

**SIMPLIFICATION OF
CUSTOMS PROCEDURES:**
*REDUCING TRANSACTION
COSTS FOR EFFICIENCY,
INTEGRITY, AND TRADE
FACILITATION*

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Acronyms

ACOS	Automated Customs Operations Systems
ADB	Asian Development Bank
AEBF	Asian-Europe Business Forum
AEM	ASEAN Economic Ministers Meeting
AFTA	ASEAN Free Trade Area
AHTN	ASEAN Harmonization Tariff Nomenclature
APEC	Asia Pacific Economic Cooperation
APEC BMC	APEC Budget and Management Committee
APEC-SCCP	APEC-Sub-Committee on Customs Procedures
APEC TILF	APEC Trade and Investment Liberalization and Facilitation Fund
ASEAN	Association of Southeast Asian Nations
ASEM	Asia-Europe Meeting
ASEM DG-C	ASEM Directors-General and Commissioners Meeting
ASEM TFAP	ASEM Trade Facilitation Action Plan
ASYCUDA	Automated Systems for Customs Data Management
ATI	Asian Terminal Incorporated
BIDA	Brokers and Importers Data Access
BOI	Binding Origin Information
CAPs	collective action plans
CAPEC	Conference of Asia-Pacific Express Carriers
CCBI	Chamber of Customs Brokers, Incorporated
CCMAA	Customs Cooperation and Mutual Administrative Assistance Agreements
CDEC	Consolidators Data Exchange Centre
CDSS	Customs Decision Support System
CIF	cost, insurance, and freight
DMCs	developing member countries
DTI	Direct Traders Input facility

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EC	European Commission
EDI	electronic data interchange
EMM	Economic Ministers Meeting
EU	European Union
FOB	free-on-board
GATT	General Agreement on Tariffs and Trade
G7	Group of Seven
HCV	Harmonization of Customs Valuation
HS	Harmonized System
IAPs	individual action plans
IATA	International Air Transport Association
IECC	International Express Carriers Conference
IEG	Investment Experts Group
IMF	International Monetary Fund
IPAP	Investment Promotion Action Plan
IT	information technology
MDBs	multilateral development banks
MOU	memorandum of understanding
NACCS	Nippon Automated Cargo Clearance System
NAFTA	North American Free Trade Agreement
OECD	Organization of Economic Cooperation and Development
PCCI	Philippine Chamber of Commerce and Industry
PFI	Philippine Federation of Industries
PTCP	Philippine Tax Computerization Program
PUC	Philippine Users Confederation
RILO	Regional Intelligence Liaison Offices
SAD	single administrative document
SEOM	Senior Economic Officials Meeting
SITA	Société Internationale de Télécommunications Aéronautiques
SOMTI	Senior Officials Meeting on Trade and Investment
SPS	Sanitary and Phytosanitary Procedures

TCRO	Technical Committee on Rules of Origin
UN	United Nations
UN CEFAC	UN Centre for the Facilitation of Procedures and Practices for Administration, Commerce and Transport
UNDP	UN Development Programme
UNCTAD	UN Conference on Trade and Development
UR	Uruguay Round
WB	World Bank
WCO	World Customs Organization
WTO	World Trade Organization
WTO-TRIPS	WTO-Intellectual Property Rights Agreement

Foreword

It was a great pleasure for us at the Asian Development Bank to host the Asia-Europe Meeting (ASEM) Seminar on Harmonization and Simplification of Customs Procedures, held on 23–26 February 1999, in cooperation with the Philippine Bureau of Customs and the private sector. It was unusual and noteworthy to assemble in a single venue high-level officials and private-sector leaders from the 15 member countries of the European Union (EU) and 10 Asian countries, both developed and developing, as well as representatives of major international organizations such as the EU itself, the Association of Southeast Asian Nations (ASEAN), and the World Customs Organization (WCO).

The ADB is the premier regional development bank for Asia and the Pacific, working independently but in partnership with the World Bank, the European Commission (EC), ASEAN, and other multilateral and bilateral organizations. The Bank is owned by 57 countries, of which 41 are from the region; the others include many of the European countries represented at the ASEM. In recent years, Bank assistance to developing member countries has averaged over US\$7 billion a year. This includes an annual grant assistance of over US\$150 million, of which a significant proportion is provided through the Japan Special Fund. The Japanese Special Fund also contributed significant resources which have made the ASEM seminar possible.

ADB has been transforming itself from a project lender into a broad-based development institution to meet the changing and increasingly complex needs of the developing member countries, with poverty reduction as the overarching goal. This transformation calls for even closer cooperation with a variety of other international efforts. This is one rea-

son why we welcomed the opportunity to support and host this seminar. There is another important reason. The Bank is vitally concerned with issues of governance and corruption, because good governance is indispensable for sound economic management and sustained development, and corruption is very costly, particularly for the poor. Customs procedures and processes are at the heart of these issues. I am confident that the papers presented in this book will make a good contribution to the analysis and the dialogue, as well and set a key precedent for continuing similar collaborative efforts in the future, in order to make tangible progress toward procedural streamlining, in the common interest of all concerned.

Tadao Chino
President
Asian Development Bank

Introduction

The Economic and Governance Dimensions of Customs Procedures*

Salvatore Schiavo-Campo

This introduction is aimed at providing a broad context to the apparently technical questions of procedural simplification in customs. Much of the following is familiar material, but necessary to underline the important linkages between the customs function and the overall economic system. The subject of customs procedures appears technical, narrow, and hardly exciting. Yet the subject is anything but just technical, and anything but narrow. Indeed, in these days of still fragile recovery from the financial typhoon that hit East Asia in mid-1997, the subject matter is crucial.

Concerning the *economic context*, the French economist Frederic Bastiat said over a century ago, in his argument against trade protection: "A customs duty is a negative railway." He meant that, by raising the cost of imported goods, tariffs have the exact opposite effect of a new railroad, which lowers transport cost. His story was right, of course, but was not the full story. Economic distance (the difference between the cost at origin and the cost at destination) is a function of *four* elements, not three: insurance, freight, and customs duties, yes, but also the transaction costs generated by cus-

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toms procedures at both ends of the line. Whether embodied in product or packaging modifications, or in time delays, or in “other ways,” these transaction costs are real. They are usually accounted for by the exporter and borne by importer and exporter in some proportion to the respective supply and demand elasticities, and entail redistributive effects as well as dead weight economic losses.

In turn, transaction costs themselves comprise costs generated by (i) procedures necessary to protect an identified legitimate public interest (safety, environment, etc.); (ii) customs procedures that are unnecessary or inefficient (or have become so as a result of information technology or other changes); and (iii) bribes or other forms of corruption.

In sum:

The Components of Economic Distance

$$\textit{Economic Distance} = \text{Transport} + \text{Insurance} + \text{Customs Duties} + \text{Transaction Costs}$$

$$\begin{aligned} \textit{Transaction Costs}: &= \text{cost of necessary and efficient} \\ &\quad \text{customs procedures} + \\ &\quad \text{cost of unnecessary or inefficient} \\ &\quad \text{customs procedures} + \\ &\quad \text{cost of corruption} \end{aligned}$$

Accordingly, improvements in customs procedures or removal of unnecessary ones produce at least an unqualified efficiency gain for both the exporter and the importer, *and* an increase in government revenue for the importing country.

Reducing corruption produces an *additional* efficiency and revenue gain and—least measurable but probably most important—a lift in public integrity, which boosts government credibility and produces a positive demonstration effect for other functions of government. As it is unfortunately true that in many countries corruption begins in the customs

offices, it is hopefully also true that systemic corruption can be reduced starting from the customs offices themselves.

But procedural improvements and reduced corruption are not independent of each other: on the contrary, common sense and actual experience the world over demonstrate that the single best way to reduce corruption is to streamline the regulations that create opportunities for it.

The simple scheme shown above also brings to light an important consideration. As each of the elements of economic distance is reduced, the others become *relatively* more significant as obstacles to trade. Hence, with the substantial reduction in tariffs over the last two decades, and the further decline in transport and insurance costs, customs procedures have increased in significance. A further boost to international trade can therefore be expected from a major simplification and improvement in customs procedures.

Hence, as summarized below, the simplification and harmonization of customs procedures is directly and closely related to both fiscal policy and governance, as well as to trade expansion.

Simplification and Improvement of Customs Procedures

- Efficiency gain for exporters (profitability of exports increases)
- Efficiency gain for importers (profitability of imports increases)
- Increase in government revenue of importing country
- Fewer opportunities for corruption in customs

Reduction of Corruption in Customs

- Efficiency gain for exporters (increased profitability of exports)
- Efficiency gain for importers (increased profitability of imports)

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- Increase in government revenue of importing country
- Improved government integrity and credibility

Overall Impact of Simplification and Improvements in Customs Procedures

- Expanded international trade
- Increased government revenue
- Improved quality of governance

At this point, however, a warning about the nature of institutions and procedural reform is important. Several developing countries have introduced reforms in their customs systems, to the point where the formal system appears robust and coherent in every respect. Yet the efficiency of customs systems remains poor, corruption is endemic, and the quality and timeliness of customs services are no better than they were at the beginning of the “reforms.” Why? As illustrated in many of the papers assembled in this book, the answer lies in the nature of institutions.

Colloquially, the term “institution” is used as a synonym for “organization.” However, according to the “New Institutional Economics,” institutions are best understood as *rules*, and are thus distinct from the organizations that function under them. To use a sports analogy, the sport of tennis is played better or worse depending on the players, but all players must follow the same rules; the “institution” of tennis does not change unless the basic rules are changed (e.g., by removing the net). Customs outcomes are profoundly influenced by customs institutions, i.e., the rules and processes. The problem is that, because institutions comprise both formal and informal rules, many technical “improvements” in the past have failed because they were in conflict with the less visible informal rules and incentives.

Thus, for example, the tendency to underestimate forecasts of customs revenues may stem from concrete incentives

to do so rather than from technical weaknesses. Or, in a multi-ethnic country, a performance bonus scheme for customs officials may be perfectly designed on the surface but fail to produce improvements if it is inconsistent with the informal rule that demands that officials use their power to help members of their same ethnic group. Indeed, under these circumstances, the “innovation” may lead to customs officials manipulating customs revenue forecasts and customs rules in the interest of “their” people, and thus to a less efficient system.

The total “stock” of institutions is always larger than is visible on the formal surface, especially in developing countries. This leads to five basic points for customs, among others:

- A design failure that does not take into account key informal rules is likely to lead to a failure of the customs reform itself (to use an analogy, it was the unexposed part of the iceberg that sank the *Titanic*).
- Durable institutional change in general, and in public budgeting in particular, takes a long time to be implemented successfully (a result of what Nobel-prize winner Douglass North called “path dependence”).
- One way to improve the *overall* institutional framework is to make the informal rules more visible.
- The media have a key role to play in exploring inefficiencies or malfeasance.
- Customs organizations and new units can be merged, restructured, and recombined, inspection services created, formal penalties increased, and so on—but no change in customs outcomes will result unless the real incentives change as well. Without consequences that are swift, predictable, and uniform (not necessarily heavy), accountability is hollow. And, because most people, including customs officials, are rational, formal improvement in rules and processes without changes in the underlying norms that regulate

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behavior will not, of course, change actual behavior. Honest and vigorous new leadership can accomplish a lot in this direction

Finally, there is a general consensus that a country's economic openness to the rest of the world is generally conducive to better economic performance, and that competition can do much for the efficient allocation and use of resources. Simplification of customs procedures is important both for economic openness and for stronger competition.

Concerning *governance*, there is an international consensus, reflected in the ADB Governance Policy of August 1995, that the four key components of governance are accountability, transparency, predictability and participation.

In customs, *accountability* is the capacity to call customs officials to account for their actions. Effective accountability has two components: answerability and consequences. Answerability is the requirement to respond periodically to questions concerning one's official actions. As noted earlier, there is also a need for predictable and meaningful consequences, without which "accountability" is only a time-consuming formality. In addition, both internal (administrative) and external accountability are needed. Particularly with the dramatic improvements in information and communication technology, external accountability through feedback from importers and brokers and the citizenry can now be obtained at low cost by customs officials and is an essential adjunct to improving efficiency and effectiveness of public service delivery. The following papers will pay considerable attention to these new possibilities.

Transparency entails low-cost access to relevant trade and procedural information. This is a must for the public (normally through the filter of capable media). It is essential not only that information be provided, but that it be relevant, understandable, and low-cost. The Internet offers remarkable new possibilities for the low-cost transfer of information.

Predictability results primarily from customs regulations that are clear, known in advance, and uniformly and effectively enforced. Lack of predictability makes it hard for exporters and importers to plan. Predictability of customs decisions is also needed as a signpost on which the private sector can rely to make its own import, marketing, and investment decisions. Most importantly, in order to be predictable, customs regulations must be effectively, fairly, and uniformly applied. Corruption is the most insidious source of unpredictability.

Participation is needed both to obtain reliable information and to serve as a reality check and watchdog for government action. Among other things, participation by external entities is needed as a spur to government operational efficiency, and feedback by users of public services is necessary for monitoring access to and quality of the services. Public/private cooperation is a hallmark of customs improvement and is addressed in several papers in this book.

Part and parcel of the general concern with governance is the new recognition of the costs and inefficiencies of *corruption*. The problem is ancient, and can be found in both the government and the private sector, as recognized in the broad definition of corruption as the “misuse of public or private position for personal gain” adopted in the ADB Anticorruption Policy of July 1998. A balanced approach to combating corruption must therefore address both sides of the equation, and make corruption more difficult and risky for those who would give bribes as well as those who would receive them. The landmark OECD Anti-Bribery Treaty, which was negotiated in December 1997 and came into force February 1999, for the first time makes bribery of a foreign official a crime on a par with bribery of a national official. According to that treaty, if a representative of the exporter bribes a custom official in the importing country, he becomes liable to criminal penalties in *his own country*. Combined with

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the new consensus on the costs of corruption and convergence of international organization policies, including the ADB and the World Bank, there is now a historic opportunity to reduce corruption radically.

The latest empirical analyses demonstrate that although corruption has complex and varied effects, its negative impact on development is clear.¹ As a result, the environment in which multilateral development banks operate has changed. Pressure for more active measures against bribery and graft is no longer likely to be isolated and sporadic, but has become a systematic feature of the broader debate over good governance and sound development management.

The Bank's anticorruption policy is centered on three objectives:

- supporting competitive markets and efficient, effective, accountable, and transparent public administration, as part of the Bank's broader work on governance;
- supporting promising anticorruption efforts on a case-by-case basis and improving the quality of the Bank's dialogue with its developing member countries (DMCs) on a range of governance issues, including corruption; and
- ensuring that the Bank's projects and staff adhere to the highest ethical standards.

The bulk of the Bank's effort will be directed toward broader measures to improve the quality of governance in the DMCs. This effort will have two components. The first will seek to reduce the scope of direct government intervention in the economy, in the belief that markets should be efficient and competitive, and have as few barriers to entry and exit as possible. This will reduce the opportunity

¹ Vito Tanzi, "Governance, Corruption, and Public Finance: An Overview," in *Governance, Corruption, and Public Financial Management*, S. Schiavo-Campo, ed., Asian Development Bank, November 1999, Manila.

for firms or officials to take advantage of artificially restricted markets or suboptimal pricing to demand monopoly rents or bribes.

The second component will focus on supporting improvements in public administration and public-sector management, including customs administration. As mentioned earlier, efforts to simplify customs information systems should improve transparency, accountability, and predictability. Strengthening audit of customs can play the dual role of helping to improve revenue performance while making theft and embezzlement easier to detect. And the streamlining of business processes can improve the efficiency and effectiveness of the public sector while simultaneously reducing opportunities for corruption.

As in the case of poverty, the goal of anticorruption efforts must be defined as *reducing* corruption, not eliminating it (which is impossible) or alleviating it (which is insufficient). However, realistic recognition of the practical difficulties in the struggle against “the cancer of corruption”—as World Bank President James Wolfenson called it in his path-breaking speech at the 1996 Annual meeting of the World Bank and the IMF—must never be allowed to degenerate into shrugging acceptance of this problem. A policy of zero tolerance of corruption is the only defensible and practical policy to minimize actual corruption; tolerance of “minor” thefts has been shown to lead in time to a climate of tolerance of major corruption. This is especially true in customs. (It is crucial, however, to prevent the classic situation where only the “small fish” are caught and penalized).

In closing, simplification of customs procedure is not a narrow technical issue. It represents nothing less than one significant route to improving the quality of governance, which has been shown to be a key factor in efficiency, equity, development, and economic performance. Annexes I and II show a WCO survey of Customs reforms and the UNCTAD trade facilitation recommendations.

The Asia-Europe Meeting (ASEM) was created over three years ago to deal with political, economic, and cultural cooperation issues affecting trade relations between Asia and Europe. Its goal since the start has been to reduce nontariff barriers and enhance trade opportunities between the two regions, complementing the efforts of other international organizations. The first part of the book assembles a comprehensive picture of international efforts at customs simplification by ASEM, APEC and ASEAN, and the World Customs Organization. The second group of papers offers a menu of recent practical initiatives, largely grounded on better public/private cooperation. The last part of the book examines the important case of the airline industry.

Simplification and greater efficiency in customs can also help bring Asia and Europe economically closer together—almost literally so. The stability of the global economic “stool” requires three strong legs: the transpacific leg, the transatlantic leg, and the Asia-Europe leg. The first two legs have been stronger in recent history (although not in earlier historical times). Strengthening the Asia-Europe leg, through trade facilitation that will accompany the simplification of customs procedures on both sides, can play a very important role in attaining sustainable economic growth in Asia and providing a healthy competitive stimulus to Europe.