05.2005]; Henke in Witte/Henke/Kammerzell, Der UZK, p. 206f.

42 Recital no. 50 of EU Reg. 952/2013, [OJEU L 269/7 of 10.10.2013].

43 Witte/Kammerzell in Witte/Henke/Kammerzell, Der UZK, pp. 194f.

44 For details see: Böhne, AW-Prax 2014, 343 (343ff.).

45 Cf. also: Witte, Der AEO im UZK, Teil 1, AW-Prax 2016, 75 (75f.) and Witte, AW-Prax 2015, 109 (109), pointing out that Art. 23 (5) will automatically produce anonymous AEOs owing to the lack of influence.

46 Weerth, AW-Prax, 2015, 90 (94).

47 Cf. Art. 23 – 25 DA.

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Transparency and integrity in customs capacity building projects: a preliminary study

Patrik Heinesson

Abstract

This paper provides an insight into and the preliminary findings of a research study that aims to gain a clearer understanding of the reasons why good governance and sound integrity, whilst normally identified as clear and strong policy objectives, appear to be rarely reflected in the Terms of Reference (ToR) of customs capacity building projects. In addition, the research aims to provide an understanding of the level of harmonisation of good governance and sound integrity among different actors (for example, provider of the fund, donor organisation and beneficiary country) during the implementation of such projects.

1. Introduction

Numerous customs capacity building projects are conducted every year and huge amounts are invested into the development of customs administrations with the overall objective of increasing their capacity, stimulating growth in international trade and hence, contributing to the economic and social prospects of, in particular, developing countries.

The World Customs Organization (WCO) plays an important role in this respect, as the intergovernmental organisation linking the vast majority of national customs administrations, representing 180 countries and 98 per cent of world trade. The mission statement established by the WCO is: 'to provide leadership, guidance and support to Customs administrations to secure and facilitate legitimate trade, realise revenues, protect society and build capacity' (WCO 2015).

The majority of such capacity building projects are generally funded through one of the main international donor agencies such as the World Bank, the Asian Development Bank (ADB), the Inter-American Development Bank (IADB) or the African Development Bank (AfDB).

The donor identifies relevant projects as well as the beneficiary countries and assumes full responsibility for conducting the project on behalf of the fund provider. Together with the beneficiary country, the donor appoints either a consulting firm or an individual expert to carry out the project. Following completion, the result is reported back by the donor to the original fund provider on the basis of agreed parameters.

The policies and objectives of the fund provider as well as the donor will have an indirect influence on the actual conduct of the project, whereas specific terms of reference and the previous experience of the consulting firm/individual expert will have a more direct influence on the project outcome.

The contemporary relevance of this research is to eventually influence drafting of Terms of Reference (ToR) in order to ensure good governance and sound integrity to be rightfully reflected in any customs capacity building project and related contractual arrangements. In this regard, Weiss and Steiner (2006), confirm that a number of intergovernmental standard-setting organisations each have their own unique definitions and interpretations of good governance, both with respect to internal decision making and to the formulation of public policy, occasionally supported by an international convention and/or a declaration.

2. Preliminary literature review

Numerous research reports, policies, strategies and related documentation provide reasons why good governance and sound integrity should form part of the operational objectives of any customs capacity building projects. One example is the Declaration of the Customs Co-operation Council Concerning Good Governance and Integrity in Customs (WCO Revised Arusha Declaration), which lays down the key principles a customs administration should apply when launching a comprehensive integrity development program (WCO 2003).

The WCO *SAFE Framework of Standards to Secure and Facilitate Global Trade* (WCO SAFE Framework of Standards) also provides guidelines relevant to this research as it highlights and encourages the need for improvements in customs capability and integrity to provide a comprehensive framework for global trade security (WCO 2012a).

Numerous initiatives by the WCO have followed the development of the WCO SAFE Framework of Standards, and perhaps the most important, with reference to good governance and sound integrity, was the development in 2007 of the WCO Integrity Development Guide, which was updated by the WCO Revised Integrity Development Guide (WCO 2012b). The Guide provides a framework for self-assessment and action planning followed by action plan review, evaluation and redevelopment, and recognises that the WCO Revised Arusha Declaration should remain the focal tool and central feature of a global and effective approach to preventing corruption and increasing the level of integrity of WCO Members (WCO 2012a, 2012b).

The WCO Revised Integrity Development Guide defines 'integrity' as 'A positive set of attitudes which foster honest and ethical behaviour and work practices' (WCO 2012b, p. 4), and, at the same time, emphasises the fact that integrity challenges remain a major obstacle to effective reforms and have a detrimental effect on the overall pride, *esprit de corps* and professionalism of an organisation.

Finally, the Guide (WCO 2012b, p. 4) identifies a number of other relevant initiatives such as the Columbus Declaration (1994) and the Lima Declaration (1997) which outline a number of recommendations related to integrity that are of specific relevance to any customs administration. In addition, there are references to the work of the Organization for Economic Co-operation and Development (OECD), the Organization of the American States, the European Union (EU), the United Nations (UN), the World Bank and Transparency International, all of which have a general focus on administrative corruption.

Other publications that address the issue of integrity include Lewis, who refers to the WCO Revised Arusha Declaration (Lewis 2013, p. 108) as a simple single page of text, which still contains several critically important issues that have dominated efforts to counter corruption and foster ethical behaviour amongst customs officers everywhere. He also stresses the fact that (Lewis 2013, p. 108), in relation to all strategic responses by Customs, if integrity is not intrinsic to the process, then there is little chance of success. He concludes that without integrity (Lewis 2013, p. 115) there can be no proper border management, no effective revenue collection and no public trust in the agency and that the Revised Arusha Declaration remains the pre-eminent source of guidance for customs administrations to install anti-corruption systems.

Widdowson highlights the fact that, in the fight against corruption, the establishment of a comprehensive and clearly articulated code of conduct is widely regarded as one of the most important weapons in the armoury (Widdowson 2013, p. 15). He indicates that for a code of conduct to be effective, there must be an unequivocal expectation of matters being dealt with in a professional, impartial manner with no fear of reprisal, and that the extent to which the confidence and trust of employees can be gained will depend on the culture of the organisation, which is heavily influenced by its leadership, particularly the perceived integrity and political will of its leadership team. Finally, he notes that compliance with the code of conduct needs to be properly monitored and strictly enforced (Widdowson 2013, pp. 15-16).

McLinden and Durrani refer to the importance of including anti-corruption initiatives as part of wider customs reform and modernisation programs (McLinden & Durrani 2013, pp. 4-5). At the same time, they highlight the importance of introducing business process reengineering of systems and procedures to simplify and remove points which are vulnerable to corruption, including minimising face-to-face interaction between customs officials and traders.

Durrani, Prokop and Zarnowiecki apply the following definition of 'governance' in McLinden, Fanta, Widdowson and Doyle (2011):

> Governance has been defined as '… the tradition and institutions by which authority in a country is exercised. This includes (1) the process by which governments are selected, monitored and replaced, (2) the capacity of the government to effectively formulate and implement sound polices, and (3) the respect of citizens and the state for the institutions that govern economic and social interactions among them' (Durrani, Prokop & Zarnowiecki 2011, p. 345).

Durrani, Prokop and Zarnowiecki (2011, p. 345) confirm that 'Earlier approaches to assessing and addressing poor governance as a barrier to border management reform had three main weaknesses', the first being the failure to link corruption risk to the overall governance environment. The second weakness refers to 'the impact of the overall governance and social environment on reform efforts', which has often been disregarded and seen as a specific area where projects could have little influence. The final weakness is considered to be a lack of clear monitoring and evaluation tools.

Further, Durrani, Prokop and Zarnowiecki (2011, p. 345) outline the response to these general weaknesses and describe in detail a mechanism to adapt available risk assessment and management techniques (both generic and sector-specific) for mapping corruption vulnerabilities to accomplish a governance accountability action plan (GAAP). They also refer to some limitations in customs reform projects identified by the World Bank (2011, p. 346), particularly projects whose focus on a specific function of customs activities limits their effect on overall institutional capacity.

Durrani, Prokop and Zarnowiecki (2011, p. 345), identify three main limitations of traditional modernisation projects: specialised reform; computerisation; and infrastructure development. They argue that, in order to avoid these limitations, a holistic approach is critical, with the final objectives corresponding to a real development strategy.

The issue of applying a holistic approach and going beyond the traditional reform agenda is also referred to by Mustra (2011, pp. 23-4) as one of the main obstacles to many developing countries, if they are to be able to take advantage of international trade opportunities. A trade supply chain is only as strong as its weakest link, meaning that localising the weakest links and addressing them are critical.

Further, Ireland and Matsudaira (2011, p. 175) identify three dimensions of reform: 'sector specific modernization, interagency coordination, and cross border harmonization'. They propose that all border management modernisation (2011, p. 183) should be based on key international instruments such as the WCO SAFE Framework of Standards (WCO 2012a) and the WCO Revised Kyoto Convention (WCO 1999).

Keen (2003, p. 154) assumes that nobody likes to pay taxes. Hence, '… some importers and/or their agents will take every opportunity and make every effort to reduce their tax burden, including, if necessary, the bribing of Customs officials'. Keen (2003, p. 155) continues to assume that '… the incentive goes beyond just the desire to reduce the tax burden, as the importer is also interested in obtaining the goods as quickly as possible; this places the Customs officials in a strong position to extract bribes in order to "facilitate" their release'. The solution proposed by Keen (2003, pp. 156-65) is to ensure an integrity system which not only promotes integrity in customs administrations as such but also ensures ongoing vigilance to ensure that any introduced measures continue to operate as intended.

McLinden (2005, p. 67) confirms that high levels of corruption drastically reduce the effectiveness of key public sector agencies and that customs administrations are frequently being cited as among the most corrupt of all government agencies. McLinden (2005, pp. 72-87) also outlines a range of practical approaches which can be applied to address the issue and stresses the importance of utilising the Revised Arusha Declaration and the Revised Kyoto Convention, the importance of taking a whole-of-government approach to fighting corruption and aligning customs strategies with national campaigns.

McLinden (2005, p. 88) concludes by stressing the fact that any anti-corruption strategy in Customs must be developed as a coherent package, addressing both motive and opportunity.

New approaches to development aid are elaborated in detail by Ramalingam (2013). Particular attention is given to new approaches related to development aid and how it can be more relevant to its context and adaptive to change. References are made by Ramalingam (2013, p. 39) to the old joke that for every complex problem there is a solution that is simple, neat and wrong. The conclusion being drawn is that aid agencies persist in treating the world in a certain way, so their *available* solution becomes *the solution*.

Ramalingam (2013, p. 65) also highlights the risk of high-level country strategies applied by a donor, being very clear in terms of overall objectives and specific in terms of what would be done or not done, but in practice may lose the links between overall objectives and particular alternative policies and practices. He also stresses the fact that a continual problem for donors has been to measure and understand impact – that is, the difference an intervention has made (Ramalingam 2013, pp. 111-12). Mostly, he sees this as being due to a lack of adequate indicators, clear objectives, baseline data and monitoring.

According to Ramalingam (2013, p. 112), focus amongst donors is not on the actual impact of a particular project but on operational aspects and the actual conduct of the project through detailed monitoring and evaluation.

3. Research methodology and data collection

The methodological approach used in this (ongoing) study is a combination of qualitative and quantitative research methods. It includes a comprehensive literature review, surveys and structured interviews of consultants involved in capacity building projects, an examination of specific ToR issued by various organisations including donor agencies and selected policy documents. The research is aimed at generating recommendations, strategies, or best practices for ensuring that 'good governance' and 'sound integrity' policy objectives are translated into or supported by the operational objectives of ToR that govern capacity building projects.

The research problems were examined through a comparison analysis of internal policies on transparency and integrity as defined by included donors (World Bank, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), European Commission (EC), Trade Mark East Africa (TMEA), Department for International Development (DFID), IADB, AfDB, UN, ADB) and the WCO Revised Arusha Declaration. Data were collected solely from open sources and structured in a way which allowed and facilitated a comparison of relevant elements.

To confirm the hypotheses, 'that there are shortcomings in transforming policies into operational objectives and hence ensuring actual realisation and implementation of various policy objectives', 24 ToR, issued by the above donors, relating to upcoming, ongoing and already implemented customs capacity building projects between 2011 and 2015 were identified, analysed and reviewed against the WCO Revised Arusha Declaration and its ten key factors.

To ensure a better understanding of the challenges associated with the actual implementation of measures related to good governance and sound integrity, a questionnaire was developed for completion by customs experts.

4. Discussion and analysis

4.1 Revised Arusha Declaration

The WCO Revised Arusha Declaration is comprehensive and addresses issues related to leadership and commitment, regulatory frameworks, transparency, automation, reform and modernisation, audit and investigation, codes of conduct, human resource management, morale and organisational culture, and relationships with the private sector. Issues such as leadership, reform and modernisation and last, but not least, the importance of fostering a sound and efficient relationship with the private sector were highlighted for inclusion in the WCO Revised Arusha Declaration by global customs leaders. This particular declaration has served as a benchmark throughout this research.

The WCO Revised Arusha Declaration and the WCO Revised Integrity Development Guide (WCO 2012b) are indicated by Durrani, Prokop and Zarnowiecki (2011, pp. 347-8) to be the most important sources for setting the standards for integrity in the customs environment, and for developing and implementing integrity and anti-corruption strategies. Of particular note, the self-assessment process outlined in the latter provides a framework to examine management, administrative and integrity strategies that are already being employed and to identify further opportunities for improvement. Consequently, any references to these sources in relevant documents would clearly increase the focus on issues related to good governance and sound integrity.

4.2 Change management

One of the key aspects and instruments identified in the literature review in terms of actually making a difference and translating policies into strategies and operations is effective change management. Nilikant and Ramnarayan (2010) provide an in-depth insight into how to avoid adopting simplistic recipes and how to actually change the way in which people think and act. Further, Nilikant and Ramnarayan (2010, pp. 25-6) affirm that no matter how changes are initiated in an organisation, they will always involve a change in the pattern of internal activities or routines. As a result, any change in the organisation will involve changing routines. This is also why the principles behind change management are largely about changing people's mindsets or mental models, another factor critical to consider when initiating a capacity building project.

Gasper (1999, p. 23) provides another focus on the topic and offers basic information related to development aid as such and, more specifically, associated with the rationale and different roles behind development aid. Particular attention is given to the issue of how aid can be more relevant to its context and adaptive to change rather than subject to numerous donor-set conditions which must be accounted for in every detail. According to Gasper (1999, p. 23-4), this refers to the fact that donors themselves must demonstrate to fund providers that their monies are well spent, which in itself should justify donors imposing on recipients whatever conditions they believe may be necessary.

Gasper (1999, p. 31), amongst others, also addresses the issue of how to evaluate international aid and refers to the fact that evaluation is frequently seen as a purely technical exercise where excessively narrow criteria and sources of information are used. He also states that donors seem to accept a share of the credit but, generally, not any blame (Gasper 1999, p. 39).

The issues of leadership and political support as well as the importance of organisational culture are repeatedly referred to in the literature. Paton and McCalman (2012) are just one example as they examine change management focusing on strategies to best manage complex change situations. They also refer to the fact that all too often the process, or the activities associated with a change, assume more importance than the change itself (Paton & McCalman 2012, p. 43). In practice, this means that actual successful

implementation is secondary to "talk a good game" and to plan for the future. The identification of relevant key performance indicators and baseline data could be one approach to measure, report and assess the actual impact of a particular project over time.

4.3 Review of selected donor policies

The preliminary review of common parameters for international donors included in the study indicates that they all have very strict internal policies which stress the importance of good governance and sound integrity. However, these policies are normally limited to safeguarding and securing good governance and sound integrity in relation to the actual conduct of a particular project rather than ensuring tangible and sustainable outcomes of the project in terms of good governance and sound integrity. As a consequence, good governance and sound integrity are rarely included as operational objectives and/or deliverables in the specific ToR for customs capacity building projects.

4.4 Review of selected ToR

Each of the 24 ToR were reviewed to identify any reference made in the specific ToR to the Revised Arusha Declaration itself as well as any references to its ten key factors.

While the vast majority of the ToR refer to key factors such as regulatory framework, transparency, automation, reform and modernisation, human resource management, and relationships with the private sector, the review identified only two ToR out of the 24 which included a specific reference to the Revised Arusha Declaration.

With respect to codes of conduct, morale and organisational culture, again only two ToR included such references, while elements of audit and investigation were identified in 16 out of 24 reviewed ToR.

4.5 Analysis of questionnaire

Whilst the number of responses to the questionnaire (23) is too limited to allow any far-reaching conclusions, the analysis provides some interesting and noteworthy trends that have informed the preliminary conclusions and recommendations.

There is a clear indication that the respondents are familiar with the WCO Revised Arusha Declaration, and 20 respondents (87 per cent) consider themselves to be aware or well aware of the Declaration. The vast majority of these experts have been working for eleven years or more and they have participated in eleven or more customs capacity building projects. Only three respondents (13 per cent) consider themselves to have limited or no level of knowledge of the Declaration.

With respect to whether or not the principles behind the Revised Arusha Declaration are regularly applied in the respondent's role as a professional expert in various customs capacity building projects, 22 respondents (96 per cent) indicated that they regularly or always apply the principles. It is pertinent to note that the vast majority of these respondents have considerable experience working on customs capacity building projects. Only one respondent (4 per cent) indicated that their role does not involve the application of the Declaration's principles.

Nineteen respondents (83 per cent) indicated that they are always or frequently briefed on donor policies relating to good governance and sound integrity prior to inauguration of a specific project. Four respondents (17 per cent) indicated that they are never or rarely briefed prior to a specific project.

Thirteen respondents (57 per cent) indicated that they are always or frequently briefed on the beneficiary country's policies related to good governance and sound integrity prior to inauguration of a specific project. Ten respondents (43 per cent) indicated that they are never or rarely briefed prior to a specific project. Whilst the role of the beneficiary country has not been reviewed as part of this study, the responses

point to a potentially critical area requiring specific attention in future customs capacity building projects to ensure improved awareness amongst project experts of the beneficiary country's policies related to good governance and sound integrity.

Regarding policies related to good governance and sound integrity and whether or not these are reflected as a strategic objective in the ToR related to a specific project, 18 respondents (78 per cent) indicated that this is always or frequently the case, while five respondents (22 per cent) indicated that these are never or rarely reflected in the ToR. Despite the fact that only two of the 24 ToR that were reviewed included references to the WCO Revised Arusha Declaration, it would appear that the principles are being applied to some extent based on these responses.

Seventeen respondents (74 per cent) indicated that policies related to good governance and sound integrity are normally reflected in the ToRs related to a specific project as an operational objective, while six respondents (26 per cent) indicated that this is never or rarely the case.

Nineteen respondents (83 per cent) indicated that actions taken to promote good governance and sound integrity are normally or always reflected in the final report following conclusion of a project. Four respondents (17 per cent) indicated that this never or rarely occurs.

Sixteen respondents (70 per cent) indicated that they frequently or always find full harmonisation between policies on good governance and sound integrity established by the donor versus the beneficiary country. Seven respondents (30 per cent) indicated that there is room for improvement with respect to harmonisation of policies between the donor and beneficiary country. This need for improvement is also supported by the author's review of donors' policies.

Based on responses to the questionnaire, the principles of political sensitivity and political correctness appear to have some but limited relevance with respect to how the issues of good governance and sound integrity are being managed operationally and practically in particular customs capacity building projects. Seventeen respondents (74 per cent) indicated that the issues of good governance and sound integrity are not seen to be too political and/or sensitive and hence neglected during project execution. Six respondents (26 per cent), however, indicated that the principles of good governance and sound integrity are neglected during project execution due to their political sensitivity.

Finally, seven respondents (30 per cent) indicated that they have experienced difficulties in implementing issues related to good governance and sound integrity, while 16 respondents (70 per cent) indicated that they have rarely or never experienced such difficulties.

5. Conclusions

The literature review strongly supports the view that good governance and sound integrity are critical to the success of any customs capacity building project, and that effective development can only be achieved when these issues are being managed properly. It also provides particularly useful insights into how to avoid adopting simplistic recipes and how to change the way in which people actually think and act.

The study's finding that the WCO Revised Arusha Declaration has very limited influence on any of the customs capacity building projects that were reviewed suggests that the WCO may have difficulty in communicating the essence and importance of the Declaration to the donor community, or possibly the donor community finds it difficult to incorporate its principles into the ToR of such projects.

One of the main conclusions from this preliminary study is that the available scientific knowledge, including its commentary on best practices is being overlooked, as it is rarely captured and reflected in the ToR of capacity building projects. Issues such as leadership, follow-up, change management, organisation, political support and self-assessment are repeatedly referred to as critical success factors

though very few references to such issues are reflected in ToR. Consequently, an increased focus on these issues by donor organisations would appear to be necessary.

Each new customs capacity building project should be considered as a window of opportunity to actually influence and improve an administration's governance and integrity. Hence, it is considered that a common template, checklist and/or approach for ToRs should be applied by all donors to any customs capacity building project in an effort to ensure that the issues of good governance and sound integrity are duly reflected. Ideally, such a template/checklist should be provided through the WCO in order to ensure full harmonisation with the WCO Revised Arusha Declaration.

The apparently strong support for the WCO Revised Arusha Declaration, not only amongst customs administrations but also by other stakeholders as indicated in the literature review, clearly indicates that the principles of the declaration could be better utilised in developing customs capacity building projects. It is considered that specific references to the Declaration in future ToR would contribute significantly to an increased focus on issues related to good governance and sound integrity. Such references should ideally also include the tenth standard in the WCO SAFE Framework of Standards:

> The Customs administration and other competent authorities should establish programmes to prevent lapses in employee integrity and to identify and combat breaches in integrity to the extent possible (WCO 2012a, p. 9).

This preliminary research helps to provide a clearer understanding of the reasons why good governance and sound integrity, whilst identified as clear and strong policy objectives, are rarely reflected in the operational objectives of customs capacity building projects. The next phase of the research will seek to validate the results to date, and will also focus on the level of harmonisation that exists between the different stakeholders (that is, fund provider, donor organisation and beneficiary country) in terms of their policies and practices relating to governance and integrity.

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Counter-terrorism and data transfers in international trade

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Abstract

Recent developments show the growing threat posed by international terrorism – including to global trade. This article begins by outlining the initiatives being taken by the United States (US) and the European Union (EU) for trade security. Their success is, to a considerable extent, dependent on transfers of information between the participating states. But what is the effect of information sharing on the security of data provided by participating companies, for the privacy of citizens and, ultimately, for national sovereignty and the rule of law? This conflict, however, reaches even further. It goes beyond the 'issue of security' and impacts deeply on the relationship between the US and the EU.

1. Introduction

The recent attacks in Paris and Brussels have shown unequivocally that the fight against terrorism will be one of the dominant policy issues of the future. The attack on New York's World Trade Center, carried out before our eyes on 11 September 2001, had already shown the potential dimensions of terrorism. Terror poses a threat, not only to civil society but also to the world of international trade. Amongst customs and trade experts, a significantly increased awareness of risk has arisen: following 9/11 it was very quickly feared that international container traffic and seaports could become the target of attention of terrorists. From low-security seaports, terrorists could extend their operations to reach international container traffic all over the world. Scenarios were developed, whereby terrorists in inadequately secured seaports could place explosive devices into containers.[1] In such scenarios, a potential threat of unprecedented proportions was quickly identified: In the 'worst case' it was thought possible that, after a series of such attacks, no country could be sure that arriving containers would not contain further explosive devices. In a subsequent panic, large parts of the container-transacted transport sector could, at least temporarily, come to a standstill – with incalculable consequences, not only for individual ports and countries but for the entire global economy.[2]

2. Security initiatives for global trade

The United States (US), followed by other countries and the European Union (EU), responded to the growing threat posed by international terrorism with a range of initiatives.[3] These differ from each other in their specific protection objectives, and in their means of implementation. However, a significant, common characteristic is embodied in the fact that, until now, controls on container traffic have been carried out on imports, at the time of their arrival in the importing country. The new initiatives stipulate

that the checks must now be displaced externally, to the actual dispatch location of the goods. The US Customs and Border Protection Service, for example, describes their Container Security Initiative (CSI) as follows:

> The Container Security Initiative is a revolutionary program to extend our zone of security by pre-screening containers posing a potential security risk before they leave foreign ports for U.S. seaports. Our goal is to process 85 per cent of all containers headed for the United States through CSI ports by 2007.[4]

The European concept of 'Authorised Economic Operators' (AEO) is regulated in Art. 5a of the European Community Customs Code (CC). Important additional rules include Art. 14a to 14x of the Implementing Provisions of the Customs Code (CC-IP). The concept of AEO consists of customs authorities identifying particularly reliable private operators and, following successful completion of an extensive examination procedure (certification), equipping them with specific trade-related privileges (so-called 'Authorised Economic Operator'). This includes operational benefits – essentially a preferential and rapid settlement of customs procedures.[5] Taken together, these security concepts mean that high-risk cargo is identified before it even has a chance to reach the territory of the state which launched the initiative, (the principle of 'Pushing Borders Out').[6] Practical implementation, however, has shown the difficulty in identifying which risks are present at what stages of which supply chains. Therefore, the 'visibility' of the supply chain is a critical factor in risk analysis. To determine risks and respond to them appropriately, governments and administrations need precise and up to the minute information about the location of any item of cargo in the supply chain – in other words, the ability to access this information in real time ('visibility on demand').

3. Data transfers: a central element of the fight against terrorism

These new security concepts throw up far-reaching questions: Not only regarding data protection generally but extending particularly to the safeguarding of corporate data. Above all though, they raise issues of sovereignty under international law. The initiatives aimed at securing the supply chain break with hitherto common thinking, whereby the state's security is ensured by those checkpoints that form the national borders. In contrast, it would now be increasingly advantageous to place the security controls even further away.

To achieve this, intelligent systems collect the appropriate data and store it according to highly complex algorithms for specific, but also open-ended, and currently not yet foreseeable, purposes. This requires a high measure of collaboration among trading partners – primarily with the countries from which the consignments most at issue will be sent. Regimes to secure the supply chain can thus be understood as real controls on virtual borders, that is, borders that are projected out for the purpose of safeguarding the territory. For the initiatives to be practically implemented, it is therefore particularly important to achieve cooperation between the countries involved. To accomplish that, numerous agreements have been concluded to provide for mutual recognition and compliance with national and regional security regimes. They are of the utmost importance for international business practice.

For example, on 4 May 2012, the US and the EU reached an agreement for mutual recognition of their Customs-Trade Partnership Against Terrorism (C-TPAT) and AEO safety regimes. This came into effect on 31 January 2013. The agreement includes the comprehensive exchange of all relevant information amongst the participating countries. This mutual recognition is highly advantageous for the affected businesses. The US recognition of the European AEO means that the specific advantages of the C-TPAT are also conferred on business entities that don't have C-TPAT but, rather, have AEO certification. The same applies for US companies certified as C-TPAT which are then brought within the scope of the AEO.[7]

The participating companies are very positive about their involvement in the international security programs as it bestows on them clear and immediately tangible benefits. As a consequence, however, they must accept a diminished overview of what happens to their trade-related data once it has been submitted – in particular, what further dissemination is implied by international exchange and utilisation. The possession of such data opens up an enormous strategic dimension. It is not surprising, therefore, that the US in particular, has been exposed to considerable criticism for its pioneering role. It has been argued that strategic considerations, rather than security, form the primary goal of the initiative, placing the far wider use of the collected data in the foreground.[8]

This criticism, however, has not gained wide acceptance. Alan D Bersin makes it unequivocally clear how important the unobstructed collection of data is, from the perspective of the US. He quite stridently demands a change in thinking in the area of security, a change that fundamentally calls into question our current understanding of data protection.[9] '*The challenge of our times is that the future is not what it used to be.*' With this quote from the poet Paul Valéry, Bersin asserts that anyone who is not able to adapt, is stuck in old ways of thinking and fails to recognise the challenge of our times. On a daily basis, the US already exchanges billions of pieces of data with its trade partners – and in this area, 'less is more' just does not apply. 'Those who hoard information today, expecting their power to grow by forcing others to ask for it, soon find themselves isolated and, over time, ignored.'[10] Today, it is critically important that all participating stakeholders contribute to risk reduction, through the exchange of information.

In an 'anarchic world', without central global security structures, it resides in the sovereignty of individual states to launch initiatives directed towards this end.[11] However, approaches that remain limited to national initiatives can only inadequately fight the international terrorism phenomenon. And the compromised exchange of information allows even greater latitude for terrorists. Bersin says that information is power, and calls for a different perspective:

> Old-fashioned, limited views of national interest, and reflexive notions of privacy and civil liberties, restrict willingness to share, and reinforce parochial and myopic concerns of long duration.[12]

Bersin believes that a solution in the fight against terrorism will only come about through the free exchange of data and the consequent generation of actionable intelligence from that mass of information. And he asserts that data protection, as well as privacy, are assured. Only when signs of a 'match' become evident, out of the multitude of anonymous algorithms, will the collected data be combined to produce recoverable information, and the previously existing privacy suspended.

This means that, in international trade, the state borders no longer serve directly as checkpoints for the guarantee of national security. In the future, it will be that exchange of information that determines where the 'new frontiers' run.

4. The conflict between security, data transfers and the rule of law

'Border' traditionally signifies, principally, the opportunity to exercise control. But what opportunities for control are offered by the 'new borders'? Fundamental questions come to mind: What about the protection of corporate data? What are the factors to be considered when balancing legitimate security concerns against other vital interests in need of protection? And above all: How can States ensure their citizens' fundamental constitutional freedoms in the face of 'shifting traditional borders'? This development has long since become a reality and, as a result, the conditions affecting sovereignty and the rule of law are changing. As an expression of their national sovereign rights, many states already regulate, to varying degrees, the collection and use of data within the national sphere. From Bersin's point of view, the legitimisation for exchanging data derives from a 'bargaining process':

> ... the intersection between privacy protection and information sharing to enhance security in the global supply chain and global travel zones is crisp and sharp. One need not reconcile different visions, or points of departure concerning how to think about privacy, in order to arrive at a common proposition regarding what steps are required to protect personal data in a specific case. At end, some application of *informed consent* can account for a satisfactory outcome. In other words, entry and engagement in global travel or supply chain activity embodies a bargain between public authorities and private actors. The contours of the bargain regarding use and dissemination have long been settled once the threshold of *entitlement to collection* has been crossed.[13]

There can be no doubt that States, and the international community, must defend themselves against terrorism. The requirements of counter-terrorism demand that data transfers be conducted on a far higher level. In critical situations, individual countries may not identify threats themselves but are reliant on information from their exchange partners. Additionally, potential risks can be better identified when the respective knowledge of individual countries is synthesised into an overall picture. This raises the question of whether those involved in negotiations on data transfers are fully aware of the associated consequences: Can the delegation of rights be justified in the name of collecting data for 'open-ended' purposes? If the criteria under which the information is being collected remain unclear, then any assumptions as to how, and to what ends it will be used later must be, by extension, vague and hypothetical.[14]

In the current debate, the tension between holding on to freedom or surrendering it through the disclosure of information, is becoming increasingly important. There is an argument that the liberal way of life needs to be actively defended to a far greater extent than used to be the case.[15] The philosopher and writer Peter Sloterdijk, in particular, has proved quite polemical and provocative in drawing attention to this tension between enjoying freedom and defending it.[16] Sloterdijk views Europe as being on the defensive. Until now, it has had little will, when required, to impose its interests by force. Rather, it has humbly depended on the quick acting and combat-ready US to take on the task. In this relationship, the peaceable nature of one is made possible only by the boldness of the other. Sloterdijk points out that Europe's dependency on the defensive umbrella of the US has led to a significant sacrifice of European autonomy. This dependence affects virtually all policy areas, such as the 'terms of trade' and many other economic sectors, the ceilings for emissions of exported diesel engines, the implementation of American skills standards or the screening of European data traffic, and even encompasses spying on European political leaders. Consequently, Sloterdijk calls for a stronger Europe and a Europe that speaks with one voice internationally. Only in this way will it be possible to regain lost 'sovereignty', including that within the field of data control and usage.

The message, then, is that the international fight against terrorism, specifically in the collaboration between the US and Europe, need not be conducted under asymmetric conditions, characterised by subservience and dependence. Recent developments have unequivocally demonstrated to Europe that its open society must be defended. And Europe well understands the challenge. In meeting that challenge, Europe cannot defend itself from a position of dependency, but only from a position of strength, and this includes extensive cooperation with partners. The key now is how quickly Europe manages, under the preconditions of the considerable diversity and differing interests of the Member States, to formulate and assert its own way.

The dimensions are now shifting. It seems paradoxical that a state of freedom can only be achieved through a simultaneous defensive posture, even though that vigilance – as the example of data security shows – does not leave our civil rights untouched. This raises some far-reaching questions: Can enhanced security and broad political autonomy be achieved only by putting limits on our freedoms and, if so, how much freedom must we surrender, in order to hold on to it at all?

Summary

The sharing of information between individual states is a central element in maintaining security in international trade. However, these data transfers profoundly impact on both the internal data security of corporations, as well as the privacy of citizens. It also raises fundamental questions about national sovereignty and the rule of law. Will safeguarding against terrorism mean a sacrifice of freedom? In the current debate, Europe is criticised for allowing its established values to be compromised. This comes about largely because Europe maintains its own 'peaceable nature' by placing itself in a dependent relationship with the US, a country which, by contrast, is self-assertive and ready to defend its interests and partners. Europe's reliance on the US goes to almost all policy areas, data security included. It is the position of this contribution, however, that the cooperation between the US and Europe need not be conducted under asymmetric conditions. By engaging in the defence against terrorism, whilst simultaneously pursuing greater security in data sharing, Europe can look after its own interests far more fully than it has done in the past.

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Notes

1 Comparable scenarios are described in, for example: Mazzetti & Shane 2010; Chang 2009; Neue Zürcher Zeitung 2010; Küchle 2008.

2 For detail, see Altemöller 2011a, 2011b.

3 Particularly noteworthy examples at the international level are: UN Security Council resolution No. 1373 from 28 September 2001 and also, No. 1456 from 20 January 2003 and No. 1624 from 14 September 2005, as well as the initiatives of the World Shipping Council. In addition, the G8 adopted an initiative to reinforce security in the area of international transportation: The Cooperative G8 Action on Transport Security, 26 June 2002; the World Customs Organization has developed an international framework (SAFE Framework) to secure and facilitate global trade (WCO 2007); Mikuriya 2007; Ireland 2009; and Grainger 2007. See also OECD 2005.

4 U.S. Customs and Border Protection 2006, p. 2; the US security initiatives are discussed by, for example, Irish 2009; Laden 2007. For a general analysis see, for example: Czyzowicz 2014; Widdowson 2007; Widdowson & Holloway 2009; Heseler 2000, and Lux 2011.

5 European Commission, Authorized Economic Operators 2006, 2007; Wolffgang & Ovie 2008; Polner 2010.

6 U.S. Customs and Border Protection 2006a, 2006b, or U.S. Department of Transportation 2009.

7 Regarding mutual recognition, see, for example: European Commission 2011; Weerth 2015; Aigner 2010; Scholl 2009, as well as the Government Accountability Office (GOA) 2008.

8 See also Dallimore 2007.

9 For background, see Bersin 2014.

10 Bersin 2014, pp. 3, 7.

11 Continued in Grillot, Cruise & D'Erman 2010; Wieland 2009 or, for example, Bures 2011 and Keohane 2002.

12 Bersin 2014, pp. 3, 8.

13 Bersin 2014, Addendum I, pp. 3, 15.

14 The European Court of Justice formulated principles for data transfers in the 'Schrems' ruling: 'Any such framework must therefore have sufficient limitations, safeguards and judicial control mechanisms in place to ensure the continued protection of the personal data of EU citizens including as regards possible access by public authorities for law enforcement and national security purposes' (European Commission 2015, p. 3). To this effect, on 2 February 2016, the EU Commission and the US approved a new treaty for transatlantic data transfers (EU-US Privacy Shield). This set of rules is intended to address the Commission's heavily criticised and – by the ECJ – rejected 'Safe Harbour' decision (European Commission 2000).

15 See, for example, Lilla 2015, p. 47.

16 Sloterdijk 2015, p. 8.

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Risk management systems in Customs: the Ukrainian context

Oleg V Komarov

Abstract

The foreign economic and customs policy of states and unions, influenced by globalisation, integration processes and the associated challenges of our times, is a changing dynamic, which through its constant transformation and adaptation is leading to new economic and trade conditions. Together with the development of customs control technologies to support the policy, schemes designed to circumvent such controls have also evolved. Customs authorities and other border agencies are therefore seeking to manage the associated risks by way of sophisticated risk management systems (RMS). This paper examines the systems introduced in the Ukraine and the progress made.

1. Introduction

The increasing complexity, speed, and volume of international trade, fuelled by the technological advances that have revolutionised global trading practices, have significantly affected the way in which customs authorities carry out their responsibilities. As a consequence, many administrations have implemented disciplined and structured approaches to managing risks (Widdowson 2005, p. 92).

The Ukraine is no exception. It introduced risk management principles into its customs control regimes in 2005. At the time, the government realised that it was necessary to adopt a modern approach to customs management in order to be recognised as a reliable stakeholder that provides a safe link in the international supply chain and, accordingly, support Ukraine's integration into the world's economic community.

The *Association Agreement between the European Union and its Member States, and Ukraine* of 21 May 2014 (the 'Association Agreement'), established a political and economic association between the contracting parties. Chapter 5 of the Association Agreement deals with Customs and trade facilitation. Article 75 provides that parties 'recognise that utmost importance shall be given to legitimate public policy objectives including trade facilitation, security and prevention of fraud and a balanced approach to them' and 'agree to reinforce cooperation in this area with a view to ensuring that the relevant legislation and procedures, as well as the administrative capacity of the relevant administrations, fulfil the objectives of effective control and support facilitation of legitimate trade as a matter of principle'.

Article 76 deals specifically with trade and customs legislation. It requires parties to have stable and comprehensive trade and customs legislation and 'that provisions and procedures shall be proportionate, transparent, predictable, non-discriminatory, impartial and applied uniformly and effectively'. In particular, legislation and procedures should, among other things, 'protect and facilitate legitimate trade through effective enforcement of, and compliance with, legislative requirements', 'lead to greater efficiency, transparency and simplification of customs procedures and practices at the border', 'apply modern customs techniques, including risk assessment, post clearance controls and company audit methods in order to simplify and facilitate the entry and release of goods', 'ensure the nondiscriminatory application of requirements and procedures applicable to imports, exports and goods in transit', apply relevant international instruments in the field of Customs and trade including those developed by the

World Customs Organization (WCO), the World Trade Organization (WTO) and the United Nations (UN), and take the necessary measures to implement the provisions of the *International Convention on the Simplification and Harmonization of Customs Procedures, as amended* (the Revised Kyoto Convention 1999).

It is clear that by entering into this agreement, Ukraine has undertaken a series of significant international obligations. In addition, Ukraine has ratified the WTO Trade Facilitation Agreement (TFA), the obligations relating to risk management of which are set out in Article 7, sub-para. 4, which provides that:

> 4.1. Each Member shall, to the extent possible, adopt or maintain a risk management system for customs control.
>
> 4.2. Each Member shall design and apply risk management in a manner as to avoid arbitrary or unjustifiable discrimination, or disguised restrictions on international trade.
>
> 4.3. Each Member shall concentrate customs control and, to the extent possible other relevant border controls, on high risk consignments and expedite the release of low risk consignments. Each Member may also select, on a random basis, consignments for such controls as part of its risk management.
>
> 4.4. Each Member shall base risk management on assessment of risk through appropriate selectivity criteria. Such selectivity criteria may include, *inter alia*, HS code, nature and description of the goods, country of origin, country from which the goods were shipped, value of the goods, compliance record of traders, and type of means of transport (WTO 2013, pp. 8-9).

2. Key issues relating to risk management

2.1 What is risk?

Why is the mastery of risk such a uniquely modern concept? Why did humanity wait the many thousands of years leading up to the Renaissance before breaking down the barriers that stood in the way of measuring and controlling risk? (Bernstein 1996, p. 11).

Older civilisations had developed quite different techniques for dealing with analogous problems, and thus had no need for a word covering what we now understand by the term 'risk'. For example, in ancient oriental maritime trade there existed what could be described objectively as risk awareness accompanied by corresponding legal institutions. Indeed, the concept of risk finds significant application in the fields of navigation and trade, with maritime insurance representing an early instance of planned risk control (Luhmann 1993, p. 9).

So, what is the risk in the term 'risk management'? According to Widdowson and Holloway (2011, p. 100) 'it is best defined as the chance of something happening that will have an impact on organisational objectives'.

An analysis of existing definitions of the term 'risk' in the context of customs administration and regulation has, however, revealed a considerable degree of inconsistency. This has been caused by the multidimensional and complex nature of the concept. Generally, its nature is characterised by such elements as indeterminacy and probability, predictability and suddenness, divergence and proneness to conflicts, choice, alternativeness or variability, danger and threat, loss, negative profit or consequences, success and failure, event, situation, etc. Causal-investigatory links and interdependency of such characteristics and qualitative descriptors, as well as specific areas of research in this area, determine and contribute to the base knowledge within the 'riskology' theory.

Customs risks are particular as they are characterised by the nature of the environment in which they arise and their specific forms of implementation/realisation, and in their broadest sense they are defined as the potential of non-compliance with customs laws (WCO 1999a). The WCO also refers to risk as the 'effect of uncertainty on objectives' (WCO 2011, p. X), apparently leaning towards the terminology of international standards (for example, ISO 31000:2009).

At a regional level, taking into consideration the European integration of Ukraine, it is pertinent to note that, according to the Community Customs Code, 'risk' means the likelihood of an event occurring in connection with the entry, exit, transit, transfer and end-use of goods moved between the customs territory of the Community and third countries, and the presence of goods that do not have Community status, which 'prevents the correct application of Community or national measures', 'compromises the financial interests of the Community and its Member States', and 'poses a threat to the Community's security and safety, to public health, to the environment or to consumers' (European Union 2013). Similarly, according to the Customs Code of Ukraine (Customs Code), risk refers to 'the probability of failure to comply with the customs legislation of Ukraine' (Verkhovna Rada of Ukraine[1] 2012).

It should be noted that the realisation of risk can result in positive, negative or neutral outcomes. Not only can the outcomes differ, but they may even be diametrically opposed, and consequently the cause/effect relationship between risk and loss is often ambiguous. Also, customs law violations do not necessarily represent any danger in terms of direct loss, damage or harm. However, the fact that such violations occur tends to undermine principles such as law and order, and the rule of law itself, and in this context it constitutes a risk which needs to be addressed. Note also that a person becomes one of those affected by the consequences of the risk occurring as he or she (intentionally or negligently) encroaches on social values and relations.

At the same time, intentional violation of customs law constitutes a risk for the offender, the risk being the prospect of being caught and penalised if the offence is uncovered. Notwithstanding, the incentive of better profit margins due to reduction of customs duties and tax avoidance, counteracts the risk of being caught. This phenomenon appears to be a central factor for customs authorities in determining the nature and scope of customs control as they attempt to ensure compliance with customs laws.

It should also be noted that customs authorities also generate risks. This occurs when a violation is committed with the support of or directly by customs officials or because of negligent or poor performance in carrying out their functions and responsibilities. In this context, the modern management paradigm requires the practical implementation of a combined approach that presupposes management not of individual, separate risks but the whole risk environment including external and internal aspects. The latter can be described as bureaucratic risks in customs administration.

By clearly differentiating government interests (that is, customs interests) from the commercial interests of foreign trade participants, the concept of 'risk' can be more clearly defined. Risk is the danger of failing to achieve the objectives of customs authorities, which poses challenges in the area of customs and trade security, as well as other areas such as public values.

Related to the concept of risk is the notion of a 'risk situation', which provides additional insight into a broader understanding of the term 'risk'. A 'risk situation' can be defined as a synergy of different circumstances and factors that create an environment and favourable presupposition for risks to occur.

2.2 What is a risk management system?

Management may be regarded as a function which is orientated to adapt to variable conditions of the external environment to achieve organisational objectives, taking into account corresponding risk factors. It involves four components: object, subject, management aims, and mechanisms of authoritative influence.

In general, management is a system of means and facilities of purposeful influence of the individual controlling objects under their control. Given this, control is one of the basic functions of customs management with both external and internal components. Such control is directed to the implementation of normative requirements, and includes the application of legal coercive measures.

A system may be regarded as a well-structured combination of elements, parts, components and items, joined with organisational links through determined common indicators, criteria, etc.; and risk management can be considered to be a complex multi-level system which includes:

- supranational level which provides collective trade security based on the activity of international organisations, trade and economic communities, as well as international standardisation and unification of risk management technologies, its methodical and methodological support
- national level under which the unification and implementation of international norms and standards occurs, and according to which the system-wide, key principles of risk management are set
- institutional level which foresees the presence of policy, strategy, mechanisms and procedures of institutional management, focused on goal achievement and taking into account corresponding risk factors
- individual level which is characterised by the presence of the human element, by noting that a person can simultaneously be an object and a subject of risk management and an intermediator of personal and public risks.

A common characteristic of customs work is the high volume of transactions and the impossibility of checking all of them. Customs administrations therefore face the challenge of facilitating the movement of legitimate passengers and cargo while applying controls to detect customs fraud and other offences (UNCTAD 2011, p. 39). It is accepted that managing risk presents challenges as Widdowson (2005, p. 92) points out, 'The more traditional procedures include physical border controls over the movement of goods and people consisting of documentary checks and physical inspections aimed at detecting illicit trade. The introduction of such controls constitutes a form of risk management, but not necessarily an effective or efficient one'.

A Risk Management System (RMS) replaces total control and becomes a new evolutionary stage in the development of customs control technologies. It may be defined as a range of measures designed to support selectivity within the scope of customs control to safeguard customs regulatory interests and state security (and, from a regional perspective, the security of member states). It represents an efficient mechanism which is intended to serve the interests of all participants in customs relations – government agencies and foreign-economic activity participants. As such, it satisfies the required principles and standards of modern customs administration.

For example, according to the WCO's *SAFE Framework of Standards to Secure and Facilitate Global Trade* (SAFE Framework), a customs administration should establish a risk management system to validate threat assessments and formulate targeting decisions. According to the WCO (2015, p. 13) customs administrations should develop automated systems based on international best practice that use risk management to identify cargo and/or transport conveyances that pose a potential risk to security and safety based on advance information and strategic intelligence. Further, in accordance with the Revised Kyoto Convention, Standards 6.2 and 6.3 of the General Annex, 'Customs control shall be limited to that necessary to ensure compliance with the Customs law'; and 'In the application of Customs control, the Customs shall use risk management' (WCO 1999a).

The scientific community, however, does not provide an agreed definition of a 'risk management system'. Often, an idealised, utopian position is prevalent when such a system is mistakenly seen as a 'panacea' for all risks connected with customs control and clearance. Nowadays, an RMS in relation

to the activities of customs authorities is predominantly viewed in the context of the application of an automated system to select high risk transactions and determine the form and scope of customs control over them. The fact that such a system of automated selection is only one of the ways of customs control is often ignored.

In our opinion, it is not appropriate to rely solely and exclusively on the application of an automated system of risk management. Such a system is only one of the instruments for risk analysis and evaluation which helps to check relevant electronic documentation. At the same time, the importance of such automated systems should not be underestimated. Thus, we define the RMS as a set of instruments of automated, manual and combined customs controls, based on the principle of selectivity within the scope of customs control required to ensure compliance with customs law.

When speaking about RMS, commentators often refer to the support system for customs decision making, which aims to minimise risk. However, this rather diminishes its importance. Undoubtedly, an RMS includes decision-making processes, however this does not restrain its functions. It also provides additional monitoring, estimation of results, identifying causes, elimination of consequences, and so on. Hence, the application of RMS encompasses both a narrow and broad context of risk. In applying risk management in customs control, customs authorities manage risks in the narrow sense as the potential for (transactional) non-compliance with customs laws, and in general, the application of RMS is aimed at minimising risks in the broad sense as the threat of non-achievement of the objectives of customs authorities.

3. RMS introduced by Ukrainian Customs

The forms and scope of controls, sufficient to ensure that the customs legislation and international treaties of Ukraine are observed at the time of customs clearance, are selected by the customs offices (customs posts) on the basis of the RMS, and may not be determined by other public authorities, nor may their officials engage in applying customs controls.

The revenue and customs authorities analyse, identify and assess risks, develop strategies, and take action aimed at mitigating risks, assess their efficiency and follow up their application. These authorities apply the RMS to identify goods, means of transport, documents and persons that are subject to customs supervision; customs controls applicable to such goods, means of transport, documents and persons; and the scope of customs supervision required. In other words, RMS control comprises risk assessment by analysing, (including through information technology), transactions to select the form and scope of customs supervision, sufficient to ensure that the customs laws of Ukraine are complied with (VRU 2012). Objectives of the application of the RMS include:

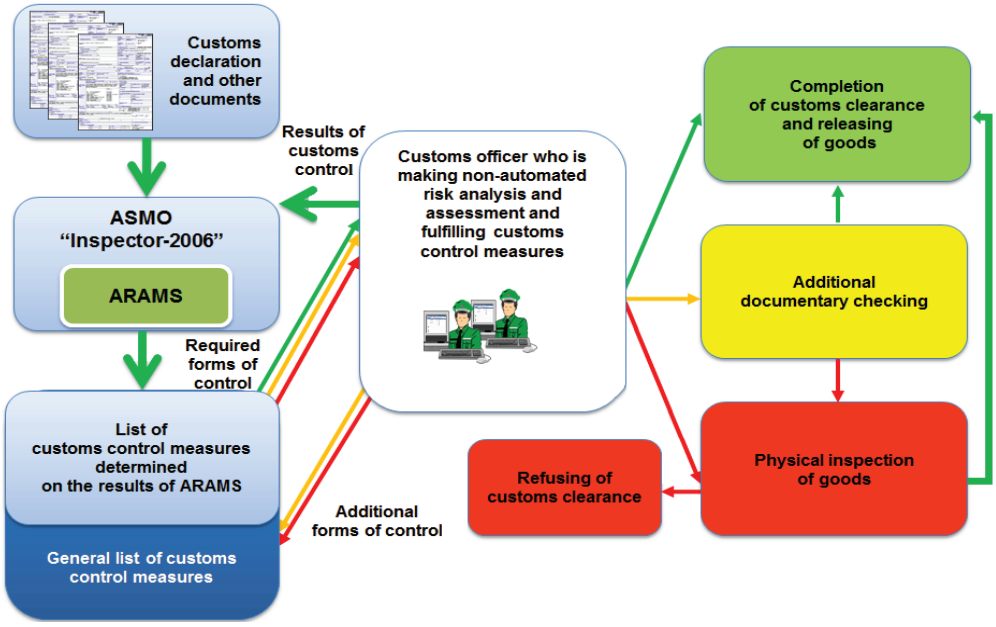
- preventing, predicting and detecting violations of the customs legislation of Ukraine
- ensuring more efficient use of resources available to the revenue and customs authorities by targeting specific groups (the objects of risk analysis) that should be subjected to particular customs controls, thereby enhancing the efficiency of customs controls (risk areas)
- ensuring that actions to protect national security, the life and health of humans, animals, plants, the environment, and consumers' interests are taken within the scope of the revenue and customs authorities' powers
- facilitating the cross-border clearance of goods.

Customs control, based on the application of the RMS, may be automated, manual, or a combination of the two (see Figure 1), with preference given to automated and combined customs control. Combined control includes automated and manual targeting, that is, analysing and estimating risks posed by foreign trade operations and identifying those that should be subjected to additional scrutiny using all sources of

information available to the customs authority. The automated aspects of the RMS are achieved through the use of the Automated Risk Analysis and Management System (ARAMS), which has been integrated into the customs database (ACCS ASMO 'Inspector') which, together with several other systems, have been developed by Ukrainian customs specialists, having taken account of the advantages and disadvantages of other countries' systems.

ARAMS provides automated data comparison within particular transactions, matching them with programmed algorithms (that is, risk profiles). Where potential risks of a breach of customs law are identified, the customs inspector is automatically given the list of customs formalities (forms of customs control) which must be applied in order to further assess the identified risks.

Figure 1: Risk Management System of Ukrainian Customs



Source: Prepared for the IOM in the implementation of PRINEX project funded by the EU.

Upon entering the declaration into the ACCS ASMO 'Inspector', automated risk assessment is executed. Analysis by ARAMS is performed in two stages. First, the level of risk hazard is determined within every risk profile (the result of its quantitative estimate). This indicator is determined in different ways in each risk profile depending on its peculiarities. Specifically, the level of risk hazard depends on a combination of indicators and their values.

The risk profile, which is considered to be one of the key instruments of risk management, comprises risk indicators and an algorithm for automated selection of high risk transactions as well as a set of measures for identifying and minimising the corresponding risk (that is, a list of customs formalities). Initially, the profile is prepared as a document, then assessed and approved by the Commission of Experts on RMS application. The risk profile code is then formulated and input into the corresponding ARAMS module of the ACCS ASMO 'Inspector'. Depending on the practicality of automating risk profiles, some such profiles may be documentary (non-automated control applying the RMS) or electronic (automated) or a combination of both.

Electronic and documentary risk profiles (developed by the Central Office Department) are applied in all Customs Houses unless other means are assigned by the risk profile itself. Documentary risk profiling developed by a particular Customs House is applied within the area of responsibility of that Customs House. Depending on the method used to assign indicator values to risk profiles, regional and central risk profiles are applied. Should indicator values need to be assigned to specific risk profiles, either standard or framework risk profiles may be applied. In this regard, risk profiling involves determining the specific application of particular risk indicators and other risk profile parameters.

In order to enable further examination and/or clarification of the risk area, monitoring of the risk area and, based on the results of such monitoring, taking prompt response measures, hidden risk profiles may be applied which do not involve certain customs formalities (Ministry of Finance of Ukraine [MFU] 2015).

In evaluating risks, there is an opportunity to take into account the track record of foreign economic activity participants, based on positive or negative history indicators of risk profiles:

- negative history indicators quantify violations in a specific period, which are taken into account when determining the level of risk hazard (increase in the level of risk hazard)
- positive history indicators highlight the absence of regulatory violations in a specific period of customs clearances, which are taken into account when determining the level of risk hazard (decrease in the level of risk hazard).

This provides opportunities to adjust the risk evaluation, depending on results of previous system operations. Thus, it is possible to reduce the probability of ineffective ARAMS operations for a particular legal entity, carrier, and so on. However, risk profiling may also be programmed to random sampling, irrespective of positive or negative history.

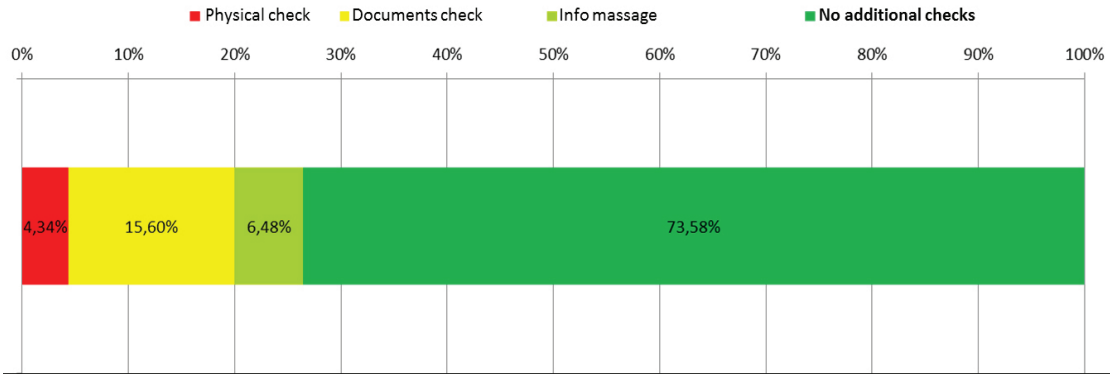
In the second stage of ARAMS analysis, a general list of customs formalities (forms of customs control) is formulated, which contains explanatory notes for the inspector concerning the aim of each type of control and the required scope of such control. Such notes also reference documents that may assist in determining compliance with customs formalities.

The system also provides an opportunity to amend the list of customs formalities depending on specific requirements of a particular customs post, and based on the use of other risk management tools (that is, manually applied risk profiles) such as documentary indicators of risk, operational intelligence, and so on. This approach (using tools of automated, manual and combined control) assists in the formulation of a suite of controls that is adequate for the level and types of assessed risks. The results of customs activities are also recorded, which also assists in analysing the efficiency of ARAMS and making adjustments as required.

Thus 100 per cent of customs declarations undergo primary inspection using ARAMS and only those which present a certain degree of risk are required to be physically inspected (ideally, it is considered that this indicator should not exceed 5 per cent). In 2014, the selection of transactions for physical inspection by ARAMS represented around 4.1 per cent of the total of customs declarations that were selected for physical customs inspection. In most cases (approximately 96 per cent) ACCS ASMO ‘Inspector’ calls for green and yellow channel processing.

ARAMS is therefore aimed at supporting selectivity of customs control (see Figure 2) and minimising the application of customs formalities in order to achieve a balance between customs control and the facilitation of legitimate trade.

Figure 2: Information on selection of customs declarations for additional checks (calculations include Import, Export and Transit (01.01.2015 – 31.06.2015)



Source: Author's calculations.

Today, the scope of ARAMS encompasses the key areas of risk (mainly of a fiscal nature) which include elements such as customs value accuracy control, classification, origin of goods, declaration authenticity, non-tariff regulation, etc. As customs authorities at the border are predominantly concerned with security risks, not only are new risk profiles being developed (and current profiles systematically updated) but complete new modules are being developed and integrated into ARAMS, for which the following are currently in operation and/or in the process of planning and development:

- ARAMS module for customs declarations (including electronic customs declarations)
- ARAMS module for automobile Border Control Posts (BCP)
- ARAMS module for automobile and railway BCPs (for commercial cargo)
- ARAMS module for seaports BCPs (in the process of development)
- ARAMS module for airports BCPs (creation is only assumed).

In order to increase the efficiency of customs control and to raise the efficiency and quality of risk profiles, IT solutions are being implemented by specialists from the Department of Risk Analysis together with specialists from the IT Department which are based on the principle of 'first-hand' risk profiling. Such solutions ('Constructor of risk profiles') will speed up the program implementation of some risk profiles and attract significant customs resources to facilitate the use of ARAMS.

Particular attention is being paid to 'alerts', another instrument of risk management. 'Alerts' represent the information obtained by a customs authority from the results of its own analytical work (or from other customs authorities) or from other law-enforcement authorities domestically and internationally. This information is of an operational and targetting nature and is used for urgent notification of the customs posts about individuals and/or means of transport which may be involved in violations of law as well as for notification about the goods that are the subject of the violation. 'Alerts' also contain information relating to methods of customs control that should be used to expose, prevent and suppress such violations.

Until recently, the use of such notification was only possible in documentary form or, in exceptional cases, by telephone with subsequent documentary confirmation, which lowered the efficiency of operational information dissemination significantly. However, a special module 'Alerts' of the ACCS ASMO 'Inspector' has been developed and implemented which now automates the process. The system

has two types of alerts: local alerts, intended for use in the area of operations of the customs post that created/submitted the alerts into the database; and global alerts, intended for use by all customs posts regardless of which customs post created/submitted the alert into the database.

4. Conclusions

Ukraine is actively taking steps to take a prominent position in the modern globalised world and to integrate into the global economic community. These processes are complemented by corresponding institutional modernisation including in the area of cross-border trade.

International standards serve as the guiding principles for Ukraine that it needs to aspire to during the processes of reformation, and fulfilment of its international obligations will be the 'sign posts' to guide the process and against which the appropriateness and quality of the reforms can be measured.

In turn, the Ukrainian Customs is actively implementing risk management principles of customs control based on international best practices as well as its own solutions, including IT solutions and products. The Ukrainian Customs does not intend to 'reinvent the wheel', but does not consider it appropriate to indiscriminately adopt the existing models which have their own shortcomings.

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Note

1 Lower chamber of the Federal Parliament of Ukraine.

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Reforming automobile excise taxes in the ASEAN region for pro-growth and pro-environment outcomes

Rob Preece

Abstract

The commencement of the ASEAN Economic Community (AEC) from 31 December 2015 could be a critical point in time for the future shape of the automotive industry in the region. ASEAN seeks to establish a 'single market' which is an opportunity for the industry to build and sell vehicles in a market of over 600 million consumers at a time when the environment is increasingly shaping government policies and consumer interest, including in the automotive sector. Can these objectives meet and see ASEAN become a major global hub for automobile production, potentially in new energy efficient and lower emission products? Significant progress towards the critical 'single market' needed to underpin growth in the automotive sector has been made in terms of cutting import tariffs on intra-regional trade, however this progress could be undermined by the emergence of various non-tariff measures appearing across the region. This paper focuses on excise taxation and the recent restructuring of some national excise systems before the commencement of the AEC and the extent to which these excise tariff measures may be acting as non-tariff barriers to the formation of a single market. In response, this paper explores the possible options in the area of developing and adopting a coordinated excise tax policy for ASEAN based on principled excise policy and reflecting changes in relation to the environment. The coordination discussed is indeed not dissimilar to the successful development of the ASEAN Harmonised Tariff Nomenclature (AHTN), and explores the concept of a possible 'ASEAN common excise tariff', or similar which, if allowed to progress, may assist in eventually removing excise taxation policies that could undermine the key principles of the AEC.

1. AEC 2015: What level of integration is proposed (and what will be seen)?

In 2003, the leaders of the 10 member countries of ASEAN agreed to the formation of an Economic Community – the ASEAN Economic Community – as part of its larger 'ASEAN Vision 2020' plan.[1] A 'road map' for implementation of the Economic Community was then set out in 2007 in a document titled the 'ASEAN Economic Community Blueprint' in which deeper regional integration was to be achieved by:

- the creation of a single market and single production base
- a highly competitive economic region
- a region which is equitable in terms of economic development
- a region which is fully integrated into the global economy.

A range of 'sub-level' objectives sit under these core objectives, many of which will be discussed in this paper, such as the free flow of goods, services, skilled labour, investment and capital and, through the Blueprint, for which the region has agreed a range of 'action items' to support the implementation of this deeper regional integration.

In terms of a move towards the 'single market and production base', there may be a different interpretation of the concept than is seen in other economic communities. Given that the AEC will operate with each of the 10 member countries retaining full border controls, the 'free flow of goods' which is outlined as a measure of the single market and production base, will not refer to the intra-regional borderless movement of goods but rather refer to the reduction of the customs tariffs on ASEAN-origin goods moving across those borders.

Therefore, 'free flow' in the AEC will not be 'free circulation' as, say, in the European Union (EU) where goods of EU origin, or goods from outside of the EU having cleared Customs, may move freely from one member country to another. Instead, under the AEC, 'free flow of goods' means, essentially, the removal of customs import tariffs under the Common Effective Preferential Tariff (CEPT) mechanism of the ASEAN Free Trade Agreement (AFTA),[2] by 2015, with some flexibility for Cambodia, Laos PDR, Myanmar and Vietnam until 2018. Similarly, the ASEAN Trade in Goods Agreement (ATIGA) also serves to ensure that tariff barriers eliminated under the CEPT are not replaced with non-tariff measures.[3]

The term 'free flow of goods' may also mean the proposed improvements to customs procedures at national borders, and a reduction in the time taken for goods to leave and enter member countries. The AEC Blueprint calls for better trade facilitation initiatives such as the simplification and transparency of relevant import/export procedures, as well as calling for improved customs integration between member states of ASEAN.[4]

Harmonised classification of goods traded with ASEAN has also been largely addressed through the development and implementation of an ASEAN Harmonised Tariff Nomenclature (AHTN) from 2003[5] and will have a positive effect on certain aspects of trade facilitation and ease of import/export transactions in the region. However, it should be noted that no 'common external tariff' has been developed, and is unlikely to be developed until the region is ready to remove customs border control on intra-regional trade, an area not really discussed as yet.

At this point, clarity may be useful in the context of what level of economic integration will be occurring from 31 December 2015. Holden (2003) has summarised the literature into the key stages of economic integration as being a:

- Free trade agreement (FTA) or preferential trade in which members reduce tariffs to zero for intra-regional trade and reduce non-tariff barriers
- Customs Union which is an FTA with a common external tariff, free flow of goods across borders but maintenance of national economic policies
- Common Market which is a Customs Union with free flows of services, investment, labour and capital, with some harmonisation of economic policies
- Economic Union which is a Common Market with common economic policies and common political and economic institutions.

Using Holden (2003) as a guide, it would appear that despite the terminology of 'Economic Community', 'single market' and 'free flows of goods and services', ASEAN is realistically developing an 'enhanced free trade area' or is at the first level of regional economic integration. Understanding this position on regional economic integration now helps inform key questions in relation to the study in that for ASEAN as an enhanced free trade area:

- How can excise taxation policy be coordinated to support tariff reduction so that the automobile industry sees ASEAN as a single market?
- How can excise taxation policy be coordinated to support tariff reduction so that the automobile industry sees ASEAN as a single value chain in the production of automobiles?
- What are the key objectives of automobile excise taxation and how do these relate to the coordination of excise reforms in the region?

The AEC Blueprint also envisages greater integration with the rest of the world and, as an entity, ASEAN has successfully negotiated and implemented FTAs with the following countries:[6]

- Australia and New Zealand
- China
- India
- Japan
- Republic of Korea.

This objective of greater global integration is designed to help boost the income of the region by opening up new market opportunities for ASEAN-based businesses, taking full advantage of the efficiencies gained from more efficient supply chains and reduced costs to be more competitive in these new markets.

However, as the 31 December 2015 start date for the AEC drew nearer, it was increasingly apparent that full implementation of the Blueprint would not be achieved and indeed, at the time of writing, the ASEAN leaders 'signed off' on a new way forward: a document known as the *ASEAN Economic Community Blueprint 2025* to finalise economic integration.[7]

In terms of the focus of this paper on automobile excise taxation, the main question will be how to coordinate excise taxation amongst the member countries so that the elements required for a strong ASEAN-based automobile industry can be put in place as a platform for the region to be exporting product through these FTAs and beyond. This point is expressly contained in the new AEC Blueprint as part of the need to coordinate certain taxation policies as:

> Explore the possibility of collaboration in excise taxation and information sharing among ASEAN Member States on common excisable products.[8]

Indeed, automobiles are subject to an excise tax in all 10 ASEAN member countries and thus very much are a 'common excisable product' (Preece 2014).

A strong ASEAN-based automobile industry will need ASEAN to be seen as a single 'domestic market' of over 600 million consumers, and as an 'integrated regional value chain' allowing for economically efficient production and distribution. Only with the ability to make competitively priced automobiles and sell into a domestic market of this size can the base be formed to compete in the global automobile market to the full potential.

2. Snapshot of the ASEAN automobile industry in the lead up to the AEC

As the AEC approaches, the ASEAN Automobile Federation (AAF) (2015) states that the current status of the automobile industry across the region includes total automobile production of 3.98 million units in 2014 (down by 10 per cent from 2013). Production is dominated by Thailand (1.88 million) and Indonesia (1.3 million) which together is around 82 per cent of total regional output. Production also occurs in Malaysia (0.59 million), Vietnam (0.12 million) and the Philippines (88,000).

In terms of sales, some 3.19 million automobiles were sold within ASEAN during 2014 (again, down around 10 per cent from 2013 sales). Thailand and Indonesia also have the largest markets: Indonesia at 1.21 million sales and Thailand at 0.88 million. Malaysia then follows with 0.67 million units sold, with the rest of ASEAN (Brunei, Cambodia, Laos PDR, Myanmar, Philippines, Singapore, and Vietnam) making up the remaining 0.43 million sales.

ASEAN's automobile industry is dominated by Japanese multinational automobile manufacturing companies. In 2013, Japanese original equipment manufacturers (OEMs) combined to account for around 86 per cent of total ASEAN production of automobiles, and some 87 per cent of automobile sales across ASEAN (*JAMA News* 2014). Within these 3.87 million automobiles produced in 2013, some 1.27 million were exported from ASEAN which makes the automobile industry one of the more important manufacturing sectors in the region. It is therefore important to note at this point that Japanese OEMs have also identified full implementation of the AEC 2015 as an area of concern, particularly the non-tariff barriers to trade along with customs and related trade procedures which work to limit the potential for future growth that could normally expected under closer economic integration (*JAMA News* 2014).

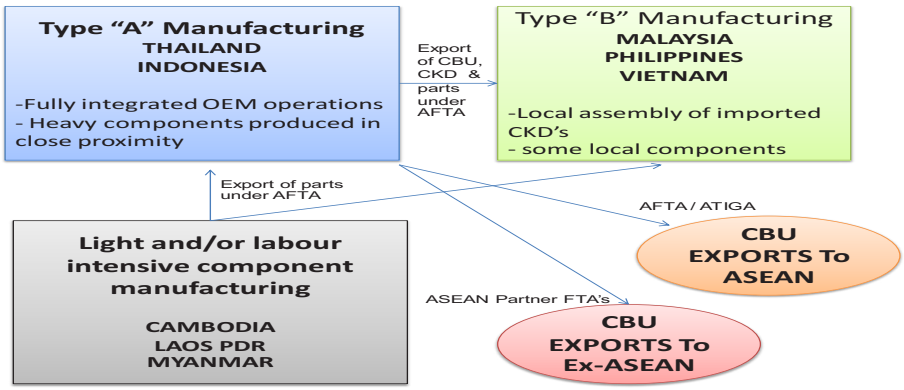
3. How might the AEC impact upon the ASEAN-based automotive industry?

The automotive industry is one of 12 'priority integration sectors' under the AEC (ASEAN 2011, p. xiii). This has earmarked the automotive industry for focus on several key integration issues such as mutual recognition of 'approvals' and harmonisation of technical regulations – both significant to the automotive industry.

Notwithstanding this, several researchers including Wad (2009, pp. 172-93) and the Economic Research Institute for ASEAN and East Asia (ERIA) (2014, pp. 4-15) have attempted to look beyond the commencement of the AEC to estimate the impact of the level of economic integration proposed (and likely) as per the discussions above. Whilst it is recognised that at this stage only predictions of the effect can be made, it is important to hear what these types of industry experts believe will be the result of the implementation of the AEC in its current form. These researchers consider that any restructure could adopt the following components, which the author has also outlined in Figure 1:

- Concentration of fully integrated or traditional automobile assembly of Completely Built Up (CBU) units into Thailand and Indonesia, supported by heavy component manufacture such as power train plants, etc., which will stay in close proximity to the final assembly places
- Some growth in the assembly in large or emerging markets of primarily imported Completely Knocked Down (CKD) units such as in Malaysia, Philippines and Vietnam, and some very small scale assembly of Semi Knocked Down (SKD) and CKD in new markets like Cambodia, Laos PDR and Myanmar
- Light components and/or labour-intensive component parts production move to lower wage cost Cambodia, Myanmar and Laos PDR with associated 'hollowing out' of auto component parts industries in higher wage cost Thailand, Indonesia and Malaysia
- Export growth of CBUs and CKDs from Thailand and Indonesia with components from across ASEAN, going to both the ASEAN market and markets outside of ASEAN, and that
- Singapore and Brunei will continue to be 'fully import' CBU markets.

Figure 1: Possible shape of automobile industry in ASEAN post AEC implementation



Source: Author.

4. Can deeper regional integration strengthen ASEAN's automotive industry? A case study from NAFTA

The premise is that the region desires greater economic growth using the AEC and its deeper level of integration to help achieve this. To begin looking at the relationship, this paper now looks at a region of similar economic integration and which has an automobile sector important to its combined economies. In this regard, the North American Free Trade Agreement (NAFTA), comprising the United States (US) of America, Canada and Mexico is an ideal case study. Commencing in 1994, NAFTA provides a number of insights into the benefits of closer economic relations and identifies that it has been positive for the automotive industries of all three countries.

Whilst the benefits to the three members of NAFTA differ somewhat, overall regional integration has been successful for the market of 485 million consumers with intra-regional trade growing from around USD290 billion in the year prior to the commencement of NAFTA to over USD1.1 trillion after the first two decades (Sergie 2014). Trade outside the region has also grown, and on an annual basis, exports from the US have grown 6.3 per cent, from Canada 4.7 per cent, and from Mexico, a significant 10.5 per cent.

In relation to the automotive industry within the NAFTA area, it appears there were immediate positive impacts for all three countries. According to the Heritage Foundation (1997), the first three years of NAFTA can be summarised with the following milestones:

- The total trade on motor vehicles and parts between the US and Mexico doubled to USD25 billion between 1991 and 1995
- US exports of motor vehicles and parts to Mexico increased 11 per cent between 1993 and1996
- US exports of motor vehicles overall increased in excess of 500 per cent between 1993 and 1996
- Mexican exports of motor vehicles and parts to the US increased by 100 per cent
- The Canadian parts industry was able to take advantage of the tiering of the industry and make necessary restructuring to stay viable

- Canadian OEMs were able to reconsolidate after the early 1990 cyclical downturn into a position of strength that may not have been possible without NAFTA
- US imports of Mexican-assembled motor vehicles contain more than 50 per cent US-made parts (and is a percentage which is continuing to rise each year).

The actual quantitative assessment as to the extent of that success for the automobile industry over the 20 years of NAFTA is very much subject to ongoing debate. Whilst the 'headline' numbers are positive, there were certain areas within NAFTA which have different experiences, for example, a US-based worker, or a US town where employment positions have been re-allocated to plants in Mexico, have been impacted negatively by NAFTA. However, at the industry level and based on the numbers, NAFTA is viewed as a success:

> '… in the past 20 years of NAFTA exports of Mexican cars have grown 480 per cent since 1993, and imports of North American cars to Mexico have increased 280 per cent – a dynamic win-win'.[9]

On a qualitative basis, the quantitative assessment is also supported by industry:

> 'The automotive industry's supply chain has successfully intertwined across our North American borders, allowing for synergies and economies of scale. Without NAFTA, Mexico's positive contributions to the automotive industry, one of the world's most critical business sectors, never would have reached fruition.
>
> 'Thanks to NAFTA, we are experiencing job creation, profits and sales across our borders in the auto industry and beyond. It is this mutually beneficial trade agreement that served as a catalyst for making North America a stronger, more powerful group of nations and a dominant player in the automotive industry.'[10]

Similar comments come from government sources, such as:

> Since 1993, light vehicle production capacity has increased in all NAFTA countries, including an increase of 714,000 units in the United States and 437,000 units in Mexico. U.S. automotive parts production has increased 81 per cent since 1992, to $181 billion in 2001 (International Trade Administration 2001).

Perhaps one measure of success is the level of Foreign Direct Investment (FDI)[11] or what investors are prepared to put into the industry and into industry in the NAFTA region. In terms of the North American automobile industry, and looking at FDI as a measure of attractiveness as a destination for investment, the first three years of NAFTA saw an additional USD39 billion in US plant and equipment and a further USD3 billion in Mexico. Since then FDI has grown steadily in Mexico as it realises its potential, but significantly its growth in FDI has come without decreases in the other two member countries – rather, NAFTA has seen real growth in FDI across the Northern American area.

Canada's benefits have not been touted in the same glowing terms as those of the US and particularly Mexico but, as discussed above, the implementation of NAFTA has seemingly allowed a 'rebuilding' and 'repositioning' of the sector to provide the strength to remain viable. This also seems to be true in the US. Some of the FDI increases for Mexico are noted to have come from the US-based auto makers and this seemingly is due to re-structuring of the industry into a series of 'productive and financially efficient networks', which in itself was a 'critical factor for United States auto makers being able to once again regain their competitive edge' (Carrillo, Lung & Van Tulder 2004, p. 146).

In the context of NAFTA, and the success for the Mexican automobile industry, it is worthwhile reviewing a particular 'challenge' for the Mexican Government which was protecting the automobile sector from imports at the time NAFTA was being negotiated – the issue of 'protectionism' which may well be

one faced by some governments in ASEAN and which will be discussed further below. Mexico had a wide range of 'protectionist' policies supporting the local automobile industry at the commencement of NAFTA but these were gradually phased out and rather than a collapse of the industry, today in Mexico the situation according to Scotia Bank (2014) is highly positive:

- some USD10.6 billion in FDI in the last three years (80 per cent of FDI from the North American automobile industry)
- annual growth of 6 per cent in automobile and automobile parts production
- Japanese and European automobile makers now responsible for 60 per cent of Mexico's automobile production
- reaching the top 10 automobile producing countries in 2006.

Thus there are important lessons for ASEAN in terms of the link between removal of tariff and non-tariff barriers to intra-regional trade and real growth in the automobile sector, with the Mexican auto sector highlighting the potential for growth in a functional 'single market and production base'.

5. Reforming automobile excise – the latest principles

Automobile excise taxes have traditionally been based on vehicle ownership being seen as a 'luxury' and having excise taxation designed to contribute to the progressivity of a country's tax system, however, this view is now slowly changing in recognition of levels of vehicle ownership and the need to correct a range of negative externalities. The OECD notes this shift in the taxation of motor vehicles in its latest consumption tax trends review:

> … ownership of car levels has led to less progressivity [arising from the taxation of automobiles]. The new objectives of automobile taxation relate to consumer or business behaviour with more recent trends being environmental – reference to CO_2 emissions, fuel efficiency, other emissions, town planning, and transport policies … (OECD 2014, pp. 143-7).

In designing any tax policy some concepts remain constant in that taxes should be neutral, or that tax rates, tax bases and tax structures should not impact markedly on investment, production or consumption decisions. Taxation should not be designed by policymakers to discriminate – either negatively or positively – so as to favour any one industry or one taxpayer over another nor should it be used to distort business and investment decisions.

However, in certain circumstances, including the taxation of automobiles, there can be a justification to levy a 'special' tax like an excise duty to correct various negative externalities associated with the consumption of selected products. In terms of automobiles, Cnossen (2005, p. 598), Preece (2015, pp. 16-17), and Weisbrod, Vary and Treyz (2003, p. 3) state that such externalities can include:

- Cost of operating public roads which is seen as an 'economic charge' on road users and would extend to addressing revenues required for road building as well as ongoing operations such as traffic lights, road signage, rescue and recovery, etc.
- Costs of maintaining roads from damage caused during normal road usage
- Emissions of CO_2 contributing to negative environmental impacts such as immediate air quality in urban areas and the broader impacts associated with climate change
- Traffic congestion from the growing number of automobiles on the road and the increased number of trips being made by those vehicles particularly at certain peak periods. This is particularly the case where road infrastructure is unable to support the volume of vehicles. There are also connections

with other environmental costs as emissions are double those from idling vehicles as from moving vehicles. There is also an economic cost from increased times taken for workers and businesses to move people and goods via road in terms of 'travel cost', 'additional business operating costs' and 'lost productivity'.

Aside from revenue and externality correcting considerations, there is often a further level of excise tax policy considerations in those countries which have an existing or emerging automobile industry. In this case, it is usual for the automobile industry to contribute substantially to that country's GDP and as such be of significant economic benefit for which excise (and other tax policies) can often be shaped to support the ongoing viability of the industry.[12]

The automobile sector covers an entire supply chain adding value from 'upstream' industries such as mining and metals, rubber, plastics, glass, etc., to 'downstream' industries such as distribution including to retail, service and repairs, marketing, finance, insurance, rentals and fuel products, and is not limited to component production and vehicle assembly. Value is added at each point of the automobile supply chain, employing many people across the economy.

Just as important to the economy is the development of new technologies and other intellectual property (IP). The value that this creates can be significant and ensures the long term position of the automobile sector and can create potentially large export income opportunities for the country. In addition, some of the next technology or IP created in the industry can be utilised in other industries (for example, CO_2 emission reductions), further expanding the value of this sector.

In this context, and as highlighted by the OECD (2014), there is a clear trend towards shifting automobile excise taxes to address environmental concerns and encourage (or support) the development of reduced emission technology in new automobiles. Across the rest of Asia, excises or special consumption taxes exist in major automobile producing countries like China, South Korea, India and Japan – and indeed policies in these countries are starting to shift towards addressing various environmental and fuel use issues (Van Calster, Vandenberghe & Reins 2015). Automobile excise taxes also appear widely across Africa, and environmental levies and surcharges have appeared in the automobile excise tax system of South Africa.

Excise taxes on automobiles are not widely used across either the Middle East or the EU. However, in the EU there is taxation of automobiles which occurs through 'road use' taxes, and in many cases will recognise energy use and environmental policies. Looking at a current example from the EU of an automobile tax, the United Kingdom's 'Vehicle Excise Duty' (VED)[13] system classifies vehicles primarily by their CO_2 emissions, then applies a rate depending on whether the vehicle uses petrol/diesel or 'alternate fuels'. However, it should be noted that VED is actually an annual road tax despite being levied on the vehicle owner and despite the tax being called an 'excise'.

6. What is happening with automobile excise reform in ASEAN?

The lead-up period to the AEC has seen several reforms to the excise taxation of automobiles, some of which will actually come into effect from 2016 in line with the AEC starting timeframe. The most significant of these reforms is Thailand's restructuring of its classification criteria to reflect CO_2 emissions – aligning with some of the international thinking on more closely linking the taxation of motor vehicles with the key externality of emissions. However, there have also been notable amendments to automobile excise taxes in Indonesia, Malaysia and Vietnam, as well as a new policy announcement made in the Philippines details of which were to be released at the end of 2015.

The following country reforms highlight some trends – particularly a move to incentivise products with 'environmentally friendly' features such as smaller engine displacements, higher fuel efficiency and lower CO_2 emissions. However, these reforms are also designed to ensure promotion of local automobile

assembly often by shaping the classification criteria to support a certain product category, and in some instances the shaping of such criteria, or indeed the design of such excise taxes in general, which can create a barrier to the import of like products in a particular category of automobile. This will no doubt arise as the AEC establishes itself and risks the creation of the 'single market and production base' that is critical in an industry such as the automotive which relies on economies of scale and the ability to source best priced componentry for assembly and distribution to a large market.

In terms of individual country reforms during the lead up to the start of the AEC, we see:

Thailand

In terms of reform, the most notable is that of Thailand which will see two significant amendments. First, it will transform its excise tax classification of automobiles to be based on CO_2 emissions, as well as incorporating a general excise tax-wide reform that will see the current *ad valorem*-based excise rates applied to each category of motor vehicle moved from the manufacturer's 'ex-factory' valuation to the manufacturer's 'suggested retail price' (JAMA 2015). The actual classification changes appear in Figure 2 and came into effect on 1 January 2016, and apply to vehicles with an engine displacement of up to 3000cc or 3250cc for Passenger Pick-up vehicles (Preece 2015).

Figure 2: Thailand: New automobile excise structure from 1 January 2016

Vehicle type	**Category** (CO_2 emissions)
Passenger cars not more than 10 seats	≤ 100 g/km
	101 - 150 g/km
	151 - 200 g/km
	> 200 g/km
	> 3,000 cc
Space-cap Pick-up	**Cab type: Rate differs for Double, Space, or Single**
	≤ 200 g/km
	> 200 g/km
Passenger Pick-up Vehicle (PPV)	≤ 200 g/km
	> 200 g/km
Space-cap Pick-up & PPV	> 3,250 cc
Eco cars	< 100 g/km
	101 – 120 g/km
Electric vehicle/fuel cell/hybrid	≤ 3,000 cc
	> 3,000 cc
OEM Natural Gas Vehicle (NGV)	≤ 3,000 cc
	> 3,000 cc

Source: Excise Department, Ministry of Finance, Thailand.

One important issue (Preece 2015, pp. 28-9) arising in relation to the use of CO_2 emissions as a criterion for taxation is that of emission certification or emission confirmation given this becomes central to the product's final classification. Given that emissions of a vehicle will depend on the type of testing conducted, it will be essential to include the emissions measurement process as part of any excise tariff law. In this regard, Thailand has combined existing CO_2 testing procedures operated under consumer and environmental law with excise law and an 'Eco Sticker' which includes CO_2 emissions expressed as grams per kilometre, as well as fuel economy expressed as litres per 100 kilometres and fuel/emission standards met, will also serve as the basis to confirm excise tax classification from 2016.[14]

In terms of a move towards a suggested retail price from the manufacturer's selling price ex-factory, this has been touted as a response to the need for increased transparency as retail prices are accessible to all parties for verification, whereas there have been issues confirming import values and manufacturers' selling prices.[15] This move to use a suggested retail price will apply to all goods subject to excise taxation in Thailand and will require a range of supporting regulations, particularly in those cases where an importer or manufacturer has little certainty about what the likely retail interest will be.

The challenge for Thailand in these two reforms will be to ensure that these respective regulations for determining CO_2 emission levels (through the Eco Sticker process) and assessment of the suggested retail price do not unduly impact on importers but rather apply to domestic assemblers.

Indonesia

Indonesia made reforms in both 2013 and 2014 to its 'Luxury Sales Tax' in relation to automobiles, the 2013 regulations supporting significant government policy objectives around attracting investment in a 'Low Cost Green Car' (LCGC) category which would strengthen the local automobile sector. The 2014 reform made through the Finance Minister's Regulation 64/PMK 11/2014 primarily placed a significant tax burden on passenger vehicles with larger engines, by increasing the tax rate on such products by 67 per cent. The new Luxury Sales Tax rates for passenger vehicles are now as follows:[16]

> Passenger Car (Multi-Purpose Vehicle Two-Wheel Drive) less than 10 passengers (spark ignition and compression engine)
>
> Engine capacity:
>
> - < 1,500 cc 10%
> - 1,500–2,500 cc 20%
> - 2,500–3,000 cc 40%
> - > 3,000 cc 125%

The effect of the reform is to create a substantial rate differential for vehicles above and below engine displacements of 3,000 cc, and places significant competitive pressures on importers or domestic producers with products in that size market. The excise rate increase for larger engine vehicles also reinforces measures taken with the reforms to the Luxury Sales Tax in 2013 which were introduced to support or further promote the LCGC program and its objectives for a product category in which the Indonesian auto sector could take leadership.[17]

Under Finance Minister Regulations 41 and 33 of 2013, the taxable value applicable in calculating the Luxury Sales Tax can be reduced by either:

- 75 per cent: Use of advanced engine technology, duel petrol/gas engines (converter kit CNG/LGV), bio-fuel engines, hybrid engines, CNG/LGV dedicated engines with fuel consumption of 20-28 lt/km
- 50 per cent: Use of advanced engine technology, duel petrol/gas engines, biofuel engines, hybrid engines, CNG/LGV dedicated engines with fuel consumption of > 28 lt/km

- 0 per cent: Motor vehicles manufactured under the LCGC and LCEP programs (other than sedans and station wagons) with:
  - Spark ignition up to 1,200 cc; or
  - Compression ignition up to 1,500 cc; and
  - Fuel consumption of at least 20 km/lt.

Whilst a clear targeting of environmental harm and fuel efficiency is part of this reform, it is unlikely that imported products will ever have access to the discounted taxable values as one criterion to access the discounts is an 80 per cent local content condition.[18] Whilst this would be a measure directly targeting support for the local automobile sector, it is in effect a non-tariff measure for which the AEC Blueprint, AFTA and ATIGA agreements seek to have removed in intra-regional trade.

Malaysia

Malaysia's National Automobile Policy (NAP) was released in 2014 and included a reform to the existing 'local added value' adjustments (discounts) to the value to be used for excise calculation as permitted under the Industrial Adjustment Fund (IAF). To encourage Malaysia to become a 'hub' for the energy efficient vehicle (EEV) certain 'multipliers' were added in addition to the local value content discounts.

These multipliers of between 1.1 and 1.6 (as awarded by the government based on levels of 'base localisation') reduce the taxable value exponentially by the awarded factor. An automotive analyst's briefing highlights this dual policy incentive effect[19] and suggests that where a 1.6 multiplier has been awarded (or 65 per cent 'base localisation'), the effective rate of excise is reduced to almost 0 per cent.[20]

Again, the excise policy reform is reflective of positive environmental and fuel efficiency outcomes, however, it is equally providing incentives through the excise system for investment into the Malaysian automotive industry, particularly through the creation of a specialised category, the EEV. As with Indonesia, the move to provide this type of support to the local auto sector has led to what can also be described as a non-tariff measure given that fully imported products will be unable to access the excise tax benefits that will be available to locally built vehicles meeting a minimum local content requirement.

Vietnam

Decree 108/2015/ND-CP of November 2015 creates new classification criteria as well as adjusting rates and the taxable value for both domestically assembled and imported vehicles. In terms of new classification criteria, for passenger motor vehicles up to nine seats, classification for excise will be based on the following engine displacements:

- < 1,000 cc
- 1,000 up to 1,500 cc
- Over 1,500 up to 2,000 cc
- Over 2,000 up to 3,000 cc
- Over 3,000 cc.

The new smaller engine classifications of < 1,000 cc and 1,000–1,500 cc have been determined 'priority' categories[21] and given effective excise tax rate cuts whilst the larger engine categories receive small rate increases that will take effect on 1 July 2016.

The revised classification criteria also introduce a new category for '*passenger cars with cargo carrying*' commonly known as 'pick-up trucks' which will receive a rate that is 60 per cent of the rate applying as if it were a passenger car (that is, determined by engine displacement) which is an effective rate increase for any pick-up truck with an engine size over 1,000 cc. Existing rate discounts for vehicles running on bio-fuels or hybrids continue to apply at the existing discounts.

The other area of reform in the Draft is the amendment of the valuation for excise tax calculation for imports from a (CIF + Customs Duty) value to an 'importer's on-selling price' that must be 'greater than 105% of the CIF + Customs Duty value' which effectively increases the excise valuation for these products. For domestic assemblers, the new excise value will be the 'wholesale price' which itself must be with 7 per cent of the average wholesale price for that product. If either imported or locally assembled vehicles fall outside these valuation parameters, a valuation process prescribed in an as yet unwritten Regulation will be used.

The Philippines

The Philippines has recently announced a new automotive industry policy through Presidential Executive Order 182 aptly titled the Comprehensive Automobile Resurgence Strategy or 'CARS' program. The intention is outlined in the Order itself that states:

> … the 'CARS Program' is hereby adopted and implemented in order to attract new investments, stimulate demand and effectively implement industry regulations that will revitalize the Philippine automotive industry, and develop the country as a regional automotive manufacturing hub …

The program will allocate a maximum of 27 million Peso to an Automotive Development Fund through the annual national budget each year for six years starting in 2016. Included in the eligibility criteria will be a need to meet the standards for fuel efficiency and emissions, as well as having a minimum production threshold. Excise tax incentives will also be introduced, however, as with all fiscal details of the CARS program, observers and industry participants are awaiting the release of the supporting Implementing Rules and Regulations (IRRs) due for release at the end of 2015 (Magkilat 2015) however, at the time of writing, these IRRs had not been released.

7. The AEC and 'pro-growth' for the automotive industry

The AEC 2015 represents a significant opportunity for the ASEAN member countries to coordinate across a range of policy areas with the intention of building a leading automobile production region which is highly competitive globally. This paper focuses on excise taxation as a possible area of better policy coordination. Currently, ASEAN as a region is producing less than 4 per cent of the world's passenger motor vehicles and less than 2 per cent of commercial vehicles,[22] therefore significant potential exists to grow this figure and for the region and its people to share in the wealth such growth would create.

The need for greater coordination lies in the core of the AEC 2015 which is to create a single market for automobiles produced in the region so that the five automobile producing member countries today are selling not just domestically but to a potential consumer base in excess of 600 million people. From such a strong ASEAN single market, the OEM based in the region are able to generate the efficiencies of scale required to build automobiles which can then begin to compete globally.

Strong regional sales will result in the necessary investments of capital by the OEMs, spreading opportunities across the region as value chains are developed, vehicles assembled and sales made. Some predictions (Frost & Sullivan 2012), have put total automobile sales in the ASEAN region at 4.7 million units (3.1 million passenger and 1.6 million commercial vehicles) by 2018, meaning it would become the world's 6th largest automobile market, provided the benefits of the AEC can be properly realised.

The potential may also expand into future technology development, with the Thai Board of Investment (BoI) aspiring to have new 'green automobile' technologies designed and produced in the region, which could make ASEAN a global centre of 'green car' production. However, the BoI notes that the success of ASEAN as a global production hub will depend upon the proper implementation of the AEC stating:

> … Although the AEC will make ASEAN a hub of auto production, there are challenges to overcome and a need to minimize any barriers that will impact industrial growth (BoI, Thailand 2013).

What does the Thai BoI mean by 'barriers that will impact industrial growth' in auto production? Whilst trade barriers between ASEAN have been largely reduced (over 99 per cent of tariff lines are now at 'zero' for the ASEAN 6, and 98.6 per cent of tariff lines at 0-5 per cent on ASEAN CLMV),[23] there is a growing level of concern that the region is implementing a number of non-tariff measures to continue a level of protection over certain sensitive industries (Austria 2013, pp. 31-4). These are described by Austria (2013, p. 34) as currently including, at the border, additional taxes and charges, import bans, import subsidies, non-automatic licensing, import procedures and technical barriers, whilst beyond the border, investment measures, state aid and trade facilitation measures, and as is the focus of this paper, the design of excise taxes.

Non-tariff measures (NTMs) are a particular concern in the automotive sector across ASEAN. Austria (2013, pp. 62-6) has reviewed the ASEAN Non-Tariff Measure Database[24] finding for HS codes 8703 (motor cars and other motor vehicles) and 8708 (parts for 8703) that between 70 to 100 per cent of trade in these HS codes in the region are subject to NTMs. This is having two main (negative) effects. First, it is risking the establishment of a 'single market', a key objective of the AEC 2015, and denying the industry the opportunity to maximise 'domestic' sales. Second, it is impacting the competitiveness of the industry as the regional value chain is having costs added to it each time parts and components move across borders for assembly. These costs resulting from NTMs add notably to the price of finished products, and again, detract from another key objective of the AEC: to create a single production base.

In terms of excise taxation, the structure (items, rates and rate differentials) of an excise tax system can operate as a non-tariff measure, impacting the commercial viability of importing or manufacturing those products which will face exponentially larger excise liabilities than those applying to competing products. The following is a summary of the common ways in which an excise tax can be designed and can effectively operate as an NTM, with each of these designs being seen across ASEAN.

Use of excise rate differentials

The use of excise rate differentials on what are essentially 'like goods'. A product category is 'split' into sub-categories based on a single criterion, in the case of automobiles it is usually engine displacement, with each sub-category being assigned a different excise rate. Usually, as engine sizes increase so will the assigned excise duty rate. Whilst this may be reasonable in excise taxation where sub-categories have different levels of externalities associated with consumption, it becomes questionable when one sub-category is assigned an exponentially higher rate so that just a small increase in engine size results in a substantially higher excise tax burden, particularly if local producers are specialising in certain engine sizes.

Excise valuation 'discounts' on meeting certain criteria that support domestic production

The use of a discounted excise valuation to calculate excise where there is local value add. Automobiles can be exported as CBUs, or exported as kits which are either SKD or CKD for which there will need to be a value add conducted in the country of import thus providing some economic benefit to that country. To encourage the maximum local value add, the excise system can be designed to provide a discount in excise for SKDs, and higher discounts for CKDs over imported CBUs.

The use of discounted excise valuations can also be used if, say, a criterion is met such as a minimum local content in the automobile. Usually, this is as a result of a government policy to support the local

automobile sector, both component production and vehicle assembly. Increasingly, this is used with other criteria relating to a government initiative to develop a new product which is perhaps environmentally friendly, energy efficient, low cost, or several of these.

The use of discounted excise valuation 'multipliers' based on local content and other criteria. As above, and usually arising from a government policy to support the local automobile sector (and other initiatives to develop new products related to, for example, the environment and emissions, energy efficiency, affordability from consumers, or several of these), the discount for use of local content or for local value add is increased exponentially, encouraging importers and manufacturers to use more local components and do more local assembly.

Use of government incentives to direct products to lower taxed classifications

Reduced production costs to access lower excise rate categories. These can be used in excise systems where excise rate differentials exist based on a particular selling price. Where a government exempts certain taxes and charges, or subsidises certain costs, these feed into the taxable value and can place the product in a lower excise category than an importer or manufacturer not given access to the same exemptions or subsidies.

8. The pathway to removing excise-based non-tariff measures

If it can be accepted that on the grounds of seeking 'pro-growth' and 'pro-environment' outcomes from the AEC for auto manufacturers, the next question to address is how does ASEAN agree on a coordinated regional policy for excise taxation which, if implemented, will steer policymakers away from designing excise tax based NTMs to support local industries? Significantly, ASEAN is not the only free trade area to consider the issue of excise tax policy coordination across its membership and options for the ASEAN region could be informed by the approaches adopted in these other trading blocs.

Looking at other 'free trade areas' it is apparent that the process of achieving excise tax coordination across a region is not easy. In the experience of three such economic communities, the issue of aligning priority areas and policy objectives of all member states is difficult, according to Cnossen (2010) in relation to the Southern African Development Community (SADC) and, similarly, Petersen (2010) in relation to the East African Community (EAC). Whilst both these communities have attained levels of economic integration deeper than ASEAN hopes to achieve by the end of 2015, excise coordination is still somewhat illusive. Even the EU which has attained the deepest form of integration, struggled with coordination of excise tax policies and achieved a degree of coordination that contains many compromises and often provides significant flexibility to accommodate the differences between the 27 members (Cnossen 2010).

Another significant factor is the legal basis of the formation and operation of the free trade area itself and the ability for a central body to make and enforce rules on member countries. This will be a challenge for ASEAN as it lacks a set of regional institutions capable of both making and enforcing regional policy and practices, instead it moves forward on concepts and issues via consensus (Cuyvers, de Lombaerde & Verherstraeten 2005; Hill & Menon 2010; Rillo & Wignaraja 2015). Rather, ASEAN through its Charter operates a Secretariat which is more a 'coordinating' body in Jakarta which works to coordinate regional members and facilitate the building of consensus, as required, between those members (ASEAN 2008). In this context, it is difficult to pursue a 'legislative' approach such as in the EU where laws made by the European Parliament and Directives issued by the European Commission are legally binding on member countries.

Therefore, it is perhaps more relevant to discuss the approach by the Southern African Customs Union (SACU) which comprises Botswana, Lesotho, Namibia, South Africa and Swaziland. Again, the formation of a customs union represents a deeper level of economic integration than is being implemented through the AEC with both a free trade agreement between members and a common external tariff setting import tariff rates for imports from outside the SACU. However, like ASEAN, the SACU maintains full border controls between members with a number of facilitation measures such as 'one stop clearances' being introduced (Stern & Ramkoloman 2013). Here, the approach to excise coordination in the SACU stems from the original agreement which established the Union known as the *2002 Southern African Customs Union Agreement* which, at Article 22, states:

> **Legislation relating to Customs and Excise Duties:**
>
> Except as otherwise provided in this Agreement – Member States shall apply similar legislation with regard to customs and excise duties.

Article 22 is merely a statement of intent and guidance for excise policymakers in each member country, and the critical aspects of excise tax coordination become the national laws of each member state – regulations, guidelines and procedures and how these operate.

Similar to the SACU, the SADC and the EAC have agreements on excise tax coordination. Whilst the SACU has a general requirement in the agreement which creates their economic community, the SADC and EAC have more definitive agreements based on treaties which create their economic communities providing for 'areas of cooperation' and a mechanism for member countries to develop protocols – in this case around excise tax coordination (SADC 1992; EAC 1999).

The SADC comprises the five SACU members plus Angola, the Democratic Republic of the Congo, Malawi, Mauritius, Mozambique, the Seychelles, Tanzania and Zimbabwe, and has agreed to a *Memorandum of Understanding in Cooperation in Taxation Related Matters* which includes a 'commitment' to harmonise taxation policy and administration as it relates to excisable goods. However, despite the success in reaching such an agreement, the Memorandum of Understanding, which was signed in 2002, has in effect seen little progress in the actual level of excise coordination in reviews conducted in both 2006 and 2010 (Cnossen 2010).

Likewise, the EAC which comprises Burundi, Kenya, Rwanda, Tanzania and Uganda has identified harmonisation of excise duties as an important trade issue for further negotiation after the economic community was officially formed in July 2000. Excise rate harmonisation remains as only one of two unresolved issues being discussed (the other being the import duty rates that will be levied in the external customs tariff) at Head of State level, with both issues long preventing the region moving forward to a full customs union (EAC 2004). Some 15 years later, both issues are still under consideration and delaying the region attaining the full benefits of deeper economic integration (Petersen 2010) and (PwC 2014).

9. Where to start coordination of excise tax policies in ASEAN?

To look at the question of regional coordination of excise tax policies, economists working in the excise field, such as Cnossen (2010, 2013)and Laffer (2014), agree on the need to first establish a number of principles on which the region can build agreement. Central to such principles are the concepts that a market should be allowed to achieve an 'efficient allocation of resources, and that tax policies should not interfere with this premise' by creating distortions in a market which impact on decisions such as investment, manufacturing location, and consumption.

Building on this basic principle of non-distortion is the need to recognise the role of excise taxation. Cnossen (2005, 2013) explains that tax policymakers need to work with a 'clear one-on-one relationship between the goals and instruments of taxation' and that in the case of excise taxation, these goals include 'internalising the external costs associated with the use or consumption of those goods or to enhance the progressivity of the tax system'. Importantly for this study, Cnossen adds that the goal of excise does not include protection of local industry and that this a goal or a function of a customs import tariff.

In this context it would appear that coordination of excise tax policy is not so much about the need for all members of an economic community to agree on a range of goods and services that will be subject to excise duties and apply a single rate to each of those goods and services but rather it is about agreeing on:

- a principle that excise policy development will avoid the use of tax design to discriminate against categories of goods and services and instead promote the operation of the single market and production base of the AEC
- the criteria on which to subject goods and services to excise
- standard definitions for product categories, product types, and services
- the most appropriate tax base for those good and services
- circumstances when exemption or rate differentials could be applied.

The nature and style of agreement will be a separate issue, and needs to be tailored to the ASEAN way of consensus rather than direction. Under the ASEAN Charter, legal instruments can be agreed and brought into force with the agreement of all 10 member countries, and indeed a range of instruments sit below the Declaration bringing the AEC into force, including a number of Memoranda of Understanding, Protocols, and ASEAN Agreements (ASEAN 2015). At this point in time, some 40 legal instruments have been agreed to in support of the AEC.

Whilst agreement on principles is critical, any regional agreement on coordination of excise tax policies should also contain substance in relation to 'technical' standards that should apply, particularly in the areas of product definitions and tax bases. Both Cnossen (2013) and Preece (2015) in relation to ASEAN, and Petersen (2010) in relation to the EAC refer to the need to standardise categories of goods and services and products within these categories as well as the legal definitions to classify such products.

As an example, Preece (2014) found that each of the major automobile producing countries within ASEAN – Thailand, Indonesia and Malaysia – have introduced excise concessions for what may be termed 'eco' or 'green' cars which are built to provide consumers with a less environmentally harmful product which, in turn, has a positive effect on a country's CO_2 emissions from the transport sector. To support this type of product all three countries have introduced an excise tax concession with a view to both recognise the reduction in harm from that vehicle's use and to assist in product pricing to attract consumers. However, without agreed guiding standards, each country has developed criteria for an 'eco' car that qualifies for a local excise tax concessional rate but which then effectively excludes from the same concession any 'eco' cars produced and imported from the other two countries. Figure 3 outlines the three sets of current criteria for 'eco' cars found in the three main auto producing ASEAN member countries.

Figure 3: What is an 'eco car' in ASEAN?

Criteria	Thailand (Phase 2)	Indonesia	Malaysia
Maximum engine size (in cubic centimetres)	1,300 (petrol) 1,400 (diesel)	1,200 (petrol) 1,500 (diesel)	< 2,500 all engines
Emissions	< 120 grams/kilometre	< 120 grams/kilometre	To be advised
Fuel efficiency	> 4.3 litres/100 kilometres	20 kilometres/litre	Depends on vehicle weight – ranges from 4.5 litres for vehicles < 0.8 tonnes to 12 litres per 100 kilometres for vehicles exceeding 2.5 tonnes
Retail price	N/A	< IDR 100 million	N/A
Fuel type	N/A	RON 93 gasoline CN 51 diesel	All fuels
Other	Meets UN Regulations for safety standards Regulations 94 and 95 Minimum production of 100,000 units by 4th year Minimum investment of THB 5 billion Pre-approved licence from Board of Investment	80% local content	Includes hybrid models

Source: Author.

For a vehicle manufacturer in, for example, Thailand, it becomes difficult to meet the minimum investment and production levels if it is unable to export a Thai version of an 'eco' car to the other major markets of Indonesia and Malaysia, as it simply cannot be competitive against locally produced eco cars. Industry observers seem to agree somewhat and state that several other manufacturers in the area are also concerned about the ability to sell Thai-manufactured 'eco cars' overseas and, therefore, meet the minimum production level requirements to access the discounted excise rates (IHS 2015). If correct, this could possibly be a significant loss of investment to ASEAN and a reason to revisit the objectives of the AEC, and in this case, pursue agreement on a coordinated regional excise tax approach.

The concept of a 'Common Excise Tariff'

A 'Common Excise Tariff' has been produced by the SACU which, notably, has also been able to develop a Common External Tariff covering imports from outside the community and so both tariffs can sit together in national tariff laws. The authority for developing both comes from Article 22 of the 2002 Southern African Customs Union Agreement which states:

> **Legislation Relating to Customs and Excise Duties**
>
> Except as otherwise provided in this Agreement Member States shall apply similar legislation with regard to customs and excise duties (SACU 2002).

The result is that the excise tariffs and supporting rules are identical in all five member countries, which is true coordination. For information, an extract relating to automobile excise is reproduced in Figure 4:[25]

Figure 4: Extract of SACU Common Excise Tariff (from Lesotho Customs and Excise Tariff Act)

Schedule 1 / Part 2B			
Tariff Item	**Tariff Subheading**	**Article Description**	**Rate of Excise Duty**
126.03	**87.03**	**Motor cars and other motor vehicles principally designed for the transport of persons (excluding those of heading 87.02), including station wagons and racing cars:**	
126.03.01	8703.10	Vehicles specially designed for travelling on snow; golf cars and similar vehicles	(See Note 2 to this Part)
126.03	**8703.2**	**Other vehicles, with spark-ignition internal combustion reciprocating piston engine:**	
126.03	**8703.21**	**Of a cylinder capacity not exceeding 1 000 cm^3:**	
126.03.03	8703.21.23	Vehicles of the open body tubular frame type, with an engine capacity not exceeding 250 cm^3 and a vehicle mass not exceeding 250 kg	(See Note 2 to this Part)
126.03.05	8703.21.60	Vehicles with motorcycle-type handlebars and hand-operated controls	(See Note 2 to this Part)
126.03.07	8703.21.70	Six or eight-wheeled vehicles, chain-driven and hand operated through an integral gearbox and differential unit	(See Note 2 to this Part)
126.03.09	8703.21.90	Other	(See Note 2 to this Part)
126.03	**8703.22**	**Of a cylinder capacity exceeding 1 000 cm^3 but not exceeding 1 500 cm^3:**	
126.03.11	8703.22.90	Other	(See Note 2 to this Part)
126.03	8703.23	Of a cylinder capacity exceeding 1 500 cm^3 but not exceeding 3 000 cm^3:	
126.03.13	8703.23.90	Other	(See Note 2 to this Part)
126.03	8703.24	Of a cylinder capacity exceeding 3 000 cm^3:	
126.03.15	8703.24.90	Other	(See Note 2 to this Part)

Notes:

2. For the purposes of items 126.02 to 126.05 the rate of excise duty on:
   (a) vehicles manufactured in the Republic shall be -
      (i) ((0,00003 x A) - 0,75)% with a maximum of 25%; and
      (ii) "A" means the recommended retail price, exclusive of value-added tax, less 20%.
   (b) Vehicles imported into the Republic shall be -
      (i) ((0,00003 x B) - 0,75)% with a maximum of 25%; and
      (ii) "B" means the value for the ad valorem excise duty on imported goods as prescribed in section 65(8)(a) of the Act.
   (c) The result of the calculations 0,00003 x A and 0,00003 x B shall be rounded-off to the third decimal comma.

Source: Lesotho Revenue Authority.

To note in Figure 4 is the linking with the excise tariff Item with the HS code which in turn becomes the Tariff Item Sub-heading and provides the product's description in classification – and is the case in all five member countries. Also noted are the attempts to ensure parity in compliance with GATT Article III between domestically produced goods and like imports.

Full excise coordination is critical in the SACU. All excise (and customs) duties collected by the five revenue authorities are paid into an SACU's 'revenue pool' from which 15 per cent is deducted for a 'Development Fund' and the remainder distributed to the five member countries through an agreed formula (revenue sharing) based on the members' GDP.[26] Non-alignment or non-coordination of excise taxes would distort the markets and reduce revenues as all excisable goods would be cleared into home consumption in the countries with the lowest excise duty rates.

10. What might ASEAN excise tax policy coordination look like?

This is a question that the AEC Blueprint 2025 needs to explore further. From the discussion above, it is apparent that certain contextual areas also need to be considered as they will determine what form and level excise coordination within the AEC can take. In this regard, the following points could guide future discussion on how excise coordination can be attempted:

- ASEAN is run by consensus between members rather than by a central authority with law making and law enforcing powers over member countries and as such, the nature and form of excise tax coordination need to be agreeable to all 10 countries.
- The AEC will seek to establish a single market and production base but will retain all border controls between member countries, and excise taxation will be payable in the country of consumption and collected by the local tax or customs border agency.
- Agreement on excise tax coordination will not be binding or enforceable through legislation or directives, and so must clearly show real benefit to all 10 members of ASEAN and likely take the form of a Memorandum of Understanding or Protocol, similar to such agreements in place today.
- Excise tax harmonisation will not be an option given the current levels of economic disparity still in existence across the region, and coordination will best take the form of an agreement which covers:
  - › principles as guidance in excise tax policy development
  - › consistency in defining product categories, products and classification
  - › consistency in the application and defining of appropriate tax bases.
- Build on the success of existing intra-regional trade coordination via the ASEAN Harmonised Tariff Nomenclature (AHTN) with a similar ASEAN Common Excise Working Tariff (ACEWT) for use in future regional excise tax policy development.
- Recognise the potential for ASEAN to significantly grow its 'regional automotive industry' to be a leading industry sector for the region which is exporting to the global market and bringing with it the FDI and associated economic benefits to lift the wealth levels of all member countries.

The design of a product, such as an ACEWT, not only needs to account for the unique environment which is ASEAN, and the characteristics of the AEC, but also needs to consider the objectives for automobile excise taxation in a region aspiring to develop a strong automotive industry competing in the global auto market. These types of considerations need to include:

- facilitating the establishment of a 'single market' by ensuring that:
  - › excise taxation is not used as a non-tariff measure to make intra-regional trade less commercially viable

  - › better alignment of product categories, products, and classification criteria allows for greater facilitation as a product carries similar classification in all member countries
  - › assessment of excise duty liabilities are transparent and readily able to be calculated.
- establishing a 'single production' base with cost effective supply chains seeing parts, components and assembled vehicles moving efficiently from source to assembly lines to market
- recognising the global trend towards fuel efficiency and reduced emissions, so that ASEAN-built vehicles are meeting the specifications of consumers in export markets
- recognising local experience and expertise in certain areas and taking global leadership in product design with development and marketing of 'regional product champions' for export to global markets
- understanding that the industry often needs a significant lead-in time when developing new models and that whilst this occurs, locally produced current models need to stay commercially viable in the ASEAN market.

Whilst the ASEAN context sets the nature of the agreement on automobile excise tax coordination, the outline of local automotive sector directions will assist in setting the technical content of the agreement, that is, they become part of the development of any proposed ACEWT.

Recognising the contextual and technical needs above, can ASEAN consider the benefits of building or developing a document for use by regional excise policymakers which captures a range of measures to assist in regional excise tax coordination? Such measures would recognise that:

- automobiles are subject to excise tax in all ASEAN member countries
- ASEAN has been able to harmonise the WCO HS nomenclature for the region
- ASEAN has considerable expertise in certain product areas such as the 'pick-up vehicle'
- a new focus is being sought to reduce CO_2 emissions through greater fuel efficiency, smaller vehicles and new technologies
- ASEAN does not have regional set standards for member countries in terms of fuel consumption and vehicle emissions.

Against this background, Figure 5 is an attempt to capture both the latest thinking in automobile excise taxation, including that within ASEAN and the need for consensus and sovereignty across the ASEAN membership.

Figure 5: Proposed Draft ASEAN Common Excise Working Tariff design

'ASEAN COMMON EXCISE WORKING TARIFF'
Schedule 1: Automobiles

Definitions

Ad valorem rate means a rate expressed in percentage terms of a value set in national excise tariff law.

Bus means a vehicle designed for the carriage of 10 or more persons including the driver and includes 'mini vans' seating 10 or more persons including the driver.

Commercial Motor Vehicles means motor vehicles principally designed for the carriage of goods, or persons (10 or more) including the driver, or for special purposes.

CO_2 emissions means the level of CO_2 emissions of a motor vehicle measured in grams per kilometre in a testing methodology approved under UN Regulations.

Fuel efficiency means the fuel consumption of a motor vehicle measured in litres per 100 kilometres in a testing methodology approved under the UN Regulations.

Hybrid means a motor vehicle with at least two different energy sources and two different energy storage systems on board the vehicle for the purpose of propulsion.

Passenger cars means a road motor vehicle, other than a motor cycle, intended for the carriage of passengers and designed to seat no more than nine persons (including the driver).

Passenger Pick-up vehicles are pick-up vehicles designed with an extended or dual cab for the carriage of no more than nine persons (including the driver).

Pick-up vehicle means any vehicle which contains both a passenger compartment designed for the carriage of less than four persons and open cargo bed for the carriage of goods.

Special purpose vehicles means a commercial motor vehicle with specific purposes such as fire-fighting, ambulances, spraying, concrete mixing, mounted cranes, etc.

Sports utility vehicles means a passenger vehicle that is designed as an off-road vehicle with four-wheel-drive capability (or two-wheel where other specifications of this definition are met), high ground clearance and a wagon body type, seating up to nine persons (including the driver).

Truck means a vehicle with a power unit and either a permanently fixed or detachable cargo carrying capability with two or more axles.

Truck tractor means a non-cargo carrying vehicle designed to tow trailers and other devices.

Van means any vehicle with a closed cargo bay designed for the carriage of goods with no more than two axles.

Schedule 2: Excise Tariff Items					
Item	**Heading**	**Sub item**	**Sub item description**	**AHTN Ref**	**Excise Rate**
1	**Motor cars and other motor vehicles principally designed for the transport of persons, including station wagons and racing cars**		To be agreed by ASEAN Criteria based on: • Engine displacement • Fuel type • CO_2 emissions		Set by national government
		1.1	***Passenger Motor Vehicles***	8703.21, 8703.22, 8703.23, 8703.31, 8703.32, & 8703.33	Set by national government

		1.2	***Passenger Motor Vehicles meeting ASEAN standard CO_2 emissions and fuel criteria***	8703.21, 8703.22, 8703.31, & 8703.32	Set by national government
		1.3	***Hybrid vehicle as defined***	87032, 87033, & 87039	Set by national government
		1.4	***Other (reserved)***	8703.90	
2	**Motor vehicles principally designed for the carriage of persons (10 or more) including the driver**		To be agreed by ASEAN Criteria based on: • Engine displacement • Fuel type • CO_2 emissions		
		2.1	***Buses and mini-vans of 10 or more seats***	8702.10	Set by national government
		2.2	***Other (reserved)***	8702.90	
3	**Motor vehicles principally designed for the carriage of goods, or special purposes**		To be agreed by ASEAN Criteria based on: • Engine displacement • Fuel type • CO_2 emissions		
		3.1	***Dumpers for off-highway use***	8704.10	Set by national government
		3.2 3.2.1 3.2.2 3.2.3	***Trucks*** Gross weight not exceeding 5 tonnes Gross weight exceeding 5 tonnes but not exceeding 20 tonnes Gross weight exceeding 20 tonnes	 8704.21, & 8704.31 8704.22, & 8704.32 8704.23, & 8704.33	Set by national government
		3.3	Special purpose vehicle other than those principally designed for the transport of persons or goods (for example, breakdown lorries, crane lorries, fire fighting vehicles, concrete mixer lorries, road sweeper lorries, spraying lorries, mobile workshops, mobile radiological units)	8705	Set by national government
		3.4	***Pick-up truck***	87042, & 87043	Set by national government
		3.5	***Van***	87042, & 87043	Set by national government

Source: Author.

Figure 5 also provides for the aspiration of some to develop ASEAN as an 'eco car' development and manufacturing hub. The critical aspect for agreement will be the classification criteria under each tariff item. The issues raised in this paper suggest that current differing automobile excise tax policy priorities and the desire by some member countries to support certain types of domestic production mean the

region could be starting a long way apart. Equally, this paper considers that to not move towards such agreement will risk the benefits that should materialise from the implementation of the AEC and that for an industry such as automobile manufacturing the options for investment are such that ASEAN may not see the future growth it could have otherwise reasonably expected for this industry.

The emerging demand for more fuel efficient and lower emitting vehicles is an opportunity for the region to seek investment in the production of such vehicles, however, the first step is to ensure that those potential investors can sell enough product locally to realise the returns they need. Thus, ASEAN and its AEC are entering a critical time for the automotive industry and the issue of regional excise policy coordination needs urgent attention. If there is the will, there are mechanisms to resolve the issues raised in this paper.

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Notes

1 The ASEAN Vision 2020 can be accessed through the ASEAN Secretariat website at www.asean.org/news/item/asean-vision-2020.

2 See Article 4 of the CEPT scheme.

3 See Article 2 and Article 6 of ATIGA.

4 See paragraphs 15-18 of the AEC Blueprint.

5 Protocol Governing the Implementation of the ASEAN Harmonised Tariff Nomenclature, viewed 12 March 2015, www.asean.org/archive/16954.pdf.

6 See www.asean.org/communities/asean-economic-community/category/free-trade-agreements-with-dialogue-partners.

7 See www.asean.org/communities/asean-economic-community, viewed 12 December 2015.

8 Paragraph V, Section B5 ASEAN Economic Community Blueprint 2025, p. 18.

9 Interview with Antonio Mandera, Chair, Panel for the Trilateral Commission's North American Regional Meeting on NAFTA and CEO of Tier 1 supply company.

10 See Note 9.

11 Foreign direct investment (FDI) is defined by the OECD as an investment involving a long-term relationship and reflecting a lasting interest and control by an entity resident in one economy (foreign direct investor or parent enterprise) in an enterprise resident in another economy (FDI enterprise or affiliate enterprise or foreign affiliate). FDI has three components: equity capital, reinvested earnings and intra-company loan.

12 See, for example, the automobile industries of Thailand 12 per cent (Board of Investment), Malaysia 3.2 per cent (EXIM Bank), China and India 7 per cent and globally approximately 3 per cent.

13 UK Driver and Vehicle Licensing Agency 'Vehicle Excise Duty' 2014, www.gov.uk/government/uploads/system/uploads/

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14 See www.car.go.th and www.unep.org/transport/gfei/autotool/approaches/information/labeling.asp#Thailandencourageconsumers to buy more efficient vehicles.

15 Interview of Somchai Pulsawat, Director General, Thai Excise Department in *The Nation*, 27 August 2014, www.nationmultimedia.com/webmobile/national/Excise-tax-to-be-levied-on-retail-prices-not-low-e-30241872.html, and remarks by Dr Nathan Junprateepchai of the Thai Excise Department at the Director-General Meeting of ASEAN Member Countries on Automobile Taxation on 20 November 2014, www.jama-english.jp/asia/news/2015/vol58/article1.html.

16 Full title: Regulation 64/PMK 11/2014 'Luxury Sales Tax on Motor Vehicle Types' coming into effect 17 April 2014.

17 See Regulation 41 of 2013, http://sipuu.setkab.go.id/PUUdoc/173799/PP0412013.pdf and Regulation No. 33/M-IND/PER/7/2013 of 2013.

18 See Note 17.

19 AmResearch 2014.

20 See Note 19.

21 See pp. 28-9 of Draft Decree *11140/BTC-CST* of 13 August 2015.

22 European Automobile Manufacturer's Association 2013, p. 39 (adjusted for Australia and Taiwan).

23 ASEAN 6 includes Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand, and ASEAM CLMV includes Cambodia, Laos PDR, Myanmar, and Vietnam.

24 See www.asean.org/communities/asean-economic-community/item/non-tariff-measures-database.

25 See Lesotho Revenue Authority, www.lra.org.ls/tariffs.php.

26 See SACU, www.sacu.int/tradef.php?id=419.

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Impact of specific excise rate simplification on cigarette consumption and government revenue in Indonesia

Ade Hidayat and Nasruddin Djoko Surjono

Abstract

This study estimates the impact of excise tariff simplification on cigarette consumption and government revenue. In addition, the study compares the 'simplification' case with the 'no simplification' case. Several estimation models using unbalanced and sub-balanced panel data, random effect maximum likelihood estimation (MLE) and panel-corrected standard errors (PCSE) are explored to estimate the impact. The results indicate that tariff simplification has a greater impact on raising cigarette prices, reducing consumption, and increasing government revenue than regularly increased excise rates. The greatest impact can be seen in cigarettes produced by large companies and white cigarette machine-made product. The results also suggest that cigarette excise taxes are 'under-shifted' to consumers and that producers bear some of the tax burden.

1. Introduction

In recent decades, cigarette consumption has declined in developed countries but has increased significantly in developing countries. At the beginning of 2000, 80 per cent of the world's 1.1 billion smokers lived in low and middle income countries (Jha & Chaloupka 2000). In 2002, the World Health Organization (WHO) stated that the problem had become an epidemic: cigarette smoking is not confined to certain demographics but extends to males and females, affluent and less affluent, as well as children.

In Indonesia, the National Socio-Economic Survey (SUSENAS) data shows that there were 25 million smokers in 1980. This figure increased to 32 million in 1986 and to 41 million in 1995. The ratio of men who smoked increased from 46 per cent to 51 per cent between 1980 and 1995. Recent data shows that in 2010, 35 per cent of people aged 15 years and over were smokers (of which 65 per cent were men and 35 per cent women).

Over a ten-year period (2001 to 2010) the number of child smokers (that is, children between 5 and 9 years of age) increased by 400 per cent, from 0.4 per cent (SUSENAS 2001) to 1.7 per cent (Ministry of Health [Indonesia] 2010), while the prevalence of adolescent smokers aged 13 to 15 years increased from 12.6 per cent in 2006 to 20.3 per cent in 2009. In 2007, Indonesia was the fifth largest consumer of cigarettes after China, the United States of America (US), Russia and Japan, and had the third highest number of smokers in the world (after China and India). In terms of the number of cigarettes consumed, De Beyer and Yürekli (2000) state that cigarette consumption in Indonesia rose by 159 per cent (from 33 billion to 84 billion) between 1970 and 1980; 67 per cent between 1980 and 1990 (from 84 billion to 141 billion); and 47 per cent (from 141 billion to 208 billion) from 1990 to 1999.

This phenomenon is very concerning considering the negative impact that smoking has on health. Kosen (2004) reported that in 2001 there were at least 200,000 Indonesians (of approximately 57 million smokers) who died from smoking-related diseases. Kosen (2004) adds that the cost incurred due to

cigarette consumption reached 127.4 trillion rupiah (Rp) (USD13.9 billion) in the same year. This figure includes the use of tobacco products, hospital bills due to illness, disability and death caused by smoking.

Pigou (1920) argued that the negative externalities generated by certain commodities need to be tackled by imposing taxes on these commodities so that externalities can be internalised earlier. This kind of tax is widely known as the 'Pigouvian' tax. The burden of Pigouvian tax on cigarettes is equated with the marginal external damage caused by tobacco consumption. In general, the term is equal to excise tax ('excise'), and excise, besides being a tool for correcting externalities, is a potential source of government revenue. Cnossen (2005) argued that excise is preferable to income tax as a means of increasing revenue because the latter seriously distorts the supply and demand for labour.

In addition, the growing trend of trade liberalisation policies with other countries (for example, free trade areas) needs to be considered as import duty rates will gradually disappear and therefore no longer provide a source of government revenue. This means that excise is becoming increasingly important. This can be seen from the Global Excise Summit, held for the first time on 2-3 July 2012 by the World Customs Organization (WCO) in cooperation with the International Tax and Investment Center (ITIC). There, participants from 160 countries discussed a wide range of excise duties collected by customs agencies, the theory and principles of tax policy, best practice, law enforcement, and excise as a means of maximising government revenue.

There are at least three things that determine excise policy: the excise burden, the excise system, and the structure of excise rates. Economists maintain that increasing excise is considered an effective means of reducing consumption. According to Chaloupka, Hu, Warner, Jacobs and Yürekli (2000), increasing the excise rate by 10 per cent of the retail price would reduce consumption of cigarettes by 4 per cent in high income countries and 8 per cent in low and middle income countries.

The excise system has also had an impact on consumption, government revenue and price (Chaloupka, Peck, Yürekli, Tauras & Xu 2010). There are three excise regimes: specific, *ad valorem* and hybrid. Specific excise is levied on the amount of goods produced or consumed as the amount per pack, stick or gram of tobacco; *ad valorem* excise is based on a percentage of the product value (price) or processing costs or the price of imports, while hybrid excise is a combination of the two.

The tariff structure determines the effectiveness of the tariff rate and excise system adopted. Variable excise rates can cause prices to rise or fall. Countries use a wide variety of tariff structures—they may impose different tax rates for each brand, a 'complex tariff', or a single rate applicable to all types of cigarettes.

Excise policy in Indonesia is constantly being reformed, especially since the Excise Act 2007 (Law No. 39) entered into force. From 2002 to 2006, the government implemented an *ad valorem* system (that is, multiple rates based on production capacity and type of tobacco products) by simply changing retail prices every year and leaving the *ad valorem* tariff fixed. From 2007 to 2008, the government used a complex hybrid system, which was a combination of the specific and *ad valorem* excise systems. Later, in 2009, the government began implementing a multiple specific tax system, where specific tax rates are increased annually in a 'quasi ad valorem' system. As a result, all tax rates in the excise tariff are specific rates levied 'per stick', however the classification which determines the rate is based on a retail sales value. In 2012, the government then simplified the excise tariff by merging the rate groups. A detailed description of Indonesia's shift in excise policy can be seen in Table 1.

Table 1: Transition of the excise system and tariff rates from 2005 to 2012

Type	System		*ad valorem*		Hybrid				Specific				
	Production		2005	2006	2007		2008			2009	2010	2011	2012
	Manufacturer Production Group	Sticks/ year	Adv (%)	Adv (%)	Adv (%)	Spcfc Rp/bt	Adv (%)	Spcfc Rp/bt	Manufacturer Production Group	Specific Rp/stick			
Clove Cigarettes (Machine-made)	I	> 2.0M	40	40	40	7	36	35	I	290	310	325	355
										280	300	315	345
										260	280	295	325
	II	0.5-2.0M	36	36	36	5	35	35	II	210	230	245	270
										175	195	210	235
										135	155	170	235
	III	< 0.5M	26	26	26	3	22	35		merged II & III			
White Cigarettes (Machine-made)	I	> 2.0M	40	40	40	7	34	35	I	290	310	325	365
										230	275	295	365
										185	225	245	365
	II	0.5-2.0M	36	36	36	5	30	35	II	170	200	215	235
										135	165	175	190
										80	105	110	125
	III	< 0.5M	26	26	26	3	15	35		merged II & III			
Clove Cigarettes (Handmade)	I	> 2.0M	22	22	22	7	18	35	I	200	215	235	255
										150	165	180	195
										130	145	155	195
	II	0.5 - 2.0M	16	16	16	5	10	35	II	90	105	110	125
										80	95	100	115
										75	90	90	105
	IIIA	< 0.5M	8	8	8	3	0	30	III	40	50	65	75
	IIIB	< 0.06M	4	4	4	3	merged IIIA & IIIB						

Source: Fiscal Policy Agency, Ministry of Finance, Republic of Indonesia 2012.

In 2009 there were 19 layers of excise tariffs on primary products. This was made up of six layers of machine-made clove cigarettes (SKM), six layers of white cigarettes machine-made (SPM) and seven layers of white cigarettes handmade/clove handmade (SPT/SKT). The number of layers was reduced to 15 in 2012 (5 layers of SKM, 4 layers of SPM, 6 layers of SPT/SKT), and further simplified in 2013 to 13 layers.

White cigarettes (filter)/Kretek (clove cigarettes) and handmade filters (SPF/TF) have the same number of layers as machine-made clove cigarettes (SKM). Initially, this product is made with SKM with the filters added manually, which is one of the strategies used by the tobacco industry to ensure their products are categorised as SKT which has a lower rate than SKM. Accordingly, white cigarettes and Kreteks made manually or by machine (either all or in part) will be classified at a specific tax rate equal to the specified SKM layer and rates (provided they use a filter).

The rate for these tobacco products (SKM, SPM, SKT/SPT and STF/SPF) made from imports has also increased but in the form of a single rate with no groups or layers. SPM attract the highest tariff, while the lowest is for SKT imports. The rate of SKM imports is equal to the rate of STF/SPF imports, following the same provisions with local products. All types of tobacco products made from imports are subject to the highest rates applied to the same type of tobacco products made locally.

Specific tax rates for other tobacco products, such as 'slice cigarettes' (Tembakau Iris [TIS]), 'leaves cigarettes' (Klobot [KLB]), 'rhubarb incense cigarettes' (Klembak Menyan [KLM]), 'cigars' (CRT) and 'other tobacco processing products' (HPTL) were not increased until 2012. In 2013 the government raised the rates of these five specific tobacco products, as can be seen in Table 2.

Table 2: Excise rate on other tobacco products

Type	Manufacturer Production Capacity		Specific Tariff					Description (Increased in 2013)
	Gol	Layer	2009	2010	2011	2012	2013	
Slice Cigarette		1	21	21	21	21	25	Increase
		2	19	19	19	19	20	Increase
		3	5	5	5	5	5	Increase
Leaves Cigarette		1	25	25	25	25	25	Increase
		2	18	18	18	18	20	Increase
Rhubarb Incense Cigarette			17	17	17	17	20	Increase
Cigars		1	100.000	100.000	100.000	100.000	100.000	
		2	20.000	20.000	20.000	20.000	20.000	
		3	10.000	10.000	10.000	10.000	10.000	
		4	1200	1200	1200	1200	1200	
		5	250	250	250	250	250	
Other Tobacco			100	100	100	100	100	

Source: Analysed by the authors based on Finance Ministry Decree No. 203/PMK.011/2008, 181/PMK.011/2009, 99/PMK.0111/2010, 190/11/2010, 167/011/2011 about Excise Tariff on Tobacco Product.

Researchers have used the excise policies implemented in Indonesia as a means of measuring related impacts, ranging from the control and reduction of cigarette consumption and the increase in potential revenue, to the manufacturer's ability to respond to and survive in the face of any changes in tax policy. The impact of the amount of excise tax has been discussed in many studies and the impact that these three systems has on the price and consumption of cigarettes was analysed in a dissertation by Surjono (2013) but, to the authors' knowledge, there has not been any analysis based on empirical research of the advantages or impact of a simple fare structure or a single rate for reducing consumption and raising revenue.

2. The research problem

The imposition of excise tax may be approached differently by individual cigarette manufacturers. Any increases in tax rates can be borne entirely by the manufacturers so that they do not cause price increases and are more likely to occur when any tax increase is significant but the demand for the product is elastic and they risk losing market share. This, of course, directly impacts the manufacturer's profit margins. Alternatively, where a product is relatively price inelastic and consumers are less impacted by price increases then manufacturers pass the new tax burden on to consumers. The tax burden can also be transferred in total (full-shifting) or in part (under-shifting) to the consumer in the form of price increases. In some cases, increases in the cigarette price may even exceed the increase in excise rates (over-shifting). High tax rate increases are assumed to cause high increases in price and can ultimately affect the consumer's decision to reduce the consumption of cigarettes and this, in turn, can improve public health.

On the other hand, an increase in excise rates does not necessarily increase government revenue. The amount of revenue is calculated by multiplying the quantity of cigarettes consumed by the excise rate. If the demand for cigarettes is inelastic, revenue will rise in line with rate increases. However, when excise rates are too high and products are relatively price elastic, a decrease in revenue is possible as consumption falls or consumers 'trade down' to products that pay less excise tax. This scenario was best highlighted by American economist, Arthur Laffer (Blecher & van Walbeek n.d.).

The complexity of tobacco taxation policy within the context of achieving revenue targets, improving the health of the population and supporting the local industry persuaded the Indonesian government to prepare a road map for the tobacco industry for the period 2007 to 2020.[1] In the short term (2007–2010), the government made employment its first priority, followed by government revenue and then health. Prioritising employment reflected the government's awareness of the need to escape the effects of the economic and financial crisis of 1997–1998. In the mid-term (2010–2015), government revenue became the top priority, followed by health and labour problems. In the longer term (2015–2020), tobacco excise policies will largely be determined by health aspects. The cigarette industry will be encouraged to export: manufacturers will be limited to prevent new players entering the market and old players will be encouraged to switch to other industries.

Implementing this road map requires, *inter alia*, an annual increase in the excise rate and ongoing simplification of the tariff structure. To this end, the Indonesian government established the specific excise system in 2009. In 2012 the government raised the specific excise rate and, at the same time, simplified the tariff structure. Cigarette brands based on the type of tobacco, and in a certain group and a certain excise rate (usually in the bottom layer of the group), were to be merged with the layer above. In other words, simplification entails a rate increase because of a merger between two or more layers of rates, while a rate increase by itself does not entail such a merger. As a result of this policy, the percentage increase owing to tariff simplification is higher than that owing to non-simplification. This can cause the price of cheap cigarettes to become more expensive and even approach premium price. Less variation in cigarette prices can reduce consumer incentives to substitute.

This policy implication was the motivating factor behind this research. It became apparent to the authors that no research has been carried out into the impact of simplifying tax rates (which in Indonesia are very complex) on the price of cigarettes, cigarette consumption and government revenue. In addition, although several countries have simplified their excise tariff structure, no empirical research is available to evaluate whether this policy can achieve its objectives. There has, however, been research on the effect of different rates for different tobacco products (Townsend 1998). According to Hanafy, Saleh, Elmallah, Omar, Bakr and Chaloupka (2010) Egypt shifted from complex specific rates to a single rate in a hybrid system in July 2010. However, that study did not look at the impact of simplification on consumption level. It did find, however, that a single hybrid tariff caused retail prices to rise by 40 per cent.

Examples of other studies that have been conducted in Indonesia include the impact of the *ad valorem* system and retail prices on market competition (Sarmuhidayanti 2008; Fauzan 2002), on government revenue (Kusumasto 1998; Purwanto 2003), and on consumption (Herlambang 2005); the impact of the *ad valorum* system on consumption and government revenue (Adioetomo, Djutaharta & Hendratno 2005) and on labour (Djutaharta, Surya, Pasay, Hendratno & Adioetomo. 2005), and the impact of three different excise systems (specific, *ad valorem* and hybrid) adopted by Indonesia on cigarette consumption (Surjono 2013).

Based on the background and issues outlined above, the aim of this study is to determine whether the effect of restructuring the excise rate would be greater than the usual price hike policy of increasing the price of cigarettes, reducing consumption, and increasing government revenue from tobacco excise.

3. Concept

Excise tax, as an economic instrument, has four goals (Cnossen 2005). Its first goal is to provide an alternative source of government revenue. Compared to income tax, excise can generate significant additional revenue at low political and economical cost (Hines 2007). Excise is also easier to administer because goods subject to excise are readily identifiable and the scope of the tax is usually narrow resulting in a limited number of taxpayers to control. Further reasons for using excise to boost revenue include the high volume of sales and limited substitutability with other items that can provide the same utility (despite the high prices due to excise duty). The second goal is the application of the benefit principle of taxation, whereby taxes are imposed on those who use the goods and services (that is, a 'user pays' principle). An example of this is where users of roads may pay an excise tax on both the automobile they purchase and on the fuel they consume, thus raising funds for the central budget from which road repair and maintenance will be funded. Correcting negative externalities is the third goal, with excise being considered compensation for external costs incurred by consumers or producers on others, at the same time the excise tax forming part of the price sends a signal to the consumer as to the cost of the harm that may be caused by consumption.

From the work of Cnossen (2005) and Hines (2007), the authors have identified at least five problems related to the design of excise collection:

1. Choosing which excise system to adopt (that is, a specific, *ad valorem* or hybrid system). As noted above, the specific system is the nominal amount of currency per unit of goods subject to excise, whereas *ad valorem* tax is based on a percentage of the selling price of goods subject to excise, and hybrid systems combine the specific and *ad valorem* systems.

2. Determining how the layer or level and the unit are used as a tax base. A single rate applicable to all tobacco products is seen as effective in reducing cigarette consumption, improving the effectiveness of tax administration and increasing government revenues. A uniform tariff also reduces the level of non-compliance and price manipulation by the cigarette manufacturers, and provides a disincentive for smokers to substitute to other types of tobacco products (WHO 2010).

3. Coordinating excise collection with the imposition of excise taxes on consumption and other indirect taxes, such as Value Added Tax (VAT), in order to achieve the intentions of each type of tax. Excise is primarily imposed to address the externalities of consumption whilst VATs are revenue-raising instruments. In all cases, excise will be applied before VAT and as such, VAT is levied on a value which includes excise.

4. Ensuring that policymakers consider the increased likelihood of smuggling, tax evasion and tax avoidance due to the implementation of the excise system, excise amount and structure of tariffs imposed on goods subject to excise.

5. Ensuring that issues related to the optimal tax rate are considered. This depends on whether the rate is set uniformly or flexibly. Ramsey (1927), who introduced the idea of optimum taxes, stated that the optimal tax rate (which does not distort economic decisions), must be charged flexibly based on the elasticity of demand for goods that will be subject to excise duty. A higher rate of excise duty will be imposed on goods that have a more inelastic demand (assuming constant supply elasticity).

Diamond (1975) elaborates on Ramsey's work, recommending that excise should satisfy the principle of optimal tax efficiency, that is, lower rates for elastic goods and the principle of fair distribution and higher tariffs for goods purchased by high-income individuals. Corlett and Hague (1953–54) add that the government's inability to collect leisure taxes led to a uniform or single tax rate which, according to Ramsey's model, was not optimal. The second-best correction in Ramsey's model is set on a higher excise tax on goods and services which complements leisure. Pigou (1920) argues that the excise rate should reflect its function of correcting externalities. He states that the tax rate is set at the marginal external damage to restore economic efficiency. Sandmo (1975) advocates the application of Pigouvian tax, whereby the government relies on excise to increase tax revenue.

This study focuses on measuring the impact of the specific system and simplification of the excise rate structure on cigarette consumption and government revenue.

3.1 Incidence tax analysis

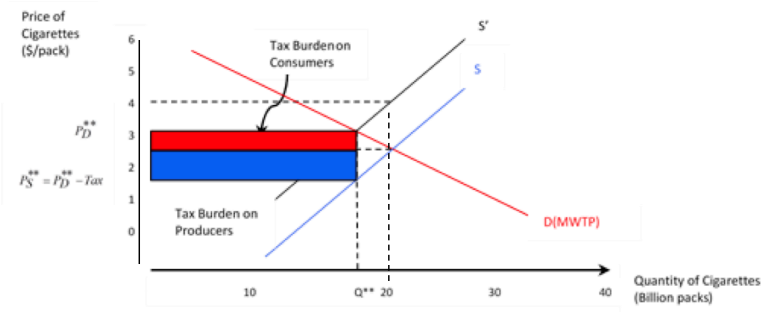
Incidence tax analysis is used to determine who bears the burden of the tax. The term 'tax incidence' can be divided into statutory incidence (a legal approach related to who is taxed) and economic incidence (who ultimately bears the burden of tax). This is possible because the tax burden can be shifted.

Incidence tax analysis on commodities can also be viewed from the perspective of who is consuming the goods (that is, users of income) and who is producing and earning income from them (that is, source of income). Rosen and Gayer (2010) maintain that the imposition of excise tax places more emphasis on the impact on consumers.

In a simple partial equilibrium, the imposition of excise duty depends on the elasticity of demand and supply. If demand for a particular commodity is elastic and supply is inelastic, then the excise duty will be paid by the seller (backward-shifting). Conversely, if demand is inelastic and supply elastic, then the tax is borne entirely by the purchaser (forward-shifting). When both the seller and the buyer are elastic, the excise burden will be borne by both parties.

A large tax burden borne by both parties (producers and consumers) also depends on the elasticity of demand and supply. When the demand curve is more elastic than the supply curve, the greater is the burden of excise duty borne by the manufacturer. This can be seen in Figure 1.

Figure 1: Demand curve more elastic compared to supply curve

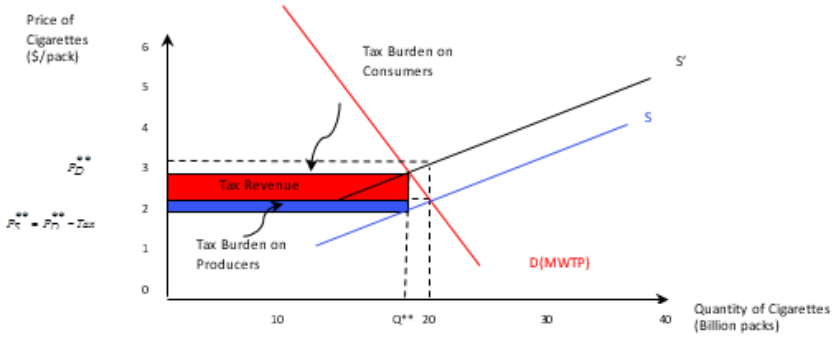


Source: Herriges 2010.

The implications would be different if the supply curve were more elastic than the demand curve. In this case, the tax burden borne by consumers would theoretically be greater than the tax burden borne by cigarette manufacturers.

The curve in Figure 2 further illustrates the supply and demand of commodities in which cigarette demand is inelastic or, in other words, supply more elastic than demand. Accordingly, producers charge more excise duty to consumers in the form of cigarette price increases (although not exceeding the amount of excise rates).

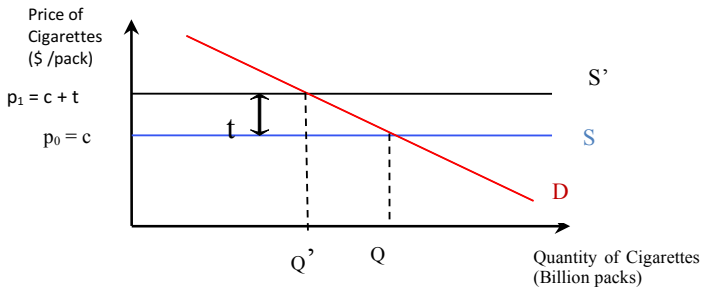
Figure 2: Supply curve more elastic than demand curve



Source: Herriges 2010.

Producers can shift the tax burden entirely to consumers in the form of price increases (full-shifting) when a perfectly elastic supply curve is a horizontal line. Figure 3 illustrates the tax incidence with perfectly elastic supply. In market competition with constant marginal cost, price is equal to marginal cost. Before subject to excise, equilibrium price is $p_0 = c$; once subject to excise duty, the price is $p_1 = c + t$. In that case, the total excise duty is charged to the buyer (full-shifting).

Figure 3: Tax incidence when supply is perfectly elastic



Source: Rosen & Gayer 2010.

Tax incidence also analyses the impact of imposing excise on price changes. When the selling price of the commodity increases but is below the level of the tax increases, the lesser tax burden is shifted to the consumer (under-shifting). If the price increase exceeds the increase in excise it is called 'over-shifting'. Furthermore, if the price increase is the same as an increase in tax, consumers bear all the burden of excise duty (full-shifting).

Delipalla and O'Donnell (1998) state that in a perfect competition market, the tax burden due to specific and *ad valorem* systems will be full-shifting, but in imperfect competition both systems can be under-shifting, full-shifting or over-shifting. Market competition in the cigarette industry in Indonesia is an oligopoly market, especially among large producers.

For specific excise $\frac{\partial p'}{\partial u} = \frac{\partial p}{\partial u}(1-a) - 1$; $\frac{\partial p'}{\partial u} < 1$ *under shifting*, $\frac{\partial p'}{\partial u} = 1$ *full shifting* and $\frac{\partial p'}{\partial u} > 0$ *over shifting*.

3.2 Relationship between excise, tariff structure, price and demand

The impact of tax rates on consumption is not direct but affects the price of cigarettes first. A complex structure of excise rates converted into a simple structure will cause the price of cheap cigarettes to become more expensive, even becoming close to the premium price. This occurs when the government collapses low tax tiers so that the cheap cigaretes fall into the higher taxed categories. As an illustration, if the specific system (u) is imposed on expensive cigarettes (P_2) and cheap cigarettes (P_1) then the relative price difference between the two prices would be reduced and become:

$P_2 + u_2)/(P_1 + u_1)$.....(2.1)

But on the contrary, if the *ad valorem* system (a) is applied to both prices, the relative price does not change:

$(P_2.(1+a))/(P_1.(1+a)) = P_2/P_1$ .....(2.2)

Furthermore, when cigarette prices do not vary significantly, prices do not affect cigarette consumption and the lack of variation reduces the incentive for substitution. The law that explains the link between the demand for a product and its price is the Law of Demand. This law states that the lower the price of an item, the greater the demand, and conversely, the higher the price, the lower the demand for that item.

From a microeconomic point of view, the consumer utility depends on the quantity of cigarettes consumed in relation to income level constraints, cigarette price, and the price of other goods. If X_1 X_2 is the quantity of cigarettes and a quantity of other consumer items, then the consumer will maximise utility by income as a constraint according to the following function:

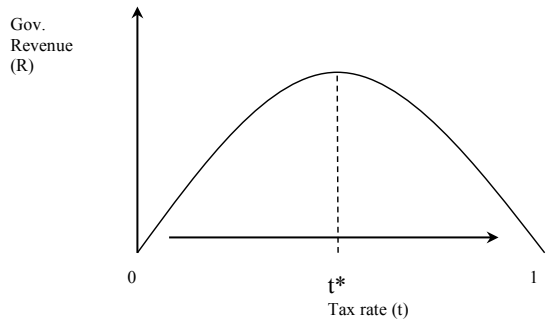
$Max\ U = U\ (X_1\ X_2)$, *subject to* $I = P_1X_1 + P_2X_2$

From this equation, we assume that the more we consume cigarettes the higher utility without looking at the health impacts. Demand for cigarettes with utility maximisation is $X_1 = f(P_1, I)$ (Pyndick & Rubinfeld 1998).

3.3 Laffer curve

The Laffer curve theory describes the relationship between tax rates (excise) and tax revenue, with Laffer analysing the maximisation of tax revenue from the supply side (supply side). This theory states that higher tariff rates do not necessarily result in higher tax revenue because, at a certain level—which is when they reach the 'prohibitive range of Government'—tax revenues will decline. The Laffer curve is shown in Figure 4.

Figure 4: Laffer curve



Source: Agung 2011.

The supply side of the economy considers the basic elements of human self-interest. In the context of cigarettes, where tax rates on cigarettes are lower, this is an incentive for consumers to increase consumption and for producers to increase production. In contrast, where the cigarette tax burden is too large, it will cause distortions in the economy both in the upstream sector (tobacco and clove farmers) and in the downstream sector (the tobacco industry and the expansion of the workforce).

From Figure 4 it can be seen that where there is an excise rate of 0 per cent, there is no government tax revenue (excise) and on the level of tax rates 100 per cent, the rational economic agents choose not to purchase and consume cigarettes. Both of these result in the absence of a government income tax. Tariff t* is an extreme point or turning point of the curve and the point at which the maximum revenue from the tax will be generated.

4. Empirical research

4.1 The effect of tax rates on cigarette prices

Empirical studies on the effect of tax rates on cigarette prices show mixed results, ranging from no effect at all to doubling the price of the tax burden (Sullivan 2012). Sullivan (2012) conducted research on the tax effect on prices in the US using city-level data. The model addresses the influence of government and city taxes on prices.

Where the excise coefficient is equal to one, then the tax is fully passed on (fully shifted) to consumers in the form of a price increase of excise burden. Where the coefficient is equal to more than one there is over-shifting, while under-shifting (where the seller bears the burden of excise) occurs where the coefficient is less than one.

4.2 Cigarette demand

Empirical studies on cigarette demand are drawn from a variety of data sources, including aggregate demand data of an area, the household survey data, and transaction data by manufacturer tax. The data used in this study is excise transaction data per manufacturer.

4.3 Application of excise tariff structure

Some countries impose a higher tax burden on imported or premium cigarettes because cigarettes are not price-sensitive and are consumed by high-income people (WHO 2010). In addition, an excise structure with various rates is generally used where the government wants to protect domestic products against the invasion of multinational tobacco products and increase revenue, that is, attract higher excise duty on cigarettes as they are less sensitive to price. However, it should also be noted that such a policy is contrary to Article III of the General Agreement on Tariffs & Trade (GATT) and should not form part of policy consideration as it opens up the whole excise tax system to dispute by trading partners at the World Trade Organisation (WTO).

Theoretical and empirical evidence suggest that a single specific high rate, with an increase or adjustment for inflation each year, is better than other tax structures and systems in terms of improving public health and increasing revenue (Sunley, Yürekli & Chaloupka 2000). Townsend (1998) states that when the Egyptian government raised the excise tax on cigarettes, but not on shisha (other types of tobacco products), consumption of cigarettes was reduced while the consumption of shisha increased.

Chaloupka et al. (2000) also note that the different tax rates encourage consumers to substitute other types of tobacco products. For example, an increase in the cigarette excise tax rates in Poland (due to joining the European Union) led to the majority of Poles switching from cigarettes to roll-your-own tobacco (RYO). When RYO tax rates were increased to a similar level to that of cigarettes, consumers substituted pipe tobacco (WHO 2010).

On the producer side, a multi-level excise system based on production scale provides opportunities for companies to establish small enterprises in order to avoid a higher rate or reduce production levels. Bird (1999) uses production data for the years 1988 to 1992, from tobacco manufacturer, PT. Djarum, to show that companies reduce production to qualify for lower tax rates and maximise profits.

The WHO (2010), in their *Technical manual on tobacco tax administration*, stress the importance of changing the structure of complex taxes to simpler ones, gradually leading to a uniform specific rate. Single specific rates were recommended as they may facilitate customs administration, reduce tax avoidance and tax evasion, increase government revenue, and lead to improvement in health as they reduce the incentive for someone to switch to another cigarette when there is a tax increase.

Some countries have made the transition from complex tax systems to simple systems. As an example, India uses a specific tax system with a multi-rate based on the length and type of smoking cigarettes (filtered and non-filtered). In 2007–2008, the first two layers of rates for filter cigarettes were combined into a single tier, and then in 2008–2009, all non-filter cigarette rates were made equal to the rate for the first two layers of filter cigarettes greatly simplifying tobacco taxation (John et al. 2010). Egypt also used a multi-tier specific tax system before it eventually implemented a single hybrid tax in July 2010 (Hanafy et al. 2010). The single hybrid tariff led to an increase in retail prices of 40 per cent.

5. Methodology

5.1 Effect of simplification model specific tariff structure on price

Surjono (2013) conducted a study using 2005–2010 manufacturer-level data to examine the effect of specific, hybrid and *ad valorem* tax systems on the price of cigarettes. From the research, the dependent variable is affected by the price of cigarettes, the independent variable, tariff, of three excise systems, with dummies for 10 types of tobacco products, and the cigarette manufacturer group.

This study also used data per manufacturer related to ordering the excise ribbons[2] in the period 2009–2012 to examine the effect of the tariff structure simplification price. In the model of this study, the price of cigarettes as a dependent variable, with independent variable specific tax rate and dummy of four types of tobacco, simplification (merger) layer rate dummy (simplification = 1, no-simplification = 0), and variable interaction/multiplication between the tariff and dummy simplification to measure the difference before and after the effect of simplifying the structure rates. Dummy variables for Types of Tobacco Product and Production Capacity are also necessary in this model because cigarette prices are influenced by both (Herlambang 2005; Surjono 2013). Types of tobacco products that have been affected by the increase and the specific tariff simplification are SKM, SPM, SK /SPT and STF/SPF.

Research model:

$$Price_{i,t} = \alpha_0 + \alpha_1\, excise\, sp_{i,t} + \alpha_2 D\_SKM + \alpha_3 D\_SPM + \alpha_4 D\_SKT + \alpha_5 D\_Gol\ I + \alpha_6 D\_Gol\ II + \alpha_7 D\_Gol\ import + \alpha_8 D\_simple_{i=j,t=2012} + \alpha_9 D\_simpel_{i=j,t=2012} * cukaisp_{i,t} + c_i + \varepsilon_{i,t} \ldots (3.1)$$

Where:

- $Price_{i,t}$ is the average nominal price of cigarettes per brand quarterly
- excise *sp* is the specific tariff nominal
- *D_simple (i = j, t = 2012)* is a dummy simplification, worth one (1) if $i = j$, where *j* is a brand of cigarette tobacco types and companies group which have been affected by simplification, t = 2012 means the period of simplification, year 2012. This variable is used to show the difference between before and after effect of simplification.
- *D_SKM* is a dummy, worth one (1) for the SKM type of tobacco product and zero (0) for other types of cigarette types
- *D_SPM* is a dummy, worth one (1) for the SPM type of tobacco product and zero (0) for other types of cigarette brands
- *D_SKT / SPT* is a dummy cigarette SKT / SPT, worth one (1) for SKT / SPT types and zero (0) for other types. Dummy STF cigarettes / SPF is used as reference
- *D_Gol I* is a dummy manufacturer group I, is worth one (1) for manufacturer group I, 0 otherwise
  D_Gol II is a dummy manufacturer group II, is worth one (1) for manufacturer group II, 0 otherwise
  D_Gol import is a dummy for import-export manufacturer, is worth one (1) for import-export manufacturer, 0 otherwise
- *Gol III* is used as a reference base
- *D_simple (i = j , t = 2012) * cukaisp* is a dummy variable interaction between simplification and excise rates to determine whether the effect of the tariff simplification is larger or smaller as the excise rate increases.

5.2 Operational definitions of research variables

Cigarette retail selling price

Price variables used in this study are the retail prices per tobacco stick. Retail price is the transfer price from retailer to final consumer, which includes all taxes. The retail price in this model is a nominal price because we want to see the effect of the tax increase on cigarette price in the same time period.

Excise burden

This is the tax burden derived from the specific tariff in Indonesian Customs data and in the Minister of Finance Decree.

Dummy types of tobacco products

This refers to the explanation of Article 4(c) of Law 39 of 2007 on the Amendment to the Law No. 11 Year 1995 on Excise.

'Dummy SKM' means a cigarette brand with the type of tobacco in the form of SKM is 1, another type of tobacco is 0. 'Dummy SPM' means a cigarette brand with the type of tobacco in the form of SPM value is 1, for the other tobacco types is 0. 'Dummy SKT/SPT' means a cigarette brand with the type of tobacco in the form of SKT/SPT value is 1, for the other tobacco types is 0. Tobacco products STF/SPF are used as a reference.

Dummy production group

Dummy manufacturer groups are used to differentiate the brand of cigarettes based on the manufacturer's production capacity and capability. Manufacturer Group I is a manufacturer that has a production capacity exceeding 2 billion cigarette sticks per year. Group II manufacturer is a manufacturer that is able to produce between 500 million cigarettes to 2 billion cigarettes per year. Group III manufacturer is a small manufacturer that can produce at most 500 million sticks per year. Dummy Gol I, means the value for the manufacturer's Group I is one (1), the other was given a value of 0. Dummy Gol II, means the value of the Group II is one (1), the other was given a value of 0. Dummy Group Import, means one (1) for companies who import tobacco products, the other was given a value of 0. Brand of cigarettes made by manufacturer Group III (small manufacturer) is used as a reference base.

Dummy simplification

Cigarette brands from certain types of tobacco products and companies group which are included in the group that experienced tariff simplification in 2012 are set a value of 1 while the other is 0. The purpose of this dummy is to see the difference between the influence of the excise tariff simplification and regular excise rate increase.

Dummy variable interaction with tariff simplification

This variable is formed by multiplying the dummy of tobacco brands from which the type of tobacco products and the manufacturer group is included in the simplification, with the specific excise tariff. This variable enables us to see whether the effect of simplification is greater in increasing cigarette prices compared to the regular rate increase. The significance of the coefficient variable is used to answer the research question.

5.3 Effect of specific tariff structure simplification model on cigarette consumption

Economic variables have links to each other, so the empirical model constructed in this study tried to look at the effect of specific tax rates with simplification structure on cigarette prices, and the effect of the price on consumption through a 2SLS simultaneous panel model when there is endogeneity between

price and excise tax. If there is no endogeneity, a standard panel model is used. An endogeneity test (Wu-Hausman F test) was conducted to determine whether the price of cigarettes is an exogenous variable.

Model simplification of the tariff structure specific to consumption:

$$Consumption_{it} = \beta_0 + \beta_1 Price_{i,t} + \beta_2 D\_SKM + \beta_3 D\_SPM + \beta_4 D_{SKT} + \beta_5 D\_Gol\ I + \beta_6 D\_Gol\ II + \beta_7 D\_Gol\ import + \beta_8 D_{simple_{i=j,t=2012}} + \beta_9 D_{simple} * price_{it} + \beta_{10} PNcap_{it} + c_i + \varepsilon_{it} \ldots\ldots\ldots\ldots\ldots (3.2)$$

where:

- $Consumption_{it}$ is the number of cigarettes per product per month
- $PNcap_{it}$ is quarterly national income per capita
- D_simple * $price_{it}$ is a dummy variable interaction with the simplification price
- Other independent variables as shown in the model referred to in section 5.1 above.

5.4 Operational definitions of research variables

Operational definitions provided here are limited to those that have not been provided elsewhere in this paper.

Consumption

'Consumption' refers to cigarette consumption data in studies in Indonesia using an approach derived from the annual SUSENAS data (Djutaharta et al. 2005). The data are the household expenditure data, however, variable cigarette consumption data from SUSENAS is too general and does not include the consumption of each type of cigarette in detail.

Cigarette consumption data used in this study is quarterly micro-data obtained from Indonesian Customs and Excise (DJBC) where there is known demand per quarter and per type. The unit of data used as a proxy of consumption is the number of sticks of the type of tobacco and production class group of companies. For example, if manufacturer A issued two types of tobacco products, namely SKM and SKT, SKT product where there are two different kinds of group production then it means there are three people/objects of research. This is done because the type of tobacco and production groups determine the amount of the rate charged.

A cigarette pack with a tax stamp affixed assumes that the cigarettes have been consumed. Cigarette-pack cigarettes with export stamps affixed means they are not intended for consumption so that cigarettes that are exported are not labelled 'ribbon' excise, while imported cigarettes will be consumed by domestic consumers that have ribbons affixed to cigarette packs. This fulfils the assumption that consumption is the addition of manufacturing production and reduced imports with exports. On the other hand, cigarettes are consumed within a year, as the quality and taste deteriorate within months, and the rate of excise stamps is less than 1 per cent. Data about packets of cigarettes with excise tax similar to the annual consumption data collected by the Indonesian cigarette ERC/TMA referenced several countries to determine cigarette consumption in a country.

Cigarette retail price

Price variables used in this study are the retail prices per production. Retail price is the transfer price from retailer to final consumer and includes all taxes. The retail price is a nominal price. In this study the nominal price is converted into a real price by the Consumer Price Index (CPI) and is applied to clove cigarettes, filter cigarettes and white cigarettes (tobacco only) using data from Statistics Indonesia (BPS).

Quarterly national income per capita

To calculate the quarterly national income at constant prices, the income is divided by the projected population at the end of the quarter of the year. National income is used as a proxy of income in this study following the consumption function. Djutaharta et al. (2005) use this data in models with monthly data consumption. National income is Gross National Product (GNP) minus depreciation and indirect taxes. GNP is Gross Domestic Product (GDP) plus net income from abroad. The proxy, National income, represents income before taxes (Djutaharta et al. 2005).

Dummy interaction variable with the simplification price

This variable is formed from dummy multiplication simplification with the retail selling price of cigarettes per stick. Signs of the coefficient of this variable are indicated if cigarette prices due to simplification cause cigarette consumption to be less than the increase in cigarette prices due to a standard tariff.

5.5 The impact of simplification on excise revenues

Research by Chaloupka et al. (2010) looks at the effects of the tax system with the independent variables of government revenue in the form of government income tax rates and investigates the influence of specific and *ad valorem* and other economic characteristics variables.

Model simplification of tariff policy effects on government revenue:

where:

- Revenue is Excise Revenue quarterly per manufacturer
- Information about the other independent variables is as included in the models and in sections 5.1 and 5.3 above.

This model can be ignored if consumption continues to rise with the increase in excise tariff.

5.6 Operational definitions of research variables

Operational definitions provided here are limited to those not defined elsewhere in this paper.

Excise revenue

Excise revenue is the quarterly tax revenue derived from customs data. As a comparison to ensure accuracy, the data are also seen from the Directorate General of Government Treasury, Treasury Management Directorate and Ministry of Finance. The data contain details of the monthly tax revenue. Data revenue from the tax is part of the income tax in the sub-section 'tobacco excise revenue'.

Data

There are two original data sets in the form of 'unbalanced panel' because there are companies that ceased operation in the period of study and/or there are companies that entered the market part-way through the study. Manufacturers do not always reserve duty within three months so that there are 'empty' transaction data used in the quarterly period. Where there is no booking transaction tax within three months it can be assumed that the production of the cigarette manufacturer has not been consumed within three months. The model used to estimate the data is the unbalanced panel random effect model of the maximum likelihood estimator. The second data set is data taken from the original form of the data portion of the balanced panel data (balanced panel) where the research data are provided in the quarterly period. Data sub-balanced panels were used to reinforce the results of the analysis with unbalanced panel data.

The main data used in this study are the data related to the ordering of excise ribbons for the period April 2009 to December 2012. The data are the daily transaction data from the database of the Directorate General of Customs and Excise, which accumulates data on quarterly transactions. Specific excise rates data are taken from the Ministerial Regulation on Customs Tariff Tobacco results for 2008–2011. The retail price of cigarettes per stick is obtained from the conversion of constant prices using the CPI according to the type of tobacco smoking investigated. This index consists of a filter cigarette, white cigarettes and Kretek cigarettes which is obtained from the Central Bureau of Statistics. The number of cigarettes, cigarette type and class (capacity) is obtained from the Directorate General of Customs and Excise data of production. Quarterly national income per capita of data was sourced from Statistics Indonesia, which is obtained from the Quarterly National Income Sub GDP and population data each quarter, based on estimated demographics.

6. Results and analysis

From Table 3 it can be seen that the nominal tax rate ranges between Rp 40 in 2009 to Rp 365 in 2012. The lowest tax rate is the tax rate for Group II (Gol II)I products SKT layer 1, while the tax rate is the highest tax rates for Group I SPM product layer 1 and SPM products imported. The real tax rate, which is adjusted for the cigarette price index, rates range only from Rp 33.39 to Rp 257.197.

Table 3: Tax rates

Variable	Mean	Std. Dev.	Min	Max	Observations
nexcisesp	93,1472	64,895	40	365	14040
Excisesp	71,451	47,949	33.39	257.197	14040
nPrice	344,915	100,467	217.5	2083.33	14040
Price	268,317	76,514	142,016	1800,167	14040
Consumption	$8{,}09 \times 10^{7}$	$5{,}72 \times 10^{8}$	1200	$1{,}64 \times 10^{10}$	14040
Revenue	$1{,}95 \times 10^{10}$	$1{,}74 \times 10^{11}$	48000	$5{,}32 \times 10^{12}$	14040
Number of Product *(unbalanced)*					1890
Number of Product *(sub-balanced)*					281

Source: Customs & Excise data, analysed by author.

The cheapest nominal cigarette price (current prices) was Rp 217.5 and the most expensive cigarettes are Rp 2083.33 per stick. When we compared the lowest tax rates with the lowest price and the highest tax rates with the highest price of cigarettes, we obtained the same result, with the amount of excise tax being equal to 18 per cent of the price of cigarettes.

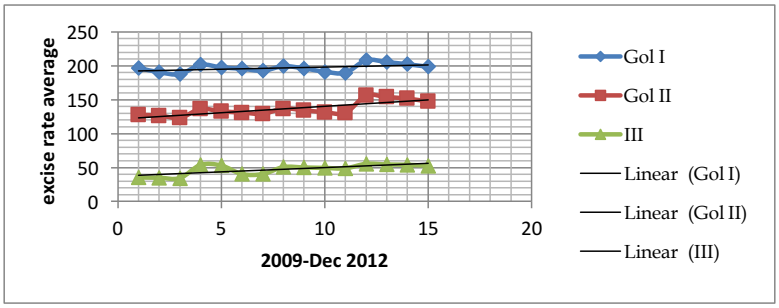
Consumption data shows that at least one cigarette brand can sell 1,200 sticks in a single quarter. On the other hand, the other cigarette brands sold over 16 billion cigarettes over a three-month period. We surmise that the companies generate considerable profit and cash flow by selling this quantity of cigarettes.

Excise revenue from one product/brand of cigarettes in the quarter ranges between USD48,000 to a significant USD5 trillion. This data may also indicate the financial capacity of tobacco companies operating in Indonesia. The extent of excise revenue indicates that the tobacco companies in Indonesia include very large companies to micro-scale enterprises.

6.1 Statistics analysis

Figure 5 shows the average tax rate in the aggregate, based on increased production class for the four-year period of the study. It also illustrates that the policy has not led to simplification of the excise tariff rates for cheap cigarettes produced by small manufacturers with regard to excise tax of cigarettes produced by companies Group II (GoI II) and Group I. The average increase in cigarette excise in Group II (GoI II) was higher than the average increase in the cigarette tax in another group. The average cigarette excise for Group II (GoI II) is close to the average cigarette excise for Group I.

Figure 5: Average tax rate per class production

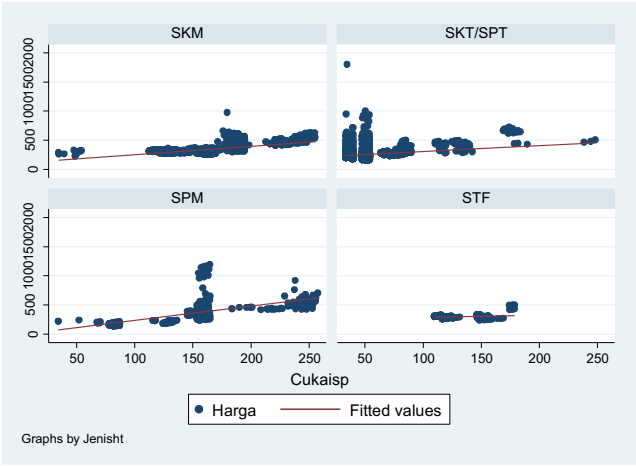


Source: Customs and Excise Data, analysed by author.

Cigarette prices

If we compare the price of cigarettes to excise tax there is a positive relationship. Figure 6 shows that when all types of tobacco products are analysed, any specific tax rate increase is also followed by a rise in prices which can be seen in the 'fitted value' line. These results show that manufacturers of all types of tobacco products responded to the government's policy of increasing excise tax by raising the price of cigarettes, although the rate of increase varied.

Figure 6: Relationship between excise tariff and price of cigarette per type

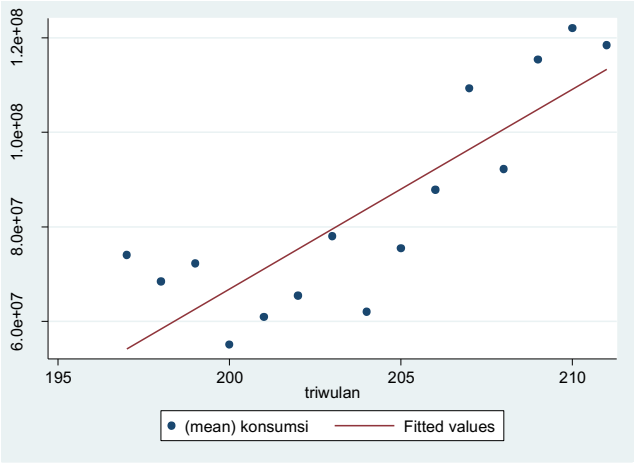


Source: Customs and Excise Data, analysed by author (Harga = Price).

Cigarette consumption

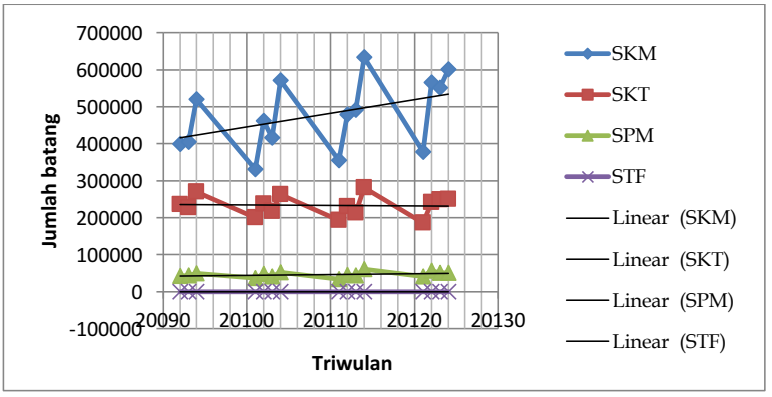
Consumption of cigarettes increased during the period 2009–2012, as shown in Figure 7. Based on the types of tobacco products, Clove Cigarettes Machine (SKM) experienced the greatest increase in the amount of production (consumption). Other types of tobacco products also tended to fluctuate despite experiencing rising trends, as shown in Figure 8.

Figure 7: Data aggregate average cigarette consumption per quarter



Source: Customs & Excise Data, processed by author.

Figure 8: Quarterly cigarette consumption 2009–2012 based on type of cigarette (in hundred thousand sticks)

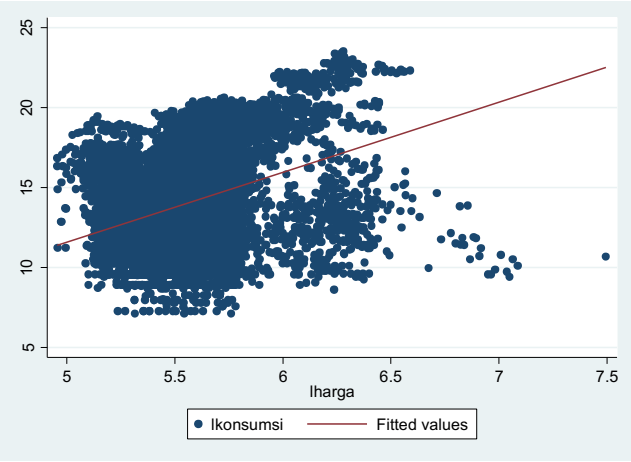


Source: Customs & Excise Data, processed by author.

The relationship between price and consumption

Based on price data and consumption in the natural logarithm, it can be seen that the price increase has no effect on consumption in general. Figure 9 shows that the increase in cigarette prices was followed by a rise in consumption. This indicates demand for cigarettes is inelastic, where the price increase does not affect the level of consumption. Commodities, such as cigarettes, that are inelastic goods have the potential to increase government revenue by the imposition of excise tax.

Figure 9: Relationship between price and cigarette consumption (in natural logarithm)



Source: Analysed by author.

6.2 Excise revenue

Government revenue from tobacco excise increases each year, and over the past five years has consistently exceeded the set target (see Table 4).

Table 4: Excise revenue on tobacco product

No.	Year	Revenue Target					(in million rupiah)
			1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
1	2008	44,535,359	11,954,330	11,030,664	14,552,342	12,389,096	49,926,432
2	2009	53,258,354	14,437,333	11,234,386	14,533,215	15,176,085	55,381,019
3	2010	55,865,922	15,921,412	15,237,241	16,032,918	16,105,339	63,296,910
4	2011	65,381,865	16,725,484	16,398,011	20,645,572	19,483,715	73,252,782
5	2012	79,864,500	20,506,000	21,978,310	25,162,652	22,901,918	90,548,881

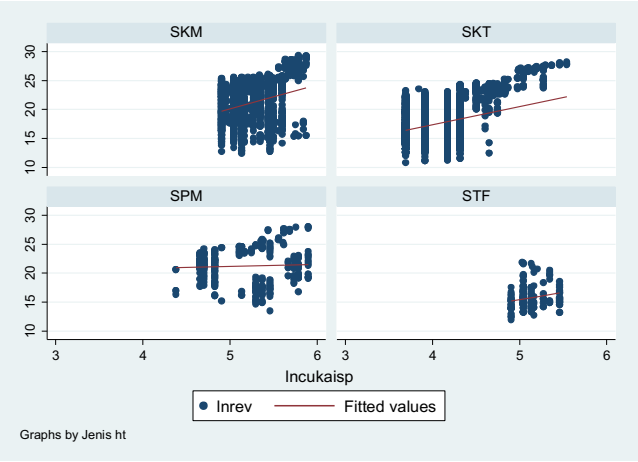
Source: DG of Treasury, Indonesia MoF.

Relationship with revenue customs tariffs

Smoking has a specific commodity impact in relation to the imposition of customs taxes. Types of cigarettes that have inelastic demand will continue to increase revenue because consumers continue to purchase them even when they are expensive due to the imposition of a very high tax.

The four cigarette products that are the subject of this analysis, and have the greatest market share, are the Clove Cigarettes Machine (SKM), White Cigarette Machine (SPM), Clove Cigarettes Hand (SKT) and Hand Clove Cigarettes Filter (STF). Results show that not all goods demand is inelastic, with the consumption of SPM cigarettes decreasing with rising prices. Figure 10 shows the SPM cigarette consumption decrease does not cause tax revenues to fall. Furthermore, the inelastic types of tobacco products are cigarettes SKM, SKT, and STF and Figure 10 shows an increase in government revenue. Cigarette excise revenue from SPM still increased, although the increase is smaller than for the other three types of cigarettes, as seen from the movement of the fitted line type of cigarette.

Figure 10: Relationship between excise tariff in each type of cigarette with revenue (in natural logarithm)



Source: Analysed by author.

6.3 The impact of specific tariff structure simplification on cigarette prices

Unbalanced panel data

According to Baltagi (2005), unbalanced panel data requires a different treatment to the balanced panel. Wansbeek and Kapteyn (1989), Baltagi, Song and Jung (2001), Davis (2002) and Boumahdi, Chaaban and Thomas (2004) state that standard estimation methods cannot be used. According to Moulton (1986), standard error and t-statistic on the ordinary least-squares (OLS) are biased due to not considering the individual and time effects. Furthermore, according to Baltagi (2005, p. 190), based on Monte Carlo Simulation, there are three models to better estimate the regression coefficient and variance component against the severe unbalanced panel; random effect method of maximum likelihood (MLE), restricted maximum likelihood (REML) or Anova Swamy and Arora estimator (MQA).

We used random effect MLE. Using MLE models, the excise burden is significant at the 1 per cent level with coefficient 0.52. A coefficient of less than one (1) indicates that the excise burden is not entirely charged to consumers through price, partly borne by producers, resulting in under-shifting. This finding contrasts with that reported by Surjono (2013) who used the pooled least square (POLS) method, concluding that there was over-shifting. Authors using the POLS models also discovered the phenomenon of over-shifting, where the tax increase raised the price between Rp 1 and Rp 1.4. In this study, we did not use POLS as a reliable model, based on the steps of model selection in panel data.

Coefficient of the interaction dummy simplification of excise tariff 0.672 showed a positive statistical significance at the 1 per cent level. In other words, after controlling for other variables, the rate increase due to simplification (merge to upper layer) increases the price by 0.672 greater than for a regular rate increase. Coefficient of dummy simplification is negatively significant at –184.39 at a rate of 1 per cent as the price of tobacco products before simplification is cheaper than the price of cigarettes in the upper layer before they were merged.

According to Harris (1987), there are two approaches to address the phenomenon of tax effect on cigarette prices in oligopoly markets. The first is to explain the relationships and rules of interaction between sellers and analyse the tax effect based on the rules of interaction, for example, whether an oligopoly market operates like a cartel, or a non-collusive behaviour, or shows partial interdependence. The second approach is that the imposition of excise affects or changes the rules of inter-firm oligopoly. In other words, the manufacturer could turn into a cartel or even damage an existing collusive relationship.

Under-shifting conditions occur because the manufacturer has raised the price of cigarettes slowly so that the tax increase is not so influential on the price of cigarettes. In partial equilibrium theory, under-shifting may occur when the supply curve has an upward slope. The opposite occurs when the tax increase is a critical focal point for the oligopolists who join together to raise the price of cigarettes, and the tax increase causes a multiplier effect on prices.

Subdata balanced panel

Baltagi (2005, p. 187), based on the Monte Carlo Simulation carried out by Baltagi and Chang (1994), concludes that the extracted data of a balanced panel from an unbalanced panel data (sub-balanced panel data) will cause a great loss in terms of efficiency and is not recommended. Mátyás and Lovrics (1991), also using Monte Carlo Simulation to compare the efficiency loss within estimator and generalised least square (GLS) models, concludes that the loss in efficiency can be nil if $NT^3 > 250$.

Sub-balanced panel data that the authors extracted is NT = 4215, which means qualified sub-balanced perform modelling of the data panel. Little loss in efficiency occurs because, apparently, only the SKM products, SKT and SPM, where SKT are used as a reference base. Imported tobacco products were not included as they were not routinely imported during the quarterly periods analysed. The Breusch-Pagan test through Lagrange multiplier (LM) test is used to check the presence of unobserved heterogeneity and it is known that the absence of unobserved heterogeneity hypothesis cannot be accepted, so POLS was unusable. The fixed effect Chow test is considered to be superior to POLS. Through the Hausman test, it is believed that the fixed effect estimator is best among random effect models and POLS. Modified Wald test shows heteroskedasticity, and with the Wooldridge test shows autocorrelation, then the most appropriate model for this kind of problem is to psar1 panel-corrected standard error (PCSE) models.

Based on the chosen model, the coefficient of tax rates 0.45, has a significant positive effect on the level of 1 per cent, where the results are not very different from the coefficient on the unbalanced panel data model. It can be concluded that there is under-shifting.

Coefficient of dummy simplification is significant at 1 per cent, which means there is a price difference between cigarette product-imposed excise simplificatian and those where it was not. Coefficient of the interaction dummy excise tariff simplification, which is the core of this study, shows a significant positive coefficient at the level of 10 per cent. This means that the rate increase due to simplification shows greater influence in increasing the price compared to the regular rate increases.

In summary, the results of MLE and PCSE model estimations can be seen in Table 5. Both models show that the effect of tariff simplification is a greater increase in cigarette prices than the usual increase.

Table 5: Price Model PCSE (balanced) and MLE (unbalanced)

Variable Independent	PCSE (balanced)		MLE (unbalanced)	
	Coefficient	p-value Significant	Coefficient	p-value Significant
Excise Tariff (nExcisesp)	0,45	0,000***	0,52	0,000***
Dummy simplification (D_simple)	-59,22	0,003***	-184,39	0,000***
Dummy interaction simplification and excise tariff (D_simple*nexcisesp)	0,144	0,070*	0,672	0,000***
Constanta	314,957	0,000***	309,537	0,000***
Chi2	923,86	0,000***	2225,43	0,000***
R- squared	0,9556			

Note: ***, **, * : significant at alpha (α) 1%, 5%, 10%

Impact of excise on the price of cigarettes by production group

The effect of an increase in excise tax on cigarette prices is greatest on large manufacturers who produce more than 2 million cigarette sticks per year, who we classified as Group I (Gol I in Indonesian) as indicated by a coefficient of 0.65, with a significance level of 1 per cent. Group II (Gol II) were of 0.56. The coefficients of Group III (Gol III), the lowest group based on cigarette production, is 0.379 (see Table 6). Hence, the imposition of excise tax rates on cigarettes is mostly transferred to price by large-scale cigarette production manufacturers (Group/Gol I).

Table 6: Comparative tax incidence per production capacity group

Variable Dependent Price	Group I	Group II	Group III
Excise Tariff	0,653***	0,560***	0,379***
Standard error	(0,0385)	(0,0210)	(0,0200)

Note: ***, **, *: significant at alpha (α) 1%, 5%, 10%

6.4 Impact of tariff simplification on cigarette consumption

Unbalanced panel data

Using random effect MLE, it is known that the coefficient of interaction between the dummy simplification and price is significantly negative at the 5 per cent level. This shows that as prices increase, simplification has a greater effect in reducing consumption than non-simplification. Dummy simplification has a significant positive indicator at the 5 per cent level. It is acceptable, because the affected simplification cigarettes are cheaper before simplification, so that the consumption is greater at the beginning of the policy being applied. Elasticity of demand for cigarettes excise is –0.9. This suggests that cigarettes are goods with inelastic demand. When divided by the type of tobacco products, the elasticity of demand SKM, SPM, SKT and STF respectively is –0.12, –1.7, –0.8, –0.3. It can be concluded that the SPM represent more elastic cigarettes while the other three are inelastic.

National income per capita coefficient is positive and statistically significant at the 1 per cent level. Positive signs mean that the higher the level of income, the greater cigarette consumption, which explains that cigarettes are normal goods, which is consistent with Handayani (2012). Coefficient of dummy types of tobacco products and the dummy group is to look at the differences between the types of HT[4] and production groups.

Sub-balanced panel

Through the selection model, the fixed effect model was selected. The classical assumption test showed that this model contains issues of heteroskedasticity and contemporaneous correlation, proven by the test of cross-sectional dependence by Pesaran test, but there is no autocorrelation, hence the final model used is the default PCSE.

The coefficient of interaction between simplification and price is negatively significant at 10 per cent and indicates that the slope for cigarette consumption caused by simplification is smaller than the slope for consumption of non-simplification cigarette brands. In other words, the effect of cigarette price increase affected by simplification is greater than the effect of reducing consumption of non-simplification price increases.

Dummy simplification is positive and significant at the 5 per cent level because the price of cigarette brands exposed to simplification (which merge into a rate layer above) is cheaper than the price of cigarettes in upper layer rates. Cheaper prices caused more consumption.

Through testing with the Wu-Hausman endogeneity test, it is believed there was no endogeneity between tax rates and price. The results of these tests are aligned with research by Surjono (2013) and Adioetomo, Djutaharta and Hendratno (2005). Hence, two-stage least squares (2SLS) models do not need to be made. Summary PCSE models and MLE results are contained in Table 7.

Table 7: Consumption model PCSE (balanced) and MLE (unbalanced)

Variable Independent	PCSE (balanced)		MLE (unbalanced)	
	Coefficient	p-value Significant	Coefficient	p-value Significant
Price	1724184	0,000***	432868,5	0,000***
GDP per capita quarterly (Pncap)		366,17***	72,754	0,000***
Dummy simplification (D_simple)	2,66 x 109	0,018**	2,05 x 108	0,142
Dummy interaction simplification and price (D_simple*harga)	-1,02 x 107	0,016**	-858,300	0,083*
Constanta	-1,24 109	0,000***	-4,33 x 108	0,000***
Chi2	680,12	0,000***	905,20	0,000***
R- squared	0,5647			

Note: *** , ** , * : significant at alpha (α) 1%, 5%, 10%

When disaggregated by type of tobacco products, the effect of simplification on cigarette prices varies. For SKM and STF cigarettes, simplification did not significantly affect the influence of cigarette consumption decline. The effect of price increases due to simplification is a significant influence in reducing cigarette consumption for SPM cigarettes. This can be seen in the coefficient of the interaction dummy simplification with prices marked negative (negative slope) and significant at the 1 per cent level and below. The reverse occurs in cigarette SKT. With simplification, the SKT cigarette consumption level is higher than the non-simplification, indicated by the coefficient of the interaction dummy simplification with prices marked a significant positive at levels below 1 per cent.

6.5 Estimation model government revenue

Unbalanced panel of data

At MLE models, the average increase in tariffs of Rp 1 boosts revenue from excise to an average of Rp 7.09 x 108 with a significance level of 1 per cent. Dummy coefficient simplification interaction with the rate increase showed positive signs with a significance level of 1 per cent (see Table 8). This means simplification rates have a greater effect on increasing government revenues as compared to the usual rate increases.

Sub-balanced panel

The model PCSE panel was the default for the sub-balanced panel due to problems of heteroskedasticity and cross-sectional dependence, but there was no auto-correlation problem. In the model, the increase in the average tax rate of Rp 1 boosts revenue from excise to an average of Rp 1.71 x 109 with a significance level of 1 per cent.

Coefficient of dummy simplification is negatively statistically significant at the 1 per cent level, indicating that the tax revenue from cigarette brands affected by simplification is smaller than the non-simplification. This is understandable because for cigarette brands affected by simplification, tax rates are lower than the previous tax rates on an upper layer. Interaction dummy coefficient indicates tariff simplification with a positive sign with a significance level of 1 per cent. This means simplification rates have a greater effect on increasing government revenues as compared to the usual increases.

Table 8: Revenue Model PCSE (balanced) and MLE (unbalanced)

Variable Independent	PCSE (balanced)		MLE (unbalanced)	
	Coefficient	p-value Significant	Coefficient	p-value Significant
Excise rate (nCukaisp)	1,71 x 109	0,000***	7,09 x 108	0,000***
Dummy simplification (D_simple)	-1,23 x 1012	0,000***	-1,21 x 1012	-
Dummy interaction simplification and excise tariff (D_simple*nexcisesp)	4,58 x 109	0,000***	4,88 x 109	0,000***
Constanta	-1,02 x 1011	0,000***	-2,6 x 1010	
Chi2	923,86	0,000***	2225,43	
R- squared	0,9556			

Note: *** , ** , * : significant at alpha (α) 1%, 5%, 10%

7. Conclusions

Based on the above analyses, the following conclusions can be made:

1. Simplification of a specific excise (tax) rate has a higher impact on raising the prices than the usual rate increase.
2. Increasing the specific excise has the greatest effect in raising prices on tobacco products produced by large manufacturers. The large manufacturers group (Group I/Gol I) is a group of manufacturers that have a production capacity exceeding 2 billion cigarettes per year.
3. The empirical model on tax incidence analysis shows under-shifting, where producers tend to raise prices under the tax increase. This means that producers bear most of the burden of excise.
4. The level of cigarette consumption due to cigarette prices affected by simplification is generally smaller than the consumption of cigarettes which do not undergo simplification of excise rate.
5. Simplification of the tariff structure significantly raises the price and reduces the consumption of White Cigarettes Machine Made (SPM), while it has no effect on consumption of Clove Cigarettes Hand Made (SKT) and even raises this kind of cigarette consumption, likely due to SPM consumers 'switching' to this cheaper category of product. SKT is a unique Indonesian tobacco product.
6. Demand for three types of cigarettes—SKM, SKT and STF—is inelastic so it is appropriate to apply the high excise rate to optimise the government revenue from the tax.
7. Simplification of the tariff structure generally has a greater impact on revenue increase than non-simplification.

7.1 Policy recommendations

Based on the results and conclusions presented in this paper, the following policy recommendations are made:

1. Governments need to be consistent and continually encouraged to implement simplification tariffs as part of their policy road map, where the purpose of imposing excise for cigarette consumption reduction and revenue optimisation can be realised. This policy can also reduce the administrative challenges of excise withdrawal.

2. Specific tariff policy is strongly influenced by inflation. Therefore, any rate increases need to be adjusted for inflation. If the specific tax burden remains (in nominal terms) or there is an increase below the rate of inflation, then over time inflation will reduce the tax burden.
3. Policies to reduce cigarette consumption need to be implemented with the material increase in tax rates, rather than to increase gradually and in stages. Gradual tax increases lose their influence because they can easily be eroded by inflation.
4. Simplification/streamlining the actual tariff structure can only be done on a specific system. If the government re-adopts the *ad valorem* tariff, then it will indirectly create hundreds of tariff structures even though only a single rate is set. This is because the amount of tax burden will follow the variations in the price of cigarettes in the market. This would be a significant setback.
5. Types of tobacco products, such as Machine Clove Cigarettes (SKM), Clove Cigarettes Filters Hand (SKTF) and Hand Clove Cigarettes (SKT), continue to provide potential as a source of government revenue by raising tax rates because demand for these products is inelastic.

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Notes

1 Tobacco Industry Roadmap 2007-2020, see http://agro.kemenperin.go.id/e-klaster/file/roadmap/KITNTB_1.pdf, viewed 29 April 2016.

2 Excise ribbon: one of the payment mechanisms to pay excise tax in Indonesia.

3 NT means Number of observations; N units and T time periods, in panel data.

4 HT is an abbreviation in Indonesian: Hasil Tembakau (Tobacco Product).

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WORLD CUSTOMS ORGANIZATION

Section 2

Practitioner Contributions

Ethics and transparency in Customs: a case study

Enrique Canon

Abstract

This case study provides an overview of the approaches taken by Uruguay National Customs Directorate to combat corruption. Measures implemented by the Customs Directorate on ethics and transparency include the commitment of senior officials to provide leadership and in so doing, to address the regulatory framework of the Customs Code of the Eastern Republic of Uruguay and the simplification of procedures based on international best practice, including increased transparency of customs operations, the introduction of automated systems leading to reform and modernisation of practices, routine auditing and greater collaboration to identify and investigate corrupt actions. A Code of Conduct has been developed, together with sound human resources management. These measures have improved the morale and organisational culture in the Customs Directorate and have led to stronger relationships with the private sector.

'The Line' in Guatemala

A suspicious flow of goods entering the country, and links between importers and customs clerks designed to evade taxes, led the International Commission against Impunity in Guatemala (CICIG),[1] to investigate allegations of involvement of senior government officials and directors from the Superintendency of Tax Administration (SAT) in a sophisticated smuggling network operating in the country's customs offices. The facilitation (involving incorrect tariff rates, false invoices, incorrect goods declarations, false descriptions and undervaluation, according to the type of product) was arranged by a telephone contact, known as 'The Line'. Also, in collaboration with senior SAT officials, customs brokers arranged for underpayments of duty not to be reported.

23 police operations led to the arrest of 20 people, including SAT officials and employees, businesspeople and customs clerks. Customs Declarations,[2] phone taps, photographs, invoices and shipping company reports were used in evidence.

In response to these developments, the Guatemalan public organised mass protests to show their disapproval of the situation. This culminated in the resignation of Guatemala's president, Otto Pérez Molina, on 2 September 2015, who was remanded in custody and is being investigated for unlawful association, passive bribery and customs fraud.

Brief analysis of corruption

Corruption affects the growth and development of countries, limiting the government's ability to implement stabilisation policies, since it undermines controls. It affects the whole economic system by lowering consumption, investment and export levels; slowing the country's growth process; and resulting in a loss of confidence in the institutions.

Three elements combine in cases of corruption. First, a clear and transparent regulation is broken. Second, an official breaks the law and obtains a benefit, and third, the benefit that is obtained is a direct consequence of the corrupt act. Fiscal corruption occurs when an illicit agreement is reached between a tax payer and an official in order to avoid tax, to the detriment of the State.

Corruption is not a phenomenon that is exclusive to underdeveloped countries, and while most commentators believe that corruption can be reduced to a minimum level, they doubt whether it can be completely eradicated.

Measures implemented by the Uruguay National Customs Directorate on ethics and transparency

Corruption cannot be attributed to a single cause, so it needs to be combated with different measures, at different levels and in a creative and innovative way. Some of the measures should be aimed at preventing corruption, while others should be aimed at punishing and penalising it, as a way of combating all the variables involved. Different measures have been adopted at the Uruguay National Customs Directorate, based on the World Customs Organization's (WCO) Revised Arusha Declaration.[3]

LEADERSHIP AND COMMITMENT: "*The prime responsibility for corruption prevention must rest with the Head of Customs and the executive management team.*"

The senior officials of our Directorate, in compliance with Art. 1 of the Revised Arusha Declaration, have confirmed their commitment and leadership duties. They have committed themselves to detecting and fighting possible transgressions within the work environment, and they comply with Law No. 17.060, issued on 23 December 1998, that requires all civil servants to submit to 'JUTEP' (Commission for Transparency and Public Ethics) the detail of their assets, listed in an affidavit, every two years.

REGULATORY FRAMEWORK: "*Customs laws, regulations, administrative guidelines and procedures should be harmonised and simplified to the greatest extent possible so that Customs formalities can proceed without undue burden*."

The Customs Code of the Eastern Republic of Uruguay (CAROU), Law No. 19276, was passed on 13 September 2014. It has systematised regulations that were scattered, and it has also updated those regulations, and aligned them with international best practice, thereby establishing clear and coherent regulations.

The simplification of procedures has resulted in a paperless approach and demanded a re-engineering of procedures and new features provided by the IT systems, in order to allow the simplification of requirements to be fulfilled and the implementation of information exchange with other agencies, as well as electronic payment. It also led to the development of new Procedure Manuals.

TRANSPARENCY: *"Customs clients are entitled to expect a high degree of certainty and predictability in their dealings with Customs."*

On 2 April 2014, the Uruguay National Customs Directorate – Private Sector Consultancy Committee was created by Customs Regulation No. 23/2014. The objective of this Committee is to receive, in an organised manner, approaches and concerns of the international trading community. As far as possible, any changes in procedures and regulations are disseminated in advance, and hearings are conducted within the Committee or in other informal settings.

Law No. 18.381, passed on 17 October 2008, that regulates the right to access public information, provides citizens with the opportunity to access information that is held by the Directorate, in accordance with Law No. 18.331, passed on 11 August 2008, on personal data protection.

The Uruguayan Constitution, in Art. 317, established the right of appealing administrative acts, which is regulated in Decree No. 500/991, issued on 27 September 1991, in Art. 142 and following. The procedure for administrative appeals provides the right to appeal customs decisions or to request a re-examination of them.

AUTOMATION: "*Where possible, automated systems should be configured in such a way as to minimise the opportunity for the inappropriate exercise of official discretion, face-to-face contact between Customs personnel and clients and the physical handling and transfer of funds.*"

Since 2010, over 1,000 desktop and portable computers have been allocated to relevant officials. This represents a high percentage of computerisation within the Uruguay National Customs Directorate, which has 1,047 officials.

The Directorate has also introduced the 'Electronic File System' (GEX), which allows (through the 'Pre-file' application) customs brokers to initiate customs files electronically, from their offices, and to receive electronic notifications.

The Project 'Digital DUA' (DUA: Single Customs Document) is a customs operations control process, for imports, exports, and transit shipments, which is documented in an electronic and automated way, and has minimal dependence on paper. Through this project, a number of initiatives have been implemented including electronic document, electronic signature, customs operations document storage under the customs brokers' responsibility, and the re-engineering of customs controls. Further, through the IT system 'Sistema Lucia', we have introduced the Electronic Customs Document and the 'Digital Goods and Merchandise Detention Record and Computerised Control of Warehouse Stock'.

The Single Window for Foreign Trade (VUCE), from the Uruguay National Customs Directorate, is a mechanism for trade facilitation aimed at optimising and unifying, through electronic means, the information and documentation required to fulfil all import, export and transit procedures via a single entry point. As at September 2015, 33 customs procedures were incorporated in 'VUCE', with 440 registered users and 8,449 import and export documents processed.

REFORM AND MODERNISATION: "*Corruption typically occurs in situations where outdated and inefficient practices are employed and where clients have an incentive to attempt to avoid slow or burdensome procedures by offering bribes and paying facilitation fees.*"

Management by Process, a project which we have embarked on, creates greater institutional security by limiting the discretionary power of customs officials.

Management Agreements are commitments made by officials designated to specific hierarchical positions (functions) within the Directorate, for a period of 15 months. After that period, a Panel is required to evaluate the official's compliance with the Management Agreement, and decide whether or not to renew the posting. The activity plans contemplated in the agreements contribute to the achievement of the institutional objectives of the Directorate.

Each Management Agreement has four kinds of indicators: fulfilment of the duties established in the Directorate's Balanced Scorecard; fulfilment of the duties included in the Unit's Balanced Scorecard; level of compliance with the punctuality and presence control duties, and fulfilment of the Unit's annual work plan.

AUDIT AND INVESTIGATION: *"… a reasonable balance between positive strategies to encourage high levels of integrity and repressive strategies designed to identify incidences of corruption and to discipline or prosecute those personnel involved."*

The National Customs Directorate is focused on training and enhancing the professionalism of its officials, as well as fostering their ability to discern whether somebody's conduct is unethical.

The Customs Inspection area, Internal Audit unit and the Customs Response and Intelligence Group (GRIA), are working collaboratively and have the autonomy to investigate and identify corruption acts. Within the last five years, 26 criminal prosecutions of customs officials have been progressed by GRIA.

CODE OF CONDUCT: ***"… which sets out in very practical and unambiguous terms the behaviour expected of all Customs personnel."***

The National Customs Directorate has submitted to the Executive Branch its own Code of Ethics, which has the status of a Decree.

Likewise, there are regulations about ethical performance of public duties in our country. These include Art. 59 of The Uruguayan Constitution, the Penal Code, Law No. 17.060 ('anti-corruption law'), the Statute for Public Servants (Law No. 19.121) and its regulatory decrees, that regulates, among other things, the disciplinary regime for civil servants. Decree No. 30/2003 sets out the duties, prohibitions and incompatibilities of civil servants and establishes the principle of pre-eminence of the public function, and in Art. 14 of Decree No. 204/013 the duties of customs officials are listed.

HUMAN RESOURCES MANAGEMENT: "*The implementation of sound human resources management policies and procedures plays a major role in the fight against corruption in Customs."*

Corporate Governance is the set of processes, habits, policies, laws and institutions that affect the way a company or organisation (corporation) is directed, managed or controlled. It also includes the relationship between the different agents involved in it (the Directorate, external controllers, creditors, investors, customers, suppliers, employees, the foreign trade community and the whole society).

Innumerable measures have been implemented to support Corporate Governance; for example, salary improvement. Aligned with this measure, the employment relationship of those officials who have applied for and obtained their permanent status has been improved, thereby encouraging their professional careers to develop.

The range of training courses that are available to officials is published on our website. Our Training and Knowledge Management Department delivered 320 courses from January 2011 to September 2015, with a total number of 4,202 enrolments.

We also follow the steps of the Integrity Development Guide from the World Customs Organization, which is disseminated through seminars, workshops and other courses.

Repairs to the Customs buildings are being made across the entire country in order to provide officials with the appropriate infrastructure in which to work. Since 2010, approximately 29 building and warehouse refurbishments have taken place, a new Integrated Control Area has been built and alarms have been installed. A building maintenance plan has been developed, which will be implemented in the period 2016-2020. This plan includes six public works projects to be carried out in Montevideo and in the provinces in order to preserve the heritage of the Directorate.

In 2013, the Incentive System for Best Performance was developed, as a way of rewarding each official fairly. In order to achieve this, three factors are considered: Responsibility, Participation in customs violations discovery, and Performance. In terms of 'Performance', the accomplishment of individual, group and corporate goals, punctuality, presence and individual performance, are measured.

MORALE AND ORGANISATIONAL CULTURE: ***"Corruption is more likely to occur in organisations where morale or 'esprit de corps' is low and where Customs personnel do not have pride in the reputation of their administration."***

In order to improve our relationship with the general community, we have developed information campaigns that explain the various activities performed by customs officials, the allocation of revenue, the importance of combatting smuggling, and how our community and the national economy are being

protected. Since 2013, Corporate Social Responsibility activities have been undertaken, with the active involvement of customs officials. The project 'Knowing the Customs Directorate' is currently under way. It consists of informative workshops aimed at primary school students from across the country, presented by customs officials. With these activities, and with others that are also taking place, a higher level of participation from officials is being sought. These activities also encourage a greater sense of belonging, commitment and a sense of pride among customs officials.

RELATIONSHIP WITH THE PRIVATE SECTOR: ***"Customs administrations should foster an open, transparent and productive relationship with the private sector."***

We have signed 11 Integrity Agreements with the private sector, in compliance with the principles of Art. 10 of the Revised Arusha Declaration, which promotes the signing of Memoranda of Understanding and the development of Codes of Conduct or Integrity that include appropriate penalties.

We already have fourteen Qualified Economic Operators in Uruguay, and to date 49 Uruguayan companies have indicated their intention to participate in this program. On our website (www.aduanas.gub.uy), there is a link to the free telephone number 0800 1855, for our stakeholders to contact us directly.

Finally, we concluded an Agreement with Brazilian Customs on 17 July 2014 and with Argentinian Customs on 4 November 2014, for the Bilateral Implementation of the Intra-Mercosur Pilot Program on Customs Security in the Goods Supply Chain. These programs support international traders by ensuring a high level of customs security within the supply chain from the time the goods are exported from the territory of a member state to the time they are imported in another member state.

Notes

1 Comisión Internacional contra la Impunidad en Guatemala (CICIG).

2 Declaración Única Administrativa (DUA).

3 Signed in Arusha, Tanzania, on 7 July 1993 (81st/82nd WCO Council Sessions) and revised in June 2003 (101st /102nd WCO Council Sessions).

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Utilisation levy: general overview and practical approach of the Russian Federal Customs Service

Boris Kabylinskiy and Victoria Menshakova

Abstract

Recycling of production and consumption wastes is one of the priorities of Russian state policy. To ensure ecological safety, including health and environmental protection measures against harmful effects of using vehicles, a utilisation levy applies to each car imported into, or manufactured in Russia. The utilisation levy is collected by the Federal Customs Service of the Russian Federation and represents a considerable proportion of its revenue. This article provides an overview of the utilisation levy and the way it is collected using as a case study the North-Western Excise Customs Post, which accounts for almost half of all duties collected in Russia.

Introduction

On 22 May 1998 the State Duma[1] adopted Federal Law No. 89-FZ on industrial and consumer waste (FZ No. 89). The Federal Law sets out legal requirements for recycling manufacturing and consumer wastes with the aim of preventing their harmful effects on public health and the environment. It also sets out ways of reusing these wastes as raw materials in other manufacturing processes. This legislation was amended on 28 July 2012 when the State Duma adopted Federal Law No. 128-FZ on modification of the Federal Law on industrial and consumer wastes and Article 51 of the Budget Code of the Russian Federation. It was then that the concept of a utilisation levy was introduced, which coincided with Russia's accession to the World Trade Organization (WTO). A prerequisite for Russia's accession to the WTO was a decrease in import duty rates and the utilisation levy was expected to offset the resulting decline in government revenue.

Under FZ No. 89, recycling is one of the priorities in dealing with wastes. Accordingly, a utilisation levy has the important status of a regulating instrument and is regarded as a 'compensation payment' for appropriate (that is, ecologically safe) recycling of vehicles that are out of operation but still remain in the territory of the Russian Federation. Thus, revenue collected as a result of this levy for purchasing domestically manufactured or imported vehicles is further directed to its utilisation in accordance with environmental standards of the Russian Federation.

Putting the utilisation levy into practice

Article 1(1) of FZ No. 89 provides that a utilisation levy be introduced to ensure ecological safety, including health and environmental protection measures against the harmful effects of using vehicles, taking into account their technical characteristics (such as release date and gross weight). This utilisation levy is actually paid in respect of each wheeled vehicle (chassis), each self-propelled car, and each trailer that is imported into, or produced in, the Russian Federation. Under Article 24(3) of FZ No. 89, it applies to the following taxpayers:

- persons importing vehicles (chassis) to the territory of the Russian Federation
- persons manufacturing and producing vehicles (chassis) in the territory of the Russian Federation
- persons acquiring vehicles (chassis) in the territory of the Russian Federation from persons who have not previously paid a utilisation levy.

Exceptions set out in Article 24(6) include vehicles that:

- are imported into the Russian Federation as personal property by individuals who participate in State voluntary resettlement programs for compatriots who live abroad, refugees or displaced persons
- are imported into the Russian Federation by, and belonging to, diplomatic missions or consular establishments, and international organisations that have privileges and immunities according to the conventional principles and norms of international law
- were manufactured more than 30 years ago, not used for commercial transportation of passengers or goods, and have their original engine and frame preserved or restored to the original condition.

Levy collection

There are two government agencies responsible for collecting the utilisation levy: the Federal Customs Service and Federal Taxation Service. This article discusses the approach taken by the former.

The Federal Customs Service collects a utilisation levy in accordance with the Resolution of the Government of the Russian Federation No. 1291 of 26 December 2013 and modification of some acts of the Government of the Russian Federation. This resolution has approved rules for calculating and paying the utilisation levy on wheeled vehicles and their chassis and defines ways of returning and offsetting overpaid levies.

Another important document is the Resolution of the Government of the Russian Federation No. 1350 of 11 December 2015 on changes in the resolution of the Government of the Russian Federation No. 1291 of 26 December 2013, which lists the vehicles to which the utilisation levy applies, and the amount of the levy. Table 1 shows the data on the levy collected by the Federal Customs Service from 2013 to 2015.

Table 1: Annual data: utilisation levy in the Russian Federation

Year	Amount of collected utilisation levy, billions of roubles
2013	39.25
2014	34.96
2015	23.04

Source: Federal Customs Service of the Russian Federation (2016).[2]

The data indicates that the value of the levy is falling annually. This is mainly due to a reduction in the number of vehicles imported to Russia and an increase in the number manufactured in Russia. It is also worth noting that car dealers do not import new cars until they have sold their existing stock of imported cars. Coupled with the economic crisis in Russia, these factors have had a negative impact on the amount of revenue collected.

Case study: North-Western Excise Customs Post

The decrease in the value of the levy collected warrants further analysis. By order of the Federal Customs Service of Russia No. 205 of 9 February 2015 on the competence of customs authorities to carry out customs operations concerning excisable and other certain types of goods, only customs posts of the Central Excise Customs Department are regarded as competent to collect a utilisation levy in Russia,[3] their competence being limited to excisable and certain other types of goods. Table 2 shows data on customs payments collected by the North-Western Excise Customs Post.[4] This is a notable example because revenue collected by that post represents 48-50 per cent of all revenue collected by the Central Excise Customs Department of the Federal Customs Service of the Russian Federation.

Table 2: Revenue collection of the North-Western Excise Customs Post during 2014-2015

Month	Customs payments, million roubles	Utilisation levy, million roubles	Month	Customs payments, million roubles	Utilisation levy, million roubles
2014			**2015**		
January	12,812.93	1,175.39	January	11,087.79	685.72
February	18,146.99	1,586.79	February	14,940.49	929.04
March	24,777.88	2,428.41	March	22,631.75	1,365.59
April	25,129.79	2,298.24	April	16,752.28	977.58
May	22,010.41	2,118.97	May	12,184.58	670.51
June	18,217.59	1,596.59	June	7,235.96	389.62
July	19,116.52	1,699.52	July	12,489.73	641.48
August	16,734.92	1,294.94	August	12,262.09	639.63
September	17,470.85	1,463.13	September	9,095.92	494.78
October	21,722.45	1,731.71	October	18,090.36	1,050.27
November	20,105.76	1,493.55	November	17,446.22	1,173.53
December	21,639.91	2,007.86	December	23,570.16	1,301.99
TOTAL	**237,886.00**	**20,895.10**	**TOTAL**	**177,787.33**	**10,319.74**

Source: Federal Customs Service of the Russian Federation (2016).

As can be seen from the above data, in 2014 the utilisation levy averaged between 7.43 per cent and 9.8 per cent of total customs revenue collected. In 2015, the proportion of the levy averaged between 5.14 per cent and 6.71 per cent of all customs revenue collected.

Table 3 shows the proportion of customs payments collected for different types of imported goods in the North-Western Excise Customs Post in 2014 and 2015. It shows that some 84 per cent of customs payments were collected in 2014 from the importation of vehicles and 76 per cent in 2015.

Table 3: Nomenclature of the issued goods on the North-Western Excise Customs Post in 2014 and 2015

Type of importing product	Number in foreign trade goods nomenclature (group classification of Eurasian Economic Union)		Share of customs payments, %	
	2014	2015	2014	2015
Vehicles	87	87	84.0	76.0
Special equipment, drilling rigs, bulldozers	84	84	5.6	4.0
Tobacco and tobacco products	24	24	4.8	7.5
Alcoholic and alcohol-containing products	22	22	1.9	2.2
Lubricants	34	34	0.9	0.9
Other	None	None	2.8	8.4

Source: Federal Customs Service of the Russian Federation (2016).

It can be seen that transport vehicles represent the largest proportion in the structure of customs payments, but as mentioned earlier, the number of imported vehicles and, consequently, the amount collected through the utilisation levy, decreases from year to year. In this regard, dynamics in the period 2014 to 2015 show that the importation of vehicles to the EEU declined, and as a result, the share of the utilisation levy in customs payments also declined despite the fact that car dealers represent a major component in the structure of customs payments (see Table 4).

Table 4: Leading car dealers' share of customs payments in 2015

Company name	Share of customs payments, %
JSC Toyota Motor	23.61
JSC Nisan Manufacturing RUS	8.62
JSC Volkswagen group RUS	6.72
JSC MMS RUS	5.45
JSC Jaguar Land Rover	3.83
JSC Hyundai CIS Motor	3.86
JSC Volvo Cars RUS	3.04
JSC Honda Motor	2.47
JSC Subaru Motor	2.38
JSC Philip Morris Izhora	2.01
Other participants of foreign trade activity	38.02

Source: Federal Customs Service of the Russian Federation (2016).

The data in Table 3 show a decrease in the amount collected through the levy in 2015 compared to 2014. This trend can be attributed to the impact of the economic crisis in the Russian Federation with the weakening rate of the Russian rouble having negatively influenced the price of goods. While trade flows have significantly decreased, what is also important to note is that vehicles are more expensive in comparison with other goods and are less likely to be purchased as frequently by traditional buyers.

It should be noted that while the amount of monthly utilisation levy collected in 2015 has generally decreased, since October 2015 the amount collected has increased. This is due to the scheduled adoption of revised coefficients for calculating the amount of the levy at that time through an amendment to FZ No. 89. Thus, in anticipation of the increase in the applicable coefficients, many foreign traders tried to import as many vehicles as possible before the existing rates and coefficients expired at the end of 2015.

What actually happened was the adoption by the State Duma of Federal Law No. 392-FZ on modification of Article 24.1 of the Federal law on production and consumption waste. This Federal law came into force on 1 January 2016 and amended the list of goods to which the utilisation levy applies, including self-propelled vehicles and trailers. Considering the share of these goods in the nomenclature of the North-Western Excise Customs Post, it can be assumed that such measures will contribute to a significant increase in the amount of utilisation levy in the structure of all customs payments. As noted, the coefficients used for calculating the utilisation levy (Table 5) have also increased.

Table 5: Changes of utilisation levy coefficients in the Russian Federation

Vehicle weight	Utilisation levy coefficient			
	New vehicles		3-year-old vehicles	
	2015	2016	2015	2016
1. Not over 2.5 tonnes	0.50	0.83	0.88	0.88
2. Exceeding 2.5 tonnes, but not over 3.5 tonnes	0.80	1.32	1.25	2.06
3. Exceeding 3.5 tonnes, but not over 5 tonnes	1.00	1.65	1.60	2.64
4. Exceeding 5 tonnes, but not over 8 tonnes	1.10	1.82	4.56	4.56
5. Exceeding 8 tonnes, but not over 12 tonnes	1.34	2.21	6.91	6.91
6. Exceeding 12 tonnes, but not over 20 tonnes	1.47	2.43	10.06	10.06
7. Trucks and dump trucks, exceeding when fully loaded 12 tonnes, but not over 20 tonnes	1.47	2.43	10.06	10.06
8. Exceeding 20 tonnes, but not over 50 tonnes	2.90	4.79	11.8	11.8
9. Trucks and dump trucks, exceeding when fully loaded 20 tonnes, but not over 50 tonnes	2.90	4.79	11.8	11.8

Source: Federal Customs Service of the Russian Federation (2016).

Coefficients of the utilisation levy for vehicles older than three years have not changed that much because they were already relatively high and exceed coefficients on new vehicles by an average factor of 2.7. Analysing the above data, based on comparing changes by such criteria such as the weight of the new vehicles (of course, other criteria exist), shows that the utilisation levy has increased by 65 per cent when compared with 2015. What does that mean for participants of foreign trade activity?

It is worth examining how the utilisation levy is reflected in the final cost of a vehicle. Supposing that in 2015 a car dealer imports a new vehicle (for example, a new van with a diesel engine, 205 h.p./150kvt, EURONCAP 5, 5200 kg weight, manufactured in 2015). In this example, the vehicle must pass through the customs procedure of release for internal consumption, so import duty and value added tax (VAT) have to be paid on it. The vehicle would fall into the category of new motor vehicles used for transportation of goods, and with a gross weight of more than 5 tonnes, the rate of customs duty would be 15 per cent. The customs value of this vehicle is 1,653,719 roubles. Having a rate of customs duty of 15 per cent (1,653,719 x 15%) and 18 per cent VAT (1,901,776.85 x 18%), the total customs revenue collected on this vehicle would be 590,377.68 roubles. The utilisation levy in this case would be 165,000 roubles. In the Russian Federation, such a vehicle costs between 2.3 and 2.7 million roubles

(or approximately USD36,000), so the proportion of the utilisation levy in the sale price is about 7-8 per cent. An increase of the coefficient for calculating the utilisation levy by 65 per cent means that the utilisation levy will be more than 270,000 roubles, which will make that vehicle significantly more expensive in the Russian Federation.

Conclusions

The utilisation levy is an important mechanism that can be effectively used by the Federal Customs Service for environmental protection and regulation of tax policy in the Russian Federation, but its increasing rate is having a negative impact on the import of vehicles into the Russian Federation.

Notes

1 Lower chamber of the Russian Parliament.

2 All tables in the article are based on data reported to the annual meeting that took place on 26 January 2016 in Moscow and which was attended by the First Deputy Head of the Federal Customs Service of the Russian Federation Vladimir Malinin, the Chief of the Central Excise Customs Department Vyacheslav Kozinitsky, senior officers of the Central office of Federal Customs Service of the Russian Federation and representatives of other state authorities.

3 Central Excise Customs Department is a specialised customs agency within the unified federal centralised system of the Federal Customs Service of the Russian Federation. The Central Excise Customs Department is under the authority of the Federal Customs Service of the Russian Federation and specialises in customs operations with excise and other particular types of goods, the list of which is determined by the Federal Customs Service. There are several functional departments and 17 customs posts in the structure of Central Excise Customs Department.

4 North-Western Excise Customs Post is the largest unit in the structure of the Central Excise Customs Department. There are seven departments of customs clearance and customs control located in Saint Petersburg on the perimeter of the North-Western Excise Customs Post, as well as 11 temporary stocks and one customs stock. Competence of the North-Western Excise Customs Post covers foreign trade activity in 10 provinces of the Russian Federation.

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Strengthening customs cooperation of BRICS countries: improving people-oriented capacity building strategies to achieve mutual recognition of Accredited Operator programs

Libing Wei

'If you want to go fast, go alone, but if you want to go far, go together.'
An African saying

Abstract

The five BRICS countries (Brazil, Russia, India, China and South Africa) are key emerging economies in driving global trade for stable economic recovery and key players in the effort to reduce world poverty. In order to facilitate global trade through adoption of business-friendly schemes, the five countries are implementing various models of Accredited Operator (AO) programs. Although these AO programs have demonstrated their effectiveness in strengthening supply chain management and economic competitiveness, this paper contends that an uphill struggle remains for the key objective: to reach a mutual recognition arrangement among customs authorities. The main objective of this comparative study is to achieve future mutual recognition arrangements of AO programs operational in BRICS countries and identify actionable approaches to people-oriented capacity building. It suggests exploring a standardised people development strategy and developing vocational training programs in a bid to facilitate mutual recognition of AO or Authorised Economic Operator (AEO) programs of the five countries. The paper also highlights capacity building instruments advocated by international organisations and seeks to motivate the development of customs professionals involved in AO programs.

1. Introduction

The G20 Summit in Antalya, Turkey announced that the five BRICS countries (Brazil, Russia, India, China and South Africa) would increasingly play integral roles in optimising global economic policy at a time of slow global economic recovery, and in fostering a healthy exchange of ideas and innovation. BRICS leaders again committed during this Summit meeting to 'the construction of a truly open global economy, increasing and diversifying trade, transport, technological exchanges, etc.'

The BRICS countries are rapidly growing economies and will continue to be a positive force for the resumption of global growth. They carry considerable weight among global economies, however, they do so mostly because of their size, population, GDP and economic dynamism, despite their faltering cohesiveness. In other words, the group's international clout depends more on the degree of their individual influence over world affairs than on their synergy. Economically they emulate developed countries but institutionally there is still an element of catch-up, and policymakers need to consider

innovative approaches within the area of customs and border management in order to reach their potential for international trade facilitation, and to function as key players in the global effort to reduce world poverty.

The increased multilateral trade between the five countries, its impact on border management and the way in which customs administrations are dealing with this is of concern to the world trade community. In this regard, it is encouraging to see that the five customs administrations appear determined to strengthen cooperation and coordination[1] in order to effectively and efficiently facilitate legitimate trade and combat illicit trade and customs fraud.

Inspired by this determination to facilitate multilateral trade through close cooperation, this paper postulates the need for the customs authorities to address the following five issues in the context of future cooperation:

1. Legal and regulatory framework, defining the necessary legal basis for cooperation in areas such as 3M (Mutual Assistance of Enforcement, Mutual Recognition of Customs Control, and Mutual Sharing of Information)
2. Institutional framework, providing the necessary procedural coordination to avoid policy inconsistencies at different levels
3. Capacity building framework, addressing people development and standardised vocational training leading to professional recognition
4. Integrity building framework, providing guidance on how best to engender trust between Customs and Business, and to maintain efficient performance of the five customs administrations
5. Infrastructure connectivity framework, providing necessary facilities to facilitate flows of transportation and communication.

Due to the scope and purpose of this study, this paper focuses on capacity building perspectives designed to strengthen customs cooperation in the area of Accredited Operator[2] (AO) programs operational in the five BRICS countries.

In recent years, the development of AO programs has become a priority for governments to enhance Customs-Business partnerships. At the first Global Authorized Economic Operator (AEO) Conference organised by the World Customs Organization (WCO) and the Korean Customs Service in April 2012, one of the outcomes was the consensus that AO or AEO-type programs represent major vehicles in facilitating customs modernisation. Such programs are seen as good practices that optimise Customs-Business partnerships and guarantee economic growth, and there are already 33 mutual recognition agreements or arrangements[3] in place worldwide (WCO 2015b). The AO programs which are mutually recognised by relevant customs authorities include programs such as the US Customs-Trade Partnership against Terrorism (C-TPAT, initiated in 2001); the New Zealand Secure Export program (initiated in 2003); the Canadian Partnership in Protection program (initiated in 1995 and revised in 2002 and again in 2006); the Swedish StairSec® program (initiated in 2006); and the Authorized Economic Operator Programs[4] (for example, the AEO program of Japan initiated in 2006, EU in 2008, and Korea in 2009).

Indeed, mutual recognition of AO or AEO-type programs is being increasingly acknowledged by the world trade community as one of the fundamental objectives to participate in such programs. Dr Kunio Mikuriya, Secretary General of the WCO (2007, p. 58) stressed that ‘mutual recognition is an essential element for consideration in developing a national AEO program. It is expected that bilateral, sub-regional and regional initiatives under development will gradually pave the way for a global system of mutual recognition of AEO status, although it will require some time to accomplish along with the

phased approach of implementing the WCO Framework of Standards'. Consequently, implementation of AO programs and differentiated risk targeting between consignments of AOs and non-AOs have become necessary for customs administrations in managing global supply chains. Widdowson, Blegen, Kashubsky and Grainger (2014, p. 18) highlighted in their research project on the Australian Trusted Trader program that 'assessing the compliance levels of such entities (Accredited Operators) assists regulators in determining where their resources should be directed. Put simply, such initiatives may be viewed as a way of reducing the size of the "risk pie"'.

2. Methodology of this comparative study

The five BRICS countries are individually key economic players based in four continents. A comprehensive analysis has been conducted through desk research, with the support of published literature and available market survey outcomes. As such, this work is mainly based on open documents and work reports of customs administrations and the WCO working committees. Sources of the study material include the following:

- Open media and the official websites of the five customs administrations
- WCO conventions, instruments, standards and recommended good practices
- Reflections from reports of the WCO Capacity Building Committee (CBC) meetings
- Multiple professional interactions with frontline customs professionals from public and private sectors
- Collection of experiences from customs officers dealing with customs brokers associations nationally and internationally; and opinions from the academic sector involved in customs-related education and research.

Considering the influential impact on the global economy by the five BRICS nations, this comparative study focuses on people-oriented capacity building to achieve a professional and common approach to compliance, so as to achieve future mutual recognition arrangements of AO programs among the BRICS customs administrations. Ideally this applied research will provide practical information and actionable approaches for reference by policymakers, for the benefit of facilitating international trade and reducing world poverty.

Section 1 above identifies the five BRICS countries as an important group in driving global trade for stable economic recovery and highlights their significance facilitating international trade by implementing business-friendly schemes like AO programs. Section 2 explains the research methodology and objective of this study. In the following sections, this paper analyses the comparable features and commonalities of the relevant AO programs and presents findings (positive elements and negative concerns) relating to the achievement of potential mutual recognition arrangements (Section 3); presents suggestions focusing on synergistic people development strategies in order to facilitate future mutual recognition of AO programs (Section 4), and concludes by emphasising the significance of people-oriented capacity building so as to achieve collaborative compliance management competencies that will engender closer cooperation among the customs administrations (Section 5).

3. Comparable features and findings to achieve potential mutual recognition of the five AO programs

Like other Customs-Business partnership programs, the BRICS AO programs[5] have been developed and are supported under relevant WCO Capacity Building programs:

- Brazil: Authorized Economic Operator Program (Launched in December 2014; this is an updated version of the Blue Line project, also known as Express Customs Clearance which was implemented in 2001.)
- China: Authorized Economic Operator Program (Launched in April 2008, and updated in 2014 with the Interim Regulations on Management of Businesses' Credibility.)
- India: Authorized Economic Operator Program (Launched in 2012. Indian Customs has another program 'Accredited Client Program' which has been implemented since 2005 with a focus on importers.)
- Russia: Authorized Economic Operator Program (Launched in 2011.)
- South Africa: Preferred Trader Program (Updated to Preferred Trader Accreditation Level 2 since 2011, which is regarded as a foundation for a future AEO program.).

Taking account of key elements of developing an AO program, the following factors have been examined: legislation, policy priorities, business coverage in foreign trade, authorisation process, accreditation criteria, benefits, audit system and eligible operators anticipated. A snapshot is summarised in Table 1.

Table 1: High level comparison of AO programs operational in the five BRICS countries

Key elements	Brazil	China	India	Russia	South Africa
Legislation	Normative Instruction IN SRF 47/2001; Normative Instruction IN RFB 1.521/2014	Measures on Classified Management of Enterprises (2008);The Interim Regulations on Categorized Management of Businesses' Credibility (2014)	The Central Board of Excise and Customs Circular No. 28/2012-Customs (2012); Circular No. 21/2015 (2015)	Articles 38-41 of the Customs Code of the Customs Union; Administrative Regulations for register of AEOs, Order No. 1877 (2011)	Section 64E of the South African Customs and Excise Act (1964); Rules to Section 64E of the Act (Level 2 accredited client status, 2011)
Focus of the program	Compliance and Security[6]	Compliance and Security	Compliance and Security	Compliance	Compliance
Coverage of business	Import, Export, Transit	Import, Export, Transit	Import, Export, Transit	Import, Export, Transit	Import, Export, Transit
Authorisation process approved by:	Customs Headquarters	Regional customs administrations	Customs Headquarters	Customs Headquarters	Customs Headquarters
Audit system including monitoring, revocation and suspension	√	√	√	√	√

Key elements		Brazil	China	India	Russia	South Africa
Accreditation Requirements	Self-assessment including audit report of previous year	√	√	√	√	√
	Compliance and external regulatory verification	√	√	√	√	√
	Sound financial solvency including length of compliant trade activity	√	√	√	√	√
	Security mechanism in place including inventory systems	√	√	√	√	√
	Obligation to ensure partner compliance	√	√	√	√	√
	Threshold amounts of customs duties and declarations	√	√	√	√	√
Facilitative Measures	e-Customs declaration system	√	√	√	√	√
	Low risk rating and low frequency of physical and documentary checks	√	√	√	√	√
	Pre-arrival lodgment of declaration	√	√	√	√	√
	Simplified inspection on AO premises	√	√	√	√	√
	Priority in declaration and release of goods before declaration with payment and/ or periodic declaration	√	√	√	√	√
	Privileged communication, performance assessment and training specific to AO	√	√	√	√	√[7]

Key elements		Brazil	China	India	Russia	South Africa
Eligible operators	Importer	√	√	√	√	√
	Exporter	√	√	√	√	√
	Customs brokers	√	√	√	√	X
	Warehouse operators	√	√	√	√	X
	Logistics forwarders	√	√	√	√	X
	Manufacturers	√	√	√	√	X
	Terminal operators	√	X	X	√	X
	Road carriers	√	X	X	√	X

Source: Author's compilation with reference to the latest WCO AEO Compendium (WCO 2015b) and relevant official websites.

As can be seen from Table 1, commonalities are prevalent amongst the five AO programs, particularly in the key areas of policy priorities, coverage of business, accreditation criteria, benefits, audit system, etc. Of particular importance, compliance elements are common across these programs, and accredited operators are required to maintain compliance levels to avail themselves of the stipulated benefits.

3.1 Positive elements in achieving mutual recognition of AO programs

It is encouraging to see there are more commonalities than inconsistencies in these operational AO programs in terms of qualification criteria, accreditation process, benefits, and positive outcome in promoting customs-related service and trade facilitation, etc. This bodes well for negotiation of potential mutual recognition arrangements by the various customs authorities. It is also encouraging to note that strong political support[8] is in place not only from the highest level of BRICS Summit meetings, but also from the meetings of individual customs administrations.

As committed by the five customs administrations, an initial step will be targeted at sharing their resources, knowledge and best practices so as to consolidate cooperation. Capacity building has been highlighted in relation to human resources, technologies and customs procedures in the first meeting of BRICS' heads of customs administrations. Under this spirit, the administrations will work towards possible solutions for achieving mutual recognition of customs controls and of trader management programs aligned to the WCO AEO concept, establishing customs interconnectivity and supporting the WCO's work on developing the Globally Networked Customs (GNC) model. (This paragraph is paraphrased from the announcement of the first meeting of the heads of BRICS' customs administrations and italicised for the sake of emphasis.)

AO programs have had a positive impact on trade facilitation and national economic competitiveness

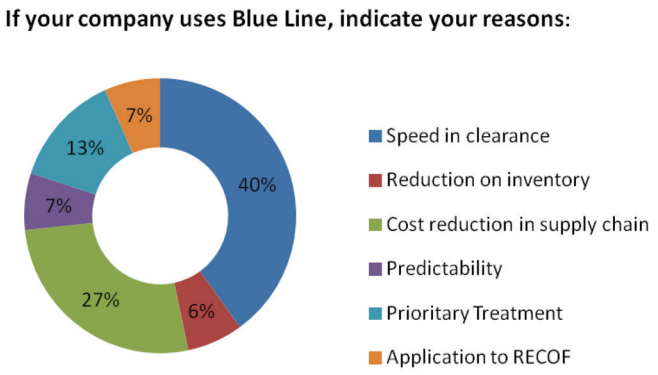
Through a careful study of the five AO programs and their impact on the economy, these programs have brought tangible outcomes in respect of the customs declaration environment, risk management, and in the promotion of facilitation and security of global supply chains.

In Brazil, border management has commonly been a target of complaints from importers and exporters, and while this trend has changed markedly in recent years, there is much room for improvement.

Through the platform Procomex[9] in consolidating partnerships between the public and private sectors, sound implementation and promotion of the Blue Line program has been observed. Accredited operators represent a significant percentage of Brazilian imports and exports, and each accredited company enjoys a substantial reduction of invasive inspections, which consequently releases customs resources to focus on trade activities with a greater risk profile.

According to a survey targeting a total of 46 accredited companies in 2012,[10] the result was encouraging. For instance, reflections with regard to reasons to use the Blue Line were: speed in customs clearance, better inventory management, reduction of cost in supply chain; predictability; priority of treatment and possibility of RECOF application.

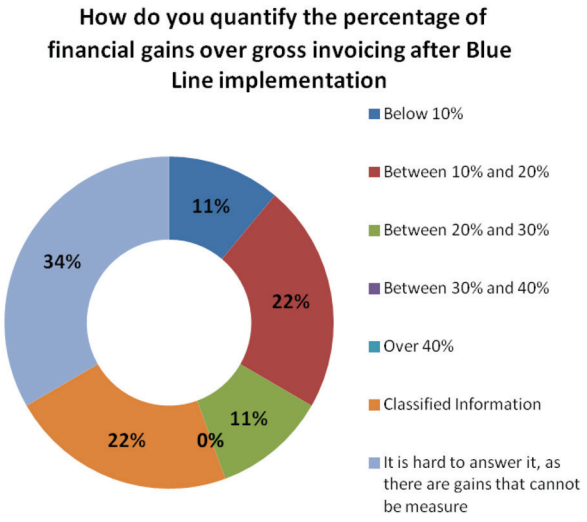
Figure 1: Reasons to use Blue Line



Source: Morini, Trevisan, Mineiro, Machado & Sá Porto 2014.

Judging from the survey result, the Blue Line procedure has facilitated financial gains for accredited operators, as the reduction in costs and time of exportation and importation promoted companies with better economic competitiveness in the international market.

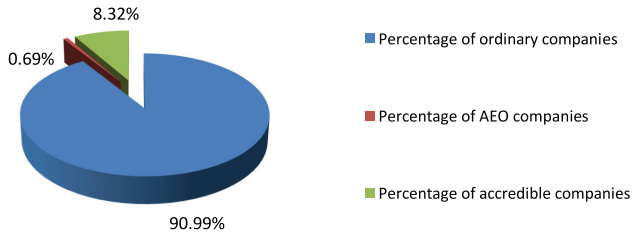
Figure 2: Financial gains over gross invoicing



Source: Morini, Trevisan, Mineiro, Machado & Sá Porto 2014.

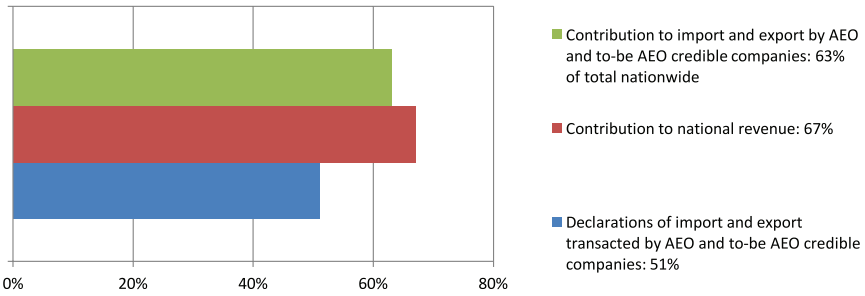
China, thanks to its constantly improved quality of products and upgrading professional standing in manufacturing industries, is branded as the world factory in modern times. According to a market survey report (China Customs Brokers Association [CCBA] 2013), the number of foreign traders registered with Customs in 2012 was around 342,600. However, only 2,360 were accredited by Customs as AEO (equal to 0.69%) and 28,518 of them as to-be AEO credible enterprises (equal to 8.32%). Among the AEO and to-be AEO enterprises, most were manufacturers (73.72%), the rest being logistics companies and other intermediary operators providing customs transaction services.

Figure 3: Percentage of AEO and to-be AEO enterprises categorised by China Customs in 2012



Source: China Customs Brokers Association (CCBA) 2013.

Figure 4: Key performance indicators of AEO and to-be AEO credible entities in 2012



Source: China Customs Brokers Association (CCBA) 2013.

In India, the customs administration took advantage of its robust and well integrated IT-based Risk Management System (RMS) when implementing its AEO program. According to Thomas (2014) during the ICAO–WCO Joint Conference in Bahrain, most consignments of AEO companies were being assessed through RMS without examination, on a self-assessment basis. The automated system has reduced cargo clearance times by one-third, benefiting importers through reduced costs on account of quicker clearances. Thomas (2014) further indicated that the implementation of AEO programs has shown value from investments, with these companies not only having received benefits from their investment but also being able to quantify numerous collateral benefits including:

- higher supply chain visibility
- improved supply chain efficiency
- better customer satisfaction
- improved inventory management
- reduced cycle time and shipping time.

From the above, it appears that accredited operators are playing an exemplary role in demonstrating the principle of *compliance for trade facilitation*. This positive impact can be found in all five AO programs.

Pioneering mutual recognition of AO Programs

There are successful trials among the BRICS countries in piloting mutual recognition of AO programs. For example, bilateral mutual recognition agreements with non-BRICS countries have been concluded by Brazil, China and India, with BRICS customs administrations accumulating relevant experience through bilateral and multilateral agreements (in terms of both tariff and non-tariff sectors), which paves the way for whole-of-BRICS mutual recognition of AO programs.

Russia and South Africa are gaining experience in mutually recognised programs through the development of regional AEO-type projects in line with the WCO AEO concept.

The Eurasian Economic Commission has drafted an 'improved' AEO concept, which is included in the draft Customs Code of the Eurasian Economic Union currently being agreed. The improved concept makes a number of substantive changes to the existing one. For example, financial stability and security (reliability) requirements are planned for companies wishing to obtain AEO status, including for the purpose of minimising the application of risk management systems with respect to such companies.[11]

The South African Revenue Service (SARS) is now developing an Advanced Accreditation (Preferred Trader Level 2) program which is considered a stepping stone to an AEO program. It is being developed by adopting the WCO SAFE Framework and aligning the accreditation procedure with that of the European Union (EU) AEO program. Further, South Africa is giving momentum to develop a regional AEO program for the Southern African Customs Union (SACU).

At present, South Africa and the SACU are piloting an Advanced Accreditation Program with key clients in government priority industries. This is a phased approach to an AEO program, ensuring that it is being implemented in a collaborative manner so as to achieve regional mutual recognition of Preferred Traders, and includes:

- Learn by testing so as to establish common SACU requirements, communication, interconnectivity, common standards of verification and governance
- Ensure enabling IT connectivity, data sharing to identify Preferred Trader clients
- Establish roadmap, common legal criteria and standards
- Ensure Customs-to-Customs exchange of information
- Ensure implementation, monitoring and reciprocation
- Ensure benefits including facilitated release from end to end
- Build structures to support regional Preferred Trader projects.[12]

These positive efforts of establishing mutual recognition of AO programs will generate a momentum of political will. Judging from the series of BRICS Customs summit meetings, there is a common view that mutual recognition of their AO programs is expected to multiply benefits of multilateral trade relations[13] by bringing trade security and facilitation from the domestic to the international level. In particular, enterprises that have been certified as AOs or are applying for AO business status in BRICS countries expect mutual recognition of their status to be recognised in return for their efforts to comply with the stipulated requirements.

3.2 Negative factors relating to mutual recognition

Even though a high level commitment for closer customs cooperation is apparent, there remains an uphill struggle for the five customs administrations to negotiate potential mutual recognition of their different models of AO programs. For example, the work agendas of the five administrations are not necessarily convergent given that their service interests, development stage and priorities differ. This results in difficulties in building compatibility, mutual validation and eventually mutual recognition of AO programs including the status of customs professionals[14] involved in AO programs.

From a capacity building perspective, the following are key concerns that should be addressed if the five administrations wish to achieve mutual recognition of their AO programs:

- Different reporting systems within government structures may result in restrictions to harmonisation of people development strategies and standardisation of training programs, besides differences in designing customs modernisation and border management programs
- Lack of a common approach to compliance awareness and the competency requirements of potential AO applicants and customs professionals serving in AO companies
- No standardised approach to compliance training and the necessary competencies to implement AO programs consistently, such as Risk Management and Integrated Supply Chain Management
- Lack of harmonisation of automated systems to enable the sharing of knowledge and customs clearance information in a timely manner.

4. Consequent suggestions

Due to differing national mandates, reporting structures and legal government competencies, it is not surprising to see that each customs administration in the BRICS group has its own development goals and work agenda. As noted by Widdowson (2007, p. 32) 'no two customs administrations necessarily look alike. What may be core business to one may fall outside the sphere of responsibility of another, and this is simply a reflection of differing government priorities, the way in which a particular country manages the business of government and the manner in which the associated administrative arrangements are established'.

In light of the findings above, this paper attempts to reduce the negative effect therewith on implementation of AO programs and to facilitate mutual recognition by promoting people-oriented capacity building coupled with a common approach to compliance and the associated desirable competencies.

4.1 Update existing AO programs in line with the WCO AEO concept enshrined in the SAFE Framework

While implementing AO programs, countries must consider their own strategic context and requirements, however, for the purpose of reaching mutual recognition and eventually implementing business-friendly facilitation measures, it is suggested they take a proactive attitude to update existing AO programs in line with the WCO AEO concept as they committed while signing the Letters of Intent to implement the SAFE Framework. This is an initial step for any potential mutual recognition of AO programs.

In this regard, Widdowson et al. (2014, p. 22) cautiously mentioned that 'although Article 7 proceeds to encourage members to develop Authorized Operator programs on the basis of "international standards" (without any specific mention of such standards), and to allow for mutual recognition arrangements, the provision is notable for the absence of any binding or formal adoption of related principles as set out in the SAFE Framework'. In fact, there is strong demand from both public and private sectors to harmonise

existing customs control methodologies including AO programs for the sake of trade facilitation and meanwhile secure supply chains. For instance, regarding potential membership participating AO programs, the SAFE Framework provided that 'potential AEOs include operators of all those involved in international trade'. They can be customs brokers and freight forwarders, and all traders involved in the global supply chains. In respect of facilitative benefits, Widdowson et al. (2014, p. 21) also highlighted that 'the criteria identified by the WTO [TFA (Article 7)] are consistent with those contained in the WCO SAFE Framework'.

The significance of raising a common approach to compliance and adopting internationally acknowledged standards in implementing AO programs is reinforced by the WCO Resolution made in its Policy Commission meeting at Dublin in December 2013, just after the conclusion of the WTO TFA:

> Customs plays a fundamental role in trade facilitation and that the Customs administrations of many WTO Members have made positive contributions to the WTO Trade Facilitation negotiations which have now culminated in the Trade Facilitation Agreement;
>
> the WTO Agreement is fully consistent with WCO tools and programmes on trade facilitation and compliance, including the WCO Economic Competitiveness Package, which incorporates, among other things, the Revised Kyoto Convention, the Data Model, Authorized Economic Operator programmes, the Coordinated Border Management Compendium and the Time Release Study (WCO Dublin Resolution 2013).

In the same vein, in terms of employing internationally recognised instruments, Ireland and Matsudaira (2011, pp. 176-7) advocated that:

> International instruments … are developed and negotiated by countries in specialized multilateral organizations. As international instruments are generally agreed and ratified at the political level, they can be a persuasive driver of change—with high level political commitment, interagency conflicts over leadership and ownership can be managed across agencies.
>
> Change based on international instruments can also bring clarity to overall change objectives, thus increasing engagement with industry stakeholders (including donor community stakeholders, private sector stakeholders, and government employees). … Furthermore, certain international instruments function as benchmarks of change by providing monitoring indices.

4.2 Mutually develop vocational training standards, upgrade professionalism and adopt a common compliance approach

Experiences from the implementation of AO programs demonstrate that there are emerging challenges for people development strategies, let alone implementation of mutual recognition agreements reliably and professionally by the 'world AO families' (stakeholders of AO programs). Indeed any customs modernisation including adoption of AO programs will exert legislative, procedural and operational impacts on customs practitioners, and bring change in the mindset and professionalism particularly of those customs professionals working on the frontline. Therefore, capacity building needs to be underpinned by an enabling strategy that gains the support of all trade stakeholders, whether they are employed in the public or private sector. In this regard, the WCO Customs-Business Partnership Guidance emphasised:

> … it becomes even more evident that joint training opportunities and bi-directional education are not only part of building mutual trust and understanding of each other's roles and responsibilities, but essential to develop the needed competencies of both partners.
>
> Through bi-directional education, Customs would be able to learn from industry experts among others about new and growing trade trends as well as develop a better understanding of how

> business models work to be able to facilitate trade. Such bi-directional education concepts could be developed in close coordination and constant communication with the appropriate industry stakeholders to better adapt to the ever-changing global trade and economic environment (WCO 2015a, p. 26).

Hence, from a capacity building perspective, this paper attempts to propose people-oriented capacity building approaches as stepping stones to facilitate the achievement of mutual recognition of AO programs:

- Mutual development of vocational training standards,
  - › establish standards based on the WCO PICARD Professional Standards and the People Development Diagnostic Tool
- Mutual development of qualification criteria for Customs Clearing Agents serving under AO programs,
  - › validate qualifications of customs clearing agents of AO companies jointly by BRICS customs authorities under an agreement framework
- Mutual support in capacity building of infrastructure so as to optimise information exchange facilities,
  - › maintain AO profile and business data traced and monitored effectively.

Mutual development of vocational training standards

International organisations and the academic community are making great efforts to promote standardised education programs targeted at specific professionals. However, except in the EU, there are very few projects pioneering joint development of vocational training standards. We have seen many countries begin to adopt the WCO PICARD (Partnership in Customs Academic Research and Development) Professional Standards[15] in educating customs managers. But the intention of Professional Standards is focused essentially on customs officials who wish to acquire academic qualifications through Bachelor or Masters degree studies. Obviously, it is limited in terms of coverage of vocational training standards for those customs professionals on the frontline, including customs brokers and freight forwarders whose expertise is actually intra-sectoral, trans-regional and cross-cultural in coverage.

In this connection, the paper suggests that the five customs administrations jointly develop standardised vocational training programs basically catering for frontline customs professionals, with input of expertise from universities, international organisations and multinational companies. This relatively low-cost, high-return initiative involves developing a multilateral partnership framework among customs administrations, academia and the private sector.

This initiative helps to overcome limitations in raising common comprehension of compliance and reduce discrepancies of training methodologies in individual BRICS countries. It can further serve as a professional benchmark for AO program managers from a regulatory perspective on the one hand, and a benchmark against which in-house training of an AO company can be measured and harmonised on the other hand.

Rationale

Customs is a highly knowledge-based and customer-oriented profession. The need to invest in promoting professionalism and compliance management has long been identified as a priority by the world trade community. Additionally, at a time of increasing change in the customs service landscape and emerging technologies, it is of critical importance to ensure that customs professionals perform their duties efficiently and reliably. From a business perspective, ensuring that customs professionals who are involved directly in customs transactions have a high degree of professionalism and compliance awareness will enable them to not only access customs facilitative measures domestically but also business opportunities across the world.

This requires establishing an organisational and operational model targeting both national education infrastructures and multilateral education policies and standards. The root of this rationale can be found in Article VII: Recognition of the *General Agreement on Trade in Services*:

> … a Member may recognize the education or experience obtained, requirements met, or licenses or certifications granted in a particular country. Such recognition, which may be achieved through harmonization or otherwise, may be based upon an agreement or arrangement with the country concerned or may be accorded autonomously (WTO GATS 1994, para. 1).

Mutual development of qualification criteria for customs clearing agents serving in AO companies

Among the five BRICS countries, a significant number of customs transactions involve agent declarations (between 85 and 100 per cent). According to a study released by the Federation of Freight Forwarders' Associations in India (FFFAI), it is estimated that '95 percent of international trade is handled by international freight forwarders and customs brokers' (*FFFAI News* 2012, p. 9). This situation helps to explain why clearing agents are generally subject to strict controls in respect of professional licence and market access in making agent declarations on behalf of other economic operators. As a matter of fact, such controls and competency standards for customs clearing agents vary in the five BRICS countries. Much of the current education effort is fragmented, let alone implementation of AO programs with a common approach to compliance and competencies on the part of customs professionals.

To raise professionalism and common approach for accredited operators, this paper considers that customs administrations have the responsibility to take the initiative[16] in setting vocational training standards and qualification criteria to motivate clearing agents of AO companies so as to establish a professional foundation. It suggests that customs clearing agents whose companies are qualified as AOs should be obliged to reach a high level of competency and compliance, and be certified professionally not only by the customs authority at a national level but also validated and mutually recognised at an international level, for instance, by the to-be-established BRICS Customs Cooperation Committee. This will facilitate consensus on levels of professional performance, people management, comprehension and implementation of mutual recognition of AO programs.

As an initial phase, the following criteria are suggested to be taken into consideration when customs administrations are designing cooperative frameworks in respect of criteria for credible customs clearing agent status:

- A college graduate and above five years' work experience in customs business
- A diploma holder from the institutes whose customs-related academic or vocational training programs have been certified by the WCO as meeting the designated international standards
- Validated by home customs administrations in terms of their security and trade compliance record (this move can be a pilot step towards being validated by all border regulators in a whole-of-government mechanism like the Single Window)
- The company he/she is representing has been granted AO or AEO-type trusted trader status.

Rationale

From a trade facilitation perspective, customs clearing agents are key stakeholders in implementing AO programs at borders, as most customs transactions are fulfilled in agent declarations. This also signifies that the vast majority of SMEs can benefit trade facilitation when their customs transactions are conducted by certified clearing agents who are employed by AO companies. These professionals gather, organise and manage the commercial and trade data on behalf of their clients, in fulfilment of formalities related to the international movement of goods.

From a customs enforcement perspective, it is these customs clearing agents that actually manage most of the global supply chain from end to end. They are the custodians of large amounts of commercial and transportation information connecting different border agencies, regions, industries, cultures and nodes of supply chains. Recognition of their voluntary compliance and cooperation is critical to effective risk analysis and risk targeting which is acknowledged as an effective means of compliance management, by freeing up Customs resources to focus on high risk traders and agents.

If credible customs clearing agents were to be officially mutually recognised by customs authorities, they would be motivated to operate in concert with the regulator, and maintain compliant procedures so as not to lose their accredited status. They would also be motivated to take the initiative to advocate knowledge-based enterprise ethics, compliance standards and codes of conduct so as to protect the interests of their trade partners and to secure the long-term sustainability of their business.

This presumption is reinforced by a number of reports of relevant international organisations and in the literature. For example, Grainger (2011, p. 167) observed that:

> Successful collaboration strategies also make enforcement far more efficient, and they can reduce trade compliance costs—expanding revenue while shrinking the shadow economy.
>
> To give one example, the so-called 20:80 principle—whereby 20 percent of the trade population is responsible for 80 percent of customs declarations—often applies. In fact, the ratio can be far higher in trade intensive economies (published research is scarce, but anecdotal evidence suggests that ratios of 5:95 or even 3:97 are not unusual). Consequently, a smart collaborative enforcement strategy is to encourage these traders with the highest volumes to internalize regulatory control objectives, freeing border agency inspection resources for use in controlling riskier movements. Commonly applied vehicles for the encouragement of good compliance records include preferential treatment and risk management, formal partnership agreements [accredited operator programs], licensing regimes, and assurance based controls [to ensure safety of goods and hygiene of foods, etc.].

In an effort to secure a high level of professionalism of stakeholders, a number of good practices are evident. For instance, in the freight forwarding community, the International Federation of Freight Forwarders Associations (FIATA) has implemented its FIATA Diploma,[17] the main purpose of which is to promote freight forwarders' professionalism. The FIATA Diploma is undersigned jointly by the Chairperson of FIATA and the National Freight Forwarders Association of participating countries. This validation mechanism enables the National Freight Forwarders Association to deliver standardised vocational training courses.

Mutual support in capacity building of infrastructure to facilitate information exchange

Previous experiences demonstrate that achieving meaningful results from mutual recognition of AO programs depends foremost on the efficient exchange of relevant information and availability of accurate information[18] provided by customs professionals. In order to implement mutual recognition arrangements reliably and professionally, it is proposed that the transactions of AO companies and their employed clearing agents should be subject to the supervision and evaluation of an authorised regional institution such as the to-be-established BRICS Customs Cooperation Committee, assisted by an efficient ICT platform to ensure transparency, fairness and consistency (for example, through the ongoing establishment of the BRICS Information Sharing & Exchanging Platform). However, the five customs administrations, like other government agencies, currently use various non-compatible automated systems which are not capable of adequately sharing information on customs transactions.

It is therefore necessary to strengthen mutual support in capacity building to optimise information exchange mechanisms and hence the timely supervision of AO performance. This will require considerable effort to be placed on technical assistance to support each other in order to sequence the necessary implementation of AO or AEO-type programs. Such mutual capacity building includes border

management facilities, networking communication and electronic customs declarations (paperless clearance), as well as proficiency in the use of relevant software and hardware, competency in digital applications, etc.

Rationale

This proposal echoes the commitment made at the first summit meeting of BRICS customs administrations, where it was agreed to take efforts to ensure mutual assistance across administrations, mutual recognition of customs controls and mutual exchange of customs information.

With the advent of e-commerce and the increasing volume of intermediary goods travelling across borders, customs authorities have been aware that information on logistics and cargo routes is critical for the fight against customs fraud. Thus customs authorities are prudent to maintain close partnership with highly reliable traders to systematically analyse cargo containers in the context of risk management. Thus dynamic management of AOs' credibility appears critical, as financial gains from avoidance of duties, taxes, rates and quantitative limits constitute an incentive to commit customs fraud.

If AO programs are implemented with an efficient, uniform and trustworthy ICT platform across BRICS countries, it will help to promote compliance with rules and regulations by economic operators and to avoid the inappropriate exercise of discretion by individual customs representatives and other trade-related regulators. Technically such mutual support activities will pave the way towards achieving mutual exchange of AO profile information and the provision of facilitative measures.

To date there are many good practices among the BRICS countries in this regard. For example, South Africa and other SACU Member states exchange customs data under the SACU Information Technology Connectivity Project. The objectives of the project include real time information sharing, risk assessment prior to arrival of a consignment, harmonisation of trade procedures through automated customs processing systems such as the integrated Customs and Border Management Solution (iCBS) and ASYCUDA++. It is envisaged that Customs in the countries of transit and import can use data provided by trusted traders for risk assessment and transaction reconciliation purposes.

5. Conclusions

With BRICS leaders having collectively committed to multilateral cooperation to improve global trade and poverty reduction, the challenge is to move ahead courageously and coordinate in an effective, accountable and measurable manner. While this is essentially an issue for BRICS central governments to tackle, the customs administrations, working with customs-related researchers, are doing their part by providing much needed theoretical and empirical studies for decision makers. Practically this emerges from the fact that cooperation among customs administrations is increasingly recognised as essential for facilitating global trade, and concern that such administrations are often the subject of review to ensure their ongoing relevance in an increasingly complex trade environment.

This requires customs administrations to make a collective effort to adopt mutually acknowledged business-friendly initiatives such as harmonisation and simplification of customs procedures. In light of the current situation relating to the implementation of AO programs in the five BRICS countries, such as differing government priorities and work systems, progress on the achievement of mutual recognition agreements is slow. Therefore, it is necessary to conduct further empirical research to convince policymakers of the associated benefits. It is also necessary to put forward feasible proposals aiming for collective compliance initiatives and agreed competencies. This involves investment in standardised education programs, enhancement of mutual training and evaluation of the effectiveness of people development strategies.

As outlined in this paper, mutual development of education programs and mutual support of people-oriented capacity building will generate a spillover effect[19] by ensuring that the legislative fundamentals of customs procedures are comprehended sufficiently across the BRICS countries, thereby facilitating mutual recognition of AO programs.

In short, any agreement reached to enhance customs cooperation should include a change in governance including the approach to education of customs professionals. While the literature has yet to fully explore the impact of mutual recognition of AO programs on people development strategies, this paper serves to reinforce the benefits of cooperation among customs administrations in achieving a common approach to compliance and the associated competencies. It is hoped that this paper will represent a stepping stone to encourage further studies in this important area of research.

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Notes

1 This commitment was made in the first meeting of BRICS heads of customs administrations in March 2013, available at: www.sars.gov.za/Media/MediaReleases/Pages/12-March-2013---Outcomes-of-1st-Meeting-of-BRICS-Heads-of-Customs-Administrations.aspx.

2 Accredited Operator, in this study, encompasses the concept of 'Authorised Person' (with a focus on customs compliance) as outlined in the WCO *International Convention on the Simplification and Harmonization of Customs Procedures* (Revised Kyoto Convention), 'Authorised Economic Operator' (requires both customs compliance and supply chain security) as defined in the WCO SAFE Framework of Standards and 'Authorised Operator' (focused on customs compliance and trade facilitation) as provided in the WTO TFA. For the convenience of discussion, this paper generically refers to them as 'AO', who are considered as trusted operators in the international trading community that are accredited to meet compliance and other regulatory requirements for the sake of secure and facilitated global supply chains.

3 The SAFE Framework defines mutual recognition as an 'action or decision taken or an authorization that has been properly granted by one Customs administration is recognized and accepted by another Customs administration'. Mutual recognition can be a means to avoid duplication of security controls and can greatly contribute to the facilitation and control of goods moving in the international supply chain. As of March 2015, 33 MRAs have been concluded and 20 AEO MRA negotiations are currently ongoing (WCO 2015b).

4 For the AEO program, it worth noting that there are, practically, three categories, AEO "C" mainly for customs clearance, AEO "S" for safety and security and AEO "F" for a combination of "C" and "S". This is a follow-up for customs administrations to implement one of the WCO's premier instruments, that is, the *SAFE Framework of Standards to Secure and Facilitate Global Trade* (the SAFE Framework) where Customs-to-Customs Cooperation and Customs-Business Partnership are enshrined as two pillars. This Framework includes the concept of AEO, whereby a party engaged in the international movement of goods is accredited by customs administrations as compliant with the supply chain security standards, and given benefits such as simplified customs procedures and reduced customs interventions.

5 The detailed information of the five AO programs is omitted considering the scale of this paper. Such details can be referred to in the latest WCO AEO Compendium (WCO 2015b).

6 The Brazilian AEO Program is scheduled to be implemented in three stages: starting in 2015, operators can only be certified based on compliance of security criteria (AEO-S). From 2016 on, certification will expand based on fulfilment of customs rules and procedures (AEO-C). AEO holders of both AEO-S and AEO-C certifications will be considered AEO Full (AEO-F). In 2017, the focus will be on integrating other government agencies aimed at streamlining of regulatory procedures.

7 South Africa has introduced an accreditation test for Preferred Traders (a Competency Testing tailored to AO). That is, client representatives responsible for accreditation need to demonstrate sufficient knowledge of customs processes and procedures.

8 During the first meeting of heads of Customs held in South Africa in 2013, the leaders established the foundation for closer links and committed to enhance capacity building mutually. Meanwhile, a Customs Cooperation Committee will be established in the near future according to the latest BRICS Customs summit meeting in July 2015, the new body will work to simplify and harmonise customs procedures within BRICS countries.

9 The goal of the platform 'the Alliance to Modernize Brazil's Foreign Trade (known as Procomex) is to draw up an easy-to-visualise iconic description of existing problems in import and export procedures and to identify opportunities for improvement. It serves as an informal mechanism bringing together more than 50 business associations and senior officials from the Customs administration and the Ministry of Development, Industry and Trade (Mein 2014, p. 132). This initiative practised in Brazil proves a successful story of joint business process mapping practised so far with synergy generated from close Customs-Business partnership and the Blue Line program.

10 The information presented here was extracted from the presentation by Professor Cristiano Morini at the International Network of Customs Universities (INCU) Inaugural INCU Global Conference in Baku, Republic of Azerbaijan (Morini et al. 2014). The survey was assisted by AER (Association of Companies of RECOF and Blue Line in Brazil). Blue Line and RECOF (Special Regime of Industrial Warehouse under Automated System Control) are Brazilian government initiatives that aim to encourage trade, with Blue Line providing companies with faster customs clearance and RECOF offering tax free benefits on import.

11 More analysis relating to the Union's AEO program can be seen at: www.lexology.com/library/detail.aspx?g=93f980f6-92f4-4c38-8be0-997da59da439.

12 This information was extracted from the presentation 'SARS' Customs preferred trader accreditation program', delivered by Mr Mohamed Ally, Executive of Customs Operations of SARS at the 2nd Global AEO Conference in 2014.

13 Currently, the total foreign trade volume of the BRICS countries makes up 16 per cent of the world total, while the trade volume between these countries is only 1.5 per cent of the world total, which suggests that the potential for economic cooperation among them has not yet been fully realised. From a border management perspective, according to the World Bank's latest report titled 'Doing Business 2016', South Africa is ranked at 14th position, Brazil 29th, Russia 66th, China 84th and India 134th, among the 189 economies listed.

14 In this paper, 'customs professionals' refer specifically to customs practitioners working on the frontline and dealing with customs transactions directly for cross-border trade, including customs clearing agents of the private sector and customs officers at the operational level (excluding customs officials at a higher executive level). Whereas a 'customs clearing agent', according to the WCO 'Glossary of International Customs Terms', refers to a person who carries on the business of arranging for the customs clearance of goods and who deals directly with Customs for and on behalf of another person. They can be customs brokers, forwarders, shipping agents, other customs intermediary operators and in-house customs professionals of import/export companies.

15 The WCO, in partnership with the INCU, developed the WCO PICARD Professional Standards targeted at professionalising Customs senior and middle management. The standards are being used by the academic world to develop educational programs which provide professional qualifications for customs staff to BA and MBA Levels. See detailed information at: www.wcoomd.org/learning_customshome_valelearningoncustomsvaluation_cbpicardoverview.htm.

16 Take South Africa as an example, a customs clearing agent may be any person as long as his or her employer/company is registered with the customs authority. But, with the introduction of the Preferred Traders Level 2 program, SARS is implementing a good practice 'an accreditation test for Preferred Traders'. This is a Competency Test tailored to AO, that is, client representatives responsible for accreditation need to demonstrate sufficient knowledge of customs processes and procedures. The introduction of the accreditation test has raised personal accountability of these representatives.

17 The FIATA diploma course is managed by the Advisory Body Vocational Training (ABVT), the education arm of FIATA. ABVT approves and validates the course material periodically and gives accreditation to the institutes run by its member associations to conduct the FIATA diploma course. Globally, 52 countries have validated their vocational training programs through FIATA and trainees from all over the world benefit from these FIATA diploma courses year after year. More information is available at: www.fiata.com/index.php?id=296.

18 This observation has been stressed on many occasions by the WCO. 'All Customs tasks and responsibilities are performed, at least in part, on the basis of data received from businesses engaged in trade—for example, data for purposes of revenue collection, risk management, admissibility checks, resource allocation and cooperation with other agencies, as well as the collection of statistical data for macroeconomic decisions' (WCO 2015c, p. 17).

19 It is advisable to keep an inclusive attitude while developing, mutually, the vocational training standards and standardised education programs by BRICS Customs. This move is to guard against suspicion that such beneficial training approaches to people development would bring negative effects in terms of training opportunities and compliance requirement on non-BRICS members, just as tariff elimination is available exclusively to members in a Free Trade Agreement.

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Section 3

Special Report

Customs Scientific Journal: recent developments and future plans

Mikhail Kashubsky, Olena Pavlenko and Victor Chentsov
Members of the Editorial Board, Customs Scientific Journal

Introduction

The *Customs Scientific Journal* (CSJ) is published by the University of Customs and Finance in Dnipropetrovsk, Ukraine, on behalf of the Regional Office for Capacity Building (ROCB) and Regional Training Centres (RTCs) for the European Region of the World Customs Organization (WCO). The University of Customs and Finance is a member of the International Network of Customs Universities (INCU).

The CSJ is published in English and Russian and since its pilot edition of April 2011, it has established itself as a valuable source of scholarly publications. It now attracts authors from a variety of countries and WCO regions, international organisations, academic institutions and the private sector. As the quality of articles has continued to improve over the past six years, the readership has also increased which is evidenced by the number of citations of papers published in the CSJ.

The Editorial Board has been considering ways to promote the CSJ and improve its academic and scientific standing to become an internationally recognised research platform. At the Inaugural INCU Global Conference 2014 in Baku, Azerbaijan, the Editor-in-Chief of the CSJ presented several ideas on how this may be achieved. A number of steps have already been taken in that regard and the purpose of this report is to update the readers of the *World Customs Journal* on recent CSJ developments, and to share the Board's plans and ideas.

Increased online presence

In order to ensure the journal is suitable for, and attractive to, both young researchers/students and established scholars, and to raise its standing and expand its reach, it is essential to have the CSJ included in at least one international scientometric database, such as Scopus, World of Science or Copernicus. After working on the procedural and other formalities required for inclusion into these databases, an application for a preliminary appraisal of the CSJ was submitted to Copernicus database in March 2016.

As part of this process, and to expand the journal's scientific geography and accessibility, a Google Scholar profile for the journal was established (https://scholar.google.com.ua/citations?user=WUUZufQAAAAJ). Currently, the CSJ h-index is 2 which, although not very high, shows that papers published in the journal are being cited and, therefore, that the journal is read and known. The CSJ has also been placed on the Open Journal Systems (OJS) platform (http://ccjournals.eu/ojs/index.php/customs), which is a journal management and publishing system. The OJS provides comprehensive indexing of content, and information from OJS is accessed by all major libraries in the world and scientific databases (http://ccjournals.eu). This allows for metadata of papers to be automatically exported to the global library system, WorldCat. Most of the other indices and libraries use the data exchange format adopted by the OJS.

The official bilingual website of the CSJ has been developed (http://umsfjournal.wix.com/customs-journal), with the pilot version launched in March 2016. The official website has a nicer look and feel than the OJS platform, but from a scientific community perspective, the Editorial Board feels it is more important to provide access to the journal on the OJS. The CSJ is also available on the websites of the University of Customs and Finance, the WCO European ROCB and the INCU.

Editorial Board changes

The CSJ has established an Editorial Advisory Board to support the existing Editorial Board. The Editorial Advisory Board consists of recognised top-ranking professionals in the field of customs affairs and foreign trade, which helps in promoting the journal and raising its standing in the research community.

Members of the Editorial Advisory Board are:

- Professor Aydin Aliyev – Chairman, State Customs Committee of the Republic of Azerbaijan; INCU Honorary Fellow
- Dr Zsolt Dezsi – Regional Training Center for the European Region of the WCO, Hungary
- Mr Roger Hermann – Head of the ROCB for the European Region of the WCO
- Professor Aivars Vilnis Krastiņš – Riga Technical University, Latvia
- Mr Oleg Platonov – President, Plaske JSC, Head of the Public Counsel at the Ministry of Economic Development and Trade of Ukraine
- Mr Zlatko Veterovski – Regional Training Center for the European Region of the WCO, Macedonia

The Editorial Board is comprised of scientists from different research fields with a citation index measured at not less than 4 (h-index), who specialise in various aspects of customs affairs, foreign trade, sustainable development or other fields.

The new composition of the Editorial Board is as follows:

- Professor Olena Pavlenko (Editor-in-Chief) – Regional Training Center for the European Region of the WCO, Ukraine
- Professor Lothar Gellert (Deputy Editor) – Federal University of Applied Administrative Sciences, Germany; INCU Advisory Board Member
- Professor Viktor Chentsov – Chairman, Scientific Council, University of Customs and Finance, Ukraine
- Professor Wiesław Czyzowicz – Warsaw School of Economics, Poland; INCU Advisory Board Member
- Dr Oksana Getman – University of Customs and Finance, Ukraine
- Dr Mikhail Kashubsky – Centre for Customs and Excise Studies, Charles Sturt University, Australia; Head of INCU Secretariat
- Professor Dmytro Pryimachenko – Vice-Rector, University of Customs and Finance, Ukraine

Sub-Editors:

- Dr Olga Triakina – Regional Training Center for the European Region of the WCO, Ukraine
- Ms Tetyana Chukhno – Regional Training Center for the European Region of the WCO, Ukraine

It is anticipated that both the Editorial Advisory Board and the Editorial Board will continue to expand their membership. The Editor-in-Chief is interested in hearing from emerging and established scholars who think they can actively contribute to the CSJ as a member of the Editorial Board.

Another development is that it is now a mandatory requirement for members of the CSJ Editorial Board to have an online researcher profile and/or citation index, such as a Google Scholar profile (all current members of the CSJ Editorial Board have researcher profiles/citation indexes).

Future plans

The inclusion of the journal into scientific databases will help to broaden the readership and authorship of the journal and attract financial resources to support the production of the journal. However, the Editorial Board understands that the inclusion of the journal into scientific databases is not the 'end game'. Further short-to-medium-term plans for the CSJ include attracting more international authors by publishing special/themed issues, expanding the composition of the Editorial Board, establishing a system of cross-citation, introducing new 'Announcements' and 'Advertising' sections of the journal, continuously improving the presentation of the journal, and introducing an online subscription facility.

For further information, please contact the Editor-in-Chief of the CSJ, Professor Olena Pavlenko at o.pavlenko@mail.ru.

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Section 4

Reference Material

Guidelines for Contributors

The *World Customs Journal* invites authors to submit papers that relate to all aspects of customs activity, for example, law, policy, economics, administration, information and communications technologies. The Journal has a multi-dimensional focus on customs issues and the following broad categories should be used as a guide.

Research and theory

The suggested length for articles about research and theory is approximately 5,000 words per article. Longer items will be accepted, however, publication of items of 10,000 or more words may be spread over more than one issue of the Journal.

Original research and theoretical papers submitted will be reviewed using a 'double blind' or 'masked' process, that is, the identity of author/s and reviewer/s will not be made known to each other. This process may result in delays in publication, especially where modifications to papers are suggested to the author/s by the reviewer/s. Authors submitting original items that relate to research and theory are asked to include the following details separately from the body of the article:

- title of the paper
- names, positions, organisations, and contact details of each author
- bionotes (no more than 100 words for each author) together with a recent, high resolution, colour photograph for possible publication in the Journal
- an abstract of no more than 100 words for papers up to 5,000 words, or for longer papers, a summary of up to 600 words depending on the length and complexity of the paper.

Please note that previously refereed papers will not be refereed by the *World Customs Journal*.

Practical applications, including case studies, issues and solutions

These items are generally between 2,000 and 5,000 words per article. Authors of these items are asked to include bionotes (no more than 100 words for each author) together with a recent, high resolution, colour photograph for possible publication in the Journal. The Editorial Board will review articles that relate to practical applications.

Reviews of books, publications, systems and practices

The suggested length is between 350 and 800 words per review. The Editorial Board will review these items submitted for publication.

Papers published elsewhere

Authors of papers previously published should provide full citations of the publication/s in which their paper/s appeared. Where appropriate, authors are asked to obtain permission from the previous publishers to re-publish these items in the *World Customs Journal*, which will acknowledge the source/s. Copies of permissions obtained should accompany the article submitted for publication in the *World Customs Journal*.

Authors intending to offer their papers for publication elsewhere—in English and/or another language—are asked to advise the Editor-in-Chief of the names of those publications.

Where necessary and appropriate, and to ensure consistency in style, the editors will make any necessary changes in items submitted and accepted for publication, except where those items have been refereed and published elsewhere. Guidance on the editors' approach to style and referencing is available on the Journal's website.

Letters to the Editor

We invite Letters to the Editor that address items previously published in the Journal as well as topics related to all aspects of customs activity. Authors of letters are asked to include their name and address (or a pseudonym) for publication in the Journal. As well, authors are asked to provide full contact details so that, should the need arise, the Editor-in-Chief can contact them.

All items should be submitted in Microsoft Word or RTF, as email attachments, to the Editor-in-Chief: **editor@worldcustomsjournal.org**

Editorial Board