

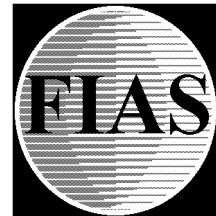
DISCUSSION DRAFT
FOR PRE-CIRCULATION

South Asia FDI Roundtable

Customs Administration:
Impediments to trade and
investment

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List of Abbreviations

ADB	Asian Development Bank
ASYCUDA	Automated System for Customs Data
CAM	Customs Administration Modernization (Bangladesh)
CIAA	Committee for Investigation of Abuse of Authority (Nepal)
Cif	Cost, insurance, freight
EU	European Union
fob	free on board
GRT	Gross Revenue Tax
HS	Harmonized System
HT	Harmonized Tariff
HTN	Harmonized Tariff Nomenclature
ICC	International Chamber of Commerce
IDA	International Development Association
ISO	International Organization for Standards
IT	Information Technology
MOD	ASYCUDA Module contained in ASYCUDA ++
NBR	National Board of Revenue (Bangladesh)
RAMP	Revenue Administration and Modernization Program (Bangladesh)
UNCTAD	United Nations Conference on Trade and Development
US	United States
VAT	Value Added Tax
WCO	World Customs Organization
WTO	World Trade Organization

1 Introduction

The quality of customs administration is an important consideration for potential investors. Customs administration can have an impact directly on costs of production and indirectly through reduced flexibility of operations. Poor customs administration can also contribute to greater unpredictability in the trading environment with consequent difficulties for planning and investment decisions.

This report looks at the issues that contribute to the quality of the customs environment and ways in which various countries have attempted to implement reforms in customs administration. **It draws on lessons from the reform experiences examined**, and concludes with a discussion of emerging issues for customs administration.

Methodology

The methodology used has been to take **two South Asian countries, Bangladesh and Nepal**, and to identify issues associated with their respective customs administrations.

- **Bangladesh** is widely regarded as a case where customs reform has succeeded well beyond the expectations of outside observers. For this reason, Bangladesh experience is relevant for many other governments that may wish to implement a reform program.
- **Nepal** is at a much earlier stage of the reform process than Bangladesh. Many of the problems that Nepal is currently experiencing are common to other countries embarking on customs reform. The review of customs administration in Nepal will have a familiar ring to many observers concerned with reform in smaller customs administrations.

In addition to the two South Asian countries, a study has been undertaken of a group of **South Pacific countries**:

- South Pacific countries use, with varying degrees of success, the same **customs computer software** as has been used or is planned for some of the smaller South Asian countries.
- South Pacific countries also share **many similar problems** with South Asian countries, such as remote ports, inadequate bonded warehouse control, and, in some cases, rampant corruption.

Both South Asian countries were visited. Discussions were held with a range of government officials and the private sector, and customs facilities and operations were viewed.

Prerequisites for reform

The key prerequisites are:

- the **existence of a legal culture** where there is a general acceptance within society that issues are resolved within a legal framework. Agents within the system must confidently expect others within the system to abide by the set of rules contained within the legal system.
- the **emergence of a domestic will for reform**. Without a domestic will for reform, no amount of external pressure will be successful.

Principles for reform

Reform should have as its basic aim to devise a system that makes minimum demands on traders whilst achieving the necessary level of compliance.

The **five principles** for the design of effective and efficient customs administration that are adopted in this study are:

- transparency;
- predictability;
- comprehensiveness;
- simplicity and
- accountability.

Elements of reform

Comprehensive customs administrative reform should include legislation, training of customs officials and the provision of the tools, including computer hardware and software, required to implement the system. While it has not been possible to cover all aspects of model legislation, references have been provided that cover in detail all the technical aspects of customs legislation.

Emerging issues for customs administration

The paper ends with a discussion of some of the emerging issues for customs administration, including administration of export quota, rules of origin, and likely advances in computerization that will have an impact on the future of customs operations.

2 Case study: Bangladesh

A feature of the Bangladesh Customs task is the land border that Bangladesh shares with India. This is a difficult border for customs administration because it is extremely porous.

The major markets for Bangladesh exports are Western Europe and the US. Almost three quarters of all exports are sold in these markets. About 75% of exports are garments, knitwear and hosiery. It should be noted that these are gross exports. Net exports of garments, which make allowance for the imports of materials used to manufacture garments, knitwear and hosiery, are much less. Jute exports, both raw jute and products manufactured from jute consist of about 8% of exports. Frozen food, largely frozen seafood, comprises about 6% of exports. Leather exports are also important with about 4% of exports from this source.

Imports consist of capital goods, textiles, yarns and petroleum products. The major source of imports is India with over 20% of the total market. Other major suppliers are China (including Hong Kong) with about 17% and Western Europe with about 8% of the market.

The number of recorded international transactions is large with about 4 to 5 million transactions per year. There are approximately 4.5 thousand licensed customs agents and approximately a quarter of a million trading entities engaged in international trade.

Domestic political pressure for reform

Bangladesh customs reform is **a model for many countries**. Despite the lack of administrative reform in many other areas, reform in Bangladesh customs can be regarded as successful and enduring. Perhaps the major reason for the reforms in customs was the recognition that Bangladesh needed to generate domestic revenue and that potential collection costs associated with customs revenue were considerably less than the collection costs associated with other forms of taxes. Added to this was the widespread recognition within the country that customs operations were corrupt.

There is now world wide experience that **corrupt practices** that benefit small groups at the expense of the wider community are difficult to maintain when they become widely known within the general community. Members of the newly emerging private sector were particularly frustrated with the costs of international trade transactions and the way that some established firms were able to receive preferential treatment.

The reform process

In 1998 a nine year revenue administration modernization program (RAMP) was introduced. This action was a necessary but not sufficient condition for reform. Institutional reform had to be accompanied by a **commitment to reform** from senior officials at the National Board of Revenue. Fortunately this was forthcoming. In the early years, this was greatly assisted by support from the Member for Customs. At lower levels there was a group of younger professional officers who aspired to operate in a professional customs service.

With the essential domestic support in place, the **external support** through IDA, WCO and UNCTAD was able to be effective. It is important to identify a significant feature of this external support. Because the domestic support from NBR and others was in place, the external support was able to concentrate on simply providing constructive professional support for the reforms rather than becoming involved in the political debate on the weaknesses of the unreformed system.

The key feature of external involvement in Bangladesh customs reform is that it was led domestically with external professional support. There are many examples where external agencies have attempted to lead the reform process with disastrous effects. Bangladesh is a good example of where **sustainable reforms** have been achieved because a domestic commitment to reform was reinforced with constructive technical external support.

Customs reform was delivered through the IDA supported customs administration modernization (CAM) project. The reforms are along the lines of those advocated in the **Revised Kyoto Convention** (Appendix 2). Although Bangladesh is not yet a signatory to the revised convention, much of the Bangladesh customs legislation and procedures are consistent with the convention. In particular the customs clearance procedures, and computerization have reduced clearance times and reduced the scope for corruption.

The external support for the reforms was conditional on an external pre-shipment inspection system for imports. This was seen as an interim measure while the internal reforms were implemented. Given the success of the reforms, it is now an appropriate time to review the extent of pre-shipment inspection required. If it is possible to reduce the requirements for external **pre-shipment inspection** using accepted risk management techniques, there will be savings to importers both in direct costs and in time involved to complete the import process.

There are now clear indications of the **success of the project**:¹

- The **tariff schedule** has been greatly simplified,² and transparency has increased. The number of tariff lines has been reduced from more than 16,000 codes to 7,055 HT Codes (In terms of the HT system this is still moderately complicated and indicates extensive resort to local digits) There are now only five tariff rates (zero, 5%, 15%, 25%, 37.5%) whereas previously there were 8 rates. Rates within chapters of the HT are similar. This reduces the possibility that classification issues become the subject of commercial negotiation. There is some minor simplification that remains to be completed. For example the 1% landing charge could be incorporated into the tariff
- The maximum **number of signatures** required to achieve an export or import clearance from 25 in 1999 to 5 signatures.
- Average **export clearance times** for 95% of consignments have been reduced from 72 hours in 1999 to 3 hours in 2002.
- The percentage of import **consignments physically inspected** has been reduced from 100% in 1999 to 10% in 2002. This has been achieved without a commensurate reduction in illegal importation because of the use of risk management techniques and pre-shipment inspections. The next reform in this area must be a review of pre-shipment inspections.
- There have been major improvements in the **data base** held by customs. These improvements allow for improved post clearance audits and allow better reconciliation of revenue collected with clearances.
- In the **trial center**, clearance forms are completed, assessment provided and the trader then goes to the bank attached to the customs point and pays the amount due. The clearance documents, together with the payment receipt are then provided at customs for release of goods. In this way customs officials are not required to collect money and reconciliation of clearances and payments at the close of the working day is simplified.
- Whilst there is as yet no remote access for traders, there is an **agents' room at the customs office** where clearance forms can be prepared and submitted via computer to the long room.

¹ Most of the SROs that provided for user specific concessions on imports have been abolished. There are however capital machinery concessions for developing areas that are difficult to administer at the Customs point of entry.

² There is some minor simplification that remains to be completed. For example the 1% landing charge could be incorporated into the tariff.

External technical support for customs reform

A key feature of the technical support has been that the computerization program, in this case ASYCUDA, has been **closely integrated** with a more general approach to customs reform. The Customs Administration Modernization (CAM) project, which was designed to upgrade customs procedures in Bangladesh, was the vehicle in which the ASYCUDA project was embedded. The contract for the first phase of CAM (CAM-1) was awarded to a US firm (Clapp and Mayne) in 1999. CAM-1 has as its overall objective to reform customs to facilitate export oriented trade.

One of the activities that falls under CAM-1 is to improve the system by using automated techniques. This activity involves the **implementation of ASYCUDA++** software in partnership with UNCTAD. ASYCUDA++ costs are covered by the Bangladesh Government supported by IDA credit, in the form of a direct contract with UNCTAD.

There are other examples where computerization through ASYCUDA has been attempted in the **absence of a broader program of customs reform**. This has generally failed. ASYCUDA in Bangladesh however appears to be successful. Not only has the implementation had the advantage of being integrated into a wider reform program but, Bangladesh has a customs task of sufficient magnitude to justify a system such as ASYCUDA and has the necessary numbers of computer literate personnel at middle management level to make the project sustainable.

Issues in the reform program that remain to be addressed

While the reform program has been a success, there are issues that remain to be addressed. These are summarized below.

- There have been **major delays in computer procurement** that have affected the computerization component. The stated aims of computerization were to introduce ASYCUDA++ at 5 project sites, ICD, Dhaka, Chittagong Benapole and Mongla Custom Houses, with a central server at the National Board of Revenue (NBR). Full automation at the pilot site has not yet been achieved. ASYCUDA++ installation, together with procedural reform, has not been completed at Dhaka and the system has yet to be implemented in Chittagong, Benapole and Mongla Customs Houses.
- **Doubts remain about the willingness of ASYCUDA officials** in UNCTAD to agree to the development, as part of the CAM project, but outside ASYCUDA, of separate modules that will be required. These modules should interface with ASYCUDA. In order to interface, Bangladesh technicians will require access to ASYCUDA code. While

the ASYCUDA personnel based in Bangladesh have made considerable progress and operate well with the broader CAM team, there is a long history in other countries of UNCTAD's refusal to permit access to ASYCUDA computer code in this way. For example Bangladesh has a large, complicated and unique system of bonded warehouses. At present these warehouses are administered manually³.

- It will be necessary for Bangladesh technicians to be able to capture inventory data from each warehouse and update the information using entries into the warehouse system and drawdowns out of the warehouse that come from ASYCUDA. They will need to develop their own **warehouse module system** with links to ASYCUDA. In this way updated inventory statements for each warehouse can be produced and these can be checked against a physical stock check. Whether UNCTAD will agree to provide the level of access to ASYCUDA code that is required for this task is a matter of conjecture. Similarly the CAM project will need to develop computer modules to manage the Bangladesh export processing zones system⁴. It should be recalled that in Mauritius, which had a similar duty free zone administration problem, officials withdrew from ASYCUDA because they could not get the cooperation required to develop computerized management of the zones that integrated with ASYCUDA.
- Customs officials estimate that currently about 10% of import declarations have duty and tax assessment made on the basis of declared value, rather than the c.i.f value on the documents accompanying the goods. This means that on many items, the customs **officials simply do not believe the supporting documents** accompanying clearance applications. This is a high figure. It implies that either there is still a considerable amount of attempted evasion by traders or that there is unwarranted interference into commercial dealings by customs officials. Customs officials should work with the agent network to reduce this figure.
- To date there appears to be very little use of the ASYCUDA data base for **post-clearance audits and investigations**. This is a common problem with ASYCUDA where implementation effort tends to focus on data entry and relatively little effort is placed on training officials to

³ The bonded warehouse system is extremely large and complicated. It consists of 2,670 garment warehouses for direct exporters; 605 Accessory warehouses used to for suppliers to the garment manufacturers; 92 home consumption bonded warehouses; and 7 diplomatic warehouses. There is a customs staff of 116 full time officers engaged in the control of these warehouses. Of these, 107 are inspectors and superintendents. Whilst the system remains a manual system it is impossible to properly verify and account for stock held in this system.

⁴ Bangladesh has 6 Export Processing Zones. They are administered by the Bangladesh Export processing Zone Authority. It will be necessary to develop a module that monitors inwards and outwards movements from each EPZ. This should be linked to ASYCUDA with an interface. Legislation for these Zones should be consistent with model legislation in Kyoto

use the enhanced data base. It is only if the enhanced data base is used that the cost of ASYCUDA can be justified.

- There is a problem with the **human resource base at customs** . Customs organizations of the future will rely heavily on computer technology. However there remain a significant number of officers with very little training in IT. New entrants to customs with no IT background continue to be recruited. At present non IT personnel have a better career path in customs than people with IT training. Ideally any new graduate entrant should have had formal IT training at university level and some should also have some basic legal training. All middle level customs officials should receive IT training and their progress in the organization should depend in part on their understanding of IT issues. At present there are a large number of entrants to the Government service, with little or no IT training, who list customs as their first preference. Questions could well be asked as to their reasons for wanting to enter the customs service as recruitment of some of these people may pose a threat to the sustainability of customs reforms. Not only does there need to be a broadening of IT skills within customs but there also needs to be a deepening of specialist IT skills. For example there is no IT Division within customs. IT experts have difficulty being promoted within the customs and NBR organization. This is despite the fact that there are a number of IT projects within customs and NBR and there is a general recognition amongst senior officers that there will be an increasing reliance on IT solutions in this area. As was pointed out the ASYCUDA progress report for 2001-2002:

“An IT division is needed to provide the infrastructure necessary to support ASYCUDA++ in an operational environment It should be headed by a person of... at least commissioner level so that he/she can relate to all of the senior executives of the organization who depend and rely on data available from the customs system. This would contribute to ensuring that IT is recognized by all as the strategic tool it should be and is used by everyone... Urgent consideration should now be given to establish the MIS structure within NBR or risk loss of expertise and the failure to maintain not only ASYCUDA++ but all other IT initiatives” (Ian Thomas and Shafiqur Rahman, 18 July 2002)

- The area of Bangladesh customs where there is significant lack of transparency is **the allocation of export quotas** for firms exporting garments under quota to North America and Western Europe. The Bangladesh Government has left the allocation of these quotas to the private sector. There is considerable political involvement in the distribution of quotas with rival political factions competing for power to allocate quotas to their supporters. One of the problems with the

system is that it favors entrenched interests and makes it extremely difficult for new exporters to enter the market. Foreign investors find the system extremely difficult to penetrate. Reform of this area is a major task. Fortunately if the undertakings made within the WTO by the US and the EU to dismantle the quota system are implemented much of the power of the garment manufacturers' organization will be eliminated. Any efforts by the association to control or license exporters after this time should be resisted.



Figure 1 A well-designed long room Bangladesh



Figure 2 Compare with the long room in Nepal Airport

3 Case study: Nepal

An important feature of the customs task for Nepal is that it is a landlocked country sharing borders with two major countries, China and India. The border between India and Nepal is extremely porous and smuggling is common. The border between China and Nepal is able to be more closely controlled as there are limited passes through the mountains that form the border.

Officially 35% of imports are from India and 13% from China (including Hong Kong). However an examination of imports from India shows that some of these were not manufactured in India but rather are imports from third countries that transit through India. As was pointed out above there is also considerable smuggling of items from India.

Exports of garments and carpets comprise over 75% of total exports. A further 14% of exports consist of woolen and pashmina items. Imports are primarily capital equipment, consumer durable items and imported inputs used in garment trade.

The number of recorded international transactions is relatively small at about 200,000 clearances per year. There are about 5 to 6 hundred customs agents in the system. The Harmonized Tariff Classification is used. The system used in Nepal has 5,512 individual codes. There are 5 tariff rates, zero, 5%, 10%, 15%, 25% and 40%. There is a 10% VAT that applies to almost all items. The VAT is calculated on the landed duty paid value. Significant excise taxes are confined to alcoholic beverages and tobacco products. There is a variety of other taxes that are collected at time of clearance. The main taxes in this category are a local development tax of 1.5% and a security tax of 3%. Tariff simplification could be achieved by amalgamating the local development tax and the security tax into the tariff.

Domestic pressure for reform

Nepal remains in a **state of civil unrest**. Much of this unrest is driven by dissatisfaction with the quality of governance and the perceived extent of corruption within government. Over the last decade there has been a much greater public awareness of corruption.

There is a general perception that the **largest source of corruption** in Nepal is associated with customs and taxation. Nepal has implemented the institutional structures necessary to deal with corruption but there remains some doubt about the willingness of government to act. For example on August 16 2002 Investigation of Abuse of Authority (CIAA) officers raided the houses of 22 tax and customs officials. These officials were identified through an examination of unexplained assets held by them and their families. Traders

now complain that some of these officials have returned to their posts in customs whilst still under charge.

Traders in Nepal are in a **vulnerable position**. Shipping containers are typically hired from Calcutta and transported to Nepal. The containers are hired for a fixed number of days with penalty rates if they are not returned within the specified time. Delays at customs in Nepal can therefore be extremely expensive. Traders complained that customs officials visit their private residences in the evenings with implied threats that shipments could be delayed unless payments were forthcoming.

Traders also complain that restrictive customs arrangements force them into **illegal practices**. For example there are only two companies permitted to import mobile telephones into Nepal. Given the number of brands of mobile telephones available in Nepal, it is clear that smuggling is rife. Even reputable traders are pressured into smuggling to meet the demand for mobile telephones with features that are not available in the telephones imported by the two licensed firms. Another example is pharmaceuticals. Only pharmaceuticals that are named on an approved list are permitted to be imported. Cheaper pharmaceuticals with the same properties but with a different name will be refused entry. Under these circumstances it is hardly surprising that there is a trade in smuggled pharmaceuticals.

If there was **domestic will to take action**, much of this illegal activity could be discouraged. For example relaxation of some import restrictions would encourage more imports through legal channels and would result in greater Government revenue. A properly functioning computerized system for clearances could readily identify customs officers who delayed clearances and also officers who altered values of shipments and resorted to declared values for calculation of tariffs and taxes. Provided traders were confident that their business activities would not be affected, many would provide information relating to unofficial payments. However this requires a willingness to take action and follow through which is sometimes lacking.

Computerization of customs

There are ASYCUDA supported clearance points at Bhairawa, Birgung and Biratnagar. In Nepal, unlike Bangladesh, customs computerization has been **attempted as a stand alone project** rather than integrated with a comprehensive program of customs reform.

ASYCUDA has had **mixed success**. The few local officers with an IT background are working under extremely difficult conditions with little technical support. There is insufficient hardware and hardware is subject to regular breakdown (the ASYCUDA server is currently not operational) and the design of the major entry point at the Airport is not suited to customs clearance.

There is **insufficient support from ASYCUDA** to develop the system or even keep the system operational. One module that needs to be developed internally for Nepal is a computerized system to record exports and imports of imported and inputs for exporters. Currently there is a manual passbook system that is confined to exporters trading with India. The module should be linked with the ASYCUDA system but it is unlikely that ASYCUDA officials would allow the necessary access to ASYCUDA code that would be required to build the interface.

There is a **need to computerize Tatopani Customs** which is the major entry point with China. It is understood that about 20 containers per day pass through this point and that delays of up to 2 days for containers are common. Nepal also has 143 small customs checkpoints along the Indian border. These cannot be ASYCUDA supported however, if ASYCUDA co-operation was forthcoming it would be possible to support these points with a Windows based Access system that could interface with ASYCUDA

Customs issues that require to be addressed

Reform in customs can only be achieved if there are strong domestic pressures that recognize the need for reform. It is not possible to impose reform externally. There needs to be further evidence that the Government actually wants reform and is prepared take strong action against corruption. Once there is recognition of the need to reform and a preparedness to act, the following key issues could be addressed.

- The **customs clearing point at the airport** is badly designed and encourages illegal activity. Despite the fact that this is a new building, it is unsuitable for customs operations. The building was provided as part of an ADB project for airport upgrading. At no stage was there consultation with customs regarding their requirements. A basic tenant of customs operations is that in the clearance area customs officers and traders should be separated. There should be no trader access to the long room and traders should not have access to goods that have not been cleared. All these principles are violated in the current airport clearing system.
- There is an urgent need for **more hardware to support the ASYCUDA** system. At present regular breakdowns make the system of limited value.
- There is also a requirement for **more technical support for ASYCUDA** in Nepal. This should be done as part of a wider customs reform program similar to Bangladesh. Support should cover the design and operation of clearance points, computerization of Tatopani, and a strategy for handling remote small ports.

- Some of the ideas that have been successfully implemented in Bangladesh, such as connection of the customs office at the airport to a bank so that customs officers do not have to receive money and reconciliations between revenue and clearances are facilitated, could be introduced. However this would require **external technical support** .
- The **special problems of Nepal** need to be examined. Sea cargo for Nepal comes through Calcutta and Haldia. At present, the cargo is cleared twice, once at the Indian port and once when the goods enter Nepal. The importer is obliged to appoint a clearing agent in Calcutta as well as one at the border. These arrangements can be improved.



Figure 3: Poorly designed clearance facilities in Nepal



Figure 4: Importers in the warehouse with uncles goods in Nepal

4 Third countries' case study: South Pacific

The South Pacific consists of a number of independent small states.⁵ Despite some recent success stories, they face a **formidable challenge** in customs reform as detailed in Appendix 4. Major exports in most are primary products such as sugar, coffee, copra and timber. In the two largest countries, Papua New Guinea has a large minerals sector and Fiji has a garments export sector that has grown strongly in recent years. The majority of imports are consumer goods and capital equipment. The consumer goods, which include motor vehicles, alcoholic beverages and tobacco, are consumed by higher income groups.

Tariff and taxes on imports

Tariffs and import taxes are **primarily for revenue purposes**. Most countries have either a Value Added Tax (VAT), a Goods Tax or a Gross Revenue Tax (GRT). Given the lack of domestic activity, the revenue from these taxes is largely derived from the application of these taxes on imports. VAT or GRT when it applies to imported products is collected by customs at the port of entry.

In some countries there has been some attempt to simplify the tariff structure and introduce tariff reform. However **reform is usually eroded over time** as governments make ad hoc changes to tariffs in order to meet revenue difficulties and cater to domestic pressure groups requesting higher protection. Papua New Guinea is a good example where wide-ranging tariff reform is gradually being eroded by ad hoc individual rate tariff changes which are implemented in the course of the annual budget.

Given that the tariff is essentially for revenue purposes and domestic taxes are usually low, there is **a case for introducing a wide ranging excise tax** that would apply to both imports and competing domestic activity. If the excise tax was applied to luxury goods, the tax would impart some income progressively. Domestic activity of luxury goods, apart from tobacco products and alcohol, is virtually none existent which means that the excise tax would be largely confined to imports. At present Papua New Guinea is moving to this type of excise tax.

Institutional structure

In the larger countries **customs is part of a Revenue Commission** that covers both taxes on international trade and domestic taxes. In most countries

⁵ Details relating to Customs administration in individual states are contained in Filmer and Lawson (2002).

collection of domestic taxes is difficult, particularly for medium and smaller size firms. This means that there is a great reliance on taxes and tariffs collected by customs at the point of entry.

Political will for reform

Domestic political will to implement customs reform **varies significantly** amongst countries of the South Pacific. Domestic political will to reform has been strong in countries such as Samoa, which can be regarded as the success story of the South Pacific, whilst in other countries, notably the Solomons, there have been few signs of domestic will to reform

At times there have been **attempts to impose reform externally**. These attempts have invariably failed. The Solomon Islands is a good example where an attempt was made by donors to impose financial reform externally. These attempts failed. However there are signs even in the Solomons that if domestic pressure for reform exists there is much greater chance of successful implementation.

In the Solomons in 2001 tariff remissions were widespread. Any Minister was able to authorize a tariff remission for a shipment. Importers simply approached a Minister and requested that they be provided with an authorization for duty free importation.

By the end of 2001 knowledge of this arrangement was widespread amongst the general community. The main newspaper⁶ in the country published a list of the names and addresses of major remission recipients, including the goods they imported, and the amount of duty they evaded through the remission system.

The **domestic pressure** that resulted from this resulted in the Government closing off this arrangement by requiring a committee to approve any application for remission as from January 2002. This has resulted in a major decrease in revenue loss from remissions.

Computerization

There has been **heavy pressure from UNCTAD** for countries to adopt ASYCUDA. In the 1990s Papua New Guinea was the only country in the South Pacific using ASYCUDA. In the late 1990s a program was introduced by UNCTAD to induce South Pacific countries to adopt ASYCUDA. The strategy was to increase the market for ASYCUDA. Countries that did not use ASYCUDA were offered ASYCUDA++ with funding through loans. Since Papua New Guinea already used ASYCUDA, it was excluded from the program. This meant that the country with most experience with ASYCUDA

⁶ Solomon Star, Wednesday 18 July 2001, page 8

was excluded from the program and was obliged to continue with an older unsatisfactory version, ASYCUDA 2.7.

While ASYCUDA++ is suitable for some of the larger countries it is **unsuitable for many of the smaller countries** where a Windows based solution using an Access data base is a much better, and cheaper, approach.

There are particular **ASYCUDA problems that affect the South Pacific**. ASYCUDA is unsuitable for systems where there are many remote small ports since these ports do not have the number of clearances necessary to justify ASYCUDA. In addition, any breakdowns in the UNIX system on which ASYCUDA is based present major problems in remote areas. There is a solution for this which would entail the design of a simple Access based system for remote ports and an interface so that the information could be merged with the ASYCUDA head office data base. However ASYCUDA staff are reluctant to provide users with access to the code so that a suitable interface could be designed.

Other problems with ASYCUDA include difficulties with bonded warehouse control. Once again this problem could be solved if ASYCUDA allowed user access to code so that users could design their own warehouse module that would interface with ASYCUDA.

5 Conclusions and lessons for reform

Customs reform and its links to investment

Customs reform is of particular importance to **investment in export oriented** activities. Export activities are obliged to be internationally competitive. That means that not only must the export task be efficiently carried out, but the exporter must have access to imported inputs at internationally competitive prices. Foreign investment in import competing activities will also usually find it to their advantage to be internationally competitive; if they are not, they must rely on tariff and other trade barriers for domestic market share.

Customs impediments have a number of **adverse effects on competitiveness**. They can add to costs in a number of ways. The most obvious way is when they impose additional costs, either in the form of taxes and tariffs or, alternatively, in the form of unofficial payments that must be made to avoid other higher costs. Often customs impediments involve additional costs of unnecessary paperwork to meet customs requirements. Mostly customs impediments impose costs in terms of time. In many less developed countries where capital costs are high, delays that tie up capital are extremely costly.

Customs impediments can also introduce **increased unpredictability** into the trading environment. For example, if there is discretion in the system, unexpected delays can arise and in some cases there will be differential treatment between traders. As a general rule, the more officials required to inspect and approve a transaction, the greater the delays and the greater the scope for corruption. Reforms can result in major savings for exporters, such as those in Bangladesh where the maximum number of signatures required to clear goods has dropped from 25 to 5 in four years and export clearance times have dropped from an average of 72 hours to 3 hours in the same period.

It is not only simple cost competitiveness that can benefit from customs reform. For example, Fiji's higher labor costs mean that Fiji's exporters of garments and footwear cannot compete on a price basis with exporters in low cost countries such as Cambodia. Fiji competes instead on its **ability to deliver** higher quality garments extremely quickly. They are regarded as a reliable supplier that can meet orders, particularly small one-off orders in a way that many lower cost competitors cannot. This selling point relies on good transport and communication and a customs system that facilitates trade.

The customs environment

The **customs clearance process** has not changed greatly for many years. Each shipment, whether an export or import, has documentation that must

accompany the goods that comprise the shipment. Each shipment is assessed separately for tax and the associated documentation is processed. The trader then pays the outstanding taxes and the goods are released.

Typically the processing is carried out using a variant of the industrial assembly line. The physical environment for processing usually involves a **customs “long room”** where documents are passed down the line as the various processes are completed. The officers working in the long room should all be customs officers. These officers receive the documents from traders or their agents, complete the process for which they are responsible, and pass the documents on to the next stage of processing. Once the documents have been passed through the various stages in the long room they are returned to the trader or trader’s agent. Only customs officers should have entry to the long room.

Despite the fact that basic customs procedures have remained essentially the same for many years, there have been **important changes in the customs task**. In developed countries the importance of customs collections as a source of revenue has declined. In developed countries where it is possible to efficiently collect domestic taxes, such as income tax, these taxes have increased over time while customs taxes have declined. For example in the 1860s US, customs was the source for about 90% of all revenue collected.

Today, US customs tariffs account for about 1% of all revenue⁷ and excise collections amount to about 4% of all revenue. In many less developed countries where collection costs are high, customs collections, remain an **important source of revenue**. In some countries in the South Pacific, taxes on imports and exports collected by customs represent the major source of Government revenue. For example, in Vanuatu tariffs and taxes on exports and imports amount to about two thirds of total government revenue. If VAT collected on imports by customs at the port is included, about 90% of all government revenue is collected at the port by the customs administration.

In all customs system there are increasing pressures for clearances to be processed in the **minimum time and with the minimum disruption** to the transit of the goods. This is one of the factors contributing towards the increased **computerization of customs tasks**. It is desirable to collect statistics on clearance times and to monitor changes over time. These statistics can be produced by most countries with computerized processing systems, However there are many countries that are understandably reluctant to produce these figures. For example these figures could be produced in Nepal however it seems that they are unavailable.

⁷In the US trade barriers are not designed for revenue, rather they are designed to placate domestic political pressures. For example in the US here are significant non tariff barriers- such as import quotas on beef and so called “voluntary” restraints that limit imports of garments from developing countries. If revenue collection was the primary objective, these non tariff barriers would be converted to tariffs so that revenue could be obtained.

While the clearance process has similarities in almost all countries, there will always be important differences. The customs environment will differ between countries for reasons that may be outside the control of the customs administration. **Differences in the environment** can arise due to differences in resource endowment and geographical location.

For example, the customs environment will differ greatly for countries that have land borders such as Afghanistan and Nepal compared to countries that have sea borders, such as Sri Lanka, and the Philippines. Some countries have many points of entry requiring a widely dispersed customs service whilst others are fortunate to have a few large points of entry. Some countries, such as Mexico⁸ which has close links with the US economy, have special pressures to upgrade their customs services and adopt procedures that will not adversely affect their ability to compete in the US domestic market.

Customs administration relies on the rule of law⁹

Any customs administration must be based on the rule of law. It is impossible to have an efficient customs service without the rule of law. Attempts to reform customs administration before establishment of a rule of law will fail.

Afghanistan is an example of where customs administration has broken down because of a break down in the rule of law. According to reports from officials in Kabul, approximately \$US6 to \$US7 million customs duties are collected each month at Afghanistan's border posts with Pakistan, Iran, and Uzbekistan but only about \$US200 thousand per month ever reaches the Finance Ministry in Kabul. The problems here are well beyond any possible reforms to the customs administration. This is not an isolated instance.

In **Mongolia**, in the early years after transition from a Communist country, some state-owned enterprises would simply refuse to pay duties on imports and the Ministry of Finance was powerless to enforce payment. Until recently, the payment of tariffs and taxes on imports in many South Pacific countries was virtually a voluntary activity.

The **time necessary to undertake the legal reform** on which customs administration is based is often underestimated. For example, Sachs (Koves and Marer, 1991: 256) has suggested that the complete institutional and legal basis for all economic reform can be established in one year. This seems to be wildly optimistic.

⁸ Mexico also has special issues associated with the relatively large component of passenger accompanied baggage. The issues of passenger accompanied baggage have not been covered in this paper because they usually form only a small component of goods trade.

⁹ For a discussion of the rule of law and economic reform see Chatterjee et al. (1996). A copy is provided on CD ROM for Roundtable Participants)

What is misunderstood by many experts is that the rule of law is not implemented by simply enacting legislation. Respect for the law, and a willingness to abide by the law requires time to develop. There has to be a **legal culture** where there is a general acceptance within society that issues are resolved within a legal framework. Agents within the system must confidently expect others within the system to abide by the set of rules contained within the legal system.

Customs reform cannot be imposed externally

One of the most difficult lessons for external aid agencies to learn is that institutional reform cannot be imposed externally. For reform to be successful the pressure for customs reform must come from domestic sources.¹⁰ The role of external agencies in customs reform is to provide technical and professional support for the domestic agents of reform.

Obtaining meaningful **domestic support** from within the customs organization is often difficult. Customs reform is usually seen by elements within the system as threatening their special interests. There will be customs officials who are opposed to reform because it threatens their power and ability to extract income from their position. Similarly established firms that have lived with the existing system and invested heavily in order to obtain a favored position in the system are often reluctant to support reform.

It needs to be remembered that customs reform requires the cooperation of the very people who have benefited from the unreformed system. Customs administrations usually employ a large number of people. At the outset most will not be committed to reform. Experience has shown that reform only has a chance of being successful if there are a **few people within the organization** who are committed to reform and who can gradually change the internal culture.

The case study of **Bangladesh provides a good example**¹¹ of how these domestic forces can arise. In Bangladesh there was strong domestic pressure that was external to the customs administration. When the Government endorsed the nine year revenue administration program (RAMP) in 1998, it was against the background of a succession of other failed policy initiatives that had been adopted by the Government, under external pressure from the multilateral agencies. The difference with RAMP was that the program was strongly supported from within the bureaucracy by the head of the NBR and the Member for Reform and Board Administration.

¹⁰ In the South Pacific there are cases where foreigners have assumed line positions in the Customs, Revenue Commission and Finance Ministry . This strategy has in almost all cases proved to be a disaster. It creates resentment amongst national officials and produces internal pressures within already weak institutions.

¹¹ The details contained in this summary of Bangladesh experience are closely based on the account contained in Draper . A copy is provided on CD-ROM for Roundtable participants.

The Member continued his active support for the program when he became Acting Chairman and then again as Reform Member. The new Chairman also strongly supported the project. In addition there was also strong support from the then Member for Customs who, in the year before he retired, promoted the reform amongst customs officials. Bangladesh was also fortunate to have a small group of younger, relatively better educated, customs officers who were strong supporters of the reform program. Elements of this group still operate within the system. They were strong supporters of a more professional customs service.

Domestic pressures for reform can emerge in a variety of ways.

Community pressure for reform can be effective. Most South Pacific customs administrations await major reforms (Appendix 4). One of the most notorious has been the customs administration in the Solomon Islands. The **successful domestically driven experience** was discussed earlier.

Features of an efficient customs administration

The primary task of an efficient customs administration is to collect duties and taxes set by Government while at the same time ensuring the prompt clearance of goods¹². Customs administrations should **have minimum interference with commercial activities** and decisions commensurate with their responsibility to collect tariffs and other taxes.

It follows from this that there are **basic features** that a customs administration should possess. These features are summarized below.

- There is a need for **transparency** of all actions and legislation. Customs decisions should be based on legislation and guidelines that are freely available to the general community. Customs administrations should be subject to audit and be prepared to account for their actions.
- Customs administration should be **predictable**. The best way to achieve predictability is to have transparent legislation, and to minimize situations where officials have administrative discretion.
- Customs legislation should be **comprehensive**. This principle follows logically from the requirements for transparency and predictability. Without comprehensiveness there must inevitably be administrative discretion.

¹² In this paper we ignore secondary objectives of Customs administrations, such as prevention of trade in goods that have negative externalities, such as drugs.

- There is a need to ensure that customs legislation and procedures are as **simple** as possible. The use of standardized documents and procedures will contribute towards achieving simplicity. This objective also has implications for tariff reform so that there is the minimum number of different rates and taxes in the schedule.
- Customs administrations should be **accountable** for their actions through transparent and accessible processes of administrative and/or judicial review.
- Customs administration should attempt **to make the minimum demands on traders to achieve compliance** consistent with the customs administration's responsibility to collect all taxes and tariffs that are imposed by Government.

The design of an efficient customs administration is not difficult. Legislation and operational guidelines can be built around the principles outlined above. Technical assistance is available at all stages in the development of an efficient system. Technical assistance ranges from external advisors, provision of model legislation, through to the software required to process clearances. **The real difficulty** in customs administration is the implementation of the system and the domestic political will that is required to successfully carry out the implementation process.

The tariff and taxation regime

The role of customs is to efficiently process international trade transactions, collect tariffs and taxes that apply to these transactions. **It should not be involved in the setting of these tariffs and taxes.** Tariffs and taxes should not be altered without detailed consideration. One of the problems with many developing country administrations is that tariffs are essentially set by officials with a primary responsibility for revenue. The important resource allocation effects of tariffs are often ignored. Revenue pressures place pressures on administrations to make ad hoc tariff changes. These ad hoc changes increase the complexity of the tariff, and make the tariff system more unpredictable. In Australia, tariffs are almost invariably only altered after public inquiry and a recommendation by an independent commission. These safeguards protect the integrity of the tariff system and provide investors with greater confidence to make longer term investment decisions.

Many tariff regimes have arrangements to provide concessions for some imports. For example, some countries offer concessions for foreign investors requiring imports of materials and capital equipment. As a general principle **concessions should be minimized.** They distort relative prices of similar products and they increase processing costs. It is important that the right to import concessions is clearly defined by legislation. Customs officials should have no discretion in granting or denying concessional entry.

In the South Pacific in **Samoa for example**, foreign investors were able to negotiate a list of items that were able to be imported at concessionary rates. Each investor negotiated a different list of items. The administrative requirements to supervise these arrangements were well beyond the Samoan Customs Bureau and as a result there was inadequate supervision. In Fiji exporters were able to receive duty free entry for imported items required as inputs. An investigation revealed that in some cases exporters had imported inputs amounting to many times the value of their declared exports¹³.

Commodity classification and valuation

The advantages of using a standard **internationally agreed classification** of commodities for customs administration is obvious. Almost all countries now use the Harmonized System (Appendix 1). The advantage for traders is that it reduces classification costs because the same codes are used on an item as it passes across any border using the HS system.

The system is **consistent and transparent**. It is supported by detailed explanatory notes and a compendium of classification opinions. The WCO's Harmonized System Committee can provide arbitration on international classification disputes and the Harmonized System Review Sub-Committee regularly reviews the Nomenclature to ensure that it is consistent with new technology and trading practices.

Similarly the use of **standardized documents** for international trade purposes is generally regarded as an important step in developing an efficient customs administration. Standardized documents should comply with the standards developed by ISO (International Organization for Standardization) and the WCO (World Customs Organization).

The use of standardized documents assists importers and exporters as it assists them to **understand the information requirements**, even if the form is in a foreign language. The use of standardized documents will become even more important as electronic transmission of trade documents becomes more widespread.

Valuation of goods is important since the valuation is usually the base on which tariff and tax liability is calculated. Most countries follow valuation procedures set out by the WTO. These countries have agreed to Article VII which attempts to provide a basis for a fair and neutral system for the valuation of goods. It does however provide customs with the right to ask for further details from the trader and, if it decided that the value is incorrect, a value can be declared by customs for duty purposes.

¹³ In Fiji a new system operated by the exporters has enabled them access to duty free imported inputs whilst avoiding the obvious problems associated with the system described here.

Valuation is a major issue in the two South Asian countries reviewed in this paper. In Bangladesh Customs officials estimate that currently about 10% of import declarations have duty and tax assessment made on the basis of declared value, rather than the c.i.f value on the documents accompanying the goods. This means that on many items, the customs officials simply do not believe the supporting documents accompanying clearance applications. This is a high figure. It implies that either there is still a considerable amount of attempted evasion by traders or that there is unwarranted interference into commercial dealings by customs officials. Customs officials should work with the agent network to reduce this figure.

In Nepal, according to the trading community, the threat of declaring a higher value and delaying clearance is used to extract illegal payments from traders. If the computerized system was working (the server is currently not operational) it would be possible to identify officers involved in the regular use of declared values and in delaying clearances.

Customs operations can be facilitated by computerization

Efficient customs administrations must address the issue of computerization. There are **significant advantages to computerization** of customs even when the level of transactions is quite low.

- The main advantage is that **computerization reduces clearance times**. The size of the paperwork involved in processing goods through customs is extremely large. In Bangladesh there are between 4 and 5 million transactions per year. Any single clearance point with more than a few thousand clearances per year will benefit from some form of computerization. The most widely used software in developing countries is ASYCUDA, which is a UNIX based system that was developed by UNDP (details relating to ASYCUDA are contained in Appendix 3) ASYCUDA can be justified at a port that processes more than about one to two hundred thousand clearances per year. Less than this level of clearances, and other simpler and cheaper computer based solutions can be implemented.
- There is overwhelming evidence that **computerization speeds up clearances**. At the ICD pilot site in Bangladesh, which has been operational since May 2002 and live since May 2002, the proportion of same day clearances rose from 7% in March 2002 to 47% in June 2002. In developed countries the speed of computerized clearances is remarkable. At the cutting edge of this technology is the US National Customs Automation Program Prototype which is designed to allow the rapid importation of motor vehicle parts into the US from Canada and Mexico by designated importers such as Ford, Daimler Chrysler and General Motors. These manufacturers hold very small stocks of

parts and it is essential that suppliers can meet orders for parts quickly. In this system documents relating to a shipment are entered electronically and the goods can usually be cleared within 20 minutes of receipt of the documents by customs.

- A second advantage is that **computerization promotes simplification and standardization of documents and procedures**. The introduction of computerization almost invariably has as a first step the simplification and standardization of coding systems for bill of entry completion. Computerization should always commence with a complete documentation of the system. The ASYCUDA software is built around international standards. These have to be introduced before the software can be implemented. For example the ASYCUDA system requires the clearance form to comply with international standards set out by the World Customs Organization and it is built around the Harmonized System (HS).
- **Computerization reduces administrative discretion and requires the codification of rules and concessions**. Unambiguous decision rules must be documented and incorporated in the software. The simple exercise of constructing a flow chart of the processing procedures as a precursor to software design will identify areas of administrative discretion. Computerization and the related activities required to for implementation, improve transparency and reduce the problem of differential treatment between firms and individuals involved in international trade.
- **Computerization reduces the amount of processing errors**. Errors can arise in entering data and calculating duty liability. Whilst errors can still occur in an electronic system, built in error checks can often immediately identify these problems. For example most software systems would automatically check whether an entry in the HT code box was in fact a legitimate code and would automatically enter the goods description that corresponded with the code, thus avoiding errors in goods description. Similarly, the system would only require data entry of the identification code for the trader. The software would then check that the identification code was a legitimate code and enter the name and address of the trader automatically. Software will also carry out the taxation liability calculation.

- **Computerization improves the quality of record keeping. It allows for audits and some aspects of customs performance, such as clearance times and revenue collection, to be monitored.** It also assists with taxation investigations in general. For example lists of major trading companies can be extracted from the ASYCUDA system and compared with records of other tax payments for the same firm. As customs services attempt to reduce clearance times by reducing inspections at time of clearance, there will be an increasing need for post clearance audit. Post clearance audit can only be carried out effectively if comprehensive, accurate records are maintained. Increasing use of bonded warehouse facilities, or similar arrangements where tax liability is not required to be paid at the time of clearance will also require records to be maintained so that tax owing can be either paid or cancelled at some later date.
- **Computerization also allows for other associated improvements to be introduced.** For example in Bangladesh the system now allows for a bank branch to be connected to the system so that once an assessment is made the firm can pay the taxes owing at the bank and then clear the goods. In this way the customs officers do not handle money and the reconciliation between assessments and revenue collected (which should be done on a daily basis) is facilitated. The interface with the banking system can be a simple single branch arrangement as in Bangladesh to a much more sophisticated system that would be used with a remote direct trader input system. Computerization also allows for improved risk management techniques, such as automatic identification at time of clearance application for high risk shipments.
- **Computerization can allow for remote clearance of documents.** Under these arrangements firms can complete their clearance documents electronically and pay any tax liability without being required to join queues at the clearance house. However ASYCUDA has been particularly slow in incorporating acceptable remote clearance facilities. It is largely because of these problems that comprehensive remote clearance facilities are not available to traders in Bangladesh.

The **choice of appropriate computer software** for customs is an issue that depends in part on the number of clearances and the nature of the customs task. Most small to medium sized countries use ASYCUDA which is software for customs designed and promoted by UNCTAD. Some countries, where there is a strong base of customs officers with computing skills such as Sri Lanka and the Philippines have benefited greatly from ASYCUDA. However ASYCUDA is not a suitable piece of software for all developing countries. Its major weaknesses are that there are problems handling remote points of entry where the number of clearances is small; some users find the bonded warehouse controls inadequate; the system does not adequately handle free

trade zones; it is not designed to collect domestic excise; the system does not handle voluntary export restraints; and it does not handle revenue from licenses and fines. Issues regarding the choice of software are covered in Appendix 3.

There are **some important lessons** to be learnt regarding computerization by looking at the experiences of Bangladesh and Nepal and the South Pacific. In Bangladesh computerization was seen as a component in a wider customs reform program. In Nepal, as in many other countries, computerization was undertaken in isolation of more general reform. It is clear from analysis of the experience of different countries that computerization is likely to be much more effective if the Bangladesh implementation strategy is used.

One of the important lessons of the South Pacific is that computerization should **always be accompanied by a contingency plan** so that clearances can proceed when there is a computer failure. Usually contingency plans involve having a manual processing procedure that can be used for short periods when there is a computer failure. Manual records can then be entered as post entries into the computer system once the computer facilities are restored. The South Pacific experience also shows the importance of having fully functioning computer equipment in reserve so that a hardware problem can be resolved by simply switching to reserve equipment until the hardware is repaired.

However, it is often difficult to convince Governments of the need to have **reserve equipment for customs** when the system appears to be able to operate without this equipment. It should be noted that Nepal in particular is in urgent need of contingency plans because their customs computer hardware is currently stretched to well beyond acceptable limits. At present, the central server has a hardware fault that renders it inoperable. A back-up server would have resolved this problem. It must be accepted that breakdowns in hardware and power failures are inevitable and plans need to be in place to meet these problems. Even in Bangladesh, there is a need for reserve hardware to meet hardware failure. Given the shortage of hardware and the number of clearances that must be processed in Bangladesh, there is the potential for a major catastrophe if hardware were to fail.

Risk management

Risk management is an issue that should be considered in any customs reform program. It benefits traders who comply with the law and assists customs to make cost savings through optimal allocation of resources. The **major benefit** to traders is that for most traders the bulk of clearances will be processed quickly without being subject to physical examination.

In considering the risk, two factors need to be considered; the potential revenue loss and the probability that evasion will be attempted. For any given level of expenditure on investigation, **optimal allocation of compliance resources** requires that, for those transactions selected for investigation, the potential revenue lost from non-compliance, multiplied by probability of detecting non-compliance when the transaction is investigated, should be maximized.

Table 1, which relates to the South Pacific, shows how these factors can be analyzed when allocating resources to check compliance of Value Added Tax collected on imports. **Activities are classified by risk of evasion and potential revenue lost.** In the Table below resources to check on compliance should be focused on activities that fall in the bottom right hand corner box - that is activities where the risk that attempts to evade tax are high and the potential revenue loss is large. In the South Pacific these are bonded warehouse operators and logging firms.

Table 1: VAT revenue loss and risk of avoidance in the South Pacific

		Potential VAT Revenue Loss	
		Low	High
Evasion Risk	Low	Small scale retailers of imported consumer goods	Large Multi National companies
	High	Small scale primary producers and small locally owned retailers	Bonded warehouse operators and Logging firms

Source: Filmer and Lawson (2002)

It should be emphasized that risk management will not obviate the need for some **random checking**. Risks change over time and random checking will provide a guide to the design of the larger risk management system. A computerized system can also assist with random checking and ensure that discretion by customs officials in the choice of goods to be inspected as part of the random check process is reduced to a minimum.

Model customs legislation

For countries that have the political will to reform their customs administration, there is now extremely useful material in the revised version of the Kyoto Convention on the simplification and international harmonization of customs procedures (Appendix 2). The revised Kyoto document provides a **comprehensive blueprint for customs reform**. The Annexes to Kyoto contain model legislation and implementation guidelines relate to key topics such as customs warehouses and duty free zones.

Emerging issues for customs administration

An issue that has received little attention in customs reform has been the **allocation of export quotas** for firms exporting garments under quota to North America and Western Europe. Access to these quotas will be a significant factor in any decision to invest in the garment sector in countries such as Bangladesh.

There is a **significant lack of transparency** in the area of export quota administration in Bangladesh. The Bangladesh Government has left the allocation of these quotas to the private sector. There is considerable political involvement in the distribution of quotas with rival political factions competing for power to allocate quotas to their supporters. One of the problems with the system is that it favors entrenched interests and makes it extremely difficult for new exporters to enter the market. Reform of this area is a major task. Fortunately, if the undertakings made within the WTO by the US and the EU to dismantle the quota system are implemented, much of the power of the garment manufacturers' organization will be eliminated. Any efforts by the association to control or license exporters after this time should be resisted.

An emerging issue for customs administration is **rules of origin**. There has been a move in recent years in world trade towards bilateral trade deals, which is fundamental to the WTO multilateral arrangements, rather than use of the most favored nation approach. It has become necessary for customs administrations to use rules to determine the country source of imports. This becomes difficult in cases where a trade deal is entered into by countries such as Bangladesh and Nepal with India and imports enter Bangladesh and Nepal from India but with substantial manufacture carried out in a third country- e.g. Japan. The arrangement can produce massive complications to customs administration.

There can be **significant clearance delays** whilst the country of origin is determined. For example, in small southern African states, most HS codes have three different rates- a rate that applies to South Africa, another to other southern African states, and a third to the rest of the world. The first two of these rates are then subject to annual downward movements. The proposed

rules of origin that have emerged to prevent misstatement of country of origin have, in this case become bizarre. The problem for traders is that they will be required to produce detailed information on the manufacturing process before qualifying for concessional entry under a bilateral trade arrangement.

Problems in this area will continue to emerge while the WCO cannot agree on a recommended treatment for rules of origin or until these bilateral deals can be brought back to a WTO most favored nation basis.

Customs administrations in the 21st century

Advances in electronic communications and the electronic storage and retrieval of data are likely to be the **main drivers in changes to customs** administration in the major developed countries. Other customs administrations are likely to follow. Remote clearance and electronic transmission of documents will become the norm. Electronic scanning of goods will increase. For some goods the documents will be attached electronically so that they can be extracted by scanning.

Risk management will allow the traditional requirement for each clearance to be linked to its own documents to be relaxed. The requirement that each clearance has its own set of documents for clearance has been a basic principle of customs for over one hundred and fifty years. However with the rapid growth in international trade this is seen as a major constraint because of the number of clearances that are now processed. Instead, major firms are likely to be able to submit a monthly or weekly statement of all shipments undertaken over the period. Payments would then be made electronically.

The changes in customs procedure will mean that there will be a **different mix of skills required** for customs officials. Information technology skills will be required for virtually all professional officers within the customs administration. In many administrations, such as the Bangladesh administration, there will need to be a greater integration of staff with information technology staff and the rest of the organization.

As the importance of the requirement to obtain revenue from tariffs and other trade barriers declines, the good news for traders is that there is likely to be a **shift towards allocating customs resources to improve the processing speed**. As domestic taxation structures improve and collection costs for domestic taxation decline, there will be greater emphasis on tax collection from domestic sources and less on tariffs and related measures. This is already the case in the major developed countries and other countries will inevitably follow this trend.

Appendix 1: The harmonized commodity description and coding system

The Harmonized System (HS) is an international commodity classification system developed by the World Customs Organization (WCO). The international commodity classification consists of six digits. Local digits can be appended to the six digit number when required. More than 98% of world trade is currently classified under the HS.

There are many advantages to the use of a common classification system. Once a commodity has received a classification its international code (that is the first 6 digits of the code) will remain the same as it moves internationally. The system reduces classification costs for importers and exporters and it assists in the detection of illegal transactions (For example using the HS Code it is possible to identify exports from the South Pacific of logs to Japan and Malaysia and then, using the Japanese and Malaysian import statistics of raw logs, establish that imports into Japan and Malaysia of these HS Codes far exceed the stated exports from the South Pacific. This is indicative of widespread illegal logging and smuggling of timber in the South Pacific. This type of analysis could not be carried out unless countries use a common trade classification). The HS classification system also facilitates international trade agreements because an item can be defined by its code.

The HS is supported by detailed explanatory notes and a compendium of classification opinions. The WCO's Harmonized System Committee can provide arbitration on international classification disputes and the Harmonized System Review Sub Committee regularly reviews the Nomenclature to ensure that it is consistent with new technology and trading practices. While classification issues at this level must be raised by Member administrations, there is private sector involvement. The (ICC) International Chamber of Commerce is invited as an observer to meetings of the Committee and is consulted regarding technical information on classification.

The HS Nomenclature is structured by economic activity or component material. For example animal and animal products are found in one section and machinery is found in another. The nomenclature is divided into 21 Sections and these sections in turn comprise one or more Chapters. There are 97 Chapters in the HS. (Chapter 77 is currently not used, but is reserved for possible future use.) The first two digits of the HS signify the Chapter to which the commodity belongs. For example motor vehicles will all have HS Codes starting with 87 because Chapter 87 is. "Vehicles other than Railway"

Typical Section Headings include Section IV, “Prepared Foodstuffs; Beverages, Spirits and Vinegar; Tobacco and Manufactured Tobacco Substitutes” and Section VI “Products of the Chemical or Allied Industries”

The Chapters of Sections I to XV (except Section XII) are grouped by biological genus or by the component material from which articles are primarily made (eg .Chapter 41 “Raw Hides and Skins”, Chapter 42, “Articles of Leather”, Chapter 44 “Wood and Articles of Wood”).

In those Chapters where items are classified by raw material then, within the Chapter, items are classified according to degree of processing. For example Chapter 44 contains items such as rough wood, wood roughly squared, and later in the Chapter, wooden finished products.

Some manufactured items where end use is readily determined are classified by use or function. For example Chapter 88, “Railway Locomotives”, Chapter 87 “Vehicles other than Railway” Chapter 88 “Aircraft etc” and Chapter 89 “Ships etc.”

Appendix 2: International Kyoto convention on customs procedures

The simplification and international harmonization of customs procedures has been an ongoing task. Efforts to further this objective date back more than 80 years. Currently efforts are focused through the World Customs Organization (previously the Customs Co-operation Council). The Council has established Conventions that are binding on Contracting Parties.

The WCO work in this area has been brought together in the International Convention on the Simplification and Harmonization of Customs Procedures (Kyoto, 18 May 1973)

In June 1999 the WCO unanimously adopted a revised version (Revised Kyoto Convention) (See <http://www.wcoomd.org> for a complete copy of the revised Convention). The Revised Convention will enter into force once 40 countries have ratified or acceded to the Protocol of Amendment. To date 12 Contracting Parties have ratified or acceded (Algeria, Australia, Canada, China, Czech Republic, Japan, Latvia, Lesotho, Morocco, New Zealand, Slovakia, and Uganda). Many customs organizations have commenced incorporation of the Revised Kyoto principles into national legislation without waiting for formal entry.

The revised Kyoto Convention is designed to be a blueprint of modern customs procedures by enabling the implementation of effective controls while at the same time facilitating international trade. The Convention contains model legal provisions covering core customs functions together with detailed implementation guidelines, including best practice information. It sets minimum standards for predictability, transparency legal process and the use of information technology. It contains guidelines for the use of modern customs management techniques, including risk management pre-arrival information, and post clearance audit.

The Convention recommends the minimum necessary control to ensure compliance. For example one of the key approaches it recommends for trade facilitation are “fast track” procedures for authorized traders with good compliance records. These fast track procedures include release of goods with minimum information at time of entry and further information provided post entry. Other important features of the Kyoto recommended approach include the use of information technology and the reduction of requirements for paper based documents. The benefits of the Kyoto approach are shared between the national economy, the trade community and customs administrations.

The body of the convention and the central annex contain the Convention Rules. It is obligatory for a Contracting Party to accept without reservation this part of the convention and the 121 legal provisions it embodies. The 10 specific Annexes that comprise 25 Chapters and 600 legal provisions can be considered separately by Contracting Parties. Acceptance is optional. A Chapter or Annex can be accepted with reservations regarding the recommended practices. Any reservation must be reviewed within 3 years by the Contracting Party. Each of the Specific Annexes are supported by implementation guidelines which are not part of the legal text.

Benefits of implementation of revised Kyoto convention

Beneficiary	Benefits
National Economy	<ul style="list-style-type: none"> Reduced Transaction Costs Reduced Delays in the Clearance Process Increased Foreign Direct Investment and domestic Industry Development Improve participation of small and medium sized enterprises Lower Consumer costs Increased National Revenue
Trade Community	<ul style="list-style-type: none"> Faster, more predictable and efficient clearance Transparent Procedures Rights of Appeal against treatment Greater facilitation for compliant traders Lower business costs Enhanced competitiveness Greater opportunity to use information technology
Customs Administrations	<ul style="list-style-type: none"> Enhanced customs control Increased trade facilitation More efficient use of customs resources Reduced integrity problem Supply chain security and facilitation

The subjects covered by the Specific Annexes are set out below

Customs issues covered by the revised Kyoto annexes

Annex	Topic
Annex A1	Customs formalities prior to the lodgement of the goods declaration.
Annex A2	Temporary Storage of Goods
Annex A3	Customs formalities relating to commercial means of transport
Annex A4	Relates to treatment of stores on board arriving vessels, aircraft or train
Annex B1	Clearance of goods for home use. Note: this Annex describes the format of the clearance document
Annex B2	Reimportation in the same state
Annex B3	Relief from import duties and taxes
Annex C1	Export procedures
Annex D1	Customs Warehouses
Annex D2	Duty Free Zones
Annex E1	Customs Transit (includes seals and identification marks)
Annex E2	Transshipment
Annex E3	Coastal transport of goods
Annex F1	Inward Processing
Annex F2	Outward Processing
Annex F3	Drawback
Annex F4	Processing of goods for Home use
Annex G1	Temporary imports
Annex H1	Customs Offences
Annex J1	Travellers
Annex J2	Postal traffic
Annex J3	Means of Transport for Commercial use
Annex J4	Stores
Annex J5	Relief Consignments
Annex K1	Rules of Origin (Pending)

The implications in developing countries

It is possible to become a Contracting Party to the Convention. Even countries that are not members of WCO can become Contracting Parties.

Clearly in developing national legislation it is important to be aware of the guidelines in the Conventions. Even if a country makes a decision not to become a contracting party it is useful to develop national legislation that is as close as possible to the guidelines contained in the Conventions.

Appendix 3: Computerization of customs clearances

The advantages of computerization is that it accelerates clearances; it promotes simplification and standardization of documents and processes; reduces administrative discretion and requires the unambiguous codification of rules; improves the quality of record keeping; facilitates audits and post investigations; and it allows for other enhancements, such as remote access and electronic transactions.

The most widely used computer software for customs in developing countries is ASYCUDA. ASYCUDA is a computerized customs management system developed in Geneva by UNCTAD. It has a long development history dating from 1981. The system currently operates in a UNIX environment. The latest version, ASYCUDA ++ is written in C++ although earlier versions, which are still in use in some countries (e.g. Papua New Guinea), were written in ABAL, a relatively little used French programming language.

The system complies with the relevant codes and standards developed by ISO (International Organization for Standardization) and the WCO (World Customs Organization) and is currently operational in about 80 developing countries. The most successful larger scale applications of ASYCUDA have been in Sri Lanka and the Philippines

The ASYCUDA Modules

The ASYCUDA++ software consists of modules. One country can have one or more modules.

Modules fall into two general categories, 'user', and 'head office'.

User Modules

The 'user' modules are used by staff in the customs offices for production work, i.e., inputting and processing declarations, cargo accounting, transaction and statistical reporting, accepting duty and tax payments (cashiers), selectivity and for other routine management controls.

Customs Office Module (MODCBR)

This module is the customs office module and deals mainly with the input, validation, storage, registration, 'red', 'yellow' and 'green' processing lane allocations, and assessment of customs declarations. It also contains reporting options to check on the status of goods under suspense regimes, such as goods in warehouses.

Brokers Module (MODBRK)

This is a modified version of the customs office module. It is designed for use by a Declarant or a Customs agent and gives them a direct electronic connection to the customs ASYCUDA++ system, ('Direct Trader Input'). Access is limited to only those functions relevant to the dealings of that declarant and excludes the customs control and reporting functions available under MODCBR.

Accounting Module (MODACC)

This module covers all accounting and payment functions of the system, and provides for cash, credit and pre-payment modes of payment.

Selectivity Module (MODSEL)

This gives the ability to control the selection and flow of declarations through the customs declaration processing system. It contains the controls to block Assessment of selected declarations, and has a range of querying and reporting functions.

Manifest (Cargo) Module (MODCAR)

The 'carrier' module is for the preparation and transmission of cargo reporting details in electronic format. It is used to create electronic carrier or transport manifests and bills of lading. Used with other ASYCUDA++ modules for cargo controls, including clearances and cargo accounting.

Deferred Input Module (MODSDI)

For processing declarations from offices that are not 'on-line'. It allows declaration data to be input to the ASYCUDA database. It works like MODCBR but has no links to the accounting system. This means declarations may be entered with the operator manually entering registration and assessment numbers and the amount of duty paid on the declaration – without validation.

Transit Module (MODTRS)

This module allows for the electronic capture and transmission of Transit data and allows customs offices to control the movement of all transit goods within their National Borders and for simplified import clearance at the border. Transit documents created and managed within MODTRS are the customs Transit (T1), TIR Carnet and FIP (First Import Procedure).

Head Office Modules

The 'head office' modules are used firstly in setting up the ASYCUDA++ system to meet national requirements, (eg, forms of declaration, national tariff, tax rates). They are then used for maintaining reference data used by the system, such as rates of exchange, and a range of codes including importer, declarant, bank, warehouse etc., also for system security.

Customs Headquarters Module (MODCHQ)

This module allows the maintenance of the database files and references, including tariff management and is also used for extracting some standard statistical reports.

Customs Headquarters Configuration Module (MODCHQCF)

This is the national customs configuration module. It allows the countries' national standards to be applied. These standards consist of:

- The Country name,
- The assignment of field types and length,
- Global calculation definitions for charges not based on declaration items,
- The definition of the Tariff columns together with the standard taxation calculation method,
- Standard Valuation apportionment calculations.

System and Security Module (MODSYSCF)

This is the systems configuration module. It allows the system to be configured for use. The system configuration module allows the following to be set up:

- The Office code,
- The list of modules authorized at that office,
- Setting of series numbering for declarations and receipts.

User management security controls – The definition of the user functional groups, including attaching users to groups.

Gateway module (MODGTW)

The 'gateway' module is for communication between ASYCUDA sub-systems in the national system. This enables all communications between offices to be automated, for example, it may be used for routine reference table updates to be transferred from headquarters to regional offices, and for transaction data to be received in return.

The decision to implement ASYCUDA

ASYCUDA is not a suitable piece of software for all developing countries. Its major weaknesses are that there are problems handling remote points of entry where the number of clearances is small; some users find the bonded warehouse controls inadequate; the system does not adequately handle free trade zones; ASYCUDA is not designed to collect domestic excise; the system does not handle voluntary export restraints; and it does not handle revenue from licenses and fines.

Some countries, where there is a strong base of customs officers with computing skills such as Sri Lanka and the Philippines have benefited greatly from ASYCUDA. In the South Pacific, Samoa appears to have successfully implemented ASYCUDA, although it does not fully utilize the enhanced data base that ASYCUDA provides. Other countries have found that it did not meet their particular requirements. For example Mauritius, which has a large Free Trade Zone, decided to discontinue with the use of ASYCUDA. In the case of Mauritius there were in house capabilities to design their own system.

One of the problems with ASYCUDA has been the reluctance of UNCTAD to fully document the system and provide code so that interfaces to meet particular local needs could be developed. For example countries with small remote entry ports could in theory develop their own system using an Access data base and then input the data at a later date- e.g. monthly into their ASYCUDA system at the central point. However to do this would require access to ASYCUDA code so that the locally produced module could interface with ASYCUDA. UNCTAD have been reluctant in the past to provide code.

The comments raised by users at the WCO Symposium (11/12 February 2002), where there was a special session for ASYCUDA users, provides a good guide to users' views on ASYCUDA.

User responses ranged from very positive to very critical. However some common problem areas were identified. There were concerns around the functionality of the modules for risk management, tariff and warehouse, which appear not to meet many user's requirements.

The lack of technical support from UNCTAD and the delay in responding to users' needs were areas of concern for a significant number of users.

There were requests, both from delegates attending and in the written submissions, for users to have greater control of their systems and for UNCTAD to release source code for the system so that users could adapt the system to meet their individual requirements. Philippines Customs representatives, who are acknowledged as being some of the more sophisticated users and are supporters of the system, emphasized that there needed to be changes in arrangements with UNCTAD so that users had project ownership and could influence developments in their national systems.

Users have expressed concern that they are sometimes pressured into adopting the ASYCUDA system. The delegate from Madagascar for example expressed concern that lending agencies, in particular the World Bank, put a requirement to use ASYCUDA a condition of lending. There is also the well documented case of Fiji where pressure was placed by the lending agency to use ASYCUDA. when existing in house system was functioning well and indeed had features that were unavailable in ASYCUDA

In Bangladesh it appears that so far the implementation of the ASYCUDA system has been successful. The major problem to date has been delays in hardware.

The test for the success of the system in Bangladesh is likely to be when additional customs modules are developed in house and there will be a need for these to interface with the ASYCUDA++ system. For example Bangladesh has a wide ranging warehouse system with unique features where imported inputs used by exporters are brought in duty free and stored until they are used. It is proposed to carry out physical stock checks of each warehouse and then develop an inhouse computer system that takes information from the ASYCUDA++ system on inputs to each warehouse and drawdowns. Using this information, the stock information would be automatically updated on a daily basis so that at any time a user could receive a report of the items that should be in any warehouse. This would then be checked at regular intervals with a physical stock check. There is a question as to whether ASYCUDA officials from UNCTAD will allow access to the ASYCUDA++ system by the Bangladesh officials so that the interface can be built. Based on past experience in other countries UNCTAD will decline to provide this level of access.

In Nepal the basic problem is inadequate support for the ASYCUDA system. The implementation program has been badly designed as a one off computerization exercise rather than as part of a comprehensive customs administration reform program.

Options for computerization other than ASYCUDA

For small countries, development of a computerized system based on an Access data base can be readily implemented. These systems can be written to comply with WCO form design and other requirements. They are far more

Appendix 4: A customs reform program for the South Pacific

Fiji

- Zero rate for VAT purposes all imported inputs not domestically produced (zippers, buttons etc). Where the tariff for these items is not zero (currently either zero or 3%) set the tariff to zero. This has minimal effect on revenue collections because the VAT revenue collected is almost entirely refunded, but it will simplify administration, lower collection costs, and make local exporters more internationally competitive.
- Reform excise. Widen the coverage and reform rates so that excise rates do not discriminate between domestic production and imports.
- Improve the administration of excise. Integrate it with other customs revenue collections and keep records that can be audited.
- Review the need for concessions on imported inputs for exporters in the light of the zero rating exercise described above. Set up a system that can be audited and can be administered largely by the exporters. (Exporter's Club system).
- Improve the administration and record keeping associated with bonded warehouses.
- Fully install ASYCUDA ++ and arrange for training so that ASYCUDA records can be used in audits and investigations.

Federated States of Micronesia

- Seek domestic political support for financial reform through a referendum;
- Implement a program of institutional strengthening for customs administration;
- If there is domestic political support for financial reform, legislate for a VAT system;
- Replace the basic tariff and the GRT by the VAT;
- Replace the current 'excise' tariffs by a WTO approved Excise regime that does not differentiate between imports and any domestic production.

Papua New Guinea

- Reform the bonded warehouse system so that warehouses can be audited.
- Upgrade the ASYCUDA system to ASDYCUDA ++.
- Develop computer software that integrates with ASYCUDA to manage remote ports and bonded warehouses.
- Upgrade computer hardware and computer support for customs.
- Avoid annual tariff changes as part of budget considerations.
- Review VAT collections and improve administration of VAT collected at ports.
- Reform administration of excise.

Republic of Kiribati

A number of criticisms of the current tariff system have been made, including the need to:

- improve the administration of the tax and customs administrations;
- consolidate the number of different rates;
- get rid of the import levy by incorporating it in the revised rate structure;
- reduce the variability of rates across similar items;
- adopt a c.i.f valuation of imports;
- minimize the use of specific rates;
- remove exemptions from paying the tariff that currently apply to certain government businesses
- convert high tariffs to Excises.
- Introduce an improved simplified computerized process using an Access data base (not ASYCUDA) to process clearances
- Consider the introduction of a consumption tax collected largely at the port of entry by customs for imported items.

Republic of the Marshall Islands

- Reduce leakages from the current tax bases, such as exemptions from tariffs.
- Institutional strengthening of customs administration to boost tariff revenues.
- Integrate customs reform with broader economic reform.
- Introduce a broader based consumption tax to replace the GRT and the tariff.
- A basic requirement for customs reform will be domestic political support. Until this is achieved other actions are likely to fail.

Republic of Palau

Customs reform should be integrated with wider tax reform.

Develop a broader based consumption tax to replace the GRT and the tariff.

Further reduce leakages from the current tax bases, such as exemptions from tariffs.

Samoa

The major emerging issue for Samoan exports is going to be international competitiveness. Tariffs and VAT on imported materials and capital items is relatively high with consequent detrimental effect on competitiveness. The advantage that Samoa has had in its clothing area has been that it is not subject to quotas into developing country markets.

This is one of the main reasons for location of firms like Pacific Cashmere in Samoa. As the US and the EU relax these quota restrictions for countries such as India, Pakistan, Sri Lanka and Bangladesh, Samoa will have to compete without this advantage. customs administration will need to facilitate international competitiveness.

- Convert most of the 20% tariffs to excise. Their function is to raise revenue and this would be better achieved through excise.
- The tariffs on capital equipment and imported materials should be a maximum of 5%. They are currently typically 10%.

- VAT on the items of capital equipment, with the exception of motor vehicles, should be zero. This would have minimal effect on revenue because most VAT on these items is either not charged or, refunded under the drawback scheme.
- There is a need to integrate customs with the rest of the Government and improve its reporting on its activities. This would reduce the need for other institutions, such as the central bank, to separately collect information on international trade clearances.

Solomon Islands

It is clear that the original purpose of this tariff structure was to raise revenue. However the concessions that have been allowed to develop have substantially eroded the revenue base and affected investment because there is a lack of predictability about liability for taxes on imports and exports. While customs administration has improved in recent years with computerisation, there are enormous pressures on customs administration when there are tariff concessions, particularly importer specific concessions. The goods tax cannot be properly administered because payment at the point of entry can be postponed.

There is little chance of meaningful reform without political will to reform. In the Solomons there is little indication that there is much internal pressure for reform.

- Reform the tariff structure. The logic of the structure is not immediately apparent. Convert most revenue tariffs to excise. Zero rate industrial inputs so that concessions do not have to apply. There is considerable scope for reform without affecting revenue because of the concessions that apply.
- Review the complicated goods tax (currently 15% of 130% of the duty paid import value). Prevent avoidance by charging this tax at point of entry.
- Review the concessions. Whilst there has been some reform, concessions are still on a case by case basis. Most concessions should be eliminated. The Government should pay tax on imports.
- Review the need for the range of export taxes. These export taxes cover almost every major export. Administration of these taxes, notably logs and fisheries are extremely poor. There is a particular need to examine the log export trade and to introduce checks to combat evasion. It would be possible to contract a private company to supervise log export. This needs to be investigated.

- Delay the introduction of ASYCUDA and review the need for ASYCUDA. The current computer system appears to be working well. It may be difficult to justify the expense (probably in excess of \$2 million) of introducing ASYCUDA with its well known deficiencies given that the existing Windows system can be upgraded to Kyoto Standards.

Kingdom of Tonga

- Improve administration of the tax systems, including customs administration.
- Improve compliance and reduce evasion of all taxes particularly taxes on imports.
- Change attitudes to the (non-)payment of taxes on imports.
- Simplify the tariff and convert the high tariffs to excises.
- Develop a broader based consumption tax to replace the current sales tax and the basic tariff rate; and in the longer term, reduce reliance on indirect taxes.

Vanuatu

- Reform of the tariff needs to be carried out in the context of reform of the total taxation system. A large amount of revenue has to be raised through the tariff and the VAT because of the absence of some other forms of taxation.
- Reform the tariff structure. Convert most revenue tariffs to excise. Zero rate industrial inputs so that concessions do not have to apply. There is considerable scope for reform if the restructuring is done within the context of a total reform of the taxation system. Examine the resource allocation implications of the tariff structure.
- Improve administration of customs with training in the use of ASYCUDA as a management tool and basic extractions and improve integration of customs collections with other revenue collections.

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