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INCU (www.incu.org) is an association that provides the WCO and other organisations with a single point of contact with universities and research institutes that are active in the field of customs research, education and training.

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Editorial

Another successful PICARD (Partnership in Customs Academic Research and Development) Conference was held by the World Customs Organization (WCO) in Baku, Azerbaijan, in the second week of September 2015. This opportunity for academics and practitioners to share and debate research findings once again served to highlight the palpable synergies of the WCO and INCU and to identify areas in which collaboration is not only possible but highly desirable. The wide-ranging nature of discussion accentuated the diverse responsibilities of Customs and other border management agencies, and the disparate areas of research that may contribute to their decision-making activities.

This edition of the *World Customs Journal* reflects this diversity, with articles addressing legislative frameworks; trends in judicial decision-making; the impact of illicit trade on economic growth; excise reform; and approaches to border management coordination, automation, capacity building, administration and reform.

Research into these and other trade-related issues, such as supply chain security and the World Trade Organization's (WTO) trade facilitation agenda, are clearly gaining momentum. However, the current immigration crisis in Europe, the Middle East and other regions of the world is rapidly raising the demand for research into associated areas of border management such as asylum seekers, refugees and people smuggling. As we enter the tenth year of publication of the *World Customs Journal*, the Editorial Board would welcome contributions to future editions that reflect this broadening focus of academic interest of the Journal's readership.

David Widdowson
Editor-in-Chief

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Section 1

Academic Contributions

Will the Court of Justice apply its anti-abuse doctrine in customs valuation cases?

Krzysztof Lasiński-Sulecki

Abstract

The Court of Justice of the European Union (EU) has recently issued two judgments in customs valuation matters where it confirmed the possibility of adding certain amounts to transaction value which were not explicitly mentioned in Art. 32 of the Community Customs Code (Customs Code). The Court of Justice seems to have relied on the concept of abuse, although it did not make clear references to this concept. This article analyses trends in the case law of the Court of Justice to determine whether recent case law can be perceived as an initial stage of a judicial anti-abuse doctrine in customs valuation cases.

1. Introduction

Core provisions regarding customs valuation in the European Union (EU) are included in Art. 28-36 of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code (Customs Code).[1] They are based on the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (CVC). The former legal act does not refer to the notion of abuse or circumvention in the chapter regarding customs valuation, while in the latter these notions are not used at all. There are further provisions on customs valuation in Commission Regulation (EEC) No 2454/93 of 2 July 1993 laying down provisions for the implementation of Council Regulation (EEC) No 2913/92 establishing the Community Customs Code[2] (Art. 141-181a) but the notions of abuse and circumventions are not used therein either. Some provisions of Art. 29 of the Customs Code may be perceived as specific anti-abuse clauses aimed at reducing particular risks. These include Art. 29(1)(d) eliminating the possibility of applying the transactional valuation method in the case of transactions between related enterprises where this relationship affected transactional conditions and – in a sense – all prerequisites of applying the transactional method mentioned in Art. 29(1)(a)-(c).

Some traders get involved in transactions which are – from the economic perspective – artificially shaped. These transactions are actually conducted in order to benefit from deficiencies in legislation on customs valuation or the entire EU legal system perceived as a whole. This article analyses trends in the case law of the Court of Justice to find out whether recent case law can be perceived as an initial stage of a judicial anti-abuse doctrine in customs valuation cases.

2. Abuse, circumvention and fraud

Abuse of customs valuation provisions and related provisions within legal systems should be clearly distinguished from fraudulent activities that also occur in the field of customs valuation, where certain businesses may attempt to hide transfers of money from customs administrations and illegally declare customs value lower than required by customs provisions (Han & Ireland 2013, pp. 3-11). Similarly, businesses may try to conceal contracts with exporters and other entities (for example, licensors) to reach the same result. Such activities are clearly against the requirements of law and constitute fraud.

Circumvention means that rules of law are *prima facie* strictly obeyed but the result of such behaviour is contrary to the aim of the law (Zalasiński 2008, p. 159). Circumvention can typically take place in private law where *ius cogens* and *ius dispositivum* rules are distinguished. Circumvention occurs when legal relationships are shaped with the use of *ius dispositivum* in such a way that binding rules of *ius cogens* are *prima facie* legally not applied. Such an understanding of the notion of circumvention could hardly be applied in the sphere of customs law as all its rules are binding and *ius dispositivum* is nonexistent.

Abuse of law or abuse of rights is a notion that resembles the circumvention of law in a sense that a person abusing rights follows the exact wording of legal provisions but does it in a way that contradicts the aim of provisions granting such rights.

Concepts mentioned in this section of the article are not understood in exactly the same manner throughout the EU. Certain differences in delimitations exist. Yet, the Court of Justice in its case law seems to have added another autonomous way of understanding these notions – particularly abuse (Zalasiński 2008, p. 156).

3. Anti-abuse and anti-circumvention clauses in the Customs Code

The Customs Code refers to the notion of abuse in Art. 139 where it states that the customs authorities shall refuse to authorise use of the temporary importation procedure where it is impossible to ensure that the import goods can be identified. However, the customs authorities may authorise use of the temporary importation procedure without ensuring that the goods can be identified where, in view of the nature of the goods or of the operations to be carried out, the absence of identification measures is not liable to give rise to any abuse of the procedure.

According to Art. 133(d) of the Customs Code authorisation for processing under customs control shall be granted only where use of the procedure cannot result in circumvention of the effect of the rules concerning origin and quantitative restrictions applicable to the imported goods.

The notion of circumvention was used in Art. 25 of the Customs Code, under which any processing or working in respect of which it is established, or in respect of which the facts as ascertained justify the presumption, that its sole object was to circumvent the provisions applicable in the Community to goods from specific countries shall under no circumstances be deemed to confer on the goods thus produced the origin of the country where it is carried out within the meaning of Article 24.

Wording of certain customs provisions is such that one may notice the aim to eliminate abuse or circumvention though none of these notions is used. For instance, under Art. 146(1) the outward processing procedure shall not be open to Community goods whose export gives rise to the granting of export refunds or in respect of which a financial advantage other than such refunds is granted under the common agricultural policy by virtue of the export of the said goods.

This overview of customs provisions shows that the scopes of meaning of notions of abuse and circumvention are unclear. For instance, lack of identification measures in temporary importation may make this procedure more susceptible to fraud rather than mere abuse. The notion of circumvention in origin rules clearly does not correspond to its pure understanding from the sphere of private law. Moreover, this anti-circumvention clause serves as a means of last resort. Even the basic rule regarding origin contained in Art. 24 of the Customs Code is worded in such a way that it is not prone to circumvention or abuse (as it refers to economically justified processing).

4. Going beyond textual interpretation?

Article 32(1) of the Customs Code states: 'In determining the customs value under Article 29, there shall be added to the price actually paid or payable for the imported goods:

(a) the following, to the extent that they are incurred by the buyer but are not included in the price actually paid or payable for the goods:
    (i) commissions and brokerage, except buying commissions,
    (ii) the cost of containers which are treated as being one, for customs purposes, with the goods in question,
    (iii) the cost of packing, whether for labour or materials;

(b) the value, apportioned as appropriate, of the following goods and services where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the imported goods, to the extent that such value has not been included in the price actually paid or payable:
    (i) materials, components, parts and similar items incorporated in the imported goods,
    (ii) tools, dies, moulds and similar items used in the production of the imported goods,
    (iii) materials consumed in the production of the imported goods,
    (iv) engineering, development, artwork, design work, and plans and sketches undertaken elsewhere than in the Community and necessary for the production of the imported goods;

(c) royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable;

(d) the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller;

(e) (i) the cost of transport and insurance of the imported goods, and
    (ii) loading and handling charges associated with the transport of the imported goods to the place of introduction into the customs territory of the Community.'

Art. 32(3) of the Customs Code states that no additions shall be made to the price actually paid or payable in determining the customs value except as provided in this article.

One of judgments where the Court of Justice confirmed that a certain amount should be added to the transaction value, although the amount in question could not be easily linked to any provision of Art. 32 of the Customs Code, was the judgment of 16 November 2006 in case C-306/04 *Compaq Computer International Corporation v. Inspecteur der Belastingdienst – Douanedistrict Arnhem* (ECR [2006] I-10991). The facts of the case were as follows. Compaq Computer International Corporation (CCIC), a company established under Netherlands law, was a subsidiary of Compaq Computer Company (CCC), a company established in the United States, sold Compaq data processing equipment in Europe and had, to that end, a distribution centre in the Netherlands. Under a contract between CCC and Microsoft Corporation, Compaq computers might be equipped with software consisting of the MS-Dos and MS Windows operating systems and sold with those systems, in return for a payment of USD31 to Microsoft for every computer equipped with those operating systems. CCC bought laptop computers from two Taiwanese computer manufacturers. As part of this sale, it was agreed that the operating systems would already be installed on the hard drives of the computers when they were delivered. To that end, CCC made these operating systems available free of charge to the manufacturers, who then installed them on those computers. CCC then sold on to CCIC the laptop computers, which were dispatched free on board from Taiwan to the Netherlands. Upon their arrival, CCIC declared the computers for free circulation.

When their customs value was being determined, in accordance with Article 29 of the Customs Code, the selling price between the Taiwanese manufacturers and CCC, which did not include the value of the operating systems, was used. This became the main issue to be solved by the Court of Justice.

It must be noted that during the customs procedure, CCIC declared the transaction value of the first sale, in which CCC was the purchaser and the Taiwanese manufacturers were the sellers, as the customs value of the computers (para. 21 of the judgment C-306/04). According to the Court of Justice in respect of the determination of the customs value in the main case, the Community legislation on customs valuation seeks to introduce a fair, uniform and neutral system excluding the use of arbitrary or fictitious customs values.[3] The customs value must thus reflect the real economic value of an imported good and, therefore, take into account all of the elements of that good that have economic value (para. 30 of the judgment C-306/04). Software constitutes intangible property. The cost of acquiring such property, when incorporated in an item of goods, must be regarded as an integral part of the price paid or payable for the goods, and hence of the transaction value[4] (para. 31 of the judgment C-306/04). The operating systems at issue in the main proceedings are software that was made available to the Taiwanese manufacturers free of charge by CCC in order for it to be installed on the hard drives of the computers at the time of their manufacture. Furthermore, it is accepted that that software has a unitary economic value of USD 31 which was not included either in the value of the transaction between the Taiwanese manufacturers and CCC or in that of the transaction between CCC and CCIC (para. 32 of the judgment C-306/04). In order to determine the customs value of imports of computers equipped by the seller with software for one or more operating systems made available by the buyer to the seller free of charge, in accordance with Article 32(1)(b) or (c) of the Customs Code, the value of the software must be added to the transaction value of the computers if the value of the software has not been included in the price actually paid or payable for those computers (para. 37). The same is true when national authorities accept as the transaction value, in accordance with Community law, the price of a sale other than that made by the Community purchaser. In such cases, the term 'buyer' for the purposes of Article 32(1)(b) or (c) of the Customs Code must be understood to mean the buyer who concluded that other sale (para. 38 of the judgment C-306/04).

It is noteworthy that the Court of Justice did not even refer to the exact legal basis of adding the amount in question to the transaction value. It merely referred to sub-paragraph letters (b) or (c). It must be emphasised that the closed catalogue of amounts that can be added to the transaction value is not an autonomous EU rule. This requirement has its ground in Art. 8 of the CVC binding the EU. As Sherman and Glashoff have rightly pointed out: 'The clear-cut mandate of Article 8.4 should not be circumvented by indiscriminate rulings that an excluded item constitutes an indirect payment by the buyer to the seller. A cost which cannot be treated as an addition to the price because of the limitations of Article 8 should not be treated as a part of the price under Article 1' (Sherman & Glashoff 1988, pp. 170-1).

The fact that the CCIC relied on the first sale seems to be deprived of any meaning. No matter whether transaction value is based on the first sale or any subsequent sale – the same requirements apply in regard to amounts to be added to the transaction value.

In the judgment of 12 December 2013 in case C-116/12 *Ioannis Christodoulou, Nikolaos Christodoulou, Afi N Christodoulou AE v. Elliniko Dimosio* (ECLI:EU:C:2013:825) the Court of Justice dealt with legal qualification of a structure where Elliniki Biomikhania Zakharis AE – a company registered in Greece – exported sugar to Bulgaria. Export declarations were made at the request and on behalf of Afi N Christodoulou AE – another company registered in Greece – which paid for them. As the export of white sugar was subsidised, the export price of that sugar was lower than the domestic selling price. Christodoulou specialised in the preparation of fruit, mainly oranges, for the production of fruit juice. It had a factory in the north of Greece. In 2006 the Thessaloniki Customs Control Department (Greece) carried out a post-clearance inspection in order to verify Christodoulou's compliance with the customs regulations on imports of orange juice with added sugar from Bulgaria since January 2002. Both sugar

and orange juice were received in Bulgaria by the same company – Agrima. The products were placed in Bulgaria under the inward processing customs procedure with a view to their re-export without payment of any customs duties. After simply mixing the two products and diluting them with water, the orange juice with added sugar, whose declared country of origin was Bulgaria, was re-exported to Greece, destined for Christodoulou. There was no written agreement between Christodoulou and Agrima.

A few issues on the interpretation of the Customs Code have arisen. The crucial one was whether subsidies on exports of sugar had any impact on the customs value of the final preparation imported from Bulgaria into the EU.

According to the Court of Justice the applicants, under cover of a permanent export and allegedly substantial processing, intended to hide the fact that the goods were in fact inwardly processed. By dint of that practice, they circumvented the application of Article 146(1) of the Customs Code, under which goods giving rise to the granting of export refunds cannot be open to the outward processing procedure (para. 62 of the judgment C-116/12). The Court continued that the scope of EU regulations must not be extended to cover abuse on the part of a trader (para. 63 of the judgment C-116/12).[5] A finding of abuse requires, in the view of the Court of Justice, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved. Secondly, it requires a subjective element to exist in the intention to obtain an advantage from those EU rules by creating artificially the conditions laid down to obtain it. The existence of that subjective element can be established by, inter alia, evidence of collusion between the EU exporter receiving the refunds and the importer of the goods in the non-member country (para. 64 of the judgment C-116/12).[6] The obligation to give back an advantage improperly received by means of an irregular practice does not constitute a penalty, but is simply the consequence of a finding that the conditions required to obtain the advantage derived from the EU rules were created artificially, thereby rendering the advantage received a payment that was not due and thus justifying the obligation to repay it (para. 66 of the judgment C-116/12).[7] The determination of the transaction value in accordance with Articles 29 and 32 of the Customs Code necessarily takes into account the export refund which the exporter wrongfully benefited from by artificially creating the conditions required to obtain that advantage (para. 68 of the judgment C-116/12).

The Court of Justice has earlier confirmed the possibility of counteracting abuse regarding subsidies in the C-110/99 *Emsland-Stärke* case. There are restrictions on the outward processing procedure stemming from Art. 146(1) of the Customs Code that eliminate to possibility of using this procedure in an abusive manner. Yet, Art. 32 does not provide a legal basis for adding subsidies (received abusively) to the transaction value of goods.

5. Sometimes the wording is decisive …

The content of both judgments focused on in the previous section of this article might give an impression that the Court of Justice tries to interpret and – in a sense – apply provisions in a way that would be reasonable and would not jeopardise the system of law.

This aforementioned hypothesis can hardly be upheld. According to the view of the Court of Justice expressed in the judgment of 23 February 2006 in case C-491/04 *Dollond & Aitchison Ltd v. Commissioners of Customs & Excise* (ECR [2006] I-02129), Art. 29 of the Customs Code must be interpreted as meaning that, in circumstances such as those of the main proceedings, payment for the supply of specified services, such as examination, consultation or aftercare required in connection with contact lenses, and for specified goods, consisting of those lenses, the cleaning solutions and the soaking cases, constitutes as a whole the 'transaction value' within the meaning of Article 29 of the Customs Code and is, therefore, dutiable.

The facts of the case were such that customers paid one fee covering supplies of goods: contact lenses and accompanying liquids (by post) and medical examination allowing them to determine the exact features of the product (contact lenses) they needed. The medical examination occurred at the customers' location. The service was not a cross-border one and was focused entirely on customers and not on goods (unlike the facts of the C-15/99 *Hans Sommer* case). The approach of the Court of Justice was in line with the wording of the Customs Code: the first sentence of Art. 29(3)(a) states that the price actually paid or payable is the total payment made or to be made by the buyer to or for the benefit of the seller of the imported goods and includes all payments made or to be made as a condition of sale of the imported goods by the buyer to the seller or by the buyer to a third party to satisfy an obligation of the seller. On the other hand, the approach of the Court of Justice definitely led to a rather peculiar situation where customs duties might potentially be levied on services provided to customers in the country of importation, not connected with imported goods, although this clearly departs from the philosophy of customs law which does not subject to economic burden local services in the country of importation that are not connected with goods.

The Court of Justice implicitly departs from the wording of customs provisions to counteract practices that might be considered to be abusive but it does not disregard the text of these provisions to alleviate unreasonable consequences of applying the Customs Code in certain situations.

6. Application of anti-abuse and anti-circumvention clauses

The Court of Justice seems to have adopted a very strict approach towards anti-circumvention clauses expressed in customs law. In its judgment of 13 December 1989 in case C-26/88 *Brother International GmbH v. Hauptzollamt Gießen* (ECR [1989] 04253) the Court held that the anti-circumvention clause in origin rules might only be applied where circumvention had been the sole object of the transfer of assembly from one country to another (para. 29). It is a rather peculiar situation where the Court of Justice is very cautious in applying the anti-circumvention clause but at the same time creates a judicial anti-abuse doctrine that can hardly be reconciled with Art. 32(3) of the Customs Code.

7. Abuse of customs law

Negative connotations of abuse are not as strong as those connected with fraud because abuse is generally legal. A person involved in abusive practices follows the wording of legal provisions (or contractual stipulations) but does it in a way that does not correspond with the aim of these provisions or to be more precise, with the aim of the legislative body that prepared these provisions.

The concept of abuse is therefore very useful in the sphere of private law where two or more persons shape their legal relationships. They create certain stipulations that affect their relationships. These persons are – at least from the legal point of view – equal parties. Certain inequalities have their roots not in the status of the parties under private law but rather in economic reality as the parties' actual potential is not equal.

This is definitely not the case in the sphere of customs law (or more generally: public law) where legal relationships are, with minor exceptions, created unilaterally by the state (or even the EU itself) whose authorities create legal provisions that have to be obeyed and later assess whether these provisions are followed. An addressee of legal provisions is expected to follow the rules expressed therein rather than just follow the general idea that stood behind the creation of these provisions. If such an addressee of a legal provision is able to follow its wording exactly with the effect contrary to the aim of the provisions

that the legislator had in mind in the course of the legislative process, this means that the provisions had been poorly written – which can hardly be seen as a feature that should negatively affect their addressees. The case law on abuse might, thus, even be seen as a measure to eliminate any effects of poor legislation at the EU level (Horsley 2013, p. 964).

In light of the above, fraud is negative both in the spheres of public and private law but the same cannot be said about abuse with regard to public law.

8. Anti-abuse judicial doctrine

One might quite easily claim that the Court of Justice in its judgments in fraud and abuse cases voiced a certain principle of interpretation of EU law under which rights stemming from EU law do not extend to cover fraudulent or abusive parties. It should only be emphasised that this principle of interpretation does not allow any court to go beyond the possible meaning of interpreted provisions. One might wonder whether this is true in the case law of the Court of Justice. For example, Art. 32(3) of the Customs Code has a rather clear meaning and does not leave too much space for incorporating the anti-abuse doctrine to cover amounts other than that expressly mentioned in Art. 32 of the Customs Code. Moreover, the Customs Valuation Code as interpreted by Sherman and Glashoff (1988) seems to constitute a strong hierarchical argument against the introduction of any implicit anti-abuse measures.

On the other hand, one might treat anti-abuse case law of the Court of Justice as based on general principles of law. General principles of EU law are among the sources of EU law. They are defined in the literature as 'an unwritten Community law the particular significance of which is that it has as its primary aim the protection of the rights of the individual' (Toth 2008, p. 86). Depriving individuals of certain rights expressly and precisely granted to them under EU directives (or under national provisions) can hardly be reconciled with the way in which general principles, especially unwritten ones, work. Under Art. 32(3) of the Customs Code individuals have the right to treat all amounts not explicitly mentioned in Art. 32 of that Code as irrelevant for the purposes of customs valuation.

9. Conclusions

Customs valuation is not the only field of law where the anti-abuse doctrine of the Court of Justice – known from, inter alia, subsidy,[8] direct[9] and indirect tax cases[10] – seems to have proliferated. On 4 June 2009 the Court ruled on the circumvention of antidumping provisions in case C-158/08 *Pometon* and its approach was criticised in the literature (Rovetta & Tack 2010, p. 71). This brings about the question of whether the development of judicial anti-abuse doctrine in the field of customs law and in particular customs valuation, may gain momentum. Neither in its judgment in the case C-306/04 *Compaq Computer* nor in C-116/12 *Ioannis Christodoulou* has the Court of Justice referred explicitly to the circumvention or abuse of customs valuation provisions. This shows a significant difference between customs valuation cases and subsidy or tax cases where the Court of Justice has analysed the notion of abuse and ruled on the basis of its anti-abuse doctrine. Yet, it seems to the author that the Court of Justice implicitly attempted to counteract abuse or customs valuation planning.

Application of the anti-abuse doctrine would require amendments to the Customs Valuation Code. One may wonder whether such amendments would actually be desirable. If one takes into account the usual vagueness of such doctrines, they might be difficult to reconcile with the aims of the Customs Valuation Code which include creating a uniform customs valuation system.

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Notes

1 OJ L 302, 19.10.1992, p. 1.

2 OJ L 253, 11.10.1993, p.1.

3 See, judgment of the Court of Justice of 6 June 1990 in case C-11/89 *Unifert Handels GmbH v. Hauptzollamt Münster*, ECR [1990] I-2275, para. 35, and judgment of the Court (Fifth Chamber) of 19 October 2000 in case C-15/99 *Hans Sommer GmbH & Co. KG v. Hauptzollamt Bremen*, ECR [2000] I-8989, para. 25.

4 See, judgment of the Court of Justice of 18 April 1991 in case *Brown Boveri & Cie AG v. Hauptzollamt Mannheim*, ECR [1991] I-1853, para. 21.

5 See, judgment of the Court of Justice of 11 October 1977 in case 125/76 *Entreprise Peter Cremer v. Bundesanstalt für landwirtschaftliche Marktordnung*, ECR [1977] 1593, para. 21, and judgment of the Court of Justice of 11 January 2007 in case *Vonk Dairy Products BV v. Productschap Zuivel*, ECR [2007] I-239, para. 31.

6 See, judgment of the Court of Justice of 14 December 2000 in case C-110/99 *Emsland-Stärke GmbH v. Hauptzollamt Hamburg-Jonas*, ECR [2000] ECR I-11569, paras. 52 and 53 and the judgment of the Court of Justice of 21 May 2005 in case C-515/03 *Eichsfelder Schlachtbetrieb GmbH v Hauptzollamt Hamburg-Jonas*, ECR [2005] I-07355, para. 39.

7 See, the judgment in case C-110/99 Emsland-Stärke, para. 56, and j*udgment of the Court of Justice of 4 June 2009 in case C-158/08 Agenzia Dogane Ufficio delle Dogane di Trieste v. Pometon SpA*, ECR [2009] I-04695, para. 28.

8 For instance, the judgment in case C-110/99 Emsland-Stärke.

9 See, for instance, the judgment of the Court of Justice of 12 September 2006 in case C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*, ECR [2006] I-07995.

10 See, for instance, the judgment of the Court of Justice of 21 February 2006 in case C-255/02 *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v. Commissioners of Customs & Excise*, ECR [2006] I-01609.

Krzysztof Lasiński-Sulecki

Dr Krzysztof Lasiński-Sulecki holds doctoral and post-doctoral (*habilitacja*) degrees in law awarded by Nicolaus Copernicus University, Toruń, Poland, in 2006 and 2014 respectively. Since 2006, he has been Associate Professor at Nicolaus Copernicus University and since 2014, deputy head of the Centre for Fiscal Studies. From 2011 to 2012, Krzysztof was senior visiting tax researcher at Vienna University of Economics and Business, Institute for Austrian and International Tax Law. In 2015, he was visiting professor at Masaryk University in Brno, Czech Republic.

Krzysztof has been a member of the Consultative Council on Tax Law advising the Minister of Finance (*Rada Konsultacyjna Prawa Podatkowego*) – Deputy Head of the Team of General Tax Law, Tax Administration and Enforcement since 2014 and was a member of the VAT Expert Group of the European Commission from 2012 to 2014. In 2008, he was an Expert of the *Sejm* (Lower House of Polish Parliament) and from that date, has been Correspondent of the International VAT Monitor, IBFD. Formerly, Krzysztof was a tax adviser at PricewaterhouseCoopers Sp. z o.o. (Indirect Taxes Team, Warsaw). He is a member of the International Fiscal Association and Information and Organization Centre for the Research on the Public Finances and Tax Law in the Countries of Central and Eastern Europe.

Breaking the code: the impact of the Union Customs Code on international transactions

Catherine Truel and Emmanuel Maganaris

Abstract

With 500 customs declarations processed every minute in the European Union (EU), the current paper-based Community Customs Code has reached its limit. Its replacement, the Union Customs Code, introduces profound changes that are described in this paper before considering their impact on customs authorities and business from strategic and financial perspectives.

1. Introduction

The European Union (EU) accounts for 16 per cent of world trade, that is, 500 customs declarations processed every minute across the EU.[1] In this context, the current Community Customs Code[2] (CCC), a paper-based system, has reached its limit. The succeeding legislation, the Union Customs Code[3] (UCC) introduces profound changes for customs administrations and world trade. This paper describes these changes before considering their possible impact on businesses, first from a strategic point of view and then from a financial perspective.

Over the past 50 years, the role of Customs has changed significantly to adapt to the evolution of international trade. Before containerisation, goods were carried in bulk, boxes or nets in a ship's hold. It took several days to unload the cargo one piece at the time, giving customs authorities time to clear the goods and collect duties. When the first containership, *Gateway City,* made its maiden voyage in 1957 from Port Newark to Miami, it allowed dockworkers to unload cargo at a rate of 264 tons an hour.[4] In the '80s, when the current Community Customs Code (CCC) was conceived, a crane at a port could unload 1,000 tons per hour. Today, a single crane can handle 3,500 tons per hour[5] unloading a 12,000 TEU[6] containership in just a half day. This advance in productivity is putting pressure on border agencies to process shipments much faster and avoid creating a bottleneck at borders.

Customs clearance operates on a transaction-per-transaction basis where each import and export is processed individually which means clearance operations are directly affected by volume. In 2007, across the 27 European Member States, customs administrations checked 1.545 million tonnes of sea cargo and 11.7 million tonnes of air cargo. They processed 183 million customs declarations, that is, 5.5 declarations per second.[7] In this context, the current CCC,[8] which is a paper-based system, reached its limits. The next legislation, the Union Customs Code[9] (UCC) introduces profound changes for customs administrations and world trade.

2. The UCC

2.1 Legal basis

The legal basis for the UCC is Articles 33, 114 and 207 of the Treaty on the Functioning of the European Union (TFEU).[10] Article 31 TFEU can no longer be a legal basis for a legislative act like the recast Regulation.[11] Furthermore, as the proposal falls under the exclusive competence of the Union, the subsidiarity principle does not apply and because the proposal does not entail any new policy developments, it does not imply reassessing compliance.[12]

2.2 Entry into force and applicability

The UCC,[13] which is binding in its entirety and directly applicable in all Member States, was adopted on 9 October 2013 and entered into force on 30 October 2013. However, only some empowering provisions are applicable.[14] All other provisions will apply on 1 May 2016, once the UCC-related Delegated and Implementing Acts have entered into force. Until then, the CCC and the Implementing Provisions continue to apply.

Furthermore, because the application of the UCC is based on the use of electronic data processing,[15] it is dependent on the availability of IT systems across Member States. A Commission decision establishes a set of dates to complete the deployment of IT systems for Member States and the trade community with a deadline for completion of 31 December 2020.[16] The application of certain legal provisions will therefore have to be postponed and replaced by transitional measures pending the availability of the IT tools.

2.3 New comitology

The Treaty of Lisbon contains new provisions redefining the powers of the co-legislators and the European Commission (the Commission) in Articles 290 and 291.[17] The UCC empowering provisions allow the European Commission (EC) to draw up the implementing acts and delegating acts,[18] replacing the current implementing provisions (CCIP).[19] The draft Delegated Act[20] (DA) and Implementing Act[21] (IA) were submitted in January 2014 and are still, at the time of writing, under discussion in line with Articles 290 and 291 of the TFEU between Member States and the business community.

2.4 Existing provisions

The current CCC,[22] Regulation (EEC) No 3925/91[23] and Regulation (EC) No 1207/2001[24] will be repealed from the date the UCC becomes applicable on 1 May 2016.[25] The short-lived Modernised Customs Code[26] was repealed on the day the UCC entered into force.[27] In order to simplify and rationalise customs legislation, a number of provisions previously contained in separate community acts have been incorporated into the UCC[28] and will also be repealed from the day of its application.[29] As well, the UCC introduces a legal framework for the application of certain provisions from the VAT Directive[30] applicable to customs legislation to trade in goods between parts of the customs territory.

2.5 Scope

The UCC applies to the EU customs territory including the territorial waters and the airspace[31] of the Member States. The UCC does not extend to trade in services or capital but only to the international trade in goods.[32] The term "goods" is not further defined in either the TFEU or the UCC, however the European Court of Justice (ECJ) defined "goods", in the context of customs duty, in *Commission v. Italy*[33] as 'products which can be valued in money and which are capable, as such, of forming the subject of commercial transactions'. The term "goods" also includes gas and electricity.[34]

3. Changes in the UCC

3.1 Legal framework

The legislator has rationalised the legal framework. Common rules, applicable to all special procedures, are supplemented by a small set of rules for each category. This structure mirrors the World Customs Organization's (WCO) Revised Kyoto Convention[35] that is built around general and specific annexes. The UCC also includes measures from the security amendment.[36] The mission of customs authorities is now clearly defined,[37] reflecting the various activities undertaken by customs administrations at borders and inland. The role is further detailed with a list of objectives that customs administrations must aim to achieve. The business community will note that the first measure signals a focus on revenue collection and that trade facilitation is at the bottom of the list.

3.2 Definitions

The UCC also introduces new definitions. It simplifies the use of the generic term "legal or natural person"[38] and adds two definitions. The "economic operator"[39] describes a person who is covered by customs legislation, that is, traders. The "customs representative" is a broker appointed to carry out the acts and formalities required under the customs legislation. This is particularly important for Article 170(1) which specifies that "any person" can lodge a customs declaration and not just "Customs representatives". Furthermore, these new definitions allow the introduction of a new set up for the provisions on customs debt, clarifying where the responsibilities fall.

3.3 Declarations

The UCC sets the legal basis for the introduction of the electronic exchange of information between customs authorities and economic operators, such as electronically lodging declarations and accompanying documents which offers identical facilities to traders in each Member State.[40] There are now only two types of declarations: the standard[41] and the simplified customs declaration.[42] The simplified declaration is subject to authorisation,[43] the conditions for which will be in the DA.[44]

3.4 Customs procedures

The legislator has reduced the number of procedures and organised them in a new structure. The UCC gives traders the choice between three customs procedures:

- Release for free circulation and relief from import duty
- Export
- Special procedures.

Special procedures are divided into four categories covering:

- Transit: external and internal transit
- Storage: customs warehousing and free zones
- Specific use: temporary admission and end-use
- Processing: inward and outward processing.[45]

The aim is to make it simple for the operators to choose the right procedure, to avoid errors and to reduce the number of post-release recoveries and repayments.[46]

An authorisation will be required for Processing, Specific procedures[47] and the storage operation for warehousing procedure.[48] Authorisations will only be available to traders providing the necessary assurance of the proper conduct of the operations[49] and a guarantee will be required.[50]

The UCC changes the rules for placing the goods into free zones, which now become a customs procedure.[51] As a result, the goods and the business records are subject to customs controls.[52]

The "processing under customs control" procedure has been removed. For notification of the "intention to re-export" it is no longer necessary to use "inward processing",[53] allowing its merger with "Processing under customs control". The new single Inward Processing procedure covers these two functions as well as destruction, except where destruction is carried out by, or under the supervision of, Customs.[54] The compensatory interest applicable when goods are released to free circulation has been removed. Furthermore, the IPR drawback is no longer available.

3.5 Representation

The UCC changes the rules for representation.[55] Traders will now be able to deal directly with customs administrations to lodge their declaration[56] although they will still be able to appoint a representative.[57] This facility is already available in some Member States and the UCC makes this function available to all EU traders. Customs representatives will be entitled to provide their services in a Member State other than that in which there are established. This applies to those complying with Authorised Economic Operator (AEO) status,[58] others will be subject to individual Member States decisions.[59]

3.6 Customs debt

The UCC simplifies the rules on customs debt by grouping together all cases incurring a customs debt on importation in order to, among other things, avoid difficulties in determining the legal basis on which the debt was incurred.[60] It consolidates the current rules on customs debt resulting from non-compliance in a single article[61] to make them simpler to apply, a move that is very much welcomed by traders.[62]

The range of debtors is changing. The UCC makes both traders and representatives responsible for the customs debt.[63] There is wide consensus that, in the collection of a customs debt, priority must be given to persons who have deliberately infringed the law.[64] Under the UCC, the debt will be incurred at the place where the trader is established, wherever the goods have entered the EU. The business local customs office is considered best placed to supervise import and export activities.[65] This is particularly important in the context of centralised clearance separating the place where the goods enter the territory and the place where the customs declaration is lodged.

3.7 Guarantees

The UCC introduces circumstances where the provision of a guarantee is mandatory, for instance, to use certain procedures.[66] Guarantees cover not only import duties but also other charges,[67] such as VAT. The UCC also introduces a new "comprehensive guarantee"[68] covering EU-wide transactions. It is available for AEOs or traders meeting certain AEO criteria[69] even in cases where, in principle, it is prohibited.[70] Guarantee waivers are available to AEOs.

3.8 Valuation

One area of contention is the removal of the earlier sale provision relating to valuation. The UCC adds one provision[71] to that effect and clarification is expected to be provided in the secondary legislation. This change follows a decision from the WCO technical committee who, after reviewing this principle, argued in an influential commentary[72] that in a series of sales, the first sale should not be allowed as the basis for customs valuation. It introduces a "last sale rule" where duties should be assessed using the price paid in the last sale prior to the physical introduction of goods into a country.

The provision for royalty payment under the UCC is similar to that under the CCC. However, it is expected that a less strict criterion will be applied in the secondary legislation to capture some royalty payments in the customs value.

3.9 Binding information

The UCC opens the possibility to extend "Binding Information" to areas other than Classification and Origin.[73] All binding information will be valid for three years, aligning the current validity of Binding Tariff Information (BTI), which is for six years, to the Binding Origin Information (BOI). Binding Information, currently only binding for the authorities, now becomes binding for business.

3.10 New facilities

The centralised clearance[74] facility will enable traders to declare goods electronically and pay their customs duties at the place where they are established, irrespective of the Member State where the goods are imported, exported or consumed. This facility is, however, limited to AEOs' customs simplifications.[75]

The UCC also introduces the facility for traders[76] to themselves determine, through their internal system, the amount of duty payable, and to perform certain controls under customs supervision. The Self-Assessment facility is also limited to AEOs' customs simplifications.[77]

The UCC includes the concept of "single window" and "one-stop-shop".[78] The "single window" allows traders to enter information on goods to only one system and have the data disseminated automatically to different government agencies. The "one-stop-shop" specifies that controls necessary for various purposes (customs, sanitary, etc.) should be performed at the same time and place.

3.11 AEO

Only two types of authorisations remain: Customs Simplifications[79] and Security and Safety.[80] The UCC increases the importance of AEO status as it becomes mandatory for using certain customs simplification facilities such as centralised clearance,[81] entry in declarant records,[82] self-assessment[83] or using a comprehensive guarantee with reduced amount.[84] Furthermore, many authorisations and simplifications available within the UCC will be assessed against certain AEO criteria.

There are also two other changes regarding the granting of status. A new criterion has been added concerning practical standards of competence or professional qualifications for employees of AEOs dealing with customs matters[85] and the scope of compliance has also been expanded to cover taxation rules,[86] not just customs legislation.

3.12 Logistics and transport

The UCC introduces the possibility to move goods under Temporary Storage[87] and the period of discharge is increased from 30 or 45 days to 90 days.[88] For the first time, ship supply is mentioned in primary EU-wide legislation.[89] This provision confirms that ship supply is a form of export regardless of the destination of the vessel, that export customs formalities can be used and that it should be exempt from VAT and excise duty. Finally, the right to be heard[90] is strengthened, giving the right of traders to be heard before any decision is taken which would adversely affect them.[91]

4. The impact on business

4.1 The strategic impact

4.1.1 The contractual environment

The UCC brings a focus on the growing importance of contractual agreements in international transactions between carriers, shippers, customers and other intermediaries along the supply chain, regardless of the Incoterms. Contracts will have to be reviewed in the light of changes such as the introduction of the last sale principle of valuation or new facilities such as centralised clearance. The multiple contracts between the various intermediaries of an international transaction are likely to be affected as new risks and opportunities are emerging from the legislation.

The mandatory aspect of certain guarantees could prompt a review of contracts covering consignment inventory or sub-contracting manufacturing to establish the respective obligations of parties relating to compliance. Similarly, the mandatory requirement of AEO status to access certain facilities raises the question of how the parties in a contract would deal with having one of the links in the supply chain losing its AEO accreditation. This could result in a cost increase for the customer or a slower movement of goods.

The business execution of pan-EU measures will raise the question of the choice of applicable law and jurisdiction as the concept of contract has significant variations between countries of common law, civil Roman law and civil Germanic law.[92] This might be a new factor weighing on strategic decisions for business locations across the EU.

4.1.2 The new "comitology"

The UCC secondary legislation will take the form of a delegated act conferred on the EC, to be renewed every five years[93] and which can be revoked by the European Parliament and the Council at any moment,[94] as well as Implementing Acts from the Council. The new comitology therefore confers a stronger presence to the Parliament in the legal process and gives democratically elected parliamentarians control over the EC.

It is unknown whether this new power of revocation will be exercised and if it is, how it will be used. The process is fixed within a very tight timeframe, which seems very short for the legislator to analyse a provision, particularly in complex cases. The complexity of interpretation could therefore result in delays in decisions and could create periods of uncertainty for traders, particularly in cases of a politically sensitive nature. This would complicate the development, adaptation or deployment of the international strategy of businesses.

4.1.3 Uniformity and predictability

Member States have had significant discretion over the implementation and interpretation of customs regulations. This was clearly demonstrated in *Kamino*,[95] where Liquid Crystal Display (LCD) monitors were classified in the Netherlands as "video monitors" with a 14 per cent duty imposed on them, while in other Member States, such as Germany or the UK, the same product was treated as a "computer monitor" subject to zero per cent duty.[96] The EC-Selected Customs Matters case[97] shows that similar issues also apply in the area of valuation.

Despite the fact that the UCC limits the variations of customs practices, some provisions will *de facto* allow them. Member States can, for instance, decide the necessary conditions for foreign representation on their territory.[98] There is also the possibility for the EC to introduce an act to authorise certain decisions that would not be valid across the entire customs territory[99] or with the possibility of derogation from electronic declarations.[100]

The scope of these derogations is unclear and one could ask whether they could be used by some countries to further simplify procedures, thereby creating a competitive advantage. These variations in customs treatment are not motivated by a competition for revenue. The duties collected by customs authorities are part of the EU's own resources[101] and Member States keep only 25 per cent of the amount to cover collection costs. However, efficient customs procedures have become a competitive field and Member States move towards the direction of offering the trade favourable conditions to increase the volume of business going through their ports, airports and distribution networks and, more generally, encourage foreign direct investment. The Netherlands, for instance, advertise their import VAT deferment system[102] on their 'Invest in the Netherlands' website:

> In contrast to most other EU member states, the Netherlands has instituted a system that provides for the deferment of VAT at the time of import. … The bottom line is that there is no actual payment of VAT at import, so that you can realise cash-flow and interest earning benefits.

French legislators recognise that in a competitive European environment, the speed of customs clearance is a central factor to customs competitiveness.[103]

Although these differences of treatment are labelled "non-uniformity",[104] from the perspective of traders they are an issue of predictability resulting in an uncertainty of how imports are going to be treated. Non-uniformity is not such a problem for the trader who would adapt to non-uniform rules as long as those rules are predictable, that is, certain. Traders may, in fact, prefer non-uniformity as it allows them to choose a point of entry in the EU where the most favourable interpretation of the rules applies.

This risk of intra-EU competition is therefore real. For instance, following the *Kamino* case, where the classification in the Netherlands led to a 14 per cent duty rate, Dutch Customs noted that:

> … not all member states are following this policy. The result is a diverted flow of business, which is harmful to the competitiveness of Dutch industry in the logistics and services sector.[105]

The UCC recognises this risk and promotes harmonised and standardised control throughout the Union 'so as not to give rise to anti-competitive behaviour at the various Union entry and exit points'.[106]

The UCC could therefore trigger strategic reviews in some businesses possibly resulting in the restructure and relocation of certain functions such as logistics and customs management.

4.1.4 AEO

The mandatory AEO status necessary to benefit from certain facilitation measures could negatively impact on traders, particularly small and medium-sized enterprises (SMEs), which do not have the resources to go through the accreditation process thereby locking them out of those benefits. While becoming an AEO could be a necessity for some businesses, it could also prove a risky move. According to the proposed directive on EU-wide sanctions on customs matters, when a person responsible for the infringement is an AEO, it is an aggravating circumstance.[107] The effect on customs authorities cannot be underestimated and leads to the question of whether customs administrations are suitably resourced to cope with a possible increase in assessment requests.

4.2 The financial impact

The centralised clearance facility, in the context of the centralisation strategy of a business, facilitates the EU-wide management of imports and exports. The combination of a European Logistics Centre with its EU customs management function could secure economies of scale and deliver cost reductions. Adding to this, the in-house EU-wide customs clearance function could deliver some cost reductions as long as the internal function is more cost effective than the outsourced option. Further, positive financial

impacts[108] include lower costs for customs clearance as a result of more competition between customs representatives throughout the EU. Some companies might also decide to redesign their distribution networks to remove some inventory locations that are no longer necessary.

However, the UCC will also put pressure on business finances. Mandatory financial guarantees could have a significant impact on cash flow for some businesses, for instance, in the UK where guarantees were generally not required. In an environment where businesses find it difficult to access finance, some companies might not be able to match this requirement and therefore be prevented from using customs procedures that suspend or remove import duties. The requirement for a financial guarantee can be waived in certain circumstances, but only for AEOs. However, it is doubtful whether the majority of SMEs have the resources and time to undergo an AEO assessment. Without access to finance to use certain special procedures such as inward processing, to repair faulty products, it might be more cost efficient for an SME to simply move their repair activity close to the customer's market and out of the EU.

The cost of the necessary upgrade to the business electronic systems to interface with Customs could be substantial to cover new software, perhaps a new network or telecommunications structure, and training, as well as maintenance and routine upgrading. The cost of customs software is, however, expected to decrease as a result of the creation of an EU-wide market. However, because the application of certain IT-related UCC provisions is postponed pending the availability of the Member States' IT tools; businesses will have to deal with transitional measures. This is a concern for the trade as they could be required to manage two parallel systems, an IT system and a paper-based system.[109] This would not only be expensive but also create risks of non-compliance. The trade, therefore, emphasised the importance of Member States adopting and implementing measures at the same time.

Another cost increase is the modification of the transaction value as the first sale is replaced by the last sale principle.[110] Its opponents argue that it is based on several incorrect assumptions about cross-border trade.[111] Companies using the first sale principle will see their taxable basis and therefore their amount of duties and taxes increase. This change has been strongly resisted by most trade organisations,[112] particularly multinational corporations. However, it has been argued that this decision could result in a fairer trading environment for SMEs.

Initially, operational costs could increase to adapt the business to the new requirements introduced by the UCC. The removal of some procedures and facilities will demand the review of the supply chain. A review of the current authorisations will be necessary and in some cases new applications for authorisations for certain procedures will be required.

5. Conclusions

There is little doubt that the current CCC, which relies heavily on paper-based processes, is no longer fit for purpose. Its successor, the UCC, rationalises and simplifies the legal framework. It introduces, *inter alia,* the concepts of electronic customs declarations and centralised clearance that will bring profound changes on how Customs and trade operate. It also tightens compliance requirements and cements the status of AEO as the benchmark for compliance.

The new legal instrument will provide challenges and opportunities for both global traders and customs organisations. Some uncertainties will be clarified in the secondary legislation while others will be left to the courts to decide, possibly creating a period of uncertainty. However, the UCC is not self-executing so this initial review needs further research in light of the Implementing and Delegating Acts and the actual implementation variations between countries.

Notes

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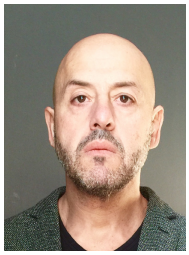
Catherine Truel

Catherine is a director of Intl Trade Instrument Ltd, the author of the best-seller *A short guide to customs risk* and a Doctoral Researcher in Law at Glasgow Caledonian University studying the Union Customs Code and its impact on businesses internationalisation.

Emmanuel Maganaris



Dr Emmanuel Maganaris is a Senior Lecturer at Glasgow Caledonian University. He obtained his LLB from the Law School of the University of Athens and his LLM and PhD from the University of Glasgow. He is responsible for the design and delivery, at undergraduate level, of the modules of Competition Law, European Union Law and International Trade Law and at postgraduate level, the design and delivery of the modules of International Trade Law and Competition Law. Emmanuel is the Director of Studies of two full time PhD students and is a member of the development board for the degree of LLM in European and International Trade Law and the Programme Leader for the Business Law degree.

Ways to modernise customs risk management in Mongolia

Tsendsuren Davaa and Batnasan Namsrai

Abstract

Customs authorities around the world are incorporating risk management strategies into their procedures in the context of achieving their two main goals: ensuring compliance with customs laws and regulations by the efficient control of the cross-border movement of goods, passengers, and transport means; and accelerating economic growth by facilitating foreign trade and investment. Risk management is an efficient and effective technique that stems from progress in science, technology and management innovation. This paper analyses the possibilities of applying comprehensive, systematic risk management approaches to the daily operations of the Mongolian customs authority with respect to its current organisational arrangements, human resources and information technology.

1. Introduction

The rapid growth of international trade limits the opportunity to control every trans-border movement of goods, passengers and transport means, and imposes restrictions on the inspection of such movements. Therefore, it is considered imperative that customs authorities introduce risk management strategies and practices into their activities, which requires a more effective approach to the planning and implementation of customs controls. More precisely, it needs to target those controls that have a high probability of detecting infractions.

Article VIII of GATT (1994) recognises the need to minimise 'the incidence and complexity of import and export formalities … [by] decreasing and simplifying import and export documentation requirements'. Consequently, while controlling the cross-border movement of goods, passengers and transport means, customs authorities need to ensure compliance with the law while also focusing on trade facilitation. This is emerging as one of the main features of present-day international trade. Customs authorities also need to focus on the cost and efficiency of their own activities.

According to Widdowson (2005), the two elements of customs control — regulatory compliance and trade facilitation — are not contradictory. He argues that it is not necessary to decrease the control level in order to facilitate trade, and that it is not an imperative to increase trade barriers in exchange for an increase in control levels. He categorises customs management approaches in the following ways:

1. '(high control, high facilitation) represents a balanced approach to both regulatory control and trade facilitation, resulting in high levels of both'
2. '(low control, low facilitation) depicts the approach of an administration that exercises little control and achieves equally little in the way of facilitation … crisis management approach'
3. '(low control, high facilitation) represents an approach in which facilitation is the order of the day … laissez faire approach'
4. '(high control, low facilitation) represents a high-control regime … the red tape approach' (Widdowson 2005, pp. 92-3).

Of these, the best approach is one of high control and high facilitation, which is achieved through the effective use of risk management strategies (Widdowson 2005). Baker (2002) also claims that 'Custom's [*sic*] recognition cannot actually review all shipments, however, has caused it to develop programs to evaluate and manage the risk to any noncompliance with laws and regulations which could result in loss or injury to trade, industry, or the public'.

Risk management should simplify customs procedures and improve economic efficiency. Ayyub (2003), who has studied the relationship between operational efficiency and risk management in customs organisations, argues that 'the control cost should not exceed risks cost due to the consequences (loss)'. Here, cost and benefit analysis should be applied to measure the contribution of risk management techniques and the risk management processes, by determining whether benefits exceed the cost of implementation or not.

For the purposes of improving the effectiveness of customs control and facilitating trade, customs authorities should not therefore seek to control all shipments, but instead should target high risk shipments. It is the authors' view that to do this, customs authorities need to apply intelligent risk assessment methods, including multi-criteria analysis and random selection.

Multi-criteria analysis is a popular approach to decision-making that incorporates different indicators into a single risk assessment indicator. Traditionally, multi-criteria analysis has involved calculating the simple weight of each indicator and estimating the weighted average. But now, multi-criteria analysis has been improved to a level that offers a number of ways to incorporate individual indicators into a single most preferred risk response that allows customs authorities to assess risk levels and identify a limited number of strategies for decision-making. In reality, risk management covers all activities that minimise negative impacts of those risks. These include the identification of control policies and types of risks; analysis, evaluation and monitoring of risk; risk control; and the prevention of risks. It is important to identify, analyse and evaluate the risks correctly to ensure the highest risks are effectively targeted.

Risk management targeting techniques rely on current knowledge and innovative methods, based on the application of intelligent IT systems that expedite customs inspections. Before these techniques were introduced, inspection was heavily dependent on the experience, judgment and insight of customs officers. IT-based intelligent risk analysis can also help minimise corruption by avoiding possible discretionary intervention by the customs authority in the selection of shipments to be controlled. This system collects all necessary data for risk analysis, enters these into risk analysis equations and produces results to be used for decision-making (Desiderio & Bergami 2014).

The application of such a system, or control selectivity system, calls for the development of methodologies that incorporate different indicators into a single risk assessment indicator. This can be done by entering different indicators into the risk assessment equation and calculating risk probability. The application of a selectivity system can be enabled by moving from customs risk descriptive statistics to a decision-making descriptive statistic approach (see Geourjon & Laporte 2005; Geourjon, Laporte & Rota Graziozi 2010; Laporte 2011).

2. Current situation of risk management in Mongolian Customs and its development trend

Mongolia is a landlocked country far from sea ports; it has poor industrial development and the country's economy is highly dependent on external trade. In view of this, since the 1990s the Mongolian Government has been implementing policies to liberalise the economy to facilitate foreign trade and investment with the purpose of accelerating the country's economic growth.

Mongolia formally introduced the concept of customs risk management in the early 2000s, but prior to that the customs authority officially reported attempts to analyse smuggled goods, and target high risk border points. It is important to note that Mongolia has been going through a number of specific development stages since it introduced its initial customs risk management strategies.

Mongolia became a member of the World Customs Organization (WCO) in 1991 and at that time, acceded to the WCO Harmonized System (HS) Convention. In 1994, the HS classification was adopted and the customs authority introduced the Automated System for Customs Data (ASYCUDA) for customs clearance. The introduction of the HS and information technology in customs practice forms part of the effort towards ensuring the correct duty assessment according to international standards, as does the improvement of customs valuation. Other initiatives include minimising face-to-face dealings for the purposes of eliminating corruption, facilitating foreign trade and increased information exchange. The Mongolian customs administration also used an internal Customs Automated Data Processing System (GAMAS) between 2001 and 2009. Since then, the Customs Automated Information System (CAIS) and the Customs External Portal System (CEPS) have been introduced, connecting all customs houses and branches.

Furthermore, Mongolia became a member of the World Trade Organization (WTO) in 1997, and in 2008, in conformity with international standards, the Mongolian Parliament passed the Customs Law and the Customs Tariff and Duty Law which have been integral to the continued customs modernisation efforts designed to facilitate trade.

Despite the fact that the customs authority established a risk management unit, strengthened its human resource capability and made continued efforts towards trade facilitation, these efforts were unfortunately a failure because there was no integrated information system that connected all stakeholders, including customs and tax authorities, banks and freight-forwarding agencies. As there was no integrated information system, the introduction of intelligent risk management also failed. Consequently, the Mongolian customs authority was primarily focused on physical inspection, post-clearance audit and a double control system. Clearly the application of a costly, time consuming and inefficient traditional control system has not met the needs of trade and investment facilitation. As a result, there is now a low level of customs offence detection, greater bureaucracy and corruption, a significant number of procedures required for customs clearance, time-consuming processes, and high operating costs for importers and exporters.

The Mongolian customs authority uses ‘red’, ‘orange’, and ‘green’ channels for customs control. The use of the red channel results in a mandatory physical and documentary inspection of the goods; the orange channel requires a mandatory check of documents only; and the green channel requires a few fields of the customs declaration to be checked. Table 1 shows statistical results of this selectivity system for the last three years. The current customs selectivity system does not target transactions, but rather economic entities, and classifies these entities by control channels, which gives rise to debate and discourse. Although the Mongolian customs authority operates three clearance channels, approximately half of the total exports and ninety per cent of total imports are selected for the red channel. This generates inefficiency and low productivity in customs practices and leads to excessive loss of time and resources of export and import entities.

Table 1: Customs clearance statistics 2012-2014

YEAR		Green		Orange		Red		TOTAL
		Amount	Percentage	Amount	Percentage	Amount	Percentage	
2012	Export	2 376	3.43	5 264	7.61	61 542	88.96	69 182
	Import	10 466	5.10	19 673	9.59	175 047	85.31	205 186
	Total	**12 842**	**4.68**	**24 937**	**9.09**	**236 589**	**86.23**	**274 368**
2013	Export	5 168	7.99	28 714	44.37	30 827	47.64	64,709
	Import	10 144	5.09	38 519	19.34	150 541	75.57	199 204
	Total	**15 312**	**5.80**	**67 233**	**25.48**	**181 368**	**68.72**	**263 913**
2014	Export	25 132	10.77	96 284	41.26	111 927	47.97	233 343
	Import	930	0.49	16 354	8.65	171 769	90.86	189 053
	Total	**26 062**	**6.17**	**112 638**	**26.67**	**283 696**	**67.16**	**422 396**

Source: Annual report of Mongolian Customs General Administration, 2012-2014.

Because of the dominant use of the red channel, productivity is significantly lower than the global average, there is a heavy workload on customs inspectors, and customs control is rendered inefficient. Table 2 shows labour productivity of the Mongolian customs administration in comparison with the average of foreign trade turnover per employee in other selected countries.

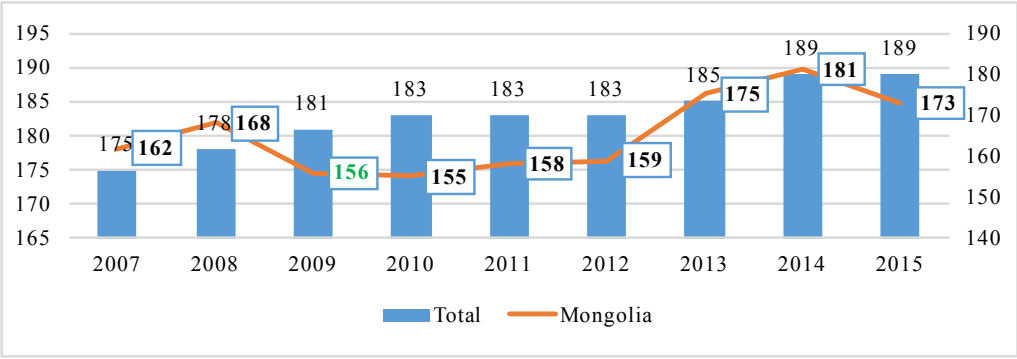
Table 2: Foreign trade turnover per employee (million USD)

YEAR	Trade turnover per employee (million USD)									
	China	USA	Japan	South Korea	Russia	Australia	Kazakhstan	Mongolia	Georgia	Fiji
2010	59.48	57.41	167.78	198.09	10.57	66.78	13.77	5.30	5.57	8.33
2011	72.55	65.00	190.88	238.43	13.49	86.76	21.20	9.04	7.71	9.88
2012	74.08	66.89	187.68	233.37	13.24	89.30	22.80	8.38	8.88	10.75
2013	72.96	63.01	173.42	239.25	14.11	85.46	23.38	7.97	5.91	11.14
2014	75.52	67.22	168.80	239.15	16.00	87.26	21.28	7.92	6.94	15.16
Average	**70.92**	**63.90**	**177.71**	**229.66**	**13.48**	**83.11**	**20.49**	**7.72**	**7.00**	**11.05**

Source: Compiled by the authors, based on WCO Annual Report 2010-2014, WTO intracen.org.

According to the World Bank's *Doing Business 2015* report, the performance of Mongolia's 'Trading Across Borders' indicator was highest in 2010, when it ranked 155 out of 183 economies, and was at its lowest in 2014, ranking 181 out of 189. In the same report, Mongolia ranked 72 out of 189 economies with its general business environment and in the last two years the country's ranking fell behind two economies (World Bank 2015). In 2015 Mongolia's ranking by the 'Trading Across Borders' indicator jumped by eight economies, ahead of 16 others. Even though Mongolia is ranked 47 out of 48 economies with the same income level, the trading across borders environment has performed poorly. Mongolia has recorded several gains in recent years; however, the country was worst on per container transportation cost terms and fared poorly in terms of time spent on container transportation.

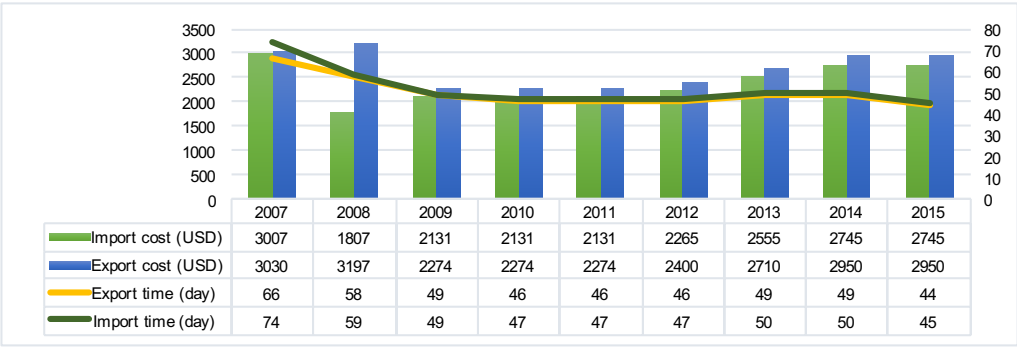
Figure 1: Trading Across Borders, Mongolia's statistics, 2007-2015



Source: World Bank, 'Trading Across Borders' indicators 2007-2015.

Clearly, costs and time spent on customs inspection affect the trading across borders indicators. In this regard, the World Bank (2015) argued that 'excessive document requirements, burdensome customs procedures, inefficient port operations and inadequate infrastructure all lead to extra costs and delays for exporters and importers, stifling trade potential'.

Figure 2: Trading Across Borders in Mongolia (2007-2015)



	2007	2008	2009	2010	2011	2012	2013	2014	2015
Import cost (USD)	3007	1807	2131	2131	2131	2265	2555	2745	2745
Export cost (USD)	3030	3197	2274	2274	2274	2400	2710	2950	2950
Export time (day)	66	58	49	46	46	46	49	49	44
Import time (day)	74	59	49	47	47	47	50	50	45

Source: World Bank, 'Trading Across Borders' indicators 2007-2015.

Based on averages over the last three years, the World Bank survey shows that Mongolia takes between 44 and 49 days to import goods, and between 45 and 50 days to export. According to this report, between 38.8 per cent and 43.2 per cent of total time spent on importation of goods is actually spent on inland transportation and port handling, while between 52.3 per cent and 57.1 per cent is spent on import documentation, and between 4.1 per cent and 4.5 per cent is spent on customs clearance and technical control. With regard to exportation, between 36.0 per cent and 40.0 per cent of total time spent is used for inland transportation and port handling, between 51.1 per cent and 56.0 per cent for export documentation and between 8.0 per cent and 8.9 per cent for customs clearance and technical control. While the time spent on each shipment differs depending on the nature, type and quantity of goods, the application of risk-based customs control could reduce the overall time spent on clearing both exports and imports.

Table 3: Predefined stages and documents for trading across borders in Mongolia, 2012-2014

STAGES	Export						Import					
	Time (day)			Cost (USD)			Time (day)			Cost (USD)		
	2012	2013	2014	2012	2013	2014	2012	2013	2014	2012	2013	2014
Document preparation	23	28	23	145	145	145	23	28	23	110	110	110
Customs clearance and inspection	2	2	2	160	160	160	4	4	4	150	150	150
Ports terminal handling	5	5	5	190	190	190	5	5	5	190	190	190
Inland transportion and handling	14	14	14	2,250	2,250	2,250	13	13	13	2,500	2,500	2,500
Total	**44**	**49**	**44**	**2,745**	**2,745**	**2,745**	**45**	**50**	**45**	**2,950**	**2,950**	**2,950**

Source: World Bank, 'Trading Across Borders' indicators 2013-2015.

3. Opportunities to introduce risk management in Mongolian customs practice and its social and economic benefits

While studying opportunities to introduce appropriate risk-based management arrangements in the Mongolian context through this study, we have used a particular risk management selectivity study of Laporte (2011). By processing descriptive statistical data from the current customs database, we have developed a methodology of risk-based selectivity of customs control.

After estimating the likelihood of noncompliance with the law, we determined that a declaration may be subject to an infraction if the binary variable equals 1, and that a declaration is unlikely to be subject to an infraction if the binary variable equals 0. For the control selectivity equation we have used five criteria for exportation and six criteria for importation, and calculated the probability of infraction. These include P_{HS} – HS classification of goods; P_I – importer; P_{CO} – country of origin; P_T – customs terminal code; P_B – customs broker; P_{TR} – type of transportation means. The calculation of the probability of infraction provides an opportunity to assess the risk level of every shipment and to select the control channel in advance.

In order to calculate the probability of infraction based on the econometric equation developed by Laporte (2011) in the risk management selectivity model, three different estimations were used: (1) estimation by a linear probability (extreme value) model; (2) estimation using a LOGIT model; and (3) estimation using a PROBIT model. For the calculation of probability of infraction binary variables were applied to a total of 960.7 thousand customs declarations, including 367.2 thousand export and 593.4 thousand import declarations cleared between 2012 and 2014.

$$P_r = \alpha + \beta_1 fq_{\_criteria\ 1_{ij}} + \beta_2 fq_{\_criteria\ 2_{ij}} + \cdots ij + \beta_N fq_{\_criteria\ N_{ij}} + \varepsilon_{ij} \quad (1.\ 1)$$

Table 4 shows the test results for PROBIT, LOGIT, and Extreme Value models.

Table 4: Test result for Probit, Logit, and Extreme Value models

Independent Variable	Probit			Logit			Extreme Value		
	2012	2013	2014	2012	2013	2014	2012	2013	2014
C	13.83***	13.08***	42.36***	41.88***	40.68***	122.47***	7.36***	6.64***	22.32***
P_{HS}	0.22***	0.35***	-2.93***	0.69**	-1.03***	-6.12***	0.12**	-0.18***	-2.14***
P_I	0.16***	-0.57***	-3.89***	0.51***	-1.62***	-7.84***	0.08**	-0.31***	-3.32***
P_T	0.08***	-0.97***	-6.32***	0.23**	-2.58***	-16.79***	-0.04**	-0.58***	-4.29***
P_{CO}	-0.71***	-3.72***	-1.63***	-2.05***	-10.15***	-3.75***	-0.39***	-2.07***	-0.96***
P_B	-0.08***	-7.34***	0.55***	-0.24***	-19.71***	1.15***	-0.05***	-4.12***	0.46***
P_{TR}	-16.43***	-3.4***	-31.85***	-47.35***	-13.02***	-97.61***	-9.03***	-1.40***	-14.38***
Prob (LR statistic)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Number of observations	925770	954641	967318	925770	954641	967318	925770	954641	967318
McFadden R-squared	0.012	0.050	0.322	0.012	0.048	0.298	0.012	0.052	0.349

** – significance level is medium
*** – significance level is high

Our study reveals that a significant level of goods classification and transport type criteria on the LOGIT and Extreme Value models were in the medium level of significance in 2012; importer and goods classification criteria on the Extreme Value model were in the medium level of significance only in 2012, while other criteria scored a high level of significance for each of the years.

Table 5: Distribution of percentage share of declarations for the intervals

Interval	Percentage share of total declarations for the interval			Percentage share of declarations without infraction in total declarations			Percentage share of declarations with infraction in total declarations		
	2012	2013	2014	2012	2013	2014	2012	2013	2014
Probit									
[0.0–0.2]	21.98	72.42	62.45	21.98	72.39	62.40	0.00	0.03	0.05
[0.2–0.4]	39.02	25.67	20.74	38.81	25.57	20.63	0.21	0.10	0.11
[0.4–0.6]	12.37	1.77	13.60	12.31	1.70	13.47	0.06	0.07	0.13
[0.6–0.8]	21.47	0.10	1.38	21.30	0.09	1.22	0.17	0.01	0.16
[0.8–1.0]	5.16	0.05	1.84	5.12	0.04	1.62	0.04	0.01	0.22
Total	**100.00**	**100.00**	**100.00**	**99.52**	**99.80**	**99.35**	**0.48**	**0.21**	**0.66**
Logit									
[0.0–0.2]	21.64	72.22	62.63	21.64	72.19	62.58	0.00	0.03	0.05
[0.2–0.4]	39.71	18.83	3.61	39.50	18.79	3.52	0.21	0.04	0.09
[0.4–0.6]	11.90	8.62	13.92	11.84	8.59	13.71	0.06	0.03	0.21
[0.6–0.8]	21.60	0.12	4.81	21.43	0.07	4.65	0.17	0.05	0.16
[0.8–1.0]	5.15	0.21	5.03	5.11	0.15	4.87	0.04	0.06	0.16
Total	**100.00**	**100.00**	**100.00**	**99.52**	**99.79**	**89.34**	**0.48**	**0.21**	**0.66**
ExtremeValue									
[0.0–0.2]	29.59	59.32	42.39	29.59	59.29	42.35	0.00	0.03	0.04
[0.2–0.4]	28.66	25.34	31.79	28.45	25.28	31.66	0.21	0.06	0.13
[0.4–0.6]	15.59	13.73	19.80	15.53	13.65	19.51	0.06	0.08	0.29
[0.6–0.8]	20.99	1.32	4.02	20.82	1.30	3.93	0.17	0.02	0.09
[0.8–1.0]	5.17	0.29	2.00	5.13	0.27	1.89	0.04	0.02	0.11
Total	**100.00**	**100.00**	**100.00**	**99.52**	**99.79**	**99.34**	**0.48**	**0.21**	**0.66**

Source: Compiled by the authors.

In general, the results of our study show that by calculating the probability of infraction for every shipment, it is possible to determine a more appropriate control channel (red, orange or green).

Table 5 shows the distribution of percentage share of infraction probability − P_r, based on the output of PROBIT, LOGIT and Extreme Value models. These were grouped into five ranges of scores, with 0.2 scales, between 0 to 1 intervals.

According to the analysis on import clearance, infraction rates were 0.48, 0.21 and 0.66 per cent in 2012, 2013 and 2014 respectively. However, despite the fact that the infraction rate was less than 1.0 per cent of the total import clearance, 90.9 per cent of total imports were selected for the red channel, and 8.9 per cent selected for the orange channel in 2014.

According to the PROBIT model estimation, 62.45 per cent of total declarations were in the low level of infraction or at 0.0 – 0.2 intervals; 20.74 per cent were in the medium level or at the 0.2 – 0.4 interval; and 16.82 per cent were in the high risk level or at the 0.4 – 1 interval in 2014. As for declarations with infractions, 7.75 per cent of total declarations were at the low level; 15.94 per cent at the medium level; and 76.31 per cent at the high level intervals in 2014. And in 2014, according to this estimation, eight out of every 10,000 declarations are in the low level, 51 in the medium, and 301 in the high levels of risk probabilities.

The customs authority, as a government agency that serves business entities and civilians, should act in accordance with national laws and regulations by delivering its service in a transparent, fair and economically efficient manner. It also needs to focus on trade facilitation by respecting timeframes for business entities and civilians and by delivering accessible and innovative services. However, balancing control functions with trade facilitation is complicated, and by using a control selectivity method the customs authority could make significant progress towards achieving those two goals simultaneously.

We have estimated the social economic benefits of applying a control selectivity method in customs practice. This estimation output is shown in Appendix 1.

Per employee, trade turnover and time spent on customs clearance are key performance indicators of customs authorities. International experience shows that by making progress in those areas customs authorities can increase the productivity and efficiency of their activities and also improve trade facilitation. We used the following references to determine changes for the above indicators:

- The World Bank's *Doing Business* 2015 report: Customs clearance and inspection time[1] indicators were taken from the 'Trading Across Borders' section.
- Estimation of customs clearance time spent[2] was taken from the 'Joint study of Business Plus Initiative' and 'Customs General Administration' (General Customs Administration of Mongolia and Business Plus Initiative, USAID 2013).
- Customs clearance time indicators[3] calculated in accordance with WTO methodology were taken from the *Time release study report of Mongolian Customs 2014*.
- Customs clearance database of General Customs Administration.

According to customs statistics, in 2014, 6.2 per cent of goods declared at the Mongolian border were controlled through the green channel, 26.7 per cent through the orange channel, and 67.2 per cent through the red channel.

Based on the analysis of 2014 customs clearance data, we suggest goods in low risk level intervals should be processed through the green channel, goods in the medium risk level interval through orange, and the high risk level interval through the red channel, as shown in Table 6. According to our estimates, goods to be controlled through the red channel will be reduced to 20.0 per cent of total goods, those through the orange channel will be increased to 20.0 per cent, and those through the green channel will be increased to 60.0 per cent.

Table 6: The effect of risk-based control systems on key customs performance indicators

No	Customs administration performance indicators	Pre-implementation	Post-implementation
1.	Increase rate of customs declaration per employee (per cent)		
	– Doing Business 2015	100.0	100.0
	– Joint report of Business Plus Initiatives and Customs authority 2013	100.0	152.7
	– Mongolian customs administration time release study 2014	100.0	189.4
2.	Increase of foreign trade turnover per employee (per cent)		
	– Doing Business 2015	100.0	100.0
	– Joint report of Business Plus Initiatives and Customs authority 2013	100.0	152.7
	– Mongolian customs administration time release study 2014	100.0	189.4
3.	Export clearance time (day)		
	– Doing Business 2015	2.0 days	2.0 days
	– Joint report of Business Plus Initiatives and Customs authority 2013	1.34 day	1.12 day
	– Mongolian customs administration time release study 2014	0.61 day	0.41 day
4.	Import clearance time (day)		
	– Doing Business 2015	4.00 days	4.00 days
	– Joint report of Business Plus Initiatives and Customs authority 2013	1.11 day	0.42 day
	– Mongolian customs administration time release study 2014	0.83 day	0.33 day

By applying efficient and effective customs control selectivity methods, based on the calculation of probability of infraction, the customs authority has the possibility to effectively control more goods, passengers, and transport means than they do today. Moreover, the customs authority could reduce the number of employees that work on goods control, and the expertise of such employees could be used in other areas within the customs authority. This should lead to an improvement in customs performance and trade facilitation, and ensure compliance with relevant laws and legislation. Furthermore, the application of a control selectivity method should lead to a decrease in time required for customs clearance, improved quality of services, increased trade turnover resulting from faster delivery, and improved business efficiency.

4. Conclusions

The establishment of a risk management-based efficient and targeted customs control system provides a solution to achieving two fundamental goals: ensuring compliance with customs laws and regulations and facilitating foreign trade and investment. This kind of control system requires risk probability-based customs inspection. Moreover, a risk-based customs control framework is considered an essential part of a modern customs administration.

The risk-based selectivity control system suggested by the authors aims to ensure compliance by mobilising customs resources and improving the productivity of customs employees. Furthermore, it aims to facilitate trade, which requires a reduction in face-to-face dealings, simplification of customs procedures, fast service delivery and cost reduction. This study shows that well targeted customs control could improve the overall performance of customs administrations and could save costs and time spent on customs control.

In conclusion, it should be noted that the establishment of an efficient risk-based customs control system requires the following activities to be organised stage-by-stage: combining risk management with a customs development strategy; intensifying capacity building of the risk management unit and its employees; using a computer-aided selectivity control system; and developing related software to harmonise risk management with internal and post-clearance audits.

Appendix 1: Socioeconomic benefits of 'Risk management selectivity criteria system' methodology

Customs control level		Export clearance (days)				Import clearance (days)					Total time (days)		Required employees (days)	
		Clearance (number)		Time per clearance (days)		Clearance (number)		Time per clearance (days)						
		2014	New methodology	2014	New methodology	2014	New methodology	2014	New methodology		2014	New methodology	2014	New methodology
Green	1*	25132	140004	2.00	2.00	930	113431	4.00	3720.0	453724.0	53984.0	733732.0	207.1	2814.3
	2**			0.97	0.97			0.21	199.6	24340.4	24493.8	159677.6	93.9	612.5
	3***			0.27	0.27			0.17	161.6	19708.6	6821.6	56809.7	26.2	217.9
Orange	1	96284	46669	2.00	2.00	16354	37811	4.00	65416.0	151244.0	257984.0	244582.0	989.5	938.1
	2			1.10	1.10			0.26	4190.7	9689.1	110183.3	61063.9	422.6	234.2
	3			0.38	0.38			0.23	3768.2	8712.3	40275.9	26407.6	154.5	101.3
Red	1	111927	46669	2.00	2.00	171769	37811	4.00	687076.0	151244.0	910930.0	244582.0	3494.0	938.1
	2			1.62	1.62			1.20	205407.1	45215.7	386822.1	120858.3	1483.7	463.6
	3			0.88	0.88			0.90	153876.4	33872.4	252745.2	75096.6	969.4	288.0
Total	**1**	**233343**	**233343**			**189053**	**189053**		**756212.0**	**756212.0**	**1222898.0**	**1222896.0**	**4690.6**	**4690.6**
	2								**209797.4**	**79245.1**	**521499.3**	**341599.8**	**2000.3**	**1310.2**
	3								**157806.2**	**62293.3**	**299842.7**	**158313.9**	**1150.1**	**607.2**
				466686.0	**466684.0**									
				311701.9	**262354.7**									
				142036.5	**96020.7**									

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Notes

1 World Bank 2015, p. 69. In this study, the time taken for customs clearance and inspection was not classified by customs control channel. Therefore, the results of this report are not sufficient to estimate the effect of our offering.

2 General Customs Administration of Mongolia 2013, 'Joint report of Business Plus Initiatives and Customs authority', pp. 1-32.

3 'Time release study of Mongolian Customs 2014' report, pp. 1-7.

Tsendsuren Davaa

Tsendsuren Davaa is a senior customs officer of the Department of Internal Audit and Monitoring under the General Customs Administration of Mongolia and has over 19 years of practical and academic research experience in Mongolian Customs. In the last five years, Tsendsuren has worked as a deputy director in the Department of Customs Control and Risk Management, senior officer in the Division of Harmonised System and Valuation, and customs officer in the Division of Tariff and Revenue Collection of the General Customs Administration of Mongolia. Tsendsuren obtained her master's degree in public finance from the National Graduate Institute for Policy Study in Japan in 2011, having been awarded a scholarship from the WCO-Japanese Customs. In 2012, she was accredited as a potential risk management expert of the World Customs Organization. Currently, Tsendsuren is a PhD candidate in Business Administration at the Mongolian National University.

Batnasan Namsrai

Professor Batnasan Namsrai has been an Acting Dean of the Business School, National University of Mongolia since 2000. Prior to joining the university, he worked as a foreign trade manager, general manager and CEO of the Mongolian trade corporation, part of the Ministry of Trade and Industry of Mongolia. Currently, Batnasan serves as a Member of the Customs Tariff Commission Economic Council, Government of Mongolia. He holds an MA in international economics and received his PhD in Business Administration from the National University of Mongolia in 2000. In 2007-08, Batnasan held a post-doctoral fellowship at the Department of Economics, Sogang University, South Korea.

Batnasan has worked as a part time adviser to the Parliamentary Standing Committee, been Academic Secretary of the Academic Council, and Academic Secretary of the School of Economic Studies, National University of Mongolia, and chaired the department and joint international MBA program. His academic interests include trade policy, CGE modelling and human development. Batnasan has written seven books, more than 20 research articles and edited the National Human Development Report of Mongolia in 2003 and 2007. He has carried out several research projects and provided advice to companies in areas of international business.

Illicit trade, economic growth and the role of Customs: a literature review

Eukeria Mashiri and Favourate Y Sebele-Mpofu

Abstract

Many developing economies depend heavily on trade-related taxes for their economic wellbeing and wealth creation. The growth in international trade, increase in the number of travellers, advances in technology and changes in trading methods have set new challenges for governments — challenges that require a change in the functioning of customs and border management if these offices are to function effectively and efficiently.

This research paper furthers our understanding of the impact of illicit trade on economic growth, an important area of customs enquiry which has received little attention in prior studies. The study seeks to identify options for improving customs activities in order to maximise the detection of revenue leakage, while maintaining trade facilitation. The study analyses the extant literature and uses cross-country data to gauge the effect of illegal imports on economic growth.

In light of limited information on the value of illicit trade due to its very nature, the analysis was restricted by the availability of data. Nevertheless, the findings show that illegal economic activity distorts local economies and reduces legitimate business and tax revenues. The paper concludes that the costs of illicit trade are not only economic but also have social implications, as illicit trade undermines the social stability and socioeconomic welfare of communities, preventing the equitable sharing of public goods. Further, it was found that Customs is a high risk area in which corrupt officials can facilitate duty evasion, causing significant financial damage to the government's budget and to the economic stability of compliant traders. The review highlights the need for improved customs practices and suggests areas for further research.

1. Introduction

Many developing countries rely heavily on trade taxes for national revenue (Guo & Yung-Hsing 2013), with the International Monetary Fund (IMF) (2005) estimating trade tax revenue for low and middle income countries to be between a one-quarter and one-third of total tax revenue. Tax avoidance or evasion eats into the national income of both developed and developing economies. Torgler and Schneider (2007) describe taxpayers as economic evaders who will always assess the benefits and costs of noncompliance. Customs duty is complex and is particularly susceptible to revenue leakage as taxpayers have many avenues to evade, including collusion with tax officials, making it difficult for the evasion to be detected. In addition, internationalisation has facilitated the global growth of illegal trade (Grant Thornton 2014).

Customs revenue is the summation of import values multiplied by tax rates applicable to imports, less tax exemptions by local laws or international agreements (World Bank 2005, p. 105). In some cases taxes and import duties are levied on specific goods to make imported goods more expensive, with the sole aim of protecting local manufacturers and jobs in local industries, hence protecting the economies from competition by goods from other countries. This is demonstrated clearly in developing countries such as Zimbabwe, where clothing companies, including Merlin, Archer Clothing and Edgars, have closed down or have retrenched staff due to competition from cheap imports and second-hand goods — the country has since banned the importation of second-hand goods in order to revive this sector.

In light of the above, it follows that economic wellbeing and wealth creation are driven by trade and it is every country's sovereign right to control the flow of goods and services across its borders according to their customs regulations. Hence customs administration plays a pivotal role when it comes to control, facilitation and regulation of international trade. According to Jones (2001), the border is the place where countries control the movement of goods, people and crafts entering or exiting their territories, and where compliance in areas such as security, food safety, customs procedures and control of prohibited goods takes place. Normally, there are commodities which are prohibited from a country, be it for religious reasons or other reasons (such as the goods being hazardous to the environment and human beings), but one still finds them having entered the country. For instance in Zimbabwe, even though skin lightening creams like Diprosone are prohibited they are still readily available on the streets and in salons.

Integrity issues are also apparent. For example, customs officials have gained fame for using statements such as, 'there is a missing page in your passport', in a bid to extort money from their victims (Dandira 2012). Recently the abuse of whistle-blowing funds by Zimbabwe Revenue Authority (ZIMRA) officials headlined the news, alleging that it has become an insider activity with officials tipping their relatives to whistle blow and share the reward. In this regard, Picur and Riahi-Belkaoui (2006) found that tax compliance increases with an increase in control of corruption and creation of tax morale.

In addition to the above, developing countries reportedly have higher import tariffs than developed countries, thus hampering trade among the developing countries and impeding the competitiveness of the economies. Developing countries are also characterised by inadequate financial and human resources, inefficient manual systems and slowness in adapting to modern technology (World Bank 2005, p. 286). There has also been a debate as to whether it is economically advisable to exempt government imports from taxes, with some arguing that there is zero benefit in the government collecting taxes on its own imports, while others argue that it is costly to verify if the imported goods are actually used for state purposes (World Bank 2005, p. 234).

Customs administrations are now referred to as the key border agencies and are expected to raise substantial revenue, protect domestic manufacturers, provide supply chain security, prevent the importation of restricted imports, and implement laws and regulations that are in line with the World Trade Organization (WTO) (World Bank 2005, p. 5). Customs reforms are important in strengthening revenue-generating capacity, enhancing trade facilitation and combating smuggling and corruption (World Bank 2005, p. 108), and Yanikkaya (2003) found that trade barriers are positively related to growth, especially in developing countries. As Bird (2010) rightly states, 'There is no simple road to better (or bigger) taxation in developing countries'. This paper is therefore of particular relevance to developing countries where economic development can be severely hindered by lower public revenue due to tax noncompliance and where women constitute approximately 70−80 per cent of informal cross-border traders (Masinjila 2009).

2. Literature review

This section defines illicit trade, examines the drivers of illicit trade, ways in which illegal trade is perpetrated, the costs involved, lessons from other countries, the impact of illicit trade on economic growth and the role of Customs in addressing customs evasion.

2.1 What is illicit trade?

The World Health Organisation (WHO) defines illicit trade as 'any practice or conduct prohibited by law and which relates to the production, shipment, possession, distribution, sale or purchase of goods and services including any practice or conduct intended to facilitate such activity'. The key drivers of illicit trade include low chances of being discovered and prosecuted, weak legal and regulatory frameworks, as well as weak enforcement (Grant Thornton 2013). Though there are various categories of illegal trade, including wildlife such as rhinoceros horns, cigarettes, etc., the categories most exposed to illegal trade are fuel, tobacco, digital and pharmaceuticals (Grant Thornton 2013). Estimations of illicit trade in pharmaceuticals for the years 2005 and 2011 are provided in Table 1, indicating the amount of revenue lost globally in this area.

Table 1. Estimated value of world illicit trade in pharmaceuticals

	2005	**2011**
Estimated value of world pharmaceutical market	Euro550 billion	Euro614 billion
Value of illicit trade	**Euro44 billion**	**Euro49.1 billion**

2.2 Illicit trade and the shadow economy

Policymakers worldwide have pointed out the positive impact that international trade has on economic recovery and sustainable growth. To this end, customs administrations are integral to economic growth. In this regard Customs needs to identify and understand the key international, regional and national strategic drivers, the nature of illicit trade, and ways in which such trade is conducted, including substitution of a commodity, incorrect quantity declaration, fictitious exports, misclassification of goods, non-declaration and mis-declaration. In Russia in 2004, the minister of the economy estimated lost revenue of about USD4.5 billion in duties on goods imported from Europe which could have been a result of false declaration. In Bangladesh in 2000, the foregone customs revenue traced to customs inefficiency was estimated to exceed five per cent of GDP (OECD 2003).

Other methods of illicit trading or duty evasion include outright avoidance of official customs controls, under-declaration of goods, undervaluation of goods, misclassification of goods, falsification of documents, collusion with tax authorities and smuggling. Fishman and Wei (2004) found a one per cent increase in tax rates being associated with a three per cent increase in customs evasion, and mostly through misclassification of imports and underreporting of import values. The impact of these activities has negatively affected trade and had a devastating impact on the formal economy.

Dutt and Traca (2008) argue that while corruption impedes trade in low tariff environments, it may also result in trade enhancement. Researchers such as Hübschle (2011) have termed such activity as the shadow economy. The size, causes and consequences vary from country to country, with estimates

of the shadow economy placing the scale of the issue at USD650 billion, or a staggering USD2 trillion including money laundering. The shadow economy is said to comprise all goods and services which should be part of the calculation of national product but are not, and there are strong indicators of the growth of the shadow economy globally. Commenting on the growth of illicit trade and the shadow economy, Glinkina and Rosenberg (2003) note that 'the effective management of the economy by the state is undermined. The taxation and foreign exchange base that any state needs to manage its economy is eroded by the rapid flight from official to the underground economy. Macroeconomic stability is thus harder to attain and sustain. Further the legitimacy of the overall legal and regulatory system is challenged'. Illicit trade and illegal trade are said to be the biggest components of the shadow economy, especially in developing countries where most of the informal traders rely on illicit means to import and export goods.

According to Olson (1985) a growing shadow economy can be seen as a reaction by individuals who feel overburdened by the state and who choose the exit option rather than the voice option. If the growth of the shadow economy is caused by a rise in overall tax, then the consecutive flight into the underground economy may erode the tax and social security base. The results of this vicious circle include further increases in the budget deficit, additional growth of the shadow economy and gradual weakening of the economy. A growing shadow economy may also attract workers from the official labour market and create competition for legitimate firms.

2.3 The impact of illicit trade on economic growth

Illicit trade also brings about risks to economic growth and sustainable development. Illicit trade and illicit markets are providing not only a safe haven and exploitable sanctuaries for illicit forces but also illicit liquidity for corrupt officials. Consequently, illicit trade and the wide availability of illicit liquidity prevent fair and open markets from reaching their full economic potential and threaten state sovereignty. This trade also causes enormous costs, such as the corruption and destabilisation of society, harmful effects of drugs, lost productivity and other social costs, including those associated with the dumping of toxic wastes, poaching of endangered species, endangering human lives and public health as a result of counterfeit drugs flooding the market. All of these illicit trade activities have an economic effect, as they divert money and other resources from the balance sheets of legitimate businesses to those of illegitimate ones. National revenue and assets intended to finance the future are instead embezzled, impairing the ability of communities and businesses to make the investments.

Illicit trade is growing in scope and magnitude due to increased globalisation, free movement of goods and internet usage. A study entitled 'Tackling the black market in Ireland', estimated that illicit trade in Ireland is costing the economy USD860 million per annum. The OECD has estimated the cost of illicit trade of physical goods to the global economy to be around USD250 billion whilst the International Anti Counterfeiting Coalition estimates the figure to be USD600 billion per annum. According to WCO statistics, the discovery by customs officials of over 9.5 tonnes of illicit products, including cocaine and heroin, more than 360 tonnes of chemicals and 200 kilograms of methamphetamines is an indication of the magnitude of this illicit trade. Customs remains a vital tool available to stimulate trade and stem the flow of illicit goods that weaken the economies, recognising that trade contributes to national development, competitiveness, job creation, wealth creation, poverty reduction and sustainable economic growth.

The effect of illicit financial flows on the economy is also significant as pointed out by O'Hare et al. (2014), who acknowledge that illicit financial flows have social consequences, including reduced expenditure on health, education and infrastructure. They define illicit financial flows as the unrecorded movement of capital out of the country in contravention of regulations. Illicit financial flows include

legitimately earned capital that becomes illegitimate when taken across borders to evade paying tax to the country of origin, and commercial tax evasion is estimated to account for 60 to 65 per cent of total illicit financial flows.

Walbeek (2014) investigated the effect of the illicit cigarette market using the government revenue data in South Africa with the aim of establishing whether increases in the illicit cigarette trade significantly undermines Treasury's excise tax revenue comparing actual excise tax revenue from cigarettes to budgeted excise tax revenue. They established that during the period 2005 to 2012 cigarette excise revenue was, on average, 2.6 per cent below the budgeted revenues, and for the period 2009 to 2012 was 6.5 per cent below budget.

Khaled (2013) looked at the effect of illicit trade in narcotics on the global economy and observed that illicit markets — especially those dealing with narcotics — constitute grievous threats to the world's economy and threaten global safety, economic progress and security. He points out that some of the effects of this illicit trade are that the trade gradually turns business rules upside down. He argues that the revenue from illegal drugs in 2011 alone was roughly ten per cent of global GDP. Hübschle (2011) asserts that illicit trade leads to huge amounts of income that is unaccounted for. For instance, in 2009 the overall amount of money from trade in illegal narcotics was roughly USD1.25 trillion that is not yet accounted for.

In reality, illicit trade generates a range of effects on the global economy, effects that touch on crucial economic factors linked to production as well as consumption and distribution (Hübschle 2011). As pointed out by Jenner (2011), illicit trade has developed to a level that is sabotaging the main economic framework. The extent to which the global economy is indeed endangered is said to be huge. According to Ellis (2009), the high amount of foreign exchange as a result of illegal trade revenues can cause currency overvaluation and loss of competitiveness for exports and domestic production, which competes with imports, among other distortions in business operations. Jenner (2011) asserts that there is a potential of slow economic progress as people's behaviours change from performing productive activities to non-productive ones. This situation is then likely to increase the costs of operating a formal economy. In the words of Mamdani (2004), illegal trade tends to encourage unequal development of regions as revenues tend to be concentrated in particular economies of the world. It also leads to distortions of resource allocation, prices, consumption and impacts on imports, exports and results in potential problems in investment and economic growth, corruption, risks of real sector volatility, strengthening of skewed income and wealth distributions, economics statistics and thus potential errors, undermining the credibility of legal institutions (UNODC 2011).

According to some estimates, the illegal economy accounts for 8 to 15 per cent of world GDP, distorting local economies, diminishing legitimate business revenue, fuelling conflict and deteriorating social conditions. From Wall Street to other financial centres across the globe, illicit trade networks are infiltrating and corrupting licit markets, reducing productivity and incentivising investments in research and development. Four major costs of illicit trade were identified as lost revenue, distortion of market prices, collapse of local industries leading to unemployment and the social costs that endanger the health and safety of nationals, destroy vital habitats and ecosystems and threaten the tourism industry. Grant Thornton (2013) also added costs of counterfeiting and corruption as costs of illegal trade. Some of the costs further include jeopardising public health, emaciating communities' human capital, eroding the security of our institutions and destabilising fragile governments (OECD 2011).

Table 2: Illicit trade market values

Black Market/Illicit Trade Market Values	**US Market Value**
Number of jobs created by the black market globally	$1.8 billion
Alcohol Smuggling	$34 million
Counterfeiting	$225 billion
Cigarette Smuggling	$10 billion
Cocaine	$35 billion
Counterfeit US Dollars	$103 million
Gas and Oil Smuggling	$10 billion
Illegal Gambling	$150 billion
Illegal Logging	$1 billion
Movie Piracy	$25 billion
Music Piracy	$12.5 billion
Kidney Organ Trafficking	$30,000 per kidney
Software Piracy	$9.7 billion
Prostitution	$14.6 billion
Total United States Illicit Trade Value	$625.63 billion
Average US Street Value for Illicit Items	**Street Value**
AK-47 Price	$400
Cocaine Price	$174.2 per gram
Ecstasy Price	$35 per tablet
Heroin Price	$200 per gram
Marijuana Price	$20–$1,800 per ounce
Meth Price	$3–$500 per gram

Source: www.statisticbrain.com/largest-grug-seizures-inhistory.

As previously noted, a black market or underground economy is the market in which illegal goods are traded. Due to the nature of the goods traded, the market itself is forced to operate outside the formal economy, supported by the established state power. People engaged in the black market usually run their business hidden under a business front that is legal. Worldwide, the underground economy is estimated to have provided 1.8 billion jobs (www.statisticbrain). Arguments have been put forward in support of the shadow economy that it also has a positive impact on the legal economy and social wellbeing of humanity as it creates jobs that improve the livelihood of many. However, research has shown that the costs outweigh the benefits and therefore illicit trade remains detrimental to the economy. The African Forum and Network on Debt and Development (AFRODAD) (2014) approximates that between 2009 and 2012 cash-strapped Zimbabwe lost USD2.79 billion through illicit financial flows, which represents nearly half of the country's national budget of USD4 billion. If these funds could find their way to the national coffers it could fund half of the national budget and be redistributed to all the citizens of the country through infrastructural developments, investments, and even poverty alleviation programs.

The estimated annual costs and revenues generated by illicit networks and organised crime groups are as follows:

- Money laundering: USD1.3 trillion to USD3.3 trillion, between two per cent and five per cent of world GDP
- Bribery: significant portion of USD1 trillion
- Narcotics trafficking: USD750 billion to USD1 trillion
- Counterfeit and pirated products
- Environmental crime (illegal wildlife, toxic wasting): USD20 to USD40 billion
- Human trafficking: 20.9 million victims globally USD32 billion annually
- Credit card fraud: USD10 billion to USD12 billion (UNODC 2011).

It is also estimated that up to USD40 billion is lost annually through corruption in developing economies. Including money laundering, this figure increases to an astonishing USD3 trillion compared with a legitimate global trade figure of about USD10 trillion to USD12 trillion. Beyond the numbers, illicit trade and organised crime have also been identified as significant barriers to economic growth, individual prosperity and corporate profitability; they stifle legitimate markets, sabotage global supply chains, deplete natural resources and endanger market security.

In 2001, Collier, Hoeffler and Pattillo estimated that if illicit outflow of funds was not taking place, GDP per capita in Africa would have been approximately 16 per cent higher. The researchers further argued — in line with the arguments by Ndikumana and Boyce (2011) — that illicit financial flows are a constraint to poverty reduction in Africa. According to the 'World Trade Report' (2013), the toxic and corrosive nature of illicit trade harms economic growth and job creation, challenges the rule of law, robs governments of the much needed revenue and threatens human life and the quality of life and thus requires a strong internationally coordinated response. Table 3 estimates money laundered as a percentage of global GDP.

Table 3: Estimates of money laundered as a percentage of global GDP

IMF estimates of money laundered	Minimum	Maximum	Midpoint
IMF estimates of money laundered as a percentage of global GDP	2%	5%	3.5%
Estimates for 2005 in USD trillion	0.9	2.3	1.5
Estimates for 2009 in USD trillion	1.2	2.9	2

Source: World Bank, World Development Indicators 2010.

This serves to illustrate that illicit trade has a significant negative impact on economic growth – if between two per cent and five per cent of GDP is unaccounted for and finds its way to the shadow economy, economic development is stifled. The Global Financial Integrity (GFI) report also seeks to estimate the cost (financial and otherwise) of illicit trade:

- USD50 billion of tax revenue from cigarette smuggling
- Up to 96% of revenues from logging in Tanzania are lost to illegal logging (Tanzania Forest Conservation Group)

- Trade mis-invoicing accounts for up to USD737 billion in illicit financial flows from developing economies (Global Financial Integrity 2011)
- 700,000 people killed each year due to counterfeit medications
- Global fisheries underperform by USD50 billion annually because of illegal over-exploitation
- 20.9 million people in enforced labour in 2012 (International Labour Organisation 2012)
- Tens of thousands of African elephants killed in 2011 and 2012 (elephant trading information system).

2.4 The role of Customs in combating illicit trade

Modern Customs should not only collect revenue but should also play two other important national roles: expediting cross-border trade to promote economic development and preventing international trafficking in illicit goods. Customs administrations therefore play a vital role in the economic welfare of a country, and for that reason, dysfunctional customs administration can easily harm trade relations and curtail foreign investment, as customs revenue represents a substantial share of total tax collection. According to the World Bank (2003), the business community frequently perceives Customs as one of the most serious constraints to business investments. The IMF (2011) has indicated that a lack of political commitment, human resources, skills gaps and insufficient funds are obstacles to faster reformation. The Transparency International Global Barometer (2005) identifies Customs as the third most corrupt government agency after police and tax administration. Bribes and tips requested by customs officials to facilitate clearance of imports and exports flow become a cost to business which is later passed to the consumer through increased prices.

One method by which Customs can strengthen compliance and regulatory frameworks is through enforcement harmonisation. Cooperation is also of importance and should be enhanced with businesses and other market actors to enable targeted interventions on both the supply and demand sides of illicit trade. Customs officials, policymakers, other border agencies, researchers and the private sector need to work closely together. Greater cooperation between regional and international organisations could also make a difference. To optimise tax collection, governments need to be able to exercise effective control over the production and importation of products, especially over excisable goods with the aim to capture undeclared markets, leading to increases in tax collection. While non-declaration and mis-declaration lead to revenue loss, effectively combating such practices would lead to other benefits such as the elimination of unfair competition brought about by untaxed goods which flood the market.

Looking at the experiences of other countries to seek to draw lessons from them, we see that severe corruption has been a major problem in countries like Mozambique, Bolivia, Uganda and the Philippines, which motivated them to introduce customs reforms (World Bank 2005, p. 108). A study conducted in Mozambique by Van Dunem and Arndt (2006) found a positive relationship between high tax rates and underreporting of import values and evasion. Some countries simplified their procedures and created a system which allows fewer contacts between staff and traders, while others upgraded IT systems and introduced the customs information systems software, ASYCUDA, to improve service delivery, increase transparency and shorten customs clearance time. In their reforms, Uganda and Peru employed measures such as cooperation with other authorities, private entities and police, expanded audits and preventative inspections to increase enforcement. However, these were not very effective in Mozambique and Bolivia. Though these efforts may have reduced the clearance time, increased seizures (especially in Mozambique) and a decline in smuggling, corruption is still high (especially in developing countries), which compromises these efforts. The World Bank findings show that political support for customs reforms is essential, together with stable leadership. Financial support is also a very important ingredient in ensuring successful reform. Also, cooperation of customs staff, taxpayers and coordination with other tax agencies are critical for effective customs reform (World Bank 2005, p. 125).

3. Conclusions and recommendations

Findings show that the illegal economy accounts for between eight per cent and fifteen per cent of national GDP, distorting local economies, reducing legitimate business revenues and revenue collected through taxes. Illicit trade also undermines the social stability and socioeconomic welfare of communities, at the same time preventing the equitable sharing of public goods as revenue that could be used to develop and improve infrastructure. Table 4 summarises the illicit financial flows in developing countries between 2000 and 2009 and their percentage growth.

Table 4: Illicit financial flows from developing economies 2006 to 2009 (in million dollars)

	CED (change in external debt, balance of payments component)					
	2006	**2007**	**2008**	**2009**	**Logarith growth (2000-2009)**	**% growth 2000-2009**
Africa	19,417	42,219	38,909	40,220	26.33	3.37
Asia	31,946	27,825	49,288	163,970	2.99	232.67
Europe	136,458	242,142	287,259	206,113	31.24	-28.25
MENA	219,639	187,986	239,956	232,723	30.94	-3.01
Western hemisphere	48,696	106,362	51,752	88,686	11.15	0.37
All developing economies	**456,160**	**606,536**	**667,165**	**731,714**	**22.16**	**9.68**

	GER (gross excluding reversals, trade mispricing component)					
	2006	**2007**	**2008**	**2009**	**Logarith growth (2000-2009)**	**% growth 2000-2009**
Africa	17,886	23,236	24,876	18,767	34.88	24.56
Asia	346,223	391,472	445,820	447,008	15.46	0.27
Europe	15,990	8,975	16,164	13,458	10.07	-16.74
MENA	8,097	5,688	7,534	9,547	17.03	26.72
Western hemisphere	70,325	81,374	102,780	80,486	9.16	-21.69
All developing economies	458,524	510,747	597,177	569,268	14.51	-4.67

	Total CED+GER					
	2006	**2007**	**2008**	**2009**	**Logarith growth (2000-2009)**	**% growth 2000-2009**
Africa	37,304	65,455	63,785	58,988	27.7	-7.52
Asia	378,172	419,297	495,109	610,978	12.94	23.4
Europe	152,448	251,118	303,423	219,572	28.96	-27.63
MENA	227,737	193,674	247,490	242,270	30.21	-2.11
Western hemisphere	119,022	187,736	154,533	169,173	10.15	9.47
All developing economies	914,684	1,117,283	1,264,342	1,300,983	18.03	2.9
	49.9	54.3	52.8	56.2	Ave CED% (2000-2009)	45.3
	58.4	50.1	45.7		Ave CED% (2000-2009)	54.7

Source: Kar & LeBlanc 2013.

Four major costs have been identified: lost revenue; distortion of market prices; collapse of local industries leading to unemployment; and the social costs that include the health and safety of nationals being endangered, vital habitats and ecosystems being destroyed, and threats to the tourism industry. This is in line with the OECD'S 2011 *Future shocks report: improving risk governance*, which points out that practices such as duty evasion cause significant financial damage to the government's budget and the economic stability of compliant traders.

Methods of illicit trading or customs duty evasion that have been identified include outright avoidance of official customs control; under-declaration of goods; undervaluation of goods; misclassification of goods; and falsification of documents.

It is evident from the literature that illicit trade presents a clear threat to the economy, economic growth, sustainable development, social cohesion, security and stability. Identifying and quantifying the impacts of illicit trade on economic growth will help pinpoint the large scale disruptions to economic activity and identify tools to reinforce the most vulnerable points of entry to the illegal economy. The idea is to reduce incentives for communities to resort to illegal commercial activity, reduce organised crime, stabilise legitimate trade and markets and help promote above-board trade and economic growth. Loss of revenue and evasion of customs duties represent particular causes for concern for most economies, especially developing economies, due to leakages through smuggling of highly taxed goods such as tobacco. The ability to assess and effectively collect revenue legally due remains a high priority for Customs globally. The literature also points to several initiatives that may help to combat illicit trade, including:

- Exchange and joint analysis of statistics of general trends of the risks and seizure of illegal and undeclared goods
- Enhance cooperation between Customs and different players in the economy, including other law enforcement agencies, to help to better infiltrate and identify production and distribution networks for illegal and illicit trade

- Exchange of knowledge and experience by customs officials regionally and internationally
- Establish and designate as appropriate national coordination agencies or bodies and institutional infrastructure responsible for policy guidance, research and monitoring of efforts to prevent, combat and eradicate illicit trade
- Introduce modernised systems, improved risk management practices, and implement audits of the custodians of regulatory controls.

Studies into the factors that motivate people to engage in illicit trade, further research into the causal relationship between illicit trade and money laundering, and quantification of the causal relationship between illicit trade and impediments to economic growth would all help to identify potential solutions to the problem.

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Eukeria Mashiri

Eukeria Mashiri is a lecturer in the Faculty of Commerce, Department of Accounting at Midlands State University in Zimbabwe. She holds a Masters of Commerce in Accounting and is currently pursuing doctoral studies in the area of taxation. She is also a bona fide member of the Institute of Certified Tax Accountants (ICTA). Taxation has been the main focus of Eukeria's teaching and she has co-authored two textbooks on taxation for Zimbabwe, and has authored research papers on taxation.

Favourate Y Sebele-Mpofu

Favourate Y Sebele-Mpofu is a lecturer in the Faculty of Commerce, Department of Accounting, National University of Science and Technology, Zimbabwe. Favourate's qualifications include an MComm in Accounting (Midlands State University, Zimbabwe), MSC in Finance and Investment and a BComm in Accounting, both awarded by the National University of Science and Technology, Zimbabwe.

Nepal's excise systems and the legal frameworks: agendas for reform

Uma Shankar Prasad

Abstract

Following Nepal's accession to the World Trade Organization (WTO) in 2003, the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) in 2004, and implementation of the South Asian Free Trade Area (SAFTA) in 2006, the Government of Nepal has pursued a policy of mobilising excise taxes to compensate for revenue losses resulting from the reduction and abolition of customs tariff rates and other obligations of WTO membership. The principal objective of this article is to analyse the existing system of excise administration in Nepal and identify ways in which the administrative burden may be reduced for both taxpayers and the government. The study identifies an urgent need to shift from the current physical control system to a self-removal system, as well as a need to rationalise the country's excise legislative provisions, in line with international practices.

1. Introduction

Excise tax was a major source of tax revenue in Nepal until the late 1990s. The number of items that attracted excise was nearly 100 in 1990-91, which reduced to seven items in 2000-01. During this process, the contribution of excise to Nepal's revenue base decreased significantly. The share of excise duty to GDP, total tax revenue and indirect tax was 1.1 per cent, 15.1 per cent and 18.1 per cent respectively in the fiscal year 1989-90, which decreased to 0.8 per cent, 8.4 per cent and 10.5 per cent respectively in the fiscal year 1994-95.

Following Nepal's accession to the World Trade Organization (WTO) in 2003, the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) in 2004, and implementation of the South Asian Free Trade Area (SAFTA) in 2006, the Government of Nepal has continued to adopt a policy of mobilising excise taxes. The purpose of the policy is to compensate for the revenue losses resulting from the reduction and abolition of customs tariff rates and other obligations of WTO membership. To this end, excise tax was imposed on additional goods in 2004-05, and since then has become more important to revenue generation in Nepal. The share of excise duty to GDP, total tax revenue and indirect tax increased to 2.2 per cent, 15.1 per cent and 20.2 per cent respectively in the fiscal year 2009-10.

Excise duty is imposed on the consumption of selected goods, such as alcoholic beverages and tobacco products. A licence is required to engage in manufacturing, importing, selling and storing of excisable goods. Likewise, the *Excise Act 2002* prohibits importing excisable services without having a licence. Excise commodities are subject to physical control and supervision at all stages of production, distribution and selling. A self-removal system has recently been implemented for many items to reduce the burden on tax administration and taxpayers. However, alcoholic beverages and tobacco, which represent 56.8 per cent of total excise revenue, are still subject to physical control and supervision.

Nepal's excise sector has a high level of informal economic activity through the production of illegal liquor and unauthorised importation of cigarettes and liquor. The compliance rate of medium and small

enterprises working in this sector has been low, and excise taxpayers have been over-burdened with complicated administrative procedures, such as registration, preparation and submission of regular returns and payments.

The principal objective of this article is to analyse the existing system of excise administration and identify ways in which the administrative burden may be reduced for both taxpayers and for the Government of Nepal. The study is an analytical study based on macroeconomic theory of the public sector. The required data were collected through both primary and secondary information, with the primary information collected through interviews/discussions with key informants, seminars and workshops, and focus group discussions with the help of an advance checklist. The secondary information was collected by reviewing published and unpublished reports, particularly from government organisations. The main institutions and publications from which secondary information was collected are: national plans and mid-term evaluation reports of the National Planning Commission; economic surveys, budget speeches, Red Books and other periodic publications of the Ministry of Finance; quarterly economic bulletins, annual economic reports, periodic publications of the Nepal Rastra Bank; annual reports, Excise Act, Liquor Act, Excise Directive, and various published and unpublished reports of the Inland Revenue Department (IRD); and various published and unpublished reports of the Federation of the Nepalese Chamber of Commerce and Industries, Nepal Chamber of Commerce and the Confederation of Nepalese Industries.

2. The nature of excise duty

Excise regimes raise revenue by imposing taxes on specific goods and services. Unlike value added tax (VAT), they are generally levied only on specifically defined goods, in particular on three product groups: alcoholic beverages, mineral oils and tobacco products (www.oecd.org).

When first introduced, the main purpose of excise duties was to raise revenue, but recently an alternative philosophy has emerged, recognising the application of excise duties as a means of influencing consumer behaviour. The case put forward in relation to alcohol and tobacco products is that drinking and smoking are health hazards and increased excise duties help to reduce consumption. For mineral oils, reasons for determining consumer behaviour reflect a mixture of energy conservation, transport and environmental issues. Over the last decade, environmental issues have played an increasing role in determining the nature and application of excise duties to, in particular, road fuel (www.oecd.org).

As well as influencing consumer behaviour, excise taxes are recognised as an economically efficient way of correcting negative externalities. Put simply, this means that when consumption of these goods does harm to others and there is a cost to the economy from that harm, then some of that cost is recovered from the consumer. The cost of the harm is included in the price of the excise good (the drink, the cigarette, the car, the fuel, etc.) and the consumer is then making an informed decision on what and how much to consume. It also affects a wide variety of social conditions. For example, it has been estimated that a 1 per cent increase in the price of alcohol decreases the rate of wife abuse by 3.1 per cent to 3.5 per cent; a 10 per cent increase in the excise tax on beer would reduce severe domestic violence against children by 2.3 per cent; a 78 per cent increase in the beer tax would reduce highway fatalities by 7 per cent to 8 per cent; a 10 per cent increase in the price of alcohol would decrease drunk driving by 7.4 per cent for men and 8.1 per cent for women; a 10 per cent increase in the beer tax would reduce rapes by 1.32 per cent, robbery by 0.9 per cent, murder by 0.3 per cent, and assaults by 0.3 per cent (Cnossen 2005).

The Protocol to Eliminate Illicit Trade in Tobacco Products was adopted by the parties to the World Health Organization (WHO) Framework Convention on Tobacco Control (FCTC) in November 2013. This treaty is aimed at combating illegal trade in tobacco products through control of the supply chain and international cooperation. Parties have committed to establishing a global tracking and tracing system to reduce and eventually eradicate illicit trade. The new Protocol will help to protect people across the globe from the health risks of tobacco and provide significant revenue increases for the governments.

Table 1 presents the contribution of excise duty as a percentage of total tax revenue and GDP in selected countries of three economic regions of the world comprising SAARC, OECD and ASEAN.

Table 1: Excise duty as percentage of total tax revenue and GDP in selected countries

S.N.	Region/country	Excise duty as percentage of total tax revenue		Excise duty as percentage of GDP	
		%	Year	%	Year
1.	SAARC • Nepal • India • Bangladesh	 14.3 16.3 0.7	 2012 2012 2012	 2.2 1.6 0.1	 2012 2012 2013
2.	OECD • Germany • France • Japan • USA	 6.3 5.4 6.2 3.7	 2013 2013 2012 2013	 2.3 2.5 1.8 0.9	 2013 2013 2013 2013
3.	ASEAN • Malaysia • Singapore • Philippines	 8.1 4.0 7.3	 2012 2012 2011	 1.3 0.6 0.9	 2012 2012 2011

Source: OECD 2014a, Ministry of Finance, Government of Nepal 2013b; Unnayan 2013; National Board of Revenue, Bangladesh 2013; Supreme Audit Institute of India 2013; IMF 2013; Republic of Singapore 2013; Department of Revenue, Malaysia 2013.

Table 1 indicates that the share of excise duty in total tax revenue is the highest in India and the lowest in Bangladesh among all three economic zones. Among selected OECD countries, the share is the highest in Germany and the lowest in the USA. In terms of GDP, the share of excise is the highest in Germany and France and again the lowest in Bangladesh.

3. Excise duty in Nepal

Historically, the political foundation of modern Nepal was laid in 1778 with Prithvi Narayan Sah's conquest of the Kathmandu Valley, known as the unification of the Nepalese state in the history of Nepal. In 1886, the autocratic Rana rule emerged with the advent of Jung Bahadur Rana, the first Rana prime minister of Nepal. The Rana rulers ruled over the country for more than a century simply with the functioning of general administration and hardly spared any thought for systematic socioeconomic development of the country, except for a few cases of sporadic attempts, such as the founding of the first undergraduate college in Kathmandu Valley in 1918 and the setting up of the first commercial bank in 1937.

Before 1951, during the Rana regime, the excise duty was collected on a contract basis. The '*Rakam Bandobasta Adda*' was responsible for excise administration which was set up during the reign of King Surendra. Under this office, a handful of contractors levied different excise duties in different parts of the country based on tradition and their own interest. There was no uniform excise rate and the excise duties were not linked to the fiscal policy of the country. The main items attracting excise duty during the period were *Raksi* (local liquor), pig hairs, leather, *ganza*, opium and hashish. There was no excise duty on industrial products. The basic purpose and philosophy behind the imposition of excise duty was to collect revenue (Pant 1985).

After the overthrow of the Rana regime in 1951, Nepal initiated strategies more aligned with planned development. The first budget was introduced in 1952. The contract system to raise excise duty from

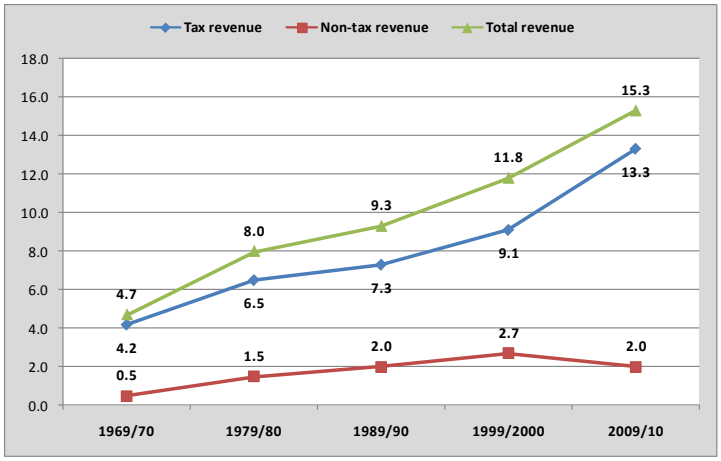
hashish and cannabis was terminated and the licensing system was introduced. The contract system on other products was, however, continued. Historically, the Civil Code 1854 had provided the legal basis for imposing excise duty on items including liquor, mining of iron, animal bones, hashish, cannabis, and timber.

The first systematic attempt at planned development in Nepal was initiated on 9 October 1955 when late King Mahendra issued a Royal Proclamation regarding the necessity of a Five Year Plan for the country. The Department of Customs and Excise was established in 1955. The *Excise Act 1959* authorised the government to impose an excise duty on domestic industrial products like matches, sugar and liquor. The contract system of low-grade production and distribution of liquor was particularly significant. The *Liquor Act 1975* was promulgated which gave legal basis to introduce a distillery system in the production and distribution of liquor. The Excise Act was revised in 2002 expanding its scope, under which the government is now authorised to impose excise on the service sector as well as on the import of goods on a selective basis.

A separate Department of Excise was established in 1965 by dividing the Department of Customs and Excise. The purpose was to make the excise administration more effective and efficient in order to raise revenue from different kinds of domestic products on a selective basis. The Department established field offices in various parts of the country. The Department was then abolished in 1998 and its responsibilities were transferred to the newly created IRD. The IRD currently has 23 field offices and is responsible for national excise administration.

The major problem for low-income aid-dependent countries like Nepal is the great difficulties experienced in raising resources/revenue to finance important development expenditures. While they need to raise more revenue in order to reduce their budget deficit and fight poverty, the collection of more revenue through direct taxes is a difficult task because of the low level of per capita income — which is said to be the major cause of the low level of savings and investments — and the quality of tax administration is weak. In this regard, developing countries have not been as successful as developed countries in designing progressive tax structures which would place a smaller burden on the poorer sections of the society.

Figure 1: Growth of public revenue as percentage of GDP, 1969-70 to 2009-10



Source: Government of Nepal 1989, 2011a, 2013b.

Tax revenue contributes three-fourths of total revenue in Nepal and non-tax revenue comprises one-fourth. Figure 1 reflects that there has been a continuous increase in the collection of government revenue in Nepal. The revenue to GDP ratio has increased from 4.7 per cent of GDP in 1969-70 to 15.3 per cent of GDP in 2009-10.

Table 2: Growth of direct and indirect taxes, 1979-80 to 2009-10

Types of taxes	Share of taxes as percentage of total tax revenue				Share of taxes as percentage of GDP			
	1979-80	1989-90	1999-00	2009-10	1979-80	1989-90	1999-00	2009-10
Direct Taxes	**16.6**	**19.7**	**27.0**	**26.7**	**1.1**	**1.4**	**2.4**	**3.6**
Income Tax from Public and Semi-public Enterprises	2.3	3.3	6.6	0.7	0.2	0.2	0.6	0.1
Income Tax from Private Corporate Bodies	0.1	0.0	4.0	7.8	0.0	0.0	0.4	1.0
Income Tax from Individuals and Remunerations	4.1	9.3	10.5	9.9	0.3	0.7	0.9	1.3
Land Revenue	3.7	1.0	0.0	0.0	0.2	0.1	0.0	0.0
House and Land Registration	4.3	5.2	3.1	3.5	0.3	0.4	0.3	0.5
Urban House and Land Tax	0.4	0.3	0.4	0.0	0.03	0.02	0.03	0.0
Vehicle Tax	0.1	0.4	1.2	1.5	0.01	0.03	0.1	0.2
Tax on Interest	0.0	0.2	1.2	1.6	0.0	0.01	0.1	0.2
Other Taxes	1.5	0.0	0.0	1.6	0.1	0.0	0.0	0.2
Indirect Taxes	**83.4**	**80.3**	**73.0**	**73.3**	**5.4**	**5.9**	**6.7**	**9.8**
Customs Duties	39.8	36.9	32.6	22.5	2.6	2.7	3.0	3.0
Excise Duty	14.1	15.1	9.4	15.6	0.9	1.1	0.9	2.1
Sales Tax/VAT	26.2	22.7	30.9	35.1	1.7	1.7	2.8	4.7
Entertainment Tax	0.6	0.5	0.0	0.0	0.04	0.03	0.0	0.0
Hotel Tax	0.9	1.4	0.0	0.0	0.06	0.1	0.0	0.0
Air Flight Tax	0.6	1.2	0.0	0.0	0.04	0.09	0.0	0.0
Contract Tax	1.2	2.3	0.0	0.0	0.08	0.17	0.0	0.0
Road & Bridge Maintenance Tax	0.0	0.3	0.0	0.0	0.0	0.03	0.0	0.0
Other taxes	0.0	0.0	0.0	0.1				0.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**6.5**	**7.3**	**9.1**	**13.3**

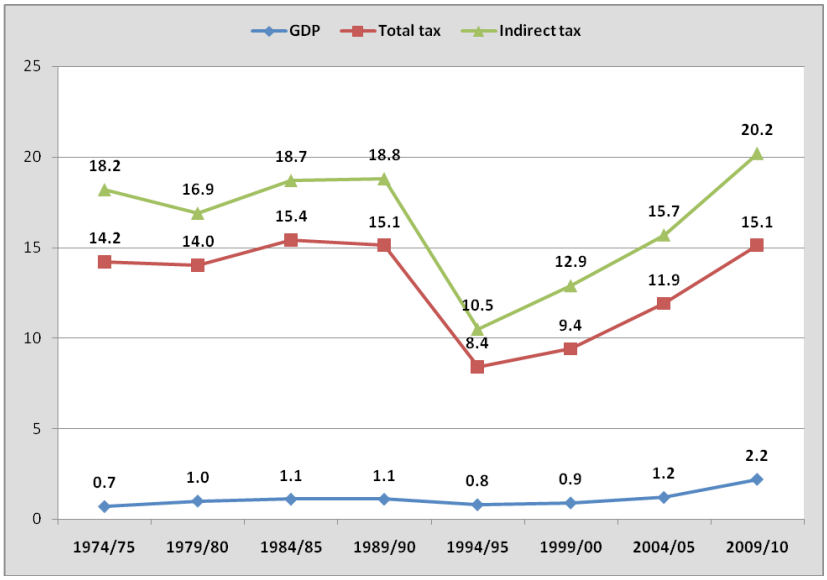
Source: Government of Nepal 1989, 2011a, 2013b.

Nepal's tax structure is highly dominated by indirect taxes, which tend to be stagflationary. Nepal collects a substantially higher share of its revenue from customs, sales and excise duties, the share of indirect tax revenue to total revenue and GDP tends to be very high, and numerous concessions and deductions apply to direct taxes. Therefore, a shift from the present dependence on indirect to direct taxes is considered necessary. This would lead to a decline in prices of mass consumption items and an increase in demand, and a reduction in demand for luxury goods due to the imposition of direct taxes, which would be beneficial on balance of payments. Both would have a positive effect on growth in the economy. It should also be noted, however, that the efficiency and quality of tax administration is very weak and irregularities in tax collection are widely prevalent (Prasad 2008).

3.1 Share of excise in revenue structure and GDP

The total revenue from excise duty has been continuously increasing in Nepal since the fiscal year 1974-75, except in the fiscal year 1977-78. The total excise collection was Rs. 119.7 million in 1974-75, which increased to Rs. 26,338.5 million in 2010-11. It shows that the excise revenue in Nepal has increased by around 220 times during the period of 36 years. The growth rate of excise duty has highly fluctuated from -1.0 in 1977-78 to 48.9 in 2009-10 with the average growth rate of 16.8 per cent between the period of 1974-79 and 2012-13.

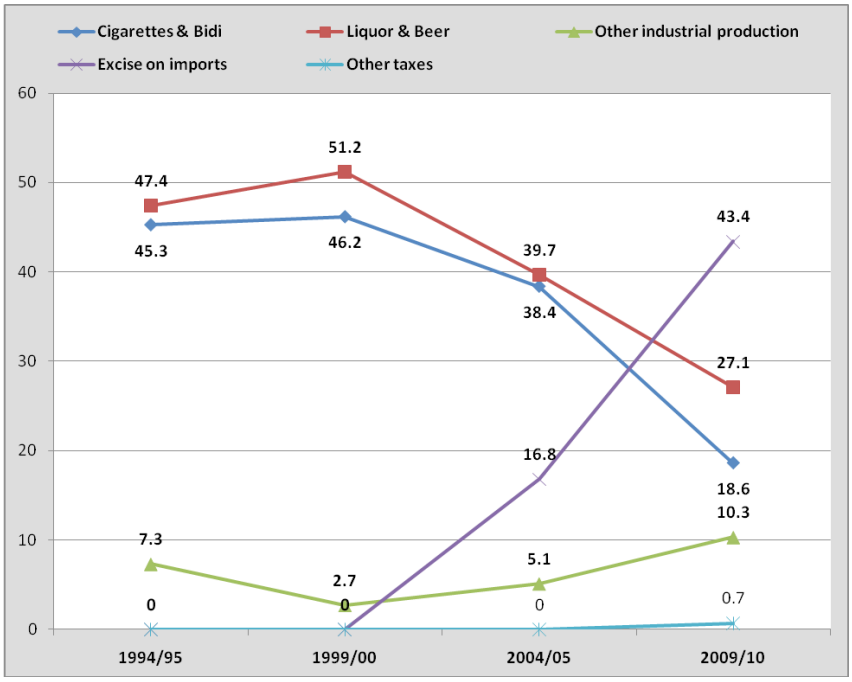
Figure 2: Share of excise in revenue structure and GDP, 1974-75 to 2009-10



Source: Government of Nepal 1989, 2011a, 2013b.

The data reveal that there is no consistent pattern during the study period. The share of excise duty decreased significantly during the late 1990s. In recent years, however, it has been increasing, mainly due to the introduction of excise duty on the import of all types of vehicles and motorcycles, frequent increase in the rates of excise duty for most products, and increases in the volume of the production of major excisable products. The share of excise duty to GDP, total tax revenue and indirect tax was 0.8 per cent, 8.4 per cent and 10.5 per cent in the fiscal year 1994-95 respectively, which increased to 2.2 per cent, 15.1 and 20.2 respectively in the fiscal year 2009-10.

Figure 3: Composition and trends of excise duty



Source: Government of Nepal 2011a, 2013b.

Figure 3 illustrates that there has been a significant contribution of excise duty from cigarettes, *bidi*, liquor and beer. However, their share of total excise revenue has decreased significantly since the 1990s due to the increase in excise from imported vehicles and motorcycles.

With the enactment of the *Excise Act 1958*, excises were imposed on industrial products on the basis of specific rates. Initially, excises were imposed on sugar and matches and it was extended to other commodities in subsequent years. By 1985-86 the number of commodities the subject of excise duty reached approximately 60. Specific duties were converted into *ad valorem* rates in 1982-83. Currently specific rates, as well as *ad valorem* rates, are levied on commodities (see Table 3).

Figure 4 reflects that there has not been a clear trend regarding the number of commodities imposed excise duty in Nepal. In the fiscal year 1961-62, excise duty was imposed on only five items, with this increasing to 41 by the fiscal year 1983-84 and to 100 by the fiscal year 1990-91. After 1990-91, the number of commodities imposed excise duty started to decline and reached to 7 in the fiscal year 2000-01.

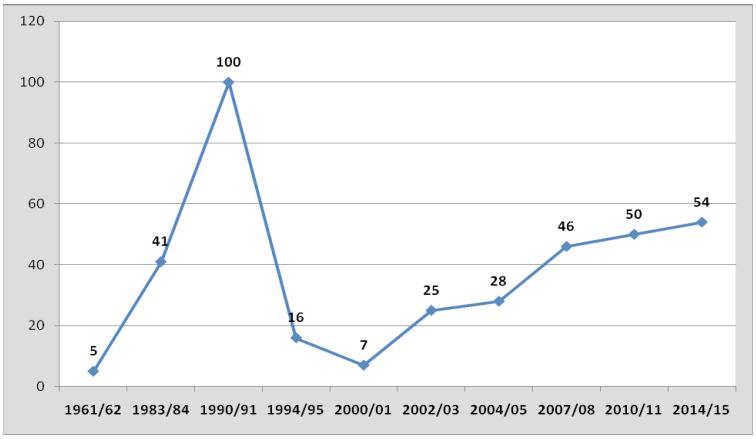
Table 3: Excise tariff for 2013-14

S.N.	Details of goods and services	Unit	Rate of excise duty
1.	**Liquors:**		
	I. Wine and brandy:		
	1. 25 U.P. strength (containing 42.8% alcohol)	Per litre Per L.P. litre	Rs. 538 Rs. 716
	2. 30 U.P. strength (containing 39.94% alcohol)	Per litre Per L.P. litre	Rs. 501 Rs. 716
	II. Whisky:		
	1. 25 U.P. strength (containing 42.8% alcohol)	Per litre Per L.P. litre	Rs. 538 Rs. 716
	2. 30 U.P. strength (containing 39.94% alcohol)	Per litre Per L.P. litre	Rs. 501 Rs. 716
	III. Rum and TAFIA:		
	1. 25 U.P. strength (containing 42.8% alcohol)	Per litre Per L.P. litre	Rs. 538 Rs. 716
	2. 30 U.P. strength (containing 39.94% alcohol)	Per litre Per L.P. litre	Rs. 501 Rs. 716
	IV. Gin and GENEVA:		
	1. 25 U.P. strength (containing 42.8% alcohol)	Per litre Per L.P. litre	Rs. 538 Rs. 716
	2. 30 U.P. of power (39.94% alcoholic)	Per litre Per L.P. litre	Rs. 501 Rs. 716
	V. Vodka:		
	1. 25 U.P. strength (containing 42.8% alcohol)	Per litre Per L.P. litre	Rs. 538 Rs. 716
	2. 30 U.P. strength (containing 39.94% alcohol)	Per litre Per L.P. litre	Rs. 501 Rs. 716
	VI. Linkers and Cordials:		
	1. 25 U.P. strength (containing 42.8% alcohol)	Per litre Per L.P. litre	Rs. 538 Rs. 716
	2. 30 U.P. strength (containing 39.94% alcohol)	Per litre Per L.P. litre	Rs. 501 Rs. 716
	VII. Ready mades others wine:		
	1. 15 U.P. strength (containing 48.5% alcohol)	Per litre Per L.P. litre	Rs. 719 Rs. 848
	2. 25 U.P. strength (containing 42.8% alcohol)	Per litre Per L.P. litre	Rs. 538 Rs. 716
	3. 30 U.P. strength (containing 39.94% alcohol)	Per litre Per L.P. litre	Rs. 501 Rs. 716
	4. 40 U.P. strength (containing 34.23% alcohol)	Per litre Per L.P. litre	Rs. 254 Rs. 423
	5. 50 U.P. strength (containing 28.53% alcohol)	Per litre Per L.P. litre	Rs. 125 Rs. 250
	6. 70 U.P. strength (containing 17.12% alcohol)	Per litre Per L.P. litre	Rs. 22 Rs. 72

2.	**Cigarettes (all kinds of cigarettes made from tobacco):**		
	1. In up to 70 mm length		
	i. Without filter	Per M	Rs. 294
	ii. With filter	Per M	Rs. 657
	1. In more than 70 mm up to 75 mm length (with filter)	Per M	Rs. 839
	2. In more than 75 mm up to 85 mm length (with filter)	Per M	Rs. 1075
	3. In more than 85 mm length (with filter)	Per M	Rs. 1463
3.	**Motor vehicles:**	**Price per cent**	
	a. Cars, Jeeps and Vans (customs headings 8702 and 8703) and their chaises (customs heading 8706)	Price per cent	60
	b. Microbuses (11–14 seats) (customs headings 8702 and 8703) and their chaises (customs heading 8706)	Price per cent	55
	c. Double cab pick-up (customs heading 8702) and their chaises (customs heading 8706)	Price per cent	60
	d. Three-wheeler auto rickshaw (customs heading 8703) and their chaises (customs heading 8706)	Price per cent	55
	e. Single cab pick-up (customs heading 8704) and their chaises (customs heading 8706)	Price per cent	50
	f. Delivery van (customs heading 8704) and their chaises (customs heading 8706)	Price per cent	30
	g. Minibuses (15-25 seats) (customs sub-heading 87021020)	Price per cent	35
	h. Minibuses (15-25 seats) (customs sub-heading 87029020)	Price per cent	35
	i. Customs heading 8702 including (15-25 seats) minibus chaises (customs heading 8706)	Price per cent	35
	j. Buses and trucks (customs headings 8702, 8704 and their chaises (customs heading 8706)	Price per cent	5
	k. Motorcycle (customs heading 8711)	Price per cent	40

Source: Inland Revenue Department, Government of Nepal 2014.

Figure 4: Number of commodities imposed excise duty in Nepal by fiscal year



Source: Finance Bill/Ordinance 1961-62 to 2014-15, Ministry of Finance, Government of Nepal.

Following Nepal's accession to the WTO and BIMSTEC and the implementation of SAFTA, the country was bound to reduce customs duties. In order to compensate revenue loss, excise duty was imposed on additional commodities. In this process, excise tax was imposed on 25 commodities in the fiscal year 2002-03, following which there has been continuous increase in the number of excisable commodities.

Currently in the fiscal year 2014-15, the total number of commodities on which excise duty is imposed has reached 54 (as shown in Figure 4) on the basis of volume of production or ex-factory price or both depending upon the excise structure, with ex-factory price including the costs of production and normal profit of the manufacturer.

In 2014 there were 27,879 registered excise taxpayers in the country. The IRD has categorised three tiers of classification of large, medium and small taxpayers: those with an annual turnover of more than NPR 400 million; those with a turnover between 250 and 400 million; and those with a turnover of less than 250 million. Table 4 identifies the number of excise taxpayers based on annual turnover which shows that while 99.9 per cent of all taxpayers are small, more than 80 per cent of total excise is paid by the large taxpayers.

Table 4: Segregation of excise taxpayers according to their transactions, 2014

Category of taxpayer	Range of taxable income	Number of taxpayers
Large	More than 400 million	21
Medium	Between 250 and 400 million	5
Small	Less than 250 million	27,853
Total		**27,879**

Source: Inland Revenue Department, Government of Nepal 2014.

4. Excise administration

Preece (2008) describes the system of excise administration and control mechanisms under three different headings: licensing or registration control mechanism; recording and reporting mechanism; and payment of excise and acquittal of liabilities mechanism. The administrative procedures of excise can be categorised as either physically controlled or self-assessed. The physically controlled system comprises various forced mechanisms for excise monitoring by the government/state, whereas under a self-assessed system, the taxpayers themselves determine the duty liability on the goods and produced commodities are cleared by the taxpayers voluntarily.

The traditional control system is the physical control system. Under this system, excise commodities are subject to physical control and supervision at all stages of production, distribution and sale. In low-income and middle-income countries with poor administration systems, 'enforced compliance' is carried out by imposing physical control over the production/manufacturing process. The system is costly for tax administrations as well as for taxpayers. The cost of physical control further increases when the potential for fraud by excise officers is considered.

The self-removal (or self-assessment) system is based on the theory of 'trust but verify'. To accomplish this, a well-established monitoring system is put in place as part of the production and distribution process and tax authorities audit taxpayer account books periodically. The self-removal system is the modern system of excise administration under which the excisable goods/items are produced, dispatched,

imported and exported without any regulatory or administrative restrictions, controls or hindrances by the government. Under this system, the taxpayers themselves determine the duty liability on the goods and clear the goods. The self-removal system has been implemented in many countries in recent years to reduce the burden on tax administration and taxpayers. In order to implement a self-removal system, tax administrators should adopt modern technologies in order to increase the efficiency of tax collection and minimise tax avoidance and evasion.

The physical control system still prevails in some ASEAN and South Asian countries like Thailand, India and Nepal, especially on alcoholic beverages and tobacco products. India and Georgia are good examples of countries that use intensive controls on tobacco manufacturing. Until 1969, there was a physical control system in India for all excisable commodities wherein each clearance of manufactured goods from the factory was done under the supervision of the Central Excise Officers. Currently, however, the physical control system is applicable to cigarettes and *bidi* only, with a tax administrator in place around the clock in cigarette and large *bidi* manufacturing facilities. Each officer records and reports the daily production and the quantity of cigarettes/*bidis* that leaves the factory. In Georgia, the government strictly supervises the sale, transportation and storage of tobacco products.

The introduction of a self-removal system in 1996 was a watershed moment in the excise procedures in India. Now, taxpayers are allowed to quantify the duty on the basis of an approved classification list and price list, and clear the goods on payment of the appropriate duty. The taxpayers assess their tax return and the department scrutinises it or conducts a selective audit to ascertain the correctness of the duty payment. Even the classification and value of the goods may simply be declared by the taxpayers instead of obtaining approval of the same from the department. In 2000, the fortnightly payment of duty system was introduced for all commodities, which was an extension of the monthly payment of duty system introduced the previous year for small scale industries. The self-removal system is applicable to all other goods except cigarettes produced or manufactured within the country.

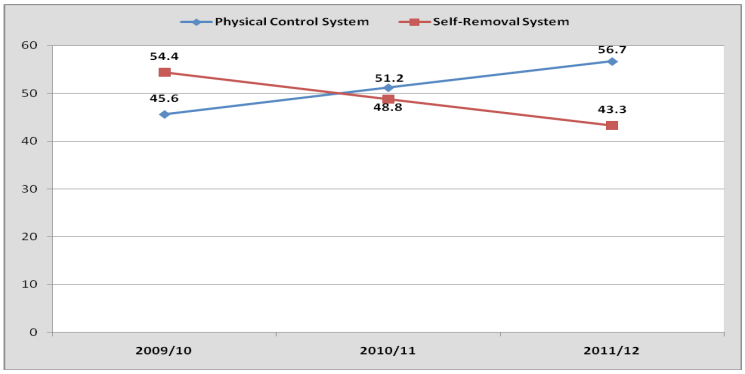
High-income countries, including the OECD countries have, in the past, adopted intensive physical controls on excisable goods. For example, whisky distilleries in Scotland once had official locks on their entrances, exits, and key areas of the production process that were vulnerable to unlawful extraction. Each distillery had a resident excise officer who lived in a provided house adjacent to the distillery, and no activity could take place without the officer being present. Similarly, in the United Kingdom each bonded warehouse used to have a resident officer who unlocked and locked the warehouse.

Currently OECD countries' excise administration is basically based on an accounting system (recording and reporting mechanism) under a self-removal procedure. Indeed, the physical control system of excise administration is essentially outdated in OECD countries. Excise is administered by relying on the taxpayer to submit tax returns and manufacturer's declaration of their production levels and then auditing the taxpayer's books of account. The high degree of compliance with excise taxes that is experienced in many high-income countries is due, at least in part, to the maintenance of a professional relationship between the taxing authority and the taxpayer. The development of such professional relationships should be part of the overall strategy to strengthen tax administration and tax compliance.

5. Excise administration in Nepal

Of the 54 categories of excisable goods in Nepal (in the fiscal year 2013-14), the manufacturing, importing and selling of molasses, alcoholic beverages (liquor and beer) and tobacco products (cigarettes and *bidi*) are administered by way of a physical control system under the Excise Act 2002. Currently, 56.8 per cent of the total excise revenue is collected from these items.

Figure 5: Excise collection under physical control system and self-removal system (%)



Sources: Ministry of Finance, Government of Nepal 2013b; Nepal Rastra Bank 2013.

Figure 5 reflects that the excise collection under the physical control system increased from 45.6 per cent in the fiscal year 2009-10 to 56.7 per cent in the fiscal year 2011-12. Conversely, the excise collection under the self-removal system decreased from 54.4 per cent in the fiscal year 2009-10 to 43.3 per cent in the fiscal year 2011-12.

Although the government has placed the manufacturing, importing and selling of molasses, alcoholic beverages (liquor and beer) and tobacco products (cigarettes and *bidi*) under the physical control system, very few factories are under the system in any real sense. This is because the government has been unable to recruit excise inspectors for each factory, and the technical expertise of current excise inspectors is lacking due to inadequate training.

Excise payers in Nepal may be categorised in two ways: as being either under the physical control or the self-removal system, and as either industrial producers or transactional excise taxpayers (excise permit holders). There are huge numbers of excise permit holders who pay only an annual licence fee, which is also regarded as excise duty. Indeed, the number of factories that fall under the excise net is small compared to the number of excise permit holders, who are engaged in transactional activities rather than industrial manufacturing.

Table 5: Number of factories under various categories, 2013-14

S.N.	Category of industry	Number of factories
Under physical control system		
1.	Distillery/liquor	45
2.	Cigarette	8
3.	Beer	8
4.	Wine	7
Sub total		**68**
Under self-removal system		
5.	Other industrial products	630
Sub total		**630**
Total industrial excise taxpayers		**698**
6.	Transactional excise tax payers/excise permit holders	27,181
Total taxpayers		**27,879**

Source: Inland Revenue Department, Government of Nepal 2014.

Table 5 illustrates that out of 27,879 excise taxpayers in Nepal in the fiscal year 2013-14, only 698 taxpayers (25%) are classed as being part of the manufacturing sector, 68 of which are under the physical control system.

Under the physical control system, an excise inspector is posted at the factory for excise purposes, and the manufacturer is required to place raw materials, semi-processed and manufactured goods under the direct supervision of the excise inspector. The excise inspector checks the process of production, the entry of materials, etc. into the plant, and the output, testing the strength as well as the quantity. The inspector pays particular attention to all transfers of the product from the factory to the bonded warehouse or similar facility, and to transfers out of the bonded warehouse — the point at which excise becomes payable. The producer is required to send monthly and annual returns showing details such as production, sales, amount of excise duty paid and product stock, to the concerned department with the certified letter of the tax inspector posted at the factory. The goods cannot be removed from the factory premises and the warehouse without the prior approval of the excise inspector and payment of duties.

The physical control system, which is more expensive than the self-removal system from both an administration and compliance perspective, has not, however, been effective in controlling leakages in excise collection. In any event, the IRD has not been able to recruit a sufficient number of excise inspectors to monitor each factory and consequently only a few factories are under the physical control system. Furthermore, the excise inspectors that have been recruited are generally non-officer level employees who lack the necessary training and education required to effectively monitor and control production and sales. Moreover, one inspector might have to supervise more than one factory and, therefore, it is not possible for the inspector to be at each factory all the time. According to one businessman, two non-officer level tax inspectors are currently responsible for monitoring and controlling around 18 liquor factories in the Nawalparasi district.

It is considered, however, that if one inspector was recruited to monitor each factory, including the smaller ones, the cost of excise collection would be unacceptable, noting also the burden placed on the manufacturer who must provide accommodation, space and other amenities for the excise inspector. During field studies it was also observed that due to the need for excise inspectors to undertake office duties as well as factory inspections, the factory is often required to provide vehicle facilities to meet the excise inspectors' travel requirements. It is evident that the presence of an excise inspector at the factory creates inconvenience for manufacturers and furthermore, according to the business community, inspectors have been known to harass manufacturers both financially and mentally. In this regard, it was pointed out by the taxpayers during the focus group discussions that the cost became particularly high when malpractices in excise collection occur.

Realising all the problems identified above, at present both the tax administration and business community are in favour of replacing the physical control system with the self-removal system, hopefully within a period of between one and one and a half years. The replacement of the physical control system with a self-removal system should have a positive impact on revenue mobilisation. While most stakeholders are in favour of such a change, they recognise the need to improve the system of physical control until such time as the self-removal system is adopted. The potential areas of improvement under physical control system include:

- Recruiting the required number of excise inspectors in the factories
- Modifying the system of keeping raw materials, semi-processed and manufactured foods under the direct supervision of the excise inspector
- Directing more attention to those factories which pay comparatively more revenue to the government and simplifying the processes in other factories

- Simplifying the process of checking all stages, including production, entry of materials into the plant, transfer of the product from factory to bonded warehouse and output
- Training/orientating tax officers in order to reduce malpractices in tax collection.

It is considered that the transformation from the physical control system to the self-removal system should be implemented in two phases: a pilot basis phase and a national phase.

5.1 Phase I (pilot)

During the first phase, the transformation should be implemented in approximately 10 large factories based on the timeframe outlined in Table 6.

Table 6: Time framework to transfer physical control to self-removal system

S.N.	Activities	Time duration	Responsible agency
1.	Implementation of 'Excise Software' at fully-fledged level	6 months	IRD
2.	Development of 'Integrated Tax Software'	1 year	IRD
3.	Either recruit calibration technicians with IRD or replace flow meter with sticker system	6 months	IRD
4.	Uninterrupted internet accessibility at the factory for online networking	1 year	Factories identified for transformation
5.	Development of specific input-output formulas in the production process	3 months	IRD and Department of Industry
6.	Adoption of the enhanced/digital tax stamp scheme	2 years	IRD
7.	Enhance the capacity of tax officers through modern training packages	1 year, ongoing	IRD
8.	Enhance infrastructure in all factories including computers, printers, internet facilities, etc.	1 year, ongoing	Respective factories
9.	Enhance the capacity of human resources in all factories through modern training packages	1 year, ongoing	Respective factories
10.	Development of online networking among IRD, IROs and producing factories	1 year	IRD, IROs and respective factories
11.	Regular supervision of the factories by the tax officers	ongoing	IRD and IROs

5.2 Phase II (national)

Following successful implementation of the pilot, the system should be extended to all large factories, followed by medium and then small factories, based on their production capacity, annual turnover and tax paid.

A move to a self-removal system will also require several legislative changes. For example, there will need to be a legal mechanism to release goods into the market. The focus would also be on the IRD creating a set of 'standards' for excise businesses, which, at a minimum, would need to include:

- minimum requirements to obtain a licence – these should be stringent and only available to highly compliant businesses
- minimum level of recordkeeping systems from material purchasing through to sales into the market
- securities, bonds or guarantees to cover duty liabilities
- minimum security levels and features for licensed premises.

5.3 Control mechanisms in wine and cigarette industries

Sticker or tax stamps systems have been adopted by many countries worldwide as a way of ensuring taxpayer compliance by monitoring production and distinguishing licit excisable goods from illicit ones. Products that do not carry tax stickers are considered to be illegally produced or smuggled.

In recent years, some governments (for example, Turkey and Brazil, the State of California in the USA) have adopted a new technology for tax stamps in order to reduce the risks of counterfeit stamps, monitor domestic producers more efficiently, and increase the efficiency in information flow. The system requires manufacturers' compliance since monitoring scanners are placed at production facilities. Monitoring scanners read the tax stamps and electronically transfer the information to the Ministry of Finance. Consequently, the tax administration agency receives live information on the production, in which factories, what the brands are, when the products are produced by which factories, and other useful information for tracking, tracing and enforcement, thereby enabling tax administrators to verify manufacturers' compliance (WHO 2011).

Another alternative is a digital tax stamp. Similar to the banderole stamps, digital tax stamps provide an effective tracking and tracing system to reduce tax evasion. They carry information about the brand and manufacturer's name, the facility where the products are produced, and the time the stamp was produced and purchased, so that the product can be traced back to its source. The main difference between the two high-tech stamps is in the way they operate. With the banderoles, the Ministry of Finance receives all information live as the commodities are being produced. The digital system, on the other hand, requires distributors to place an order via a secure connection to a designated government authority. After the authority verifies and approves the order, the distributor fulfils the order by delivering encrypted codes and authorising digital stamps. However, it is not clear how the authority verifies the order. It is the distributors that print the digital stamps prior to shipping to retail outlets (WHO 2011).

According to the tax officers at IRD, the sticker system has been successful in increasing revenue collection. The cost of stickers is at a reasonable level compared to revenue collection. The cost-revenue ratio of a sticker related to excise duty is around one per cent. Since the sticker is also used to collect VAT and income tax, the cost of the sticker becomes around 0.4 per cent of the total revenue collection. However, there are some problems which need to be addressed, such as the poor quality glue used in the stickers, the lengthy procurement process (compared to the global tender scheme), the problems associated with the initially widespread use of duplicate/fake stickers (although this problem has since decreased considerably), the lack of trained human resources to identify duplicate stickers, and issues related to stickers which are reused several times to evade excise.

The government should also explore the new technology, track and trace (T&T). It allows for comprehensive details about production, sale and duty payments to be recorded in the stamp and be scanned at any point in the supply chain, so the status of goods can be verified and the point when they went 'missing' can be identified if there has been an attempt at tax evasion.

5.4 Control mechanisms in breweries

Another issue is the flow meter system which was introduced in breweries in the fiscal year 2008-09. The flow meter directive has various provisions, including the installation of flow meters, checking quality conditions, calibrating, licensing, repairing, assessment and monitoring, software and networking.

According to tax officers and the business community, the flow meter system has not been successful, the main reasons being:

- Installation of flow meters with inadequate preparation particularly without proper IT networking among factories, IROs and IRD
- Lack of interdepartmental cooperation
- Lack of training of tax officers
- Lack of ownership by the factory and management
- Lack of infrastructure
- Lack of technical human resources with Nepal Bureau of Standards for calibration processes
- Lack of initiation taken by manufacturers for undertaking repairs
- Failure to fully implement excise software.

Therefore, it is necessary to address these problems. It is essential to either recruit calibration technicians with IRD to ensure the proper functioning of flow meters, or replace the flow meter system with a sticker system, which has the benefit of a multi-stage monitoring mechanism comprising tax authorities, police and consumers.

5.5 Revenue leakage

Despite legal and administrative provisions to control leakage, the significant leakage and corresponding loss of revenue is frequently reported. Although it is difficult to quantify the extent of the leakage as there is no national survey conducted on excisable products, the IRD believes that the leakage amounts to more than 40 per cent annually. This significant proportion is attributed largely to the illegal production of low quality liquor at the domestic level, smuggling of foreign liquor and cigarettes in the domestic market, and lack of effective monitoring and follow up. The Auditor General has reported that: the licences of some of the manufacturers have not been renewed for five years and the department does not know their existence, indicating lack of monitoring and follow up; the recovery from tobacco to manufacturers for different brands is grossly underestimated; and the exemption of production loss during the production process is claimed by the manufacturer and is largely not verified by the IRD. Methods of excise evasion are: illicit distillation; selling alcoholic products without a licence; under reporting of production and sales; quantity and quality manipulation by not showing the actual record of raw material imports; local raw materials used in production; and removal of final products (Ghimire 2006).

Apart from excise evasion and leakages in liquor, there has also been leakage in other excisable products, such as self-removal products, and duplicate wine and cigarette imports from Tibet. Therefore, further studies are required regarding the magnitude of excise evasion and leakage in Nepal.

Attention must also be given to the risks of evasion through smuggling or illicit production. Smuggling is easiest for bulk goods of high value but may occur for a wide range of items where borders are long and lightly policed. In these conditions it may be advisable to hold tax rates close to those in neighbouring countries that might be a source of smuggling. Illicit production is a problem mainly in the case of beer, toddy, and distilled spirits. The difficulty of checking these items has caused some countries to refrain from taxing certain popular beverages with low alcoholic content that compete with commercial products at the margin and no doubt has caused taxes on the latter to be kept down (Goode 1986).

There is also a large number of liquor producers outside the tax net in Nepal which is believed to represent approximately 40 per cent of the total liquor production. Illicit production has negative impacts on health due to low quality while also causing a revenue loss. The major reasons behind the non-compliance are connected with traditional liquor consumption behaviour in the country, lack of monitoring and supervision by the concerned authority, a less than effective Illicit Liquor Production Control Committee and lack of public awareness.

6. Excise and Liquor Acts and Rules

Two relevant Acts and two associated Regulations are currently operational in Nepal: the Excise Act and the Excise Duty Rules 2002; and the *Liquor Act 1974* and Liquor Rules 1976. IRD, under the Ministry of Finance, is the government authority responsible for the proper implementation of these Acts and Rules.

The key provisions of the Excise Act 2002 relate to excisable products, collection methods, and exemption of excise duty, deputation of excise inspectors, licensing processes, regulating mechanisms and penalties for wrongdoers. The related regulations, the Liquor Rules 2002 include provisions relating to licences; collection of excise duty; withholding, auction and forfeiture of property and auction sale; power to forfeit product or property; functions, duties and powers of excise duty officers and licensees; and special provisions relating to cigarette and *bidi*, liquors and loaf-sugar and molasses.

Similarly, the key provisions of the Liquor Act 1974 relate to the production, sale and distribution, export and import of liquor; licences; powers of officers, penalties, forfeiture and sale of liquor and other goods; rewards and power to frame rules. The provisions of the associated Liquor Regulations 1976 relate to licence applications for production, sale and distribution, exporting and importing liquor; duration and renewal of licences; renewal fees; timing and restriction of liquor sales and distribution; and conditions for non-licence provisions.

Of the 18 articles contained in the Liquor Act 1974, almost all articles are more or less included either in the Excise Act 2002 or the Excise Duty Rules 2002. The Excise Act, in Chapter 7 under the heading of 'special provisions relating to liquors' has eight Articles, which define the various rules very clearly, with several of these special provisions having been derived from the Liquor Act. As there are negligible differences between the Excise Act and the Liquor Act, for the purposes of clarity and simplicity, it is considered appropriate to merge these two Acts and Rules in order to create a single piece of legislation.

7. Conclusions and recommendations

The study has identified two key issues. First, the physical control system is significantly more costly than the self-removal system in terms of both administration and compliance. Second, the non-officer level excise employees lack training and education and are unable to effectively monitor and control excise production and sales. It is therefore considered that an urgent need exists to replace the current physical control system with a self-removal system. In this regard, a phased approach is recommended, commencing with ten of the larger factories. In the meantime, options to simplify the complex arrangements associated with the physical control system should be examined, as well as options for improving control mechanisms relating to alcohol and tobacco, including the adoption of enhanced and digital tax stamps.

In addition, the need has been identified for further studies to be conducted into the magnitude of excise evasion and leakage. Finally, as many of the provisions of the Excise Act, Liquor Act and associated regulations are similar in nature, it is recommended that these be merged, thereby creating a single Excise Act in line with international practices.

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Uma Shankar Prasad

Dr Uma Shankar Prasad is Associate Professor at the Central Department of Economics, Tribhuvan University. Uma's PhD was awarded by the Centre for Economic Studies & Planning (CESP), School of Social Sciences, Jawaharlal Nehru University. He has contributed research papers to national and international journals and books on issues including fiscal federalism, globalisation and poverty. In 2012, he was a Guest Researcher at the Institute of Federalism, University of Fribourg, Switzerland, and has worked for the Government of Nepal, the UN system, bi-lateral and multi-lateral organisations and INGOs and NGOs.

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Section 2

Practitioner Contributions

Rwanda Electronic Single Window supports trade facilitation

Christian Nizeyimana and Luc De Wulf

Abstract

This paper provides an overview of the implementation of the Rwanda Electronic Single Window (ReSW) and its impact on trade facilitation since its introduction in 2012. In an effort to improve trading across borders, Rwanda's Doing Business Committee planned to implement the ReSW in the shortest possible time and appointed the Rwanda Revenue Authority (RRA) as the lead agency. An ReSW Steering Committee and project implementation team were established which included all stakeholders to ensure that the project addressed the broadest needs to achieve its goals. The use of the ReSW has resulted in reduced clearance times, and direct and indirect costs associated with international trade. Suggestions are offered in this paper about ways to further reduce time delays, for example, by critically reviewing the need to physically inspect a large part of cargo presently being inspected.

1. Introduction

The Rwanda Electronic Single Window (ReSW), since its introduction in 2012 has been a major force leading to facilitating international trade. Clearance times have been reduced, and both direct and indirect costs connected with international trade have been reduced as processes were re-engineered and simplified. Officials and private sector stakeholders are pleased with the outcomes. The ReSW provides a system that allows for the submission of a single declaration containing all information required by the various agencies responsible for controlling trade into and out of Rwanda and enables these agencies to inform traders and their representatives of the progress of the release process. The ReSW underwent a systematic evaluation in early 2015 as to its relevancy, efficiency, effectiveness and sustainability. This paper draws on this evaluation and provides insights that may be useful to other administrations as they evaluate the costs and benefits of introducing a Single Window as recommended by both the World Customs Organization (WCO) and the World Trade Organization (WTO).[1]

2. Why a Single Window?

For some time traders, government officials and international observers have become increasingly worried that high trade costs are hindering the expansion of exports, increasing the cost of trading and generally undermining the external competitiveness of the country. The growth ambitions of Rwanda, its objective for greater integration with the East Africa Community (EAC) as well as its objective to reduce poverty were increasingly viewed as being undermined by high trade costs. The high trade costs were clearly documented by the World Bank's 'Trading Across Borders' indices which are part of the widely circulated 'Cost of Doing Business' and in the World Bank's bi-annual publication 'Logistics Performance Indicators'.[2] For 2008, the 'Trading Across Borders' ranked Rwanda 166th out of 178 countries in the study. In the same year, its ranking on the Logistics Performance Index was 143rd out of 150. Establishing a Single Window was expected to reduce the cost of trade, hence improve these

rankings, and was consistent with the government's objective of making more government services available on line.[3] A feasibility study undertaken in 2008 suggested that the introduction of a Single Window with the adherence of the various border control agencies and the trader community combined with efforts to simplify operational procedures would achieve this objective.

3. What business model?

Rwanda had to make several decisions with respect to the managerial and operational details of the ReSW. Which agency would be in charge, would the Private Public Partnership (PPP) model be appropriate and cost effective, and which information technology platform would be adopted? The Rwanda Revenue Authority (RRA) was responsible for guiding the ReSW implementation. A team established for that purpose examined the various Single Windows that were operational at the time. When donor funding became available the advantages of the PPP model, which would have required compensation for capital invested by the private partner, became less attractive than a model under which the ReSW would be operated as a fully publicly owned entity.[4] Also the RRA, with donor backing, was believed to be fully capable of managing the implementation process. Five service providers were identified by RRA as potential vendors of a Customs Management System and a Single Window System with functionalities that would meet the primary requirements of the ReSW. Following an intensive due diligence exercise, UNCTAD's ASYCUDA World was selected and provided with a contract to replace/upgrade RRA's ASYCUDA ++ and to install it as the ReSW platform. ASYCUDA World is based on modern ICT technology (web, Java, etc.) that allows the implementation of e-Government and e-Business by interfacing the management information systems of the different agencies and stakeholders concerned.

4. Implementation process of the ReSW

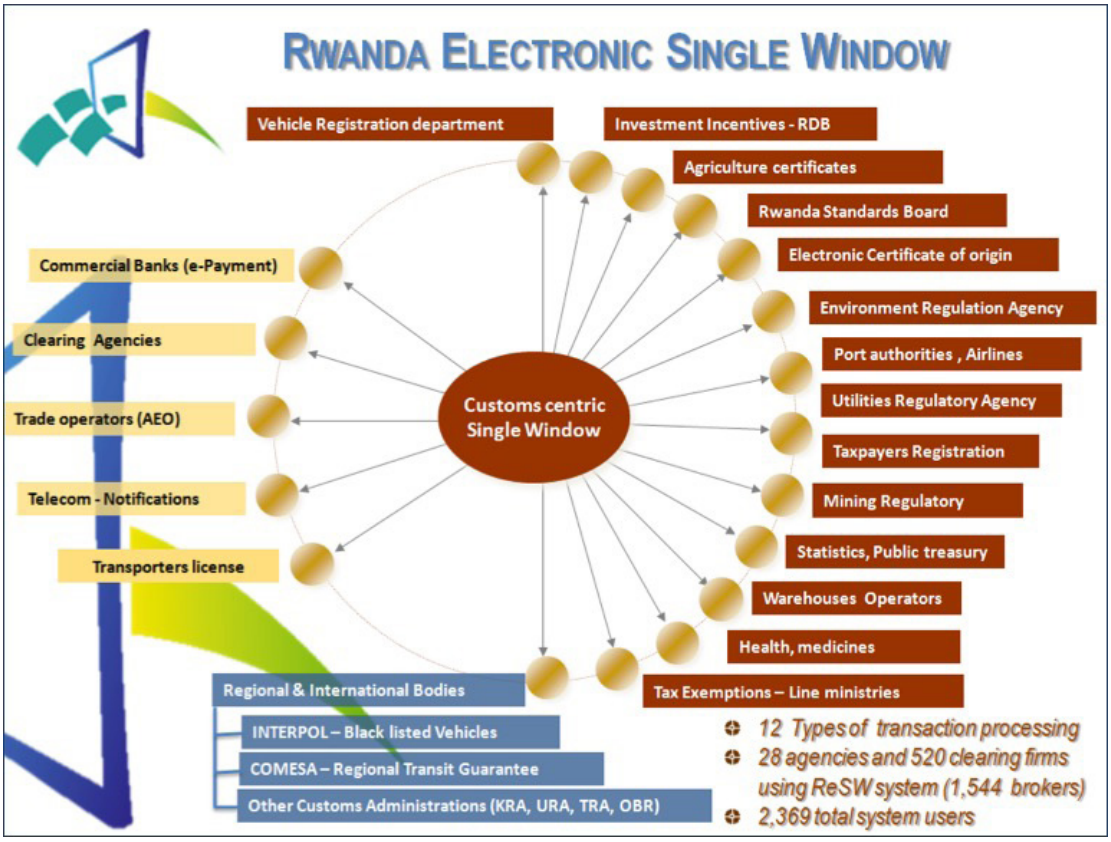
Rwanda's Doing Business Committee examined different ways of improving cross-border trade and decided to implement the ReSW within the shortest possible time and to appoint the RRA to spearhead its implementation as lead agency. An ReSW Steering Committee and project implementation team were established to guide the implementation process of the ReSW with all stakeholders obtaining representation on the Steering Committee.

A hybrid approach was applied to implement the ReSW. For all stakeholders an interface with ReSW was to be made available. However, in 2012, those ReSW stakeholders that did not yet have a computerised environment were provided with direct access to the ReSW using an integrated approach that was to be upgraded to an interfaced approach once agencies acquired adequate computerised systems.

The legal framework for the operation of the ReSW is based on the legislation pertaining to electronic messages, electronic signatures and electronic transactions. In order to establish administrative agreement on implementing the ReSW, Memoranda of Understanding between the RRA and the various stakeholders were signed. Internet connectivity at times caused access delays, a factor that gradually receded with the build out of stronger internet connections. During the piloting stage of the ReSW that started in February 2012 the following agencies were selected as official stakeholders in addition to the RRA: (i) Rwanda Development Board (RDB) which regulates investment incentives, (ii) Rwanda Standard Board (RSB), (iii) Ministry of Health (MOH) – and one private company that manages a public bonded warehouse. The piloting started with the Gikondo office, which is the Customs office handling the majority of cargo destined for Rwanda, with all clearing agencies operating at this office. The MOH however, was unable to participate in this startup of the ReSW and it is still lagging behind. Mid-2012 saw the launch of the notification system and registration process, whereby traders could receive notification of the progress of the clearance of their consignment by the ReSW. Comprehensive

training of all clearing agents, customs staff and other involved stakeholders, as well as an awareness campaign for the trading community, preceded the roll out. A communications expert assisted the RRA in developing the communication strategy. By the end of 2012, the roll out to all Customs offices was completed and the development of electronic payment arrangements with the main commercial banks operating in Rwanda had also been implemented. The number of agencies implementing the ReSW has been gradually expanded. Figure 1 provides a systematic overview of the ReSW structure as envisaged at the outset. Currently, the ReSW has 12 types of transaction processes, which have been implemented by 28 agencies and 520 clearing firms operating in Rwanda and the EAC in general. System users now total 2,369. Table 1 provides details of existing arrangements while Table 2 indicates the operations that are to be incorporated in the near future.

Figure 1: Rwanda Electronic Single Window design when fully rolled out



Source: Nizeyimana 2015.

Table 1: Rwanda Electronic Single Window stakeholders operational in early 2015 and pending

ReSW Process	Agencies/Department	Key features
Investment incentives management	• RWANDA DEVELOPMENT BOARD	Online application and approval of investment registration according to investment sector Online application and approval of exemption on importation
Bonded Warehouse Operator	• MAGERWA	Transmission of manifest information into MAGERWA system Receiving tally report on warehouse goods Automatic generation of Arrival notice
e-Payment	• BANK OF KIGALI • I&M BANK • ACCESS BANK • ECOBANK • MOBICASH • MOBILE MONEY (MTN) • TIGO CASH (TIGO)	Sharing of payment details with commercial bank; Use of internet or mobile banking to pay customs declaration Receiving payment notification from commercial bank Automatic payment of customs declaration
e-Exemption	• MINAFFET • MINAGRI • MINALOC • MINEDUC • MININFRA • RWANDA GOVERNANCE BOARD • SPECIAL ECONOMIC ZONE AUTHORITY	Online application and approval of tax exemption on importation Management of different work flow depending on different structure of involved ministries or agencies Linked exemption approval or rejection with customs declaration
Integrated Risk Management	• RWANDA STANDARDS BOARD • RWANDA AGRICULTURE BOARD	Integrated risk management for all government agencies carrying out any sort of inspection Simultaneous risk selectivity triggering that allows joint inspection Enforce the control so that no release of goods can be done unless all involved agencies finalise inspection
Agriculture (e-Phytosanitary and Import permit)	• RWANDA AGRICULTURE AND LIVESTOCK INSPECTION AND CERTIFICATION SERVICES (RALIS)	Exporter/Importer applies for phytosanitary certificate using RALIS e-portal After approval, ReSW receives electronic phytosanitary certificates Write-off approved quantity as customs declaration is processed

e-Cargo manifest	• KENYA REVENUE AUTHORITY • TANZANIA REVENUE AUTHORITY	ReSW receives electronic information of cargo manifest destined for Rwanda from shipping via coast countries (KRA or TRA) Clearing agent accesses manifest information into ReSW
Taxpayer Registration	• RWANDA DEVELOPMENT BOARD • TAXAPAYERS REGISTRATION DEPARTMENT	Automatically receives Taxpayers' Identification details for companies registered by Rwanda Development Board (for companies) or Domestic Tax department (for individuals)
Black listed Motor vehicles	• INTERPOL	Back end process that allows ReSW to transmit declared motor vehicle to Interpol for check if it is not black listed If any motor vehicle is found, notification is sent to Interpol
Motor vehicle Registration	• MOTOR VEHICLE DEPARTMENT	Transmit electronic information from customs declaration to motor vehicle department; After assignment of vehicle number plate and log book, information is shared with Customs for release of vehicle
Notifications	• MTN (Tel Com) • Mail (RRA Mail server)	Empower both SMS and e-mail notification for all ReSW transactions (Application, approval, rejection, etc.)
Transit Guarantee Management	• COMESA	Transmission of information on every transit transaction to COMESA Regional Customs Transit Guarantee system Electronic issuance of carnet

Table 2: Rwanda Electronic Single Window, pending operation

ReSW Process	Agencies/Department	Key features
Pharmacy regulatory	• MINISTRY OF HEALTH	Online request and approval of operational licence Online request and approval of visa Online request and approval of import licence Integrated import licence with customs declaration
e-Certificate of origin (e-CoO)	• RULES OF ORIGIN SECTION	Online request and approval of e-CoO Information transmission to importing country
Other export certificates	• NAEB	Online application and approval of permit to export Tea and Coffee from Rwanda
Mining Certificate	• OGMR	Online application and approval of permit to export mineral from Rwanda
Utilities Regulatory	• RURA	Online application and approval of type approval Automatic checking of type approval *vis a vis* declared goods in Customs
Mobile Customs Declaration	• Small Cross-border traders	Pre-lodgment and payment of customs declaration for small cross-border traders before arrival at the border

Source: Nizeyimana 2015, prepared for this report.

5. Operation of ReSW drastically reduced release times

The 2012 project documents identified a lack of proper communication between importers and the various border control agencies as the major reason for the lengthy release times observed. The ReSW's first objective was therefore to improve communications amongst all key players in the clearance process. The aim of the project was to reduce the overall clearance times – defined as the time elapsed between arrival of the import cargo at the border to removal from customs control (excluding transit time) – from 2 days 10 hours to 1 day 9 hours, that is, by 1 day and 1 hour or 42%. Time between lodgment and release was to fall by 6 hours, or 48%, from 12 hours 33 minutes to 6 hours 33 minutes.

The RRA valuation of the ReSW undertaken in early 2015 drew on the ASYCUDA data and calculated the time taken between the customs registration and the actual release from customs control.[5] At the end of 2014 the release time for imports had been reduced drastically from 2 days 18 hours to 1 day 15 hours or by 40%, and from 2 days 16 hours to 1 day 4 hours or 55% for exports (see Figures 1 and 2 and Tables 3 and 4). These Figures and Tables provide detailed data on the time taken in the various stages of release, that is, between registration and payment, between payment and acceptance, between acceptance and release and between release and exit. In addition to the introduction of the ReSW some other minor changes were introduced to the import and export process, yet it is clear that most of the reductions in release time were due to the various process improvements made possible by the introduction of the ReSW.

Table 3: Import release times 2010-2014 (in minutes)

Import	2010	2011	2012	2013	2014	Per cent change 2014 over 2010
Registration to Payment (Average)	826	857	787	752	604	-27
Registration to Payment (Std Dev)	*1,219*	*1,221*	*1,330*	*1,279*	*1,163*	*-5*
Payment to Acceptance (Average)	467	387	456	600	597	28
Payment to Acceptance (Std Dev)	*955*	*847*	*1,012*	*1,387*	*1,400*	*47*
Acceptance to Release (Average)	1,808	2,278	912	921	620	-76
Acceptance to Release (Std Dev)	*1,930*	*2,220*	*1,601*	*1,607*	*1,343*	*-30*
Release to Exit (Average)	838	789	845	659	544	-35
Release to Exit (Std Dev)	*1,188*	*1,166*	*1,461*	*1,384*	*1,300*	*9*
Registration to Exit (Total Time)	**3,939**	**4,310**	**3,001**	**2,931**	**2,365**	**40**

Source: Data extracted from the ASYCUDA database by the authors.

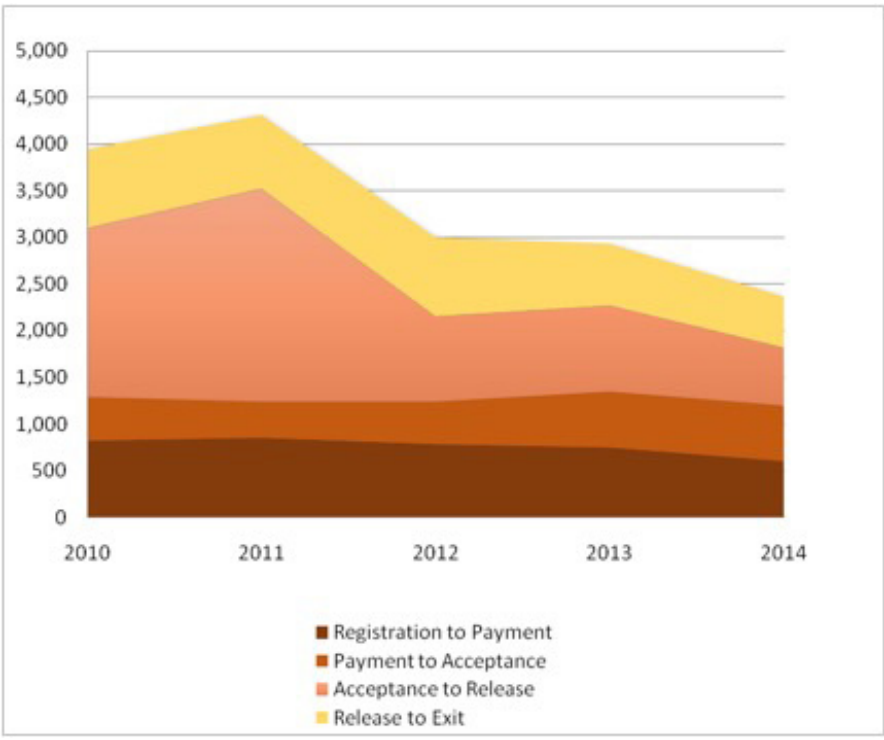
The time between registration and payment was reduced by 27% as use of the e-payment facility enables the importer to effect payment **directly** using internet or mobile banking as opposed to the previous method of requesting information from a clearing agent, filling bank cheques, requesting cheque certification and queuing at the bank counter for payment processing.

Time between payment and acceptance rose by 28% due to the centralised validation process undertaken by the RRA. The RRA is considering reviewing this process to provide a greater level of facilitation.

The time between acceptance and release fell by 65% as a result of the implementation of integrated risk management strategies by the various government agencies. Previously, each control agency carried out its inspection independently but now inspections are undertaken jointly as the system assigns risk selectivity ratings for all involved agencies, thereby greatly enhancing communication between Customs officers, clearing agents and importers. The RRA also automated the work flow between verification officers, valuation and tariff sections.

Release to exit experienced a reduction of 35% due to the real time notification to importers, thereby enabling importers to remove their cargo much faster than before.

Figure 2: Import release times, 2010-2014 (in minutes)



Source: Data extracted from the ASYCUDA database by the authors.

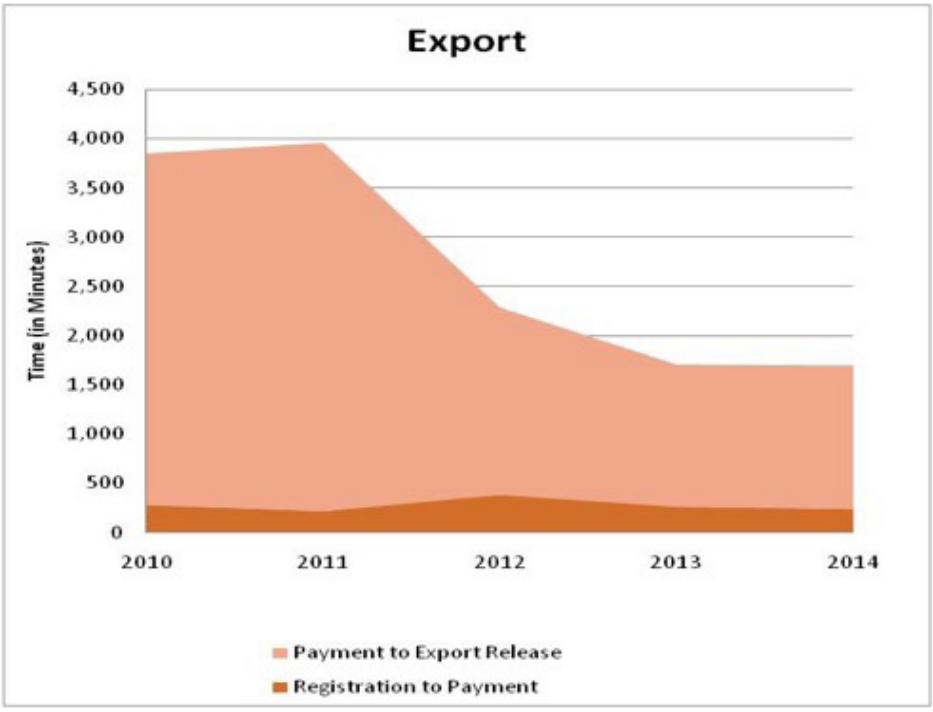
The overall time to process export from lodging an export declaration to exit of cargo at the border has been improved by 55% due to simplification of export document processing, fee payment and export permit arrangements. We expect this time will be further reduced with the implementation of initiatives such as the electronic certificate of origin and mineral export permit. Since most exports from Rwanda are coffee and tea, the integration of the National Agricultural Export Development Board (NAEB) into Single Window processing should reduce this time even further.

Table 4: Export time release, 2010-14 (in minutes)

Export	**2010**	**2011**	**2012**	**2013**	**2014**	**Per cent change 2014 over 2010**
Registration to Payment (Average)	283	221	387	266	243	-14%
Registration to Payment (Std Dev)	*525*	*483*	*1,029*	*666*	*660*	*26*
Payment to Export Release (Average)	3,564	3,735	1,899	1,443	1,456	-59
Payment to Export Release (Std Dev)	*2,378*	*2,696*	*1,984*	*2,038*	*2,051*	*-14*
Registration to Exit Release (Total Time)	**3,847**	**3,956**	**2,286**	**1,709**	**1,699**	**-55**

Source: Data extracted from the ASYCUDA database by the authors.

Figure 3: Export time release, 2010-2014 (in minutes)



Source: Data extracted from the ASYCUDA database by the authors.

A major saving in the implementation of the ReSW is due to the removal and/or reduction in the physical movement of documentation between the different stakeholders. Such time consuming movements included the filling of application forms, dealing with traffic congestion to deliver the forms to different agencies, security checks and communication difficulties between applicants and the approving authority. For instance, to obtain tax exemptions granted by the Rwanda Development Board (RDB) a clearing agent was required to fill an application form manually and submit it to the RDB for approval after endorsement by the investor. Due to the distance between the Customs office, clearing agency, importer premises and the RDB, this could take a full day to complete. With the introduction of the ReSW, an online application can be made at the time the clearing agent processes the customs declaration. Half the applications submitted to the RDB presently take only one hour, with some taking less than 15 minutes.

6. Standard deviations of release time suggest a problem!

Tables 2 and 3 also provide the standard deviations for the release times per release stage. This is valuable information that is rarely presented in reports on the ReSW performance. When the standard deviations are very large, as is the case in Rwanda, the release time an importer or exporter can expect depends less on the average itself than on the type of goods traded. This is because some goods experience much longer release times than the average. Traders are interested not only in the average time taken to release the goods but also an assurance that the time taken to clear goods is predictable. With very large standard deviations this predictability is undermined and traders need to adjust for this uncertainty by building up larger inventory levels, which is costly.

The significant standard deviations are caused by a number of factors. Traders may delay payments for a variety of reasons, and operational issues on the RRA side may result in delays. On the RRA side, one of the major causes of the large standard deviations results from the inspection process and risk assessment system. Goods which must go through the red channel (high risk) require significantly more time than goods through the green channel, which tend to be released very quickly (Table 5).

Table 5: Rwanda Revenue Authority: risk management by channel 2010-2014

	2010				2011				2012				2013				2014			
Selectivity Channel (%)	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	Q1	Q2	Q3	Q4
GREEN	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	3%	4%	5%	6%	7%	8%
BLUE	54%	35%	57%	62%	59%	59%	58%	55%	50%	50%	53%	47%	60%	54%	58%	57%	61%	56%	53%	49%
YELLOW	8%	6%	10%	8%	7%	7%	7%	7%	12%	9%	12%	9%	6%	6%	8%	8%	8%	9%	11%	11%
RED	26%	19%	19%	18%	29%	28%	28%	29%	27%	26%	27%	25%	25%	32%	23%	24%	20%	27%	23%	27%
NON CHANNEL	13%	40%	15%	12%	5%	6%	7%	9%	11%	14%	8%	19%	9%	9%	8%	7%	6%	2%	6%	6%
TOTAL	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Data extracted from the ASYCUDA data base by the authors

The percentage of cargo inspected by the RRA using the red channel (requiring physical inspection) has remained largely constant since 2010, at about one quarter of total imports. In early 2014, the inspection of these goods took 29% longer than for cargo inspected through the yellow channel and 275% longer than for cargo classified as blue. Green channelled cargo is released even faster than the blue as it undergoes no document or physical inspection. One method to reduce the release time (as well as the standard deviation for release time) for the RRA and the relevant OGAs is to critically review the need for physical inspections.

The RSB inspected 14% of total cargo in 2010, of which 74% was channelled through the red channel (Table 6). By 2014, the RSB tightened its inspection procedures and inspected a total of 42% of all cargo, with about 70% being channelled through the red channel. This intensification of the RSB's inspections clearly increased overall release times.

Table 6: Rwanda Standards Board: risk management data 2012-2014

YEAR	RED		YELLOW		BLUE		Total RSB targeted	Total Commodities	Percentage of RSB targeted to total imported commodites
	Number	Percentage	Number	Percentage	Number	Percentage			
2012	32,575	74.14%	1,226	2.80%	9,963	22.76%	43,764	307,694	14.22%
2013	69,459	65.20%	17,039	15.99%	2,002	18.79%	106,518	312,400	34.10%
2014	99,700	70.30%	29,415	20.74%	12,696	8.95%	141,811	332,561	42.64%

Source: Data extracted from the ASYCUDA database by the authors

7. Conclusions and the way forward

Data suggest that the ReSW has made a major contribution to the trade facilitation agenda of Rwanda. Time needed to import and export has been substantially reduced, thus increasing the external competitiveness of the country. More progress could be made if special attention were to be given to the following issues:

- Continue to expand the list of stakeholders of the ReSW and the operations covered (certificates of origin and mobile payment, Ministry of Agriculture and related agencies regulating tea and coffee exports).
- The RRA to continually review its risk management practices to reduce the number of imports that are earmarked for physical inspection. The outcomes of the various inspections undertaken could be analysed to modify the risk profiling embedded in the ASYCUDA program.
- The RSB, which greatly increased its intensity of physical inspection in recent years, could similarly review how to implement its mandate without slowing trade flows. As suggested for the RRA, the RSB could analyse the productivity of its interventions with an eye to reducing them. The Authorised Economic Operator concept that was recently initiated by the RRA would assist.
- Address the poor trade logistics and in particular high transport costs which hinder external competitiveness as they represent a higher impediment to Rwanda's external competitiveness than slow release time at the border.

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Notes

1 World Customs Organization 2008; World Trade Organization 2013, Article 8, section 4 notes: 'Members shall endeavor to establish or maintain a single window, enabling traders to submit documentation and/or data requirements for importation, exportation, or transit of goods through a single entry point to the participating authorities and agencies' (December).

2 Various issues of the World Bank's *Doing Business* and 'Connecting to compete: trade logistics in the global economy'.

3 For a systematic overview of the process of introducing an electronic single window, see Siva 2011, pp. 125-45.

4 USD3.3 million donor funding was mobilised and channelled through TradeMark East Africa, an East African not-for-profit company limited by guarantee, established in 2010 to support the growth of trade – both regional and international – in East Africa. TradeMark East Africa is focused on ensuring gains from trade result in tangible gains for East Africans.

5 To eliminate extreme time release data which do not reflect normal business practices of the border control agencies, the exercise eliminated all time release data that exceeded 7-day events which in all likelihood refer to extremely slow release due to bankruptcy or death of the importer or the clearing agent or other exceptional circumstances.

Christian Nizeyimana

Christian Nizeyimana is head of Customs operational policy and business development in the Rwanda Revenue Authority. He is responsible for the successful implementation of the Rwanda electronic Single Window and in that capacity coordinated the project implementation team and other agencies implementing the Single Window system. Christian is a member of the Technical Working Group tasked with the implementation of the Single Customs Territory for the East Africa Community. He also led the introduction of the risk management function in Rwanda Customs.

Luc De Wulf

Dr Luc De Wulf obtained a Licentiaat-doktorandus degree in economics from the Katholieke Universiteit Leuven, Belgium (Lic.Doc) and a PhD from Clark University, Worcester, MA, USA. He taught economics at the American University of Beirut, Lebanon, before joining the International Monetary Fund in 1972. In 1984 he moved to the World Bank where he worked on Africa and the Middle East. After his retirement in 2000, Luc worked as a consultant in the areas of trade facilitation and customs modernisation. He was the main editor of *Customs Modernization Initiatives: Case studies* (2004) and *Customs Modernization Handbook* (2005), both published by the World Bank, Washington, DC.

Political will as an enabler for a customs administration to implement coordinated border management: a practical example

Theo Colesky and Roux Raath

Abstract

This article considers the important role played by customs administrations in the context of a practical example that entails the awarding of a multinational project spanning various countries. It demonstrates that it is not only a country's public and private business enterprises that would be adversely affected by inadequacies in the administration of customs matters but also a region as a whole. In this case, it was found that, although the way in which customs matters are managed in South Africa could *prima facie* have contributed to the country (and region) not being awarded the project in its entirety, the actual findings indicated that the customs administration itself was not responsible for the low score attracted under the Customs and Excise assessment heading of the practical example. Instead, many of the findings merely related to logistical issues within a wider operational framework where a customs administration is but one role player amongst many. Subsequently, the focus turned to a current customs topic, namely coordinated border management and its critical success factors, in particular political will, in order to determine if more could have been done by the South African government towards full implementation. This revealed what the government has achieved in this regard over the past two decades. Furthermore, it was again reiterated that the South African customs administration is only one part of the government's administration. Effective customs administration is entirely dependent on political will and a whole-of-government approach, that is, a truly coordinated approach to border management.

1. Introduction

According to the World Customs Organization (WCO) the responsibilities of a customs administration are revenue collection; national security; community protection; trade facilitation; and collection of trade statistics (WCO 2007, p. 6). This results in a vast and challenging environment within which customs officers must perform their duties, and where a responsibility is placed on a customs administration as an important enabler of economic growth, social development, and national security (Colesky 2014, pp. 2, 44). Uncertainty in relation to customs procedures could result in an increase in costs which is passed on to the consumer, or could act as a disincentive to potential investors (International Trade Centre 2013, p. 1).

This article analyses a practical example, namely the awarding of the Square Kilometre Array (SKA) Project, to determine the importance and role of a customs administration in relation to coordinated border management (CBM).

2. The Square Kilometre Array (SKA) Project

The SKA is an international project that aims to build a radio telescope tens of times more sensitive and hundreds of times faster at mapping the sky than today's best radio astronomy facilities. In simple terms, the SKA Project will construct the world's largest radio telescope with a square kilometre of collecting area, and will deliver new and unparalleled insight into the universe (SKA n.d., Frequently Asked Questions). The Project is by any measure impressive and carries immense prestige in scientific circles across the globe. According to the SKA (SKA 2015), the telescope 'will allow scientists to look far back into the history of the universe and will give much more detail than before on how the universe has evolved over 14 thousand million years. More information will be obtained on how stars, galaxies and clusters of galaxies formed and how they have changed since the Universe was young'.

The Project has a truly international footprint and whilst organisations from eleven member countries (Australia, Canada, China, Germany, India, Italy, New Zealand, South Africa, Sweden, the Netherlands and the United Kingdom) form the core of the SKA Project, around 100 organisations from some twenty-one countries (that is, the eleven member countries plus Brazil, France, Japan, Malta, South Korea, Poland, Portugal, Russia, Spain, and the United States of America) were involved in its design and are continuing to play a role in relation to the Project (SKA n.d., Participating Countries).

Both South Africa and Australia competed to become the site location for the SKA telescope. From a South African perspective, Deputy President Ramaphosa (McDonald 2015) said that the SKA forms part of efforts to transform the economy through human capital development, innovation, value addition, industrialisation and entrepreneurship. He also made reference to job creation, not only during the next decade of construction but also over the next fifty years of operation.

The SKA Project is cited as a case study in this article when evaluating South Africa's CBM status and efforts against the SKA Site Advisory Committee's (SSAC) findings.

2.1 Selection criteria

According to Taylor (2012) the SKA Project Development Office evaluated various submissions and expert reports in order to determine the location (or locations, as it turned out) for the Euro1.5-billion SKA Project. Both South Africa and Australia had submitted final reports where technical factors, for example, levels of radio frequency interference and the long-term sustainability of a radio quiet zone, accounted for 75 per cent of the overall score, and non-technical factors, for example, security aspects and customs considerations, accounted for 25 per cent of the overall score.

Table 1 illustrates the seventeen factors (although four carried no weight) used to evaluate the bids. As can be seen, the evaluation of customs and excise accounted for 6 per cent of the overall score.

Table 1: Selection criteria: factors and weights

Factor #		Factor Name	Weight (%)
A	1	Ionospheric turbulence	21
	2	RFI measurements	27
	3	Radio Quiet Zone protection	
	4	Long-term RFI environment	
	5	Array science performance	17
	6	Physical characteristics of the sites	5
	7	Tropospheric turbulence	5
B	8	Political, socioeconomic, and financial	2
	9	Customs and excise	6
	10	Legal	3
	11	Security	3
	12	Employment	6
	13	Working and support environment	5
C	14	Provision and cost of infrastructure components based on the Model of the SKA	N/A
	15	Provision and cost of internal and external data transport based on the Model of the SKA	N/A
	16	Provision and cost of electrical power based on the Model of the SKA	N/A
	17	Consolidated costs of capital and operations expenditures	N/A

Source: Moran et al. 2012, p. 8.

The Report and Recommendation of the SKA Site Advisory Committee (the Report) states that:

> The SSAC vote for the Category A and B Factors favored RSA [South Africa] with scores of 9.60 ± 0.09 for ANZ [Australia and New Zealand] and 10.40 ± 0.09 for RSA, on a scale where 10–10 represented no significant difference and 20–0 represented very serious differences (Moran et al. 2012, p. 4).

South Africa was favoured in five of the seven Technical and Scientific Factors, but Australia and New Zealand were favoured in all six of the 'Other Selection Factors' (that is, non-technical). According to the Report (Moran et al. 2012, p. 4), in so far as South Africa's bid is concerned, 'much of the concern in these Factors derived from the difficulties of coordinating the laws and procedures among the six partner countries in southern Africa, as well as the security and political challenges in the region'.

In the Report (Moran et al. 2012, p. 108), under the Customs and Excise Factor assessment, the Australia/New Zealand proposal was awarded a score of 13.3, and for South Africa 6.7. The SSAC was of the opinion that 'the ANZ proposal presented a better customs, excise, tax, and regulatory structure for the construction and operation of the SKA and that siting the SKA in ANZ would be simpler and less costly' (Moran et al. 2012, p. 108).

2.2 Specific findings in relation to Customs and Excise

Due to volume limitations, only the Report's findings, as well as subsequent references therein to a KPMG Expert Report, are cited for purposes of this article. In the Report it is stated, as an introduction to the Customs and Excise Assessment, that:

> The SSAC reviewed the various customs systems and duty rates, the excise tax regimes and tax rates, and related issues such as import and export processes that will impact the SKA over its lifetime. A wide range of issues was considered since the SKA involves a large multinational investment of funds, materials, and services, including the provision of scientific and technical equipment, and personnel in various remote locations (Moran et al. 2012, p. 108).

It is further held that high level requirements for Customs are to ensure the 'prompt, efficient free movement of goods, products, and personnel in and out of any sites and countries hosting the SKA…' and to 'minimize the impact of any type of taxes, customs duties, administrative and shipping costs, GST [General Sales Tax], VAT [Value Added Tax], and other taxes' (Moran et al. 2012, pp. 108-9).

Based on the Report's Customs and Excise assessment (Moran et al. 2012, pp. 108-110), the considerations and findings were categorised, by the authors, under three headings, namely:

(a) Diverse geographic locations and different jurisdictional requirements, supported by trade agreements
(b) Tax and duty structures, and certainty
(c) The ease of doing business.

(a) Diverse geographic locations and different jurisdictional requirements, supported by trade agreements

The SSAC makes reference to and draws a clear distinction between the 'six diverse RSA member countries; cross-border coordination and logistical issues presented by the RSA proposal; and the diverse customs, excise, and regulatory structures in the two candidate sites' (Moran et al. 2012, p. 108). The Report assessed that the various (or many) members' involvement in the South African consortium could lead to increased complexity with regard to 'transit, export, import, customs, logistical procedures; valuation issues; and related issues' (Moran et al. 2012, p. 109). As an example, the Report cited the shipment of goods from South Africa via Zimbabwe (a non-SKA member) to Zambia, claiming that the cross-border movement could be complicated as a result of Zimbabwe being an intermediary.

In contrast, the Australian consortium has only two members and the Report favourably considers this as it will drastically reduce the complexity and costs of moving people and goods. This is, in part, based on the previously mentioned KPMG Expert Report's findings in which it is held that 'the multiple jurisdictions create the problem that "the complexity of the indirect tax considerations has increased with each [additional] jurisdiction." The Report also noted that "the considerations and potential impact of this appear to be limited to the movement of goods directly between South Africa and relevant satellite countries rather than third countries, and [the RSA proposal] does not consider the other complexities that this raises"' (Moran et al. 2012, p. 109).

The Report also alludes to the Southern African Customs Union (SACU), but states that it has 'limited scope' (Moran et al. 2012, p. 109). The Report is, however, much more positive about the longstanding Australia–New Zealand Closer Economic Relationship Trade Agreement (ANZCERTA) which 'allows for the free flow of goods, services, and people between Australia and New Zealand, and if the SKA is sited only in Australia, the project will be governed by only one country's laws and regulations' (Moran et al. 2012, p. 109). The Report again cites the KPMG Expert Report which stated: 'It is unclear at this time if prompt customs clearance is available across the geographical reach of the [RSA] candidate jurisdictions' (Moran et al. 2012, p. 110).

(b) Tax and duty structures, and certainty

The KPMG Expert Report, cited in the Report (Moran et al. 2012, p. 108), refers to a wide range of customs and non-customs tax considerations, in both the South African and Australian proposals, and to a review undertaken of the respective VAT, GST, import duties and processes, customs duties and tariff rates, excise duties and taxes, and import and export restrictions.

It is noted that at time of the SSAC making its recommendations, no written confirmation was received from the South African consortium that no VAT or GST will be charged on the SKA in South Africa or its partner countries, despite the South African delegation stating that it had approached the tax authorities in South Africa regarding a possible VAT exemption. In contrast, the Report states that the Australian government submitted written confirmation that there will be no GST payable by the SKA Project in Australia. The Australian Tax Office also confirmed its willingness to 'provide guidance and assistance in establishing the optimal no-tax or low-tax financial structure for SKA operations if Australia is selected' (Moran et al. 2012, p. 110). Insofar as import (customs) duties are concerned, it is stated that the rates 'have fallen steadily in Australia [over time] with most imported goods attracting a rate of between zero percent and five percent', whereas duty rates in South Africa 'range from 0% and 20%' (Moran et al. 2012, pp. 109-10) on the majority of products.

(c) The ease of doing business

The Report referenced the World Bank's authoritative compendium 'Doing Business 2012: Doing Business in a More Transparent World', which produces an analysis with regard to the complexity in doing business with countries worldwide. At the time of evaluating the bids, the World Bank ranked 'Australia as number 10, New Zealand as 15, and South Africa as 35 for providing a business, legal, and commercial environment in which operations may be conducted' (Moran et al. 2012, p. 110). Again quoting from the KPMG Expert Report, the Report noted that "Australia's trade policy framework continues to be characterized by an unusually high degree of transparency" and mentioned the World Trade Organization's (WTO) April 2011 Trade Policy Review which identified that Australia is "one of the most open economies in the world" (Moran et al. 2012, p. 109).

It is interesting to note that in the World Bank's 'Doing Business 2015: Going Beyond Efficiency', Australia (World Bank 2015, p. 169) is still ranked at number 10 (out of 189) in terms of its ease in doing business with. New Zealand (p. 207) has improved its ranking and is now placed at number 2 overall, but South Africa's position (p. 218) has worsened to number 43. More significantly, in the same compendium (on the evenly numbered pages) various factors are weighed under the sub-heading 'Trading Across Borders' (that is, a sub-set of the weights that add to the overall score of a country). Aspects such as the number of documents to export/import; days to export/import; and the costs in United States dollars to export/import a container are considered. Australia is ranked at number 49, New Zealand at number 27, and South Africa at number 100.

Comments: SKA

Having reflected on the Report's Customs and Excise findings, it is opined that most of the findings fall well outside the mandate of a customs administration. Under a 'Customs and Excise' heading, one would have expected findings relevant only to specific **customs** functions, and not general logistics and/or other government functions. It is the authors' opinion that the South African customs administration may have attracted unfavourable scores as a result of this. However, since the same non-specific considerations were applied to Australia, this is nullified.

The number of role players in the South African consortium, when compared to the Australian consortium (six versus two), adds to the view that the complexity of moving a consignment increases every time it crosses a new jurisdiction/border, especially where there are no established trade agreements. This may well be the case, but it bears mentioning that a customs administration is generally not mandated

to negotiate trade agreements on behalf of the government, where this usually falls within the scope of a department specifically mandated to deal with foreign affairs/international relations and/or economic development.

It is also not disputed that higher duties lead to increased costs, but again tax and duty rates are usually set by a national treasury, or a department for trade/economic development, and not by a customs administration. However, in order to ensure tax certainty, written confirmation from a government on matters such as tax and duty rates, and subsequent rebates, renders an advantage over a 'competitor' where government is silent, or still in the process of finalising its position.

The 'Ease of Doing Business' finding in the Report speaks less to customs efficiency, and more to a country's overall ranking in terms of its overall ease of doing business where a wide range of factors is considered. To a large degree, lesser relevance was placed on customs operational competence and more on non-customs-related aspects.

In an attempt to establish what the South African government, and in particular the customs administration, could have done to attract a higher score under the SKA Customs and Excise assessment, the roles and responsibilities of a customs administration have to be considered. For the purpose of this article the focus falls on trade facilitation in South Africa, in particular how it contributed (or could have contributed) to the SKA Project evaluation.

3. Trade facilitation

Within a customs context trade facilitation is considered as a way to improve a country's competitiveness by reducing bureaucracy in customs transactions. The WCO (www.wcoomd.org) defines trade facilitation as 'the avoidance of unnecessary trade restrictiveness', while the WTO (www.wto.org) defines it as the 'simplification and harmonization of international trade procedures'. Grainger (2008, p. 17) adds 'standardisation and modernisation' to this definition.

The WCO contributes towards trade facilitation through its instruments, specifically the *International Convention on the Simplification and Harmonization of Customs Procedures* or Revised Kyoto Convention (RKC) (WCO 1999). Accordingly, customs administrations are supported in achieving a balance between statutory functions, regulatory control, and trade facilitation. South Africa is a member of the WCO and has acceded to the RKC – thus accepting and implementing the minimum standards.

The WTO also contributes to the formalisation of trade facilitation by way of a formal agreement, namely the Trade Facilitation Agreement (TFA) which is yet to come into force. It has, however, been found that the RKC and the TFA have many overlapping provisions, and that the existing WCO instruments make more than adequate provision for all the provisions covered in the TFA. In fact, 'an updated RKC would even be more modern and comprehensive than the TFA' (Wolffgang & Kafeero 2014, p. 36). Regardless, the WCO instruments are considered to be compatible with, and complementary to, WTO agreements. The difference is that the WTO agreements 'set out the high principles for trade facilitation such as simplification, harmonization, transparency, partnership, cooperation and risk management', while the 'WCO instruments provide an administrative basis and practical guidance to ensure their effective implementation' (WCO 2011, p. 13).

In practice trade facilitation is enhanced by tools and concepts, including the Time Release Study tool; a Risk Management concept; Customs and Trade Partnerships including the Authorised Economic Operator (AEO) concept; Customs-to-Customs cooperation including the Globally Networked Customs concept; CBM; and the Single Window concept (WCO 2011, pp. 13-15).

The focus of this article now turns to CBM in South Africa, and in particular how it contributed (or could have contributed) to the awarding of the SKA Project.

4. Coordinated border management

4.1 Background

The WCO states that the Customs community recognised CBM 'as a potential solution for the challenges that the 21st century presents especially with respect to efficient and effective border management' (WCO n.d., Coordinated Border Management). It follows that the WCO's theme for 2015 is 'Coordinated Border Management – An inclusive approach for connecting stakeholders' (Mikuriya 2015, p. 10). According to Aniszewski (2009, p. 2), CBM 'refers to a coordinated approach by border control agencies, both domestic and international, in the context of seeking greater efficiencies over managing trade and travel flows, while maintaining a balance with compliance requirements'.

In seeking greater efficiencies in trade and travel, two key factors are the coordinated flow of information, and the coordinated physical movement of people and goods. The key principles for the flow of information are Regulatory Transparency, Streamlined Submissions, Information Sharing, and Information Protection; while the key principles for the movement of people and goods are Streamlined Checks and Clearance, Congestions Management, Manpower Availability, and Equipment Availability (WCO 2013, pp. 7-9). In practice, the key factors are achieved through trade agreements, memoranda of understanding, one-stop border posts, etc. CBM is also not restricted to coordination by domestic stakeholders since coordination with international stakeholders is necessary.

The critical success factors for the implementation of CBM include Political will; the Establishment of a Project Team; a Strategic Plan; a Legal Framework; Information and Communication Technology; Infrastructure; Training; and Communication (WCO 2013, p. 9). These critical success factors are considered below from a South African point of view.

4.2 CBM in South Africa

The main stakeholders at South African borders are the Department of Home Affairs (DHA), the South African Police Service (SAPS), and the customs administration – residing under the South African Revenue Service (SARS). Secondary stakeholders include the Departments of Transport (DOT), Public Works (DPW), Agriculture, Forestry and Fisheries (DAFF), Health (DOH), Environmental Affairs (DEA), Trade and Industry (DTI), and the State Security Agency (SSA) (see www.borders.sars.gov.za).

Political will for a CBM concept was expressed as early as 1996. Subsequently, in 1997, a project team was established in the form of the National Interdepartmental Structure on Border Control (NIDS) and tasked to present a unified governance structure for border control, with the SAPS as lead agency. With an intended lifespan of five years, NIDS failed to deliver such a governance structure and was dissolved in 2001 as it was considered that it could go no further without a 'single command driving a single border strategy' (Steinberg 2005, pp. 3-5).

Subsequently, in 2002, the Border Control Operational Coordinating Committee (BCOCC) was established with a mandate to, amongst others, develop and implement a National Integrated Border Management Strategy and to create a workable balance between security, trade, tourism and economic development in South Africa and the Southern African Development Community (SADC) region. Initially the BCOCC was chaired by the SAPS, until it was replaced by the DHA in 2005. The DHA was also appointed as the lead agency at non-commercial ports, while SARS became the lead agency at commercial ports. Later, in 2007, SARS replaced the DHA as lead agency at ports of entry and as chair of the BCOCC (BCOCC 2008, pp. 1-22).

In June 2009, President Jacob Zuma announced the establishment of a Border Management Agency (BMA) (Baker 2009). In March 2010, the then Minister for Justice and Constitutional Development, Jeff Radebe, announced that a BMA would be established later that year (defenceWeb 5 March 2010). This announcement turned out to be over-ambitious, as a BMA was not established as intended.

More than a year later, in June 2011, the then Minister of State Security, Siyabonga Cwele, stated that his department was studying global 'best cases' on border management and that '[t]he migration to the new model will be completed by 2014' (defenceWeb 8 June 2011). In December 2012, the then Minister of the DHA, Naledi Pandor, announced that a South African border agency was at an advanced stage and that a white paper was in development (Mungadze 2012) – it is anticipated that the BMA will reside under the DHA (Pandor 2013a). On 8 November 2013, Minister Pandor announced the appointment of a project manager for the BMA's project office, responsible for developing proposals for policy and structure. The key objectives were listed as research and development of an appropriate BMA model, and drafting the enabling legislation (Pandor 2013b). In December 2014, Radebe, now in his capacity as Minister in the Presidency for Performance, Monitoring and Evaluation, stated that Cabinet approved a vision, the establishment of a pilot site, and a proper legal framework for a BMA (Radebe 2014).

The current Minister of the DHA, Malusi Gigaba, stated on 15 July 2014 that he hoped that a BMA would be established by the end of 2016 (Gigaba 2014). On 1 February 2015, ninety-three staff members from SARS were seconded to the BMA Project Management Office, and the minister announced on 6 February 2015 that a BMA Bill was due for submission to Cabinet by mid-2015 (Gigaba 2015). On 6 May 2015, the minister changed his previous statement, instead saying that he hoped that the BMA will be operational in 2017 (Paton 2015). On 21 June 2015, Ministers Gigaba and Nosivwe Mapisa-Nqakula (Defence) raised a number of serious concerns regarding one entity mandated to manage the diverse requirements of border control. One such concern was the constitutional conflict that may exist in relation to functions of a BMA and that of the South African National Defence Force (SANDF) (Dodds 2015). On 5 August 2015, the DHA published a Draft Border Management Bill (Gazette No. 39056), followed by a Correction Notice the following day (Gazette No. 39058). According to the Bill the constitutional concern has been addressed whereby the border protection functions performed by the SANDF are excluded.

Comments: CBM

Seemingly, since the initial announcement in 2009, the responsibility to establish a BMA has resided with at least three departments. Furthermore, the announcements by the different ministers are contradictory in that a BMA has been established neither in 2010, nor in 2014. The 2016 goalpost of a BMA was also moved to 2017. As a result the coordination at the ports remains the responsibility of the BCOCC, while footwork to establish the BMA is still in progress.

Beyond the statements above referring to case studies, a new model, implementation dates, white papers, a project team, enabling legislation, a legal framework, and that the BMA concept was at an advanced stage, no further information was found in the public domain. As a result, the status of all the respective success factors could not be considered. Although political will was expressed often, some doubt is cast on the earnestness of implementing a BMA when considering the lapse in time since the initial BMA announcement, the continuous moving of the goalpost, and the inability to establish a BMA to date. A positive aspect though is that a project manager and team have been appointed and that the remaining success factors, namely a Strategic Plan, Legal Framework, Information and Communication Technology, Infrastructure, Training, and Communication would receive attention in due course. The secondment of staff to the project team is a further positive development, as is the publication of the Draft Border Management Bill.

During the eighteen years that have passed since the establishment of NIDS, all three of the main stakeholders at the border have had the opportunity to lead the CBM concept. However, despite the time that has passed and rotations of the lead agency, CBM materialised only partially. Border operations are still coordinated and managed by the BCOCC, despite the six years that have passed since the initial announcement of a BMA by President Zuma. Considering the time it takes for the legislative cycle to run from drafting to promulgation, even the date of 2017 seems ambitious.

5. Conclusions

This article set out to consider the role and importance of Customs in relation to CBM with particular reference to a practical example, namely the SKA Project. The SKA Project highlighted the extent to which a country and region can benefit from an international project – it also underscored that aspects of Customs are key considerations for any multinational project.

It is, however, concluded that many of the aspects considered under 'Customs', in the awarding of the SKA Project, were not actual customs functions. Instead, many of the considerations were 'logistical' by nature. This is supported by the importance afforded to the consideration of two countries as opposed to six. It is commonly accepted that the more participating member countries there are in a consortium, the bigger the potential for increased complexity in relation to logistical transactions. The authors are of the opinion that, under similar circumstances, any other consortium consisting of six countries would equally have experienced difficulties in attracting a higher score. Similarly, it was found that concluding agreements and setting rates of duty do not reside with the South African customs administration.

Furthermore, whether South Africa, and in particular its customs administration, could have done more to streamline the flow of people and goods for SKA purposes through its borders, is questionable. It was found that the importance of CBM was recognised as early as 1996 and could have contributed to a more favourable score, but despite the political will being declared, the optimal implementation of CBM has proven to be more challenging than initially anticipated.

It is undisputed that a customs administration is one of the key role players at the border. However, the customs administration is dependent on other role players and therefore cannot make unilateral decisions. A customs administration is ultimately dependent on political will and throughput – it remains but a small cog in a large wheel that should not be held responsible for CBM if the prerequisites have not been addressed.

A successful CBM program requires far more than a customs administration addressing customs operational matters. It requires a committed whole-of-government strategy and approach and without this, introducing CBM will not succeed. It is essential to steer away from the perception, wherever this may exist, that only a customs administration is responsible for a successful CBM implementation. Any CBM strategy should cater for Customs-to-Customs matters (that is, the 'external leg'), as well as for the customs administration to the rest of government (that is, the 'internal leg'). It is held that if a BMA, in support of CBM, has been fully implemented in South Africa, its customs administration would in all likelihood have attracted a higher score under the Customs and Excise assessment of the SKA Report. A full implementation of aspects such as trade agreements, tax and duty certainty, and the ease of doing business (through memoranda of understanding, one-stop border posts, information sharing, coordination of operations, etc.) would have positively supplemented the South African SKA bid. For example, a practical agreement regarding the seamless movement of people and goods in support of a specific multinational project across the SADC region was found wanting and should be addressed. This will bring the region 'on par' with for example, Australia/New Zealand. In fact, SADC member states should not wait for the next multinational project to address multilateral strategic and operational shortfalls as were evident with the SKA Project, but should act proactively in assessing how the seamless flow of goods and people can pragmatically support similar future projects.

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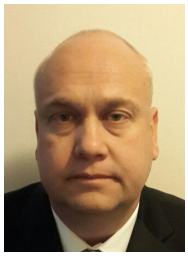
Theo Colesky

Dr Theo Colesky is a Senior Manager in the Enforcement Division of the South African Revenue Service in Pretoria, South Africa. He holds the degrees Baccalaureus Iuris and Baccalaureus Legum from the University of South Africa, Master of International Customs Law and Administration from the University of Canberra, Australia and Doctor Legum degree from the University of Pretoria, South Africa. Theo has more than twenty years' experience in the field of customs, in both the private and public sectors.

Roux Raath



Roux Raath is a Senior Specialist in the Enforcement Division of the South African Revenue Service in Pretoria, South Africa. He holds the degrees Baccalaureus Artium (Political Sciences) and Baccalaureus Artium Honours (International Politics with Strategic Studies) from the University of South Africa, Magister Philosophiae (MPhil) Taxation degree from the University of Pretoria, South Africa, and is currently a second-year PhD student with the University of Pretoria's African Tax Institute. Roux has more than twenty years' experience in the field of customs, in both the private and public sectors.

Germany – unlocking trade and customs potential in Africa

Dhunraj Kassee[1]

Abstract

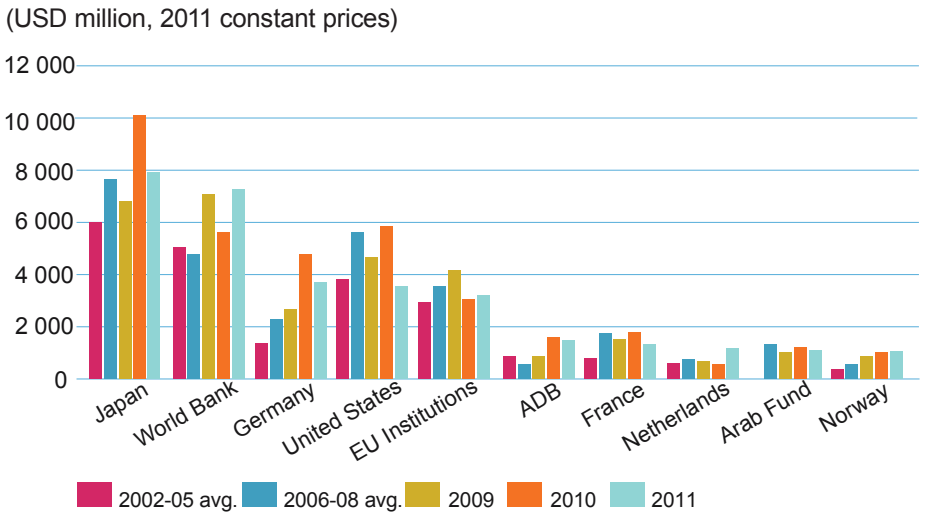
Aid for Trade is an initiative that assists developing and, in particular, least-developed countries to integrate into the multilateral trading system by boosting their capacity to export goods and services. It encourages developing and least-developed countries' governments and donors to recognise the role that trade can play in enhancing economic growth and development. According to the World Trade Organization (WTO), since the initiative was launched in 2005 in Hong Kong, Aid for Trade commitments from donors — governments, international and regional development institutions — reached USD41.5 billion in 2011, up 57 per cent from 2005. The initiative is an example of the WTO's mandate to achieve 'coherence in global economic policymaking'. Aid for Trade is particularly important for Africa as it has the highest number of least-developed countries facing a myriad of supply-side trade-related infrastructure challenges which constrains their ability to engage in international trade. This paper seeks to highlight the significant contribution that Germany has made to bolstering trade and customs capacity in Africa, particularly in the regions of Economic Community of West African States (ECOWAS), East African Community (EAC) and South African Development Community (SADC).

1. Introduction

Germany and Africa are linked by a long shared history, extending from the era of the German colonial presence in Namibia, Tanzania, Rwanda, Burundi, Cameroon and Togo, to the support that Germany has given to African countries since their independence. Today, Germany maintains diplomatic ties with every country in Africa and has embassies in nearly every capital city on the continent. Germany, one of the continent's leading trade partners, is generally well regarded and is viewed as an attractive partner for Africa. According to the latest figures, taken from the joint WTO/OECD publication, *Aid for Trade at a Glance: Connecting to Value Chains*, in 2011 it spent USD3.7 billion on Aid for Trade (in the broad sense); this puts the country in second place – after Japan – among bilateral donors (see Figures 1 and 2). While a large percentage of these funds is invested in infrastructure projects in the energy sector, support for transport routes, warehousing, communication systems and logistics issues is also notable.

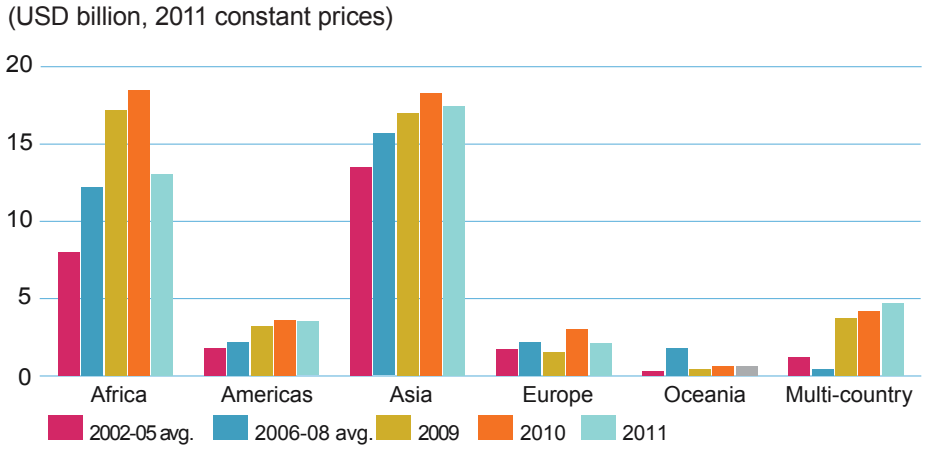
Germany's support for trade and regional integration processes in Sub-Saharan Africa dates back to the 1990s. Assistance for Regional Economic Communities (RECs) has increased substantially over the past decade. German development policy is formulated by the Federal Ministry for Economic Cooperation and Development (BMZ) and implemented by organisations such as the BMZ, the Society for International Cooperation (GIZ) and the Reconstruction Loan Corporation (KfW).

Figure 1: Top 10 Aid for Trade donors



Source: OECD Creditor Reporting System Database, http://stats.oecd.org/index.aspx?DataSetCode=CRS1#.

Figure 2: Aid for Trade by region



Source: OECD Creditor Reporting System Database, http://stats.oecd.org/index.aspx?DataSetCode=CRS1#.

The main goal of Germany's trade-related development policy, as laid down in the BMZ Aid for Trade Strategy Paper (published in June 2011), is to assist partner countries in their efforts to diversify their economies and exports, become successfully integrated into the global trade system and regional economic communities, and use trade and foreign direct investment to reduce poverty more effectively in the context of sustainable development.

Six fields of interest for the implementation of the new Africa Strategy for Germany were identified by the German government: peace and security; good governance; economy; environment and climate; energy and natural resources (mainly raw materials), as well as sustainable and knowledge-based development.

2. Germany and East African Community (EAC)

The EAC is one of eight regional economic communities recognised by the African Union (AU), and the only one that has a vision of political federation. In the treaty establishing the EAC, the partner states decided to expand and intensify their economic, political, social and cultural integration. Since as early as 1998, German development cooperation, on behalf of the German BMZ, has contributed to the capacity development of the Secretariat of the EAC through a variety of programs and projects. Germany's financial commitment to the EAC integration process amounted to about a total of Euro55.8 million in 2012. Also since 1998, German development cooperation has made substantial contributions to the integration process in East Africa, in accordance with the German Government's Africa Strategy including:

2.1 Organisational development and strengthening of public relations in the EAC, with focus on improving the structures, systems, processes and capacities of the EAC Secretariat

- Introduction of an organisational diagnostic tool, a quality management system and an East African system for monitoring the integration process.
- Strengthening public relations through improved EAC branding and training measures for the East African media on the EAC integration process.

2.2 Deepening of regional economic integration

- Advancing the liberalisation of trade in services in selected sectors, and removing restrictions for the mutual recognition of training and qualifications.
- Improving implementation of the customs union, harmonisation of taxes and procedures, and elimination of non-tariff barriers.
- Promoting regional industrialisation and investment policies, with focus on private investments in the pharmaceutical and energy sectors, and on the establishment of a regional industrial promotion centre.

2.3 Improving the dialogue between the EAC Secretariat and private sector and civil society organisations

A consultative dialogue framework (CDF) has been set up to facilitate the dialogue involving the private sector, civil society and the EAC. The program is now concentrating on the following measures for its implementation:

- Establishing topical dialogue platforms integrated in the East African Business Council (EABC) and the East African Civil Society Organisation Forum (EACSOF) to represent the interests of the private sector and civil society.
- Capacity building (training) for private sector and civil society organisations.
- Awareness raising and information campaigns to ensure broader awareness of the EAC, and of the opportunities it creates among the general population, ultimately leading to greater public participation in the EAC through the CDF.
- Publishing the Non-Tariff-Barrier Index.

Box 1: EAC Industrialization policy

The EAC industrialisation policy was approved by the Summit of EAC Heads of State in November 2011. The German support program to the EAC integration process facilitated the elaboration of the EAC Industrialization Policy and Strategy through studies, expert meetings and an international conference on industrialisation and technology transfer. The fast pace of developing and approving this policy shows that industrialisation constitutes one of the EAC's priority policy areas. The vision of the EAC Industrialization Policy is 'a globally competitive, environmentally-friendly and sustainable industrial sector, capable of significantly improving the living standards of the people of East Africa by 2032'. In addition, GIZ supported the EAC Secretariat in the development of draft roadmaps and sub-sector strategies on the harmonisation of education systems and training curricula, the drafting of the Customs Management (Enforcement and Compliance) regulations, as well as the drafting of the EAC – European Commission Economic Preferential Agreements (EPA) development matrix.

Source: http://eacgermany.org/wp-content/uploads/2014/10/GIZ-EAC-Phase-2-Report.pdf.

3. Germany and the Economic Community of West African States (ECOWAS)

ECOWAS is a regional group of fifteen countries (Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, the Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo), founded in 1975. Its mission is to promote economic integration in 'all fields of economic activity, particularly industry, transport, telecommunications, energy, agriculture, commerce, monetary and financial matters'.

The basic approach of the support program for the ECOWAS Commission consists of strengthening sector-specific expertise at the ECOWAS Commission and enhancing its strategic management structures and capacities. This should facilitate the design and implementation of regional agreements on taxes, customs, tariffs and other trade-related issues, and also support reform processes in conflict prevention and mediation. On trade and customs matters, the technical assistance of Germany is to support the introduction of the Common External Tariff (CET) in the ECOWAS region. Other services include providing advice on legal changes, offering training for customs administrations in the member states and support for the introduction of the Common External Tariff (CET) in the ECOWAS region.

4. Germany and Southern African Development Community (SADC)

One of the eight RECs recognised by the African Union Head of States as the building blocks for continental integration is the SADC. The Treaty is the main agreement establishing the Southern African Development Community in 1992 and comprises of Angola, Botswana, Democratic Republic of Congo, Lesotho, Namibia, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Zambia and Zimbabwe.

In the SADC, technical assistance was provided to spur the process of developing the SADC Trade Protocol starting in 1996. Since 2002, the cooperation approach between SADC and Germany has been much enhanced so as to include, under the overall heading of 'Support to Governance Reform Processes', support for the organisational development and institutional strengthening of the SADC Secretariat, and also support for trade policy, standards and quality assurance, customs modernisation, macro-economic convergence, and promotion of regional private sector associations and public-private dialogue.

4.1 Enhancement of private sector involvement

SADC places great importance on strengthening cooperation between Customs and the private sector in order to give customs administrations in the SADC region an opportunity to offer more efficient and effective service to their clients. The overall purpose of Customs-to-Business partnerships is to ensure a partnership and dialogue structure of key stakeholders in the trading chain that contributes to trade facilitation, improvements in customs operations and higher compliance by the trading community. The SADC Private Involvement Strategy urges the establishment of National Customs Business Forums in every member state. The SADC Secretariat, in collaboration with the GIZ and other partners, has established such forums in Malawi, Zambia, Namibia and Seychelles. These forums are designed to facilitate a stronger partnership between Customs and business at the national level, promoting a regular and results-orientated dialogue, and taking action on existing challenges in the supply chain of goods.

Box 2: Establishment of Namibia Customs Business Forums in Namibia (2013) and Seychelles (2014)

The Namibia Customs Business Forum was launched by the Finance Minister Saara Kuugongelwa-Amadhila in 2013 in Windhoek, Namibia. According to the Minister, the forum is envisaged to become 'a bi-annual dialogue forum that brings together public and private sector [actors] in the trading chain to continually assess and adopt measures that promote effective trade facilitation, as well as enhance customs operations and higher compliance'.

While launching the Seychelles Customs Business Forum, the Minister of Finance, Trade and Investment, Mr Pierre Laporte addressed that 'It is undeniable that our country relies heavily on international trade for economic growth and prosperity. Agencies at the border, especially Customs, must constantly reflect on how it's regulatory framework and procedures impact on the trading community, and must see how existing compliance frameworks can become more effective in facilitating legitimate trade in and out of Seychelles. "Customs-to-Business Partnership" has been highlighted by the World Customs Organization (WCO) in its Customs in the 21st Century Strategy (adopted in June 2008) as one of the building blocks of modern customs administrations. For our own administration to take this bold step, it therefore signifies their commitment to engage into reforming and modernising to the prescribed "World best practices", under the Revised Kyoto Convention and also the SAFE Framework of Standards'.

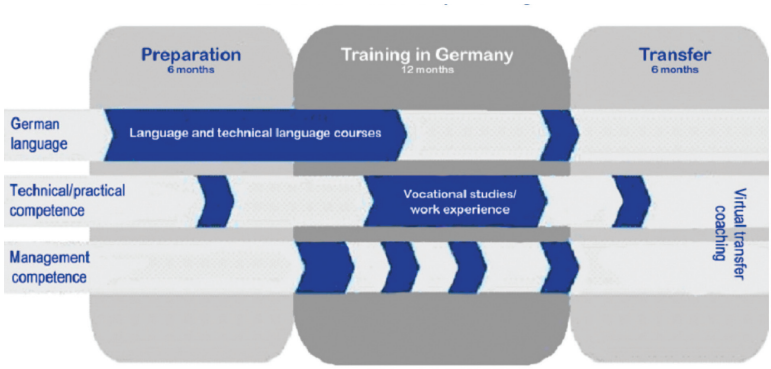
Source: www.sadc.int/news-events/news/establishment-and-launch-national-customs-business-forums-wi/; http://nation.sc/article.html?id=240635.

4.2 International Leadership Training (ILT)

Germany recognises the fact that for developing countries, efficient customs administration is a key tool for promoting economic growth and social development as public revenues in developing countries still largely depend on Customs. The traditional functions of customs administrations are highly challenged by the liberalisation and globalisation of trade. Customs administrations therefore need to prepare for their new tasks: bringing forward trade facilitation, elaborating trade statistics, supervising trade agreements, protecting intellectual property rights and supporting the development of regional economic communities such as free trade areas and customs unions.

Consistent with this, Germany introduced the International Leadership Training program in 2005 with the main purpose of providing advanced training for officials of customs authorities from SADC, EAC and ECOWAS member states, eventually supporting the RECs to modernise their customs administrations. The objective was also to create a pool of qualified professionals who are able to prepare and implement the respective transformation processes. The training program consists of different parts, which are interlinked: the preparatory, training in Germany and transfer phases. The following chart gives an overview of the educational goals and processes in each phase:

Figure 3: International Leadership Training



Source: https://gc21.giz.de/ibt/en/opt/site/ilt/ibt/programme/globaltrade/xhtml/construc.sxhtml.

The specific objectives of the ILT 'Global Trade' were to:

- increase the professional know-how and practical expertise of young professionals in customs authorities, ministries of finance and other relevant institutions from SADC, EAC and ECOWAS member countries
- enable graduates of the course to perform tasks professionally relating to modern customs policy and administration, in international and regional negotiation teams on trade and customs, regional and international institutions respectively, to serve national interests at their home organisation and fulfil daily tasks at their workplace
- enable graduates of the course to contribute to further developments and improvements in the customs administration of their countries.

However, the crux of the ILT program was the professional technical courses held at the University of Münster. Six main technical areas and three managerial areas were covered as follows:

- Customs policy and legislation
- International customs rules and customs instruments
- International customs management (including risk management)
- International trade law and non-tariff trade rules
- The multilateral system of trade
- International trade relations
- Self-organisation, work organisation and presentation techniques
- Communication and networking
- Competence in transfer project implementation.

The program finally covered a short internship period at German customs stations such as Frankfurt Airport, Examining and Scanning Units, Hamburg Port and study visits to the European Commission and the WCO. The ILT Global Trade program was implemented during the period from June 2005 to December 2011 for a total of seven courses and 133 participants.

Box 3: Some key achievements by alumni:

The success/impact of the International Leadership Program can actually be measured by the number of high calibre professionals and experts it has produced in the region. Experts from the alumni are currently working as key experts in the EAC, COMESA, SADC and SACU Secretariat, African Development Bank (ADB), respective Customs/Revenue Administrations and even as Commissioners, Deputy Commissioners and Customs Attachés. Below is feedback from some of the Alumni on how the ILT impacted on their career.

Tebello Makhechane, Deputy Commissioner Customs of Lesotho Revenue Authority
The ILT in Germany has been the program that took my career to a level I could never have imagined. A year after my return from Germany and within six months of graduating, I again applied for a managerial position and this time succeeded in getting the position. I was appointed as a Regional Manager in charge of six border posts in 2010. My success this time was due to my training in ILT. I had gained not only confidence but also the necessary knowledge in both management and administration of Customs. Three years later in 2013, I applied for a senior managerial position of Deputy Commissioner of Customs and was thankfully appointed. The breakthrough to this success was the ILT. This success was not unique for me, many of the ILT participants in Lesotho have improved their careers; two are working for international organisations outside Lesotho (one at SACU, another at African Development Bank), six have joined the management cadre of the Lesotho Revenue Authority with three of the six being part of the Senior Management Team.

Ajay Dunputh, Internal Auditor, COMESA Secretariat
I am actually working as Internal Auditor at COMESA, Lusaka, Zambia as from August 2013. The requirement to join COMESA was a master's degree. Given that I had a master's degree from Germany, I was recruited at COMESA. The master's degree is like a "Green Card" whereby all the graduates from Germany are very marketable and can easily get a job on the foreign job market. I thank the Government of Germany, Inwent, the WCO and all others who have helped me to obtain my master's degree.

Ally Allexander, Customs Expert, EAC Secretariat
After completing my ILT Program studies in 2006, I joined the Institute of Tax Administration which is part of Tanzania Revenue Authority as Assistant Lecturer. I decided to join because I felt I have sufficient knowledge and experience and therefore I wanted to impact/share with a wide community through training others. In 2007, I joined the East African Community Secretariat as Customs Officer responsible for administration of the EAC Tariff regime, Rules of Origin and Customs Valuation code, compilation and dissemination of trade statistics, customs-related negotiations and training in customs-related matters. Without undergoing the ILT Program, performing these duties and responsibilities could not be possible.

Alcides Monteiro, Program Officer Customs, SADC Secretariat

I always keep seeing Münster in my mind. This sentence summarises the short and long way I took on my professional career. Soon after Münster I had a lot of expectation in my Administration but very soon realised that whatever I had learnt over there was not easy to implement. At that time, my Administration was been restructured from a single Customs Administration to a Revenue Authority and because of that there was an opportunity to introduce new ways of conducting business.

Rajeev Nawosah, Internal Audit Officer, Mauritius Revenue Authority

After successfully completing the ILT Program in 2010, I was transferred to the Capacity Building Unit to assist the Director of Customs in the development of Customs Reforms and Modernisation Projects. I was appointed as Trade Analyst in 2011 at the Ministry of Industry, Commerce and Consumer Protection (Trade Division) where I was responsible for advising the business community on Trade Policies, Execution of Trade Policy Measures and approval of Trade Documents. I am presently working as an Internal Audit Officer at the Mauritius Revenue Authority. I am also part of the Technical Team of the Investigation Authority under the aegis of the Ministry of Foreign Affairs, Regional Integration and International Trade to conduct investigation on cases of dumping, subsidies and safeguard.

Box 3: Some key achievements by alumni: *continued*

Gugu Treasure Dlamini-Zwane Customs Attaché, Brussels

The Master of Customs Law and Policy described in one word is an "enabler". It all began in 2005 in Münster, Germany. Straight from there, I was tasked with establishing an International Relations and Cooperation Office. I am currently a Customs Attaché based at the Embassy of Swaziland in Brussels. After this training I can boldly say I have been able to integrate myself nationally, regionally, continentally and globally. I have never felt irrelevant. My confidence levels are increasing day by day and I am able to accept bigger challenges such as being the first Chairperson of the WCO Working Group on Trade Facilitation Agreement. The greatest moment in my life was when I chaired a WTO Information Session organised by the WCO. I found myself sitting between Mr Kunio Mikuriya (Secretary General of the WCO) and His Excellency Ambassador Roberto Azevêdo (Director-General of the WTO. I can't imagine how we could have dealt with the challenges of Customs in the 21st Century without the MCA. The MCA is the correct dose for African customs administrations.

4.3 SADC Training of Trainers Program 2013-2016

The SADC Protocol on trade provides for member states to undertake to develop or adopt joint training programs, exchange staff and share training facilities and resources. In the same vein, an SADC Training of Trainers Program has been implemented in collaboration with GIZ and the WCO since 2013. The SADC Training of Trainers Program is a response to the challenges of a future integrated operational customs environment within SADC which will include the reform and modernisation of SADC customs administrations. The main objective of the program is to provide technical and professional support to the implementation of the SADC Protocol on Trade, particularly in view of the contribution of customs administrations to the successful implementation and consolidation of the SADC Free Trade Agreement (FTA) and the SADC Protocol on Trade.

Priority is given to those issues that are particularly relevant for the implementation of regionally agreed commitments, such as the Trade Protocol, or which are demanded by a majority of member states. The priorities will also derive from a systematic and continuous review of training needs, which should provide a realistic direction in which the training will be delivered. To date, the following courses have been covered under the program:

- Communication and Facilitation Skills
- SADC Rules of Origin
- Risk Management in Customs
- Tariff and Non-Tariff Barriers
- Customs Valuation (August 2015).

One of the distinctive features of the training is that customs administrations are expected to ensure dissemination of the training to relevant stakeholders and cascading of same to other officers at the national level. According to information gathered, some of the trainers are already cascading such training at the national level especially on SADC Rules of Origin. Finally, it is also notable that the training is being held in close collaboration with the WCO Regional Office for Capacity Building (ROCB) and the WCO Regional Training Centres in Mauritius, South Africa and Zimbabwe.

Box 4: Training of Trainers (TOT) Course on Tariff and Non-Tariff Barriers (NTBs) held in November 2014

The SADC Protocol on Trade, which came into force in 2000, seeks to further liberalise intra-regional trade between Member States and provides for elimination of Non-Tariff Barriers to Trade (NTBs) and requires Member States to refrain from imposing any new NTBs.

The objectives of this training were to:

- Equip the trainers so that they are able to conduct training on NTBs at the national level for other customs officials and stakeholders
- Educate trainers on the need to eliminate NTBs
- Understand the nature, categories and impact of NTBs in SADC.

Categories of NTBs within the SADC region include Customs and administrative entry procedures, Technical Barriers to Trade and Sanitary & Phyto-Sanitary (SPS) measures.

Source: www.sadc.int/news-events/news/train-trainer-course-sadc-customs-administrators/.

4.4 Strengthening quality infrastructure for trade enhancement

The SADC recognises that maintaining standards of quality are important to businesses and consumers in the region and beyond. As a result, it has established a formal framework – the Standardization, Quality Assurance, Accreditation, and Metrology Programme – to oversee standardisation of policies and procedures for ensuring quality and safety of trade in the region. The implementation of the Technical Barriers to Trade Annex poses some challenges to the member states, as both the capacities and the competences of quality infrastructure are not yet sufficiently developed.

Box 5: SADC – PTB (Phisikalisch Technische Bundesanstalt) project "Strengthening Quality Infrastructure (QI) for trade enhancement and consumer protection in SADC"

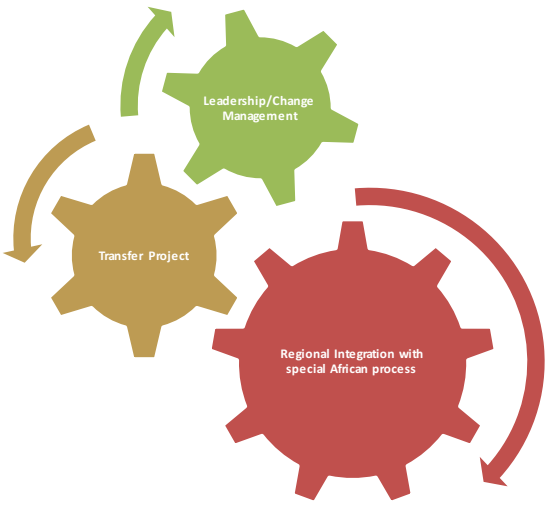
The project was implemented between July 2010 and August 2013 and had four components, directed at capacity development of the Secretariat in the area of Quality Infrastructure/Technical Barriers to Trade, capacity enhancement of the QI structures, the international recognition of the QI-Structures as well as the participation of the private sector. In September 2013, the German National Metrology Institute (Physikalisch Technische Bundesanstalt [PTB]) launched a follow-up project based on the very promising evaluation results of the last project. The overall objective of the project is to strengthen the quality infrastructure for trade enhancement and consumer protection in SADC in accordance with the TBT Annex to the SADC Protocol on Trade. The project will run until August 2016 with a commission value of Euro1.5 million.

Source: www.sadc.int/news-events/news/ptb-renews-its-cooperation-sadc/.

4.5 The customs leadership program for EAC and SADC

The new initiative 'Customs Leadership Training for Managers in African Customs Authorities and Trade Ministries' is focused on a special human capacity development (HCD) approach. Its goal is to reinforce the capacities in the customs authorities and trade ministries of the EAC and SADC member states and to provide executives/decision makers with special competences for their facilitation and mediation tasks during ongoing implementation processes of regional and international customs agreements. Particularly, management and leadership abilities in connection with special strategic technical customs expertise will be enhanced, so that senior managers/executives will be acquainted with identifying and developing sustainable solutions to the challenges facing them. The course program has three main components as shown in Figure 4.

Figure 4: Leadership program components



Source: Author.

According to GIZ, the overall objective of the regional integration component is, firstly, to update and inform custom officials on relevant technical issues. The selection of topics will be based on the specific interests and demands of the participants in order to ensure practical relevance for the customs authorities concerned. The regional economic integration component aims to provide participants with the following:

- Provision of specialised and demand-orientated technical knowledge with high relevance for the practical work of customs authorities in the context of African regional economic integration
- Updates on latest developments and decisions in the context of regional economic integration and the potential consequences for customs authorities.

Practical application of acquired content in the design and implementation of change management processes.[2]

4.6 Supporting the deepening of regional integration

In November 2014, based on the SADC Treaty, Protocols and the Revised Regional Indicative Strategic Development Plan (RISDP), the SADC Secretariat and Germany agreed on the overarching aim of 'supporting the deepening of regional integration for the benefit of the people in the SADC region', with a special focus on:

- Regional economic integration and infrastructure
- Peace, security and good governance and management
- Protection of biodiversity and resilience to climate change.

In addition to some specific sectors, increased importance will be given to support SADC's priorities of industrial development and infrastructure in the region, which will have a definite impact on SADC intra and extra trade. From the outset, both parties recognised the significance and value added of more than twenty years of cooperation during which Germany has committed around Euro300 million to SADC. Apart from the above, GIZ is also assisting SADC in building the capacity of the Secretariat, monitoring the implementation of the Protocol on Trade and conducting trade-related studies and surveys.

5. Conclusions

Mother Africa is rising and it's the fastest growing continent in the world. According to the Annual Effectiveness Development Review (AEDR) 2013, more than two-thirds of the continent has registered overall improvement in the quality of economic governance in recent years, with increased capacity to deliver economic opportunity and basic services. The report further adds that greater regional economic integration on the continent will improve the prospects for growth by enabling African producers to build regional value chains, achieve economies of scale, increase intra-African trade and become internationally competitive. According to the AEDR, growth in the continent's low-income countries exceeded 4.5 per cent in 2012 and is forecast to remain at above 5.5 per cent in the next few years. Africa's collective gross domestic product (GDP) reached USD953 while the number of middle income countries on the continent rose to 26, out of a total of 54.

However, Africa's inadequate infrastructure remains a major constraint to the continent's economic growth and development. Infrastructure can be attributed to ICT and logistics performance of an economy. According to various credible global and regional indexes and surveys, such as the World Bank's Doing Business Report, Logistics Performance Index, WEF Competitiveness report, the IMF Regional Outlook and the Global Innovation Index, Africa still suffers from logistics performance and supply-side constraints and is lagging behind other regions. Lack of productive capacity, poor infrastructure, poor trade diversification, inefficient customs procedures, excessive red tape and difficulties to meet technical standards in high value export markets have a negative impact on the ability to trade and on the competitiveness of the exports.

Aid for Trade can be the right window for African economies to take advantage of opportunities created by unilateral, bilateral or multilateral trade openings and hence it is an important tool to facilitate trade reforms, improve the business environment, support regional integration and provide opportunities to integrate into global value chains. Aid for Trade from various countries, including Germany, should in normal circumstances be the most appreciated cooperation considering its associated benefits and achievements. This is also essential especially at a time when implementation of the same measures of the WTO Trade Facilitation Agreement 2013, such as Advance rulings, Electronic payment, the Single Window concept, Authorised Operator initiative, Risk Management, Post Control Audit and Border Agency Cooperation can be a challenge to all the least-developed countries and many developing countries. However, Africa should also not become dependent on development aid, hence the need for considerable commitments from the region. Trade-related reforms, including trade facilitation and customs modernisation in Africa, will be successful and sustainable if Africa can take ownership of such reforms. A program of regional trade reform can only be credible if governments are fully committed to it and take ownership of the process (Jayne et al. 2002).

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Notes

1 The views and opinions presented in this paper are those of the author and do not necessarily reflect the views or policies of the Southern African Development Community (SADC) or its Member States.

2 See www.devex.com/projects/tenders/human-capacity-building-hcd-leadership-training-for-customs-authorities-in-sub-saharan-africa-2015-2016/178785 and GIZ.

Dhunraj Kassee

Dhunraj Kassee is a Program Officer – Customs, with expertise in customs, trade, regional integration and management issues. Since February 2010, he has worked at the Southern African Development Community (SADC) Secretariat, Gaborone, Botswana, where he is mainly responsible for capacity building and ICT in the Customs Unit. From 1994, Dhunraj worked for the Mauritius Revenue Authority as a customs expert and prior to that in the Ministry of Labour. Dhunraj has a Master of Customs Administration, Policy and Law from the University of Münster, Germany. He also holds a Degree in Public Administration and Management from the University of Technology, Mauritius, and a Diploma in Marketing and Management from the Institute of Commercial Management (UK).

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Section 3

Special Report

10 Years of promoting the academic standing of the customs profession

David Widdowson
President, International Network of Customs Universities

From its humble beginnings in 2005, the International Network of Customs Universities (INCU) has come a long way. The primary motive for establishing the network was to promote the academic standing of the customs profession – something that was clearly needed at the time, and which, I am pleased to say, has been well and truly achieved in the intervening ten years. As the INCU celebrates its 10th Anniversary, it is worth recalling at least part of that journey, and contemplating what might lie ahead.

I recall the day I first proposed the development of a Masters degree with a customs specialisation. One of my professorial colleagues asked why one would need a Masters program to teach people how to search bags. Those of you who are involved in trade and customs matters and who understand the breadth and complexity of the subject would have shaken your head as I did. There is far more to the customs profession than baggage search! But that was the perception some 15 years ago and it was that perception which prompted the establishment of the INCU.

Recognising the academic significance of customs and border management, a small number of universities had already developed customs-specific qualifications and research streams in the 1990s, notably Münster, Germany and Canberra, Australia. And while national endorsement of such programs represented a significant step forward, it was international acknowledgement that was required before customs studies could be recognised as a true academic discipline.

To this end, the INCU has been working closely with the World Customs Organization (WCO) to further this cause, and together we have developed formal standards for the customs profession, globally recognised academic programs, an academic journal that is about to enter its tenth year of publication, and a series of international conferences that focus on academically recognised research and development.

Notably, neither the WCO nor the INCU could have achieved this outcome independently of one another. While international policymaking is beyond the jurisdiction of the INCU, it can significantly support such decision-making through its extensive research initiatives. Similarly, the WCO lacks the credentials to issue academic qualifications, but can influence the development of programs that lead to such qualifications by formally recognising those which meet the professional requirements of its members.

The experience to date has served to highlight the natural synergies which exist between the two organisations. Like many partnerships, the whole has proved to be much greater than the sum of its parts. The key to such a synergistic relationship lies in the fact that competition does not and cannot exist. While common areas of interest are shared, each organisation has its own agenda and its own imperatives. Each pursues its charter to the satisfaction of its members, and each is given the opportunity

to further the achievement of its objectives by actively participating in the activities of the other. This is recognised by the fact that both organisations feel compelled to collaborate with other organisations in areas which touch on their particular sphere of activity. From an INCU perspective this includes some 20 international organisations. For the WCO it involves many more, as it recognises the important role that many international organisations play in developing and facilitating international trade and travel, including the associated customs and border management policies.

The INCU sphere of engagement includes several fields of interest that receive little attention by the WCO but are considered by some of its members to be high on their list of priorities. That is not a criticism of the WCO. Like many governments around the world, the WCO is coming to terms with the fact that the role and responsibilities of what has traditionally been termed "Customs" can no longer be clearly defined. I discussed this phenomenon in my article, 'The changing role of customs: evolution or revolution?'[1] in which I concluded:

> … it is no longer possible to clearly define the role of 'Customs'. While the responsibilities of border management continue to be carried out, the nature and mix of relevant government agencies is changing. Consequently, what may represent core business for one administration may fall outside the sphere of responsibility of another. Indeed, … the organism known as 'Customs' appears destined for extinction.

For example, the WCO recognises the need for coordinated border management in the context of rallying the support of other agencies to assist in strengthening a country's economic competitiveness, including through the facilitation of legitimate trade. However, a number of countries have integrated their traditional customs functions with immigration responsibilities, resulting in organisations with priorities that fall outside the scope of traditional WCO membership. For such administrations, priority issues include the management of asylum seekers, people smuggling and human trafficking.

While the WCO is doing its best to maintain its relevance to all its members, like any international organisation of its size, it has the turning circle of the *Queen Mary* and will take many years to effectively respond to such significant shifts in focus. That is where the agility of the INCU can be used to greatest effect. Its hundreds of researchers, including research students across some 100 countries, have the ability to focus on emerging trends and help inform the decision-making processes of the border management community through empirical studies that contribute to the existing body of knowledge.

To achieve this requires robust interaction among policymakers, practitioners and academia. To this end, the INCU recently introduced global conferences that are designed to complement the WCO's PICARD[2] Programme by establishing a forum that provides its members with a greater opportunity to explore research priorities with policymakers and present the findings of their research; and for younger researchers and students to present their research proposals to a broader audience.

The Inaugural INCU Global Conference was held in Baku, Republic of Azerbaijan in May 2014, with the theme "Trade Facilitation Post-Bali: Putting Policy into Practice". The conference brought together delegates from over 70 countries including representatives of customs administrations, 20 international organisations, the private sector and academia. The conference was also the first of its kind to provide simultaneous telecast via YouTube – clearly a sign of the times!

Proceedings included a welcome address by the Director-General of the World Trade Organization (WTO), H.E. Roberto Azevêdo, keynote addresses by three eminent Nobel Laureates, the Assistant Secretary of International Affairs of the US Department of Homeland Security and a number of other highly respected speakers. Amongst them was the Chairman of the State Customs Committee of the Republic of Azerbaijan, Professor Aydin Aliyev, who was admitted as an Honorary Fellow of the INCU in recognition of his significant contribution to the objectives of the organisation, and an existing Honorary Fellow, Lars Karlsson, who first established the WCO's PICARD Programme.

A key outcome of the conference was the Baku Resolution which recognised and built upon the significant achievement of the WTO in reaching its Agreement on Trade Facilitation (the Bali Agreement). Among other things, it was resolved to formally engage with a broader cross-section of the international community and identify further ways of providing opportunities for academics, students and less experienced researchers to present and publish their research.

Another important resolution was to develop a definition of the term "customs profession" which includes both public and private sector members of the international trading community; identify the requisite knowledge, skills and competencies of those engaged in the customs profession; and develop guidelines for accrediting education and training programs that meet the identified knowledge, skill and competency requirements. This further builds upon the excellent work undertaken to date in collaboration with the WCO.

To further support the development of accredited qualifications, it was also resolved to encourage mutual recognition of INCU Member education and training programs through credit allocation, cross-institution arrangements and other means. This is already occurring, with formal arrangements having been established across a number of educational institutions in Australia, China, Germany, the Maldives, Qatar, Sri Lanka, Tanzania and the United States.

Further collaboration with the WCO, other international organisations, and member institutions will certainly provide the basis for future activities, as will focused research designed to inform strategic policymaking. It is in this context that the INCU looks forward to its next ten years of working closely with the WCO as we collectively progress our endeavours in customs academic research and development in order to further raise the academic standing of the customs profession.

Notes

1 *World Customs Journal* 2007, vol. 1, no.1, pp. 31-7.

2 Partnership in Customs Academic Research and Development.

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WORLD CUSTOMS ORGANIZATION

Section 4

Reference Material

Guidelines for Contributors

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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.

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- 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.

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