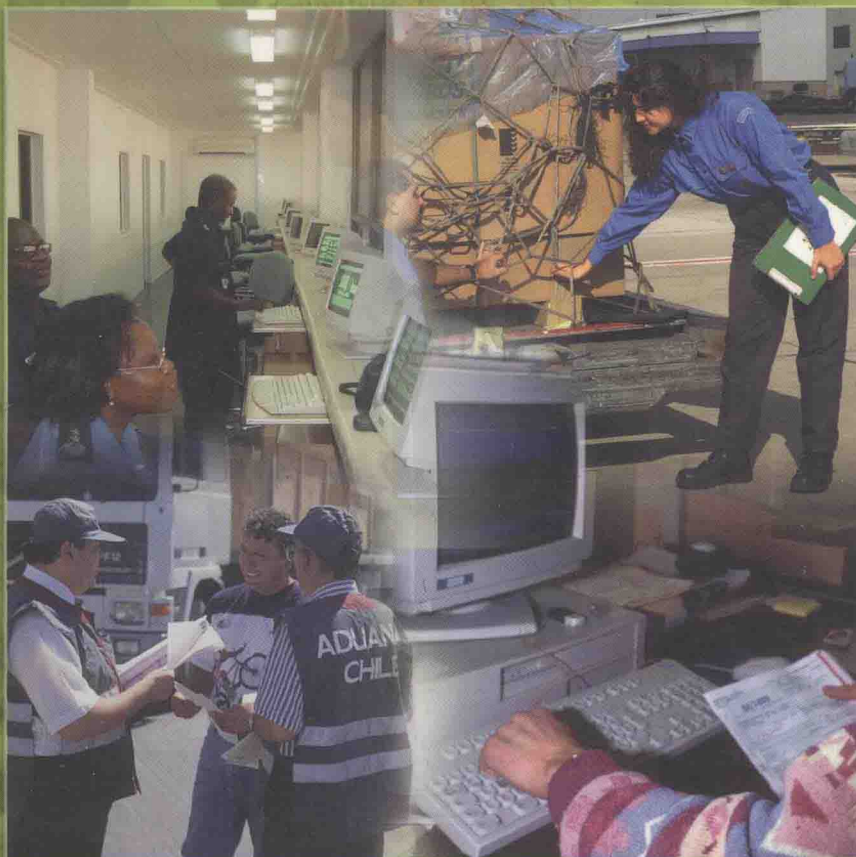


# CUSTOMS MODERNIZATION HANDBOOK

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Editors  
Luc De Wulf • José B. Sokol



THE WORLD BANK

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# CUSTOMS MODERNIZATION HANDBOOK

# FOREWORD

The experiences of recent decades have shown that the countries that have most successfully integrated into the world economy also have tended to record the highest growth rates. This result should not come as a surprise. Integration brings with it improved allocation of resources, intensified competition, and pressures to raise productivity, as well as exposure to new technologies, designs, and products. With world trade growth expanding more than twice as rapidly as world gross domestic product (GDP) over the past decade, the potential rewards from participating in world trade are considerable. Increased trade openness, through lower levels of protection in developed and developing countries, has contributed to this outcome. Nevertheless, it is widely acknowledged that an open trade regime will only foster trade integration when a range of complementary policies is in place.

One of the most important complementary policies is to put in place a well functioning customs administration that provides traders with transparent, predictable, and speedy clearance of goods. Indeed, a poorly functioning customs administration can effectively negate the improvements that have been made in other trade-related areas.

For many countries, achieving efficiency and transparency in customs operations remains a formidable challenge. In 2002, over US\$6.3 trillion of goods crossed international borders. Each one of those shipments passed through customs controls at least twice—at entry and at exit. Customs services have often had to cope with these growing trade volumes without any commensurate increase in staff or resources. In addition, customs administrations continue to face changes to their operating environment, which emphasize the need to adjust and modernize their processes. These include:

- more sophisticated and demanding clients, for example, traders who have invested significantly in modern logistics, inventory control, manufacturing, and information systems

- greater policy and procedural requirements associated with international commitments
- proliferation of regional and bilateral trade agreements, which significantly increase the complexity of administering border formalities and controls
- heightened security concerns and demands to respond to the threats posed by international terrorism and transnational organized crime
- widespread revenue fraud.

Many customs administrations are struggling to meet the continually increasing demands and priorities placed on them.

During the last decade many countries devoted substantial resources to reforming and modernizing their customs administrations, often with financial and technical support from international financial institutions and bilateral donors. The World Bank, the World Customs Organization, the International Monetary Fund, the United Nations Conference on Trade and Development (the ASYCUDA program especially), and the Regional Development Banks have, for a long time, been providing such support. As a result, a number of customs administrations have improved their capacities. Yet, far too many still operate inefficiently and, to some extent, fail to fulfill their assigned objectives. Modernization of customs is therefore likely to remain on the development agenda of many governments, and the donor community will be called upon to continue its support for customs modernization.

In recognition of this, the Trade Department of the World Bank prepared this *Customs Modernization Handbook* to provide guidance to the many organizations and individuals involved in the preparation and implementation of customs modernization projects. The Handbook draws on the lessons learned from past successes and failures, both by the Bank itself and a range of other organizations. It also draws on the collective experience of a wide range of individuals with extensive practical experience in

the field. The Handbook is complemented by a 2004 World Bank publication of eight case studies of customs modernization in developing countries—*Customs Modernization Initiatives*. These works, in conjunction with the recent IMF publication *Changing Customs*, which focuses on the revenue mobilization function of customs administrations, provide the necessary tools for initiating and undertaking the process of customs reform.

The guidelines contained in the Handbook are aimed at several audiences. First, they are aimed at policymakers and national managers who are called upon to take the lead in providing advice and guidance on the direction of reform efforts and securing the necessary political support for such initiatives. Second, they are aimed at project managers, national as well as from the donor community, who are required to design and implement customs modernization projects. Third, they are aimed at students of trade facilitation, who will find in the Handbook the context and operational modalities

of an organization that plays a crucial role in the overall trade logistics chain.

This Handbook is not intended to be encyclopedic. It is deliberately selective. It avoids many technical issues that are well covered in the many manuals and guidelines provided by organizations such as the World Customs Organization. Rather, it focuses on the critical issues that need to be addressed when designing and implementing effective and sustainable modernization projects and related initiatives.

We at the World Bank hope that the *Customs Modernization Handbook* will help in the achievement of the objective of helping policymakers to implement the needed reform and overall modernization that will enable customs to fulfill its role in the 21st century.

Danny M. Leipziger  
Vice President and Head of the Poverty  
Reduction and Economic Management Network

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# ABBREVIATIONS AND ACRONYMS

ACI	Advanced Cargo Information	CARICOM	Caribbean Community
ACI	Airports Council International	CAS	Country Assistance Strategy
ACP	Africa, the Caribbean and the Pacific	CBI	Cross-Border Initiative
ACP	Autoridad del Canal de Panamá	CBP	US Bureau of Customs and Border Protection
ACV	Agreement on Customs Valuation	CCC	Customs Cooperation Council
ADCS	Automated Data Collection System	CCO	Central Customs Office
AfDB	African Development Bank	CCP	Central Control Point
AFTA	Asian Free Trade Association	CEFACT	United Nations Centre for Trade Facilitation and Electronic Business
AGOA	African Growth and Opportunity Act	CEPS	Customs Excise and Preventive Services
ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement	CIF	Cost, Insurance, and Freight
ANZSCEP	Agreement between New Zealand and Singapore on a Closer Economic Partnership	COMESA	Common Market for Eastern and Southern Africa
APEC	Asia-Pacific Economic Cooperation	CRO	Committee on Rules of Origin
ARA	Autonomous Revenue Authority	CSD	Container Security Device
ARO	Agreement on Rules of Origin	CSI	Container Security Initiative
ASAC	Aviation Security Advisory Committee	CSTF	Cargo Security Task Force
ASEAN	Association of Southeast Asian Nations	C-TPAT	Customs–Trade Partnership Against Terrorism
ASEZA	Aqaba Special Economic Zone Authority	DF	Diagnostic Framework
ASYCUDA	Automated System for Customs Data	DFID	Department for International Development
ATA	Air Transport Association	DSS	Duty Suspension Scheme
BDV	Brussels Definition of Value	DTI	Direct Trader Input
BGMEA	Bangladesh Garments Manufacturing and Export Association	EAC	East African Cooperation
BIR	Bureau of Internal Revenue	EBA	Everything but Arms
BIVAC	Bureau of Inspection Valuation Assessment and Control	EC	European Community
BOC	Bureau of Customs	ECA	Europe and Central Asia
BOT	Build-Operate-Transfer	ECAC	European Civil Aviation Conference
BOT	Bureau of Trade	ECO	Economic Cooperation Organization
BOO	Build, Operate, and Own	ECOWAS	Economic Community of West African States
CA	Crown Agents	EDCS	Electronic Data Collection System
CACM	Central American Common Market	EDI	Electronic Data Interchange
CAM	Customs Assistance Mission	EEC	European Economic Community
		EFT	Electronic Funds Transfer
		EFTA	European Fair Trade Association
		EPZ	Export Processing Zone
		EU	European Union
		FAK	Freight of all Kinds



FDI	Foreign Direct Investment	ILO	International Labor Organization
FOB	Free on Board	IMF	International Monetary Fund
FTA	Free Trade Agreement	IMO	International Maritime Organization
FTZ	Free Trade Zone	IOC	Indian Ocean Commission
GAO	General Accounting Office	IRU	International Road Transport Union
GATT	General Agreement on Tariffs and Trade	ISPS	International Ship and Port Facility Security
GCMS	Ghana Customs Management System	IT	Information Technology
GCNet	Ghana Community Network	ITF	International Transport Workers Federation
GDP	Gross Domestic Product	LDC	Least Developed Country
GEP	<i>Global Economic Prospects</i>	MDCS	Mobile Data Collection System
GMS	Greater Mekong Subregion	MFN	Most Favored Nation
GOIEC	General Organization for Import and Export Control	MODAAC	ASYCUDA++ Accounting Module
GOM	Government of Mozambique	MODTRS	ASYCUDA++ National Transit Module
GSP	General System of Preferences	MOF	Ministers of Finance
GST	General Sales Tax	MOF	Ministry of Finance
GVC	GATT Valuation Code	MPF	Ministry of Planning and Finance
HQ	Headquarters	MTSA	Maritime Transport Security Act
HRO	Harmonized Nonpreferential Rules of Origin	MUB	Manufacturing Under Bond
HS	Harmonized Commodity Description and Coding System	NAFTA	North American Free Trade Agreement
HWP	Harmonization Work Program	NCTS	New Computerized Customs Transit System
IACA	International Air Carriers Association	NGO	Nongovernmental Organization
IATA	International Air Transport Association	NPR	Nepalese Rupees
ICAC	Independent Commission Against Corruption	NTB	Nontariff Barriers
ICAO	International Civil Aviation Organization	NVOCC	Nonvessel Operating Common Carriers
ICC	International Chamber of Commerce	OECD	Organisation for Economic Co-operation and Development
ICMP	International Customs Modernization Process	OED	Operations Evaluation Department
ICR	Implementation Completion Report	OP	Operational Policy
ICS	Inspection and Control Services	OSC	Operation Safe Commerce
ICT	Information and Communications Technologies	PAD	Project Appraisal Document
IDB	Inter-American Development Bank	PIN	Personal Identification Number
IDI	Institutional Development Impact	PRA	Port Risk Assessment
IFALPA	International Federation of Airline Pilots Associations	PRSP	Poverty Reduction Strategy Paper
IFIA	International Federation of Inspection Agencies	PSI	Preshipment Inspection
IGAD	Intergovernmental Authority on Development	PSR	Project Status Report
		PTA	Preferential Trade Agreement
		RCDP	Russian Customs Development Project
		RFID	Radio Frequency Identification
		RIFF	Regional Integration Facilitation Forum

RMG	Ready Made Garments	TCCV	Technical Committee on Customs Valuation
RSC	Regional Steering Committee	TCRO	Technical Committee on Rules of Origin
RSO	Recognized Security Organization	THA	Tanzania Harbors Authority
RTCD	Road Transit Customs Declaration	TI	Transparency International
SAARC	South Asian Association for Regional Cooperation	TIMS	Trade Information Management System
SACU	Southern African Customs Union	TIR	Transport International Routier
SAD	Single Administrative Document	TRA	Tanzania Revenue Authority
SADC	Southern African Development Community	TRACECA	Transport Corridor Europe Caucasus Asia
SADOC	Système de l'Administration des Douanes et de l'Office des Changes; Computerized Support for Customs Clearance	TRIE	Transit Routier Inter-États
SAL	Structural Adjustment Loans and Credits	TRIPS	Trade-Related Aspects of Intellectual Property Rights
SAR	Staff Appraisal Report	TSA	Transportation Security Administration
SAT	Satisfactory	TTCA	Transit Transport Coordination Authority
SBW	Special Bonded Warehouse	TTFSE	Trade and Transport Facilitation in Southeast Europe
SCC	State Customs Committee	UCR	Unique Consignment Reference
SDT	Special and Differential Treatment	UD	Utilization Declaration
SECI	South East Cooperation Initiative	UDEAC	Union Douanière des Etats de l'Afrique Centrale
SGS	Société Générale de Surveillance	UNCTAD	United Nations Conference on Trade and Development
SITPRO	Simplifying International Trade	UNECE	United Nations Economic Commission for Europe
SOLAS	International Convention for the Safety of Life at Sea	UNSAT	Unsatisfactory
SPARTECA	South Pacific Regional Trade and Economic Co-operation Agreement	URA	Uganda Revenue Authority
SSP	Sector Strategy Paper	US	United States
SSP	Shipper Security Plan	UTRA	Technical Unit for Restructuring Customs
SUNAT	Superintendencia Nacional de Administracion Tributaria; Internal Revenue Service	VAT	Value Added Tax
TA	Technical Assistance	WBCG	Walvis Bay Corridor Group
TAEPD	Trade Assistance Evaluation Project Database	WCO	World Customs Organization
TAL	Technical Assistance Loan	WEF	World Economic Forum
TAP	Temporary Admission for Inward Processing	WTO	World Trade Organization
TARIC	Tarif Intégré de la Communauté; The Integrated Tariff of the Community	ZRA	Zambian Revenue Authority

# OVERVIEW

This handbook aims to make a positive contribution to the efforts that many countries are undertaking to modernize their customs administrations. The handbook views a competent and well-organized customs service as one that successfully balances its various responsibilities to ensure a high level of compliance with revenue objectives and regulatory requirements while at the same time intervening as little as possible in the legitimate movement of goods and people across borders.

The handbook recognizes that conditions differ greatly across countries, so that each customs administration will need to tailor its modernization efforts to national objectives, implementation capacities, and resource availability. Nevertheless, meeting the modernization objectives will most likely require the adoption of the core principles discussed in this handbook: adequate use of intelligence and reliance on risk management; optimal use of information and communications technology (ICT); effective partnership with the private sector, including programs to improve compliance; increased cooperation with other border control agencies; and transparency through information on laws, regulations, and administrative guidelines.

Success in customs modernization is, as importantly, tied to the overall trade policy environment. Simple, transparent, and harmonized trade policies reduce administrative complexities, facilitate transparency, and reduce the incentives and opportunities for rent-seeking and corruption. Customs modernization, therefore, also needs to be examined from the broader and complementary perspective of trade policy reform.

## *Improving Customs Processes Is Part of the Trade Facilitation Agenda*

Trade facilitation measures need to complement trade liberalization if countries are to increase their external competitiveness and become better integrated into the world economy. When the European Community, introduced a common exter-

nal tariff in 1968 it quickly realized that to fully benefit from its common market, it needed to streamline customs processes. In the same vein, the World Trade Organization (WTO) in 1996—as part of the Singapore agenda—added trade facilitation to its negotiation agenda realizing that nontariff barriers, to which excessive customs costs belong, are at times more important trade barriers than tariffs and prevent the achievement of trade liberalization objectives.

Trade involves goods crossing borders. This requires that a number of procedures foreseen in the national legislation be followed. Some of these procedures pertain to issues of security and standards, while others deal with customs. Customs procedures are governed by the national legislation and implemented by customs staff that operate mostly under the Ministry of Finance. Conforming to these procedures is not costless, but these costs are often excessive. It is not the intention of the handbook to elaborate on inefficiencies nor to detail all the dysfunctionalities of customs organizations and customs operations, even though some of these are described in individual chapters, as introduction on how best to remedy them. Yet, it is their persistent recurrence and their impact on a country's competitiveness that prompted traders and political leaders to seek out ways to make their customs organizations more effective and efficient. This handbook aims at assisting them in this ambition. It must suffice, therefore, to briefly note the main inefficiencies that these reforms aim to address. First, outdated legislation may not clearly establish the authority of customs, may be out of tune with international commitment, may provide for inadequate transparency and predictability, and may require complex procedures while preventing full use of information technology and risk analysis. Second, customs staff may lack the competence to interface with traders that operate in a constantly changing and challenging business. Often their compensation packages, including career management and training, are inadequate, so that motivating and retaining qualified staff is a major

challenge. Third, operational procedures are often excessively and unnecessarily complex and open to discretionary decisions while exporters have poor access to duty-free inputs. Fourth, customs all too often makes insufficient use of available communications and information technology, and thus is out of tune with modern business practices that rely on advanced notification, direct trader input, and tracking devices. This increases costs to traders, opens the door to discretionary decisions, and undermines oversight and audit activities. Fifth, high levels of corruption characterize many a customs agency, as is testified to in investors' surveys and corruption indexes. Sixth, smuggling activities undermine revenue generation and impart unfair advantages to unscrupulous traders, and undermine the intended protection policies embedded in the tariff structure. In sum, customs procedures are often excessively time consuming, unpredictable, and weak in their revenue generation function.

### *Good Diagnostics Are the Key Starting Point*

Customs operations consist of sets of interlocking processes. To be efficient and effective they need to be adapted to changing trade practices and modern management approaches as well as reflect the various objectives of the country. Yet, customs practices in quite a few countries are not well attuned to these criteria. Rooted in long-standing traditions, they tend to delay the clearance of cargo and conduct operations in a nontransparent manner. Experience shows that effective customs modernization processes generally start with good initial diagnostic work to identify the shortcomings of the existing system, to define a strategy for reform, and to mobilize stakeholder support. Successful modernization also requires a comprehensive approach, that is, an approach that encompasses all aspects of customs administration to address the issues identified, as well as an adequate sequencing of actions. Strategies need to be realistic and should consider the country's capacity to implement, the time that is required, and the level of stakeholder and political support that is needed.

These reform efforts also need to be consistent with the trade policies pursued and should have the capacity to adapt to changing circumstances. For example, the emphasis on issues such as trade facilitation and national security are now more prevalent than in the past.

### *Human Resources Policies Need to Be at the Center of Customs Reforms*

The task of customs has become increasingly difficult because of the growing complexities of trade policy due to the proliferation of regional and international trade agreements, the greater sophistication of traders, and the multiple and shifting objectives imposed on customs. Security is now a new important challenge. Uniformity of customs operations across the territory and across cargo categories is important, and speedy release of goods is crucial to supporting the competitiveness of traders. There is also a need to adhere to international standards on value and classification, as well as regional standards on rules of origin.

Good human resources management is the linchpin to effective and efficient customs administration. This is too often neglected. The management of human resources is multifaceted. It includes recruitment, training, staff compensation and promotion, as well as enforcement. None of these tasks is easy, and often must be implemented in a constrained environment. These difficulties should not discourage the investigation of possible new initiatives and alternative approaches. However, case studies do suggest that within these constraints still much more attention should be given to human resources issues.

To address the constraints imposed on human resources reforms by rigid and often outdated civil service administration policies, many countries have pursued drastic organizational changes. For example, Autonomous Revenue Agencies (ARAs) have been established to avoid rigid civil service rules, as well as to provide more financial autonomy and greater flexibility in operational matters. However, experience has shown that creating an ARA is no guarantee for success because they have too often been focused on providing better staff compensation without sufficient attention to the other elements of customs operations that enhance effectiveness and efficiency. Also, quite a few ARAs failed to maintain, over the longer term, the flexibility and the autonomy with which they were originally established.

Another mechanism to implement reforms has been the pursuit of management contracts with the private sector. Management contracts can indeed improve aspects of customs operations if they are

well designed and monitored. So far, these management contracts have largely been tested in unique circumstances in countries emerging from severe conflicts (Mozambique and Angola, for example) and where institutional capacity was exceedingly weak. Engaging private service operators in those countries had the advantage of substantially improving revenue performance in the short run and under difficult circumstances. The track record for transferring management capabilities to nationals, however, is still being tested. Initial reports suggest that this has proven more difficult than originally imagined.

Changes in the organizational structure of customs can at times be instrumental to improving performance, as change can lift important operational constraints. Evidence suggests, however, that such changes will only have lasting effects if they contribute to good human resources management and better customs clearance practices.

### *An Adequate Legal Framework Is Important*

The modernization of customs laws and regulations and their supporting legal environment is an essential component of the reform effort. In this area, countries can refer to (or adopt) the Revised Kyoto Convention, which provides both the legal framework and a range of agreed on standards to improve customs operations with a view toward standardizing and harmonizing customs policies and procedures worldwide. Countries that are signatories of the Convention can still tailor their policies and procedures in specific ways to meet their unique legal, political, cultural, and economic requirements.

In many countries the Customs Code needs to be modernized, especially to exclude noncore customs elements, seek harmonization and compliance with agreed on international commitments, and ensure transparency and predictability by providing basic information on matters such as rules, decisions, consultation mechanisms, and adequate appeals processes. A revised Code can also help trade facilitation by supporting the use of risk management practices and by eliminating complex or redundant customs formalities that delay clearance and create opportunities for unnecessary discretionary interventions. Finally, the Code should also grant adequate authority for customs to achieve its enforcement and compliance goals.

### *Improved Integrity Is Key to Promoting Investment and Growth*

Customs is frequently perceived as being corrupt. To the extent that this is true, this image negatively affects the overall investment climate of the country and the processing of international trade transactions. Corruption undermines the country's external competitiveness and its attractiveness to domestic and foreign investment. If left unchecked, this image of corruption undermines the growth potential of the country.

Customs is vulnerable to corruption because the nature of its work grants its officials substantial authority and responsibility to make decisions that affect the duty and tax liability of traders or the admissibility of goods. High tariffs and complex regulations enhance opportunities and incentives. That many customs staff members are poorly paid adds to the problem.

The adoption of procedures that provide little discretion to customs staff and that have built-in accountability mechanisms reduces both the opportunity and incentive for corruption. In conjunction with improved trade policies, the first line of defense against corruption consists of implementing modern procedures that reduce face-to-face contact between traders and customs officials and that reduce the discretionary powers of customs officials. In addition, providing adequate staff compensation, enhancing the risk of detection, and strengthening the capacity to investigate and prosecute breaches of integrity would go a long way toward promoting integrity in customs. Most customs managers are of the opinion that corruption is such a prevalent phenomenon today that countermeasures would require the implementation of specially designed policy efforts. This is the approach that is promoted by the World Customs Organization and is incorporated into the Revised Arusha Declaration on Integrity in Customs.

In looking to implement the key elements of the Revised Arusha Declaration, experience suggests that a good starting point is to conduct a comprehensive assessment of the situation to identify the shortcomings that present opportunities for corruption and to establish realistic priorities, as well as practical objectives and activities, all leading to an integrity plan that should be a part of all comprehensive customs reform efforts.

### ***Risk Management Underpins Much of Modern Customs Practices***

In an effort to achieve an appropriate balance between trade facilitation and regulatory control, customs administrations are generally abandoning their traditional, routine “gateway” checks and are now applying the principles of risk management with varying degrees of sophistication and success.

*Organizational risk* refers to the possible events and activities that may prevent an organization from achieving its objectives. Risks facing customs include the potential for noncompliance with customs laws as well as the potential failure to facilitate international trade. Customs, like any other organization, needs to manage its risks and do so while interfering as little as possible with the flow of legitimate trade. There clearly is a trade-off between control and trade facilitation. Too much of one makes it difficult to achieve the other. Customs therefore needs to apply a set of management procedures that takes this into account. These procedures include the identification, analysis, evaluation, and mitigation of the risks that may affect the achievement of these objectives.

Basic risk management has always been fundamental to customs operations, and has guided the formulation of antismuggling policies, the functioning of border controls to verify the movements of goods and passengers, and the establishment of documentary controls and physical inspection procedures. However, in recent times the increasing complexity, speed, and volume of international trade, fueled by technological advances that have revolutionized global trading practices, have significantly affected the way in which customs authorities implement risk management. This has led many customs administrations to adopt a more disciplined and structured approach to managing risk.

Customs needs to evaluate the risks that are presented by the nature of its operations. This includes the need for customs to review its operational procedures and assess where breaches of procedures are likely to jeopardize the attainment of stated objectives. Such assessment could be included in the above-mentioned overall diagnostic exercise. In other words, customs needs to provide a risk map that identifies the potential vulnerabilities of its processes and determine how its procedures may need to be geared toward ensuring better realiza-

tion of its objectives. On the basis of the risk assessment, a risk containment strategy should be defined. This implies that priorities would be set, operational details would be geared toward these priorities, and resources would be effectively and efficiently deployed. If smuggling turns out to be a major problem, the strategy should reflect this, and border posts and mobile inspection teams may need to be strengthened. If undervaluation is a major problem, there may be a case for strengthening the valuation unit and for increasing the number of traders subject to post-clearance audit. If the risk is that goods tend to be misclassified to attract a lower tariff rate or are declared with lower unit counts or weights, there may be a need to physically inspect the cargo. In any event, risk management should ease the controls on the less risky aspects of trade and should focus on the part that represents the greatest risk. This would reflect a balanced approach between control and trade facilitation.

### ***Customs Valuation Is a Core Customs Function***

Customs valuation practices are subject to the WTO Agreement on Customs Valuation (ACV), which mandates that the customs value of imported goods, to the greatest extent possible, should be the transaction value, that is, the price paid or payable for the goods. However, valuation fraud is frequently reported as a major problem in developing countries, and many of them still find that implementing the ACV presents one of the most challenging aspects of customs work. Valuation work is particularly difficult in some countries in which the reliability of commercial invoices tends to be poor, and where trade undertaken by the informal sector and in second-hand goods is significant. Also, many countries are still ill equipped to undertake post-clearance audit.

Substantial efforts have so far been made to explain the intricacies of the ACV to customs officials of developing countries. Yet, most observers realize that valuation reform, in the absence of comprehensive customs modernization programs, is likely to disappoint. A narrow focus on valuation work will fail if reform takes place within an administratively and technically ill-equipped customs. The reform elements that will benefit valuation work must include the streamlining of operational procedures, the introduction of a modern customs

compliance improvement strategy based on a formalized risk management strategy, the use of post-clearance audits, the development of a commercial intelligence capacity, and the adoption of appropriate incentives and disincentives designed to progressively increase the level of voluntary compliance.

Direct technical assistance for improved valuation work might be more productive if such assistance were concentrated on the development of valuation databases, risk management systems, and post-release review and audit. A valuation database should be established and constantly updated to provide customs with a practical tool for research and risk management purposes. The valuation function in Customs could be strengthened by setting up an appropriate legal framework; establishing valuation control procedures based on selective checking, risk analysis and management, and post-release audit; establishing central and regional valuation offices; and providing specialized training.

The hiring of preshipment inspection (PSI) companies may be useful in assisting customs with valuation work during its initial reform stages, where capacity is being enhanced to carry out the valuation function. However, if PSI services are used, care needs to be exercised to maximize their utility and to ensure maximum consistency with the WTO valuation principles. This handbook spells out a number of conditions that should be investigated when considering the adoption of PSI services or when evaluating their contribution.

### ***Rules of Origin Should Be Simplified***

Determining the country of origin, or the “nationality,” of imported products is necessary for the application of basic trade policy measures such as tariffs, quantitative restrictions, antidumping and countervailing duties, and safeguard measures, as well as for requirements relating to origin marking and public procurement, and for statistical purposes. Such objectives are met through the application of basic or nonpreferential rules of origin. Countries that offer zero or reduced duty access to imports from certain trade partners apply preferential rules of origin. These differ most frequently from the nonpreferential ones. Preferential rules are designed to ensure that only goods originating from participating countries enjoy preferences.

However, rules of origin can be designed to restrict trade and, therefore, can and have been used as trade policy instruments. The proliferation of free trade agreements with accompanying preferential rules of origin is increasing the burden on customs in many countries because the clearing of preferential trade is more complex than nonpreferential trade. This suggests that the trend toward more preferential free trade agreements may conflict with trade facilitation.

The determination of the country of origin of products has, in the last few decades, become more difficult as technological change, declining transport costs, and the process of globalization have led to the splitting up of production chains and the distribution of different elements in the production of a good to different locations. The issue becomes, which one or more of these stages of production define the country of origin of the good?

WTO members have so far failed to reach an agreement on the definition of rules of origin, despite efforts undertaken in the World Customs Organization (WCO) since 1995. Having harmonized rules of origin for nonpreferential purposes would save time and costs to traders and customs officers and provide for greater certainty and predictability of trade. Harmonized rules would also help avoid trade disputes that arise from uncertainties in the determination of the country of origin with regard to antidumping and countervailing duties, safeguard measures, and government procurement decisions. In general, clear, straightforward, transparent, and predictable rules of origin, which require little or no administrative discretion, will add less of a burden to customs than complex rules.

### ***Good Duty Relief and Exemption Control Systems Are Important***

Customs may provide duty relief for some imports. This practice is mainly used for the importation of inputs used for the manufacture of export products. The justification for doing so is simple. Any duty paid on these inputs would increase the cost of the exports and make these exports less competitive. In fact, following the widely accepted destination principle of taxation, only goods destined for domestic consumption should bear a tax burden. Duty relief for inputs that are directed toward the



production of exports can be granted in two ways: either a suspense regime is applied and no duties for imported inputs are paid at the point of import; or duties are paid and later refunded, when the products into which the inputs are incorporated are exported. The WCO Revised Kyoto Convention provides guidelines on how this should be done and these can be reflected in the Customs Code and translated in operational guidelines for importers and customs staff. However, experience shows that many developing countries have difficulty in properly administering and monitoring duty relief and exemption regimes, resulting in abuse, fraud, and revenue leakage. In the absence of smoothly operating duty relief mechanisms, export manufacturers have to produce at higher cost than would be the case if they had full and easy access to production inputs at world prices.

Export manufacturers have a preference for temporary admission systems, bonded warehouses, and export processing zones over duty drawback, especially when tariffs are high, when inflation erodes the duty refunds, and when interest rates for working capital are high. The prepayment of import duties on inputs increases the production costs of the exporter. The drawbacks have all too often been disbursed late, thus substantially eroding real value when inflation and financing costs are high. However, governments in most developing countries require customs to focus on revenue collection rather than trade facilitation and, therefore, tend to prefer drawback to temporary admission systems.

Managing duty relief schemes in a secure and cost effective way requires well-defined processes and controls. It requires that special mechanisms be put in place to ensure that claims for duty relief are legitimate and correctly executed, and that goods admitted under duty suspense regimes are effectively incorporated in exports and not diverted for home consumption.

The scope of duty exemptions should be limited as much as possible as exemptions can be abused, thus leading to unfair competition and revenue losses. Moreover, there are good economic and administrative reasons for maintaining duty exemptions only as required by international conventions and for noncommercial goods. Until the redundant exemptions are eliminated, customs should devote adequate technological and man-

power resources to the control and monitoring of such exemptions.

### *Customs Procedures Should Facilitate Transit*

Poor transit procedures are a major obstacle to trade and penalize many landlocked developing countries. A transit system aims to facilitate the transport of goods through a customs territory, without levying duties and taxes in the countries of departure and transit, in accordance with the destination principle of taxation that states that indirect taxes should only be levied in the country of consumption. The Customs Code should provide transit-related legislation, failing which, transit should be regulated by a binding agreement between customs and the different parties affected by the transit operation.

The core provisions of a good transit system include that the shipments be sealed at the point of departure, that guarantees can be made available to ensure the payments of duties and taxes if traders do not provide proof that the goods have left the country, and that customs has an information system that informs it when the goods have left the country so that the guarantee can be released. In many countries these core elements are either lacking or weak and should be the focus of any transit modernization initiative.

Trade policies should recognize that customs transit is only one part of a wider range of policy issues that affect transit. These other issues pertain to many other participants and procedures, including cross-border vehicle regulations, visas for truck drivers, insurance, police controls, and the quality of infrastructure. Even if customs transit procedures are made effective and efficient, full trade facilitation will require that these issues be addressed. The TIR (Transit Routier International—the international road transit procedures) and its network of national guaranteeing associations offer the best current reference system.

Effective and efficient transit facilitation institutions such as corridor agreements can promote active cooperation between and among transit and landlocked countries. Transit agreements are important in forming and shaping such cooperation, either at the bilateral, subregional, or regional level. Transit operations will benefit from good public-private cooperation that can identify deficiencies in border-crossing procedures.



### *Security Has Become an Integral Customs Objective*

The emergence of international terrorism has caused security to become a major issue for many governments, and customs administrations are increasingly called upon to contribute to national security objectives. In the past, many customs administrations performed most of their preventive operations as goods arrived at seaports, airports, and land borders, based upon an entry declaration made at the time of importation. To provide the level of security that is required, governments will increasingly depend on information and risk assessments that are undertaken in advance of the arrival of the cargo in the country of destination. International conventions that apply to sea and air transport provide for agreed upon mechanisms to enhance the security of these modes of transportation—vehicles, cargo, and personnel—as well as how these transport modes are operated. Several national governments, particularly that of the United States of America, have issued regulations and have promoted private–public sector agreements to enhance security. These, again, are largely based on the advance submission of information and certification that the particular companies adhere to a range of security standards. Such regulations are constantly being refined and implemented. Customs' skill in assessing the information through analytical processes, deployment of resources, effective communication and decision-making, therefore, has become even more important than in the past.

Protecting society involves protection of the entire international trade supply chain from the moment the cargo leaves the export country to the moment of arrival at the destination country. This changing environment requires an “all of government” approach. In this way, governments can use customs as a key resource in border security, using its experience of managing risks and knowledge of international trade as an important element of national security. Thus, customs can usefully complement the contributions made by other competent agencies, such as immigration, intelligence agencies, and those involved in policing maritime, aviation, and land operations.

While security is of great importance to governments and traders, customs has an equal responsi-

bility to facilitate legitimate trade. If applied correctly, security can enhance facilitation by building business confidence, increasing predictability, and, as a consequence, facilitating inward investment. However, the international community will need to monitor how specific security initiatives and advance notice requirements will affect weaker trading partners, particularly those that use ports that are not receiving technical assistance to strengthen their security to the satisfaction of the ports of destination. These traders may have difficulties in fully complying with the advance notice requirements.

While it is not possible at this time to predict the trade-related consequences of the heightened security agenda, it seems probable that the countries that feel vulnerable to terrorist attack will regard consignments from certain countries as representing a higher risk. In this regard, the level of integration of the world economy is such that even countries that are not directly involved in a conflict or subject to terrorist attack suffer losses in trade and welfare as a result of increased security concerns and higher frictional costs of trade. For those countries with a high degree of reliance on trade (ratio of trade to GDP), including many developing countries, the need for concerted action in the security area becomes a key priority in the development agenda.

### *Information and Communications Technology Promotes Customs Modernization*

An effective customs administration that leverages technology can benefit from improved transparency, greater efficiency, and enhanced security. However, the benefits that could be derived from greater reliance on ICT has at times been undermined by the failure to streamline customs procedures, thus creating a process where outdated manual practices continue alongside computerized practices. Although ICT for customs administration is not a panacea or an end in itself, it can powerfully contribute to effective customs administration and operations when integrated into a broader modernization effort.

To meet its mission, a customs administration must effectively integrate modern practices and processes with ICT-driven customs management systems. In doing so, customs should identify