New Customs

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Squaring new security concerns with the need to facilitate trade is a daunting challenge for many

CUSTOMS administrations are not the most popular of organizations. In many countries, they are perceived as remarkable mainly for their corruption and inefficiency. And, in an ideal world of free trade and mutual trust, they simply would not exist. They are, however, almost unavoidable. Even their revenue collection role continues to be important as trade taxes are now—and will continue to be for the foreseeable future—a significant source of revenue for many countries, especially developing ones. Customs also has a key role to play in collecting other taxes, notably the value-added tax (VAT). For this reason, the IMF—a strong advocate of trade liberalization—devotes a good deal of its technical assistance to improving the performance of customs administrations. More generally, too, trade facilitation is receiving greater attention in the context of the Doha Round of global trade talks, with ministers endorsing the multiagency Integrated Framework initiative as a viable model for trade development in least developed countries.

But how, exactly, can customs administration be improved? What are the challenges, and how can they be addressed? This article brings together the lessons the IMF has learned over many years of providing technical assistance.

Fiscal frontiers and border control

What is the main role of customs administration? In a world of heightened security concerns, customs officers have a range of tasks, primarily related to the movement of goods across national borders. In addition to collecting tax revenue on growing volumes of merchandize trade, they play an important role in other areas of border control—more than half of VAT in developing countries is often collected at the border. They combat smuggling, administer the complex provisions of an ever-expanding number of regional trading arrangements (with over 160 now notified to the World Trade Organization), collect international trade statistics, and address security worries (a role that has come to prominence, in particular, in the United States after the terrorist attacks of September 11, 2001).

Despite significant trade liberalization over recent decades, for many developing countries, and especially the poorest of them, tariff revenue continues to be a core component of government finances. While collected tariff rates—tariff revenues as a percentage of import value—over the past 25 years have more than halved in the developed countries of the Organization for Economic Cooperation and Development (OECD), elsewhere in the world the reduction has been less marked. The average collected tariff rate in Africa remains especially high. In sub-Saharan Africa, trade taxes still account for around one-fourth of total tax revenue; in Asia and the Pacific, they account for about 19 percent (see table).

At the same time—no doubt reflecting in part the reduction in tariff rates—trade flows have soared since 1980, especially for developing countries (see chart). And it is these trade volumes that drive the workload of customs administrations. Thus, the demands made on customs administrations are likely to continue to increase, and the challenge will be to ensure that trade taxes are levied in a way that does the least collateral damage to international trade flows.

Easing trade flows often requires improvements in customs administration. What are the key problems that need addressing? Undoubtedly, they will vary, but in a typical unreformed customs administration, the whole process of assessing and collecting trade taxes is built around extensive physical inspection of shipments at points of entry. This task is overburdened and complicated by outmoded legislation—in many cases mandating 100 percent inspection—and by trade tax policies that involve extensive rate differentiation and exemptions, thereby adding to the difficulties of monitoring trade flows. Some use is made of information technology to process and record shipments, but little creative effort is made to apply that technology to simplify the compliance

Show us the money

Taxes on trade are diminishing but still remain too high in most regions.

Trade taxes as a share of total tax revenue (unweighted average, percent)

	1980	1990	2003
OECD[1]	4.7	2.7	0.8
Africa	38.6	31.9	25.3
Asia and Pacific	29.0	27.6	19.0
Middle East and Central Asia	31.7	28.9	19.8
Western Hemisphere	24.9	14.3	12.4

Sources: IMF, *Government Financial Statistics* and *World Economic Outlook* (various issues); OECD, *Revenue Statistics*.

[1]Organization for Economic Cooperation and Development, excluding Czech Republic, Hungary, Luxembourg, Poland, and Slovak Republic.

A U.S. customs officer scans containers at the port of Long Beach in California.

burden on the private sector or to ease the inspection effort. Shipments commonly experience substantial and unpredictable delays—20 days or more—before release from customs control. Procedures governing such routine but critical operations as establishing accurate import values and monitoring against misuse of exemptions are haphazard in design and are often poorly implemented. Bureaucratic procedures inhibit full information exchange and cooperation with other government departments, including the domestic tax administration.

Moreover, corruption is often widespread and taken for granted as a normal feature of business activity. Relations between the private sector and the customs administration are commonly adversarial. On both sides, morale is low and suspicion is high—often with good reason. To improve these dangerous dynamics, something needs to be done.

Key elements of modernization

It has become fashionable to refer to the work of a customs administration, and its improvement, as an aspect of "trade facilitation." But this is Orwellian newspeak, given that customs administration, inescapably, impedes trade. The point of modernization is to reduce the impediments—manifested in the costs of administration incurred by government and of compliance incurred by businesses—to the minimum consistent with the policy objectives that the customs administration is given. These impediments are potentially very costly. A 1994 study published by the United Nations Conference on Trade and Development (UNCTAD) estimates that the costs of trade transactions in the early 1990s represented about 7–10 percent of the value of world trade. Other studies put traders' costs in complying with border formalities at about 27 percent of the value of the shipment and often far higher in developing countries. Even within the European Union, the cost of internal border controls, prior to their removal, was put at 3–4 percent of the value of internal trade—and that was a context in which no trade taxes were being levied.

Addressing security concerns while continuing to facilitate trade (and minimize compliance costs) is particularly challenging. Security is being tackled actively by the United States, on a bilateral basis, through its Container Security Initiative (CSI) (see Box 1). At the same time, the World Customs Organization has developed the Framework of Standards to Secure and Facilitate Global Trade, which was adopted at its June 2005 annual meeting.

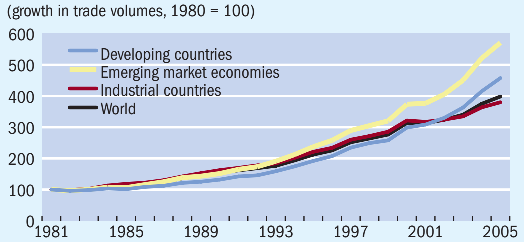
To reduce the significant economic costs involved in inefficient customs operations requires fundamental changes, both in the environment within which the customs administration works and in the way it operates. The objective is an effective customs administration that ensures that duties and taxes are collected as prescribed by the legislation in the most efficient way and in a manner that is as free as possible from corruption and political influence. The experiences of many countries point to some key characteristics that permit the customs administration to operate effectively. These include

- a clear separation between the setting of tax policy and its administration, with laws and regulations that are as simple and transparent as possible;
- confidentiality of taxpayer information;
- performance criteria, including revenue targets and service expectations, and the resources required to meet them;
- professional customs administrators who are well trained and well paid;

Turn up the volume

Between 1980 and 2005, the volume of all merchandise exports quadrupled—the increase was even more marked for developing countries than for developed.

(growth in trade volumes, 1980 = 100)



Source: IMF, *World Economic Outlook* database.

Box 1

Tackling security concerns

The perception of a heightened threat of terrorism since September 11, 2001, has led to a renewed emphasis, especially in the United States, on the physical inspection of cargoes. Topping U.S. concerns are the shipment of weapons of mass destruction in container ships (the "nuke in the box") and a possible massive disruption to key ports.

Initially, the increase in the number of inspections led to huge and costly delays at U.S. border points. But, in an effort not to raise costs to traders, and perhaps even to reduce them, the United States has increasingly been entering into agreements with other countries for the prescreening in those countries, by U.S. officials, of cargo destined for the United States. Clearance of this prescreened cargo is then expedited upon arrival in the United States. At the heart of this approach is the Container Security Initiative (CSI). By May 2005, the customs service had entered into 22 CSI bilateral arrangements covering 36 operational ports in Europe, Asia, Africa, the Middle East, and North America.

- a code of conduct for the staff that clearly spells out expectations and consequences of nonperformance;
- an effective internal audit function; and
- a clear and effective appeals procedure and, more generally, an atmosphere that encourages taxpayers to raise issues of interpretation of the tax laws and their administration (for example, through discussions with industry associations).

To foster or reinforce these characteristics, four key changes are required:

Establish coherent trade policies and clear supporting legislation. In its revenue functions, customs administration is a tool of trade and fiscal policy. Well-designed policy measures, simple and encapsulated in transparent legislation describing both the policy itself and the means of its implementation, are essential if the work of the customs administration is to convey benefits to society that offset the costs it necessarily involves.

Adopt modern, simple procedures. Customs administrations must cope with a wide range of special issues, many of which jeopardize revenue and other policy objectives. Goods that are exempted from duty on the grounds that they are in transit to another country, for instance, or because they are to be used to produce exports, may be fraudulently diverted to the domestic market. Exemptions given to specific goods, perhaps conditional on particular uses being made of them, may also be abused. Goods may be undervalued in order to reduce the duty payable. Protecting against these threats without unduly interfering with legitimate trade requires well-designed, simple procedures supported by computerization and the use of modern methods of data exchange.

Shift to substantial reliance on taxpayer self-assessment, supported by a shift from physical to postrelease controls. The key to effective tax administration is voluntary compliance by the taxpayer, and the key to voluntary compliance is self-assessment: that is, a system that relies on taxpayers to declare and pay the tax due but, crucially, provides for follow-up checks of those declarations, with penalties for misdeclaration. This is as true in the area of customs as it has proved, for instance, for the VAT or the income tax. In the customs context, it means less emphasis on physical inspection at the point of entry, with importers (or their agents) themselves simply declaring the duties payable—and more on effective controls after goods have been cleared for entry, in the form of postrelease audits.

Introduce incentive and organizational structures that promote integrity and effectiveness in customs administration. Customs administrations must be given a clear mandate, be free of political interference, and be well placed to cooperate with the tax administration and other branches of government. Corruption can never be eradicated, given the magnitude of the potential gains from illegal movement of goods, but it can be tempered by providing customs officers with both reasonable rewards for work well done and effective penalties. Some customs activities can be outsourced to the private sector—for example, by using inspection companies,

Box 2

Successful modernization in Morocco and Ghana

Both Morocco and Ghana have successfully modernized their customs administrations.

Morocco: In 1996, the average stay of containers in the port at Casablanca was 16 days, 10 of them resulting from customs controls. The authorities then embarked on a reform program that included improving the customs code, streamlining and simplifying procedures, implementing controls based on risk assessment, adopting performance standards and effective internal audit, using information technology effectively, and establishing a consultation process with the private sector. Three years later, the processing time for customs declarations had fallen from 10 days to three hours, and after five years 85 percent of declarations were processed in under an hour and a half—all with no apparent cost in terms of customs revenue collected (World Bank, 2002).

Ghana. In the 1990s, Ghana introduced trade policy reforms designed to attract foreign direct investment and promote business competitiveness. By 1998, it was clear that, to be successful, the policy reforms required parallel reform of the customs service. A key element was the introduction of the Ghana Community Network (GCNet), an electronic trade documentation system that enables the exchange of data among all players in the import process (customs, ministry of trade, Bank of Ghana, shipping lines, freight forwarders, and banks). It was modeled on the Singapore TradeNet, which Mauritius also subsequently adapted and implemented. By 2003, the time taken by customs to process import paperwork had been cut from 24 hours to 10 minutes, while bank payments averaged 10 minutes, rather than a few hours as previously.

although this runs the risk of dealing with the problem of ineffective domestic capacity by, in effect, giving up.

Daunting challenges

The position of customs officer is not quite the oldest profession in the world, but its lineage is ancient: the Bible refers to a customs collector called Zacchaeus (who was, predictably, corrupt but, happily, reformed). And the profession is still in a state of change—indeed, perhaps more so than ever.

Bringing about change is not easy, but many countries, such as Morocco and Ghana, have shown that it can be done (see Box 2). The modernization of customs administration requires strategic planning in often difficult circumstances, and strong political commitment. Critical challenges include securing revenues in the face of continued expansion in the volume of trade and the complications associated with regional trade agreements; rooting out corruption; coping with rapid changes in ways of doing business; and serving the wide range of nonrevenue functions (in particular addressing security concerns) still expected of customs administrations—all while seeking to minimize obstacles to legitimate trade.

What makes these challenges particularly daunting is the wide range of responses they demand: in procedures, legislation, organizational structures and incentives, the use of information technology, and relations with—and use of—the private sector. They also require resources, though in many cases it is not money but commitment that has been lacking.

Incidentally, the tools a modern customs administration needs to reconcile intensified security concerns with the goal of facilitating trade—reliance on more effective methods of risk assessment and more efficient exchange of information between the private sector and customs administration, and among customs administrations in different countries—are the same tools that developing countries need to reduce compliance costs for traders and collect revenue more effectively.

Measuring the potential gains from modernizing is difficult: past episodes of modernization have typically been accompanied by many other changes, for example in tariff rates and structures, that make it hard to isolate the effects of administrative changes. And there have been few attempts to measure the compliance costs that customs arrangements impose on taxpayers, and still fewer attempts to do so before and after reform.

Although it is hard to quantify with any accuracy the potential benefits of modernizing customs administration, there is ample evidence of the improvements that can be made in raising revenue and improving service to the trade community. These gains can be considerable. ■

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