



Kent Academic Repository

Mikuriya, Kunio (2009) *The evolution of customs valuation in the developing world: From Deregulation to Developing State Capacity*. Doctor of Philosophy (PhD) thesis, University of Kent.

Downloaded from

<https://kar.kent.ac.uk/86401/> The University of Kent's Academic Repository KAR

The version of record is available from

<https://doi.org/10.22024/UniKent/01.02.86401>

This document version

UNSPECIFIED

DOI for this version

Licence for this version

CC BY-NC-ND (Attribution-NonCommercial-NoDerivatives)

Additional information

This thesis has been digitised by EThOS, the British Library digitisation service, for purposes of preservation and dissemination. It was uploaded to KAR on 09 February 2021 in order to hold its content and record within University of Kent systems. It is available Open Access using a Creative Commons Attribution, Non-commercial, No Derivatives (<https://creativecommons.org/licenses/by-nc-nd/4.0/>) licence so that the thesis and its author, can benefit from opportunities for increased readership and citation. This was done in line with University of Kent policies (<https://www.kent.ac.uk/is/strategy/docs/Kent%20Open%20Access%20policy.pdf>). If y...

Versions of research works

Versions of Record

If this version is the version of record, it is the same as the published version available on the publisher's web site. Cite as the published version.

Author Accepted Manuscripts

If this document is identified as the Author Accepted Manuscript it is the version after peer review but before type setting, copy editing or publisher branding. Cite as Surname, Initial. (Year) 'Title of article'. To be published in *Title of Journal*, Volume and issue numbers [peer-reviewed accepted version]. Available at: DOI or URL (Accessed: date).

Enquiries

If you have questions about this document contact ResearchSupport@kent.ac.uk. Please include the URL of the record in KAR. If you believe that your, or a third party's rights have been compromised through this document please see our [Take Down policy](https://www.kent.ac.uk/guides/kar-the-kent-academic-repository#policies) (available from <https://www.kent.ac.uk/guides/kar-the-kent-academic-repository#policies>).

Kunio Mikuriya

Degree of Doctor of Philosophy

Subject: International Relations

The Evolution of Customs Valuation in the Developing World:
From “Deregulation” to Developing “State Capacity”

April 2009

Executive summary

An accurate assessment of the value of imported goods by customs is an essential precondition of an accurate determination of an importer's tax liability. However, customs authorities in many developing countries experience considerable difficulty in discharging this function. Poor compliance of importers, weak administrative capacity in customs, and pervasive corruption are often identified as the major problems. Beginning in the 1980's neo-liberal approaches to customs modernization encouraged states to adopt "market solutions" to customs problems. As a result, core customs functions including revenue determination were contracted out to private inspection companies with the support of international financial institutions. These companies proposed to examine documents and carry out physical inspection of consignments (in exporting countries) and to provide information on quantity, quality, value, and tariff classification of the goods for the benefit of the importing jurisdiction before the actual shipment of the goods. Today some 30 governments have adopted this partial privatization, called Preshipment Inspection (PSI), to address the weakness of customs.

Based on a realization that unregulated privatization did not bring about the expected efficiency enhancements, states have recently moved to re-regulate these private companies. This movement has been observed in assessment discussions held at the WTO and in other forums, as well as in improved contracts with PSI firms. States and international financial institutions have also become more focused on directly enhancing the capacity of customs authorities. The inspection industry has responded to this trend. It has begun to offer services that *support* the business model of customs, rather than *replace* customs functions. Case studies of four countries that have adopted the PSI service show that benefits have been mixed in terms of both their ability to enhance revenue and improve the integrity of customs administration. There is little evidence of transfer of skills and technology to customs authorities. In fact, the use of the private sector has often resulted in a long-term dependence on expensive PSI contracts. Only governments that made serious efforts in direct customs reform have demonstrated an ability to improve customs operations and exit from the PSI program.

Table of Content

Introduction	-- 1
Chapter 1: Evolution of customs function and international rules	-- 12
Chapter 2: Evolution of customs valuation rules towards the WTO Agreement	-- 28
Chapter 3: Implementation Issue of the WTO Agreement on Customs Valuation and the original PSI solution	-- 44
Chapter 4: Literature review on PSI, theoretical background on Neo-Liberal Privatization and New Public Management, and analytical framework of case studies offered by the existing literature	-- 61
Section 1: Critical review of the existing literature	-- 62
Section 2: Neo-Liberalism and New Public Management theory	-- 73
Section 3: Analytical framework offered by the existing literature	-- 89
Chapter 5: Evolution of the PSI service and (re)regulations by the WTO Agreements	-- 95
Chapter 6: Proposed alternative solutions and the new services of the PSI industry	-- 116
Chapter 7: Case-study – The Philippines	-- 134
Chapter 8: Case study – Kenya	-- 163
Chapter 9: Case study – Bangladesh	-- 189

Chapter 10: Case study – Togo	-- 211
Chapter 11: Comparative analysis of case studies	-- 233
Conclusion	-- 256
Bibliography	-- 263

Introduction

This paper studies the experience of selected developing countries on the pre-shipment inspection (PSI) to contract out customs valuation to the private sector in an effort to improve efficiency, their evolution towards public-private partnership, the expectation of user countries, the way these programs were actually implemented, and their own assessment. The study includes the institutional issues, namely the development in customs mission and WCO standards, WTO rules on customs valuation, those on PSI, and the development of PSI industry. Four developing countries were selected to analyze how these countries experienced the PSI program offered by inspection companies, how they assessed the program in relation to their own expectations. Originally this policy was guided by the neo-liberal thinking that placed faith on “deregulation” to introduce market forces into the public sector. Later, both the states and the international financial institutions realized that “re-regulating” was needed in the customs inspection industry and new international rules were developed. The result has been a variety of new partnerships among states and inspection companies, putting more emphasis on developing “state capacity.” However, the PSI program did not work as expected, because the internal capacity of user governments to oversee inspection companies was limited on one hand, and because inspection companies were not interested in capacity building in customs on the other.

Chapter 1 explains the role of customs authorities regulating the cross-border movement of goods to ensure trade compliance in the areas of revenue collection, protection of society, and economic development to introduce the complexity of customs operations. This explanation provides the background of the need of assistance for developing countries to run well-functioning customs administration. The core function of customs is to receive and examine information that accompanies the movement of consignments to ensure compliance with international trade rules on one hand, and to conduct necessary physical inspections of consignments on the other hand. Over the years, the customs community has developed its best practices in improving border control and incorporated them into international standards, such as the WCO Revised Kyoto Convention. These best practices include the use of information technology, the use of risk management, and other modern customs control techniques. With the expansion of international trade and the growing awareness of the costs associated with cumbersome procedures at the border-crossing, many customs authorities have been making efforts to reduce the pressure on the borders by

introducing selective inspection and audit-based enforcement approaches. It has been a challenge for customs administrations in developing countries however to enhance their administrative capacity when applying these best practices in an environment where trade compliance is often very poor.

Chapter 2 focuses on the evolution of international rules on customs valuation and the practice of contracting out customs functions to inspection companies. Among a range of customs functions, revenue collection is fundamental, especially in those developing countries where customs duties constitute a significant share of overall national revenue collection. It is therefore vital for these customs authorities to properly assess the value and other attributes of imported goods. They determine tax liability by examining documents and inspecting consignments where necessary. Taking into account the need to establish a reliable customs valuation system, international rules and standards upon which domestic customs administrations base their activities have been developed. In order to clarify the original GATT article of 1947, the Brussels Definition of Valuation (BDV) was adopted in 1950 and was applied in many countries. The GATT Agreement (Tokyo Round Code) of 1979 was later transformed into the WTO Agreement on Customs Valuation of 1994. The WTO Agreement superseded the BDV and set down the detailed rules of the transaction valuation methods.

However, these international rules were mainly based on the practice of developed countries. Many developing countries experienced difficulties in applying the valuation regimes of the BDV 1950, subsequently of the GATT 1979 and eventually of the WTO 1994. All of these regimes require that customs authorities have the capacity to collect accurate information on the goods and to verify them, something that is not often available in developing countries. It is against this backdrop that the practice of contracting out customs functions to private inspection companies was recommended – roughly in the period of the 1980's and the 1990's. To give more detail, it is normal practice for customs to examine documents and perform physical inspections of consignments at the arrival of cargo in the importing country. Instead, inspection companies offered the PSI service of examination and inspection before the shipment of cargo. This function was to be performed in the exporting countries. It was initiated as an inspection of consignments among private traders, and was subsequently extended to governments. The objective of government-contracted PSI service evolved from (a) exchange control (through the detection of over-invoices), into

(b) revenue enhancement (through the detection of under-invoices). Currently, approximately 30 governments engage the private sector to carry out these customs functions.

Chapter 3 reviews the performance difficulties that the existing literature observed among customs authorities, namely poor compliance, weak administrative capacity and corruption, and attempts to review their causes as identified by observers. These are so called implementation-related issue under the WTO Agreements that have been frequently taken up at the WTO forum. In the efforts to overcome these problems, customs authorities had initially set up lists of prices that were used as minimum values, but it proved to be problematical to keep listed prices updated. The PSI program was supposed to provide a solution for this question. The problem of corruption has attracted a particular attention of observers who suggested PSI and other measures to fight corruption in customs administrations.

Chapter 4 presents the literature review on PSI in its first section, largely by probing the view of international financial institutions on the PSI program and how it has evolved. At an early stage, the IMF and the World Bank frequently endorsed the use of the PSI program to address the weakness in customs. After promoting this new policy, both institutions have moved to focus on ensuring the effective use of the PSI service and advised that enhanced cooperation is needed between customs authorities and inspection companies as well as basic improvement in contract design. The lending institutions gradually found that the PSI program had not delivered what it had promised in terms of sustainable institution building in customs. In some cases, long-term dependence on expensive PSI contracts was the notable result. While the views are still divided among experts in the lending institutions about the usefulness of PSI, many of them increasingly express a cautious view when recommending the PSI solution and urge customs authorities to ensure better use of the private sector. They often emphasize the need for ownership-based capacity building.

Subsequently, the section two of this chapter explains the theoretical background and framework of the evolution of neo-liberal privatization and public management, because it has shaped the thinking of promoters of the PSI program and its development. It will elucidate the gradual adjustment of orientation by the main literature to the reality in a critical way. This development will also provide the

theoretical backdrop of the discussion in the WTO forum on the implementation issue of the PSI Agreement reviewed in the following Chapter 5.

The quasi-privatization of the customs function was initially encouraged by the neo-liberal thinking that advocated a greater role for markets and a smaller role for governments wherever possible. Neo-liberalism became popular in the 1970's as an alternative policy framework to remedy sluggish economic situation in developed countries. This fiscal conservatism was driven by a negative view of state action, based on public choice theory, which conceptualized the state as a self-serving (rent-seeking) interest group, which was prone to corruption. The involvement of the private sector in public policy arena entails a shift from government to governance, where the state produces a regulatory and monitoring framework that sustain a combination of competition and cooperation among key actors. The practices and techniques of market-oriented administrative reforms also gave birth to a variety of organizational hybrids – public-private sector partnerships. While the outcome of “public-private partnership” has been mixed in developed countries, its value was advocated widely in the developing world by international financial institutions. Contracting out the provision of public services was advanced aggressively under the structural adjustment programs in the 1980's and 90's, bringing market efficiency into the delivery of public services. As time passed, questions emerged about the ability of developing countries to manage contracts and monitor their execution. Recent studies have identified the institutional constraints on the public sector when directly outsourcing government functions, as well as in other derivative forms of public-private partnership. This critical view of new public management revived interest in the need to strengthen the administrative capacity of the state. Consequently, lending institutions have recently shifted its emphasis to recommend new services that are supposed to be more supportive of capacity building as alternative to the traditional PSI service, as reviewed in the Chapter 6.

Finally, the section three of this chapter reviews the analytical framework of the success and failure of the PSI program offered by the existing literature. In order to get a logical understanding of success and failure, it would be necessary to clearly define the dual goals of the PSI program: namely, revenue enhancement in the short term; and capacity building in customs in the long term to make revenue enhancement sustainable. Otherwise, excessive fear of losing revenue might create over-reliance on service provider, resulting in the frequent renewal of contract over a longer period than

initially expected at the expense of long-term capacity building in customs. Although at the initial stage the user government and donors used to put too much emphasis on the short term goal, their views have gradually shifted to stress the importance of the long term goal as a result of acquired experience. As the means of achieving success, the existing literature seems to suppose that the PSI program is expected to exert a positive influence on the three areas, namely compliance environment of traders, administrative capacity and the integrity situation. Naturally, the constraints and conditions in these areas would in turn affect the performance of inspection companies. This paper therefore identifies that many observers view the PSI program tends to be successful when those three factors are present: positive policy in compliance environment; implementation of customs reform and modernization; and improvement in integrity. Conversely, the majority would hold the view that the program tends to fail when there is lack in these three areas. This study consequently finds that the recent literature argues that success of the PSI program needs a comprehensive set of these three enabling factors for the both goals of improving revenue and administrative capacity. However, most of the available studies do admit that the objective analysis would be complex because of the inter-related feature of these factors, and because of the resultant difficulties to investigate causality in a verifiable way. Moreover, the performance assessment is complicated by the fact that it has not been always evident if the dual goals are compatible, mainly owing to the lack of state capacity to oversee inspection companies and the conflict of interest by the profit seeking nature of inspection companies.

Likewise, the existing literature points out that the lack of empirical study has been another gap in this field to enable advanced academic research. This paper intends to fill this gap by conducting case studies for the selected PSI user countries. In order to gain greater insight on the usage of PSI service, the experience and the assessment by the user countries, Chapters 7 to 10 present case studies conducted in four countries (Bangladesh, Kenya, the Philippines and Togo). These countries were selected from among all PSI-user governments because they (a) profile different regions (two are from Asia and two are from Africa), and because they (b) present different stages of economic development (three are from low income countries, one is a lower middle income country), and because they (c) have a different current status with respect to PSI (two are former user countries and two are current user countries), and because they (d) provide different aspects in relation to the three factors for success and failure offered by the existing literature. These case studies consider the factors that

affect customs operations, such as economic environment, tax and trade policy, as well as the profile of the customs administration. The case studies define the challenges of customs valuation in each country and review the introduction of the PSI program, its evolution and its assessment by the user country and other stakeholders. In each instance the performance of the PSI service is analyzed with a combination of qualitative and quantitative criteria that takes into account specific attributes of each country. A statistical comparison will be used where possible. It is complemented with the best available qualitative information, including existing literature and interviews with critical stakeholders.

Chapter 5 considers how the PSI service has evolved and has been shaped by the rules and standards developed in the WTO. This paper shows the often-neglected transformation of PSI industry in relation to the development in the WTO Agreement, which will also put the case studies in the historical and regulatory context. The WTO Agreement on PSI of 1994 was designed to regulate the foreign exchange control aspect of the PSI service, in order to address complaints from exporters in the early 1980's. However, with the liberalization of foreign exchange controls in the 1980's and 1990's, the inspection industry shifted the purpose of the PSI service from foreign exchange to customs revenue. This paper argues that the PSI Agreement was used to legitimize and endorse the PSI program for customs revenue by the inspection industry and the lending institutions, without regard for the origin of the PSI Agreement, and the negotiated intent of the parties. Consequently, the number of user governments of the PSI service for customs purpose increased from 27 in 1993 to 41 in 2001 while the PSI service for foreign exchange purpose has almost disappeared. This is the first transformation of the PSI program. It occurred in the 1990's. The implementation of the WTO Agreement on Customs Valuation changed the nature of the PSI program. The PSI certified price could no longer be used for determining value, but only for testing whether or not the declared value could be accepted for valuation purposes. This second transformation of the PSI program took place after the year 2000, when developing countries gradually started to apply the WTO Agreement on Customs Valuation. This change considerably diminished the usefulness of the PSI service by turning it into a risk assessment tool, rather than a value determining regime.

Furthermore, the WTO Working Party on PSI, established under the PSI Agreement to follow-up its implementation, recommended in 1999 that the PSI program incorporate the principles of modern customs procedures, including selectivity. The

recommendations include the provision of technical assistance to help the PSI user countries build capacity so that they could terminate their PSI contract. Based on this criticism of their performance and the resultant loss of contracts, the inspection industry has been gradually moving away from offering traditional PSI services, and began proposing new business models that would support customs authorities. According to the International Federation of Inspection Agencies (IFIA), the number of traditional type of PSI contract has fallen from 41 in 2001 to 14 in 2008. In the same report, IFIA states that in addition to the 14 user of traditional PSI program, 17 customs authorities engaged in customs “supportive” services, namely selectivity-type PSI and/or destination inspection. Consequently, the aggregated number of PSI-related contracts amounted to 31 in 2008. The IFIA report showed that the inspection industry also offered support services that are not related to PSI, such as offering information technology network between customs, port operators and other economic operators.

Chapter 6 explores alternate solutions that have been proposed under the PSI program in light of the views expressed against the use of the private sector. This will also give explanation to the efforts of inspection industry in some of the case studies from a wider perspective. These alternatives include the exchange of information, the use of electronic datasets and the establishment of valuation databases. The exchange of information was taken up in the WTO Doha Ministerial Conference in 2001 that launched the Doha Development Agenda. The discussion in the WCO shows that it would work as part of a standard verification process, but it does presuppose a reasonably well-established customs administration. Electronic exchange of customs data could be a technical tool that enables the exchange of information in a routine manner, but this solution does require legal arrangements for exchanging information to ensure protection of data. Valuation databases need maintenance after installation through constant updating of data. This implies a substantial change in organization and operation in customs authorities. Therefore, this paper argues that each of these proposed measures are important technical tools that need to be part of a comprehensive customs reform.

Observing this heightened awareness of the need for capacity building, inspection companies have changed their commercial strategy. Since 2000 they have gradually shifted their focus more on “supportive” services for customs authorities than “substituting” for them. They have proposed new services, especially destination

inspection combined with scanning service, which have spread in Africa since 2000. However, these services often contain the core element of the traditional PSI service, such as documentary examination and physical inspection by inspection companies, and therefore do not necessarily guarantee the transfer of skills to customs officers. It is after all up to each government to ensure a comprehensive customs reform, using supportive service offered by the private sector with ownership. At the same time, this paper argues that the inspection industry has yet to prove the usefulness of their service for the user government by keeping transparency and avoiding undermining the proper management of contracts.

Chapter 7 takes up the case of the Philippines, where the PSI program was partially introduced in 1987 and expanded for global application in 1992. When the PSI program was in place, there was a sharp growth in trade and customs revenue, as it coincided with liberalization of trade and exchange control. Taking into account these macro-changes in economic policy, this paper examines a quantitative assessment of customs reform (including the PSI program) that implies that the contributions of these reforms were less clear-cut than anticipated. One of the unfortunate consequences in the Philippines was an unanticipated increase in smuggling activity aimed at circumventing the PSI regime. Together with automation, it had been expected that the reform would reduce corruption, but these effects are thought to be limited. An overall lack of incentives for customs officers to modify practices was apparent in critical areas like “working condition” improvements. The transfer of skills from inspection companies was considered insufficient and the necessary reform in customs was judged to be slow, partly due to the development of a long-term institutional reliance on inspection companies.

Chapter 8 describes the case of Kenya where customs modernization began with the creation of a revenue authority in 1995 that had great flexibility in management decisions. The PSI program for customs was introduced the year before, in 1994. While trade liberalization resulted in a sharp expansion in volume of imports, customs duty revenue increased at a higher rate than imports. This improved revenue level was sustained throughout 1990's, in spite of the gradual reduction in customs tariff. An academic analysis demonstrated the effectiveness of the PSI service in boosting revenue at the early stages of the Kenyan program. The Kenyan Revenue Authority subsequently developed a variety of hybrids with inspection companies, reducing its costs, and ensuring a broad transfer of knowledge. Consequently, the

Revenue Authority gradually took over the valuation work and obtained a valuation database from the private company. It has improved the integrity of customs officers in an attempt to gain the confidence of the trading community in anticipation of the phase-out of reliance on the inspection company. While the revenue authority continued customs reform, it is with the termination of the PSI contract in 2005 that its implementation really gathered pace.

Chapter 9 considers the case of Bangladesh where the export of ready-made garments has been the national economic engine since the 1990's. Improving the efficiency of customs procedures and the control of bonded warehouses was identified as instrumental in the promotion of export and inward investment. Customs authorities relied on a list of minimum import prices in order to protect the domestic industry and to secure revenue. However, they found it difficult to keep the list updated. Under the guidance of the IMF and the World Bank, Bangladesh introduced an initial PSI program in 1993. This program was optional and offered a choice of PSI companies for importers. This triggered free competition among the private companies to attract importers by offering certification at a lower price. Consequently, this system was for all practical purposes abandoned in 1997 amid allegations that the PSI system was promoting customs evasion instead of protecting revenue. However in 2000 with the support of the lending institutions, Bangladesh again engaged the PSI service to prepare for the implementation of the WTO Agreement on Customs Valuation. The use of the PSI program was made compulsory and was implemented on a monopoly basis for each company within a geographical division. In spite of improvement in contract design, the overall reform process has been undertaken rather independent of PSI program. Bangladesh has continued to experience difficulties in using the PSI service in customs valuation while building capacity to consolidate revenue function in customs.

Chapter 10 reviews the case of Togo, a jurisdiction where there is a large informal sector and significant smuggling activities, which take advantage of the permeable borders with neighboring countries. With the advice of the IMF, Togo introduced the PSI program in 1995 as part of structural adjustment reform to enhance revenue. However, the usefulness of the traditional PSI program was judged rather limited, because there were many consignments arriving at the destination without PSI certificates. It was therefore difficult to recognize the impact of the PSI service on its own. Mindful of the limitations of the traditional PSI program, the customs function

was transformed into a public-private partnership, and adopted extensive use of X-ray scanners to inspect containers on their arrival in Togo.

Chapter 11 summarizes and compares the outcomes of the four case studies where the PSI program was expected to address problems of false declaration of quantity, quality and value. The paper reviews the individual background of the four countries, determines the factors that led to the introduction of the PSI program and its further development. As a result of this review, it argues that the PSI program had changed over the years in response to the criticism against the use of the private sector in customs, but the difficulties have still persisted in fulfilling expectation of user countries. In order to provide more detail, this chapter assesses the performance of PSI in each of the expected area of achievement. In the area of revenue enhancement, there are academic analyses and comments by stakeholders that emphasize the positive outcome of the PSI program, but other commentators indicate that there is mixed and unclear performance. With regard to customs reform, transfer of skill to customs officers was of little value and the PSI program often remained longer than expected, reflecting the delay in capacity building and the resultant over reliance on the service of the private inspection company. The PSI effect on corruption was reportedly not perfect in addressing its fundamental cause. Therefore governments changed contracts to address these problems, but its effect was limited and remained short of their expectation. Meanwhile customs officers tended to be hostile to the PSI program, making it difficult to get their cooperation. The view of the trading community was divided on a country-to-country basis and subject to the individual interest. As a more fundamental cause of this unsatisfactory outcome, this chapter reviews the institutional constraints on customs authorities in making the best use of the PSI service, in line with the theoretical framework presented in the section two of the Chapter 4. These include little recognition on the inherent limitations of the program, the lack of reliable audit, the risk of over-reliance on the private service, and the difficulties in developing cooperation between customs and inspection companies. In fact, the recent literature focuses on building state capacity to use the tools that the private sector offers including the PSI. Finally, this section reviews the case study, using the analytical model given by the existing literature that stresses the importance of improvement in compliance environment of traders, customs reform project and integrity as the factors of success and failure, as provided for in the section three of the Chapter 4. However, this paper argues that the aforementioned factors were not necessarily found in the four case study countries in a satisfactory manner. This explains the termination of the

traditional PSI service or the shift of inspection companies towards new services combined with technological support. As one example of new services, this paper reviews Destination Inspection (DI) and finds that DI does not necessarily provide better support for customs officers in customs valuation than the traditional PSI program, because it encounters similar problem in the area of customs valuation. This paper argues that developing countries experienced their own poor assessment on the PSI program despite its evolution over the years.

Finally, as a conclusion, the study observes that over the short time span of 20 years, and parallel to changes in public management policy, the focus of customs valuation has quickly shifted from reliance on the service provided by private companies to developing the capacity of customs authorities. The inspection industry has adjusted their services to adopt more supportive models. The launch of WTO negotiations on trade facilitation also aims at sustaining customs reform and modernization as a catalyst for enhancing the competitiveness of developing countries. The customs community is expected to seize this opportunity to secure the support of their governments with the accurate understanding of the usefulness and the limit of the private sector service. However, this paper argues that the experience in developing countries has yet to show a successful model of using the private sector in customs valuation.

Chapter 1 Evolution of customs function and international rules

This Chapter provides a general picture of the evolution of the customs function, which nowadays embraces a range of responsibilities beyond its original fiscal function. This has come about because the customs administration is in the forefront of national responses to gradual changes in global trade. This transformation has prompted customs administrations to develop new control methods to adapt to progress in trade practice, resulting in the development of international rules and best practices of customs procedures. At the same time this increasingly complex customs operations calls for compliance culture of business and enhanced administrative capacity of customs authorities. This necessity poses a challenge to many developing countries, which require assistance in establishing a well-functioning customs administration.

1. Customs function and its evolution

Customs administrations originally started as the organization for revenue collection at borders. This is the case in ancient times and possibly beyond written history. Adam Smith, who was later appointed commissioner of customs in Scotland, wrote in “Wealth of Nations” that, “They (the duties of customs) seem to have been called customs as denoting customary payments which had been in use from time immemorial.”¹

Historically speaking, customs duties played an essential role in establishment of the fiscal basis of political power, including nation-state building in the modern times. This function of customs duties is still important today in many developing and least-developed countries where the establishment of a domestic tax basis is under way and economic development largely depends on international trade. Expectations are also high these days for customs administrations to protect society at national borders from the cross-border movement of hazardous and controlled goods carried by various means of conveyance and individuals personally, including for example, drug trafficking and movements of weapon of mass destruction (WMD).

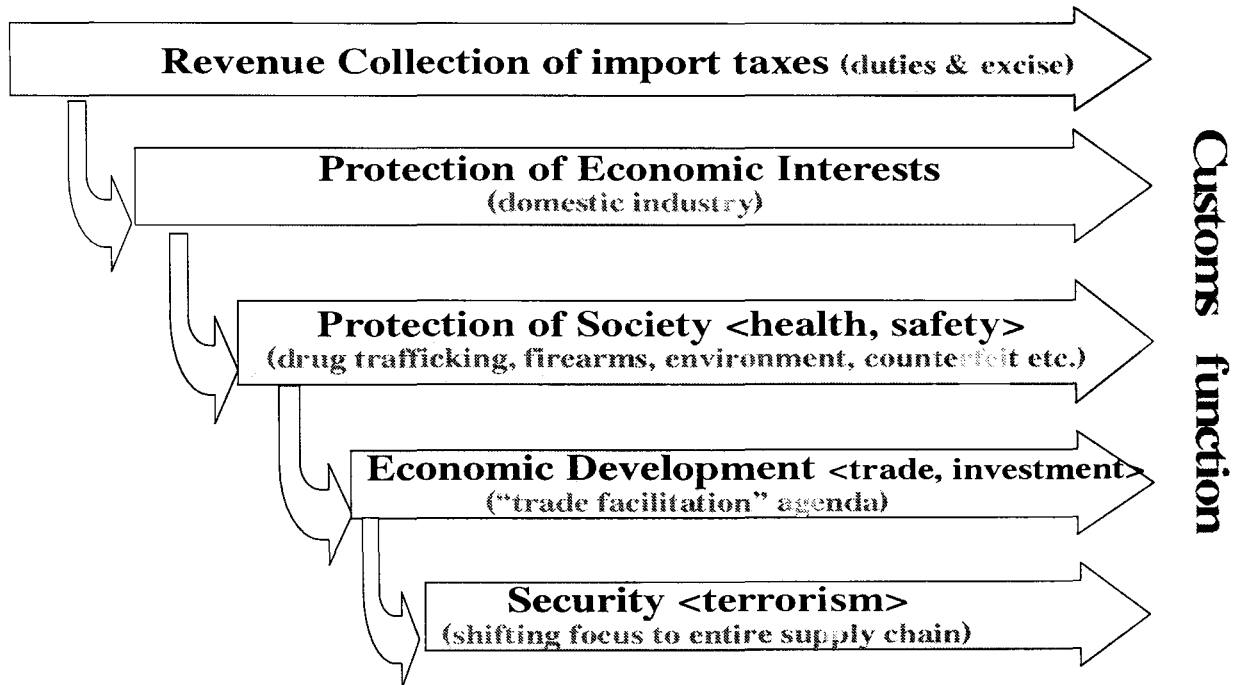
¹ Adam Smith. An Inquiry into the Nature and Causes of the Wealth of Nations (Wealth of Nations). Book V Chapter II “Of the Sources of the General and Public Revenue of the Society,” 165, ¶ V2. London, Methuen and Co. Ltd., ed. Edwin Cannan, 1904 (First published: 1776).

On the other hand, along with the global trade and economic development, the efficiency of trade procedures has become a significant factor in promoting the inflow of direct investment. Foreign direct investment is widely considered to be a primary engine of economic development. It has therefore become crucial for customs administrations to maintain effective and efficient control over cross-border movement of goods and people without hindering the smooth flow of legitimate trade. Customs operations need to fulfill both the requirements of trade control and trade facilitation. As a result, customs operations tend to be complex and call for the development of considerable technical expertise and effective procedural standards.

In other words, the functions served by customs administrations have evolved over time, and can be seen today as comprised of five core attributes, as shown in the diagram below. First, customs has a revenue collection function at borders with tariff assessments – including control of documents and goods to detect and deter commercial fraud and smuggling. Second, by using tariff and other border measures as trade policy tool, customs is often asked to protect the economic interests of domestic industry. Third, the border control function has led customs to assume the role of protecting society from the inflow and outflow of prohibited or controlled goods – including drug trafficking, firearms, environmentally hazardous and counterfeited goods. Fourth, customs is increasingly recognized as playing an important role in economic development by facilitating the flow of legitimate trade and promoting investment. Fifth and finally, after the terrorist attacks of September 11, 2001, the role of customs to protect the international trade supply chain was recognized. This security function entails a shift in focus from the traditional place of importation to the protection of the entire trade supply chain. These five core functions are inter-linked and mutually supportive. However, the focus and emphasis of these functions in a customs administration is different from country to country. Specific emphasis is a reflection of (a) the development stage of the country concerned and (b) the national priorities set by the local government. Needless to say, customs roles are not necessarily limited to these five major areas. Providing information on the health of the national economy, including trade statistics, is also an important task.

(Figure 1-1)

Evolution of customs



2. Importance of the fiscal function

Many countries have relied on customs duties to finance public expenditures at the earliest stages of their economic and political development. This role is dominant before a country is able to establish the infrastructure needed for the collection of internal revenue.

By way of historical example, the United States established its customs service on July 31, 1789, following the Tariff Act of July 4, 1789. This Act authorized the collection of duties on imported goods, and was called “the second Declaration of independence” by the news media of the era, because it was aimed at providing the fiscal foundation to finance budget of the young nation immediately after the declaration of independence in 1776. In fact, customs paid for the nation’s early growth and infrastructure, including the purchase of territories, the construction of

roads and railways. Since then it funded virtually the entire federal government for nearly 125 years before the introduction of income tax.²

While customs often collects other taxes at the borders – such as, excise duties and value added taxes – the main source of customs-generated revenue is from duties or tariff on imported goods. Because the fiscal burden of a tariff is imposed only on imported goods and not on domestic production, it has been often been pointed out that tariffs have a direct effect on international trade patterns. This has provided customs with another type of mission. Indeed, whereas the tariff was at the outset predominantly revenue collection function, it was later used as trade policy tool to protect domestic industry. This is why tariffs have often been perceived as a main barrier to international trade. The WTO has pursued the gradual reduction of tariff levels to liberalize trade through a series of negotiations. Moreover, tariff reduction and its eventual elimination provides a basis for regional integration, both for customs unions and free trade agreements. In the process of the economic integration of the European Union the abolition of customs control at the internal borders in 1992 was seen as the symbol of the completion of the single market. It is noteworthy that regional integration naturally entails discrimination against non-members. Therefore, tariff protection at the external borders for “sensitive goods” including agricultural and textile goods remains high in developed economies.

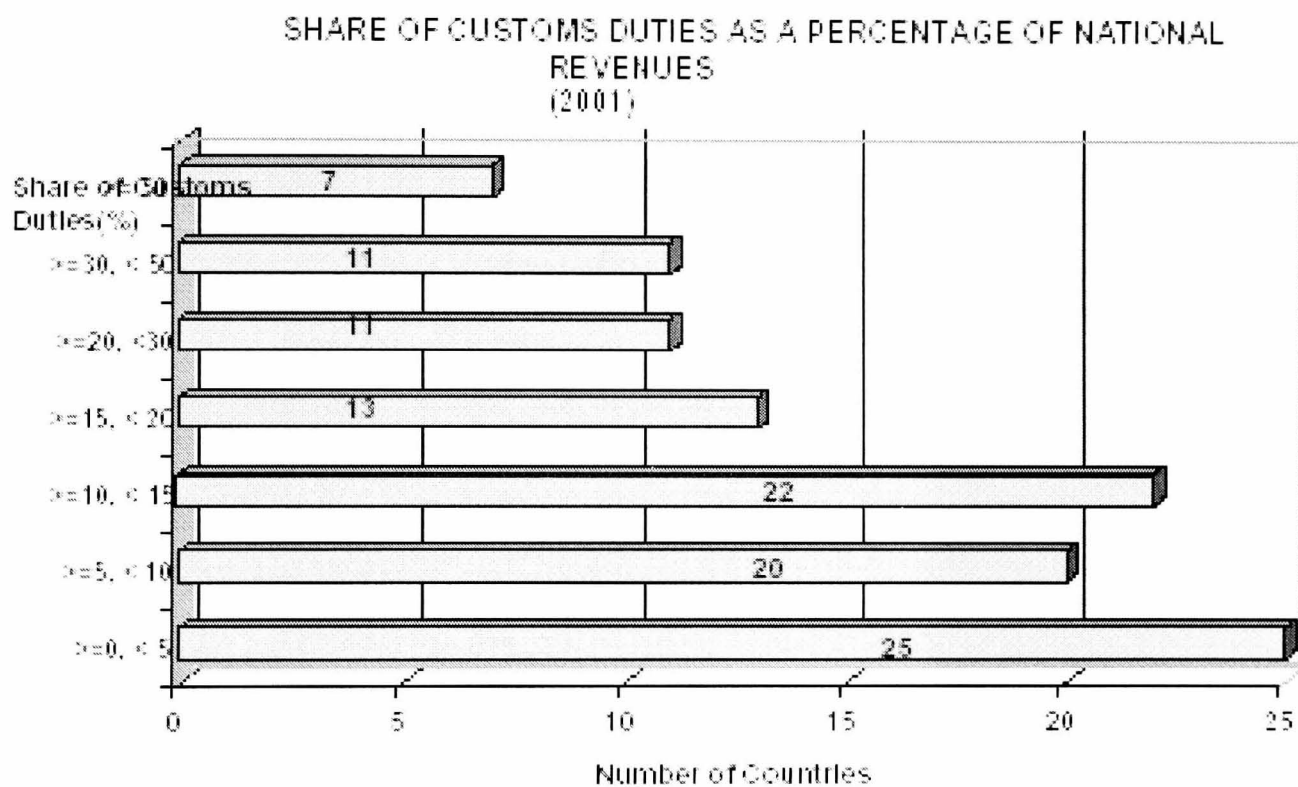
The collection of tariffs remains a top priority for many developing countries economies-in-transition, as customs duties are often one of the primary fiscal resources. It is often pointed out that tariff levels remain very high in developing economies. In fact, a WCO study reveals that among 109 countries surveyed in 2001 where information was available, customs duties alone provides more than 30% of the total fiscal revenue in 18 countries, as shown in the table 1 below.³ For 64 of the countries surveyed, over 10% of national revenue was derived from customs duties. On the other hand, for 25 of the countries, less than 5% of national revenue came from customs duties. It can be seen that customs duties have continued to play an important role in the national revenue profiles of many countries even though their importance should be

² US Customs and Border Protection. “US Customs Service – Over 200 Years of History.” (2003) *Available at* <http://www.cbp.gov/xp/cgov/toolbox/about/history/history.xml> (last visited 6 June 2007).

³ World Customs Organization. “Annual Survey to Determine the Percentage of National Revenue Represented by Customs Duties” WCO HS Committee Document NC0806E1 (20 April 2004).

diminishing due to efforts at reducing or eliminating tariff barriers. It should be noted that this survey was limited to the collection of customs duties and does not reflect the complete fiscal role played by many customs administrations which often includes the collection of excise duties and indirect taxes including value added tax. The importance of the revenue function will continue for the majority of these countries in the foreseeable future. A recent IMF report estimates that in Sub-Saharan Africa trade taxes still account, on average, for about one-quarter of total tax revenue in the 2000's, after 20 years of tariff reduction, as compared to about one-third in the early 1980's.⁴

(Figure 1-2)



In terms of duty collection, customs administrations also collect anti-dumping and countervailing duties as a part of the larger effort against unfair trade. These measures take the form of a duty even though they are trade policy instruments and have little to do with the fiscal function of customs. In fact, these measures have been often brought to dispute settlement bodies in the WTO arena.

⁴ International Monetary Fund. "Dealing with the Revenue Consequences of Trade Reform" (Background Paper for Review on Fund Work on Trade), Fiscal Affairs Department, (15 February 2005) at 3. Available at <<http://www.imf.org/external/np/pp/eng/2005/021505.pdf>> (last visited 6 June 2007).

In addition to tariffs on imported goods, customs administrations are in charge of collecting indirect taxes on goods when they cross the national borders. These indirect taxes include VAT (Value Added Tax)⁵ and other excise taxes on alcohol, tobacco and petrol. While tariffs have a direct effect on trade patterns in adding costs to imported goods, these indirect taxes are considered trade-neutral in principle, because the same tax treatment should be applied to domestic goods. Along with trade liberalization, the IMF often advises developing countries to replace tariffs with VAT. In many customs administrations the revenue weight of VAT has gradually grown and now often exceeds that of tariffs.

Since the source of VAT arises from transactions both domestically and at border, it can be collected mainly by internal tax authorities and then supplemented by customs in developed countries. However, in practice, customs administrations in developing countries often play an important role in revenue collection even under these replacement policies. This is frequently caused by the inadequacy of the domestic tax infrastructure. Since VAT is normally levied on businesses at all stages of production through to the final retail stage, it presupposes an appropriate domestic tax infrastructure, including reliable accounting systems within businesses that can be made available to tax authorities. If this pre-requisite is not fulfilled, the collection of VAT would be only feasible at the borders without following through the domestic transaction chain. The IMF also concedes that a considerable part of excise and VAT revenues are collected at the borders, using much the same machinery as is used to collect customs revenue and that it is not uncommon to find that developing countries collect more than half of their VAT revenues from imports.⁶ The IMF report also suggests that low income countries in particular have experienced considerable difficulty in replacing lost trade tax revenues with monies from other sources, unless of course domestic tax reform accompanies trade liberalization.

⁵ In some countries they are called Goods and Service Tax, or GST, and in others Consumption Tax.

⁶ See IMF (2005) *supra* note 4 at 12.

3. Improvement in control

In order to discharge the revenue collection function, customs administrations exercise control over goods and the accompanying trade documents at the borders. The main target of customs enforcement has been the commercial fraud of using false documentation, including under-invoice, or smuggling to evade tax liability. Customs collects trade data, verifies trade documents, inspects goods, and collects duties on dutiable goods to ensure the compliance. This assessment and verification procedure, which is part of the clearance process includes such activities as tariff classification, valuation of goods, calculation of customs duties, assessment of related taxes, and making sure that importers comply with other legislation. These procedures usually start with the submission of declarations by importers or their customs agents (brokers).

Faced with an expansion of global trade and resource constraints, it has become difficult for customs to implement 100% examination of documents and inspection of goods. In order to solve these challenges, modern systems are designed to enable customs to concentrate their resources on areas where there is high potential for non-compliance with customs law. This method entails a shift from an all document and full physical inspection policy, to a selective check and inspection of documents and goods that pose higher risk of revenue loss. This will facilitate the flow of other goods, considered part of legitimate trade, while maintaining appropriate border control measures. Resources are thereby focused where they are most necessary. Effective risk management has become a central concern of modern customs operations, and provides the means to achieve an appropriate balance between trade facilitation and regulatory control.⁷

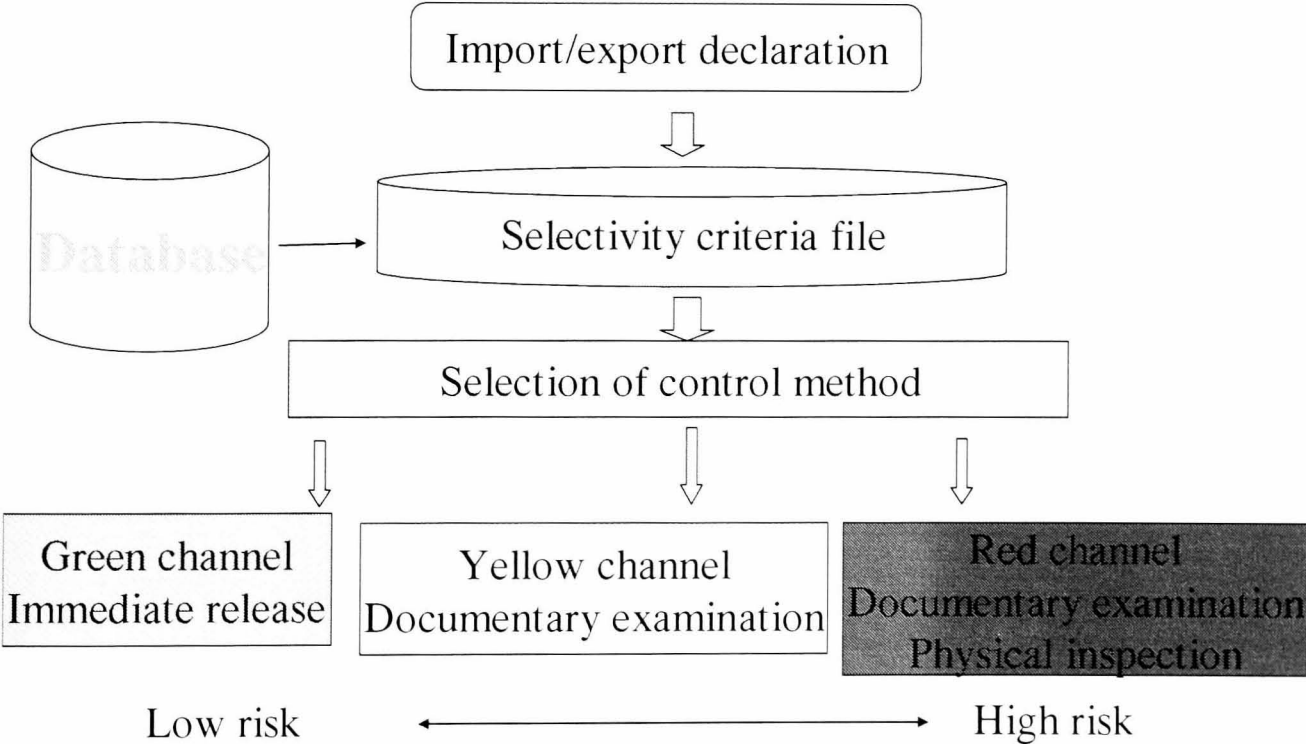
At the operational level, risk assessment is carried out to determine the level of control needed to deal with potential problems. Information technology has greatly facilitated the development of risk assessment techniques by introducing selectivity criteria in customs automation systems to systematically determine the level of intervention needed. Upon the entry of import declarations information technology automatically identifies the risk level of the shipment and classifies it. In more detail, what occurs is that customs establishes databases for digital analysis of data collected

⁷ David Widdowson. "Managing Risk in the Customs Context." In Luc, De Wulf. & Jose B. Sokol, (ed.). Customs Modernization Handbook, Washington DC., World Bank, 2005.

from import declarations, examination records and trends of customs offences to identify risk indicators of potential of non-compliance. These risk indicators include specific commodities, country of origin, value declared, traders and means of transport. Then, customs produces a risk profile that will help it target potentially high risk movements of consignments. The risk profile constitutes selectivity criteria installed on the customs computer system. When the automation system processes import declarations, data is screened against the selectivity criteria file that will then suggest a control method for each consignment. Many countries adopt a three channel system of green/yellow/red. Low risk consignments will be classified into the green channel for immediate release, while cargo with higher risk will be classified into either the yellow channel for documentary examination or into the red channel for documentary examination and physical inspection, as shown in the diagram below. The selection criteria should be periodically reviewed and adjusted based on performance and examination records.

(Figure 1-3)

Green/yellow/red channel



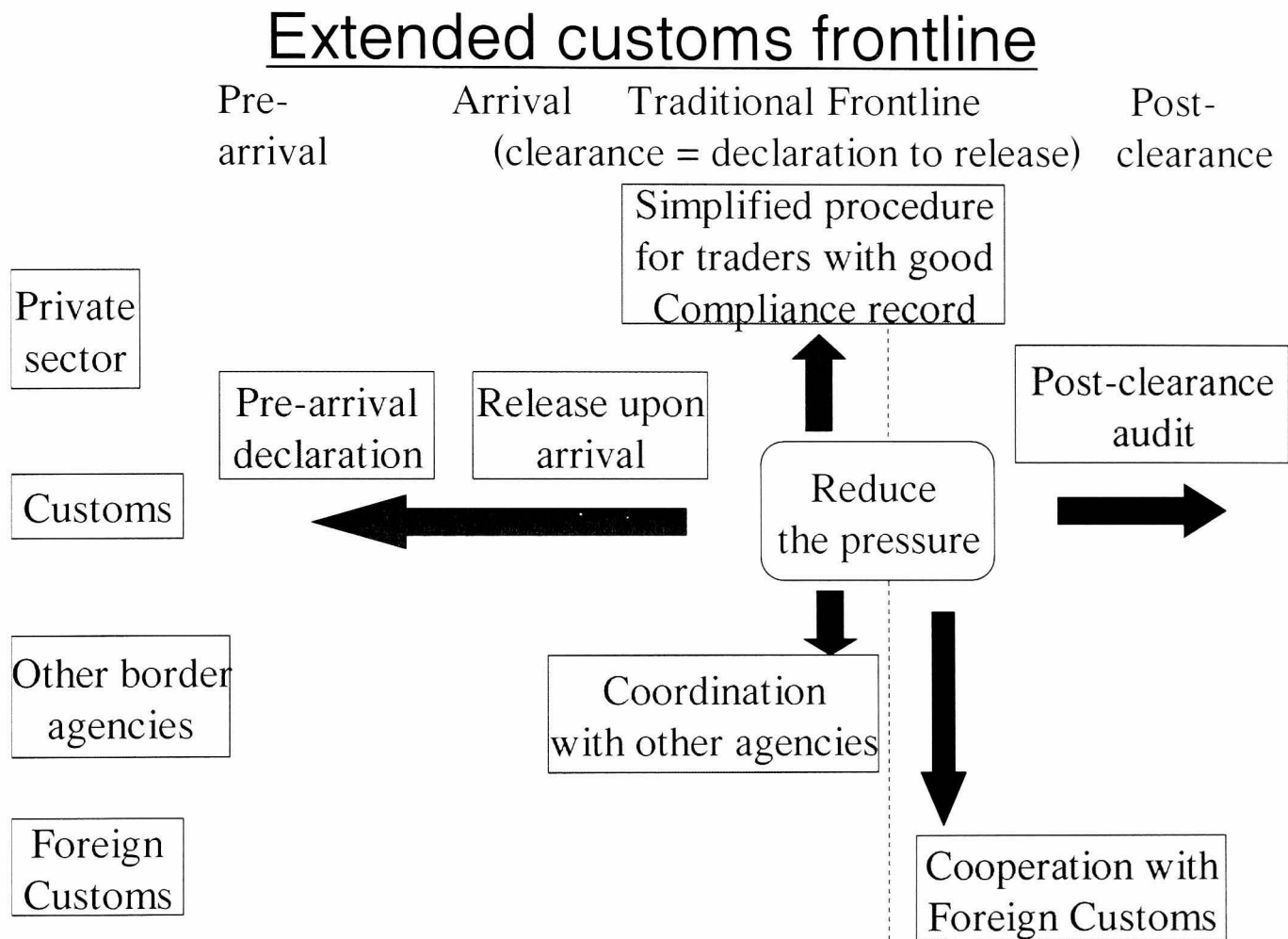
Risk management however, presupposes the improved compliance of those traders that are judged to have a low overall risk profile. In order to encourage improved compliance in the trade, compliant traders receive quick clearance with minimal examination. Customs administrations could provide authorizations to these compliant traders with special facilitative procedures, a system called “Authorized Trader”. Under the supply chain initiative, this system was developed into “Authorized Economic Operator”, as described in the section 4 below. Partnerships with trade associations are often promoted by setting up consultative bodies, and by concluding memoranda of understanding (MOU) for closer cooperation.

In addition, the “frontline” of the customs administration is extended from the immediate point of border crossing to pre-arrival and post-clearance positions to reduce the pressure on customs procedures at the clearance stage. Data collection starts before the arrival of goods for risk analysis to determine the level of control. It is not necessary for a long waiting period upon the arrival of goods and the subsequent submission of trade documents. If cargo is considered to be low risk, it could be released upon its arrival. Spending too much time on verification of documents during the clearance process causes huge delays in the movement of goods. Thus, customs selects importers for post-clearance audit and visits their premises for more in-depth audits checking the appropriateness of their valuation, classification and other fiscal matters. At this time the information on traders and their compliance that is acquired through this process is made available to be added to the database and will help ensure the further accuracy of the risk management system.

The key to successful enforcement of the control function is intelligence based on good information gathering. Trade documents submitted to customs for clearance offers a good preliminary basis for assessment, but traders can also be a useful source of information. Measures that promote close cooperation including the conclusion of MOU make significant contributions to the accuracy of risk management systems. Once customs fraud or smuggling are spotted, customs needs to investigate these cases in detail. These results will provide insights into the modus operandi of fraudsters and help chart fraud trends. Data from the investigation enhances the accuracy of risk management and other control techniques. Complementing the intelligence and investigation measures of customs are cooperative arrangements with other law enforcement bodies, including internal tax administration, police, and other border agencies. These agencies can provide valuable information to improve the customs

system. The customs administrations of other countries are also helpful. They can provide direct administrative assistance as well as the exchange of valuable information. In this way, the modern customs operation uses an enlarged “frontline,” as well as partnerships with the trade, other border agencies and foreign customs administrations, as indicated in the diagram below.

(Figure 1-4)



4. Importance of trade facilitation

Customs performance is increasingly considered to be a critical feature that will define the investment climate for doing business in a country. There is a heightened awareness by business of the costs associated with applying inefficient and outdated border procedures. In particular, the move to global production sharing, supported by the technological developments in information and communication, transport and logistics, heightens the importance of timely and efficient business transactions. These attributes are now viewed as an important factor for national competitiveness.

Given these developments, there has been a notable increase in expectations for prompt, cost-efficient and more predictable border processing of goods and people. This business need is reflected in the WTO Doha Development Agenda, which includes trade facilitation in its negotiation agenda and which placed considerable focus on customs procedures.⁸

Mindful of this background, customs administrations have been making continuous efforts to simplify their procedures and enhance their efficiency and effectiveness. Modern control techniques such as risk management and audit-based control led to the concept of “authorized traders” with good compliance records. In more detail, traders compliant with customs requirements, or authorized traders, could receive authorization from customs and receive greater facilitative measures, including fast track procedures for release of goods. Best practices and simplified procedures, including the use of information technology, risk management and partnership with trade and enhanced cooperation with other border agencies, have been incorporated in the WCO revised Kyoto Convention on Simplification and Harmonization of Customs Procedures, adopted in 1999. The revised Kyoto Convention is seen as the blueprint for the modern customs administration and providing the legal framework for customs operations. It addresses trade facilitation and improved control in an efficient and effective way.⁹

One concrete example of trade facilitation gains is the reduction in clearance time. The WCO developed a guidance for Time Release Study to measure the time needed from the arrival of cargo to its final release, and for each stage within this process, to identify bottlenecks in the entire clearance procedure and to identify possible solutions. By periodically repeating this exercise, the government can measure the effects of policies in terms of trade facilitation. As shown in the diagram below¹⁰, Japan has carried out the Time Release Study from 1991 when they introduced the automation system for sea cargo. With the introduction of a series of trade facilitation measures, including the use of pre-arrival information and enhanced coordination with other border agencies, Japan has achieved a significant reduction in clearance time.

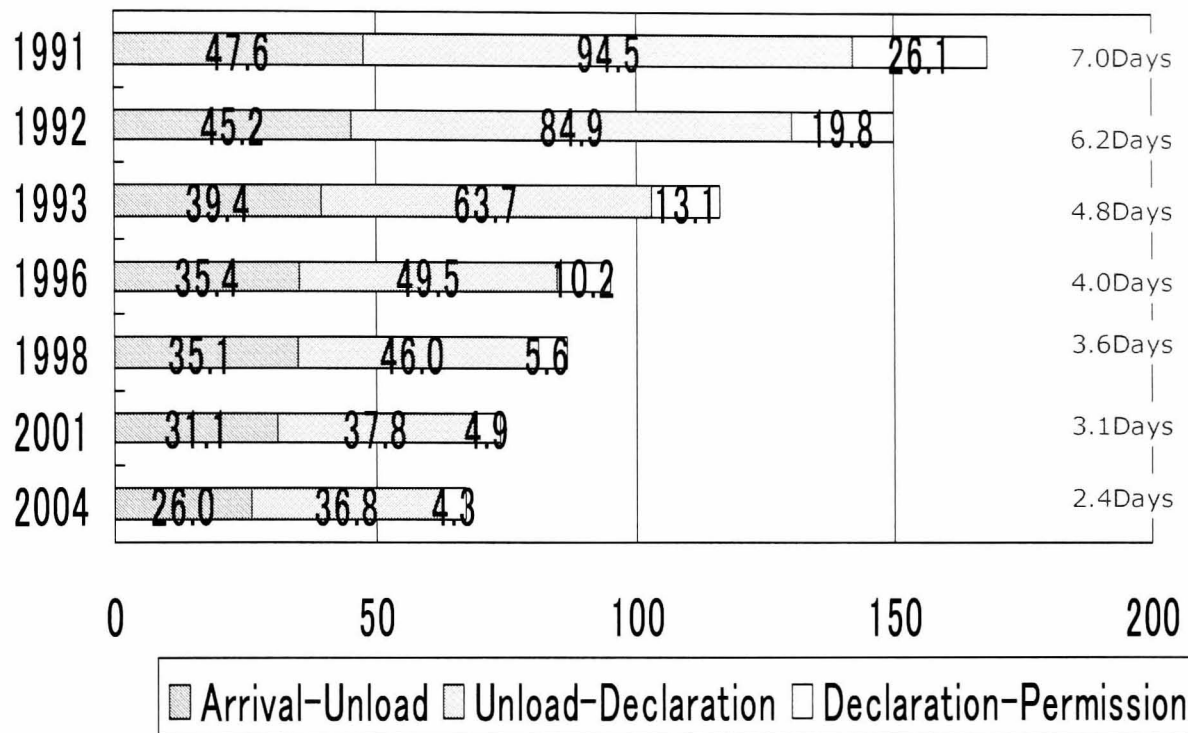
⁸ Kunio Mikuriya. “The Customs Response to the 21st Century.” 1.1 *Global Trade and Customs Journal* (2006) 22.

⁹ Kunio Mikuriya. “Legal Framework for Customs Operations and Enforcement Issues.” In (ed.) Luc De Wulf & José b. Sokol Customs Modernization Handbook, Washington D.C. World Bank (2005) 73

¹⁰ Ministry of Finance, Japan. “Time Release Study.” Presentation at the APEC Customs-Business Dialogue, Korea (September 2005).

(Figure 1-5)

Time Release Study (Sea Cargo)



- Hours unless otherwise indicated, source: Ministry of Finance, Japan

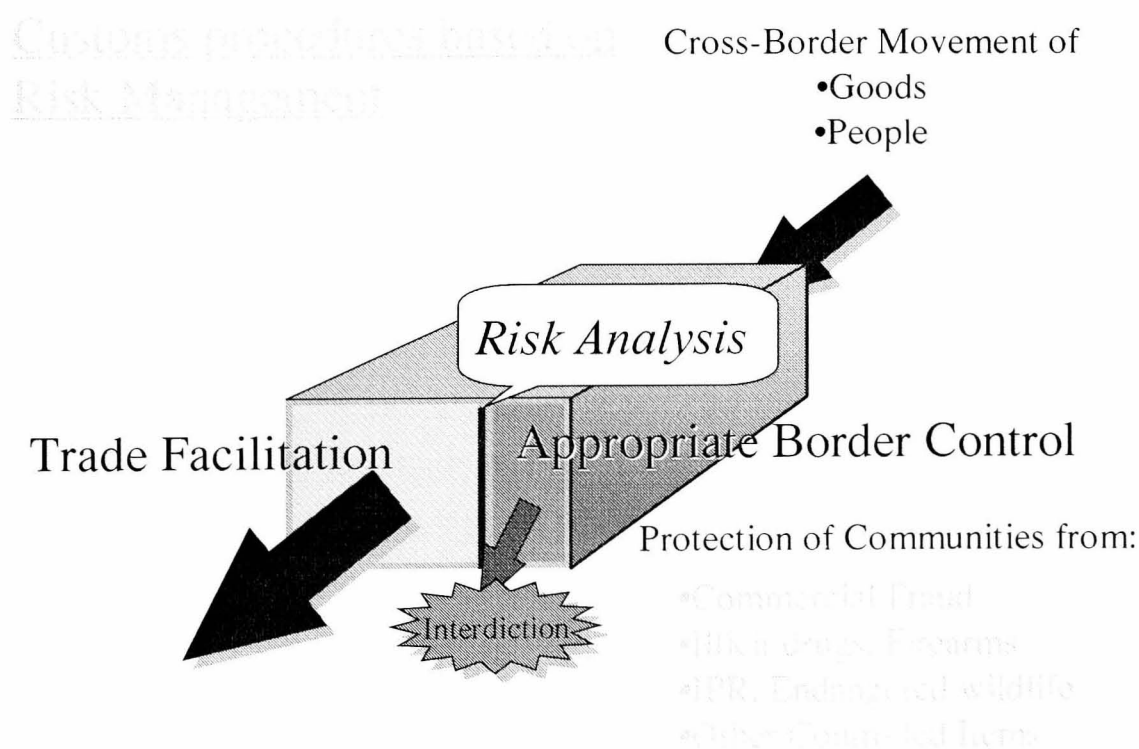
In this connection, there is a growing recognition that corruption is the biggest obstacle to economic and social development. Simplification of procedures, including automation, to diminish the opportunity for discretionary intervention is often regarded a practical and viable way to tackle this issue. It will promote good governance and contribute to development.

Customs administrations in all countries, including the developing countries, are expected to base their procedures on internationally accepted standards, in particular the revised Kyoto Convention, to discharge their responsibilities. With improved opportunity to harness information technology, many developing countries have been engaged in customs reform with a significant focus on the automation of procedures. In order to maximize its benefit, a comprehensive customs reform and modernization is necessary, incorporating the principles of modern customs into procedures and management. Capacity building, which is crucial to the integration of developing countries into the global trading system, should be set as a main goal of development policy.

5. Protection of society

As a border control agency, customs is also in charge of protecting society from the illegal cross-border movement of prohibited and controlled goods in line with national laws. Located at the borders to control the cross-border movement of goods, customs is best suited to assure the safeguarding of public health, safety and the quality of life of its citizens. Undeniably, it is more effective to intercept the prohibited or restricted goods in large quantities at the borders than doing so after they are dispersed in street level quantities. In fact, the seizure of illicit drugs or counterfeited goods at the borders annually amounts to 70 - 80% of the total seizure. This is why customs enforces the laws and regulations of other government ministries and agencies on their behalf at the borders. By way of example, on its public web site the US Customs explains that it enforces well over 400 provisions of law for at least 40 agencies.¹¹ Another advantage in using customs is the adoption of risk management techniques which enables other border agencies to perform their duties without unnecessarily hindering the smooth flow of trade, as shown in the diagram below.

(Figure 1-6)



¹¹ See US Customs and Border Protection (2003) *supra* note 2.

This function has gained in importance since criminal organizations, including terrorists, increasingly exploit illegal trans-border activities as a main source of funding. Illicit drugs and counterfeits are commodities typically used for this purpose. Criminal organizations are increasingly using counterfeit goods as another funding source. They use goods of mass consumption and various routings to conceal the origin of goods. In fact, the G8 Leaders' Summit in 2005 issued a statement urging customs administrations to strengthen border control in the fight against the infringement of Intellectual Property Rights (IPR) at the borders.¹² Customs administrations are also expected to join in the fight against organized crime with other law enforcement agencies. In this connection, anti-money laundering activity is also high on the customs agenda. Customs ability to intercept illegal cross-border movement of cash, monetary instruments and other commodities is deemed critical in this effort.

Another responsibility that customs is increasingly expected to discharge is the control of cross-border movement of hazardous waste. The United Nations Environment Programme (UNEP) issued a statement in December 2006 which called for tighter controls on the illegal trade of electronic waste, including lead, cadmium, mercury and other hazardous substances, as a result of growing demand for computers and other consumer electronics.¹³ It pointed out the need for coordination with relevant organizations, including customs, in the treatment of international transport of hazardous waste, illustrated by the dumped toxic waste in Cote d'Ivoire in August 2006 that caused serious public health and environmental damage.

6. Supply chain security and facilitation

After the terrorist attacks of September 11th in 2001 in the United States and the following attacks elsewhere in the world, all governments have become aware that there is a need for enhanced border control for national security. While there has been no evidence that terrorist attacks in the past have been caused by the vulnerability of

¹² G8 Gleneagles 2005 Summit Document "Reducing IPR Piracy and Counterfeiting through More Effective Enforcement." (8 July 2005). *Available at* http://www.fco.gov.uk/Files/kfile/PostG8_Gleneagles_CounterfeitingandPiracy.pdf (last visited 6 June 2007)

¹³ United Nations Environmental Program Press Release "Call for Global Action on E-Waste." (1 Dec 2006). *Available at* <http://www.unep.org/Documents.Multilingual/Default.asp?DocumentID=496&ArticleID=5447&l=en> (last visited 6 June 2007)

international trade supply chain, customs has started to address this newly emerging security concern. Another change was the recognition that it is no longer sufficient to focus customs control entirely on import, as had been the tradition, but it is now necessary to focus on the entire supply chain, including exports. Finally, acknowledging that customs is not the sole agency on the borders in charge of security, there has been a heightened awareness that it is essential to improve cooperation or integration with other border agencies.

Some administrations have already initiated enhance security measures. Knowing that 90% of world cargo moves by sea-going containers, the US Customs adopted the Container Security Initiative to keep high-risk containers concealing WMD from arriving the US ports. This was done in cooperation with those countries that are significant exporters into the US market. For the partner administrations, this meant that export control needed to be exercised over containers destined for the US and that intelligence needed to be shared with the US Customs in the area of anti-terrorist activities. These security measures have also been expanded to include all modes of transport, including maritime, air and land transport. In addition to bilateral undertakings, the Asia Pacific Economic Cooperation (APEC) and some other regions have also set out regional cooperation schemes in this area.

These efforts ultimately require a global cooperative arrangement in order to avoid the marginalization of developing countries from the global trading system by making them the weakest link in the chain. The G8 issued a call for cooperative action for transport security in June 2002 and urged governments to develop and implement an improved global container security regime that would identify and examine high-risk containers and ensure their in-transit integrity.¹⁴ In response, the WCO has adopted the SAFE Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework of Standards) in 2005. The core of these measures for supply chain security and facilitation are the improvement in risk analysis, based on the information supplied at an early stage of supply chain through electronic means by business and other customs administrations. Built upon the revised Kyoto Convention and other WCO instruments that have been developed for trade facilitation and improved control, the SAFE Framework of Standards addresses security and facilitation of international

¹⁴ G8 Kananaskis 2002 Summit Document “Cooperative G8 Action on Transport Security.” (27 June 2002). *Available at* <http://www.g8.gc.ca/2002Kananaskis/tranterror-en.pdf> (last visited 6 June 2007)

trade supply chain. It rests on two main pillars: (1) customs-to-customs network arrangements to encourage cooperation among customs administrations based on common and accepted standards; and (2) customs-to-business partnerships to identify business with a high degree of security guarantee as defined in the “Authorized Economic Operators” concept. It is necessary to offer tangible benefits to AEOs, including quicker movement of low-risk cargo, and uniformity and predictability of customs procedures.

7. Inclusiveness of customs function

Customs discharges a range of responsibilities as described above. The focus of the customs function is different depending on the economic and social development stage of a country. Developing countries normally put an emphasis on revenue collection while the developed countries are more concerned with protection, security and trade facilitation. However, since providing a business-friendly environment has been recognized as an important avenue for economic development, the developing countries are also increasingly concerned with the trade facilitation aspect of customs administration. Likewise, whereas the customs duty has lost its importance as a revenue instrument in the developed countries, it continues to be important for them to assure the compliance of participants in the trade supply chain. Getting access to the parallel flow of data accompanying the consignment, originally for revenue purposes is critical. It would therefore be essential for customs administrations to retain all of these responsibilities, to maximize each of its multiple roles, because they are all mutually supportive.

Customs is not the only administration on the borders. There are other government agencies that are tasked to ensure border control. There is a growing demand from the trading community to integrate government controls on cross-border movement of goods. Customs is often recognized as the most suitable agency, playing the central role as a “single window” in this regard. Moreover, because customs administrations in neighboring countries are also being asked to carry out one-stop and joint control functions, there is a new trend of integrated border management that shapes the long-term agenda of customs community.

Chapter 2 Evolution of customs valuation rules towards the WTO Agreement and the brief overview of the PSI program

This Chapter explains the need for rules in customs valuation, which is the core customs activity in assuring efficient revenue collection. This paper follows the development of international rules in this area, including the GATT articles, the Brussels definition of Valuation, Tokyo Code and finally the WTO Agreement on Customs Valuation. All of these regimes require customs authorities to collect accurate information on the goods and to verify them, which is not often available in developing countries. This is why the contracting out of customs function to private inspection companies (PSI) was recommended, which is aimed at assisting developing countries in carrying out their valuation work of examining documents and inspecting goods at the exporting countries. This part provides the context within which the case studies of PSI service in the four selected countries are considered.

1. Customs valuation and multilateral rules

Since many developing countries rely to a great extent on import taxes, including customs duties, to finance their national expenditure, revenue collection is normally the top priority for customs in these countries. There are two major types of customs duties: specific duties and *ad valorem* duties. They can be imposed together. In the case of specific duties, the assessment is based on the quantity of goods, multiplied by a predetermined unit duty. Therefore valuation is not necessary for specific duties, and the Agreement on Customs Valuation does not apply to them. While this system appears easy to apply for commodities with a stable value, it will raise questions about the equity of the tax system when goods that have large variability on in quality measures and which change prices frequently. This is especially the case for manufactured goods in a competitive modern marketplace. In order to avoid this problem, it is necessary to prepare a wide range of unit prices for goods according to quality, and frequently review them. This is not practical in most instances, and in the end it may constitute a barrier to trade. This is why most countries have adopted *ad valorem* systems whereby the duty is calculated as a percentage of the value of imported goods. The use of specific duties is increasingly limited to a few commodities, those that pose difficulties for valuation.

Customs valuation requires a good understanding of the market and the specific transaction. Customs officials must act in cooperation with traders. Developing countries tend to have relatively high tariffs on imports, and this offers incentives for fraud whereby importers under-value goods in an attempt to reduce tax liability. In the absence of reliable commercial documentation from traders, and customs officials experienced in valuation, the whole process can be seen as arbitrary and subject to negotiation between customs officials and traders. Compelled to fulfill revenue target set by the government and suspicious of under-invoicing, customs officials are often inclined to uplift the value of goods. Traders may not be cooperative in providing necessary commercial data in an effort to protect their commercial interest, which creates an asymmetry of information. In order to facilitate the valuation process for customs officers so that they may arrive at an acceptable valuation while at the same time deterring under-invoicing, many customs administrations in the developing countries set the reference price or minimum price for imported goods based on market information. However, the lack of accurate and timely information on market prices often resulted in the difficulties in setting minimum prices in line with commercial realities. Moreover, verification of valuation could cause a considerable delay in the clearance of goods. These problems were often seen as a non-tariff trade barrier.

In fact, valuation remains a continuing source of complaints and concerns for trade. The US Trade Representative (USTR) each year publishes an annual report on foreign trade barriers based on the complaints it receives from the US trade.¹⁵ While the content of reports could be controversial, it is an indication of how US companies perceive trade regimes and what the problems are for US trading partners. In its 2003 report the USTR made a compilation of 56 countries or trade groups. It raised concern over customs valuation in seven out of the ten Asian countries surveyed, often pointing out arbitrary and discretionary valuation practice. It also described customs valuation problems in seven out of nine African countries as well as seven South and Central American countries. The report also touches upon delays in customs clearance, to which lengthy price verification issues often contributed together with non-customs procedures including health and safety regulations administered by other border agencies. Another concern raised in the USTR reports is the use of arbitrary valuation for certain goods for the protection of national producers of similar goods.

¹⁵ United States Trade Representative. 2003 National Trade Estimate Report on Foreign Trade Barriers. Washington D.C. (2003).

In order to promote trade liberalization and address the fraud and integrity problem, economists often suggest the establishment of a reliable internal tax system to reduce the heavy dependence on revenue collection by customs. However, this solution needs an appropriate level of domestic economic activity and reliable domestic institutions. It is therefore regarded as a longer term solution, especially for least-developed countries. Moreover, since the application of domestic taxation increasingly relies on an indirect tax on transactions in goods, like the Value Added Tax, these taxes also collect tax on the declared value of goods at customs, and the importance of an accurate valuation is not avoided.

Customs officials therefore need a solid and internationally accepted system by which they can determine whether the declared transaction value is an acceptable basis for taxation. A solid system of valuation is also necessary for traders who could suffer from delays and additional cost caused by lengthy valuation processes, as well as arbitrary customs valuation decisions. In the latter case, the effectiveness of trade liberalization through GATT on tariff reduction would be severely undermined, since the valuation system would impact agreed duty rates and be altered unilaterally simply by modifying the valuation criteria. This explains the long-term international efforts to standardize valuation methods in a manner that will address these concerns.

2. 1947 GATT

Ad Valorem customs duties are not a modern invention; they were already in existence in the Middle Ages and earlier. However, predictable valuation methods and the possibility of administrative recourse against administrative decisions on valuation were often lacking in centuries past. At the international level, unstable and disparate valuation systems were a serious obstacle to the expansion of trade, as well as preserving the effective outcome of carefully negotiated tariff agreements. It has long been thought desirable that as many countries as possible adopt the same criteria for valuing goods. Thus, at the beginning of the 20th century, groups wishing to promote international trade began to study ways of replacing the unstable and arbitrary methods of valuation currently in use with an internationally accepted system which would be neutral in its effect on competition and trade policy. After several attempts

under the auspices of the League of Nations, the first international agreement was incorporated in the GATT Article VII in 1947.

The GATT Agreement laid down the principles that customs value of imported goods:

- should be based on the actual value of the imported goods or of similar goods;
- should not be arbitrary, fictitious or based on the value of indigenous goods;
- should be the price at which such or like goods are sold in the ordinary course of trade under fully competitive conditions; and
- when the actual value is not ascertainable value, should be based on the nearest ascertainable equivalent of such value.

GATT Article VII only sets out general principles and provides little guidance as to practical application. It allowed the use of differing valuation methods. Based on the principles stated in the GAT Article VII, two major types of valuation methods were developed: (a) the price at which the imported goods or similar goods are sold (a transaction value concept or positive concept); and (b) the price which the imported goods would fetch in a competitive commercial environment (an open market price concept or notional concept of normal price).

3. 1950 Brussels Definition of Valuation

The European Customs Union Study Group developed and produced a definition of value suitable for use world-wide: the Brussels Definition of Value (BDV). The Definition was incorporated in the Convention on the Valuation of Goods for Customs Purposes, signed in Brussels in 1950 and entered into force in 1953. This system is based on a notional concept of “normal price”, which is the price that the goods would obtain under open market conditions between unrelated buyer and seller at a specific time and place. Since the invoice price will meet this definition for the majority of imports in practice, the BDV recommends that the invoice price be used as the normal

price to the greatest extent possible. However, if a customs administration feels that the price paid or the invoice does not correspond to the open market price, then that price can be rejected. When the invoice price cannot be used, customs is entitled to construct the normal price, using all information available and taking into account the actual conditions relating to the transaction. In practice, customs often established a list containing a normal price for each product and determined valuation based on the list. A declared price was usually taken into account only when it was higher than the listed price.

During the 1970's, 33 countries, including the members of the European Union, were Parties to the BDV and around 70 were applying it de facto.¹⁶ The Valuation Committee under the auspices of the World Customs Organization has administered the Convention on the Valuation of Goods for Customs Purpose. The Committee is composed of delegates from the Contracting Parties to the Convention and observers from other WCO Members and international organizations. It has undertaken numerous activities to ensure the uniform interpretation and application of the BDV, including the adoption of Recommendations, drafting of Explanatory Notes and publication of Valuation Opinions based on specific problems encountered by Members.¹⁷

However, the United States never applied this Definition and used a positive concept of transaction value, based on the prices actually agreed on in a sale, reflecting a desire to restrict customs authorities' discretion in determining value. In fact, many exporters complained that the BDV gave too much discretionary power to customs administration, resulting in arbitrary adjustments in prices. They maintained that the notional concept of open market value may have corresponded to the commercial environment in 1950, but increasingly did not reflect the commercial realities where new products emerged and prices changed frequently. The adjustment of notional price usually took time and the list often did not contain new or rare products that resulted in difficulties in applying the BDV method.

¹⁶ World Customs Organization. Customs Valuation Considerations. Brussels (1999).

¹⁷ Since the GATT Valuation system entered into force and the majority of developed countries abandoned the BDV in favor of the new system, the Valuation Committee's has practically finished its activities.

4. 1979 Tokyo Round Valuation Code

The GATT Tokyo Round negotiations (1973-1979) took up the issue of valuation in the context of non-tariff barriers to trade. The Tokyo Round is the first GATT negotiation that dealt with improvements in GATT rules, resulting in agreements on anti-dumping measures, customs valuation, government procurement, technical barriers to trade and other non-tariff measures which were known as the “Tokyo Round Codes.”

During the negotiations, the European Communities (EC) was the main advocate during this negotiation for improvement in the uniform application and interpretation of GATT Article VII. The negotiating group, backed by the EC and many developing countries, initially developed draft Principles and Interpretative Notes, largely based on the BDV and its explanatory notes. However, the EC made a fundamental change in its position in 1977 and opted for a US valuation system based on positive approach to transaction value instead of the notional approach used by the BDV. This reconsideration of the EC position, which came as a surprise to many developing countries, actually paved the way for the Agreement on the Implementation of Article VII of the GATT, or the Tokyo Round Valuation Code, concluded in 1979.

The new system is based on a positive concept that prescribes the transaction value of the imported goods, as the “price actually paid or payable,” and this is to be the primary method of establishing the customs value. When transaction value (method 1) cannot be used, the Agreement prescribes the five alternative methods (method 2 to 6) to be applied in a strict hierarchical order:

1. Transaction value;
2. Transaction value of identical goods;
3. Transaction value of similar goods;
4. Deductive method, whereby values may be determined based on the sales price in the country of importation from which certain costs and profits are deduced;
5. Computed method, whereby value may be determined based on the costs of material and production in the country of exportation plus other auxiliary costs and profits; and

6. Fall-back method, whereby value can be determined based on any of the previous methods as adjusted in a flexible manner to account for special circumstances.

Many developing countries argued that under the Tokyo Round Code the invoice price in principle should be accepted as the customs value, unless otherwise proved unequivocally wrong by customs, an undertaking that would be difficult and time-consuming. They maintained that the Agreement did not provide sufficient power for customs to verify the truth or accuracy of an invoice and its authority to reject the invoice price is thus considerably limited. The Tokyo Round Code was a stand alone agreement and the accession to the Code was optional. Most developing countries therefore did not join the Agreement. They were fearful of revenue losses and pointed out that their customs administrations operate in an environment where under-invoicing was more pervasive than in developed countries. As to the institutional arrangement, the Committee on Customs Valuation was established under the auspices of the WTO to be responsible for all aspects of the Agreement concerning trade policy, whereas the Technical Committee on Customs Valuation was established under the auspices of the WCO to be responsible for all practical applications of the Agreement.

5. 1994 WTO Agreement of Customs Valuation

The Uruguay Round negotiations (1986-1994) established the WTO and under the single undertaking principle obliged Members to adhere to all the WTO Agreements including the Agreement on Customs Valuation (1994) that replaced the Tokyo Round Valuation Code. The content of the WCO Agreement remained essentially the same as that under the Tokyo Round Code. The main difference is the obligation to all Members, including developing countries, to implement all the WTO Agreements. Special and Differential Treatment was established for developing countries. While all developed countries had to apply the WTO Agreement immediately upon its entry into force, developing country members, not party to the Tokyo Round Code, were granted a transitional period of five years to implement the Agreement from the date of entry into force of the WTO Agreement for the member concerned. Furthermore, the Agreement provided for another set of Special and Differential Treatments for developing countries.

including the favorable consideration of a request for an extension of the transitional period by a developing country with a good cause. Many developing countries have started the process of applying the Agreement upon the expiration of this transitional period, most doing so in 2000.

Apart from the transitional period, in order to meet the concerns of developing countries on revenue implication, the “Decision regarding cases where customs administrations have reasons to doubt the truth or accuracy of the declared value” was issued. India played a vital role in representing the voice of developing countries, supported by Brazil.¹⁸ This ministerial decision forms an integral part of the entire Uruguay Round package and clarifies that customs authorities do have rights to challenge importers. When customs have reasonable doubts as to the truth or accuracy of the importer’s declaration, customs enters into consultation with importers and can ask the importers to prove that the declared value actually represents the total amount actually paid or payable for the goods. If customs officers have such reasonable doubts after further information is provided by the importer, they may decide that the customs value cannot be determined on the basis of transaction value. In this process, customs needs to fulfill due process in consultation with importers and follow alternative methods to determine the value, prescribed in the Agreement on Customs Valuation.

6. Tariff classification

Related to valuation, tariff classification is another expertise that customs needs in determining tax liability. Since an *ad valorem* system requires the duty to be calculated (as a percentage) of the value of imported goods, it is necessary to determine what tariff should be applied as a percentage to be multiplied on the calculated value of goods. Tariff schedules are usually included in national legislation or in the international treaty, including GATT, as a result of tariff negotiations. They follow the format called the Harmonized Commodity Description and Coding System (HS) established by the WCO. This system for classifying goods in international trade is embodied in the HS Convention, that entered into force in 1988. Under the latest

¹⁸ John Croom. Reshaping the World Trading System: A History of the Uruguay Round. Geneva, WTO (1995).

Harmonized System, called HS 2007, commodities must be clearly distinguished from one another into 1221 four-digit headings which are further divided into 5052 six-digit subheadings. For each commodity or category of commodities, only one heading or subheading should be applicable, thereby precluding classification in any other heading or subheading. These subheadings may be subdivided further to reflect national administrative and statistical requirements. The tariff schedules as a part of national law follows the format of the international HS system (headings and subheadings), accompanied by national subdivisions of subheadings.

Generally speaking, once the classification of a good is identified in the nomenclature, the duty rate is automatically determined. Once the classification of a good is identified in the HS nomenclature, it must be applied uniformly all over the world. In order to assure uniform application, the WCO HS Committee makes recommendations on interpretation of the HS Convention when classification questions or disputes arise between members. As difference in classification may result in a sizeable change in the sum of customs duties, disputes involve considerable commercial interests. Examples include whether a minivan falls within the category of passenger motor vehicles (the US tariff was 2.5% in 1989) or vehicles for transport of goods (the US tariff was 25%).¹⁹ While disputes are settled from a purely classification point of view reflecting its technical nature, the HS Committee acts as an international tribunal for HS classification disputes.

The HS nomenclature is constantly reviewed and updated to keep pace with changes in technology or the pattern of international trade. The review period is normally five years and the HS Convention has been amended three times since it entered force in 1988. The fourth cycle of amendments, which should enter into force in 2007, has been completed and it includes a review on information technology provisions that have been the subject of many recent disputes.

The purpose of HS is not limited to the GATT tariff schedules or the collection of customs duties and trade statistics. It is an important tool to apply other trade policy measures including licensing and quotas. It is also used to monitor the trade in goods,

¹⁹ The dispute was brought against the US classification decision in 1989 that classified a minivan within the category of vehicles for transport of goods. The HS Committee recommended that a minivan should be classified within the category of passenger motor vehicles in 1990. After the domestic judicial procedures the US reclassified a minivan in line with the HS Committee recommendation.

particularly those related to environmental and social concerns, reflecting customs role in protecting society. The creation of subheadings for ozone depleting substances, precursor chemicals to manufacture illicit drugs, hazardous wastes, endangered species, narcotics, and psychotropic substances are examples of this responsiveness to international concerns. Similar recommendations relate to the Chemical Weapons Convention. The HS review increasingly takes into account the requirement of governments to ensure compliance with their own regulatory framework.

Misclassification would lead to the loss of revenue for customs if the wrong classification of a product under a tariff category was intentionally carried out under a lower duty rate. As declaration by importers or their agents (customs brokers) submitted to customs will include a tariff classification of goods. It is necessary for both customs and the trade to apply a standard system for customs classification. In order to address this concern, the HS is constantly updated to meet the needs of the evolving trade environment. Best practices have also developed to implement the HS Convention, including the establishment of a classification infrastructure. In addition to the organizational arrangements, such as the classification center at the headquarters of customs to ensure uniform application of HS nationwide, the best practices recommend measures to improve transparency and predictability in classification decisions. One such recommended practice is an advance classification ruling system whereby the trade can receive a ruling on classification of goods prior to importation. In a more general way, the revised Kyoto Convention Standard 9.9 stipulates that customs shall issue binding rulings at the request of the interested person, provided that customs has all the information deemed necessary. Although tariff classification is the most common area for binding rules, rulings on origin and valuation are also common.²⁰

7. Implementation problems and the use of the private sector in customs

Whereas customs valuation and tariff classification are the fundamental expertise necessary for customs to fully discharge its responsibility, especially in revenue collection, the developing countries often claim that the lack of capacity in

²⁰ World Customs Organization. Kyoto Convention General Annex Guidelines, Chapter 9 “Information, Decisions and Rulings Supplied by Customs,” (2000) at 11.

customs makes it difficult for them to properly carry out customs valuation. In order to enhance revenue collection by addressing this problem, developing countries sought an improvement in their customs function. However, capacity building is often considered a longer-term objective and some governments resort to private companies to take up part of the function that customs normally assumes. Another background issue in this approach is addressing the perceived problem of integrity in customs. Some governments engaged the private sector to discharge this customs function also. While there are several kinds of contracting out, including introduction and maintenance of information technology system and consultancy, one type of service, called Preshipment Inspection (PSI), was considered as the quasi-privatization of customs and has caught the attention of governments, international organizations and the trading community. Initially it was expected that the private sector would help customs build up their own capabilities, and thus reliance on the private sector was considered to be an interim measure.

To give more detail, some thirty governments today contract with inspection companies to examine documents and inspecting goods before their embarkation for export (Preshipment Inspection Service, or PSI in short) to verify all elements related to duty determination – namely valuation and classification. The inspection companies originally developed their business model of inspection and testing of goods to assure conformity with contracts on behalf of private sector buyers and sellers. They developed their international service by investing in a worldwide network to carry out verification services of goods for export on behalf of importers. Using their network and infrastructure worldwide, they extended their business to government service, by initially helping the Central Bank or Ministry of Finance in the fight against capital flight to complement the exchange control mechanism in the 1960's. Later, in the 1980's, they transformed their service for the protection of customs revenue from tax evasion. While overvalued invoices are often used for capital flight, undervalued invoices are used for tax evasion. According to the International Federation of Inspection Agency, there are currently 31 PSI user countries as of May 2008, and the majority of them are the least-developed countries in Africa, as shown below.²¹ They are composed of 24 countries in Africa, 3 in America, 3 in Asia and 1 in Central Asia.

²¹ World Trade Organization, Committee on Customs Valuation. Preshipment Inspection, Note from the Secretariat. G/VAL/W63/Rev.10 (13 May 2008).

The PSI industry has been changing quickly in an effort to meet the new market needs and environment. Originally the PSI program was launched almost exclusively to address the issue of capital flight by preventing over-invoicing. Reflecting the change in foreign exchange policy of many countries, contracts are now almost exclusively drafted for revenue protection purposes with a small number of exceptions for foreign exchange purpose. Following the needs of developing countries in reducing costs and seeking for more effective service, the PSI industry has recently developed new business models. One is called “selective PSI” with the explicit application of risk assessment in selecting consignments for physical inspection, whereas the traditional PSI service notionally covered all shipments for inspection. This reflects the development of risk-based selection systems and the recognition of the expensive nature of the operating inspection companies which had more or less been employing a selective inspection method. For example, Kenya was successful in incorporating this approach in the PSI contract in 2000 with considerably reduced fees payable to inspection companies.

Another type is called Destination Inspection where shipments are subject to physically inspection at the destination in importing countries, whereas under the traditional model the PSI service inspects cargo at the point of shipment in exporting countries. Destination Inspection may include price verification and classification on a pre-shipment or post-shipment basis. Destination Inspection is accompanied and supported by the development of non-intrusive inspection technology. Of the 31 countries that have PSI-related contracts, 14 are traditional PSI contracts (referred as PSI in the type column in the below table 2-1) and 17 contracts are called “customs support services” including destination inspection (referred as Destination in the type column in the below table 2-1) and selective PSI (referred as Selective in the type column in the below table 2-1). Selective PSI and Destination Inspection are combined in 6 countries out of the 17 “customs support services”.

(Table 2-1) PSI user countries compiled by the IFIA, as of 13 May 2008

COUNTRY	TYPE	MANDATED MEMBERS OF IFIA PSI COMMITTEE	IFIA MEMBE CHOICE
Angola	PSI	BIVAC, Cotecna, SGS	Importer
Bangladesh	PSI	BIVAC, Intertek, SGS	Geographic
Benin	PSI	BIVAC	-
Burkina Faso	PSI	Cotecna	-
Burundi	Selective	SGS	-
Cambodia	PSI	BIVAC	-
Cameroon	Selective, Destination	SGS	-
Central African Rep.	PSI	BIVAC	-
Chad	PSI	BIVAC	-
Comoros	Selective	Cotecna	-
Congo	PSI	Cotecna	-
Cote d'Ivoire	Destination	BIVAC	-
Dem. Rep. of Congo	PSI	BIVAC	-
Ecuador	Destination	BIVAC, Cotecna, Intertek, SGS	Importer
Equatorial Guinea	(Destination)	Coteca	
Ghana	Destination	BIVAC, Cotecna	Air & land / sea-
Guinea (Conakry)	Selective, Destination	BIVAC	
Haiti	Selective	SGS	-
Iran ²²	PSI	BIVAC, Cotecna, Intertek, OMIC, SGS	Importer
Liberia	Selective, Destination	BIVAC	-
Mali	Selective, Destination	Cotecna	-
Mauritania	PSI	SGS	-
Mexico	PSI ²³	BIVAC, Intertek, SGS	Importer
Mozambique	Selective, Destination	Intertek	-
Niger	PSI	Cotecna	-
Nigeria	Destination	Cotecna, SGS	Port of Arriv
Senegal	Selective, Destination	Cotecna	-

²² Physical inspection (quantity/quality only) for foreign exchange purposes.

²³ Only certain categories & origins of goods if their unit value is inferior to estimated prices published by Government.

COUNTRY	TYPE	MANDATED MEMBERS OF IFIA PSI COMMITTEE	IFIA MEMBE CHOICE
Sierra Leone	Selective, Destination	Intertek	-
Tanzania	Destination	Cotecna	-
Togo	Destination	Cotecna	-
Uzbekistan ²⁴	PSI	Control Union International, Intertek, OMIC, SGS	Importer / expc

(source) WTO, G/VAL/W63/Rev.10, 13 May 2008

The majority of countries have contracts with one PSI company (23 out of 31 as of May 2008), while others have split contracts where several PSI companies operate either on a geographical basis or to allow importers a choice of PSI companies. The Société Générale de Surveillance (SGS, Switzerland) is the largest PSI company. It had the majority of the market share in early days of PSI service. Its share has subsequently declined. By way of comparison, it was operating a PSI service in 24 countries out of 41 in 2001, but only 11 countries out of 31 in 2008. The current number of countries in which each PSI company operates in 2008 is as follows:

BIVAC (Bureau Veritas Group, France) 14,
COTECNA Inspection (Switzerland) 13,
SGS 11,
INTERTEC Testing Service (ITS, UK) 7,
Overseas Merchandise Inspection Company (OMI, Japan) 2, and
Control Union International (Germany) 1.

The top four companies, SGS, BIVAC, COTECNA and INTERTEC, dominate the market and often conclude contracts with a user country on an exclusive basis. Others have contracts with shared responsibilities in one country. This oligarchic situation suggests that the entry into this market is not easy for newcomers because of the initial investment size in setting up and then the maintenance cost of an overseas network and infrastructure.

The PSI service has often been promoted as a good example of the private sector involved in government functions to improve efficiency. Indeed, inspection companies

²⁴ Including reporting for foreign exchange purposes. No programs now include intervention on invoice price.

often showed impressive records of “saving” foreign exchange or revenue as a result of adjustments of imports, indicating a potential contribution to the increase in revenue. They promoted their activities as a solution to the customs integrity problem or advertised the delivery of technical assistance and training, accompanied by the PSI program.

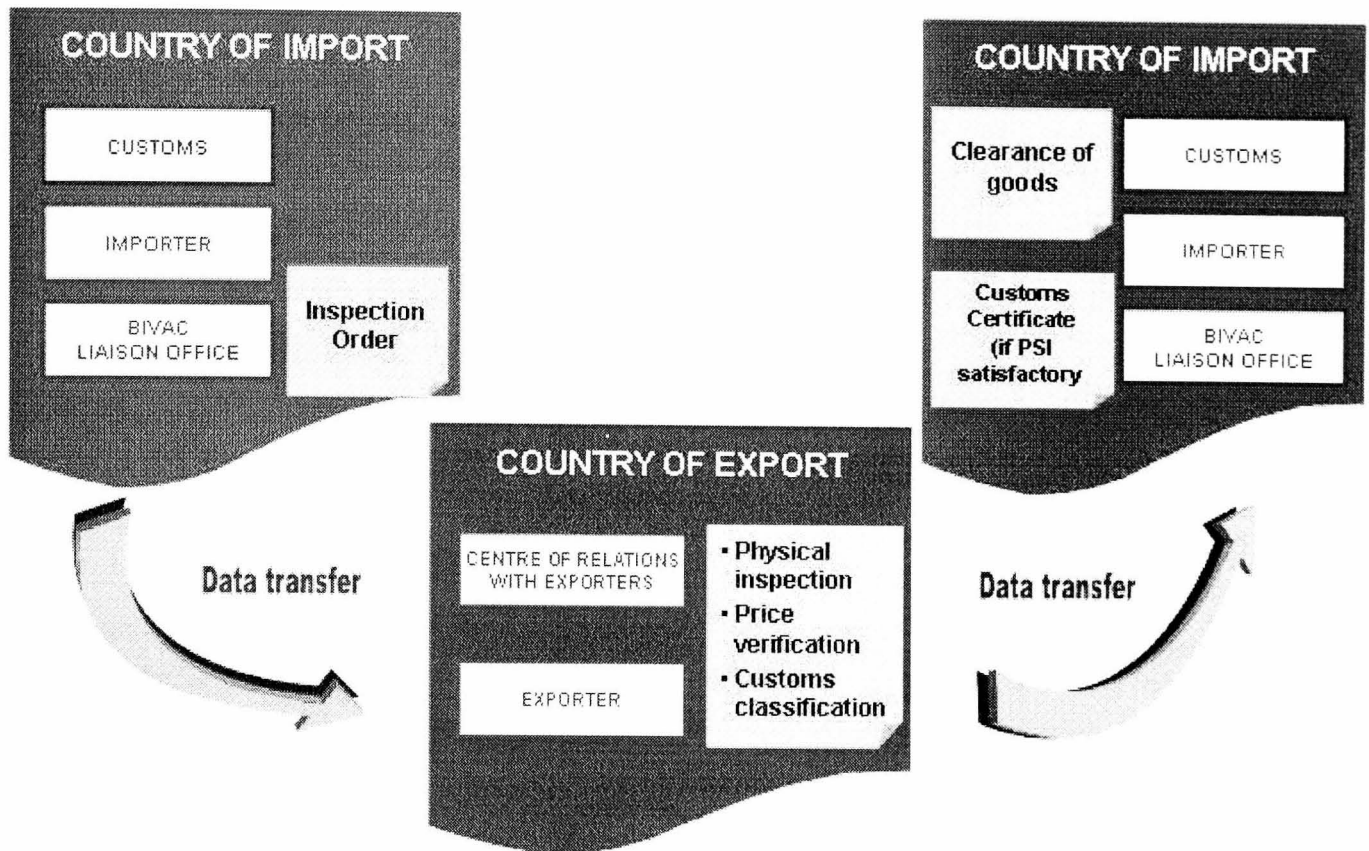
A PSI contract for customs revenue purposes encompasses the hiring of a private company that verifies the quality, the quantity, the price and the customs classification of goods to be exported at their point of embarkation. A typical flow of PSI procedures is as follows, also shown in the flow chart below:

- The exporter is required to submit the goods and invoice to the local PSI office in a country of exportation;
- The PSI companies verifies that the goods conform with the specifications of contract, including quantity and quality, and that the price paid by the importer is reasonable, in comparasion to “the price of identical or similar goods offered for export from the same country of exportation at or about the same time;”²⁵
- Based on its inspection of the shipment against the invoice, the PSI company makes amendment to the invoice, if necessary, then, seals the shipment and sends a “Clean Report of Findings” (CRF) to the customs service of importing countries;
- The customs service collects revenue on imported goods using the report from the PSI; and
- In some cases the CRF is also sent to the importing country’s Ministry of Finance for “ex-post reconciliation”, by which it checks for any discrepancies that might exists between the data coming from the PSI and that from the customs service to ensure the proper use of CRF by customs.

²⁵ World Trade Organization, Agreement on PSI. Article 2.2b.

(Figure 2-1)

Pre-Shipment Services Flow Chart²⁶



Exporters were increasingly expressing their concerns that the PSI service had become another layer of non-tariff barriers by making export procedures cumbersome and costly. Hence, the WTO Uruguay Round negotiations took up the issue and the WTO Agreement on PSI was negotiated to deal with the potential problem arising from the use of the private sector in a traditional government function. The PSI regime has also attracted considerable interest and discussion in the trade, customs and donor communities, especially with regard to its usefulness and effect on capacity building in customs. Corresponding to this debate and the changing needs of user countries, the PSI industry has adapted itself to new market demands and constantly evolved their business model.

²⁶ BIVAC "Preshipment Inspection Service Flowchart" [BIVAC.com](http://www.bivac.com) (May 2007). Available at <http://www.bivac.com> (last visited 6 June 2007).

Chapter 3 Implementation issue of WTO Agreement on Customs Valuation and the original PSI solution

This Chapter reviews the difficulties encountered by developing countries in implementing the WTO Agreement on Customs Valuation. Areas of concern include the compliance environment and administrative capacity. It then examines the minimum values method that many administrations employ as a base for their valuation and how the PSI solution was expected to complement this method. It also reviews another institutional weakness – both in trade and customs – of corruption and how the PSI program was supposed to overcome this issue. The preliminary examination will point to the realization that there was a need for more comprehensive customs reform rather than simply relying on the service of the private inspection company.

1. Implementation problem of valuation for developing countries

When the Agreement on Customs valuation was negotiated during the GATT Tokyo Round negotiations in the 1970's, many developing countries expressed their concern regarding the difficulties in implementing the Agreement. They pointed out the weakness in compliance of traders and administrative capacity as the major obstacles for accepting the use of the transaction value that the Agreement mandated. Fearful of revenue leakage as a result of applying the transaction value, which is normally reflected in the invoice price, many developing country members of GATT did not accede to the Agreement on Customs valuation and its membership remained less than half of GATT members. It was only under the Uruguay Round negotiations that the Agreement on Customs valuation was made a part of single undertaking in 1994 and the developing country members accepted the transaction value system. While the new Agreement was accompanied by a longer period of implementation for developing countries, which could be extended to 2000, the above obstacles have largely remained unchanged.

Many developing countries felt a limited sense of responsibility in implementing the new WTO rules. This lack of ownership of the reforms goes back to the negotiating history of the Uruguay Round with the limited participation of developing countries. While the WTO/GATT matters have become more complicated, many developing

countries were not able to allocate enough attention and resources to the trade negotiations. The negotiators in Geneva have often simply reacted to proposals from their developed country partners. They often did not receive instruction from their capitals, as trade ministries in capital fail to make necessary domestic coordination with other ministries in charge of topics under negotiation. Consequently, many developing countries viewed the new valuation system as “imposed” by developed countries over the weakness of their negotiators.²⁷ More importantly, developing countries were apprehensive that the change over to the new valuation system might result in loss of revenue while the possibilities of raising additional revenue through other direct or indirect taxes to compensate for the loss were limited.²⁸

This is the background of the implementation-related issue of the WTO Agreements, which surfaced before the launch of the Doha Round negotiations in 2001.

2. Compliance environment

The Brussels Definition of Valuation (BDV) on which many developing countries had based their valuation uses a notional concept of “normal price” that the goods would fetch under open market conditions between unrelated buyer and seller whereas the Agreement on Customs Valuation uses a positive concept of transaction value. The BDV system also presupposes that theoretically the transaction price can be taken as a valid basis for “normal price” for the majority of imports. However, developing countries often perceived that the transaction value declared by importers could not be taken as a basis for “normal price”, because of the poor level of compliance among traders. Customs officials in many developing countries were aware of the ease with which import invoices are falsified at the point of export or even produced in the country of destination.²⁹ Therefore they often rejected the transaction value and constructed the normal price as mandated by the BDV system. Many of them developed minimum

²⁷ Michael Finger & Philippe Schuler. Implementation of Uruguay Round Commitments: the Development Challenge. World Bank Policy research Working Paper 2215, Washington DC, World Bank, (1999) at 3-5.

²⁸ Vinod Rege. Customs Valuation and Customs Reform. In Bernard Hoekman & Aaditya Mattoo. & Philip English. (ed.), Development, Trade and the WTO – A Handbook, Washington DC, World Bank, (2002) at 131.

²⁹ Luc De Wulf “Customs Valuation in Developing Countries and the World Trade Organization Valuation Rules” in (ed.) Luc De Wulf & José B. Sokol Customs Modernization Handbook Washington D.C. World Bank (2005) at 202.

values or referenced prices for goods to be used as the normal market values. Their accession to the WTO changed this situation and obliged them to verify the transaction value as the basis of valuation, requiring adequate valuation control. Nevertheless, it is worthwhile noting that both systems require accurate information on the price of goods in verifying either “normal price” or transaction price. This asymmetry of information between customs officers and importers is the core of the problem that resulted in the introduction of PSI program in all four countries under case studies.

In more detail, the developing countries often claimed that it was difficult to expect compliance of traders with relevant laws for the following reasons.

First, due to the high level of tariffs, there is a strong incentive for under-valuation. Fisman and Wei empirically show the responsiveness of tax evasion to tax rates in China’s imports from Hong Kong.³⁰ Since high levels of customs duties have the effect of restricting trade, many countries have recently reduced tariff levels in the efforts to boost trade as part of strategy for economic development. In the Philippines, trade liberalization resulted in the reduction in tariff but boosted trade volume, which should have contributed to an increase in customs revenue to offset the revenue loss. However, recent IMF reports reveal that over the past 20 years, trade liberalization has been associated with a marked decline in trade tax revenue relative to GDP in many countries, and that there are signs that some poorer countries have been unable to recover lost trade tax revenues through strengthened domestic taxation.³¹ More precisely, it showed that among 69 low- and middle-income countries, trade tax revenue went up in 9 countries from early 1980’s to late 1990’s, while 60 countries experienced decline in the same period. It also shows that among low-income countries, total tax revenues as a percent of GDP have on average declined parallel with trade tax revenues. This result indicates that revenue enhancement effects by trade liberalization, including increases in trade volume, were not able to offset the reduction in tariff levels in the majority of countries surveyed. This finding is likely to send a cautious signal that it would not be prudent to assume that trade liberalization would automatically be offset with revenue enhancements, which depend on a range of considerations. The IMF paper recommends the strategy of using domestic consumption taxes – both the excises on particular goods and any general sales tax (the

³⁰ Raymond Fisman. & Shang-Jin Wei. Tax rates and tax Evasion: Evidence from “Missing Imports” in China. 112 *Journal of Political Economy* 471-96 (2004).

³¹ IMF. Dealing with the Revenue Consequences of Trade Reform (Background paper for Review of Fund Work on Trade) (2005) at 4-7.

archetype being the VAT) to offset any revenue loss from tariff reduction.³² In this connection, Emran and Stiglitz caution by demonstrating that due to the existence of a large informal sector, price-neutral tax reform, shifting from import tariff to consumption tax, might result in reduction in overall revenue.³³ It is noteworthy that the introduction of these taxes does not necessarily reduce the temptation for under-valuation, due to its similar tax structure to that of ad valorem tariff.

Second, the predominance of an informal trade sector that does not report income is problematic for tax collection. In all four case studies the informal sector is estimated to represent over a third of total economy. Trade is frequently the source of informal economic sector to quickly and easily gain profit, taking advantage of circumventing often rigid and restrictive trade regime. Several countries, including Kenya, have taken measures to bring the informal sector into the tax net, including sensitization of taxpayers and proposing tax amnesties. However, there is a cautious view on this policy because “Tax amnesty may lower barriers into the official economy but they can also lead to the expectation that they might be repeated in the future, thus reducing the incentive to operate officially.”³⁴ In developing a tax strategy, it would be necessary to note that the profile of taxpayers is categorized in three broad categories: (i) large taxpayers; (ii) small and medium enterprises in the formal sector; and (iii) informal businesses sector. In order to improve voluntary compliance for each specific group of taxpayers, the tax authority needs to tailor and deliver a set of strategies that are appropriate to the unique characteristics and compliance issues presented by each group.³⁵ Based on this view, the IMF has recommended that developing countries establish large taxpayer units (LTU) to increase control over large taxpayers who represent a large proportion of tax collection in developing countries. The LTU approach has facilitated major tax policy reform, such as adoption of a VAT, as well as the reform of administrative procedures, including implementation of self assessment

³² *Id.*, at 11.

³³ M. Shahe Emran. & Joseph, E. Stiglitz Price-neutral Tax reform with an Informal Economy. RePec (2003) at 1.

³⁴ Suresh N. Shende. Informal Economy, The Special Tax regime for Small and Micro Businesses: Design and Implementation. Paper presented at the third Regional Training Workshop on Taxation (UN and CIAT) (2002) at 9.

³⁵ William McCarten. Focusing on the Few: The Role of large Taxpayers Units in the Revenue Strategies in Developing Countries. Paper presented at the fourth Conference on Public Finance Issues in an International Perspective: the Challenge of Tax reform in a Global Economy at the Andrew Young School of Policy Studies, Georgia State University (2004) at 11.

and modern auditing.³⁶ The IMF report stresses the need to integrate LTU practice into “a border tax administration reform also aimed at improving the administration of medium-sized and small taxpayers”.³⁷

Third, the importance of trade in second hand goods makes the application of the transaction value method extremely difficult. Since the import of second hand cars is often perceived as involving a major risk of undervaluation, customs in the importing countries often request information on value in the exporting countries. Periodic commercial publications of secondary market prices in the exporting countries, all of which are often available on web sites, and could provide the key to solution. On the other hand, it is difficult to acquire information on the value of second handed clothes, which is often linked to the protection of domestic industry. In some countries, the tariff system still maintains a specific tariff for second hand clothes to cope with this question.

Fourth, many importers deliberately maintain poor records and maintain special relationships with exporters who are willing to participate in the falsification of documentation.³⁸ There are often no legal provisions that stipulate obligations like record keeping for business, or their implementation meets resistance from the private sector. This is particularly unhelpful in carrying out a verification of declared value at a post-clearance audit. Whereas the Philippines made keeping commercial record obligatory in 2000, traders were not necessarily ready to move to full implementation of post-clearance audit from the current pilot project basis.

Consequently, customs officers in developing countries often suspect that a great majority of imports are undervalued. In fact, as one IMF economist observed, “During the course of missions and field visits, it is indeed common for IMF missions to be informed that importers have links with suppliers/traders who are willing to participate in the falsification of documentation. In a number of countries visited, especially in Asia and Africa, cargo may arrive on feeder vessels, after being transshipped in other

³⁶ *Id.* at 1

³⁷ Katherine Bear, Olivier, P. Benon & Juan, R. Toro. Improving large Taxpayers' Compliance: A Review of Country Experience. IMF Occasional Paper 215, Washington DC., IMF (2002) at 39.

³⁸ James T. Walsh. “Customs Valuation” in (ed.) Michael Keen Changing Customs Washington D.C. IMF (2003) at 84-85.

ports, again providing the opportunity to alter documentation.”³⁹ This perception of field customs officers lead to their general inclination towards uplifting declared value. In anticipation of this customs attitude, the trade tends to submit undervalued declaration. This vicious cycle only aggravates the problem.

3. Administrative capacity

Administrative capabilities are another pre-condition for the appropriate valuation work, which entails checking the information given by the importers according to the proper legislation and regulations. Along with the rapid development of world trade, customs work must deal with a large variety of goods in an ever-changing commercial environment, where goods in similar categories could display widely differing prices. A whole range of modern customs techniques were developed to support the valuation process, but they require a well-organized customs administration, well-trained customs officers and a well-functioning computer system under the strong leadership of top management. However, in reality, many developing countries suffer from severe administrative limitations. Preoccupied with achieving short-term revenue targets, governments often fail to make necessary investments to allocate financial, human and technological resources in support long-term customs reform.

Valuation control requires expertise with respect to goods and their prices to identify suspicious transactions. However, customs often do not have market price data and poor communication systems do not allow officers sufficient access to price information.⁴⁰

The Agreement of Customs Valuation is complex and needs specialists who can interpret the law and solve problems. Moreover, as post-clearance audit at the importers' premise is regarded as the key to providing necessary information to complement price verification, customs needs experts who can audit the books and records of importers.⁴¹ Therefore it becomes essential to offer acceptable working

³⁹ François Corformat Issues and strategies for technical assistance to developing countries, presentation at the WTO Seminar on Technical Assistance on Customs Valuation (6-7 November 2002).

⁴⁰ De Wulf (2005), *supra* note 29, at 202.

⁴¹ Walsh (2003), *supra* note 38, at 93.

conditions with career opportunities to recruit and retain well-educated personnel. Linked to the civil service system, customs administrations cannot always guarantee attractive remuneration. In addition, it often does not have adequate training facilities and a systematic training program.

Political patronage is another constraint observed in developing countries. Top management is frequently changed according to the political agenda, which does not help to sustain customs modernization. With the arrival of a new top manager, the policy direction of customs modernization is often reviewed from zero. The leadership of the top manager is severely undermined if his competence of management in the organization and with personnel is not assured. This is often the case, due to political interference on the ground of ethnic or constituency backgrounds. While an institutional line of command exists between the management and the personnel, it is often reported that the real relationship among customs officials is very different because it follows political patronage lines.

Another weakness of administration lies in the management of information technology. While customs reform projects are often driven by automation, customs computer systems and databases are frequently limited or ill-managed and do not necessarily support desired levels of functionality for risk management or post-clearance audit. As the IMF notes, “international experience has demonstrated that customs administrations often find it difficult to implement these complementary components of the modernization efforts [to computerization]... It is not difficult to find examples where inappropriate introduction and use of computer systems have exacerbated existing problems.”⁴² At a practical level, it is often observed that after the initial installation of a computer system, governments ignore allocations of financial resources for maintenance and upgrading of the system. The problems associated with IT application are also caused by the shortage of technological experts or consultants, whom customs administrations have difficulty retaining due to budgetary constraint. More importantly, weak management leadership with respect to decisions on design, implementation, expansion of computerization programs, and the monitoring of automation processes frequently compounds the problem. As a result, the IT system may not be well incorporated into the risk management system, and its functionality remains underemployed. While it is normal to outsource the technical work of an IT

⁴² François Corformat. & Patricio Castro. Computerization of Customs Procedures in Keen, Michael. (ed.) *Changing Customs*, Washington DC. IMF (2003) at 119-20.

system, it is essential for customs to develop the necessary capability of setting the requirements for automation and assessing the IT function.⁴³

4. Minimum prices and the original PSI solution

Under these constraints – poor trader compliance and weak administrative capacity – it was considered problematic to accept self-assessment of importers on value, tariff and tax liability as the basis of valuation. Therefore many developing countries developed valuation practices, different from those in developed countries. Instead of introducing valuation control, based on modern principles such as risk assessment and post-clearance audit to identify actual transaction value, they established a list containing a normal price for each product and determined valuation based on the listed price.⁴⁴ The listed prices were drawn from domestic prices, prices in major exporting countries and other sources. They were used as prior-determined minimum values and declared prices were usually taken into account only when they were higher than the listed prices. When domestic prices were offered by local producers associations, they were often kept high to protect the domestic industry. Sometimes diplomatic services were tasked to provide prices in major exporting countries. However, as in the case with the Philippines, it was usually difficult to keep the listed prices updated, because of the limited domestic and overseas resources for research on market prices. As a result, listed prices frequently failed to reflect the changes in markets and became inapplicable, or the list turned out to be of limited coverage. In these cases, customs officers usually did not have sufficient information for determining the value of goods, except to rely on importers' documents. Importers might be tempted to submit documents containing undervalued invoices in an effort to evade tax liability while customs officers suffer from asymmetry of information. This would provide an opportunity for an interaction between customs officers and importers which often resulted in negotiations between them to agree on mutually acceptable values. This provides an opportunity for collusion between them, and is prone to corruption.

⁴³ The IT Guideline attached to the WCO Revised Kyoto Convention provides the implementation guideline for automation in customs.

⁴⁴ Finger (1999), *supra* note 27.

The PSI service could be useful to correct this asymmetry in information. It was expected to set the price level of goods that would be accepted as transaction value, based on data collected from suppliers and market information gathered from their network and expertise. This was viewed as a good example of contracting out a public function that can be performed more efficiently by the private sector. Naturally, to make this mechanism of addressing asymmetry in information effective, it would be necessary to ensure that customs officers actually used PSI reports in their valuation process. There should be an internal control mechanism where each import declaration and the proof of duty payment should be kept, accompanied by the corresponding PSI report for internal review. Observers suggested that customs management introduced ex post reconciliation between these documents to ensure that the PSI reports are actually used by customs officers. The PSI program was considered a quick fix to counter the prevailing problem of compliance and weak administration under the BDV system that allows for wider interpretations in the use of reference prices or PSI-certified prices. It was also viewed as a solution to deter possible collusion between customs officers, customs brokers and importers. In addition, inspection companies proposed training and other services to enhance the capability of customs officers in the valuation area.

Later, it turned out that in spite of the expense the performance of the PSI program was mixed in both the revenue collection and its ability to provide assistance in administrative capacity development. The PSI program could not get sufficient cooperation from customs officers in maximizing its benefit or from user governments in utilizing its monitoring function. Furthermore, under the WTO transaction valuation system that replaced the BDV system, customs authority primarily depended on the invoice price in valuation and verifies it with supporting documents to prove its truth or accuracy. This new valuation system therefore excludes the use of prior-determined minimum values. It does not allow the determination of customs values based on minimum prices or PSI-certified prices, unless a reservation is made to retain any established minimum value on a limited and transitional basis. The PSI-certified price could only be used as a means of testing whether or not the transaction value is acceptable. If rejected, the WTO Agreement on Customs Valuation requires the application of valuation methods prescribed in the Agreement in a hierarchical way. The realization of the limitations in the PSI program compelled states to rethink about the usefulness of contracting out these services and to refocus efforts on enhancing the state function.

5. Corruption in customs

Related to the above issues, the problem of corruption has often been identified as a factor that aggravates the problem arising from the inadequate compliance environment and administrative capacity. Customs is frequently rated as an institution with a corruption problem, together with the police and the tax authority.⁴⁵

(1) Typology of corruption in customs

There is a large body of literature on corruption and one can broadly distinguish two types of corruption in customs administrations that correspond to the categories set out by Klitgaard (1) payment for illicit services and (2) payment licit services.⁴⁶ In one typical case, an importer seeking higher illicit benefit asks a customs officer for illicit service of approving an unlawfully low tax liability in an attempt to make tax evasion easier. Examination of valuation and classification can offer an opportunity for importers and customs officers to engage in fraud. In developing countries where tariff rates are normally high, this collusion provides importers with huge financial gains while reducing the risk of being detected by customs officers. The low salary level of public servants, including customs, does not help this situation, especially when compared with the huge profits that customs officers can earn from engaging in illegal activities. This type of corruption usually involves falsification of documents and large losses for the national treasury.

In contrast to the collusive corruption of asking for illicit services, there is another type of corruption, often called “speed money” or “facilitation fee”. Customs officers can speed up clearance, which itself is licit behavior, but only upon the receipt of illegal “speed money” from importers. In a culture where the tradition of baksheesh or gift for service rendered is embedded, some observers used to defend the practice on cultural grounds. It usually involves petty amounts of money and one may think of it as a tip or an overtime wage. However, the possibility of attaining such “rents” for their services has in many cases led government officials to extort payments for the

⁴⁵ Transparency International, Global Corruption Barometer 2003. People surveyed in 47 countries voiced the need for addressing corruption in various institutions with their choice of priority: political parties (29.7%) Courts (13.7%), Police (11.5%), Medical services (8.4%), Education system (7.5%), Business licensing (7.0%), Tax revenue (5.2%), Customs (4.2%)

⁴⁶ Robert Klitgaard. Controlling Corruption. California, University of California Press (1988) at 19.

providing of any service at all. This quickly evolves into a required payments and then into extortionary fees, resulting in inefficiency.⁴⁷ While this phenomenon has been widely observed, in customs it usually takes the form of coercive actions of intentionally delaying clearance procedures to make sure there is a collection of “speed money”. This coercive corruption is sometimes said to constitute structural distribution of additional salary within customs offices concerned, as the salary level is often extremely low.⁴⁸ The direct costs to government revenue of these practices seem to be modest, and it was reported that some governments even tolerated them to compensate the low wage of customs officers. In fact, the UN Convention against Corruption adopted in 2003 did not consider this type of corruption within its scope. However, these practices discourage trade and investment, and thereby reduce the chance of economic development and potential of government revenue in the long run. Some traders are willing to participate in corrupt practices because of the short-term benefits they receive, even though they know that corruption is ultimately detrimental to everyone involved. The International Chamber of Commerce reviewed its Rules of Conduct to Combat Extortion and Bribery and adopted a new version in October 2005 which includes a strong rejection of facilitation payments.⁴⁹ While the new rules clearly prohibit facilitation payments, they provide for exceptions on a limited and provisional basis, after appropriate management review. It would be difficult to deal with this type of corrupt practice, unless national governments clearly prohibit them in national legislation, supported by the highest level of political and management leaders.

(2) Cause of corruption in customs

In the past, the international community did not pay much attention to the problem of corruption for various reasons, including political sensitivities, cultural difference, or economic reality. However, the donor community has increasingly identified corruption as one of the main obstacles to economic and social development in a country. In parallel manner, the customs community has also recognised that corruption can destroy the legitimacy of a customs administration and severely limit its capacity to effectively accomplish its missions. It was in the late 1980s to early 90’s that customs administrators began to openly acknowledge the scale of problem and face

⁴⁷ *Id.* at 41-42.

⁴⁸ The distribution of the totality of collected facilitation fees is sometimes called “Friday envelop” that contains informal additional salary.

⁴⁹ ICC “Rules of Conduct to Combat Extortion and Bribery” (Oct 2005). *Available at* www.iccwbo.org (last visited 9 June 2007).

up to its negative consequences. Prior to that time the subject was regarded as an essentially taboo subject because it was considered a matter of national pride. However, as corruption is increasingly recognised as one of main obstacles to economic and social development, the customs community started to discuss the cause and effects of integrity issue in an open and honest way.

The second Global Forum on Fighting Corruption and Safeguarding Integrity held in The Hague in 2001 was a first attempt at the ministerial level to review the integrity situation in customs in a thorough way. Its Customs Workshop found that the integrity situation in customs reflected that of its parental society and should not be seen in isolation from the rest of the society. Customs is a microcosm of society. Customs is often singled out when integrity is at issue partly because of the high visibility of customs activities. The Workshop identified the following factors that make customs administrations particularly vulnerable to corruption:

Customs administrations are also responsible for overseeing a wide range of complex government regulations, while many unethical people try to bypass these regulations and taxes in order to save either themselves or someone else time and money. Customs also has an unavoidably close working relationship with the trade community and in order to discharge its function effectively, customs has within its purview a wide array of discretionary powers. Also, customs officers often have extremely low salaries compared to what people are able to acquire through illegal activities. Lastly, customs administrations are vulnerable because of their frequent need to work in highly decentralized locations, which make direct supervision and accountability difficult to maintain.⁵⁰

(3) PSI solution

The PSI solution was promoted to improve integrity in customs, in addition to its main function in revenue enhancement. Based on the principal agent model, Low

⁵⁰ The Global Forum on Fighting Corruption and Safeguarding Integrity II in The Hague, 31 May 2001 Annex to the Final Declaration: Report of Workshops, 13, *Available at* <http://web.worldbank.org/WBSITE/EXTERNAL/WBI/EXTWBIGOVANTCOR/0,,contentMDK:20944440~menuPK:1962490~pagePK:64168445~piPK:64168309~theSitePK:1740530,00.html> (last visited 6 June 2007).

gives a theoretical framework on the behavior of two-part corruption, involving taxpayers and tax collectors, as follows.⁵¹ First, taxpayers are corrupt if they try to defraud the revenue through false declarations of their liabilities, with or without collusion from tax collectors. Second, customs officers are corrupt when they use conferred monopoly power to collude with taxpayers in defrauding the treasury. Subject to a risk (likelihood) of being detected, a taxpayer will seek to defraud the tax authorities if the gains from doing so exceed the penalties payable upon detection. Government policy can influence the level of tax to be paid through the setting of the tariff level, the level of penalties and the likelihood of detection. PSI-generated information could raise the likelihood of detecting fraud and thus deter tax evasion by corrupt importers. In the efforts to reduce the likelihood of detection, a taxpayer might try to collude with a tax collector at the cost of bribes. Subject to a risk of being detected by higher or external authority, a tax collector has an incentive to engage in dishonest behavior if the expected return is greater than the loss in income upon detection. Government therefore has a vital interest in making the loss of employment costly by providing an adequate level of pay to tax collectors.

Low suggests that PSI-generated information automatically reduces almost to zero the scope for fraudulent behavior by taxpayers unless they can act collusively with collectors. Therefore, he strongly urges that the PSI system be complemented by ex-post reconciliation reports to high-level officers that monitor the behavior of tax collectors. However, he questions the political will of user government for improving customs service in the absence of a reconciliation process in the vast majority of PSI contracts. Even if ex-post reconciliation was included in the contract in Tanzania in 1992, it was not used for monitoring the performance of revenue collection.⁵² This illustration raises the need for enhancing the capacity of the state to maximize benefits from contracting out.

Low is also conscious of another limitation of the PSI solution, that it would be only valid for customs fraud cases within a relatively short timeframe. “Speed money” type bribes are outside of the scope of the PSI solution.⁵³

⁵¹ Patrick Low. Preshipment Inspection Service. World Bank Discussion Paper 278. Washington D.C. World Bank (1995) at 101-05.

⁵² *Id.* at 109.

⁵³ *Id.* at 100.

Naturally the usefulness of the PSI program presupposes that there is no collusion between a PSI employee in the export country and an exporter who could represent the interest of an importer. The pay level of PSI companies for their employees is normally set high enough to discourage them from engaging in collusive conduct. While there always remains criticisms that PSI employees were not necessarily corruption-free, the incidents are supposed to be relatively low due to better working conditions. The question associated with the integrity of the PSI service has been raised on the occasion of awarding contracts. Corrupt payments to win major contracts and concessions are generally the preserve of large businesses and high-level officials.⁵⁴ Critics argue that, as a result of intense competition among PSI companies to contact with governments, key members of governments reportedly struck personally lucrative deals with some PSI firms.⁵⁵ By way of example, a 1998 New York Times article said that two Swiss PSI companies, SGS and COTECNA had allegedly paid kickback of 9% (\$11.8 million) to secure PSI contracts from Pakistan to the then Prime Minister Benazir Bhutto and her husband.⁵⁶ The case remains in a court in Switzerland.

(4) Arusha Declaration

Preserving integrity is considered an integral part of institution building. In response to the growing awareness of the need to improve integrity in customs, the WCO began work on a comprehensive integrity and anti-corruption strategy. The work resulted in the Arusha Declaration on Integrity in Customs,⁵⁷ adopted by the WCO in 1993, and further revised in 2003. The core recommendation of the Arusha Declaration is the reduction of opportunities for malpractice through the simplification of customs procedures and adequate human resource management. In more detail, the Arusha Declaration recommends a regulatory framework where tariff level should be moderate, exemptions should be minimized, and customs procedures should be simplified, and based on international standards, including the WCO Revised Kyoto Convention on customs procedures. Another set of recommendations are related to

⁵⁴ Susan Rose-Ackerman. Corruption and Government. Cambridge, Cambridge University Press (1999) at 27.

⁵⁵ François Corfiat. "Are PSI Services Useful in Improving Revenue Collection and Promoting Customs Integrity – Viewpoint of IMF". In Rege. Vinod, (ed.), Preshipment Inspection: Past Experiences and Future Directions, London, Commonwealth Secretariat (2001) at 71.

⁵⁶ "Bhutto Clan Leaves Trail of Corruption in Pakistan" New York Times (9 January 1998).

⁵⁷ Available on WCO web site <www.wcoomd.org> (last visited 6 June 2007).

human resource management, including providing sufficient salary, adequate training, and implementing an appropriate performance appraisal. It also underlines the importance of staff selection and promotion procedures which are free of bias and favoritism and based on the principle of merit.

While the Arusha Declaration puts an emphasis on the implementation of sound human resource management, including among other things the provision of a sufficient salary, other remuneration and conditions to ensure customs personnel are able to maintain a decent standard of living, it calls upon customs administrations to understand a comprehensive approach to customs reform. Rijckeghem and Weder suggest that their cross-country regressions support the presumption that an active wage policy can help to fight against corruption, although a large increase in wages is required to eradicate corruption solely by raising wages if it is not accompanied by policies that increase transparency and accountability in the civil service or in society as a whole.⁵⁸ Even if pay level is low, Chand and Moene suggest that the payment of a properly designed bonus could be a powerful incentive, provided that corruption at higher levels is reduced.⁵⁹ Besley and McLaren emphasize the importance of monitoring by suggesting that in a society with low level of bureaucratic loyalty and weak monitoring, the government may optimize tax collection through “capitulation wages” below what an individual can earn elsewhere, supplemented by bribery.⁶⁰ In general, incentive payments based on performance will be more likely to be successful if additional efforts by public servants actually increase effectiveness, if employees are not too risk-averse. It is effective and results are easy to measure, if officials have sufficient discretion to respond to incentives.⁶¹

In this regard, the revenue authority model was promoted partly in the efforts to improve the management of human resources with its greater autonomous power. This aspect includes insulation from political interference, stable management, recruitment, remuneration and training. In fact, lending institutions and donors

⁵⁸ Caroline Van Rijckeghem. & Beatrice Weder. Bureaucratic Corruption and the Rate of Temptation: Do Wages in the Civil Services Affect Corruption, and by How Much? 65 *Journal of Development Economics* 307-31 (2001).

⁵⁹ Sheftal, K. Chand & Karl, O. Moene. Controlling Fiscal Corruption. 27 *World Development* 1129-40 (1999).

⁶⁰ Timothy Besley. & John McLaren. Taxes and Bribery: the Role of wage Incentives. 103 *The Economic Journal* 119-41 (1993).

⁶¹ Robert Klitgaard. Cleaning up and Invigorate the Civil Service. 17 *Public Administration and Development* 498 (1997)

actively promoted the establishment of revenue authorities as a solution to poor performance of a revenue agency in the 1990's. Recognizing that the quality and honesty of a tax administration official is largely determined by the environment within which the human element is placed, Jenkins provided the theoretical framework of a revenue authority as a semi-autonomous agency responsible for its own recruitment, training and salary structure.⁶² He considers that keeping revenue administration as a part of the general civil service has resulted in situations where salaries are low, qualifications of staff poor, hiring subject to political patronage, and opportunities for rent-seeking plentiful. This observation led to the suggestion to set up revenue agencies that operated autonomously from the state as a commercial entity like central banks. The revenue authority model was followed by as many as 40 countries, especially in East Africa and Latin America. In the subsequent reviews by other researchers, some positive results were reported, including a successful case in the KRA with staff improvements and reduced corruption.⁶³ On the other hand, the basic problem to this model is the enclave nature of many past efforts where pay raises and incentive bonuses work for a while but then begin to undermine morale elsewhere in government, causing resentment and backlash.⁶⁴

With more experience and insight gained, a recent IMF report compares the achievements of revenue authorities with the traditional line directorate of the ministry of finance.⁶⁵ It concludes that revenue authority should not be viewed as a panacea. In fact, it observes that revenue administration reform and modernization is being pursued with equal comprehensiveness and rigor in many non revenue authority countries as it is in many revenue authority countries, including in the area of human resource management. The IMF maintains that the experience of many developing countries shows that after an encouraging start, the performance of revenue authorities has frequently been undermined by political changes. It concludes that it is now widely recognized among observers that while the organizational reform may provide a fresh start in initiating reform, it does not necessarily improve the effectiveness of

⁶² Glenn P. Jenkins "Modernization of Tax Administrations: Revenue Boards and Privatization as Instrument for Change" *Bulletin for International Fiscal Documentation* (February 1994) at 76.

⁶³ Robert Taliencio. Designing Performance: The Semi-Autonomous Revenue Authority Model in Africa and Latin America. World Bank Policy Research Working paper 3423 (2004) at 16-17.

⁶⁴ Rose-Ackerman (1999), *supra* note 54, at 184.

⁶⁵ Maureen Kidd. & William Crandall. "Revenue authorities: Issues and problems in evaluating their success" IMF Working Paper, WR/06/240 (October 2006).

customs administration. This IMF observation shows that organizational change alone does not always guarantee an expected solution. After all, sustainable political commitment to customs reform is the key to addressing the administrative weaknesses, irrespective of the organizational model.

In a similar vein, the afore-mentioned Customs Workshop in the second Global Forum on Fighting Corruption and Safeguarding Integrity in 2001 recommended that for corruption to be eliminated from customs, governments need to focus their attention and resources on the comprehensive reform and modernization of their customs administrations.⁶⁶ It maintains that without such a holistic approach, attempts to eliminate corruption are likely to fail in the long run. With regard to the PSI solution, the Customs Workshop specifies that “quick-fix solutions such as employing preshipment inspection companies to undertake some aspect of customs may appear attractive, but experience shows that they rarely achieve their goals. Typically, these companies further erode the capacity of the organizations they are intended to assist.” This finding urged the states to rethink the use of PSI program and focus on capacity building in customs. Realizing this trend, the inspection industry moved towards more supportive roles in the assistance of capacity building of customs administrations.

⁶⁶ The Global Forum on Fighting Corruption and Safeguarding Integrity II (2001), *supra* note 50, at 16.

Chapter 4 Literature review on PSI, theoretical background of Neo-liberal Privatization and New Public Management, and analytical framework of case studies

This Chapter has three sections. The section 1 reviews the existing literature on PSI by largely probing the evolution of thinking and view of international financial institutions, which have often given advices on the PSI to developing countries. At an early stage the IMF and the World Bank frequently endorsed the use of PSI, but they have gradually found that the PSI program had not met the initial expectation. As a result their view on the use of PSI has become more cautious than before. The section 2 outlines the analytical discussion on Neo-liberal and New Public Management, because it has influenced the thinking of the promoters of PSI. It summarizes that the “early” neo-liberalism placed a naïve faith in the reduction of government and unregulated privatization, and this had a significant influence on development activities in the developing world. This unbridled use of private entities in the public sector led to a realization that there was a real need for re-regulation at national and international levels, accompanied by a shift from government to governance through standard setting and monitoring. The neo-liberal agenda gave rise to “new public management” which was replicated in developing countries, and included an expansion of public-private partnerships. This evolution will provide the theoretical background of the negotiations of the WTO Agreement on PSI and the subsequent efforts to re-regulate the PSI industry, studied in Chapter 5. Following this development, there has been a renewed focus on the state capacity and the role of the private sector in supporting the state functions in developing countries rather than replacing them. This is the theoretical background of the evolution of PSI program towards offering new service, reviewed in Chapter 6. Then, this Chapter explains the analytical framework offered by the existing literature on the elements determining success or failure of PSI. It first defines the goal of PSI as revenue enhancement and capacity building, and then argues that to achieve this goal the existing literature identifies the three factors the PSI program aims to influence: namely compliance; administrative capacity; and corruption. Using this analytical framework of the three factors as part of selection criteria, the paper selects four countries from the PSI users to conduct case studies, contained in Chapters 7 to 10. This analytical framework will be used in Chapter 11 to check the comparative summary of case studies.

1. Critical review of the existing literature

(1) Original literature – World Bank Study in 1995

The IMF and the World Bank played an important role in promoting PSI services for customs purposes in the 1980's and early 1990's. The World Bank confirmed in 1997 at the WTO Working Party on PSI that although it had no institution-wide policies dealing with the use of PSI, it had conditions regarding the use or administration of PSI in terms of its loans to a wide range of countries, including structural adjustment loans in the 1990's. The primary focus of its staff was on the implications of the trade regime for economic efficiency, rather than on revenue-raising objectives. On the other hand, the IMF confirmed that the use of PSI services is a positive element in customs rehabilitation in countries where customs revenue performance was weak and/or corruption in customs administration was thought to be a major problem.⁶⁷ Reflecting the growing interest of the lending institutions whether the emerging PSI service could be a solution to the malfunction of customs, there was an intense demand for research and practical guidance for the use of PSI. The World Bank discussion paper on PSI by Patrick Low (1995) responded to this expectation. It explains the work of PSI, discussing how it can be used, but also considering its drawbacks.⁶⁸ This is the first comprehensive study on PSI service and it provides a basis for the debate on this topic.

Low explains that originally, the utilization of Pre-shipment Inspection by the lending institutions originated as a means of controlling procurement financed by their lending, whereby the inspection companies assure that the loan is properly used for the purchase of goods by debtor countries. Since the mission of the inspection industry is reporting information to its principal, the same business model was used by some Central Banks in developing countries to fight against the capital flight since the 1960's. With the liberalization of exchange control, the inspection companies promoted their service for another market in revenue area since the middle of 1980's. Some economists at the IMF and the World Bank were attracted by the idea of using the reporting function of inspection companies in gathering price information at the supplier's premise. This private sector service was expected to enhance revenue and

⁶⁷ WTO Report of the Working Party on Preshipment Inspection to the General Council, G/L/214, (December 1997) at 2.

⁶⁸ Low (1995), *supra* note 51, at Executive Summary.

streamline import regime by replacing the cumbersome procedures by customs authorities in the importing country, which were often perceived as riddled with corruption.

While Low's study points out possible pitfalls in using a PSI service, his dim view of customs reform, and his suggestions for improving PSI functionality at times provides encouragement for the active use of a PSI service. This was the era when privatization or contracting out was promoted as providing efficiency through competition by the neo-liberal school. Government officials were often seen as motivated by personal interests under the influence of public choice or rent-seeking theory. As the lending institutions and their consultants were disseminating the neo-liberal thinking to developing countries, the PSI program was viewed as a typical contracting out method to reduce the role of the government and to increase the role of the private sector in order to gain efficiency and expertise. Low recommends that when national customs administration is weak or corrupt and its reform will take a long time, PSI has a role to play to protect revenues as an interim solution. As proof, he points out that most of the reported revenue savings brought in by PSI companies more than covers the cost of the service. In spite of this impressive report of revenue savings, Low qualifies his direct assessment of the performance of PSI companies. Assessment is difficult because the introduction of the PSI regime often occurred at the same time as the introduction of trade reform measures. Furthermore, Low maintains that those savings cannot be taken at face value, since the savings are only realized if governments properly apply PSI program recommended by lending institutions. In terms of the role of PSI as deterrent to corruption, Low suggests that PSI-generated information will significantly diminish the scope for fraudulent behavior by taxpayers if it is used effectively by customs officers.

Based on this observation, he recommends several conditions in order to make the PSI service work effectively. First, he stresses the importance of monitoring by ex-post reconciliation between the value reported by PSI and actual customs valuation to ensure that the customs service properly uses PSI reports. Second, he suggests the necessity of keeping the competitive supply of services by developing appropriate contract design. Third, he urges the user government to institute a credible customs reform and modernization program in which PSI could also play a role. These recommendations reflect the efforts of the World Bank understand and improve the

functioning of the PSI service by advising the state to monitor and re-regulate the use of the industry.

(2) Monitoring, competition and customs reform

The above recommendations are typical of prescriptions by the lending institutions, and they merit a closer look. The first recommendation to strengthen monitoring proved to be more difficult in practice than in theory, especially because of it is a resource-demanding requirement to actually match each PSI document with the corresponding import and prove duty payment. A higher authority in the government that supervises the customs administration is the natural candidate to carry out this ex-post reconciliation. However, many countries were not ready for this task when the WTO Working Party reviewed the PSI operation in 1997. In sharing its national experience, Kenya stated that it had yet to successfully complete a full reconciliation on PSI data, but would be well along the way to establishing the infrastructure to complete this essential part of the PSI program.⁶⁹ This difficulty has persisted throughout the PSI regime in Kenya before it was terminated in 2005. In the absence of state action, Low suggests that PSI companies could extend their function to undertake ex-post reconciliation, rather than leaving it in the hands of customs. However, its full effect might not be necessarily guaranteed unless the government takes leadership in making the best use of PSI service. Citing the experience of Tanzania where the government failed to monitor customs function, regardless of the availability of ex-post reconciliation by the PSI companies, Low emphasizes the vital factor of political will in ensuring a better use of the contracting out of customs.⁷⁰ Under strong political support, ex-post reconciliation could be a useful tool for the top-management of customs administration to monitor the conduct of customs officers, and employees of inspection companies.

The second recommendation of appropriate contract design was considered essential in promoting competition among PSI providers with the belief that it will contribute to a more efficient, responsive and better priced service. This topic stimulated lively discussions on desirable contract designs to promote competition, and whether more than one company should be employed simultaneously or whether only

⁶⁹ WTO National Experience with the Agreement on PSI – Communication from Kenya, G/PSI/WP/W/14 (20 October 1997) at 3.

⁷⁰ Low (1995), *supra* note 51, at 109.

one company should be hired with competitive tendering for a limited duration. If multiple companies are employed, there are two main types of split contracts: on a geographical basis and on an importer choice basis. The debate in this regard focused on which type of contract would promote greater competition. Low argues in favor of unitary contracts of short duration (two or three years), combined with appropriate procurement procedures, rather than split contracts.⁷¹ Among the 32 countries with PSI contracts in 2006, there were four countries using importer choice contracts, and only one country using a geographical split contract. Bangladesh was the only country that maintained a split contract on a geographical basis after having experienced perverse competition for looser control in the late 1990's. The majority of contracts are unitary ones with open biddings for renewal. In fact, according to the WTO notes, only half of the PSI user countries in 2008 retained contracts with the same companies as in 2001.⁷² At the outset, just one company SGS could offer a comprehensive service, but later other inspection companies entered the market, although their numbers have been limited, because of the need for maintaining infrastructure in a wide range of exporting countries. The competition has therefore been limited to a small number of inspection companies, which continue to outbid each other and take over from each other. In earlier days, their offered services and fees were similar and the WTO Working Party members felt that there was not much competition among PSI companies in 1998, because of the market structure.⁷³ The World Bank also pointed out that fees are remarkably similar in parallel competition arrangements in 1999.⁷⁴ The competition has intensified with more diversified services offered since 2000, including the introduction of selectivity. Preserving integrity in contract awarding procedures is often pointed out as a potential vulnerability when contracting out as a legitimate policy tool. It has often been alleged that PSI contracts involve illegal financial arrangements to induce policy decision-makers in favor of specific companies. The Pakistani case of two inspection companies that allegedly concluded contracts against bribes to top politicians has damaged the legitimacy of the inspection industry.

⁷¹ Low (1995), *supra* note 51, at 96.

⁷² WTO Committee on Customs Valuation. Preshipment Inspection, Note from the Secretariat. March 2000, G/VAL/W63, & See WTO (2008), *supra* note 219.

⁷³ WTO, Working Party on Preshipment Inspection – Minutes of the Meeting of 11 November 1998 G/PSI/WR/M/8 (23 December 1998) at 4.

⁷⁴ Mark Dutz. "The Use and Usefulness of PSI Services," in (ed.) Vinod Rege Preshipment Inspection: Past Experiences and Future Directions London, Commonwealth Secretariat (2001) at 62.

The third recommendation of using PSI in conjunction with or as part of customs reform requires user governments to invest more in customs for its modernization. The ministry of finance often fails to involve customs in negotiating contracts to ensure the cooperation between customs and the PSI company and thereby clearly setting a phase-out strategy of PSI service. It is not an inherent role of PSI companies to promote its phase-out or customs reform, since capacity building in customs is obviously the responsibility of user governments. However, after engaging in PSI service to deal with the problem of revenue collection, the Ministry of Finance often loses its pressing interest in customs reform. The high cost of hiring the PSI service reportedly hinders governments in securing additional resources for customs reform. Although PSI contracts often include training of customs officers, user-governments consider that the transfer of skills has been limited. The contribution of inspection companies to customs reform has been the most contested area within the international financial institutions. The World Bank observed in 1998 that a number of countries had been using PSI for over ten years without concomitant customs modernization and that there appeared to be a fundamental conflict of interest for a PSI company to be appointed as the primary external agent responsible for customs modernization.⁷⁵ The IMF shared this view, stating that under many of the existing PSI programs, the customs administration had not regained its traditional role within a reasonable period of time.⁷⁶

As Noel Johnson (2000) suggests, if institutional capacity is weak, then the use of the PSI program would be difficult.⁷⁷ For example, credible commitment to ex-post reconciliation by both customs and the Ministry of Finance might not exist in a country with weak institutions in the foreseeable future. Starting from this assumption, Johnson wonders whether the target of PSI user countries could be better limited to “intermediate” countries where there already exists a relative well-functioning customs service, as the PSI program is expected to contribute to capacity building of customs. In fact, among the 11 countries that terminated the PSI service over the past 6 years, 5 were upper or lower middle income countries.

⁷⁵ *Id.* at 62

⁷⁶ Corformat (2001), *supra* note 55, at 73.

⁷⁷ Noel Johnson, Committing to Civil Service Reform: The Performance of Pre-shipment Inspection under Different Institution Regimes, The World Bank (2000). Available on the World Bank website.

(3) More recent literature

Since the Low report there have been several studies based on the experiences gained by development agencies. Although these works generally recognize the usefulness of the PSI program in theory when certain conditions are met, they differ considerably in its practical implications. There has been a gradual shift of views in the lending institutions towards more cautious ones over the usefulness of the PSI service.

The Commonwealth Secretariat organized a technical seminar in cooperation with the WTO in June 1998 to review the use and usefulness of the PSI service. Both the World Bank and the IMF contributed to the technical seminar by expressing their cautious view on PSI, based on their recent experience. On the other hand, the WCO expressed its outright opposition to the use of PSI, due to the frequent lack of cooperation between customs officers and PSI staff.⁷⁸ Mark Dutz of World Bank expressed the divided view in his institution: "The Bank has been generally supportive of the government's decisions to adopt PSI service as an interim measure. However, PSI certainly does not have universal support at the Bank. While some managers were positively inclined, others were overtly hostile. The dispersion in views among World Bank staff may reflect different policy priorities (a shorter term revenue collection focus versus a longer-term emphasis on trade facilitation and productivity growth) as well as a lack of empirical clarity regarding impact."⁷⁹ Francois Corformat of IMF echoes the caution by affirming that "There are mixed views about the effectiveness of PSI programs in improving the customs revenue and curbing corruption. The Fund (Fiscal Affairs Department) therefore considers that the use of PSI service was not always advisable but may be considered on a case-by-case basis."⁸⁰ In terms of improvement in revenue collection, Corformat maintains that it is virtually impossible to determine the weight to be assigned to the individual elements of PSI programs, based on the IMF experience. After sharing the experiences of lending institutions and other stakeholders, the Commonwealth technical seminar in 1998 adopted two recommendations. The first one calls on a further study on how competition could be ensured both while selecting the companies and once they are selected, in allocating business among these companies. The second one calls for provision of technical

⁷⁸ Vinod Rege (ed.) Preshipment Inspection: Past Experiences and Future Directions London, Commonwealth Secretariat (2001) at 21.

⁷⁹ Dutz (2001), *supra* note 74, at 57.

⁸⁰ Corformat (2001), *supra* note 55, at 72.

assistance to countries using the service of PSI companies for developing a database on price and for improving their capacity to use modern information technology based methods.⁸¹

The technical seminar was held when the review of the WTO Agreement on PSI was going on in the WTO forum. Consequently it also illustrates the perception of many of user governments at that time (not that of customs administrations) that they were defensive of the right to use PSI for fear of revenue loss. They did not wish that the WTO Working Party on PSI to add further obligations to them or unduly restrict freedom of the companies.⁸²

The WTO Working Party on PSI was established in 1996 and produced reports in 1997 and 1999, containing the review of PSI performance, complaints procedures and a series of recommendations. The final report of 1999 contains the following four recommendations that its members were able to agree upon:

- Ensure conformity of contracts with the PSI Agreement;
- Examine incorporating selectivity and risk assessment in the contracts;
- Audit of PSI should be on non-discrimination basis; and
- Provide technical assistance.⁸³

There was a critical view on the performance of PSI from practitioners in the field. For example, former Deputy Commissioner of US Customs Lane stated that “While there may be some immediate advantages to the use of PSI services, there are also a number of significant disadvantages, which may include high costs, long-term dependency, and implementation of outdated customs methodologies. There is little or no incentive or capacity for these [PSI] companies to transfer state-of-the-art customs practices to the customs administrations.”⁸⁴

The recent IMF publication, “Changing Customs” includes a chapter on “The role of the private Sector in Customs Administration.”⁸⁵ After presenting the views of

⁸¹ R. Gold. Forward, in (ed.) Vinod Rege Preshipment Inspection: Past Experiences and Future Directions London, Commonwealth Secretariat (2001) at VII-VIII.

⁸² Vinod Rege (ed.) (2001) *supra* note 74, at 27.

⁸³ WTO Report of the Working Party on Preshipment Inspection G/L/300, 25 March 1999

⁸⁴ Michael H. Lane. Customs Modernization and the International Trade Superhighway. Westport, Connecticut, Quorum Books (1998) at 9.

⁸⁵ James T. Walsh, “The role of the Private Sector in Customs Administration” in (ed.)

proponents and detractors of PSI, the author concludes that experience shows that contracting out services to the private sector is not a miracle cure for treating inefficient or corrupt customs services. He maintains that in certain circumstances it can provide the authorities with time to bring about institutional improvement, if it is implemented as part of a comprehensive and well-designed customs reform program. The IMF expert urges governments that there should be a careful analysis of the costs and benefits before any such program is implemented, in order to establish that the money being invested will bring a reasonable return. He suggests the following seven elements for successful use of PSI:

- Incorporation of PSI into a comprehensive customs reform;
- Inclusion of modernization of procedures and organizational issues in customs reform;
- Clear specification of contracts
- Cooperation between customs and PSI staff;
- Establishment of a steering committee of PSI;
- Setting up of end dates of PSI service; and
- Evaluation of customs reform.

The World Bank has also echoed the cautious view of the IMF in the chapter “Customs Valuation in Developing Countries and the World Trade Organization Valuation Rules,” contained in the recent publication of the “Customs Modernization Handbook.”⁸⁶ The author suggests that based on proponents and critics of PSI and experiences, many educated observers point out that under certain circumstances, including the cases where government services have been devastated by conflicts and no expertise was available, the utility of PSI services for a short duration was seen to be an advantage for some developing countries. He concludes that the objective of PSI should be specified as facilitating valuation work during its initial reform stages when capacity is being built up to carry out the valuation function. He makes a similar set of recommendations for the successful use of PSI with the IMF. However, he advises that if and when PSI services are used, care needs to be exercised in order to make good use of these services to complement a sustainable customs modernization. Otherwise, the World Bank expert cautions that governments should reconsider recourse to such services.

Michael Keen Changing Customs Washington D.C. IMF (2003) at 167-77.

⁸⁶ Wulf (2005), *supra* note 29, at 193-216.

The number of empirical studies on PSI is limited. Studies on customs modernization of PSI user countries usually refer to PSI to a limited extent, but it is rare to see empirical studies focused on the use of PSI. The Commonwealth Secretariat files a series of short descriptions of experiences of PSI in 15 countries by participants to the technical seminar in 1998, but they are mostly statements of government policy for respective country.⁸⁷ On the revenue implication of PSI, Graham Glenday analyzes economically the effect of the PSI program on revenue in Kenya from 1989 to 1999.⁸⁸ On the implication of contract design, Faizul Latif Chowdhury gives an insight on what happened in Bangladesh when it introduced the first PSI program in 1993.⁸⁹

(4) Critical review of the literature and the contribution of this thesis

The PSI program has been experimented and spread by managers and consultants of lending institutions as part of loan conditions. Therefore the majority of the existing literature was written by them on the assumption that the PSI program could be a useful tool to address the weakness of customs institutions in developing countries. Behind their thinking there was rising Neo-liberal thinking of the 1980's that the private sector could serve as a driving force in bringing market efficiency to the public sector. Moreover, they regarded the WTO Agreement on PSI, which was mainly negotiated in the late 1980's, as endorsing the use of PSI. However, these mainstream consultants belong to lending institutions which have been also receptive of the development in the theory of New Public Management in developed countries. This theory recognized the need for re-regulation of the private sector in the public domain, moving away from the unabashed confidence in the superiority of the private sector to the public one. They tried to apply this new theory in developing countries to rectify the malfunction and other discovered flaws of the PSI service. When the WTO reviewed the implementation of its Agreement on PSI in the late 1990's, there were many suggestions in improving the regulation on the use of the private sector in the customs field. These recommendations were further developed and later incorporated

⁸⁷ Rege (2001) *supra* note 78

⁸⁸ Graham Glenday. "Trade Liberalization and Customs Revenue: Does Trade Liberalization Lead to Lower Customs Revenues? The Case of Kenya." Development Discussion Paper No. 764, Harvard Institute for International Development (June 2004).

⁸⁹ Faizul Latif Chowdhury. "Corrupt Bureaucracy and Privatization of Tax Enforcement in Bangladesh." Pathak Shamabesh, Dhaka, Bangladesh. (2006)

into the IMF and the World Bank publications for customs modernization and reform published respectively in 2003 and 2005. However, as the Commonwealth Secretariat documented in the outcome of its technical seminar in 1998, there was a wide-spread perception or fear among the policy-makers of developing countries that the re-regulation of PSI might restrain the activities of PSI entities, thus resulting in the loss of revenue. This perception was reflected in the WTO report in 1999 whose recommendations were mitigated ones.

On the other hand, there were minority views of some practitioners in the field that the lack of cooperation between customs officers and PSI employees, which did not allow the PSI program to meet the initial expectations, might be caused by the PSI mechanism itself. This view resulted in the attempt by the inspection industry to move into public-private partnership, again recommended by the New Public Management theory. At the same time, it led to the review of the very applicability of this theory in developing countries. This explains the resurging interest in state capacity building.

It is therefore necessary to follow the development of Neo-liberalism and the New Public Management and its application in the customs field, in conjunction with the evolution of WTO Agreement on PSI, in order to fully understand this development of the mainstream literature. The next section of this chapter will provide the theoretical discussion on Neo-liberalism and New Public Management. Using this analytical scheme, Chapter 5 will explain its application to the customs field in connection with the implication of the WTO Agreement on PSI. Then, Chapter 6 will examine the alternative solutions to PSI, as well as the new service offered by inspection industry in pursuit of public-private partnership.

On the other hand, the mainstream literature talks about the factors leading to successful use of PSI and makes recommendations to achieve this goal. However, their usage of “success” is ambiguous. Usually it is judged against revenue enhancement, trade facilitation, anti-corruption measures and capacity building of customs administrations. However, the existing literature failed to show any “success” story in a verifiable way. The record on revenue performance was given by inspection industry and it has been rare to see the government statistics to endorse the contribution of PSI service in this regard. In terms of trade facilitation, the effect of PSI on speeding up the clearance procedures remains anecdotal and is difficult to

separate from that of administrative reform. With regard to anti-corruption measures, the PSI program was expected to deter falsification of documents and abuse of containers for smuggling purpose, thus reducing the opportunity of fraudulent traders to approach customs officers to bribe. However, its effect is limited as smuggling or bribing opportunities are not limited to the area covered by the PSI program and fraudulent traders exploit the way to circumvent the inspection industry. The contribution to capacity building is more problematic as the PSI service tends to stay longer than expected, either by advice of lending institutions who estimate that sufficient progress in capacity building has not been made or by user governments who explain that they fear the potential loss of revenue. It is often difficult to see the justification of prolonged employment of the PSI program from the capacity building angle. However, the fact that it was consultants of lending institutions that recommended the use of PSI program makes it difficult to give impartial assessment in the existing literature.

In sum, the mainstream literature lacks the clear indicator or goal upon which to measure success of the program. While it admits the shortage of empirical studies, this fact does not provide an insight on practical difficulty in using PSI and the way to exit from it, which should be regarded as an element to judge the successful completion of PSI program. This deficiency seems to partly derive from insufficient consideration on the nature of inspection industry as business entity and the applicability of PSI solution to states with limited capacity. In addition, the existing literature tends to underestimate the effect of the implementation of the WTO Agreement on Customs Valuation on the usage of PSI service. Therefore this paper tries to fill the gap caused by the shortage of empirical studies by providing the analytical framework that identifies the factors that determine success or failure of PSI, described in the section 3 of this chapter. This will be complementary to the model of thinking that lending institution has followed in employing PSI, as described in the section 2 of this Chapter. Based on the analytical guidance, contained in the section 3, this paper presents case studies on four countries, contained in Chapter 7 -10 and summarized in Chapter 11 for its policy implications.

2. Neo-liberalism and New Public Management theory

(1) Neo-liberalism and the reduction of government

In the post-war period international institutions were designed to prevent a repetition of catastrophic experience of the Great Depression of 1930's and the subsequent inter-state geopolitical rivalry through "tariff wars", one of root causes of the World War II. Free trade in goods was encouraged under a system of fixed exchange rates, supported by the GATT, the IMF and the World Bank. Each country was allowed autonomy in domestic economic affairs. State intervention was considered indispensable to achieving full employment, economic development, and improving the welfare of citizens by fixing "market failures" through "Keynesian" fiscal and monetary policies. This "embedded liberalism" in the social community formed the basis of the longest and most equitable economic expansion of the 1950's and 1960's within industrialized countries.⁹⁰ However, liberalism was unsustainable. There was mounting pressures from sizable capital flows on the system of fixed exchange rates leading to "stagnation", unemployment and inflation throughout the 1970's. The earlier attempt to strengthen state control and regulation, epitomized by the "We are all Keynesians now," remark of US President Richard Nixon in 1971, was viewed as ineffective in dealing with stagnation and huge budget deficits in the mid 1970's. In Europe social democracy and corporate approaches also failed to rectify economic problems. The Soviet Union and other communist models, once the great hope of the intellectual classes, had not proved to be successful by that time either.⁹¹

It is under these circumstances that a change in the climate of opinion towards neo-liberalism took place, giving markets a greater role and governments a smaller role. Milton Friedman, an influential economist promoted this line of thinking, and maintained that this change was produced by experience, not by theory or philosophy. It was because the role of government was exploding under the influence of the welfare state and Keynesian views.⁹²

⁹⁰ John Gerard Ruggie. "International Regime, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order." 36 *International Organization* 393-98 (1982).

⁹¹ David Harvey. A Brief History of Neoliberalism. Oxford: Oxford University Press (2005) at 12-13

⁹² Milton Friedman. Capitalism and Freedom, 40th Anniversary Edition, Chicago and London, The University of Chicago Press (2002) at Preface, xiii.

Neo-liberalism was originally nurtured in the Mont Pelerin Society, established by Friedrich von Hayek in 1947. It advocated free market economic policies and the political value of individual freedom. It gained fame in the 1970's in the US and the UK as an alternative policy framework to remedy the economic troubles of stagflation, balance of payment problems, the size of public expenditure, and the cost of providing public services.⁹³ The emergence of conservative governments in the UK and the US consolidated neo-liberalism in the 1980's. Margaret Thatcher, on assuming the British premiership in 1979, abandoned Keynesian policies and adopted a monetarist "supply-side" solution, along with the privatization of public enterprises. Ronald Reagan, on assuming the US presidency in 1980, also endorsed monetarist policies, favoring those of Paul Volcker, the chairman of the US Federal Reserve System, and unfolded the neo-liberal policies of deregulation, tax cuts, budget cuts, and attacks trade unions.⁹⁴ As a result, neo-liberalism was accepted as a new economic orthodoxy with an emphasis on exposing public sector activities to market pressures so as to improve efficiency and effectiveness.

One important background note on the rise of neo-liberalism was the negative view it had of state action and political processes, or the perception of "government failure" as opposed to "market failure". This view was supported by public choice theory that had been spearheaded by James Buchanan since the 1960's. It analyzes the behavior of people acting politically, whether voters, politicians and bureaucrats, by applying to political action the assumption that individuals in the market place behave in a self-interested way.⁹⁵ This assumption of self-interested motivation for those working in the governments that Buchanan called "Politics without Romanticism" also generated another insight – that of "rent-seeking" behavior. Under this heading government restrictions upon economic activity are seen as giving rise to demands for rents in a variety of forms. People will often compete for the rents, sometimes legally and in other instances illegally, such as by paying bribes.⁹⁶

⁹³ R. C. Mascarenhas. "Building an enterprise culture in the public sector: Reforms in Australia, New Zealand and Great Britain." 53 *Public Administration Review* 319-28 (1993),.

⁹⁴ Harvey, *supra* note 91 at 24-25.

⁹⁵ James M. Buchanan. "Public Choice "Politics without Romanticism." 19 *Policy* 16 (2003)

⁹⁶ Anne O. Krueger. "The Political Economy of the Rent-seeking Society." 64 *American Economic Review*, 291 (1974).

The economists who belonged to this neo-classic school expressed their concern about “opportunism” in public administration – that is self-serving (rent-seeking), even deceitful and dishonest, behavior by bureaucrats, their clients and politicians created either because environmental uncertainty made contracts incomplete or because “principals” cannot effectively monitor their “agents”, who do not have identical interests and who have information that is not accessible to everyone.⁹⁷ Indeed, the problem of rent-seeking is particularly apt to arise in domains where the government has decided to regulate economic activity. Those appointed to protect the public interest are apt to become “captured” by the very industry that they regulate. As this occurs, the regulatory process becomes the chief vehicle by which the monopoly extracts rents from other economic actors.⁹⁸ This conceptualization of the state as a self-maximizing interest group strongly contrasted with the previous perception that saw the state as a group of technocrats who would make and implement decisions in the long-term public interest or for overall social welfare.⁹⁹

On the other hand, neo-classical economists argued that the market is an extraordinary mechanism that allows any society to organize the production and distribution of goods and service efficiently by virtue of competition. The “invisible hand” of the marketplace coordinates the activities of innumerable “rational”, egoistic and self-oriented economic actors in such a way that the social good is assured.¹⁰⁰ In fact, there was a belief in the Thatcher government in the 1980’s that the private sector was inherently better than the public. This was not a theoretical position about markets; rather it was a preference for business people over public servants.¹⁰¹

As right-wing, conservative governments came to power in the UK and the US in the late 1970’s, emphasis and strategy within the IMF and the World Bank shifted toward a more market-oriented philosophy. This shift was to have a profound influence on the package of reforms that developing countries in crisis were to undertake in the 1980’s and 1990’s under the auspices of these two multilateral

⁹⁷ John Dixon, Alexandar Kouzmin. & Nada Korac-Kakabadse. “Managerialism – something old, something borrowed, little new.” 11 *International Journal of Public Sector Management*, 168 (1998).

⁹⁸ George F. DeMartino. Global Economy, Global Justice. London and New York, Routledge, (2000) at 73.

⁹⁹ Ziya Önis. “The Limits of Neoliberalism: Towards a Reformulation on Development Theory.”. 24 *Journal of Economic Issues* 101 (1993).

¹⁰⁰ DeMartino, *supra* note 98 at 4-5.

¹⁰¹ Norman Flynn. Public Sector Management. fifth edition, London, Sage (2007) at 28.

institutions.¹⁰² This package of reforms was later dubbed the “Washington Consensus”, as it was shared among three Washington-based institutions – the IMF, the World Bank and the US Treasury Department.

The Washington Consensus was originally developed to overcome the financial crisis in Latin America in the 1980’s and 90’s. When Mexico was driven into default in 1982-84, the Regan administration found a way to use the powers of the US Treasury and the IMF to resolve the difficulty by rolling over the debt, in return for neo-liberal reforms.¹⁰³ A “structural adjustment” package of reforms typically includes fiscal discipline, privatization of state enterprises, and trade liberalization. Joseph Stiglitz points out that while the IMF was originally founded on the belief that markets often worked badly, a dramatic change occurs in the 1980’s through the championing of “free market fundamentalism.” This followed the purge of Keynesian influence and the arrival of a chief economist, specializing in “rent-seeking” and seeing government as the problem.¹⁰⁴

Going first to the IMF and then to the World Bank meant accepting stabilization and structural adjustment packages with their accompanying conditionalities in order to obtain credits and debt rescheduling from creditor banks and multilateral lending institutions. Policy-based lending by multilateral institutions became an instrument to encourage crisis states to embark on reforms that were pro-market and pro-private sector.¹⁰⁵ Reducing the size and role of government by allowing the private sector a greater share of economic activity was hailed as a new solution to problems in developing countries during the 1980’s.¹⁰⁶

¹⁰² George A. Larbi. The New Public Management Approach and Crisis States. United Nations Research Institute for Social Development Discussion Paper No. 112 (1999) at 6.

¹⁰³ Harvey *supra* note 91 at 29.

¹⁰⁴ Joseph Stiglitz. Globalization and its Discontent. USA and Great Britain, Penguin Books (2002) at 13.

¹⁰⁵ Larbi *supra* note 102 at 6-7.

¹⁰⁶ Willem Van Der Geest (ed.) Negotiating Structural Adjustment in Africa, New York, UNDP (1994) at 4.

(2). Re-regulation issue; from government to governance and emergence of new public management

As Renate Mayntz summarizes, the disappointment of the belief in the state as an effective political center of society gave rise to the search for alternative modes of guiding socio-economic development. One of these alternatives was deregulation and privatization, turning from the state to market. But a series of political crises and economic set-backs discredited the bright promises of the market as driving force of progress. Increasingly attention has been given to a second alternative to the hierarchical state – the move from government to governance. This means that state authorities cooperate with private corporate actors and that private organizations are involved in public policy-making.¹⁰⁷

Likewise, Ziya Önis claims that the neo-liberal approach to development draws excessive attention to competition and free markets as a source of industrial success. The degree of competition per se provides an insufficient basis for explaining highly successful cases of industrial development. Based on his comparative study on the development state model in East Asia, the democratic corporate model in small European countries, and small firms and flexible specialization model in Italy, he concludes that a high degree of exposure to competitive pressure constitutes only one aspect or precondition of industrial success. He maintains that the common feature of all three successful development models is a mix of external competition with exposure to international market forces and cooperation among key economic actors in the domestic sphere. Furthermore, another common characteristic is active state intervention designed to sustain a desirable mix of involvement by key non-state institutions.¹⁰⁸

Neo-liberalization therefore has increased reliance on public-private partnerships. The shift from government (state power on its own) to governance (a broader configuration of state and key elements in civil society) has been a marked characteristic of neoliberalism. In this respect, the state typically produces legislation and regulatory frameworks that advantage corporations. Forms of surveillance and

¹⁰⁷ Renate Mayntz, From Government to Governance: political Steering in Modern Societies. Summer Academy on IPR: Wuerzburg (2003) at 2. Available at www.ioew.de/governance/english/veranstaltungen/Summer_Academies/SuA2Mayntz.pdf (last visited 6 June 2007).

¹⁰⁸ Önis, *supra* note 99 at 97.

policing multiply.¹⁰⁹ Private organizations fulfill regulatory functions that are ultimately in the public interest. This societal self-regulation takes on the form of a negotiation between the representatives of different interests. It is a form of “private government.” This means that private organizations impose norms and standards on their members that not only serve their own needs, but also satisfies public interests. They are often established by the express delegation of functions from the state to private organizations, and they are monitored by the state.¹¹⁰

Since international competitiveness is a central public policy concern for nations aggressively pursuing economic development strategies, states are increasingly subjected to neoliberal governance pressures from the world political economy. Tore Fougner has demonstrated that globalization allows firms and capital great latitude in selecting among business locations. Fougner argues that the meaning of “international competitiveness” has been transformed from the ability of national firms to compete with firms from other countries, to the ability of nations to attract or retain global enterprises.¹¹¹

International competitiveness in terms of “attractiveness”, as compared to traditional “aggressiveness” in export and (outward) foreign direct investment,¹¹² presupposes (re)locational freedom on the part of capital. The granting and securing of such freedoms are integral to ongoing efforts of neo-liberal global governance. There is fairly clear acknowledgement that the realization of a global marketplace is dependent not only on active dismantling of state barriers to the free flow of goods, services and capital, but also on putting in place basic political, legal and institutional frameworks through which a market is constituted and policed.¹¹³

The reintroduction of regulation to achieve this goal has become important at both domestic and global levels. Domestic regulation is no longer insulated from the international agenda and is under strong pressure to conform to the international norm. As the IMF describes, economic globalization limits the scope for countries to pursue

¹⁰⁹ Harvey, *supra* note 91 at 76-77.

¹¹⁰ Mayntz, *supra* note 107 at 4.

¹¹¹ Tore Fougner. “The State, International Competitiveness and Neoliberal Globalization : Is There a future beyond « the Competition state » ?” 12 *Review of International Studies* 174-175 (2006).

¹¹² Stéphane Garelli. “Competitiveness of Nations : The Fundamentals.” *The World Competitive Yearbook 2000*, Lausanne IMD (2000).

¹¹³ Fougner *supra* note 111 at 176-77.

policies that are incompatible with medium-term financial stability. The discipline of global product and financial markets applies not only to policy-makers (via financial market pressures), but also to the private sector. This makes it more difficult to sustain unwarranted wage increases and mark-ups. Markets eventually exert their own discipline, and may do so in such a way that the time period for adjustment may be brutally shortened.¹¹⁴ In fact, locational competition stimulates convergence as state authorities increasingly compare their policies and institutions to those of competitors, and seek to adopt the “best practice” or the “best offer” in order to remain in the locational game.¹¹⁵

At the global level, as Stephen Gill suggests, international agreements on trade and investment can be understood as reinforcing national and regional policies to restructure the state and thus lock-in neo-liberal reforms politically, thereby securing the rights of investors and property holders. Some of these multilateral reforms are being institutionalized in the WTO. Other companion arrangements involve the adoption of standards and product rules that adjust the competitive terrain of the global economic system. This process is partly arbitrated by non-state actors including institutional investors and private credit-rating agencies, such as Moody’s, that provide assessments for fund managers and speculators in the capital and exchange markets.¹¹⁶ Likewise, there are an abundance of actors that work to (re)constitute state actions, increase government flexibility, and manipulate market actors on a continuous basis. These actors include IGOs like the OECD, the UNCTAD and development banks, whose policy guidelines are often framed in terms of the need of states to compete for mobile capital, or institutions like the IMD and the WEF, whose competitiveness indexes function as benchmarks with respect to the relative ability of states to attract capital.¹¹⁷

Under the neo-liberal agenda, the role and institutional character of the state and of the public sector have been under pressure to be more market-oriented and private sector-oriented. These practices and techniques of administrative reform have conventionally been labeled the “new public management” (NPM) or new “managerialism”, although their commentators and advocates stress different aspects of

¹¹⁴ International Monetary Fund. World Economic Outlook 1997. Washington DC, (1997) at 70-71.

¹¹⁵ Fougner *supra* note 111 at 182.

¹¹⁶ Stephen Gille. “European Governance and New Constitutionalism: Economic and Monetary Union and Alternative to Disciplinary Neoliberalism in Europe” 3 *New Political Economy*: 12 (1998).

¹¹⁷ Fougner *supra* note 111 at 181.

the doctrine; for example, professional management, performance measurement, output controls, decentralization, competition, private-sector management style and greater discipline in resource use, as noted by Christopher Hood.¹¹⁸ NPM was presented as providing a future for smaller, fast-moving service delivery organizations that would be kept lean by the pressure of competition and that would need to be user-responsive and outcome-oriented in order to survive.¹¹⁹ Successive UK governments, for example, have implemented a variety of arrangements to manage and control public services. Key elements of the reform include services that remained mostly in public ownership and are provided by public employees to motivate and control direct employees, as well as parts of the public sector that were contracted out to the private sector, privatized completely, or managed through some form of partnership between the public and private sectors.¹²⁰

New forms of governance involving partnerships between public and private actors [organizational hybrids] play an important part in the implementation of collective action. The blurring of boundaries between political jurisdiction and markets provides for real concern.¹²¹ In the 1999 report “Modernizing Government”, the UK Labor Government announced that the last [Conservative] Government adopted an approach to competition in the public sector which favored privatization for its own sake and damaged the morale and ethos of the public service. Although it delivered savings and efficiencies, this was sometimes at the expense of quality. The Labor Government maintained that it would not make the mistake of rigidly preferring private sector delivery over public sector delivery, or vice versa. Instead, it would develop an approach based on the straightforward idea of the “best supplier,” maintaining an open mind about which supplier, public, private or partnership, can offer the best deal.¹²²

While the Labor language of reform is less dogmatic than that of the previous Conservative governments, they share the ambition of correcting the apparent failings of public sector organization through applying private sector principles of efficiency,

¹¹⁸ Christopher Hood. “A Public Management for All Seasons.” 69 *Public Administration*, 3-6 (1991).

¹¹⁹ Larbi *supra* note 102 at 16.

¹²⁰ Flynn, *supra* note 101 at 120.

¹²¹ Ole Johan Andersen. “Public-Private Partnerships : Organizational Hybrids as Channels for Local Mobilization and Participation ?” 27 *Scandinavian Political Studies* 1-2 (2004).

¹²² Cabinet Office. Modernizing Government. Cm 4310. London (1999) at 41.

competition and entrepreneurship.¹²³ Since capital investment by the public sector was chronically neglected and big backlogs of maintenance projects had accumulated, the UK governments used the Private Finance Initiative, later called Public-Private Partnership (PPP) to restore investment without increasing capital spending. PPP was a leasing arrangement: a private company or a consortium of companies would undertake to finance and build an asset, and in some cases run the asset and provide the service associated with it, in exchange for an annual fee under a long-term contractual arrangement.

(3) “Hybrid” forms of governance and the state capacity

Under the PPP arrangements, a variety of organizational hybrids were introduced in OECD countries. Initially tested in the UK, Norman Flynn estimates that the success of PPP contracts there has been mixed.¹²⁴ Graeme Hodge also observes that the PPP experience to date has been mixed in Australia. In terms of transferring risks to private parties through PPP arrangements, he points out that in one infrastructure case study [the City Link road project in Melbourne], while commercial risks were largely well managed, governance risks were not. There was a lack of publicly available prior-evaluation, no comparison between completing this task in the public or private sectors and limited protection of consumers.¹²⁵ David Harvey is also critical. He indicates that in many instances, particularly at the municipal level, the state assumes much of the risk in the PPP while the private sector takes most of the profit.¹²⁶

Grimshaw et al. found from their two case studies in the UK [the IT partnership and the National Health Service Trust Private Finance Initiative] that the contention that the public sector benefited from downward cost pressures of market competition over the duration of a contract were seriously flawed. They recall a lesson learned in the 1980's and 90's under the Conservative government that while greater use of the market and contracts may bring about an apparent reduction in costs, these

¹²³ Damian Grimshaw, Steve Vincent & Hugh Willmott. “Going Privately: Partnership and Outsourcing in UK Public Services.” 60 *Public Administration* 478 (2002).

¹²⁴ Flynn, *supra* note 101 at 252-67.

¹²⁵ Graeme A. Hodge. “The Risky Business of Public-Private Partnerships.” 63 *Australian Journal of Public Administration* 37-49 (2004).

¹²⁶ Harvey, *supra* note 91 at 77.

savings are often offset by less readily quantifiable costs such as damage to the quality of services provision, or an erosion of the public sector ethos among workers. Moreover, the public sector partner tended to underestimate the time and resources needed to negotiate and manage the terms and conditions of the partnership contract. This put the private sector partner in the driving seat and enabled it to exploit its greater experience in working to contract and winning favorable terms.¹²⁷ Likewise, the EU regulatory strategy of delegating responsibility for setting the rules governing market access to standard-setting bodies (firms) did not produce expected outcomes. While delegation enabled firms to become dominant players in the policy-making process, firms were unable to overcome collective action problems that plagued harmonization process.¹²⁸

In spite of the skepticism and limitations that have become apparent over the years, the UN World Public Sector Report estimates that the NPM and “reinvention” produced some “value added” in several parts of the world. The value added area included developing countries. The NPM questioned many traditional practices and modified old ways. The approach has been direct, internationally practical and cost-effective with a focus on economic efficiency and effectiveness. These values have been widely diffused due to the simplicity of approach and message.¹²⁹ Hood argues that the bureaucratic reform agenda since the 1970’s is favorable when seen in the context of other administrative “mega-trends”. They include the attempt to slow down or reverse government growth, the shift towards privatization and away from government, the development of information technology and the development of a more international agenda.¹³⁰ The process is continuous. One UK minister in charge of changing NHS remarked that “Reform is not a process that starts one day and ends the next: it must go on and on and on”.¹³¹

This experience in the UK and other Western countries was globalized by international financial institutions, and international management consultants. State agencies contemplating institutional change or strengthening, often enlist the services

¹²⁷ Grimshaw, *supra* note 123 at 499 & 479.

¹²⁸ Michael Egan. “Regulatory Strategies, Delegation and European Market Integration.” 5 *Journal of European Public Policy* 485 (1998).

¹²⁹ United Nations. World Public Sector Report – Globalization and the State. New York (2001) at 54

¹³⁰ Hood, *supra* note 118 at 3.

¹³¹ Alan Milburn. “Speech of 22 May 2002,” as quoted in Flynn, *supra* note 101 at 117.

of expert consultants to clarify available options and recommend courses of action.¹³² It was often in the context of IMF/World Bank-supported structural adjustment programs (SAPs) that developing countries tried to replicate the experience of industrial countries. In fact, the implementation of SAPs put pressure on most states in crisis to embark on complementary public administration and management reforms. As part of the efforts to reconfigure state-market relations in order to give more prominence to markets and the private sector, contracting out the provision of public services was advocated by lending institutions in the 1980's and 90's.¹³³ The rationale for contracting out is to stimulate competition between service-providing agencies in the belief that competition will promote cost-saving, efficiency, flexibility, and responsiveness in the delivery of services.¹³⁴ It also reduces the areas of discretionary behavior for individuals and groups in an organization and imposes discipline that results in improved performance.¹³⁵ There has been a noticeable emergence of new non-governmental providers of public services, and public-private partnership in service provision is becoming common in a wide range of activities.

While the earlier wave of reforms in the 1980's responded to the problems created by "too much state" [large size of public sector employment and the wage bill], they paid too little attention to the problems of "too little state" [weak capacity of government and its administrative apparatus].¹³⁶ Marylee Grindle notes that only after a decade of experimentation with reducing government did economic reformers become explicit about the importance of strengthening government by infusing it with the capacity not only to manage macroeconomic policy, but also to regulate market behavior.¹³⁷ However, there are severe questions over the ability of many developing country governments to ensure the quality of service providers in the private sector through regulation, managing contracts and monitoring. The World Bank, for example,

¹³² Phillippa Bevan. "Consultants and Change: What makes the Match Succeed?" 23 *Insights* (1997). Available at <http://www.id21.org/insights/insights23/insights-iss23-art05.html> (last visited 6 June 2007).

¹³³ Larbi *supra* note 102 at 27.

¹³⁴ E.S. Savas A Typology of Market-Type Mechanism PUMA Market-Type Mechanisms Series, OECD, Paris (1989) as quoted in Larbi *supra* note 102 at 27

¹³⁵ A. Israel Institutional Development : Incentives to Performance. Baltimore and London, John Hopkins University Press (1987) as quoted in Larbi *supra* note 102 at 27.

¹³⁶ Larbi *supra* note 102 at 8.

¹³⁷ M. S. Grindle. "The good government imperative : Human resource organizations and institutions." In M.S. Grindle (ed.) Getting Good Government, Harvard University Press (1997) at 3-28.

recommended in its World Development Report 1993 on health issues to improve management of government health services through contracting out of services and to promote diversity and competition among suppliers in delivering clinical services and providing drugs and other inputs.¹³⁸

However, Anne Mills expresses a concern that such policy prescriptions are being advanced in the almost total lack of knowledge on whether these solutions are likely to be any better than the systems they are intended to replace. She maintains that it is not clear that it will be any easier to develop government capacity to negotiate and monitor contracts and regulate the private sector, than to improve the efficiency of public providers.¹³⁹ Indeed, while contracting out and other market-type mechanisms have become popular in public services in developing countries, many observers express a cautious view. Larbi notes that there are institutional constraints and capacity issues in this regard. First, the availability of efficient market and private sector capacity to undertake public services is not always guaranteed. Second, the prevalence of patronage systems and other institutional weaknesses may undermine the benefits of contracting out, which may be more prone to corruption and mismanagement. Third, there is no guarantee that the private sector under a competitive contracting will perform better than the public sector. Fourth, contracting out could put the core business of organization at risk, resulting in loss of control and over-dependency on the outside agency. Fifth, fear could arise among in-house staff that they may lose their positions and competence, resulting in de-motivation and resistance to change. Larbi maintains that these five constraints on capacity to contract out and manage contracts lead to more explicit capacity issues of management responsibility, including effective regulatory, monitoring and evaluation capacity, supported by analytical capacity of comparative data about public and private performance.¹⁴⁰

More fundamentally, the exportability of “convergent” administrative reform developments, hitherto hailed by some international organizations has been increasingly questioned, even in developed countries. Based on recent comparative

¹³⁸ World Bank. World Development Report 1993: Investing in Health. Washington DC (1993) at 6.

¹³⁹ Anne Mills. Improving the Efficiency of Public Sector Health Services in Developing Countries : Bureaucratic vs. Market Approaches. PHP Departmental Publication, 17, London, London School of Hygiene and Tropical Medicine (1995) at 30.

¹⁴⁰ Larbi *supra* note 102 at 29-31.

studies in developed countries, Rune Premfors notes that these observations contain a criticism of the OECD's earlier stress on similarity and convergence with regard to administrative reform in the OECD countries, and that they frequently include observations on causal factors behind this variable pattern, typically stressing the importance of historical and structural determinants.¹⁴¹ He concludes that contrary to the earlier assumptions made by the OECD, there is no evidence of a linear homogeneous trend in public sector development, and that the plurality of regulatory regimes makes it impossible to derive and justify ranking of these regimes or to presuppose that any specific regime (particularly the Anglo-Saxon model) is necessarily more efficient than others.

The UN World Public Sector Report notes belatedly that some organizations and experts, including the OECD and the World Bank, gravitate towards the view quoted by Premfors.¹⁴² In fact, in the World Development Report 1997 the World Bank warns that what is feasible in New Zealand [the most dramatic example of using market mechanism] may be unworkable in many developing countries. It advises that greater use of market mechanisms must be accompanied by effective regulatory capacity, which is not always easy to achieve for developing countries, where both markets and state capacities are weak.¹⁴³ The OECD advocates a cautious approach by transitional countries in embracing the ideas of the NPM in its newsletter for public management practitioners in Central and Eastern Europe in 2001.¹⁴⁴

As Larbi notes, the critical review of the NPM approach and concern about social cohesion, equity and stability have revived interest in the active role of the state in some aspects of development. He observes that the 1997 World Development Report, entitled as "The State in a Changing World" marks a significant shift of the World Bank in thinking about the state and its role in development: the need to factor the state back into development.¹⁴⁵ In fact, the World Bank suggests a two-part strategy to make every state a more credible, effective partner in its country's development: (1) matching the state's role to its capability, as many states try to do too much with few resources;

¹⁴¹ Rune Premfors. "Reshaping the Democratic State : Swedish Experience in a Comparative Perspective." 76 *Public Administration* 145 (1998).

¹⁴² UN (2001), *supra* note 129 at 55.

¹⁴³ World Bank. World Development Report 1997: The State in a Changing World. Washington DC (1997) at 87-88.

¹⁴⁴ Allen, Richard. Budgetary Reform in Central and Eastern Europe. OECD/SIGMA, *Public Management Forum* (2001).

¹⁴⁵ Larbi *supra* note 1022 at 35.

and (2) raising state capability by reinvigorating public institutions.¹⁴⁶ Likewise, the UN World Public Sector Report refocuses on the need to strengthen the administrative capacity of the state (Chapter IV), fostering capacity building.¹⁴⁷ The emphasis on capacity building of states has become the major concern in the international trade and development community. It is reflected in the Doha Ministerial Declaration in 2001 that launched the WTO Doha “Development” Agenda.

(4) The use of the private sector in customs

The above logic of development in administrative reform since the “early” days of neo-liberal thinking is expected to elucidate changing modes in the employment of the private sector in a range of government services. This paper examines if this course of development could explain the transformation of the use of the private sector in customs, which has been evolving since the 1980’s.

The private inspection industry originally started its business as an agent for buyers to inspect the conformity of merchandises with contracts between sellers and buyers at the time of shipping since the 19th Century. It developed an international network and infrastructure for inspection to cover overseas trade. Its clientele was gradually expanded from buyers to include public and private procurement bodies and central banks. Under the exchange control system, several central banks in developing countries employed the PSI service (FOREX-type) to deter capital flight since the 1960’s. The inspection industry carried out examination of documents and inspection of goods to detect over-invoicing as means of evading exchange control from the 1960’s. Meanwhile, the debt crisis in Latin America in the early 1980’s brought about change in economic policy by embracing a more liberal trade and exchange regime to promote economic development through export-oriented industrialization in Latin American countries.

This neo-liberal strategy was encouraged by the IMF and the World Bank, which became a standard policy recommendation that was disseminated in developing countries in other regions. Improvement of the fiscal situation and the trade regime were among the key objectives of the World Bank, and recommendations included

¹⁴⁶ World Bank, *supra* note 143 at 3.

¹⁴⁷ UN (2001), *supra* note 129 at 100-103.

measures to enhance the function of customs administrations, when they have been encountering difficulties in acquiring accurate price information from importers to assess the value of goods. Under the neo-liberal impulse of privatization, some staff of lending institutions embraced the idea of using the private sector to fix the problem of asymmetry of information by providing price information in the exporting countries and transferring valuation skills to customs. This contracting out of the core function of customs to the private sector, called customs-type PSI, was often included in a package of lending conditions under the structural adjustment. In 1997 the World Bank stated that it included the use of PSI in the terms of its loan, including structural adjustment loans in the 1990's (before 1997) to nine countries, while noting that the primary focus of its staff is on the implications of the trade regime for economic efficiency, rather than on revenue-raising objectives.¹⁴⁸ In this way, The Breton Woods institutions often played an important role "in persuading or requiring borrowing governments to use PSI services".¹⁴⁹ This suited the inspection companies, as they were faced with the loss of FOREX-type PSI market contracts as a result of the growing number of countries that were abolishing exchange control in the 1980's. Thus they found a niche in substituting for customs administrations in the first wave of neo-liberal privatization, mandated by international financial institutions.

Since the introduction of the FOREX-type PSI in the 1960's there had been a growing concern over its performance in that it caused huge delays and additional cost in trade procedures. These mounting complaints were taken up during the Uruguay Round negotiations in the late 1980's and the negotiators developed a set of international rules to regulate the industry, resulting in the WTO Agreement on Preshipment Inspection.

However, along with the transformation of the PSI contracts from FOREX-type to customs-type, the WTO Agreement on PSI was used to legitimize the emerging customs-type PSI service, rather than serving the original objective of regulating the FOREX-type PSI and addressing the concern of exporters. It was after the entry into force of the WTO Agreement on PSI in 1995 that the WTO Working Party was established in 1996 and reviewed the provisions, implementation and operation of

¹⁴⁸ World Trade Organization. Report of the Working Party on Preshipment Inspection to the General Council, G/L/214 (1997).

¹⁴⁹ Low. (1995) *supra* note 51 at xi.

the Agreement on PSI and produced recommendations in 1997 and 1999 that were specifically focused on customs-type PSI.

The inspection companies established their own code of conduct through the International Federation of Inspection Agencies (IFIA). These regulations and self-regulations have substantially alleviated the grievance from exporters while there remained caution regarding its implication on revenue performance, transfer of skills and cost.

Parallel to this regulatory evolution, a new set of rules on customs valuation was also negotiated during the Uruguay Round. While the main focus of customs administrations in developing countries has been a revenue concern, the trading community often pointed out that a lengthy valuation process was a non-tariff barrier, causing delays and additional costs for clearance of the goods. In response, the international rules on customs valuation were developed during the Tokyo Round (1973-79) and the following Uruguay Round (1986-1993) negotiations, incorporated into the WTO Agreement on Customs Valuation that entered into force in 1995. There is a grace period of five years for implementation by developing countries. The application of the new WTO valuation system by the vast majority of developing countries in 2000 had an effect on customs operations and the nature of the PSI service itself.

Under evolving rules and regulations, PSI-user countries developed a variety of public-private partnerships. Governments expected better revenue collection, customs officers expected transfer of skills, and importers expected less cumbersome clearance procedures, each of which provided a breeding ground for corruption between customs officers and traders. In this connection, negotiating and managing the contract was considered important, as in many contracting out cases. It was also viewed to be essential to ensure the cooperation of customs officers to make this partnership function. However, some constraints were observed, which were common to all public-private partnerships. First, the availability of an efficient and competitive market was limited, as the entry to market was difficult due to the necessity to establish an international network. In fact, there are only four dominant companies that offer customs-type PSI service. While there is fierce competition among the four, they retain the upper hand in negotiating contracts, thanks to their expertise in the exporting countries. Second, the prevalence of a patronage system undermined the benefits of contracting out and reportedly offered an opportunity for corruption in the

highest political level. Third, there was no guarantee that the private sector would perform better than the public sector. In fact, the performance of PSI in revenue enhancement was mixed. Moreover, there was little transfer of skills and technology to customs officers, because of the inherent conflict of interest for the inspection industry. Fourth, there was the risk of over-dependency of the inspection industry. After engaging an inspection company, governments often lost attention on customs reform, which resulted in prolonged reliance on the private sector assuming customs functions. Governments frequently renewed PSI contracts and made little investment in modernizing customs. Fifth, it was often difficult to get the cooperation of customs officers with the PSI program, because they normally perceived the PSI service as a substitute for the customs administrations, resulting in the loss of positions and competence. Insufficient communication from higher authorities and little involvement of customs in contract negotiation often caused a lack of motivation for the effective use of PSI service in customs.

There has been an attempt to overcome these constraints by involving customs in contract negotiations, explicitly including the transfer of skills and technology in contract design, and promoting competition by adequate procurement. Furthermore, governments realized the need to put in place a withdrawal strategy for PSI service by enhancing customs capability. The implementation of the new WTO valuation system in 2000 gave impetus to this reform. Several countries terminated the PSI contracts and regained traditional responsibilities. The inspection industry also changed its business model and began offering more supporting services. They included the development of valuation databases, and acquisition and maintenance of non-intrusive inspection equipment. At the global level, the capacity building of customs administrations became a priority in the WTO Doha Development Agenda.

3. Analytical framework offered by the existing literature

(1) Factors determining success and failure of PSI

Drawing upon the review of the existing literature in the section one of this chapter, this section studies the possible analytical framework in selecting the countries for case study and in appraising the performance of the PSI service in these countries.

Across the literature the factors of success or/and failure, identified based on the observations of authors, could be summarized as follows¹⁵⁰:

- Degree of cooperation between customs officials and PSI staff;
- Management and communication;
- Capacity of customs service;
- Support from trade/local business group;
- Political leadership;
- Contract design; and
- Degree of corruption.

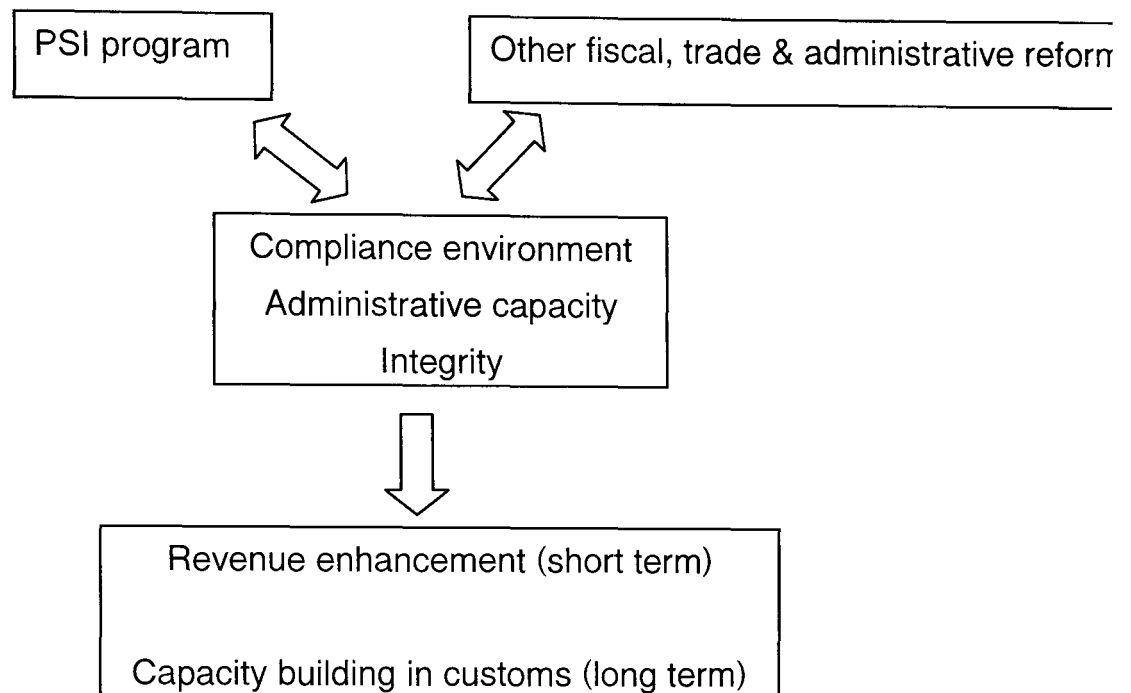
In considering the factors for success or/and failure, it is indispensable to define the “success” of PSI program. As viewed in the previous chapter, the PSI program was introduced to enhance revenue in the short term. The mainstream literature tends to emphasize on the increase in revenue as the main goal. However, it is also expected to contribute to capacity building in customs administrations in the long term to make the revenue enhancement sustainable.¹⁵¹ Otherwise, hiring the private sector will create overdependence of customs on the service provider. ¹⁵²

Subsequently, it is useful to categorize the afore-mentioned factors as the three means of the PSI program to achieve the dual goals of revenue enhancement and capacity building. They could be summarized as improvement in the three areas, namely poor compliance environment, administrative capacity, and integrity situation. Naturally, its performance is also affected by these challenges that form the surrounding environment for the inspection companies. The chart below shows this relationship.

¹⁵⁰ For example, De Wulf (2005), *supra* note 29, at 212-214, Walsh (2003), *supra* note 85, at 173-175

¹⁵¹ Dutz (2001) *supra* note 74, at 57.

¹⁵² Johnson (2001) *supra* note 77



The performance of PSI is not always easy to measure separately from other reform measures, as PSI is often adopted as part of a bigger revenue enhancement measures.¹⁵³ As a matter of fact, the PSI contribution to revenue usually remains for a short period. Fraudulent traders can adjust their invoices and other documents to the valuation method of inspection industry to avoid lengthy price verification process. Or they can find other ways for smuggling methods or circumventing ways, such as abuse of transit, to avoid the payment of duties.¹⁵⁴ Therefore the period in which the PSI program can improve revenue level tends to be short. Another feature that warrants the attention is the limit of the PSI program caused by the inherent conduct of the private inspection companies. They are profit-seeking entities and show little interest in capacity building in customs for obvious reason of potentially losing market in the future.¹⁵⁵ In order to remain competitive in the market, they are eager to show their contribution to revenue enhancement. However, they are not keen to transfer skills and expertise to customs officers, who would not be ready to cooperate with inspection companies. Hiring PSI companies for a long duration is clearly against the longer-term interest of state to improve capabilities of customs, which is one of the most

¹⁵³ Corfmat (2001) *supra* note 55, at 72.

¹⁵⁴ Walsh (2003), *supra* note 85, at 173.

¹⁵⁵ Dutz (2001) *supra* note 74, at 62.

important institutions nationally to provide fiscal foundation of a state, because inspection companies have no interest in capacity building as it will result in losing their market.¹⁵⁶ User governments often neglect the investment in customs after hiring the private sector to substitute the traditional customs. Moreover, the fact that it was consultants of lending institutions that recommended the use of PSI program makes it difficult to give impartial assessment in the existing literature. This feature complicates causal reasoning, as stakeholders' views are prone to represent their vested interests. Therefore, it would be essential to reconstruct the narratives of stakeholders in conducting case study and use the analytical framework offered by the existing literature as checklist for the case study.

(2) Model for analysis

This study summarizes the existing literature as assuming that the PSI program tends to be successful when the following factors are present:

- Create the environment in which compliance level of traders is improved, including:
 - ✓ Reduction in tariff level to liberalize trade;
 - ✓ Effective use of PSI advice by customs officers, supported by the prospect of early exit from the PSI regime;
 - ✓ Strengthen border control to prevent circumvention such as smuggling and diversion of goods from bonded warehouse; and
 - ✓ Enhance communication and education to raise compliance level with taxpayers, such as record keeping;

- Undertake improvement in administrative capacity in customs by using effectively the PSI program, including:
 - ✓ Strong leadership of customs management at top and middle levels, supported by political leaders, that positions the PSI regime as a short-term measure to support customs reform;
 - ✓ Computerization of customs procedures to enable customs to introduce intelligence-based selectivity supported by appropriate database;

¹⁵⁶ Lane (1998) *supra* note 84, at 9

- ✓ Involvement of customs in drafting the PSI contracts in clearly delineating the role of customs and PSI company and defining the exit strategy as part of customs reform program;
- ✓ Encourage cooperation between customs officers and PSI employee to ensure transfer of skill and competence from the latter to the former; and
- Address integrity issue including:
 - ✓ Provide incentives for customs officers to enable them to support customs reform and cooperation with the PSI company, including offering acceptable working conditions;

On the other hand, this study summarizes that the existing literature assumes that the PSI program tends not to be successful where the following factors are present:

- Lack of appropriate compliance environment, including:
 - ✓ Shortage of accompanying reform in trade and fiscal policy to liberalize trade while ensuring appropriate level of compliance;
 - ✓ Deficiency in communication between customs and trade and the resultant mutual mistrust;
- Lack of accompanying customs reform, including:
 - ✓ Unstable leadership in customs management and the resultant lack of vision for customs modernization;
 - ✓ Mutual mistrust between customs officers and PSI employees that hinder cooperation and transfer of technology;
 - ✓ Unsatisfactory measurement of performance of the PSI program and customs reform;
- Lack of measures addressing integrity issue, including:
 - ✓ Ignorance of government in addressing integrity issue.

Which factors are more important for the success of the PSI program? Since all the factors are inter-related, it appears that the existing literature finds rather difficult to identify relative weight of the factors. As a matter of fact, almost all the recent literature emphasizes that success needs a comprehensive set of enabling factors

for the both goals.¹⁵⁷ This model will be used for selecting the countries for case studies and for comparing the case studies in the Chapter 11.

¹⁵⁷ For example, De Wulf (2005), *supra* note 29, at 216, Walsh (2003), *supra* note 85, at 177

Chapter 5 Evolution of PSI service and regulation by the WTO Agreement

This Chapter reviews the evolution of the PSI industry and how it has been shaped by the rules and standards developed in the WTO. It shows that the original PSI program for foreign exchange control caused concern among exporters in the 1970's and 1980's, resulting in the WTO Agreement on PSI in 1994. However, trade liberalization since the 1980's transformed the PSI program for customs revenue purposes, and the paper argues that the WTO Agreement was used to legitimize the new service. The PSI service underwent yet another transformation through the application of the WTO Agreement on Customs Valuation, which considerably diminished the usefulness of PSI. Over the years there emerged the realization of the need for re-regulation of PSI program to make it more supportive to the user governments and a strengthened state in managing contracting out of functions. This awareness has resulted in WTO recommendations that in turn, prompted the PSI program to develop a variety of new public-private partnerships. In reality, the number of the traditional PSI contracts has reduced dramatically from 41 in 2001 to 14 in 2008 while the number of contracts of new type of PSI-related service has grown considerably.

1. The origin of PSI service and the exporters concern

Inspection companies historically started their business by inspecting and verifying the quality, weight and quantity of traded commodities at the time of shipment on behalf of buyers. By way of example, SGS was found in 1878 in Rouen as a French grain shipment inspection house. Inspection companies originally offered services to private companies testing product quality and performance against various health, safety and regulatory standards, using their laboratories, or certifying the conformity of products with required standards set by governments or standardization bodies. Their clientele was gradually expanded to include national governments.

The preshipment inspection for government service was initially developed to detect over-invoicing as means of capital flight for countries in balance-of-payment difficulties, called "foreign exchange (FOREX) contracts". Zaire concluded the first contract of this type in 1960's and maintained the usefulness of PSI service during the Uruguay Round negotiations. In its submission to the negotiating group, Zaire

recounts that early in 1963 it became aware of fraud cases where imported goods were replaced by undervalued goods or “ghost shipments” to illicitly transfer foreign currency.¹⁵⁸ To counter such trafficking, it engaged an inspection company to check the quality and quantity of goods prior to shipment. Likewise, its Central Bank suspected another way of illicitly transferring currency by over-invoicing and as a result the PSI program was extended to include price comparison in 1965.

The PSI industry explains that the over-invoicing of goods occur as a result of the importer’s circumvention of exchange control regulations through collusion with the seller who typically agrees to pay the difference between the export market price and the invoice price to the importer’s bank account abroad.¹⁵⁹ This illegal transfer of the fund could be used for the payment of unofficial commissions paid by the exporter to a third party outsider at the request of the importer, frequently observed in the case of public purchase. In addition to these money laundering cases, the inspection industry suggests that there might be cases where sellers overcharge the importer taking advantage of the importer’s lack of knowledge of the export market price.

However, along with the deregulation of exchange control, the main objective of PSI has gradually shifted from capital flight to addressing the revenue concern through the detection of under-invoicing and misclassification.¹⁶⁰ This is called a “customs contract” and Indonesia concluded the first contract of this type in 1985. A number of subsidiary services were often provided by PSI companies that included the verification of the origin of the product, maintenance of data for statistical and valuation purposes, technical assistance, and training.

The trade community, on its part, expressed its growing concern from the early days of the PSI FOREX service, because exporters were directly affected by the downward adjustment of price on the grounds of preventing capital flight. In addition to what they saw as arbitrary price adjustments in a non-transparent way, exporters suffered from delays caused by PSI inspection, and they often perceived PSI as non-tariff barrier, another layer of red tape. The trading community requested the establishment of acceptable rules governing price verification, expeditious clearance without unnecessary cost burden, and the introduction of appeal procedures.

¹⁵⁸ Uruguay Round Negotiating Group on Non-Tariff Measures, Communication from Zaire, MTN.GNG/NG2/W/17 (July 1998).

¹⁵⁹ COTECNA Guidelines for Exporters, March 2005. *Available at* www.cotecna.com (last visited 6 June 2007).

¹⁶⁰ It is pointed out that over-invoicing is still in use for money laundering purpose.

These complaints resulted in the United Nations Economic Commission for Europe (UNECE)'s Working Party on Facilitation of International Trade Procedures adopted a recommendation on the discouragement of PSI in 1982 as follows:

“The present trend towards increased preshipment inspection of goods for purposes other than phytosanitary, sanitary and veterinary controls causes serious concern because of its implications in the form of costs and delays. This practice should be discouraged. When there is a legitimate need for inspection, the authorities concerned should accept certificates issued by official control bodies in the country of origin.”¹⁶¹

The International Chamber of Commerce (ICC) Committee on Regulations and Procedures in International Trade set up a Working Group entrusted with the task of drafting a Code of Conduct on the PSI activities. In response, PSI companies, through the International Federation of Inspection Agencies (IFIA), prepared a draft Code of Practice, submitted to the ICC for consideration. In order to deal with this concern, a number of governments, including Germany, started to require PSI companies operating on their soil, to obtain a license from the relevant government authorities. Faced with complaints that mounted in the 1980's, developing countries that use PSI service maintained the need for PSI, mentioning the commercial practice in their countries where price fixing was rampant and often used for the transfer of funds. They were also concerned by the lack of administrative capabilities in their customs administration to detect the over-pricing that would result in outflow of hard currency.

2. The negotiating history of WTO PSI Agreement

(1) Agenda setting for the GATT Uruguay Round

The PSI issue had originally been taken up by the GATT Committee on Customs Valuation in 1987, where the United States expressed the concern that PSI activities were inconsistent with the basic notion of the GATT Agreement on Valuation as well as

¹⁶¹ UNECE. Recommended Measure 8.2 in the Recommendation No 18 on “Facilitation Measures Related to International Trade Procedures.” (1982).

the principle of other GATT rules.¹⁶² While the exporters' concern was mainly related to the PSI service on capital flight, Indonesia was concerned that unilateral regulations on PSI by exporting countries could hamper the new type of PSI for revenue purpose that they had started in 1985. In 1988 it suggested that the PSI issue should be taken up in a wider forum, particularly since some 20 developing countries, which implemented PSI programs, were not signatories of the Customs Valuation Code. It also pointed out that certain governments and industry groups in developed countries had sought unilaterally to regulate and/or inhibit the use of PSI programs, which could damage the interest of the service users in the developing countries. Indonesia formally proposed the inclusion of this subject into the on-going GATT Uruguay Round negotiations, which had started in 1986, more specifically in the UR Negotiating Group on Non-Tariff Measures in February 1988. It advocated this negotiation, stating that due to its multilateral nature, PSI required a multilateral response, rather than unilateral regulation.¹⁶³ Other PSI user countries, whose purpose was capital control, were initially reluctant to take up the issue in the UR. They maintained that PSI was a legitimate instrument at their level of development to save significant sums of foreign exchange and did not see the need for multilateral rules. As a compromise, Zaire, supported by other user countries, proposed a non-binding appeal mechanism consisting of representatives of exporters, inspection agencies and an impartial element, while supporting the idea of a self-regulating Code of Conduct drawn up by the IFIA in May 1989.

There was, however, a gradual shift of views among user countries, "probably reflecting their realization that multilaterally-agreed rules which they had helped to draw up would be preferable to differing rules unilaterally developed by the exporting countries, and easily imposed by these countries because the inspections took place on their territory."¹⁶⁴ In November 1989 Zaire accepted the idea of a GATT instrument that included some general principles such as transparency and an appeal mechanism.¹⁶⁵ At the same time, exporting countries became ready to recognize the legitimacy of PSI programs by user countries. This compromise paved the way for the

¹⁶² The accession to the GATT Agreement on Customs Valuation was optional and the majority of developing countries stayed out from the accepting the Agreement and were not members of the Valuation Committee.

¹⁶³ The GATT Minutes on the Negotiating Group on Non-Tariff Measures, Meeting of 22 and 25 February 1988, MTN.GNG/NG2/6.

¹⁶⁴ Croom (1995), *supra* note 18.

¹⁶⁵ The GATT Minutes on the Negotiating Group on Non-Tariff Measures, Meeting of 30 November 1989, MTN.GNG/NG2/14

negotiation of a multilateral set of rules, designed to minimize the trade distortions caused by PSI programs, while safeguarding the right of developing countries to resort to the PSI services.

(2) Agreement on PSI

The Informal Drafting Group, which held its first meeting on 30 April and 1 May 1990, began the reading of the paper drawn up by the GATT Secretariat, bringing together drafting suggestions by delegations. The negotiations progressed quickly based on the draft text prepared by the GATT Secretariat in the course of 1990. As the GATT rules by nature deal with the regulations by governments, they avoided directly regulating the PSI companies. The PSI Agreement provides for obligations of governments, mainly those of user governments to ensure the PSI companies followed the rules in carrying out their operations of physical inspections and verification of prices. With regard to the legitimacy of the PSI that developing countries maintained, the developed countries tried to emphasize the temporary nature of the PSI service. In this respect, the Swiss proposed a provision for a phase out of mandatory PSI, but Zaire did not agree, pointing out that developing countries were forced to maintain the program by unethical price-fixing practices in trade.¹⁶⁶ The phase-out of the PSI service was not made mandatory, and was only retained in the preamble in an implicit way, as follows: “*Recognizing* the need of developing countries to do so for as long and in so far as it is necessary to verify the quality, quantity or price of imported goods.” Another attempt was the introduction of a simplified procedure for compliant traders, which also met objections from the user countries. While the EC submitted the proposal of exempting from PSI exporters who had proved good conduct, it was not retained in the final agreement due to the opposition by Zaire, which did not think that their good conducts could be certified.¹⁶⁷ This opposition to a mandatory phase-out and selected inspection reveals the deep suspicion of PSI user countries on the reliability of traders, as well as the lack of enthusiasm of their negotiators for reform and modernization of their own customs.

¹⁶⁶ The GATT Minutes on the Negotiating Group on Non-Tariff Measures, Meeting of 21 March 1990, MTN.GNG/NG2/17

¹⁶⁷ *Id.*

The final draft of the PSI Agreement included principles that respond to the concerns of exporters. These included non-discrimination among exporters affected by PSI activities, transparency (provision of information to exporters), protection of confidential information, time-limits for issuing a CRF, guidelines for price verification, and appeals procedures. The PSI entity may reject a contract price agreed between the exporter and the importer only if it can demonstrate that the findings of an unsatisfactory price are based on a verification process, stipulated in the PSI Agreement. Whether the goods for comparison by PSI companies under the verification process should be limited to those destined for the same country or allowed to include those destined for other countries (third-country prices) remained unsolved at an early stage, because the Agreement on Customs Valuation, under negotiation at that time, prohibits the use of the third-country price to determine the value (Article 7. 2. e.). The PSI user countries feared that this restriction would not provide sufficient examples for comparison as the import of the goods concerned to their respective country might be scarce and its price would be easily manipulated. A compromise was reached and the Agreement on PSI permits the PSI entity to base its price comparison with the third-country price (Article 2. 20. b.). The difference reflects the basic tenets on which the two Agreements are based: the Agreement on PSI requires the PSI companies to use information on prices available in the exporting countries whereas the Agreement on Customs Valuation requires customs authorities to use the information available in the importing countries.¹⁶⁸ Information and communication technology at that time was supposed to cause difficulties for customs authorities in obtaining information from exporting countries.¹⁶⁹

It is noteworthy that the use of the third-country price is limited as a test value or advisory opinion in checking the truth or accuracy of a price, but customs authorities cannot automatically determine value on the basis of prices recommended by PSI companies. An examination has to be carried out in each case. If importers do not accept the PSI-recommended prices, customs authorities should follow the procedures and the methods laid down in the Agreement on Customs Valuation to determine the prices where they cannot use the third-country price in this process. To make clear this relationship between the PSI price verification, which could be used as test value, and determination of value as stipulated in the Agreement on Customs Valuation, a

¹⁶⁸ Rege. (2001) *supra* note 78, at 17, View expressed by the WCO representative at the Commonwealth Secretariat technical seminar on PSI, 1999

¹⁶⁹ Rege (2002), *supra* note 28, at 137-138.

footnote was inserted to the Agreement on PSI to the effect that PSI user countries are bound by the obligation of the Agreement on Customs Valuation in determining the value.

In this retrospect, the PSI Agreement served to address the concern of developing countries over the difficulty in implementing the transaction valuation system. The PSI industry offers the PSI service in a narrow sense to issue a Clean Report of Finding by which customs can judge the acceptability of transaction value as the basis of customs valuation. In addition, inspection companies could offer an advisory service of providing the price of identical or similar goods sold for export to the user country from their price database in helping customs determine the value of the goods concerned. As a result of this compromise, both the draft PSI Agreement and the Agreement on Customs Valuation were among the first to be agreed on the ad referendum basis at the GATT Ministerial Conference in 1990. They were later adopted as part of the WTO Agreements in 1994 when negotiators agreed on other issues, including market access in agriculture.

3. Transformation of PSI

(1) From FOREX to customs revenue type

The PSI Agreement was negotiated during the UR negotiations from 1988 to 1990 and the negotiations were largely driven by the problems pertinent to the FOREX contracts, which date back to 1960's, whereas the first customs contract emerged only in 1985. Negotiators based their concern mainly on the difficulties the exporting industry encountered in coping with the FOREX-type contracts, and did not pay sufficient consideration to the implication on customs revenue-type contracts due to the lack of experience in this new area. As a result, the Agreement mainly takes care of exporters' concern in avoiding arbitrary price adjustment and delays caused by PSI firms, whereas it takes little care of importers interests and impacts on customs in importing countries, especially those of developing countries that need capacity building in customs. However, in the end, the Agreement clearly covers both the FOREX contracts to prevent capital flight and customs contracts for revenue purposes.



While the draft Agreement was negotiated mainly in an effort to address the past concern of exporters on foreign exchange control, capital control was considerably eased by the time the Agreement entered into force. The PSI companies shifted their activities from FOREX to customs contracts. By way of example, Zambia engaged PSI services in 1978 with main objectives to deter capital flight through over-invoicing under strict foreign exchange control. With the liberalization of the economy starting in 1992, PSI contracts shifted towards customs contracts with the main aim of preventing slippage of customs revenue as a result of under-valuation or deliberate misclassification of imports by traders. Another example was the case of Kenya where in 1988 an inspection company was awarded a PSI contract by the Central Bank of Kenya, which was mostly geared towards the protection of the country's foreign exchange reserves. In 1994, the same inspection company was awarded, by the Ministry of Finance of Kenya, a PSI contract including enhanced customs revenue services.

As these examples illustrate, the transformation of PSI service took place almost at the same time as or later than the PSI Agreement was negotiated in Geneva. The PSI industry actively used the PSI Agreement as a proof of their legitimacy and thus facilitated the shift in focus of PSI service from FOREX to customs contracts. As a World Bank economist put it, "On the legal and regulatory side, the ratification of the WTO Agreement on Preshipment Inspection in 1994 has enabled companies to claim that official endorsement of PSI gives it a new legitimacy and respectability in international trade. Since 1993, the number of countries actively using PSI has increased from 27 to 39 in 1998."¹⁷⁰ This transformation of PSI services to customs contracts was commonly perceived by customs administrations as substitution rather than support for customs, often due to the lack of clear phase-out strategy and insufficient technical assistance provided by the inspection companies. User governments often failed to integrate the PSI program into customs modernization and acted as if it was a permanent solution. The Ministry of Finance that negotiated the PSI contracts or Ministry of Trade that negotiated multilateral trade rules were rarely involved or consulted when customs organizations engaged in their negotiations. Customs employees thus frequently felt that inspection companies were acting as invaders to their territory, depriving them of their job, pride and sometimes, rent-seeking opportunities. The resentment was all the more bitter when the cost of PSI service, around one percent of the value of merchandises inspected, was compared

¹⁷⁰ Dutz (2001), *supra* note 74 at 55.

to the resource allocation to the customs administration. The IMF expert estimates that in developing countries like Bolivia, Cameroon, Sri Lanka, Tanzania and Uganda, the customs administration operates with a budget representing a small fraction, sometimes 3-5 percent of the cost of PSI service.¹⁷¹

(2) From BDV to transaction value

The PSI system has been experiencing another transformation caused by the gradual change in valuation method brought about by the Agreement on Customs valuation that entered into force in the same year as the PSI Agreement in 1995. As the new Agreement on Customs valuation provides for a transitional period of five years for developing country Members, many of them have migrated to adopting the transaction value system since 2000, which requires the adjustment in the usage of PSI services. The PSI system had been easier to operate for customs under the BDV system where customs administrations have more discretion in determining the value of goods based on PSI reports than under the transaction valuation system where PSI reports provide reference material for risk management and a basis for starting a verification process in consultation with importers.

In more detail, when a PSI-recommended price is different from a declared value by an importer, customs may take it as the reason to doubt the truth or accuracy of valuation and start an examination in each case. If customs believes that the PSI-recommended price or a price other than the declared one represents the correct price after the examination, customs will contact the importer if he agrees with the customs finding. When the importer does not contest the finding, customs can determine the value on the basis of that price. On the other hand, if the importer does not agree, customs should give him an opportunity to present documentary evidences to justify his declared price. The WTO Agreement on Customs Valuation expects that there should normally be a process of consultation between the customs administration and importer with a view to arriving at a mutually acceptable basis of value. If the importer does not agree and customs still suspects the truth or accuracy of declared value, customs may decide that the value cannot be decided on the transaction value method. Then, the Agreement lays down five other methods of valuation, to be applied in a prescribed hierarchical order. They are transaction value of identical goods,

¹⁷¹ Corfmat (2001), *supra* note 55, at 71.

similar goods, deductive method, computed method and fall-back method.¹⁷² It cannot determine the valuation on the basis of the PSI Clean Reports of Finding.

Precisely because of this change of valuation method, the utility of PSI services should have been reduced in theory. This transformation will take a longer time in practice as customs should develop their expertise and there are still complaints heard from the trade that some customs administrations tend to use PSI reports for determination of value instead of risk management purpose. In practice, inspection companies verify the invoice price against the price of identical or similar goods in producing Clear Reports of Finding. Therefore, customs often use these prices as a basis of valuation when customs rejects the invoice price as the basis of customs valuation. In its submission to WTO in 1997, Kenya wondered what would happen to PSI services as the year 2000 approaches.¹⁷³ Since Kenya observed that the PSI agencies carry out price check against a computerized valuation database, they wondered what would be the implication on building an adequate database for price comparison. Furthermore, they expressed their concern on quality control of drugs and chemicals on the ground of protecting health of people and environment. In reality, after the introduction of transaction valuation system, the KRA officers found the PSI reports less useful compared to under the BDV system. In addition, at the PSI contract, they made sure that the database was transferred from the inspection companies. However, the concern over quality assurance of drugs resulted in retaining the PSI program to ensure the conformity of imports with standards. In Bangladesh observers often point out that the PSI reports are still used as means of determining valuation.

The PSI system was transformed twice in a short period of time. First its focus shifted from the FOREX service for Central Bank or Ministry of Finance to customs revenue service for the Ministry of Finance in the late 1980's and early 1990's. Second, it had to adopt the business model with the introduction of ACV method by developing countries since 2000. While the inspection industry took advantage of the first transformation in expanding its scope of activities, the second transformation could result in a loss of revenue sources, together with the review of performance. The drop in the number of PSI-user countries seems to suggest this trend.

¹⁷² WTO, Agreement on Customs Valuation, General Introductory Commentary

¹⁷³ WTO Working Party on Preshipment Inspection. "National Experience with the Agreement on Preshipment Inspection, Submission by Kenya." G/PSI/WP/W/14 (Oct 1997).

4. The WTO review of the Implementation of the PSI Agreement

The PSI Agreement entered into force in 1995 as a part of WTO Agreements. In line with Article 6 of the PSI Agreement that provides for a periodic review of the provisions, implementation and operation of the Agreement, the WTO Working Party on PSI was established by the WTO General Council in 1996. The Working Party produced reports in 1997 and 1999, containing the review of PSI performance, complaints procedures and a series of recommendations.¹⁷⁴

Article 6 of the PSI Agreement: “At the end of the second year from the date of entry into force of the WTO Agreement and every three years thereafter, the Ministerial Conference shall review the provisions, implementation and operation of this Agreement, taking into account the objectives thereof and experience gained in its operation. As a result of such review, the Ministerial Conference may amend the provisions of the Agreement.”

(1) Overall estimation

The WTO report in 1999 estimates that while most of the user Members expressed satisfaction with their PSI programs. However, one former user Member considered that their program had not met any of the goals of ensuring revenue collection, had not facilitated trade, and the costs of the PSI program had exceeded the revenue collected. On the other hand, governments and traders of exporting countries have claimed that recourse to PSI had created delays to shipments and incurred additional costs to international trade. They raised concerns that on occasion PSI companies resorted to arbitrary methods, failed to keep inspection appointments, required additional documentation, demanded confidential business information, and arbitrarily uplifted values. Yet a number of exporters (including some whose governments use PSI) have expressed their general satisfaction with the implementation of the Agreement.

It is not easy to draw a general conclusion on the PSI performance from the above conflicting views expressed by the WTO Members. One assumption could be that PSI user countries acted to justify their policy of hiring PSI service which is costly, while a former user country defended its termination of PSI contract. Another

¹⁷⁴ WTO Report of the Working Party on Preshipment Inspection G/L/300 (1999)

assumption could be that exporters in general perceived PSI service as another layer of red tape, while some traders preferred PSI programs to customs, which they perceive as too inefficient or/and corrupt to take normal responsibility. This divergence of view on the PSI service could be an indication that the suitability or the desirability of applying PSI program could be different for countries with various backgrounds.

By way of example, the 2003 USTR report on foreign trade barriers states that US exporters generally consider PSI regime an obstacle to trade in the country report on Argentina where the PSI program was terminated in 2001.¹⁷⁵ Moreover, in its 1999 report the USTR urges that the Philippines Government to prioritize improving the administration of its customs regime, rather than retain a private, for-profit company to carry out vital customs clearance and revenue collection functions ordinarily maintained by governmental authorities.¹⁷⁶ The Philippines actually terminated the PSI contract in March 2001. On the other hand, the USTR report describes the fact on PSI regime in several African countries without adding any comment. This difference in description might reveal the perception of US traders on the customs environment for each country. The IMF also observes that the use of PSI has been largely restricted to countries “where there are significant problems of corruption and/or lack of capacity” or “in post conflict countries where there has been a need to implement quickly customs administration following the cessation of hostilities.”¹⁷⁷

The WTO report in 1999 also reviews the WTO mechanism for settling disputes between exporters and PSI companies, the Independent Entity. The Independent Entity is constituted jointly by the WTO, the International Chamber of Commerce (ICC) and the International Federation of Inspection Agencies (IFIA), and is administered by the WTO. However, there have been only two cases brought to the Independent Entity to date.¹⁷⁸ The ICC suggested in the WTO report in 1999 that non-use of the Independent Entity might be attributable to three possibilities: the PSI Agreement have removed some sources of disputes between the inspection companies and the exporters; the exporters were concerned that identifying themselves to the

¹⁷⁵ USTR (2003), *supra* note 15.

¹⁷⁶ USTR 1999 National Trade Estimate Report on Foreign Trade Barriers Washington D.C.

¹⁷⁷ Corformat (2001), *supra* note 399.

¹⁷⁸ They were brought in 2005 and 2006, involving the same inspection company and the exporter.

inspection companies could result in aggravating rather than alleviating the situation; or the costs associated with its use were considered high. The IFIA was of the view that in many cases problems had been settled between the inspection companies and the exporters concerned. The IFA members developed the PSI Code of Conduct that stipulates the obligations of inspection companies in carrying out inspection activities contracted or mandated by a user government, in line with the WTO PSI Agreement and the Agreement on Customs valuation. This inspection industry maintains that the Code of Practice assures the acceptable behavior of its members.

(2) WTO recommendations

The Working Party exchanged views on seven identified issues based on the experience of PSI programs, reflecting the change in PSI service since the Agreement on PSI was negotiated in 1990. The work focused on the issues related to the customs-type PSI program, and its outcome was therefore supplementary to the Agreement which does not necessarily take into account the impact on customs reform. The issues included (i) a model contract and code of conduct developed by the IFIA, (ii) the standardization of inspection documentation, being carried out by the ICC and the IFIA, (iii) selective examination of shipments, (iv) auditing of PSI entities, (v) the promotion of competition amongst PSI agents, (vi) fee structures for PSI entities, (vii) price database. The Working Group also discussed trade facilitation and technical assistance.

The WTO report in 1999 contains four specific recommendations that its members could agree upon, as follows:

(a) Governments should ensure conformity of contracts to the PSI Agreement and be encouraged to consider following the model contract;

(b) Governments should examine incorporating the principles of selectivity and risk assessment in their contracts;

(c) Audit of PSI should be guided on non-discrimination and national treatment basis; and

(d) Developed countries should ensure that developing countries receive the necessary assistance for domestic capacity building in order that the transition away from PSI can be made.

While these recommendations are on a voluntary basis, the introduction of selectivity and risk assessment principles will have a fee implication, as shown in the case of the contract of Kenya in 2000. The offer of technical assistance by developed countries is a reaffirmation of the current provision in the PSI Agreement (Article 3.3), but the recommendation specifies its objective as a transition away from PSI, which is not explicit in the PSI Agreement. In discussing audits of PSI, the Working party found out that only two of the then user governments, which amounted to 35, actually carried out an audit, which remains of optional character in the recommendation.

Interestingly, the Working Party was not able to agree on several issues. While the Working Party members noted insufficient competition among PSI companies, given its oligopolistic market structure,¹⁷⁹ it was unable to make a specific recommendation, including the automatic adoption of competitive bidding among PSI companies for those members currently using PSI companies. As Dutz suggests, large investments by incumbent companies [in maintaining a wide international network of inspection offices or a system of electronic data interchange for customs documents] could increase sunk costs and thereby raise entry barriers.¹⁸⁰ With regard to fee structures, the IFIA agreed to consider charging fees on an ad valorem rates of the declared value instead of ad valorem fee based on the clean report of finding (CRF) to avoid giving an incentive for companies to pursue an arbitrarily upward system of valuation. However, the Working Group could not agree on the desirability of using fee structures on ad valorem rates or who should bear fees – user governments or importers.

The WTO report in 1999 also recommended that the Customs Valuation Committee should undertake future monitoring of the PSI Agreement. According to the Agreement that stipulates that the review takes place every three years, this monitoring exercise should have taken place in 2002. However, no Members showed interest in taking up the issue. Together with the little use of the Independent Entity, it could well be assumed that exporters, who are often the driving force behind WTO negotiators, are less concerned with the current status of the PSI service. This lack of interest could be explained either because they are satisfied with the implementation of the Agreement, or because the Agreement has become less relevant to their concern,

¹⁷⁹ WTO Working Party on Preshipment Inspection Minutes of the Meeting of 6 and 8 October 1998 WTO document G/PSI/WP/M/7 (12 November 1998) at 7.

¹⁸⁰ Dutz (2001), *supra* note 74, at 61-62.

along with its transformation away from FOREX service that could directly damage exporters' interests. The question seems to be more relevant to customs reform than the traditional WTO interest on behalf of exporters.

Building on the previous recommendation on preshipment inspection in 1982, the UNECE adopted a separate recommendation on the subject in 1999, noting the substantial increase in the use of PSI program.¹⁸¹ The recommendation reaffirms its concern on PSI, lends support to the WTO PSI Agreement and the WCO Arusha Declaration, and strengthens these initiatives by recommending a time limit to the use of the PSI program.

5. Transformation of PSI with new business models

The inspection industry has continued to evolve after the adjustment to the WTO transaction valuation system. In observing its own performance and the change in business environment, there has been a growing recognition even among the inspection companies that the traditional PSI service was not as effective as initially designed and has become hard to sell. This has resulted in another transformation of PSI service into a variety of new services.

First, a selective type was introduced where only certain shipments are subject to physical inspection based on risk assessment. This new type of contract corresponds to the development of modern customs principles of selectivity and risk assessment. The traditional PSI service was initially considered effective, because the inspection is notionally carried out over the totality of consignment before the shipment. However, as the risk management technique has been developed in customs, the physical control method over consignment in many customs administrations has shifted from inspection of 100% shipments to that of a selected number of shipments where potential risk is considered high. In fact, there has been criticism that since the degree of physical inspection was totally at discretion of PSI agents, they were likely to pay less attention to cargo of compliant traders and concentrate resources on high-risk areas. A number of suppliers in different countries asserted that physical inspections were often

¹⁸¹ UN/CEFACT Recommendation on Preshipment Inspection ECE/TRADE/237 (1999).

perfunctory or not undertaken at all.¹⁸² Taking into account this development, the WTO report on PSI review in 1999 recommended that user governments examine incorporating the principles of selectivity and risk management in the PSI contracts. These principles had been advocated by the WCO that was finalizing the revision of the Kyoto Convention on customs procedures, adopted also in the same year. This will affect the profit of PSI companies as they calculate their fees based on the value of cargo inspected, by which they can justify the fee level, because physical inspection requires a considerable amount of labor, which Low estimates account for 30-50% of the total cost of the service.¹⁸³ In fact, the typical fee level of the PSI program has been lowered from the original over 1% to below 1%. When Kenya introduced the selective application of inspection service in 2000, it was expected to bring the saving of a third of the annual fee.¹⁸⁴

Second, the increased emphasis on its transitional nature has resulted in the heightened awareness of the need to ensure the transfer of technology to customs that will enable user governments to move away from the PSI service. Following the WTO report in 1999 that included this recommendation, the Doha Ministerial Declaration in 2001 has underlined the importance of technical assistance and capacity building support in enabling the developing country governments to implement the WTO rules, including customs authorities. This is the area the inspection industry has been less enthusiastic about because of its adverse impact on future market potential. Naturally, it is also the area where inspection companies have been most criticized in the past, as they tend to stay longer than initially anticipated by continuously renewing contracts. In response to this criticism, the traditional PSI providers were increasingly asked by governments to study the possibility of incorporating more capacity building and supportive elements to customs into PSI contracts.

Third, many customs administrations try to apply technology in updating their operations, including automation and non-intrusive inspection. In order to respond to these demands, there are a number of information technology solution companies that supply computer and other technology equipment. Inspection companies are naturally interested in this area to keep their market in the government service. Partly in competition to other private sector companies, inspection companies have recently

¹⁸² Low (1995), *supra* note 149, at 66.

¹⁸³ Low (1995), *supra* note 149, at 67.

¹⁸⁴ "New Kenya Rules Slash Earnings for Verification Firms." The East African (25 December 2000).

started to further explore commercial opportunities in offering supportive service that are closely related to customs operations.

This change in market demand has led to the emergence of new services. While these emerging features of PSI and related service are still new and only limited experience is available, some observers believed that it has the potential for supporting customs activities, if properly managed to build capacity of customs administrations. As a result of this new business model, there has been a marked reduction in traditional PSI programs with considerable growth in more modern programs.

Each year the WTO Secretariat publishes a list of PSI-user countries, compiled by the International Federation of Inspection Agencies (IFIA).¹⁸⁵ The IFIA is an association of international inspection companies and was founded in 1982. As of March 2001, 41 countries were using the PSI service, whereas the number of user countries was 29 in 1993¹⁸⁶ before the entry into force of the WTO Agreement on PSI. This increase shows the effect of the WTO Agreement on PSI that was used to legitimize and promote the PSI program for customs revenue purposes. Subsequently, the number was reduced to 31 seven years later, as of June 2008. In more detail, 13 countries terminated the PSI program between 2001 and 2008 whereas 3 countries started the PSI program (Chad Equatorial Guinea and Haiti), as shown below. Africa remains the location of the majority of user countries.

(Table 12-1) PSI-user countries

	March 2000	May 2008
Africa	30	24 (Δ 8, +2)
America	5	3 (Δ 3, +1)
Asia	4	3 (Δ 1)
Former Soviet Union	2	1 (Δ 1)
Total	41	31 (Δ 13, +3)

¹⁸⁵ WTO Preshipment Inspection, Note from the Secretariat, G/VAL/W63/Rev.1, March 2001 and WTO. (2008) *supra* note 21.

¹⁸⁶ Low (1995), *supra* note 149 at 9.

According to the IFIA, in addition to the 13 countries that terminated the PSI contract after March 2001, 7 countries (2 in Africa, 3 in America and 2 in Asia) had already terminated the PSI arrangements prior to March 2001. In sum, the number of countries that exited from the PSI service amounts to 20 by 2000. Furthermore, among 31 countries, only 14 countries maintain the traditional PSI contract whereas 17 countries have contracts of customs support service with destination inspection and/or selective inspection, new types of PSI service. The number of user countries of traditional PSI contracts has reduced dramatically from 41 to 14 between 2001 and 2008.

6. Further discussion in the WTO

The WTO launched the Doha Development Agenda in 2001 and in this context agreed on the modality of the negotiations on trade facilitation in 2004. The aim of trade facilitation negotiations is to expedite the cross-border movement of goods by improving border procedures with much focus on customs procedures. Many WTO members submitted proposals to improve customs procedures and other border-related procedures in the trade facilitation negotiation group. The European Communities and Chinese Taipei submitted a legal text-based proposal on the mandatory elimination of preshipment inspection in June 2006.¹⁸⁷ Recognizing that the elimination of the PSI program is often undertaken as part of a broader program of customs reform, the proposal sets the provision for transitional periods to enable user members to undertake the requisite reform to ensure a well-functioning customs administration. The proposal also asks for the commitment of WTO members not to introduce or apply any new requirements to use preshipment inspections or their equivalent. The EC negotiator introduced the proposal in the trade facilitation negotiation meeting in June 2006, explaining that the PSI program was costly for both traders and user governments. He maintained that while the PSI program was meant to be a temporary arrangement pending the establishment of properly functioning customs administration, the past experience showed that it was becoming a fairly permanent fixture in many countries. He also suggested development aid to progressively build up the competence of customs administrations.

¹⁸⁷ WTO Negotiating Group on Trade Facilitation Submission by EU, Chinese Taipei and Switzerland, TN/TF/W/109 (1 June 2006).

The EC intervention was followed by a question on the proposal's coherence with the policies of the lending institutions, because the PSI regime had been often part of conditionality by the structural adjustment program supported by the Breton Woods institutions. In response, a World Bank representative stated that while the World Bank and the IMF had included the use of PSI in certain loan conditions in the past, there was a gradual change of views of many practitioners in this regard.¹⁸⁸ Observing that there had barely been a transfer of knowledge from PSI companies to customs officers, both Breton Woods institutions preferred to see the funds channeled in building capacity of countries to more effectively manage their own customs departments and responsibilities. The World Bank typically recommended user countries to develop an exit strategy.

In this connection, in the report published in December 2006 the World Bank published a report in which it specifies that the elimination of PSI may not be necessarily difficult but are likely to be problematic due to a prevailing perception that it may lead to short term revenue losses.¹⁸⁹ In more detail, the World Bank conducted a study on the needs and costs for technical assistance in implementing a future WTO agreement on trade facilitation in 2006. The study involved six countries (Egypt, Paraguay, the Philippines, Rwanda, Senegal and Sri Lanka) and was carried out in cooperation with the IMF and the WCO. Three key issues are looked at: What would be the gap between the proposals under consideration in Geneva and the procedures currently applied? What would be the cost of the technical assistance and capacity building required? How difficult would it be to implement the proposals? The study picked up 40 measures from the proposals under consideration in the WTO and categorized them by cost and implementation difficulty. Of the six countries, there are two former users of PSI (the Philippines and Rwanda) one current user (Senegal). The elimination of PSI is categorized as one of 10 measures considered significantly more difficult to implement than other measures and/or will require large amounts of technical assistance and capacity building. Nevertheless, it is qualified as one of the measures that may not necessarily be difficult to implement but are likely to be

¹⁸⁸ WTO Minutes of Trade Facilitation Negotiation Meeting of 7 June 2006, TN/TF/M/14

¹⁸⁹ World Bank Needs, Priorities and Costs Associated with Technical Assistance and Capacity Building for Implementation of a WTO Trade Facilitation Agreement – A Comparative Study Based on Six Developing Countries http://siteresources.worldbank.org/INTTLF/Resources/Needs_and_Priorities.pdf last viewed on 1 January 2008

problematic due to a prevailing perception that they may lead to short term revenue losses. Furthermore, the study notes that PSI has already been eliminated and officials claim that it has not resulted in any significant revenue loss in two of the surveyed countries. It maintains that they did, however, need to establish a sound exit strategy to allow them to progressively assume certain customs responsibilities previously provided by the PSI companies.

In responding to the proposal sponsored by the EC and Chinese Taipei, the International Federation of Inspection Agencies (IFIA) distributed a non paper describing the evolution of PSI service through the Swiss delegation to the informal WTO session in June 2006. In its informal submission, the IFIA reasoned that the industry often received criticisms that the “transitional period” never seemed to end and that governments came to rely upon PSI without developing their own customs organizations and infrastructures. However, it points out that the inspection service finds itself in the midst of change as user governments are increasingly more interested in post-import activities on their own territories than pre-export activities. As a result, the PSI services that previously operated as a partial substitution for functioning customs services after the introduction of the WTO Agreement on PSI in 1995 are now evolving into targeted technical assistance and support organizations for customs and other government bodies. The IFIA paper cites the introduction of risk assessment, selectivity and cargo scanning as part of these new services that also contribute to trade facilitation. It maintains that 18 countries have already terminated the PSI contracts and about 10 countries have developed risk management style programs and destination inspection arrangements. This leaves only about 20 countries in which the traditional customs-related PSI programs are operative. However, the IFIA predicts that further developing countries will require assistance in customs related areas in the future as an integral part of any capacity building program and that the inspection service might further evolve to meet current market needs.

The question arises whether or not the WTO Agreement on PSI has largely lost its relevance after a series of transformation of the PSI industry. In terms of addressing the concern of exporters with regard to the FOREX-type PSI program, which was the origin of the WTO Agreement on PSI, the little use of the PSI dispute settlement indicates the diminished interest of exporters. The PSI Agreement was used for the legitimization of the customs-type PSI contract, but the Agreement alone proved to be inadequate in ensuring the good functioning of the PSI industry as a

temporary measure for maximizing revenue collection. This aspect was supplemented by the WTO Working Party report in 1999. Finally, the new services offered by PSI entities seem to be aimed at activities in importing countries and therefore largely outside the scope of the Agreement that regulates the activities on the territory of exporter WTO Members. By way of example, the aspect of physical inspection at the destination contained in Destination Inspection is outside the scope of the Agreement while the aspect of documentary examination, which Destination Inspection program usually contains and is carried out in exporting countries, could be theoretically viewed as covered by the Agreement insofar as the extraterritorial activities are concerned. On the other hand, the inspection industry suggests that outbound inspection for security purpose could be a new business for pre-shipment inspection, if carried out on behalf of importing countries.

Most of new services in support of customs operations are carried out in importing countries and could be viewed as part of implementation issues under a future WTO Agreement of Trade Facilitation. At this point in time, it is unclear how the phase-out proposal of the PSI service will be treated in the final package of the current work by the Trade Facilitation Negotiation Group, as it will critically affect the existence of another WTO agreement, administered under the auspices of the WTO Committee of Customs Valuation, which has shown little interest in reviewing the PSI Agreement.

Chapter 6 Proposed alternative solutions and new services of the PSI industry

This Chapter reviews proposed solutions to the implementation of the Agreement on Customs Valuation, which could be viewed as alternatives to the traditional PSI program. They include the exchange of information, especially provision of export data to verify import value, the use of electronic database and the establishment of valuation database. After examining these proposals and new services, this paper argues that they are important technical tools, but they do not necessarily assure improvement in customs valuation work, because they presuppose a reasonably well-functioning customs administration. Therefore they should be viewed as part of an overall improvement in the customs process and that there has been an increased need for building capacity in customs. In response to the criticism against the traditional PSI program, the inspection industry has begun to change its strategy by offering new services of a supportive nature to customs, including destination inspection and cargo scanning service. This service shifts physical inspection of cargo from pre-shipment to destination stage, but documentary examination usually remains in the hand of inspection companies, which require customs authorities to tackle the development of capacity in customs valuation on their own.

1. Proposed solutions to the WTO implementation-related issues

The main concern of developing countries remains revenue leakage through under-invoicing by importers, especially in applying transaction valuation system, as prescribed in the WTO Agreement on Customs Valuation. A wide-spread perception has emerged of “the unbalanced outcome” of the Uruguay Round between developed and developing countries. It has been amplified by the fact that implementation assistance had been urged, but not provided for, as implementation was a legal obligation, whereas provision of assistance was not.¹⁹⁰ Another revelation was that the obligations of the WTO Agreement which were essentially taken from current practice in the more advanced economies were not always seen as good development advice. This can be seen in the recent IMF study on the revenue consequence of trade reform¹⁹¹, and which has already been explained in the Chapter 9. This question was raised as a pre-condition prior to the launch of the post-Uruguay Round of trade negotiations. At

¹⁹⁰ J. Michael Finger. & John S. Wilson. Implementing a WTO Agreement on Trade Facilitation: What Makes Sense? World Bank Policy Research Working Paper 3971, Washington DC, World Bank (2006) at 5.

¹⁹¹ IMF (2005), *supra* note 31.

the Doha Ministerial Conference in 2001 an agreement was reached to open a new round of negotiations, which addressed implementation issues in the Ministerial Declaration and in the Decision on Implementation-Related Issues and Concerns. The WTO Secretariat explains the Decision with regard to the Agreement on Customs Valuation as follows:

One of the key questions in dealing with customs fraud is whether the declared value of imported goods is correct. Cooperation with the customs authorities in the exporting countries can be important for the customs authorities in the importing countries. When the ministers launched the new Doha round in November 2001, they agreed that member governments have to cooperate in exchanging information, including on export values, within their domestic laws and regulations. The ministers instructed the WTO Committee on Customs Valuation to look at practical approaches to verifying the accuracy of declared values, including the exchange of information on export values.¹⁹²

Following this mandate, the WTO Committee engaged in discussions about practical approaches. They also asked the WCO Technical Committee on Customs Valuation to look at the issue of the exchange of information, as well as the use of the valuation database which the WCO had been studying. Many developing country members of the WCO were in favor of such an endeavor in hopes of finding an alternate solution to the dependence on the PSI program.

Moreover, the WTO Doha round includes Trade Facilitation in its agenda to further expedite cross-border movement of goods with a focus on streamlining customs procedures which are based on modern customs principles. This agenda reflects the heightened awareness of the need for institution-building in customs. Given the situation in many of the least developed countries, changing the valuation process without overall customs reform is not likely to improve the predictability of the customs process, nor would it mitigate significantly the possibility of using the customs process as a non-tariff barrier.¹⁹³ In a broader context, throughout the Doha Ministerial Declaration, WTO member governments made new commitments on technical cooperation and capacity building. The Doha round itself was dubbed Doha

¹⁹² WTO Secretariat. *The Doha Decision Explained*. Available at <http://www.wto.org/english/tratop_e/dda_e/implem_explained_e.htm> (last visited 6 June 2007).

¹⁹³ Finger (1999), *supra* note 27, at 6.

“Development” Agenda in order to show trade as a main element of reducing poverty and to include trade measures in their trade strategies.

2. Exchange of information

In order to detect and prove under-invoicing, some developing countries are eager to get price information that is contained in the export declaration lodged in the customs authorities in the exporting countries, and also to verify the authenticity of import declaration by importers. This proposed alternative to the PSI program was first suggested formally by the Norwegian Committee on Trade Procedures (NOPRO) in its submission to the UN Economic Commission for Europe (UNECE) Working Party on Facilitation of International Trade Procedures in 1992.¹⁹⁴ The core of the proposal is that the customs authorities of exporting countries should make export declarations, or information contained in them, available to the customs authorities of the importing country. Once electronic data transfer between customs services is possible, the requisite information from export declarations could be made immediately available to customs in the importing country. While acknowledging the merit of further studying this proposal as a substitute for the PSI service, Low questions the willingness of national customs authorities to cooperate in this fashion. Customs authorities in exporting countries would have to devote extra resources and would have to be willing to accept a degree of liability, if misleading information were passed to the importing country whereby they could prejudge the commercial interests of exporters. On the other hand, customs authorities in importing countries would have to be confident of the reliability of the verification provided by the exporting country. Low also pointed out that it would take some time before electronic data interchange would become generally available.

In fact, most of developed countries have legal provisions requiring confidentiality or data protection in their legal system. Developing countries often put the blame on the developed countries' reluctance to share information, on grounds of confidentiality, which could result in a situation where exporting countries' authorities turn a blind eye to the possible misconduct of traders. They allege that exporters fear the disclosure of export prices because it would embarrass importers who might be

¹⁹⁴ Low (1995), *supra* note 149, at 40.

tempted to declare under-invoicing declarations. This lack of cooperation from exporters could mean, in the view of customs authorities in importing countries, complicity of customs fraud between exporters and importers. However, exporters view this differently and point out that there remain risks that some importing countries might abuse the provided data in determining the customs value or pursuing their own trade policy and other purposes, rather than strictly limiting their usage as a risk indicator for valuation purpose. Consequently developed countries prefer a bilateral approach that allows them to put conditions based on their domestic legal system on providing information to multilateral approach that would give blanket authority to all WTO Member countries to request the provision of information. The Doha Decision stipulates that member governments must cooperate within their domestic laws and regulations. It is essentially a requirement of confidentiality, which could provide leeway from a multilateral obligation on the exchange of information.

When the WCO began deliberations on the Guide to the Exchange of Customs valuation Information, as mandated by the WTO, many countries expressed their concerns regarding the burden on customs administration from routine requests for exchange of information. Indeed, some developing countries had intended to send hundreds of import invoices to exporting countries requesting verification against export documents. In order to prevent an excessive burden on resources of the exporting countries, the WCO Guide limited the scope of the exchange of valuation information between customs authorities to cases where there are reasonable grounds to doubt the truth or accuracy of the declared value and fraud is suspected. Moreover, a check list of the standard verification process was developed to ensure that requesting administrations undertake, to the extent possible, all appropriate verification procedures in the importing country before requesting information from the customs administration of the exporting country.

This approach differs from the earlier Norwegian proposal that entails routine transfer of export values or “a binding mechanism for exchange of information” advocated by India and others.¹⁹⁵ It is perceived as part of a valuation control regime that depends on a long-term strategy of customs reform and modernization. When the WCO report containing the Guide to the Exchange of Customs Valuation Exchange¹⁹⁶

¹⁹⁵ WTO Minutes of the WTO Committee on Customs Valuation of 23 May and 22 July 2003, G/VAL/M/35 (30 September 2003).

¹⁹⁶ WTO Technical Committee on Customs Valuation Response to the Terms of Reference for the Work of the Technical Committee on Customs Valuation in Connection

was submitted to the WTO, the WTO forum appreciated its technical advice, but could not agree on the practical approaches given by the WTO Ministers in the Doha Decision. When the WTO General Council adopted the decision on the Doha Agenda work program in August 2004, called the “July Package”, it was stipulated in the “Modalities for Negotiations on Trade Facilitation” that “The negotiations shall further aim at provisions for effective cooperation between customs or any other appropriate authorities on trade facilitation and customs compliance issues.”¹⁹⁷ Therefore the exchange of information was to be continued in the WTO Trade Facilitation Negotiation Group under the Doha Round.

Reflecting on the WTO debate, the WCO adopted a new International Convention on Mutual Administrative Assistance in Customs Matter, called the Johannesburg Convention in June 2003 in order to provide a legal basis for the exchange of information.¹⁹⁸ The Johannesburg Convention includes an obligation on the exchange of information on the assessment of import and export duties and taxes, subject to safeguard measures for national interest and legitimate commercial interest and the need to prevent routine or trivial requests. The Johannesburg Convention is now open to the WCO members for accession, but many developed country members expressed their reservation over early ratification, instead preferring a bilateral exchange of information.

In principle, the exchange of information stipulated in the Guide to the Exchange of Customs Valuation Information or the Johannesburg Convention would work as part of a standard verification process, with a reasonably well-established control capacity to identify suspect declarations. The short-term usefulness of this proposed solution as a substitute to the PSI solution might be limited for customs authorities with weak institutions. Customs authorities would find it useful to follow the standard verification process and other suggestions that this approach describes in developing its capacity in valuation control and a long-term customs capability.

with Concerns on the Accuracy of Declared Value G/VAL/54 (16 May 2003).

¹⁹⁷ WTO. Decision Adopted at the General Council on 1 August 2004. WT/L/579 (2 August 2004).

¹⁹⁸ Available on the WCO web site

<http://www.wcoomd.org/ie/en/Conventions/MAA%20Legal%20Text%20FINAL%20VERSION_publish%20E.pdf> (last visited 6 June 2007).

3. Electronic exchange of customs data

In examining the Norwegian proposal, Low suggested in 1995 that electronic data interchange might not be available for some time, as described in the previous section. However, the development of an e-commerce environment has been at such a high pace that it has enabled companies to drastically reduce the logistic and transport costs for movement of goods. It has also provided customs administrations with an opportunity to utilize electronic transfer of customs data with traders and other customs. In fact, many customs administrations in both developed and developing countries have introduced information technology to a varying degree and are increasingly receiving customs declarations and necessary commercial data from traders by electronic means. In this connection, the diversity of requirement for customs data in different customs administrations was identified as a possible non-tariff barrier to the further development of international trade. In order to reduce the costs associated with a variety of border procedures, the G7 heads of governments agreed in the Lyon Summit in 1996 to standardize and simplify customs data requirements of the G7 countries and to standardize the format in which data are to be reported electronically. This initiative of standardized data sets and electronic messages using international code standards, called the Data Model, is expected to enable effective and efficient exchange and sharing of information for B2G (business to government) and G2G (government to government). In today's inter-connected electronic environment, customs controls should increasingly include advance transmission of data from trade as well as from partner customs in applying effective risk assessment. In 2002 the WCO had taken over the initiative to broaden its scope of application from G7 countries to the WCO with its membership of global coverage. The WCO finalized the second version of WCO Data Model in 2005.¹⁹⁹ Once implemented, it will open up the possibility for further streamlining customs procedures by introducing the standardized dataset between the export declaration and its corresponding import declaration. Importers can use the same electronic data to customs administrations in the exporting and importing countries to lodge declarations, while customs administrations can exchange information, using the WCO Data Model. Several customs authorities have started testing the prototype of Data Model, involving traders who are willing to participate.

¹⁹⁹ See the WCO public web site for more detail. www.wcoomd.org (last visited 6 June 2007).

The terrorist attacks of September 11, 2001 added another dimension to the exchange of information, as the need to secure and protect the international trade supply chain from being used for acts of terrorism or other criminal activity became high on the agenda of the international community while ensuring continued improvements in trade facilitation. This would increase the importance of advance transmission of standardized customs data to identify those goods and conveyances that may pose a security risk and to facilitate the movement of legitimate trade. Keeping in mind this need, the G8 heads of governments in Kananaskis Summit in 2002 asked the WCO to specify the essential data elements necessary to identify high risk goods.²⁰⁰ Following this request, the WCO identified 27 essential data, including the total invoice amount, which was incorporated in the Data Model.²⁰¹

Building on this work, the WCO Council adopted the “SAFE Framework of Standards to Secure and Facilitate Global Trade” in 2005.²⁰² The Framework of Standards is based on the concept of enabling the smooth flow of legitimate trade from the origin to the destination along the secured international trade supply chain. It is therefore essential that customs administrations have the legal authority to request the advance electronic submission of data from the exporter and carrier for security risk management purposes. In addition the Framework promotes enhanced cross-border cooperation between customs administrations on risk assessment and customs control by sharing data using standardized electronic data. Moreover customs in the exporting country should be allowed to inspect cargo identified as high-risk before its shipment, using non-intrusive inspection technology. In order to realize this scheme, the Framework of Standards, promotes the harmonized advance electronic cargo information requirements on inbound, and outbound and transit shipments.

The strongest advantage of the PSI companies is the availability of price information in the exporting countries. When the PSI Agreement was negotiated, customs in the importing countries did not have access to such information. However, the development of information technology made it possible for customs to get the price information from either customs in the exporting countries or from the business involved in the trade by electronic means. Whereas the technical means for the

²⁰⁰ G8 Kananaskis 2002 Summit Document (2002) *supra* note 14

²⁰¹ The Administrative Committee of the Johannesburg Convention has the authority to modify the list of data elements to accommodate the changing needs of customs for information to conduct risk assessment.

²⁰² Available on the WCO web site www.wcoomd.org (last visited 6 June 2007).

exchange of information or even the routine transfer of export valuation was thus made available for importing countries, it was up to each customs administration to decide whether to actually use the electronic data format to share the information. The SAFE Framework of Standards provides a political context for customs cooperation, and it could be tested by pilot projects at the bilateral or regional level for a wider implementation. This solution presupposes a customs authority that is capable of managing an information technology system and securing the domestic and international arrangement for the exchange of information. This is a potential area where the private sector can provide a supporting business with its technical expertise in IT.

8. Valuation Database

A valuation database has often been considered a useful tool in alleviating the implementation problem of valuation. With the introduction of information technology in the customs procedures, many customs administrations are now equipped with a computer system that enables them to process trade data and to establish a data house. It has become a common practice for modern customs administrations to develop and maintain a confidential database containing information covering factors such as classification of goods, price, name of shipper, consignor, consignee and origin of the goods, in order to assess the risk of a particular shipment. When the declared price of particular goods is outside the price range of identical or similar goods in the database, it could possibly indicate a need for further verification to ensure the truth or accuracy of the value of goods concerned. Price data contained in the database normally includes those found in previous import declarations, and is possibly supplemented by other sources, including customs research, price catalogues, internet, trade fairs and exhibitions, or an external commercial database provided by commercial companies. While inspection companies use similar sources, they often hire former employees in the industry of their specialization, and on occasion, former customs officers.²⁰³ It is important to note that the flexible use of a database as an aid to duty assessment is quite distinct from reliance on prior determined reference prices or minimum values.²⁰⁴

²⁰³ Low (1995), *supra* note 149, at 67.

²⁰⁴ *Id.* at 50.

The issue of a valuation database has been extensively discussed in meetings of the WTO Working Group on PSI before it finalized its report in 1999.²⁰⁵ A valuation database has so far received mixed blessings from the WTO forum. On the one hand, the US and the EU expressed their concern that price databases were particularly susceptible to abuse and could lead to the use of fictitious prices or *de facto* minimum price regime to enhance revenue or to protect domestic industry, that is inconsistent with the WTO Agreement on Customs valuation. On the other hand, developing countries argued that provided such databases were used in a WTO consistent manner, as one of many means available to highlight possible inaccuracies, they could become a valuable tool enabling the customs authority to contest a declared value on a reasonable basis. They maintained that having such databases would be a useful stepping-stone in the transition to modern customs administrations and the withdrawal from the PSI services. While noting both expressed concerns and the possible positive contribution on the valuation database, the WTO report on Pre-shipment Inspection in 1999 only stated that the Working Party agreed that price databases must not be used to determine minimum prices, or applied in a way that is inconsistent with the Agreement on Customs Valuation.

Bearing in mind the revenue implication on developing countries, the IMF recommended the establishment of automated price reference systems and valuation data specific to the importing and exporting country.²⁰⁶ The IMF discussed with a number of developing countries that it would be advisable to take a phase-in approach, starting with those commodities that generate the majority of customs revenue.

Based upon the request by the WTO, the WCO adopted “the Guidelines on the Development and Use of a National Valuation Database as a Risk Assessment Tool” in 2004 and transmitted it to the WTO.²⁰⁷ Taking into account the earlier WTO discussion, the Guidelines offer a balanced view on the use of valuation database. It points out that the value stored in the database represents the initial indicative information and serves as indicator of potential risk, alongside other indicators applied by customs. In more detail, the difference between the declared value and the

²⁰⁵ WTO (1998), *supra* note 73.

²⁰⁶ Corformat (2002), *supra* note 39.

²⁰⁷ WTO Technical Committee on Customs Valuation Response to the Terms of Reference for the Work of the Technical Committee on Customs Valuation in Connection with Concerns on the Accuracy of Declared Value - Supplement G/VAL/54Suppl. 1 (13 October 2004).

database value for the product could constitute a potential risk factor, but any such difference must be considered along with other potential risk factors, including the lack of supporting documentation and prior problems with the importer, in determining what further action is appropriate. The Guidelines also indicate a number of measures by customs to deal with identified potential risk, including monitoring of the importer; pursuing verification procedures; and post-importation audit of the importer.

One of the advantages that the PSI companies offer is their opinion on prices of goods based on their price database. Their price database contains the outcome of their market research and the previous inspection record. This is why the transfer of a price database is often seen as a crucial element for the exit from the PSI service, as seen in the case of Kenya. After the transfer, the maintenance and upgrade of the database is an essential task for customs. It would require a customs administration capable of verifying and validating import values. Many developing countries are making an effort to establish and maintain a database, drawing on the experience of other administrations. The inspection industry and other private companies can offer maintenance of the database or another supplementary source of data.

9. The need for comprehensive customs modernization

As described above, there has been an effort to explore possible solutions as a substitute for the PSI program. However, they only provide technical tools and do not offer an ultimate solution. They should be viewed as forming part of a more comprehensive approach. By way of example, valuation database requires constant updating of its data on market prices. Otherwise, the content of the database would become quickly obsolete and of little use. This implies a substantial change in the organization and operation of customs. Import values should be validated by experienced officers before they are stored in the database. The establishment of a valuation unit is necessary to study the market price of the most common and strategic goods by market research, internet, catalogues and other available means. Import declarations could be studied in depth by examining accounting books and other relevant records at importers' premises. It is therefore essential to establish a post-clearance audit unit within customs and to provide legal authority for customs to secure access to the importer's commercial data. This will also enable customs to

speed up clearance as the pressure on valuation work will be shifted from frontline to post-import stage. Conducting an investigation of importers and sharing this information with tax administrations, police, and foreign customs could be another source of verifying the accuracy of data.

In this regard, the WCO report to the WTO in May 2003²⁰⁸ on the exchange of information identifies a number of techniques and processes for the determination and verification of the value of the goods. They include valuation risk management, dialogue with importers, post-clearance audit and customs internal coordination between valuation, clearance, investigation and intelligence units. A Valuation Database is perceived as a risk-assessment tool to help customs concentrate valuation fraud controls on targeting areas of highest risk. In more detail, the WCO report recommends that customs should have the necessary legal and administrative framework for the effective implementation of the WTO Valuation Agreement, as follows: (1) a supporting legislative framework that facilitates truthful and accurate value declarations, such as the need for record keeping; (2) a comprehensive sanctions regime to address non-compliance and support voluntary compliance; (3) a legal framework that provides for the right of appeal to the importer; (4) policies and procedures governing valuation and compliance; (5) administrative and technical capacity; (6) strategies for dealing with particular sectors (e.g., the informal sector) of trade; and (7) partnership with trade. This statement of the WCO reveals that the effective implementation of the WTO Valuation Agreement requires much more than a simple government agreement or its supporting tools. It usually involves a broad and comprehensive process involving all aspects of customs administration and cannot be tackled successfully on a narrow technical or single-issue basis. As Finger suggests, “More is involved in the implementation of the WTO rules on customs valuation, than the simple removal of bad policies. Implementation is about creating infrastructure, [and] about creating the institutions that facilitate economic activity.”²⁰⁹

Bearing in mind this need for a comprehensive customs reform to discharge any responsibilities assigned to customs, the WCO Council in June 2003 adopted the Customs Capacity Building Strategy²¹⁰ which makes a case for the investment in

²⁰⁸ WTO (2003), *supra* note 1960.

²⁰⁹ Finger (1999), *supra* note 27, at 3.

²¹⁰ Available on WCO web site

http://www.wcoomd.org/ie/En/Topics_Issues/CustomsModernizationIntegrity/Strategy.pdf (last visited 6 June 2007).

customs to achieve a comprehensive customs modernization. The Customs Capacity Building Strategy was designed to convince the donor community and governments that customs is serious about addressing capacity building and wants to achieve meaningful and sustainable results. As a follow-up, the WCO established the Capacity Building Directorate in 2006.

The movement in the WCO was also an attempt to respond to the WTO Doha Ministerial Declaration in November 2001 which highlighted the role of technical assistance and capacity building, including customs-related areas. Since many developing countries have had difficulties in implementing the outcome of the Uruguay Round negotiations, they have addressed these concerns by reviewing the obligations of the WTO Agreements on one hand, and capacity building to implement these obligations on the other. This is the reason why the WTO Doha Declaration placed so much importance on capacity building, in addition to releasing the Ministerial Declaration on implementation-related issues. Ministers confirmed that technical cooperation and capacity building are core elements of the development dimension of the multilateral trading system.

In response to the WTO Doha Declaration's call for assistance in capacity building, other institutions have also raised the priority of customs modernization in their agenda. Over the last few years the World Bank has significantly stepped up their support for trade activities in order to help developing countries better integrate into the world trading system. It established a new International Trade Department in June 2002 to coordinate its policy, research and capacity building work on trade. The World Bank has published a "Customs Modernization Handbook" that advocates a comprehensive approach compared to a sector specific approach.²¹¹ The IMF has also published "Changing Customs," based on lessons learned from their technical assistance activities in the customs area.²¹² Other international organizations and bilateral donors have also raised their profile in support of customs reform. The WTO negotiations on trade facilitation are expected to produce a framework for coordinated action for capacity building in customs, including the aspect of customs valuation, among the relevant public and private sector stakeholders.

²¹¹ Luc De Wulf & José Sokol. (ed.) Customs Modernization Handbook, Washington D.C. World Bank (February 2005).

²¹² Michael Keen (ed.) Changing Customs: Challenges and Strategies for the Reform of Customs Administration, Washington D.C. IMF (October 2003).

The PSI program was initially supposed to be a temporary measure to provide necessary time to customs administrations to implement a comprehensive customs reform. However, user governments tended to over-rely on the private sector without necessarily developing the capacity of customs authorities despite its high cost. Along with a growing recognition of the need for capacity building of public institutions, international financial institutions has also started to review the use of the PSI program and have become cautious about recommending this solution to recipient countries for loans.

10. New services offered by the inspection industry

The inspection industry has also come to realize that the traditional PSI program's limitations did not necessarily have a good reputation among customs authorities and in the development community. As the development community moves towards capacity building support in a variety of areas, including IT management, maintenance of database, acquisition of cargo scanning, risk-assessment and supply chain security, inspection companies also have suggested new services to meet this changing and evolving market demand. They maintain that these newly offered services are all "supportive" for modern customs operations rather than a "substitution for customs." Many of them used to be components of the PSI program, but they were further developed as a module to address the identified key problems for customs.

(1) Development of a valuation database

One such area is the commercialization of a price database, which would be used by customs for assessing the risk of undervaluation for goods. The database would also provide prices of similar or identical goods for the valuation determination when the transaction value is not accepted. Inspection companies could offer the service of establishing and maintaining the price database until such a time when customs administrations acquires enough expertise to take over the function. In the past, the inspection companies were not eager to transfer the valuation database. Even when the database was handed over, developing countries found difficult to maintain the database updated. The maintenance of a valuation database requires an extensive

market research of price, as well as the validation of the data of import history before they are loaded in the database. The private sector and the PSI companies see their business chance in this area and suggest that they can provide supportive services for gathering of price information and data management. While this task appears highly demanding for developing countries, experts suggest a phase-in approach for customs in order to establish and maintain the database by initially focusing on the limited number of commodities. Often a small number of categories of imports in a country may yield the majority of total customs revenue collections. The use of an automated clearance system would make it easy to capture import data and the development of the internet facilitates access to the market price. Many customs authorities have been making efforts to develop valuation database as part of their automated risk management system. Some countries, including India and Indonesia have developed a highly sophisticated valuation database.

In this connection, some inspection companies have proposed a service of intelligence and information gathering for importing countries. When the value declaration is outside the range of price reference, contained in the valuation database, customs may ultimately initiate verification and investigation after careful examination, especially when commercial fraud is suspected. In the course of verification or investigation customs may wish to carry out an on-site enquiry to exporters or manufactures in the exporting country. This service would be employed both at the clearance or post-clearance audit stage. Mexico has already concluded a contract with an inspection company for an information gathering service for their post-clearance audit in 2003.

(2) Risk management and selectivity

Another service model suggested by the inspection industry is the risk assessment and selectivity program in the field of inspection of consignments. This module can be directly linked to the customs computer system to analyze the results of the past interventions. Based on this risk profiling, it would identify the risk of cargo on each customs entry, which could result in classifying the cargo into green/yellow/red channels to determine the type of customs intervention. The application of this module is expected to enable customs officers to carry out selective inspection of high-risk areas, shifting from a 100% or purely random-based inspection. This would help with the

introduction of a risk management system that would provide trade facilitation for low-risk legitimate trade, in line with the international best practice. An automated risk profiling system would require a wide range of data, especially on compliance records of importers, which would include past records on inspection, post-clearance audit or information from other law enforcement agencies. Therefore, the usefulness of this module would be maximized when it is put in place as part of the entire intelligence-based customs operations. Usually customs authorities incorporate risk management and selectivity in their IT development.

(3) Cargo scanning service

The technological development enabled customs to apply non-intrusive scanning technology for cargo inspection. A cargo scanning system comprised of huge X-ray or Gamma-ray machines has already been introduced to scan containers for concealed or smuggled goods, without opening and taking out the contents. While it could facilitate trade with a greater capacity of inspection in less time, there has been caution over the use of scanners, as they are expensive and require skill to operate. Unless it were used as part of a risk assessment and management strategy with a more selective approach, scanner operators might not select the necessary containers or they could even end up scanning all containers. Such an operation would neither detect much, nor would it facilitate legitimate trade. Inspection companies have developed a scanner service to finance and operate the expensive equipment with BOOT (Buy, Own, Operate and Transfer), BOO (Buy, Own and Operate) or leasing arrangements. With technological expertise in operation and maintenance, inspection companies could assure good functioning of the equipment. The WCO SAFE Framework of Standards of 2005 recommended the use of non-intrusive inspection equipment for security purposes where appropriate. The inspection industry has promoted the purchase of scanning equipment as a measure to enhance not only trade facilitation but also security. However, they often approach higher authorities within the government to obtain the contract without properly involving customs authorities or paying attention to customs risk management strategy. While the inspection industry moved in a discrete way, the problem of managing contract once encountered with the traditional PSI seems to shift to cargo scanning service.

(4) Destination inspection

This program entails a shift of the inspection company's physical inspection in the pre-shipment-stage in the exporting country to the destination-stage in the importing country. The physical inspection at the destination is usually combined with the use of non-intrusive inspection technology and carried out jointly by PSI employees and customs officers. However, the service normally includes the documentary examination by the inspection company to verify and certify the valuation and tariff classification of goods outside the destination location, often before the shipment of goods from the exporting country, like the traditional PSI operation. The first project was introduced in Ghana in 2000 where inspections were conducted jointly by private sector employees and customs officers, using an X-ray scanner for containers on a risk-based selective approach. The valuation and classification of imports were undertaken at the inspection companies by customs staff under the supervision of inspection company staff. The inspection was based on information from overseas affiliates of the inspection companies that conducted the preliminary investigation of the value and tariff classification.²¹³ The new business model was promoted as providing a technical solution to speed up the clearance process, compared to the traditional inspection carried out by customs authorities. This type of contract has expanded in the least developed countries of Africa. Between 2001 and June 2008 this type of contract is in force in 10 countries.²¹⁴

Low suggests that destination inspections are the same thing as normal customs work, the only question being who actually performs the task.²¹⁵ He prefers the PSI program to destination inspection, because a far greater degree of physical inspection is possible under the PSI program. Nevertheless, he sees the advantage of destination inspection as transfer of skills could be expected through jointly performed inspection by the national customs service and a private entity. This transfer of skills is questionable taking account of the poor record of the inspection industry in this area due to the apparent conflicts of interest. Destination inspection is usually combined with the cargo scanning service, because financing and the expertise of acquisition and maintenance of scanning equipment are often lacking in the least developed countries. The traditional PSI program encountered difficulties in African countries because of

²¹³ Walsh (2003), *supra* note 85, at 168.

²¹⁴ WTO (2008), *supra* note 21

²¹⁵ Low (1995), *supra* note 149, at 80-81.

insufficient cooperation from customs officers and the inefficiency in covering all imports prone to smuggling. Therefore, the inspection company have found an opportunity to modify the PSI program by introducing cargo scanning service. In this way, they could shift the physical inspection from preshipment to the destination stage while retaining the essential part of verification of value and tariff classification in utilizing their overseas network. While this service has the potential to provide supportive service for customs authorities, it has yet to prove its usefulness, especially in assisting customs authorities in developing their capacity in the core function of documentary examination and physical inspection.

(5) Supply chain security

More recently, heightened security concerns have resulted in the shift of the attention of customs control from traditional imports to the entire supply chain including export control. Following the adoption of the WCO Framework of Standards in 2005, the inspection industry has suggested a new service providing supply chain security, combining a range of services. These include validation of compliant traders, independent inspection of goods at the point of origin for security purposes, non-intrusive inspection of containers, the use of RFID (Radio Frequency Identification) technology for tracing goods, secure transmission of electronic information and the development of an end-to-end supply chain system. These services are mostly at the exploratory or pilot project stage.

(6) Other services

Another service that inspection companies suggest is the audit of customs inspection to help governments monitor its customs performance. Inspection companies could set up a second inspection program for a small percentage of consignments after customs inspection. While this program would normally be performed by customs management or the Ministry of Finance, Mexico has concluded contract to introduce this service to address integrity problem. The program has reportedly resulted in lengthy inspection by customs officers who try to avoid being detected any irregularity. In addition, the program has been extended beyond the initial expectation.

(7) Overview

Inspection companies have been trying to promote the new customs-related service as described above, in combination with capacity building assistance in customs. They put emphasis on capacity-building aspect of the service in the efforts to convince governments and donors of their relevance. One such example is the phase-out of the PSI contract over four years between the government of Madagascar and an inspection company which concluded in 2003. It included a gradual reduction of the inspection rate from 100% in the first year, to 45% in the second year, and 10% by the third and the exit at the final year. During this period it was expected that Madagascar Customs would acquire the necessary expertise in valuation, post-clearance audit and classification, with an extensive set of training offered by the inspection company.²¹⁶ The government of Madagascar has embarked on a comprehensive customs reform with the new IT system and terminated the PSI program in 2007. Political stability is considered the key for Madagascar to advance the customs reform project.

Both the IMF and the World Bank suggest that more attention should be given to the recent evolution of the service that the private sector including PSI companies offer. Representing the view of the IMF, Walsh believes that there is now a growing realization, even among the PSI companies, that the traditional PSI services may no longer be the most effective way to address issues and that the needs of customs administrations are changing.²¹⁷ On behalf of the World Bank, Wulf suggests close monitoring of these new services to evaluate its effect on customs modernization.²¹⁸ However, as discussed above for each new service, this paper argues that despite some encouraging progress, the inspection industry has yet to prove the usefulness of supporting service while it is up to customs authorities to take an ownership in properly using the offered services.

²¹⁶ Wulf (2005), *supra* note 29, at 214.

²¹⁷ Walsh (2003), *supra* note 38, at 176.

²¹⁸ Wulf (2005), *supra* note 29, at 215.

Chapter 7 Case study – the Philippines

1. Introduction and summary

This Chapter reviews the introduction of the PSI program in the Philippines and its impact on the customs function. This was one of the earliest PSI programs and it was viewed as a success story at an earlier stage, but in later stages it also displayed its limitations. This case study is intended to support the overall thesis that contracting out of the customs function started with faith in the private sector, which brought a short-term enhancement of revenue. However, upon review its benefits turned out to be mixed in the area of revenue collection in a longer term as well as in the area of capacity building in customs. The transfer of skills was limited and the dependency on the PSI delayed necessary customs modernization, such as the development of valuation database and the introduction of post clearance audit. This realization led to the recognition that there was a sincere need for appropriate regulation, complementary actions by customs, and more focus by the state on building its own capacity.

2. Economic environment

The Philippines is a lower middle income country with GNI per capita US \$1,320 (2005).²¹⁹ In addition to the traditional agriculture base, it developed a light industrial sector in the 1990's, including food processing and electronic assembly, and business process outsourcing service. However, inward investment often stagnated, and most growth came from private consumption, supported by rising overseas remittance. This lack of competitiveness compared to the neighboring East Asian countries reflects the infrastructural, macroeconomic and structural problems. A large budget deficit and high debt level were frequently identified as a major source of macroeconomic instability and vulnerability. These fiscal constraints limited the government's ability to spend resources on infrastructure and social policy. Institutional and structural problems included wide disparity in income distribution, a

²¹⁹ World Bank. "GNI per capita, Atlas Method" in World Development Indicators 2005. Available at <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNIPC.pdf> (last visited 6 June 2007).

large informal economy (estimated to be as large as 45.6% of GNP in 2002/2003)²²⁰ with a large informal employment (estimated to be as large as 72% in non-agricultural employment in 1994/2000).²²¹ Perceived corruption was another problem that would be a deterrent to foreign investment.²²² All of these elements constitute environment in which customs operates.

Successive governments had set up strategies for economic growth with poverty reduction. Actually, the latest strategy defined in the “Medium-Term Philippine Development Plan (MTPDP) 2004-2010”²²³ puts much emphasis on macroeconomic stability, including reduction of the public sector deficit. Key fiscal priorities include expanding the revenue bases and achieving budgetary savings, while at the same time increasing expenditure on infrastructure and social programs. The MTPDP 2004-2010 also recognized the need to address corruption, excessive bureaucracy and regulation.

3. Tax and tariff policy

The government revenue ratio to GDP in 2003 represents 14.6%, which is relatively low compared with other ASEAN neighbors in the same year, with 19.2% in Indonesia, 24.3% in Malaysia, and 17.1% in Thailand.²²⁴ The national government deficit represents 4.6% of GDP, exceeding annual revenue fivefold, and the debt service payments amounted to over one third of total revenue. This debt reduced the private sector’s access to finance, and hindered public investment in essential infrastructure as budgetary funds were increasingly committed to servicing debt.²²⁵ In 2004 the

²²⁰ Friedrich Schneider. The size of Shadow Economies of 145 Countries all over the World: First Results over the Period 1999-2003 IZA (Institute for the Study of Labor) Discussion Paper No 1431 (Dec 2004).

²²¹ ILO Women and Men in Informal Economy – A Statistical Picture Geneva, ILO (2002) at 19 & 22.

²²² The Transparency International rated the Philippines 121st among 163 countries surveyed in 2006 in its Corruption Perceptions Index 2006. Available at <http://www.transparency.org/news room/in focus/2006/cpi 2006 1/cpi table> (last visited 6 June 2007).

²²³ The Government of the Philippines website. Available at <http://www.neda.gov.ph/ads/mtpdp/MTPDP2004-2010/PDF/MTPDP2004-2010.html> (last visited 6 June 2007).

²²⁴ *Id.* at Chapter 7 “Fiscal Strength.”

²²⁵ World Trade Organization. Trade Policy Review – the Philippines – Report by the Secretariat (21 July 2005) 8, WT/TPR/S/149/Rev. 1.

government revenue ratio to GDP had further fallen to 12.3%. President Arroyo recognized in her State of the Nation Address to Congress in July 2004 that the most urgent problem was the chronic budget deficit that had squeezed infrastructure investment and programs necessary for peace.

The major fiscal weakness and contributor to persistent budget deficits was considered to be inadequate tax revenues. The MTPTD for 2004-2010 points out that significant deterioration in tax collection effort arose from a confluence of factors. These include non-indexation of specific taxes, poor implementation of value-added tax (VAT), tax under-declaration or evasion, proliferation of tax incentive laws and under-declaration or misclassification of imports. The MTPTD for 2004-2010 stipulates a six-year program to balance the budget, because putting the government fiscal house in order was regarded vital in assuring investors of a more conducive investment environment, a key to creating more jobs. The revenue program included improved enforcement mechanisms to increase efficiency by both customs and tax administrations, rationalization of fiscal incentives, and a broadening of the tax base for VAT and increasing VAT rate from 10 to 12%.²²⁶

In the area of trade policy, the Philippines started its trade liberalization in the 1980's to raise the competitiveness of its industrial sector. After adopting the floating system in currency in 1984, further liberalization in foreign exchange control ensued. Following the political change in 1986 with the arrival of President Aquino, the Medium Term Philippine Development Plan of 1987-1992 included a trade reform package of eliminating quantitative restrictions and licensing requirements. An import liberalization program reduced regulated commodities from 32% of tariff lines in 1980 to 2.8% in 1992. Quantitative restrictions were converted to tariff, which should be further reduced over the years. However, since the domestic industry group lobbied against trade liberalization for fear of losing tariff protection against cheap imports, it took some years to start tariff reduction. It was not until the mid-1990's that the gradual reduction of tariff started at the request of industry sector that imports capital goods and raw materials to improve their competitive edge. The need to prepare for the implementation of the ASEAN Free Trade Agreement and the outcome of the Uruguay negotiations also prompted a downward review of tariff level. As a result, the

²²⁶ The VAT rate increase was approved by the Congress and implemented on 1 February 2006.

average nominal tariff level was reduced from 26% in 1992 to 8% in 2000 and further down to 6% in 2003, as shown below in the table below.²²⁷

(Table 4-1)

Average Nominal Tariffs by Sector

(in percent)

Sector	1981	1985	1990	1991	1995	1998	2000	2001	2003
Agriculture	43.23	34.61	34.77	35.95	27.99	18.91	14.40	14.21	11.04
Mining	16.46	15.34	13.97	11.46	6.31	3.58	3.27	3.25	2.84
Manufacturing	33.74	27.09	27.49	24.61	13.96	9.36	6.91	6.68	5.43
OVERALL	34.60	27.60	27.84	25.94	15.87	10.69	7.95	7.70	6.19

Source: Tariff Commission.

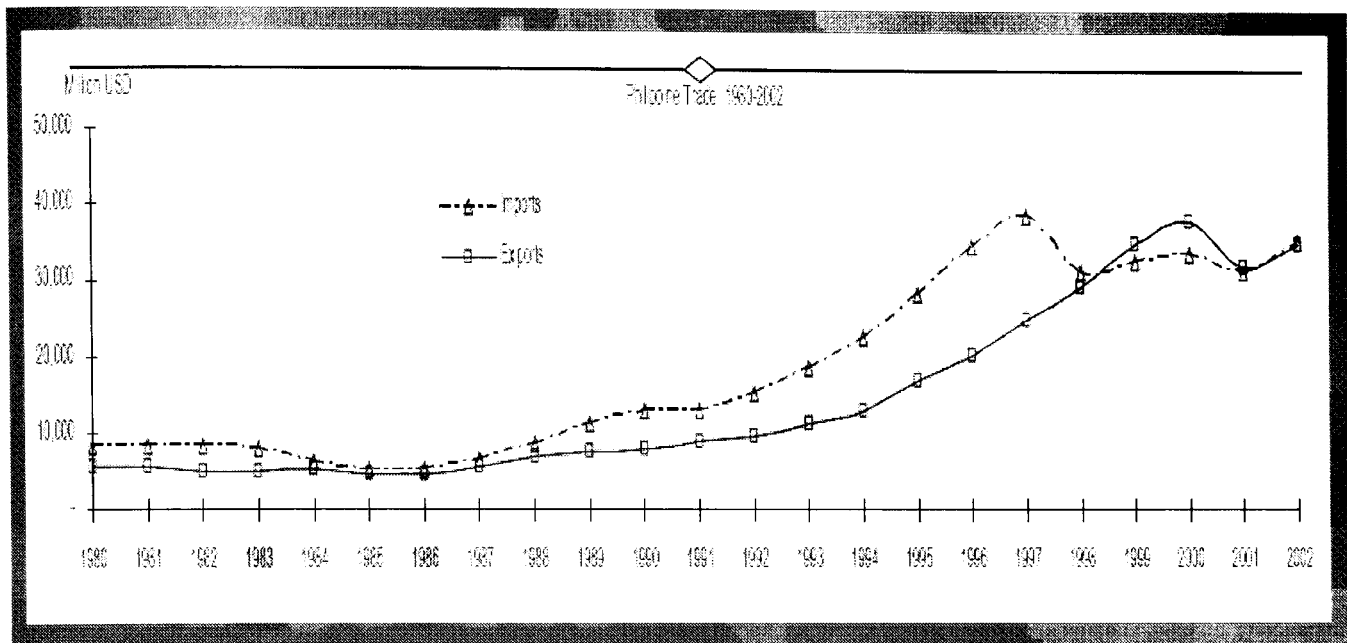
As a result of these trade liberalization measures, as well as the Asian economic boom, trade volume started to increase from 1987 and then expanded quickly in the 1990's until the Asian currency crisis hit the Filipino economy in 1997. Imports were affected from late 1997 and exports also started to fall in 2001, reflecting the sluggish world economy, as shown below.²²⁸

(Figure 4-1)

Expansion of imports and exports in the Philippines from 1990 to 2002

²²⁷ "Tariff Commission," as cited in Amelia A. Menardo. Trade, Industry and Utilities Staff, National Economic and Development Authority (8-9 September 2004) APEC High-Level Conference on Structural Reform, Tokyo, Japan.

²²⁸ Philippines National Statistics Office, cited in the presentation "What Free Trade Meant for the Philippines" by Ramon L. Clarete, Professor, School of Economics, University of the Philippines



(source) Philippines National Statistics Office

The successive tariff reductions, however, were partially reversed from late 2003, largely in response to political pressure to protect domestic industry and to increase customs revenue. Thus the average tariff level rose from 5.8% in 2003 to 7.4% in 2004.²²⁹ A number of general and sector-specific tariff exemptions still remain, which adds complexity to tariff regime and furthers losses in revenue.

4. Customs profile and its environment

The history of customs administration dates back to the 16th Century under Spanish colonial rule while collection of tributes associated with trade existed even before that period. It was the passage of “The Philippines Customs Administrative Act” in 1902 under the US colonial regime that the current customs service was created. Later it was transformed to the Bureau of Customs (BOC) under the supervision of the Department of Finance. After independence in 1947, the Customs and Tariff Act was passed by the Congress in 1957, an expression of autonomous tariff policy.

Nowadays, with a workforce of 5,500, the BOC is headed by a Commissioner under the supervision of Secretary of Finance. Since 1947 there have been 32 Commissioners nominated; with a few exceptions the change has been frequent. The Commissioner is assisted by five Deputy Commissioners and 14 District Collectors, each

²²⁹ WTO (2005) *supra* note 225.

responsible for a district port. Under the high budget deficit, the main mission was revenue collection, providing 18% of total revenue. The BOC is constantly under huge pressure to achieve revenue targets set by the Department of Finance in a commercial environment where ensuring acceptable level of compliance is not always easy. The proper application of customs valuation is therefore an important issue for customs, together with combating smuggling. The BOC has also been pursuing reform process, supported by Information Technology (IT) to enhance its revenue function. This reform should address other responsibilities of the BOC to improve investment climate, as well as to effectively combat criminal organizations involved in smuggling, drug trafficking and other illegal activities.

The IT system, called ACOS (Automated Customs Operation System) was developed based on the ASYCUDA (Automated System for Customs Data Management) ++ system of the UNCTAD since 1993 and completed in 1999, which resulted in some efficiency gain. The challenge for the BOC is the sustainability of the reform process, including the funding for maintaining and upgrading the ACOS. Along with the development of IT available for business, the BOC is now planning to introduce an internet-based system as the core of their continued reform efforts.

5. Challenge of customs valuation²³⁰

Since the creation of the modern customs service in the Philippines in 1902, the major concern of customs has been to acquire reliable and timely price information on which to base customs valuation. Whereas customs had a discretionary power to determine the value in the pre-Customs Valuation Agreement era, the BOC suffered from the asymmetry in valuation information between customs and trade, which resulted in undervaluation and misclassification employed by fraudulent importers to circumvent full payment of duties. In terms of revenue leakage one estimate is that the extent of under-invoicing ranges from 12.2 to 53.0% of recorded imports.²³¹

²³⁰ This section greatly owes to the Ramon L. Clarete "Customs Valuation Reform in the Philippines" Background paper prepared for the World Development Report 2005 (2004). Available at http://siteresources.worldbank.org/INTWDR2005/Resources/477407-1096581040435/wdr2005_philippines_customs_reform2.pdf (last visited 6 June 2007).

²³¹ Guillermo L. Parayno Jr., "Philippines" in Luc De Wulf & José B. Sokol (ed.)

The BOC followed the Brussels Definition of Valuation (BDV) method of using notional market price of imported goods as the basis for customs valuation. Customs and Tariff Act of 1957 that has established autonomous tariff policy contained customs valuation rules requiring the use of market value. The “market value” was defined as domestic value of the same or similar merchandise when sold in the Philippines, appropriately adjusted to make it comparable to the value of the goods at border. It also authorized the use of invoice value when they were believed to match notional market value. However, the wide-spread under-invoicing and weak customs research capabilities on domestic market, which resulted in the lack of accurate information, made the “market value” system difficult to apply properly. Compounded with high tariff rates, therefore, the “market value” rules gave both business and customs an incentive to negotiate mutually acceptable values, resulting in revenue leakage and corruption.

In order to deal with these problems, in 1972 the Philippines adopted the “Home Consumption Values” system, whereby customs valuation is based on price at the wholesale level in the exporting countries, plus applicable shipping and insurance charges. Customs was required to publish the list of home consumption values and constantly upgrade it with the help of overseas consular offices in collecting price data in the exporting countries. Moreover, exporters could obtain consular certification of the authenticity of values contained in commercial invoices of goods bound for the Philippines at the Filipino diplomatic service in the exporting countries.

The success of this system was entirely subject to the reliability of published lists of home consumption values, updated by price information provided by the overseas diplomatic service. However, the gathering of price information by diplomatic officers was never sufficient in its coverage, accuracy and timeliness. Moreover, budget constraints caused the downsizing of the country’s diplomatic offices and their workforce abroad, resulting in the deterioration of the quality and quantity of price information of exporting countries. Furthermore, the consular certification service was abolished in 1985, which was another source of price information.²³² As a result, the list of home consumption prices was of limited coverage, and became increasingly

Customs Modernization Initiatives, Case Study. Washington D.C. World Bank (2004) at 89.

²³² It was reported that the involvement of diplomatic officers only resulted in spreading the integrity problem rooted in customs administration to consular offices.

obsolete and different from actual market values in the exporting countries for goods covered by the list.

A survey carried out by the SGS in 1987 revealed that 80% of the merchandises imported the Philippines did not have any published values, and out of the remaining 20% that had published values, only half of them were acceptable as a basis of valuation. In the absence of reliable information, customs officers claimed that they gradually had to accept whatever value importer declared. The lack of real time synchrony between published official home consumption value and actual market price, as well as the narrow coverage of the published list were identified as the main causes of poor revenue collection. The question of integrity was also highlighted, coupled with collusive behaviour between some customs officers and business people.

6. Introduction of PSI program and its development

It was under these circumstances that the PSI customs service was introduced to restore the imbalance in information between customs and importers in 1987. Hiring a private sector company to strengthen revenue collection was perceived as part of an economic reform under the newly-established government of President Corazon Aquino. A contract was concluded with the SGS with the scope of a limited number of countries, namely Japan, Hong Kong, and Taiwan in 1987.²³³ The SGS issued a Clean Report of Findings (CRF) to the BOC, indicating the validated dutiable values and classification after conducting inspection of merchandises in the exporting countries. It was intended to address the ineffectiveness of the home consumption values system by providing customs with price information in exporting countries. The PSI program was progressively expanded both in geographic coverage as well as the type of goods subject to inspection as a measure to enhance revenue collection. It was in 1992 that a “Comprehensive Import Surveillance Scheme” was introduced that required all goods destined for the Philippines with a value in excess of US \$500 to be inspected prior to shipment by a representative of SGS in the country of shipping. At the same time, the new administration under President Ramos launched a horizontal customs reform by appointing a new Commissioner who stayed during the Ramos presidency till 1998.

²³³ The Philippines was the second country in Asia to conclude a PSI contract in customs revenue after Indonesia that had concluded one in 1985.

This stability at the top management, which was an exception to the BOC history, was said to have contributed considerably to the sustainability of customs modernization during the period.

Later, in 1995 the WTO Agreement on Customs Valuation entered into force and made it mandatory for WTO members to apply the new valuation system, based on transaction value. As part of its obligation as a developing country WTO member, the Philippines made efforts in adopting the transaction valuation system by 2000, as mandated by the WTO Agreement. The Philippine Congress passed a law in 1996 that reflected the provision of the WTO Agreement. However, this law also enabled customs to use published notional values in determining import assessments. Customs authorities were instructed to use the higher of the two methods, namely transaction values and published home consumption values. This legal arrangement reflected the fear of domestic industry that the transaction valuation scheme would facilitate the dumping of imported merchandises. The domestic industry lobbied for the continued use of the list of published values, based on the presumption that many of imports were undervalued. The 1996 law was a compromise between the need to comply with the WTO obligation and to address the domestic concern.

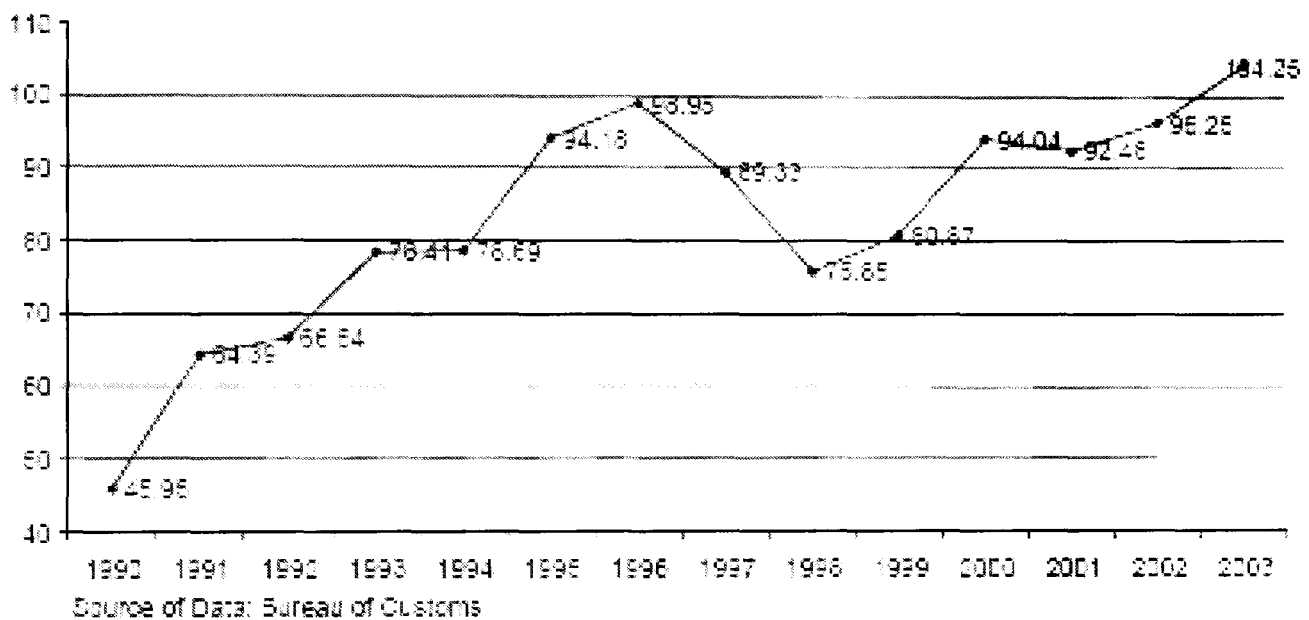
While the PSI service could have been regarded as a complementary means in providing information to update the list of published values under the law of 1996, the new government of President Estrada, sworn in 1998, ordered a review of the service and decided to terminate the service altogether in March 2000. In 2001 a new law was enacted to improve the valuation system to make it fully consistent with the WTO Agreement and removed the published values from the basis of valuation. As a safeguard to the potential threat of undervaluation, the new law established the post-entry audit system by customs to ensure compliance of importers.

7. The performance assessment of PSI

The PSI service was implemented between 1987 and 2000 at the same time as trade liberation measures were adopted. As a result of trade liberalization and the favorable economic environment of the neighboring East Asian countries, import volume started to grow from 1987, which coincided with the introduction of the PSI

service. This growth continued until 1997 when the Philippine economy was hit by the Asian currency crisis. Import growth had a positive effect on customs revenue by enlarging the taxable basis. However, the reduction of tariff level itself had a negative effect on customs revenue, while it certainly contributed to the increase in imports. The import volume grew almost threefold by 188% between 1990 and 1996 (calculated in peso), which should have had a positive effect on revenue. At the same time, the average nominal tariff level was lowered from 27.84% to 15.87% during the same period, which should have a negative effect on revenue. It requires more in-depth analysis to analyze the contribution of PSI program to improved revenue collection, which more than doubled by 115% during the same period, as shown below.²³⁴

(Figure 4-2) Philippines BOC collection: 1990-2003 (in billion pesos)



(1) Assessment by academics

In assessing the revenue performance of BOC, Clarete quotes the study of Abrenica and Tecson, who analyzed the effect of automation on customs revenues in the Philippines. They compared customs duty collection over GDP and projected customs duty collection over GDP, calculated based on trade volumes, annual average tariff level and import duty exemption.²³⁵ The annual customs data used in this analysis was

²³⁴ "Bureau of Customs," as cited in Clarete (2004), *supra* note 230, at 34.

²³⁵ Abrenica and Tecson, as cited in Clarete (2004), *supra* note 230, at 38.

from 1993 to 2002, covering the beginning of the automation project and the supposed period for having its full effects on revenue performance. The study assumed that if the relationships between actual and projected ratios were similar over the years, it could be inferred that automation had little effect on revenues. The table below shows that the change in relationships over the years, indicated in the column G, do not clearly show the upward trend of the actual customs duty collection surpassing the projected customs duty collection. Abrenica and Tecson concluded from this result that the expectation of automation enhancing the revenue generation capacity of customs has not materialized.

(Table 4-2) Effect of Customs Valuation: Analysis of Customs Duty Collection Normalized for Changes in Imports relative to GDP. Average Tariff Rates and Duty Exempt Imports

Year	Custom duty over GDP (in %) (A)	Imports over GDP (in %) (B)	Simple average tariff rate (ATR) (in %) (C)	Dutiable imports over total imports (in %) (D)	Imports over GDP times ATR times dutiable import share (E) = (B)*(C)*(D)	Projected customs duties over GDP based on a pre-reform (1993-1999) structure (in %) (F ^a)	Actual customs duty over projected duty (in %) (G) = (A)/(F)
1993	2.8	32.5	23.5	61.0	0.05	3.3	85.27
1994	2.9	33.6	19.7	60.8	0.04	2.8	102.24
1995	2.9	35.7	15.9	61.4	0.03	2.5	118.06
1996	2.7	38.6	15.6	60.8	0.04	2.6	104.63
1997	1.9	44.4	13.4	57.7	0.03	2.4	78.53
1998	1.6	45.3	10.7	40.6	0.02	1.4	115.36
1999	1.4	40.7	10.0	43.1	0.02	1.2	113.24
2000	1.5	42.2	8.1	43.0	0.01	1.0	144.79
2001	1.1	42.1	7.7	48.0	0.02	1.1	100.30
2002	0.9	38.5	6.6	45.6	0.01	0.8	110.20

^a F = Base A * E_t / Base E; Base A = 1993 to 1999 average of A; Base E = 1993 to 1999 average of E; t is year.

Source of A through D: Abrenica, J. and Tecson, G. (2004)

Clarete applied the same technique to analyze the effect of transaction valuation reform on revenues, implemented in 2000. By comparing the relationships between actual and projected ratios in the post-transaction valuation years of 2000-2002 with those in the years before 2000, he determined that the collection performance of the

BOC was at par before and after the implementation of the WTO Customs Valuation Agreement. In spite of the much fear of the possible negative effect of the new valuation system on the revenue, she concluded that this fear was unfounded.

The above assessment of computerized customs procedures by Abrenica and Tecson could be also pertinent to the effect of PSI service, because the coverage of PSI was expanded to full application in 1992 and terminated in 2000, the same as the period of automation. Both measures of the automation and the PSI program were expected to provide upward trend of actual collection over projected collection. The absence of an upward trend in revenue collection between 1993 and 2000 however did not show a positive impact of PSI service either, based on the Abrenica-Tecson methodology.

Likewise, the analysis of Clarete on the effect of migration to the transaction value system could be used for the effect of terminating the PSI contract, which coincided the application of WTO Agreement in 2000. There was a widely shared fear that both the change in valuation methodology and the end of PSI service might adversely affect the revenue level. The fact that collection performance in the post-PSI years 2000-2002 did not fall indicates that the concern of revenue loss as a result of the termination of PSI contract was also unfounded.

In another publication, Clarete observes that using the data on collection related to the three major ports of the country (Port of Manila, Manila International Container Port and Ninoy Aquino International Port) for the period before and after the introduction of transaction valuation, revenue increased by 2.6% in 2000-2001.²³⁶ He suggests that the transaction valuation reform brought down the unit values of imports, which then expanded the base of import tariffs and border taxes.

One could argue that the effect of PSI could have been fully materialized by 1993 when the PSI was enlarged to a comprehensive geographical coverage, following the gradual expansion of its coverage since 1987. One could maintain that this continued good performance of revenue collection after the termination of PSI could be interpreted such that the effect of PSI could be incorporated in the customs operations and be sustained even after its discontinuation. Despite the allegation of the lack of transfer

²³⁶ Ramon L. Clarete "Philippines: Adopting the Transaction Basis for Customs Valuation" in (ed.) Peter Gallagher, Patrick Low & Andrew L. Stoler. Managing the challenges of WTO participation – 45 case studies, WTO, Cambridge University Press (2005).

of technology, customs officers might have learned the valuation methodology from the PSI employees, as viewed in the next section of exit strategy. If this argument holds, it might indicate that the duration of PSI service should be limited to a short period in which customs officers acquire valuation knowledge based on the PSI method.

In a similar attempt to quantify the effect of PSI service, Anson, Cadot and Olarreaga show an ambiguous effect of PSI service on the level of customs fraud.²³⁷ First, they make a prima-facie analysis, based on a comparison between the trade statistics of source and destination countries at the tariff-line level. They presume that source and destination trade statistics in value show a parallel movement in the absence of fraud. If the PSI service addresses the under-invoicing problem, there should be a narrower difference in aggregate trade values between source and destination countries. Across the 16 countries they find that 6 shows positive change toward narrower difference, 2 negative, and 8 inconclusive, including the Philippines. Second, they introduced an econometric approach, based on game theory between importers' fraud decisions and customs efforts in preventing them to assess the PSI effects in three countries. Their model suggests that the PSI service shows an ambiguous impact on the extent of fraud, and the findings indicate that the PSI was useful in the Philippines, worsened the situation in Argentina, and had no effect in Indonesia, all of which are inconsistent with the prima-facie analysis.

The macroeconomic approach so far has not provided a clear-cut positive effect of the PSI program in the Philippines.

(2) Assessment by BOC

There is an estimation of PSI revenue contribution by the then Commissioner of the Philippine Customs, Mr. Parayno.²³⁸ He estimated that the introduction of the PSI program was helpful in improving revenue with the caution that the PSI service could not cover all aspects of customs operations. In fact, there were reports of cases where shipments were split so that they were below the inspection threshold to avoid PSI inspection or where the goods were declared under the category of exempt goods,

²³⁷ Jose Anson, Olivier Cadot & Marcelo Olarreaga. "Tariff Evasion and Customs Corruption: Does PSI Help?" (August 2003) Policy Research Working Paper, World Bank

²³⁸ Parayno (2004), *supra* note 231, at 96.

including household goods for personal use. Other reports revealed that containers had been tampered with after inspection at the port of origin by PSI agents and the consignments inside the container were replaced with goods for smuggling. Another technique of circumvention was the abuse of the bonded area where goods were supposedly imported for re-export and thus free of duty and then in practice they were diverted to the domestic market. In support of this circumventive phenomenon, Dean Yang empirically shows that the introduction of PSI in the Philippines reduced the targeted method of duty avoidance, but led to substantial displacement to an alternative duty-avoidance method (split of shipments into below threshold, shipping via duty-exempt export processing zone).²³⁹ These leaks were almost impossible to measure, but he suggests that this phenomenon could be construed as the evidence of the enforcement effect of the PSI program. He concludes that governments seeking to discourage an undesirable activity face the possibility that increased enforcement [PSI program] could simply push the activity to alternative channels. He suggests that crime displacement can be very large when the enforcement targets just a subset of lawbreaking methods [under-invoice], so that the amount of crime may be essentially unchanged after the increase in enforcement.

As quantifiable figures of PSI effects, Parayno recalls that in 1997 the BOC established a study group to evaluate the PSI contract. The study group noted that if the service were to be terminated at that time, an estimated 2 billion peso per year, net of inspection fee, would be uncollected. This was described as the difference between the estimated valuations by SGS and the declared invoice values, hence the direct outcome of PSI service. On the other hand, the positive impact of PSI service on revenue will not necessarily be limited to the direct effect as explained above. In fact, the BOC study group also mentioned other possible negative impacts of PSI termination, including, the loss of deterrence to incorrect declarations and to smuggling provided by cargo inspection abroad. These effects were however difficult to verify in a quantifiable way.

²³⁹ Dean Yang. "Can Enforcement Backfire? Crime Displacement in the Context of Customs Reform in the Philippines." (Sept 2006) Accepted for publication in *The Review of Economics and Statistics*. Available at http://www-personal.umich.edu/~deanyang/papers/yang_displacement.pdf (last visited 6 June 2007).

Using the estimate of Clarete that the PSI cost 3.7 billion peso a year,²⁴⁰ the increase in revenue by using the PSI program was estimated 5.7 billion peso or 50% above the cost, which is not negligible. On the other hand, compared to the total BOC revenue collection in 1997, amounting to 98.95 billion peso, this estimate shows that the direct net impact of PSI on revenue would be calculated at the order of 2%.

These figures could be seen as showing concrete benefit of the PSI service, but also its relatively limited magnitude and expensive nature. In fact, Clarete observed that critics, a few of whom were in high positions in the Philippine government, claimed that the Philippines did not get a good return from the PSI contract. The critics maintained that the data and analysis provided by the PSI firm fell short of proving the claim to them. They may have wondered what would have happened if the government spent the same amount of PSI fees in the reform of customs. When President Estrada took office in 1998, he ordered a review of the contract, reportedly saying that the government was not getting anything for the billions of pesos it paid the SGS and smuggling (customs fraud) had remained rampant. He also pointed out the SGS's failure to transfer its technology to the Philippines, giving the Philippines a bad reputation.²⁴¹

On the other hand, Parayno estimates that the PSI service had more positive effects in trade facilitation rather than revenue increase, with a caution that the PSI measure should be matched by the customs efforts in fighting against smuggling and other circumventing measures from PSI. In the area of trade facilitation, he points out that full container load shipments inspected at the port of exportation and sealed were deemed to have been examined for customs purpose and would not have to be re-examined upon the arrival in the Philippines. It has a considerable effect on simplifying import procedures and possibly reducing the opportunity for unnecessary interaction between customs officers and traders. In a more precise manner, Low shows the positive effect on trade facilitation by quoting study results that between April and November 1992 the containers released within 48 hours increased from 10.3% to 26%.²⁴² Moreover, this treatment facilitated the shift of customs procedures to more selective inspection of consignments from a mandatory 10% inspection of all consignments, as PSI-inspected containers were waved from this obligation. Following

²⁴⁰ Clarete (2004) *supra* note 230, at 44.

²⁴¹ Newsflash, Philippine Headline News Online (8 March 2000). Available at <http://www.newsflash.org/2000/03/pe/pe001066.htm> (last visited 6 June 2007).

²⁴² Low (1995), *supra* note 149, at 70.

this experience, the law was amended in 1993 to remove the mandatory inspection of 10%, enabling customs authorities to adopt more rational criteria for choosing which consignments were to be physically inspected. It should be noted however that this gain in trade facilitation at the port of importation was made possible at the cost of inspection at the port of export.

8. Effects of PSI service on integrity

The introduction of the PSI service was often promoted by PSI companies as a measure to address the integrity problem in the customs field. When a customs administration is weak in performing its function, there is often an opportunity for rent seeking by both customs officers and the private sector companies involved in trade. This is a complex problem, caused by several factors, involving customs specific elements but also deeply affected by the social and political context in which customs operates.

(1) Causes of corruption and possible remedies

In the case of the Philippines, the informal sector of the economy is significantly large, estimated to be as high as 43% of the total economy according to the World Bank survey. Consequently, customs officers are suspicious of compliance by traders and try to raise the tax liability of importers by uplifting value and applying tariff classifications with higher duty rates. With the lack of reliable information and expertise, compounded with a poor compliance situation, BOC officers tend to see importers as akin to tax evaders and consequently engaged in lengthy examinations at the border on all goods to verify the accuracy of documents submitted by importers. Moreover, the national rules on customs valuation that made 100% examination mandatory and allowed wide ranges in interpretation of valuation before the adoption of WTO rules exasperated the problem and provided a breeding ground for malpractice. Importers, represented by customs brokers, often sought to negotiate with customs officers in an effort to get lower tax liabilities or even offering a bribe. In addition to possible collusion with importers in fraudulent activities, there is another type of bribe of customs officers, called a "facilitation fee" against which customs officers agree to

speed up clearance. Customs officers were sometimes accused of delaying clearance to extort “facilitation fees.”

An important background to corruption was the lack of adequate human resource management. Recruitment and promotion are often subject to political patronage and interference, which could hamper the BOC management to exert strong leadership. Customs officers could show more loyalty to their political patrons than to the BOC management. Training for personnel was often criticized as neither sufficient nor well organized, caused by poor allocation of resources by the government. The BOC is not equipped with suitable training facilities and often has no choice but to rely on foreign donors for training without being able to adequately incorporate the training into the career path program of employees. Observers often point out that there remains room for improvement in providing decent working conditions. In this connection, it is noteworthy that the extremely low level of salary for government officers in the Philippines, including customs officers, was often identified as the root cause of the integrity problem. This situation could result in seeking opportunities to supplement low pay by colluding with importers in their tax evasion or collecting “facilitation fee” to be shared among customs officers. Parayno explains that the salaries of nearly half the staff members were below the official poverty line for an income earner with a family of six, and that the salary of customs personnel itself was the source of corruption.²⁴³

Since the cause of corruption is multi-faceted the remedies should cover a range of areas to effectively address the problem. First, it is essential to provide accurate information to customs officers to prevent fraud by importers, a major ground for corruption. Second, it is vital to reduce opportunities for discretion of officers by simplifying procedures, in particular through automation. Third, it is helpful to give an incentive for traders to improve their compliance through risk management. Fourth, it is crucial to strengthen human resource management, including providing adequate pay levels and monitoring performance. However, most of all, political will and commitment is indispensable to support customs management in the fight against corruption. In this connection, the Public Ethics and Accountability Program, which the Aquino administration introduced to combat corruption, had a major influence on the shape of customs reform.

²⁴³ Parayano (2004), *supra* note 231, at 94.

(2) Effectiveness of anti-corruption measures

It is difficult to measure the effect of the PSI program on integrity, but the improvement in clearance time could be used as proxy. The positive progress in shortening clearance time might indicate a reduction in interaction between customs and trade. While the PSI report could be useful in addressing the asymmetry of information, it would have a limited role in tackling corruption involving a “facilitation fee” or little role in smuggling, as those activities do not necessarily involve fraudulent import documents. In dealing with these issues, it is essential to simplify customs procedures which will diminish the chance for “facilitation fees,” but also to reduce the opportunity for traders and customs officers to engage in negotiation for favorable tax liability treatment.

The PSI regime of simplifying import procedures played a role in this respect, even if at a considerable cost of export procedures and public expenses. The BOC tries to make the best use of automation in reducing the human intervention in clearance. In doing so, it reviewed all the entire procedures and introduced a selective system for inspection. This as a major shift from physical inspection of as many as consignments possible to more focused allocation of resources to high-risk area. At the same time, it allowed the BOC to introduce measures to encourage importers to improve compliance by giving facilitative measures to compliant traders, including reduced inspection and faster clearance. In this connection, Parayno estimates that the PSI service has contributed to the introduction of selectivity through the exemption of physical examination of sealed containers.²⁴⁴

On the other hand, as the major setback in the anticorruption efforts, Parayno points out the failure of the Parliament to accept proposals to exempt customs employees from the public pay system and provide them with remuneration equivalent to the private sector. The proposal was abandoned on the ground that it could lead other civil servants to ask for higher salaries, but many law makers reportedly believed that customs personnel had access to other illegal source of income and that therefore did not need a salary increase. Parayno regrets that this parliamentary rejection undermined the internal motivation of staff and the organizational support for to improvements in the integrity situation parallel to customs modernization. He

²⁴⁴ Parayano (2004), *supra* note 231, at 92.

observed that value formation workshops and training did not have any significant effect on corruption, due to inadequate compensation. In fact, the USTR report on the Philippines in 2000 points out that there are periodic reports of requests by customs officials for the payment of (unrecorded) “facilitation” fees which are not related to service rendered.²⁴⁵ This statement was written at the last phase of PSI days, which might show how the similar effects the little effects of PSI program were on “facilitation fee” side of integrity issue.

The revenue performance by tax and customs agencies has recently improved considerably, achieving revenue targets more or less.²⁴⁶ However, as the Economist points out, the recent improvement is often seen achieved “by cracking the whip over the sluggish and corruption-riddled tax-collection agencies.” In fact, the Attrition Act of 2005 sets incentive payments to those who over-perform target and dismissal to those who fail to achieve target by 7.5% to be implemented in the future. This anticipated introduction of incentive and sanction measures might have impacted the improved performance of BOC revenue collection. However, there has been a considerable increase in complaints and appeals for review on duty collection lodged by importers.

9. Exit strategy from the PSI service in relation to capacity building

The PSI service was introduced to provide customs administration with valuation and classification information as a short-term measure and provide the time to gradually acquire expertise before customs resumes full responsibility. In the case of the Philippines, the PSI service was expanded to a comprehensive coverage in 1992, parallel to the customs reform and modernization package. It was supported and advised by the World Bank. However, the Philippine government states that the decision to contract the service of a PSI company was an autonomous policy made by the government and it had nothing to do with the requirement of any international institutions in order to meet revenue collection targets.²⁴⁷ The central element of this reform program was espoused in 1992, entitled “The Blueprint for Customs

²⁴⁵ USTR, “National Trade Estimate on Foreign Trade Barriers 2000.”

²⁴⁶ “Muddling along” *Economist* (22 June 2006).

²⁴⁷ World Trade Organization, Working Party on Preshipment Inspection. “National Experience with the Agreement on Preshipment Inspection – Submission by the Philippines” (29 May 1997) G/PSI/WP/W/4.

Development towards the Year 2000". It was an application of advanced information and communication technology, using the ASYCUDA ++ system. This process presupposed the reengineering of customs procedures based on risk management and compliance of traders. Another impetus for the modernization at a later stage was the application of the WTO Agreement on Customs Valuation, scheduled for 2000.

Since the new valuation system will transform PSI reports into risk assessment tools as opposed to direct tools for valuation, the government considered that the value of PSI service was reduced and therefore it discontinued the PSI contract in 2000. The reform efforts were concentrated on automation during the PSI era, which prepared for the following measures for the exit, but it was only towards the end of the PSI program when the government belatedly started to embrace a clearer exit strategy. While automation started almost the same time as the initiation of the PSI service, major measures for regaining the traditional function, including valuation database and post-clearance audit, were introduced after the termination of the PSI program. There were frequent changes in the commissioner of customs from 1998 to the end of 2005. Having 8 commissioners over 8 years was not helpful in pursuing customs reform in a consistent manner. Upon the arrival of a new commissioner, the modernization process would be restarted or considerably reviewed. Frequent changes in management reflect the difficulty in getting political support for customs modernization in a sustainable way in the Philippines.

(1) Modern customs procedures and automation

The customs reform in the Philippines was driven by information technology. The introduction of automated system (ACOS) started in 1993 and was completed in 1999, with US \$27 million. It involved the assistance of several international agencies, including the World Bank (with lending of US\$ 19 million) and the UNCTAD (providing technical assistance in installing its ASYCUDA++ system.).

The ACOS addressed the problem of an insecure collection and payment system by its linkage to banking IT system, and thus enabling customs to verify payments of import duties and taxes in real time. At the same time, automation required streamlining customs procedures, as it would not make sense to use it only for speeding up documentary processing, based on the existing paper-based procedures. As a

result of reengineering of customs system and procedures, the UNCTAD maintains that signatures required to release a cargo from the port were reduced from 92 to 5, replacing about 30 documents with a Single Administrative Document, which resulted in a remarkable contraction of the period for processing a cargo in the area where the ACOS was introduced.²⁴⁸

This feature was expected to improve the integrity situation by reducing unnecessary face-to-face human interaction between customs officers and business and reducing the discretionary power of customs. Since the perception of widespread corruption in customs was one of the background factors for contracting out the valuation function to the PSI service, automation was expected to address this problem, especially as it reduced opportunities for the negotiation of duty to be paid and the “facilitation fee.”

In reality, the automation met varying degrees of resistance from the customs workforce, importers and brokers who had been used to the manual method of processing. Most of the resistance derived from feelings of insecurity due to the perception that jobs would be lost as people were replaced with automation. In sum it was a fear of the unknown, and the BOC management launched an aggressive Change Management Program to allay these fears.²⁴⁹ Parayno points out that resistance to computerization was caused by the elimination of much of the face-to-face interaction, which had hitherto characterized the manual and paper-based systems and had created opportunities for customs officers to obtain gifts and favors.²⁵⁰

The ACOS also paved the way for selective inspection through its systematic management of data and automated selectivity system that tags high-risk shipments. Selective inspection of consignments based on risk assessment had already become the “best practice” in the customs world, especially in implementing a transaction value system, by the time the BOC decided the ACOS project. Its core ASYCUDA ++ system already incorporated these principles of modern customs operation, including selectivity

²⁴⁸ UNCTAD Technical Note, “Use of Customs Automation System” (October 2005). Available at http://r0.unctad.org/ttl/technical-notes/TN03_CustomsAutomationSystems.pdf (last visited 6 June 2007).

²⁴⁹ Georges Jereos, Deputy Commissioner, BOC, WTO Workshop on Technical Assistance and capacity Building on Trade Facilitation, Geneva (10-11 May 2001). Available at www.wto.org (last visited 6 June 2007).

²⁵⁰ Parayano (2004), *supra* note 231, at 93.

criteria whereby the ACOS selects shipments for release (green lane), documentary examination (yellow lane), and documentary examination plus physical inspection (red lane). The selectivity criteria included elements related to revenue and those related to the requirements by other government agencies.

The real challenge was the implementation aspect of risk management and the updating of selectivity criteria. In terms of risk management, it was in 1993 when the ACOS project started that the parliament amended the customs legislation, allowing the BOC to shift away from the mandatory inspection of consignments. This legislative change facilitated the BOC's preparation to adopt modern customs techniques in the context of applying the WTO Agreement on Customs Valuation. However, the development of database and selectivity criteria has been slow. In fact, the BOC developed the valuation database after the termination of the PSI service, as described below. Therefore, the benefits of automation were not maximized before the implementation of the transaction valuation system. Another challenge was the risk indicators provided by other government agencies required a high level of inspection. Moreover, it was reported that goods in the red channel are released quicker than those at green channel, raising the question of the effectiveness of risk-based clearance practice.

(2) Valuation Range Information System

Under the new WTO obligations, the customs administration has to use transaction values, declared by importers, as the primary basis for customs valuation. However, the customs administration may ask the importers to provide further explanation when it has reason to doubt the truth or accuracy of invoices and other documents in support of this declaration. With the implementation of the WTO obligations, some countries transformed PSI reports, at least in theory, from the basis of value determination to benchmarks for assessing the truth or accuracy of invoice values as a risk assessment tool.

In the absence of the renewal of PSI contract in 2000, the BOC developed the Value Range Information System (VRIS), a valuation database as a tool for assessing the risk of undervaluation of the declared value. The VRIS is a database in the ACOS

and establishes a normal value range for each imported item. It automatically tags declarations falling outside the range, which will result in the review of the declarations concerned by the Valuation and Classification Review Committee, set up by the BOC at each port of entry. The Committee determines whether the declared value is justifiable based on the documents submitted by importers.

There is an observation that the BOC should have negotiated the establishment and transfer of the valuation database with the SGS at the initial contract as part of an exit strategy. Actually, it was only at the application of the WTO Agreement of Customs Valuation in 2000 that the BOC started to develop the VRIS. However, the PSI report was based on price information at the country of export, which would not be necessarily feasible for the BOC to fully emulate without external assistance. With long-time reliance on intelligence and risk management provided by the PSI service, the BOC personnel did not have much motivation to develop these functions. The inspection company did not encourage the development of a valuation database by BOC, as it had an obvious conflict of interest. The VRIS was designed to be based on a range of sources of information, but the BOC currently uses verified import data as the basis for input to the VRIS. In practice, it is reported that the Philippine industry often submits price lists of domestic industry, which could be used as a means of protecting the domestic industry.

The usefulness of a valuation database will depend on its constant updating with reliable data. Instead of automatically entering the import history, experienced officers in the BOC validate, and correct if necessary, the declared value ranges of merchandise that is submitted to customs before they place them in the database. Unfortunately, import declarations can not be trusted on their face, due to the poor level of compliance by traders. The VRIS is updated every quarter with this validated data to keep it abreast of the price changes. The challenge of the valuation database is a further categorization of goods belonging to the same tariff line. Since the value of an item belonging to the same tariff line can vary depending on its characteristics, including its function and brand, it would be helpful to create sub-category for goods of different characteristics, even if they belong to the same tariff line. In this case, the description of goods needs to be sufficiently detailed and precise. Otherwise there might be many cases of unnecessary “hits” by the system.

(3) Post-clearance audit

Before the introduction of the transaction valuation system, customs control focused on border enforcement where customs officers determine the valuation, based on relevant information, including PSI reports. Goods were released only after the settlement of duty assessment and payment, and the verification of compliance with other laws and regulations. However, under the new valuation system, BOC officers verify the import documentation without the assistance of the PSI service. It has become practically impossible to verify all documents and determine their acceptability as a basis of valuation solely with border enforcement. Moreover, there are valuation-related elements, including royalties and commissions that are difficult to determine from invoices.

In dealing with this challenge, customs administrations around the world developed post-clearance audits to improve compliance of traders. This approach implies that customs would increasingly rely on importers' self-assessment and their voluntary compliance with customs laws and regulations. Accordingly, it was made mandatory for importers and customs brokers in the Philippines to keep import and relevant business records for three years after the importation for audit purpose. In practice, customs authorities collect and accumulate information on importers and develop risk profiles, from which they select the importers to be audited. Then, customs officers carry out a post-clearance audit at the importers' premise to ensure compliance, including appropriate recording and controlling system of transactions, which are the prerequisite for proper valuation and classification.

The BOC adopted this post-clearance approach and combined it with offering benefits for users, called the Super Green Lane (SGL) system for selected compliant and large tax payers. The SGL system is an advance processing and immediate clearance system without documentary examination or physical inspection of consignments, as far as customs revenue is concerned. Those consignments should however undergo inspection required by other government agencies, which could delay the entire clearance process. In spite of this possible delay by the requirement of other agencies, one of the advantages of SGL for users is the submission of declarations by Electronic Data Interchange from companies. These qualified importers are subject to post-clearance audit by the BOC at any time to prove their compliance. Cargos by other importers are subject to risk assessment and go either to the green lane (low-risk

cargo for release without documentary examination or physical inspection), the yellow lane (moderate-risk cargo with documentary examination) or the red lane (high-risk cargo with documentary examination and physical inspection).

While post-clearance audit was regarded as an alternative solution to the PSI program measures for compliance assistance and revenue enhancement, customs brokers initially opposed to its introduction, argued that it could be used for abuse and harassment. These concerns resulted in a detailed discussion on the selection of traders to be audited. Post-clearance audit could be used for non-compliant importers to detect possible fraud and improve their compliance. By comparing recorded invoices and their related contracts, correspondence and payment, this could be a powerful tool to detect under-invoicing. However, at this stage the BOC puts emphasis on ensuring compliance of SGL users on the ground that they represent a major source of revenue. Moreover, the initial proposal for a record-keeping period of five years was reduced to three years. Post-clearance audit started in 2004 on a pilot basis, but it is still yet to be fully implemented. It is noteworthy that the post-clearance audit was meant to be part of the exit strategy from the PSI program, but its introduction was not prepared well in advance. In fact, it was first proposed in 1999 and enacted only in 2001, after the termination of PSI contract. It has taken longer than expected before the authorities began shaping the actual program for implementation.

(4) Transfer of knowledge

The PSI firm organized training and observation tours for customs officers. However, observers often pointed out that it was customs officers' involvement in appeal procedures against CRF reports that served as an on-the-job training and allowed them to acquire skills in valuation. Appeals against customs valuations and classifications were made to the BOC-SGS Appeals Committee on Valuation and Classification after tentative release of the shipment against security by filing a bond in cash or through a bank guarantee. An importer who was not satisfied by the decision of the Committee could file a formal protest. Between 1993 and 1998, 24,344 cases were appealed to the BOC-SGS Committees, of which 24,000 have been solved.²⁵¹ The Philippines reports that the Appellate Committee receives 160 cases each week covering

²⁵¹ WTO Trade Policy Review, The Philippines, Report by Secretariat, August 1999, WT/TPR/S/59

valuation and classification of goods and the cases are resolved on average within two to three weeks.²⁵² Through the discussions in the Committees customs officials gradually learned the valuation method employed by the SGS.

10. View of customs

Customs officers were in general hostile to the outsourcing of their core function to the private company. Together with automation, the PSI program was perceived as measures being dictated and imposed by the World Bank and the IMF in conspiracy with the government-appointed PSI agency.²⁵³ While the PSI company did provide observation tours and trainings, they were not necessarily highly appreciated by customs officers. Rather, some of those who participated in training or tour claimed that the PSI expertise was not of high quality or beyond their reach. This observation could be reflected in the assessment of fees payable to the SGS after the termination of its PSI contract in 2000. The Joint BOC-SGS Review Team reviewed the billing of the SGS which amounted to 6 billion peso. A deputy commissioner of BOC, who served as the chair of Team, expressed her view that the fees should be reduced from their initial billing to 3 billion peso, because of possible double billings and the penalties on their errors, stipulated in the PSI contract. The issue of payment to the SGS attracted media and political attention and it remained unresolved.²⁵⁴ The SGS brought the case in 2002 before the International Center for Settlement of Investment Disputes for arbitration.²⁵⁵ This outstanding dispute was partially originated by the lack of objective criteria for assessing the PSI performance.

On the other hand, Parayano, as the top manager of the then BOC, observed positive side and shortcoming of the PSI service and drew the following lessons learned in this respect:²⁵⁶

²⁵² WTO Working Party on Preshipment Inspection, "National Experience with the Agreement on Preshipment Inspection, Submission by the Philippines," (June 1997) G/PSI/WP/W/4

²⁵³ Parayano (2004), *supra* note 231, at 94.

²⁵⁴ Willie Ng. "Government case against SGS hits blank wall." Manila Bulletin (11 February 2002).

²⁵⁵ Irma Isip. "SGS moves on to lab, techno testing." Malaya (1 July 2006).

²⁵⁶ Parayano (2004), *supra* note 231, at 96.

1. PSI service is subject to circumvention, and customs should deploy its resources to fill the gap;

2. PSI must be for a fixed term only and accompanied by a clear exit program, which was not necessarily the case in the Philippines;

3. Price database based on inspection should belong to customs and an adequate IT infrastructure must be made available to customs, which was not clear in the PSI contract;

4. Performance measurement of PSI should be established at the beginning of contract to avoid disputes about the payment of fees, as was actually the case;

5. Adequate dispute settlement system for valuation and classification is essential for the proper functioning of PSI; and

6. Gain on trade facilitation from PSI could outweigh additional revenue.

Although acknowledging the usefulness of the PSI program as an interim measure for revenue purpose, Parayno points out its limitations and difficulties in practically managing the program, including various circumvention measures to the PSI program. He also reveals the difficulty in transfer of technology such as the price database, and adequate monitoring of PSI performance. Addressing all of these problems requires strong leadership and involvement of the management of customs from the early stages of contract negotiation. Furthermore, he calls attention to the aspect of trade facilitation in introducing risk management. In sum, Parayno was concerned by the failure of the BOC in building capacity to assume customs responsibility while employing the PSI service.

11. View of trade

The USTR has been critical of the PSI program in the Philippines from the beginning of its global-coverage service in 1992. In its 1995 report on foreign trade barriers, the USTR states that exporters in the US and many countries have complained that PSI inspectors are often not available, resulting in costly shipping delays. The arbitrary nature of the PSI valuation methodology has often resulted in significantly higher assessed values, and higher duties. There is an appeals process for considering grievances by importers seeking to challenge PSI decisions, but it is slow.

cumbersome and uncertain.²⁵⁷ In the 1999 report the USTR asserts in detail the default of the appeal process that it lacks transparency and perpetuates an unacceptable and inappropriate conflict of interest, as representatives of the PSI sit on the appellate board deciding the complaints filed against its own conduct.²⁵⁸

This view was consistently repeated in the USTR report every year. Even after the termination of the PSI contract, the 2002 USTR report reiterates that under the PSI regime operated until March 2000, there were frequent abuses reported, including arbitrary and unjustified increase or “uplifts” of the invoice value of imports, often on the basis of inappropriate or questionable information.²⁵⁹ It went further to assess the post-PSI regime and observed that US exporters had voiced fewer complaints about the Philippine Customs’ current valuation system. This statement was made in response to the announcement by the Philippine Government in late 2001 that it might consider returning its customs administration to a PSI system. The 2002 USTR noted the problematic history of PSI and urged the Philippines to continue reforming its current customs regime without resorting to PSI. The 2003 USTR report replicated this part in its finding on customs barriers.

This US view was echoed in 1999 in the letter addressed to the government of President Estrada, jointly signed by the foreign chambers, including the Chambers of Commerce of the US, Australia-New Zealand, Canada, Europe, Japan, Korea, and the Philippine Association of Multinational Companies Regional Headquarters. The letter announces that many members have experienced serious problems with the Philippine Government’s contracted PSI entity. They hoped the Government would reflect carefully before deciding on whether to renew the PSI contract.

It should be noted that the view of trade did not seem to be unanimous about the termination of PSI. Prior to the final decision on the fate of PSI contract in 2000, there had been serious concerns expressed by domestic business, about the capability of the BOC in taking over the work of SGS. They were afraid of possible delays in clearance of goods in import and harassment by customs officers with lengthy procedures.

²⁵⁷ USTR 1995 National Trade Estimate Report on Foreign Trade Barriers Washington D.C.

²⁵⁸ *Id.*

²⁵⁹ USTR 2002 National trade Estimate Report on Foreign Trade Barriers Washington D.C.

Foreign companies cover both export and import and tend to see the cost implication of PSI on the entire logistics.

12. View of donors and lending institutions

The PSI in the Philippines was often viewed as a success story by the donor community at an early stage. In fact, Noel Johnson mentions the Philippines as the most well known success stories in lending institutions, supported by institutional arrangement, including ex-post reconciliation and the handling of payment of customs duties by PSI companies, in his research paper for the World Bank.²⁶⁰ However, later there has been a criticism that the reform had not progressed as expected during the use of PSI service. Moreover, the World Bank and the IMF have changed their positions and questioned the value of PSI itself, especially in terms of the transfer of technology in building the capacity of customs administrations, including the Philippines. They suggest that a relatively advanced economy among developing countries, such as the Philippines, should make more efforts to develop the capabilities of customs by assuring more political support and commitment to customs modernization.

²⁶⁰ Johnson. (2001) *supra* note 77.

Chapter 8 Case study – Kenya

1. Introduction and summary

This Chapter reviews the introduction of the PSI program in Kenya and its impact on the customs function. It will also examine the evolution of the PSI contract, including the effort to gain more control over PSI activities, and to make the contractor more responsive to the needs of the state by examining ways to reduce costs. Considered in the context of the customs reform during the same period, this chapter studies the verification process with respect to the decision of the Kenyan Customs Administration to phase out the PSI contract by developing its own capacity. This case study supports the overall thesis that contracting out of customs function evolved from unregulated privatization to a better managed service through such efforts as (1) regulation, (2) better contract design, and finally (3) to a more focused approach on developing the state's capacity to perform the customs function on its own. Typically, Kenya experienced the transformation of the PSI service from a foreign exchange function to its customs purpose, and observed the eventual focus on the incorporation of modern customs principles into the PSI contract.

2. Economic environment

Kenya is a low income country with its GNI per capita accounting for US\$540 (2005).²⁶¹ Its economy largely depends on agriculture and the service industry. Agricultural commodities, such as tea, coffee and horticultural products, have continued to be the main exports whereas machinery and transport equipment are the major imports. After a promising period in the 1960's following independence, the economy has experienced years of stagnation, due to a falling commodity prices, lack of infrastructure, education and other social services. Like many of its neighboring countries, an informal economy is significant (estimated as large as 36.0% of GDP in 2002/2003)²⁶² with informal employment that outgrew formal employment according to a 2003 study,²⁶³ accompanied by a poor compliance culture with laws and regulations.

²⁶¹ World Bank (2005), *supra* note 219.

²⁶² Schneider (2004), *supra* note 220.

²⁶³ WTO Trade Policy Review – East African Community Secretariat's Report Annex 1 Kenya WT/TPR/S/171/KEN (20 September 2006) at A1-36.

The current government of President Mwai Kibaki came to power in 2003 with the promise to fight endemic corruption, but the fight is still on the way.²⁶⁴ Kenya has had on-off relations with the donor community due principally to apprehensions related to governance and the management of donations in Kenya.²⁶⁵

Kenya occupies an important position in trade and finance in East Africa, due to its geographic and historical situation. Mombasa, the largest seaport in Kenya, has served as the entry point of goods destined for inland countries in East Africa, including Uganda, Rwanda, and Burundi, connected by railways. Hence, the customs operation in Mombasa affects the performance of international trade of these neighboring land-locked countries. Its obsolete and poor infrastructure is often identified as impediments for facilitating trade in the entire region.

The government of Kenya tried to boost its economy by creating a favorable environment for investment and by fixing the identified problems. One of the priorities has been revenue enhancement, which will support macroeconomic stability through fiscal discipline and will contribute to financing infrastructure and other development policy measures. By way of example, the latest strategy for economic growth with poverty reduction, defined in the “Economic Recovery Strategy for Wealth and Employment Creation (ERS) 2003-2007”²⁶⁶ highlights revenue enhancement as one of the key components. Actually, the strategy is based on four pillars, and all of them are more or less related to good functioning of the customs authorities:

- rapid economic growth in an environment of macro economic stability, including enhancing revenue collection;
- strengthening of institution of governance, including implementation of Anti Corruption and Economic Crime Act and Public Officer’s Ethics Act;
- rehabilitation and expansion of physical infrastructure, including the modernization of port of Mombassa and railways; and
- investment in the human capital of the poor, including education and health.

²⁶⁴ Kenya ranked 142nd among 163 countries surveyed according to the Transparency International, Corruption Perceptions Index 2006, *supra* note 222.

²⁶⁵ WTO (2006), *supra* note 263, at 35.

²⁶⁶ Kenya Ministry of Planning and National Development website. Available at < http://www.planning.go.ke/publication/economic_recovery_plan.pdf > (last visited 6 June 2007).

3. Tax and tariff policy

The government revenue amounts to 21.2% of GDP in 2004, which is relatively high compared with 10-11% in the neighboring Uganda and Tanzania. Nevertheless, the fiscal account deficit increased during 1999-2004 at 3.4% of GDP in 2003, caused by a combination of stagnation in total revenue, due to (1) a reduction of tax rates to favor private sector activity, (2) governance problems and slow economic growth, and (3) expansionary public expenditure.²⁶⁷ Hence, the pressure to increase revenue collection is high, for all revenue sources. The share of customs duties is currently on the order of 10% of the total national revenue, along with income taxes (41% of total revenue), Value Added Tax (VAT, 31%) and excise duties (18%) in 2004/05.

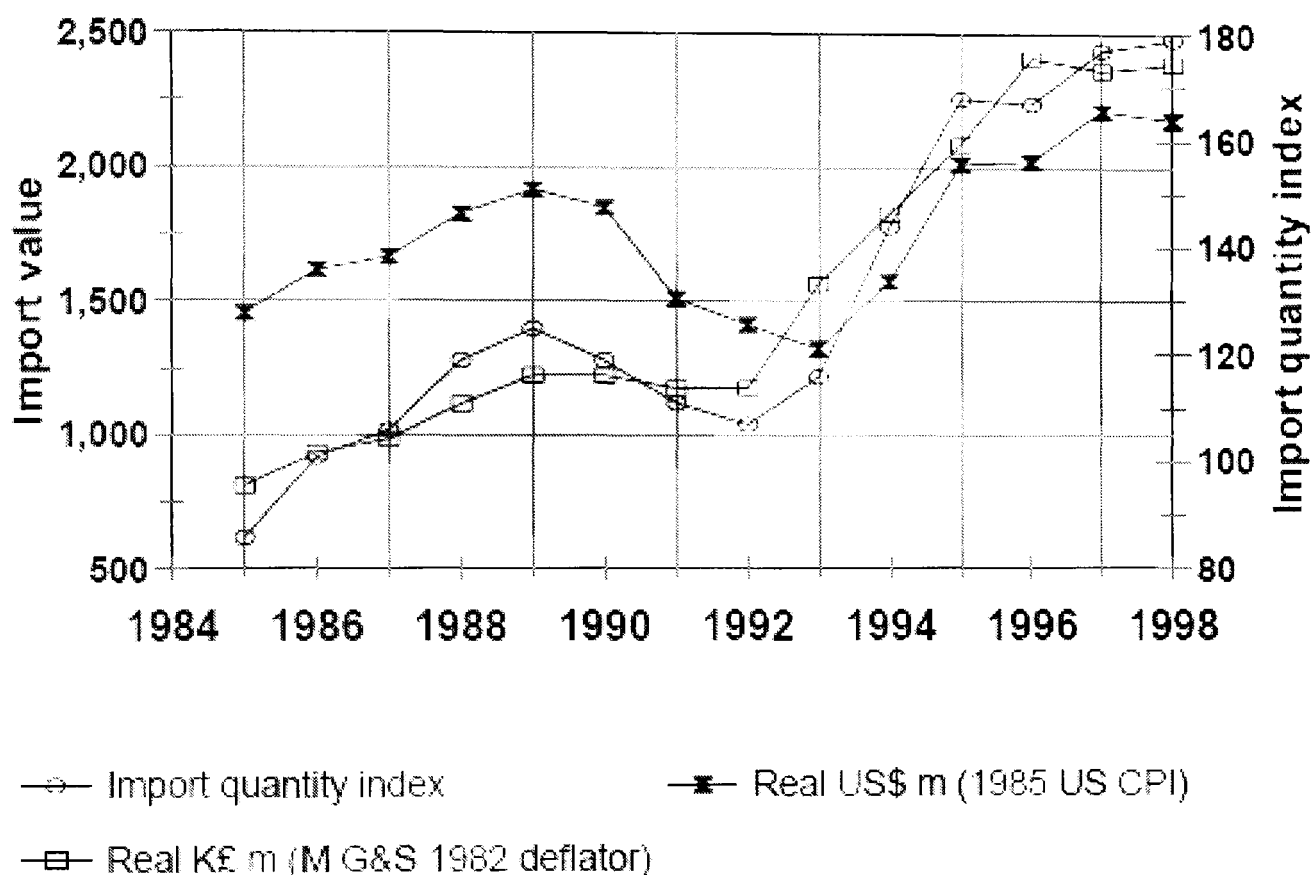
The Ministry of Finance (MOF) sets the revenue target for each three month period to closely monitor the performance of customs and tax administrations. The Kenya Revenue Authority (KRA) is responsible for administering both customs and tax revenues since 1995. Actually, the KRA was able to surpass the revenue target in 2003/04 and 2004/05 and nearly achieved the target (99.5%) in 2005/06. In fact, revenue collection has grown at an average rate of 13.8% in the last three years, which was more than the nominal growth of GDP.

In order to maintain the revenue-to-GDP ratio at above 21% of GDP, the government envisages the broadening of the tax base to ensure the compliance of large tax payers and include the informal sector in its tax net. The KRA embarked on an organization-wide revenue administration reform and modernization program to respond to this challenge. It consists of several measures, including the computerization of customs and tax procedures, and the establishment of a Large Taxpayer Office in 2005 to ensure compliance of large taxpayers. The KRA is also very active in sensitization campaign in calling on the private sector to perceive the payment of taxes as a call to national duty with the motto "Pay your taxes, set our country free". Another example to widen the tax base was the Tax Amnesty announced in June 2004. This measure covered tax and customs duties, which people had hitherto failed to report and pay. If they report this past record of negligence by the end of 2004, they would be exonerated from paying fines and penalties. The tax administration would integrate these applications in their file and keep track in the efforts to uphold these newly acquired taxpayers.

²⁶⁷ WTO (2006), *supra* note 263, at 37-38.

In the area of trade and tariff policy, Kenya has implemented a program of economic liberalization in the 1990's to create a pro-business environment with more inward investment. The removal of import-license requirements and foreign exchange controls in 1993 was considered to be the key measures in boosting trade as shown below.²⁶⁸

(Figure 5-1) Imports into Kenya: 1985-1998



(source) Graham Glenday, 2000

Kenya has also embarked on a series of tariff reforms by rationalizing tariff bands and reducing tariff levels in the 1990's. As a result, current standard tariff rates are 0% for raw materials, 10% for intermediate goods and 25% for finished goods. Obviously, the government uses tariff in a strategic way to protect and promote domestic industry. The above tariff escalation is one example. In the textile sector,

²⁶⁸ Graham Glenday. "Trade Liberalization and Customs Revenue: Does Trade Liberalization Lead to Lower Customs Revenues? The Case of Kenya." Development Discussion Paper No. 764, Harvard Institute for International Development (June 2004).

import duties for fabrics are set between 25 and 35% and tariff on used clothing is significantly high (\$0.75/KG or 50% ad valorem, whichever is higher), while duties on basic inputs such as yarn are zero to encourage the development of textile industry. High import duties protect the agricultural sector, with the current 35% import duties on foodstuffs that compete with Kenyan products.²⁶⁹ From a revenue point of view, the lower level of tariff was expected to widen the tax base by boosting trade in spite of obvious negative effects. The scope of duty exemption was also narrowed to expand the tax base.

Kenya's tariff was increasingly affected by regional and bilateral trade negotiations, especially through its membership of the East African Community (EAC). The EAC, established in 2001, is a regional trade arrangement with Tanzania and Uganda, integrating the three countries' farm-based economies. Its customs union entered into force in January 2005 with a common external tariff with a transitional period of five years. Kenya is also a member of the Common Market for Eastern and Southern Africa (COMESA), which also aims for a common external tariff.

4. Customs profile and its environment

The history of customs administration dates back to 1895 when the East Africa Protectorate was promulgated by the British government to cover the present-day Kenya. The customs headquarters was initially located at the then Protectorate's capital Mombasa before its relocation to Nairobi. During the British colonial period customs in Mombasa collected revenue not only for Kenya but also for the Protectorate of Uganda. After the independence in 1963, however, the customs department experienced the effects of civil unrest in the neighboring countries in the 1970's and the 80's, resulting in the establishment of a 100% inspection policy to prevent arms smuggling, which undermined the effectiveness of customs. Along with the relative stability in the region and trade liberalization in the 1990's, customs started to modernize its procedures in introducing selective examination and enhancing intelligence capabilities and transit control.

²⁶⁹ USTR Foreign Trade Barriers Report 2005.

The Kenyan Revenue Authority (KRA) was established in 1995 as a semi-autonomous government agency, encompassing both customs and tax administrations. Its aim was to improve the staffing and management of customs and tax departments, as well as to provide a platform for better coordination in policy and administration between the two departments. While the MOF promulgates tax policy, including tax rates and exemptions, the KRA implements government policy as spelled out in the related laws. Compared with a traditional tax administration, which is a line ministerial department, a semi-autonomous revenue authority enjoys greater autonomy, including management, funding and personnel system. The IMF and the World Bank, as well as bilateral donors, promoted the establishment of revenue authorities in Africa and Latin America in the 1990's as a possible solution to improving revenue performance, compliance, administrative capacity and integrity. They expected greater efficiency in public resource utilization via financial and administrative independence/ autonomy, and employment of a competent, disciplined, and more qualified staff via freedom to offer higher compensation than the civil service and the freedom to recruit and fire on own terms.²⁷⁰ Kenya was one of early examples of revenue agencies.

In practice, the KRA is headed by a Commissioner General (CG) under the supervision of a Board of Directors, the membership of which is drawn from both the public and private sectors. The CG runs the KRA in a manner similar to that of a chief executive in the private sector. He has greater flexibility in organizational and personnel matters and appoints all staff, which is intended to protect customs from political interference and patronage in recruitment and promotion of personnel. As a funding mechanism, the KRA receives 1.5% of collections, and an additional 3% of the difference between the actual collections and revenue target for a three month period, set by the MOF, but subject to a maximum of 2% of collections. This financial autonomy helps the CG pay adequate salaries, enabling the institution to attract and retain competent professionals and thus providing a basis for preventing officers from receiving illegal bribes.

The Customs Service is one of five operational divisions that compose the KRA together with Domestic Taxes, Large Taxpayer office, Road Transport (register of motor

²⁷⁰ Arthur J. Mann. "Are Semi-Autonomous Revenue Authorities Answer to Tax Administration Problems in Developing Countries? – A Practical Guide." USAID (August 2004).

vehicles and collection of purchase tax for second hand motor vehicles), and Support Services. The Customs Services, headed by a Customs Commissioner at the KRA headquarters, has a decentralized structure with three regional offices in Nairobi (North Region), Mombasa (South Region), and Kisumu (Western Region). It has a workforce of approximately 1,300 customs officers including support staff.

5. Challenges of customs valuation

Like many developing countries, Kenya applied the Brussels Definition of Valuation (BDV) method of using notional market price of imported goods as the basis for customs valuation. While this system allows customs discretionary power to determine the value of goods, acquiring reliable and timely information has always been a challenge for Kenya Customs. In developing countries where the tariff rate is kept high, observers often report that temptation is high for tax evasion, using false classification and under-invoicing. The existence of a large informal sector compounds this problem. Because of this background, customs officers in developing countries often regard tax payers' declarations as prone to falsification and tend to uplift the value of goods therein. This behavior can result in alleged arbitrary taxation and long clearance time in checking invoices and accompanying documents. On the other hand, tax payers tend to declare under-value, anticipating the perception of customs officers. Kenya is no exception to this vicious cycle, caused by the asymmetry of information on valuation between customs officers and tax payers. The "tax gap", the difference between the tax that should be paid and the tax actually paid, is frequently used to illustrate the magnitude of this problem. There is an often quoted anecdotal comparison by IMF economists who visited Kenya in 1997 on the tax gap, as follows:

- 10% for Singapore, New Zealand and Denmark;
- 20% for US, Canada and Chile; and
- 40% for Argentina, Peru, the Philippines and Kenya.²⁷¹

²⁷¹ M.G.Waweru, Commissioner general, KRA. "Tax Administration in Kenya: Problems and Prospects" speech at the Federation of Kenya Employers (10 March 2004).

Moreover, the abolition of exchange control, which was a part of trade liberalization in the mid-90's, envisioned an increase in trade volume and inward investment. As a consequence, it has become imperative for customs administrations to enhance revenue collection while ensuring trade facilitation to promote trade and investment. They raised the concern about the shortage of skilled customs officers and the lack of coordination with domestic tax service. The merger of customs administration into the KRA with tax administration in 1995 was intended to deal with this problem. However, the information and skill to identify and counter the possibly falsified customs classification and valuation was regarded a key to solve the problem. Acquiring the skill to detect falsified information of importers was often viewed as a mid to longer term objective, considering the capacity of officers and the poor compliance of importers. Getting information on the price at the point of export was thought to provide a quick fix.

At that time there were inspection companies operational in Kenya, ready to assume the role of providing export value of goods. These companies were employed by the Central Bank to address the problem of capital flight. From 1981 to 1993 the Kenya shilling was pegged to the SDR. In order to protect the country's foreign reserve, the Central Bank of Kenya introduced the PSI service in 1988 to detect possible over-invoicing of imports, by which Kenya might lose its hard currency. However, the government suspended the Foreign Exchange Control Act in 1993, which paved the way for a market determined exchange rate. Subsequently it authorized foreign equity investment and repealed the Foreign Exchange Control Act in 1995. At the same time, the PSI companies, which had lost their commercial opportunity of checking foreign exchange reserve, lobbied to shift their service towards the customs arena. They offered services using their network of information gathering and infrastructure for inspection at overseas markets. The lending institutions frequently recommended the use of PSI in Africa as a short-term solution as well. Consequently, the MOF of Kenya was attracted by its potential benefit and awarded PSI contracts in 1994 as a revenue enhancement measure. At that time, the World Bank and the IMF provided advice on the design of the contract.²⁷² Since then, PSI contracts were successively renewed, resulting in four series of PSI contracts for the following periods: 1994-96; 1997-2000; 2001-02; and 2003-05. Two or three companies were awarded contracts at a time. As a result of competitive tendering among the companies, the awards were not necessarily

²⁷² WTO Working Party on Preshipment Inspection. *Supra* note 173.

made to the same firms throughout these four periods. In fact, only one company (COTECNA) kept a contract throughout all four periods.

6. The introduction of PSI service

Kenya adopted a comprehensive PSI program for all goods above US\$5,000 as well as all motor vehicles and cloths irrespective of the threshold. In avoiding circumvention of PSI by splitting the invoice to value under US\$5,000, the Commissioner of Customs was entitled to require inspection of consignments in the case of suspected splitting. In practice, an importer required to submit an Import Declaration Form (IDF) to a PSI company' liaison office in Kenya to inform of his intention to import goods. The IDF should be accompanied by supporting documents, including an invoice indicating the value of importing goods. The PSI office transmitted the information to its overseas office in the country of export. The overseas office contacted the exporter to ask for information on specification and price of goods and carried out a price analysis, complemented by the result of its market research. Then it proceeded to the physical inspection of the quantity and quality of goods at the pre-shipment stage.

Based on the analysis and inspection, the PSI agency issued a Clean Report of Finding (CRF). It included a recommended value, tariff line to be applied, the amount of duties and taxes payable, and the conformity with other required standards. A non-negotiable report of finding was issued if there remained unsolved problems regarding quality, quantity, and price of shipments. The electronic submission of PSI reports was introduced to make them available at the time of importation. The prior FOREX-type PSI did not require this feature, and approximately 50% of the CRFs were not available at the time of importation.²⁷³ If the importer agreed with the CRF, he could clear goods through customs with the payment of duties and taxes. Customs officers usually applied the price contained in the PSI report as the basis of valuation. In the case of suspected undervaluation, customs officers verified the value against the related import documents, catalogues, and similar quantities of goods. If the merchandise arrived without a pre-shipment inspection, it would undergo destination inspection, which was a similar examination of document and physical inspection at the

²⁷³ *Id.*

point of importation with a much higher fee of 15% than the normal import declaration fee of 2.75%.

The original PSI contracts were concluded in 1994 for three years with three companies, each with a specific geographical allocation to cover the source countries of exports for Kenya: SGS (Asia and Africa), COTECNA (UK, Ireland and Americas), and Bureau Veritas (Middle East and Europe). Splitting contracts on a geographical basis was believed to create competition. While the PSI program was made mandatory for all import consignments, the threshold of the minimum value of the consignments for the inspection was gradually raised from US\$500 to US\$5,000 by 1998. The three companies were also tasked with destination inspection for goods that arrived without PSI controls. They typically received 1% of the free on board (FOB) value, equivalent to KShs 2 billion (\$25 million) as an annual fee from the government. Importers were required to pay the import declaration fee of 2.75% of the FOB value to the government or minimum 5000 Kenya Shillings even if the consignment was under the threshold, and thus out of the PSI scope. The import declaration fee goes to the treasury and a part of it is used to pay for the PSI service.

At the outset, the contracts included regulating foreign exchange and allocation of export compensation scheme. The export compensation scheme was intended to encourage exports by paying back to exporters a certain percentage of hard currency earned by exports and subsequently deposited in the Central Bank. This scheme was considered prone to abuse and later abolished.²⁷⁴ Following this development, the law was amended in 1996 to expressly allow for customs-oriented PSI service. Furthermore, quality inspection of imports started in 1995 to ensure that imports into Kenya comply with the requirements of the Kenya Standards or any standards approved by the Kenya Bureau of Standards. This measure was expected to eliminate the flooding of substandard goods at unfairly cheap prices into the local market. There was also a growing fear that pharmaceutical companies might dump out-dated medical products in the African market. The government made an arrangement that the PSI service that included the quality inspection of imports to ensure the compliance with these standards.

²⁷⁴ In the early 1990's there occurred the Goldenberg scandal which involved the fictitious export of smuggled gold and diamond with often over-valued export price in order to receive the government payback. It was later revealed that the top politicians, including the then President Moi, ignored and rejected the control measures and warnings by customs, Central Bank and other government agencies.

7. The assessment of PSI performance

(1) Assessment by academics

The PSI service dealt with the asymmetry of information by providing information on export prices, which could help customs uplift the declared value in cases of undervaluation and change the classification of goods to higher tariff bands, to improve the revenue performance of Kenya Customs. In fact, the revenue collection considerably increased over 1993 and 1994 when a major trade and customs policy change occurred, including the removal of import licensing and foreign exchange control in 1993, as well as the introduction of the PSI service in 1994. In the 1990's the government pursued a phased tariff reduction, with an accelerated pace from 1994 onward. While trade liberalization measures as a whole should widen the tax base by boosting imports, tariff reduction has a direct, negative impact on revenue as well. However, after a sharp increase in revenue collection in 1994, the KRA was able to maintain an improved level of revenue, in spite of the gradual reduction in the average tariff level. This outcome was often attributed to change in trade and tariff policy that boosted imports and improved customs administration and compliance, including the introduction of the PSI program.

As always is the case, assessing the performance of PSI service is difficult, because there are several inter-twined factors that influence revenue levels.

There is an academic analysis on the causes of improved collection of customs revenue between 1987 and 1999 by Glenday to assess the impact of reform in 1993/94 and its aftermath.²⁷⁵ The study compared the change in imports and customs duty collection between the five year period of 1989/90-93/94 and that of 1994/95-98/99. As shown in the table below, while the ratio of imports to GDP increased from an average of 26.1% to 29.0% (column B), the ratio of customs duty collection to GDP increased from an average of 2.8% to 4.0% (Column A). In this calculation, imports are defined as those for home use, excluding duty-free imports for transit. He points out that the import ratio increase from trade liberalization of 11% (29.0%/26.1%) is not sufficient to explain the increased revenue yield of 54% (4.0%/2.6%), especially considering the decline in trade-weighted average duty rates from 24.1% to 16.9% for imports, including those subject to specific duties (Column D). He then takes into account other factors

²⁷⁵ Glenday (2000), *supra* note 268

that could affect revenue yield, including the increase in non-exempt imports for home use from 68.4% to 76.3% (Column C). After these adjustments, he compares the actual customs duty collection over projected customs duty collection, which is calculated based on the import volume, tariff rates, and exemption. He observes that the actual yields after 1994/95 still exceed projected yields by some 65% to 95%, as indicated in the column A/E in the table below.²⁷⁶

(Table 5-1) Comparison between actual and projected customs duty collections

(%)

Fiscal year	Customs duty over GDP	Home-use import over GDP	Non exempt import over total import	Trade weighted average duty rate	Projected customs duty over GDP	Actual customs duty over projected duty
	(A)	(B)	(C)	(D)	(E)	(A/E)
89/90	3.3	27.5	66.9	26.3	3.1	108
90/91	2.4	25.3	67.3	24.2	2.6	92
91/92	2.1	21.3	72.6	21.3	2.1	100
92/93	2.5	25.4	70.6	23.6	2.7	92
93/94	3.8	31.4	64.8	25.3	3.3	123
94/95	4.3	27.3	73.4	20.7	2.6	165
95/96	4.3	33.1	78.7	16.8	2.8	155
96/97	3.9	31.1	78.2	15.2	2.3	167
97/98	3.7	27.7	73.1	14.7	1.9	195
98/99	3.8	25.6	78.0	16.9	2.1	172
Average 89/90-93/94	2.8	26.1	68.4	24.1	2.8	103
Average 94/95-98/99	4.0	29.0	76.3	16.9	2.3	171

²⁷⁶ *Id.* (reproduced and edited from the tables).

In order to explain this excess in revenue performance, Glenday analyzes the composition of imports according to tariff levels and the share of imports that actually paid duties. He finds that the share of home-use imports in the high duty rate class increased significantly by 43% between the two 5-year periods and the share of home-use imports paying duty increased in all duty rate classes, but most significantly in the high duty rate class by more than 50%. He assumes that a remarkable shift occurred in the composition of imports towards those in the high duty rate class and in the customs compliance of these imports. He mentions several factors that explain these two findings. First, the removal of import licensing in 1993 and a significant tariff reduction in the high rate class have resulted in drop in the domestic price for imported goods, which could facilitate a marked shift toward higher duty rate imports. Second, the systematic lowering of duty rates assisted the tightening of the duty exemption policy and administration. Third, enhanced customs enforcement measures could have contributed to declaration of higher tariff rates with less exemption. In this connection, he identifies that the use of the PSI program, together with an improvement in customs administration in the 1990's by the creation of KRA and its tighter control on transit and bonded warehouse, could be a source of major improvement in revenue collection. Glenday concludes that improved administration and compliance, with the PSI program playing a considerable role, raised import duty collection from at least one-third to over two-thirds higher than could be explained by changes in trade, exemption and import duty rates.

It could be inferred from this study that the PSI service contributed to sharp increases in revenue at the initial stage by addressing asymmetry of information and that it had a lasting effect on the revenue level.

(2) Assessment by government

Kenya has been actively involved in the WTO Working Party on Preshipment Inspection and made a submission on its national experience in 1997.²⁷⁷ It reports dramatic increases in revenue collection as a result of the introduction of the PSI program in 1994, which allowed for the lowering the tariff rates, particularly in the top rate bands, resulting in further increases in revenue collection through improved importer compliance. This assessment seems to support the analysis by Glenday.

²⁷⁷ WTO (1997), *supra* note 272.

The WTO submission estimates that the current benefit of PSI arrangements under the BDV rules stems mainly from avoiding discretion at the port of importation which avoids negotiated duties. In this connection, the Kenyan government expressed its concern over the implementation of the WTO Agreement on Customs valuation in 2000, which would replace the PSI with a return of the difficult problem of controlling negotiated customs values, caused by a weak and still developing customs administration.

This assessment confirms the government perception on the value of the PSI program in addressing asymmetry of information that is subject to negotiation between customs officers and traders to determine the value of goods. This should prevent corruption and improve integrity in customs. The Kenyan submission also mentions some disappointment with PSI performance within the government and the importing community. There was the occasional discovery of a corrupt employee of a PSI company, owing to the lack of adequate internal control. Moreover, they found many examples of erroneous reports after PSI intervention. Errors were partially caused by manipulation after PSI intervention, leading Kenya to introduce the requirement of sealing full container loads when requested in the 1997 contract.

Another estimate by the Ministry of Finance indicates that up to 20% of duty collection enhancement is related to PSI activities.²⁷⁸ There are other indicators that were used to document the effectiveness of PSI according to the Ministry of Finance. One indicator was a surge in transit entries, presumably to avoid pre-shipment inspection. These goods declared as transit and therefore free of duty were often lost inside Kenya during transit transport. Another indicator was a noted increase in cross-border smuggling on the land borders as customs fraud in the main ports of entry became reportedly more difficult. Kenyan Customs tried to deal with these displacements of fraud by enhanced customs control, because this is an area that the PSI companies could not deal with.

²⁷⁸ A. Okello. "Kenya's Experience with Preshipment Inspection" Commonwealth Trade and Enterprise Paper in Preshipment Inspection: Past Experiences and Future Directions Commonwealth Secretariat (2001).

8. Improvements in PSI service

While there have been indications that initial PSI contracts were successful in raising revenue level, observers suggested that PSI service could be improved to meet the demands of governments in several areas. These include a cost reduction by introducing modern control technique, introduction of destination inspection to complement PSI performance, and enhancing the capacity of customs by transferring of technology. Kenya tried to improve the PSI arrangements in these three areas, as described below.

First, the traditional PSI service presupposes that all shipments undergo inspection, irrespective of the compliance record of exporters and importers. However, in reality PSI companies are likely to carry out quick or no physical check with goods imported by honest traders with good compliance record. In this case, it would be unnecessary to pay full inspection fees to PSI companies. In fact, modern customs administrations adopt risk management technique whereby they inspect only selected consignments that are assessed a high-risk for potential non-compliance with customs laws and regulations. This method allows customs to concentrate its limited resources on risk areas and to conduct efficient and effective controls, while facilitating legitimate trade. If PSI service bases its inspection on this technique, governments can reduce cost for PSI service without losing its effectiveness, and compliant traders can get speedy export inspection process.

Since the introduction of selectivity would reduce the profit of PSI companies, they resisted the adoption of this method under the 1994 contracts and the 1997 contracts. It was after a major review of the scope of service in 2000 that new PSI contracts covering the period from 2001 to 2003 introduced this risk-based inspection service. The timing also coincides with Kenya's implementation of the WTO Agreement on Customs Valuation to which it is easier to apply risk management as opposed to than the previous BDV system. The new contracts shifted from inspecting all imports above the threshold of US\$5,000 to the selective application of import verification. The selective inspection is based on risk assessment to identify shipments with greater risk to government revenue. This method was expected to facilitate legitimate trade. The government divided the service into four categories based on the level of the inspection required. They include (1) Full detailed inspection, (2) Detailed quality inspection to ensure conformity with standards, (3) Verification of comparative

price, and (4) Destination inspection. Risk management will be carried out by examining the IDF and its accompanying document at the initial stage – when the IDF is received from importers. As the scope of detailed physical inspection narrowed, it was estimated that the government would save a third of the annual fee, equivalent to 700 million Kenya Shillings (\$8.75 million). When Kenya opted for the selective PSI verification in 2001, analysts cautioned that selective application of inspection services could create loopholes for unscrupulous importers to evade paying taxes and expose local producers to unfair competition from cheap imports.²⁷⁹ However, customs revenues have more or less met the revenue target since 2001, despite the reduced scope of PSI service.

Second, PSI originally refers to inspection at the export location, but Kenya briefly introduced post-shipment inspection in 1998. While it is often called “Destination Inspection”, it is different from the destination inspection for goods arriving without pre-shipment inspection. The aim of “Destination Inspection” or post-shipment inspection is to monitor and improve the PSI function, because there were fears that the PSI program alone might not be maximizing revenue collection. By way of example, one newspaper article reported that Kenya imported goods worth KShs 200 billion in 1999, out of which KShs 50 billion, equivalent to a quarter of total import, may have been landed with poor verification, leading to loss of revenue.²⁸⁰ This article dates after the introduction of destination inspection service, but it would apply to the days before its implementation. Moreover, since the PSI companies could not assure the integrity of containers after inspection, there were instances whereby the contents of containers were replaced by goods for smuggling. The designated company, Inspection Control Services (ICS), formerly Swiss Procurement Company (Swipco), carried out post-shipment verification at the ports of entry with customs officers.

However, this contract was terminated two years later, amid allegation by customs brokers that the service had caused a huge delay and constituted harassments.²⁸¹ In fact, there was a widely reported incident where representatives of a company and customs officers differed on the verification at the entry point, which resulted in a huge delay in clearance. While post-shipment inspection could have facilitated the transfer of expertise to customs officers if properly implemented with

²⁷⁹ The East African (2000) *supra* note 184.

²⁸⁰ *Id.*

²⁸¹ “Agents Welcome Exit of Swipco.” The East African (5 February 2001).

post-shipment agents and customs officers, it in fact showed the lack of cooperation between them. Furthermore, the quality of the post-shipment inspection company employees was sometimes alleged to be dubious. The company had difficulty recruiting qualified employees, and often reportedly hired retired local customs officers. Because the ICS could not properly perform audits the contract was terminated, There was strong opposition from the Parliament, which reportedly alleged that the companies has powerful connections with important persons in the government and the opportunity was very lucrative in nature.²⁸²

Third, in terms of the capacity building of customs, a profit-seeking private sector entity, like a PSI has an interest in continuing the PSI service without transferring much knowledge to customs officers. On the other hand, customs seek the transfer of skills and technology from PSI companies, which will pave the way for terminating PSI contracts. There is an apparent conflict of interest.

While technical assistance, including the transfer of price data, was included in the 1997 contracts, its implementation was not satisfactory for customs authorities. Based on this experience, the 2003 contracts were carefully drawn and included explicit provisions on the transfer of necessary technology, skills and equipment to customs officers, preparing for the exit from PSI service. Accordingly, the KRA received the valuation database at the termination of the contract. Moreover, the 2001 contracts specified that customs officers engaged in destination inspection for goods arriving without pre-shipment inspection together with the PSI employee to get the expertise from them. The 2003 contracts took further steps to leave destination inspection entirely in the hands of customs officers. Likewise, it stipulated that the KRA was scheduled to gradually take over the role hitherto assumed by PSI companies, including the issuance of Import Declaration Form (IDF), which entailed risk assessment. This enabled customs to enjoy a greater opportunity to instruct the inspection level of each import represented by IDF to be carried out by PSI companies ranging from full detailed inspection to simple comparative price verification.

²⁸² “MPs targeted Swipco in amended Bill.” The Daily Nation (23 November 2000).

9. Phase-out of the PSI service and customs reform

(1) Background of phase-out

Since the introduction of the PSI service customs was making efforts in regaining the customs function that had been delegated to the private sector. With the experience of destination inspection and the dispute settlement with importers, customs officers gradually acquired knowledge on customs valuation. They viewed this progress as a part of the exit strategy from the dependence on PSI agencies. Kenya's acceptance of the WTO Agreement on Customs Valuation in 2000 accelerated the urge to terminate the PSI service among customs officers, because under the new valuation system customs must base valuation on commercial practice and documentation, and not on the PSI report, which could be primarily used for assessing the risk of under-valuation of shipments concerned. This change of valuation rules was viewed as diminishing the importance of PSI service, which had been aimed at increasing revenue. Furthermore, the compliance of traders had increased considerably and 95% of the prices recommended in the CRF were said to be identical to invoice prices at a later stage. This improvement in compliance was brought about partly because of the reduction in tariff, but also because of the adjustment of invoice price by importers who found out the acceptable level of declared value.

At a WTO conference in 2002 the KRA Customs Commissioner stated that PSI programs in the developing countries put too much emphasis on maximizing revenue at the cost of adhering to the WTO rules and thus distorted the implementation of WTO Agreement on Customs Valuation that prescribes use of the transaction value system.²⁸³ He even hinted that PSI contracts were often renewed as a result of political pressure rather than real need, because of the strong connection between PSI companies and the higher political class. However, he was also candid in expressing the difficulties his administration faced in properly implementing the transaction value system, including the lack of accurate information on value and skill of customs officers. He identified several challenges to overcome these difficulties, including adequate human resource development in customs administration, improvement of compliance by traders, and use of information and communication technology.

²⁸³ Francis Thurania, KRA, "Challenges to implement the Agreement on Customs Valuation." WTO Seminar on Technical Assistance on Customs Valuation (6-7 Nov 2002).

(2) Measures undertaken

In fact, the KRA has made efforts in addressing these challenges that would allow the termination of PSI contracts. However, the implementation of these measures was accelerated when the termination of the PSI program was in sight. Implementation was influenced by the legacy of the PSI program.

(a) Human resource development

In the area of human resource development, realizing that PSI companies could not be relied on to transfer knowledge or management skill, the KRA urged donors for assistance and more than 500 officers benefited from training in customs valuation. In order to attract more resources for technical assistance and promote a regional approach in this regard, it volunteered to host a Regional Training Center for the Southern and Eastern African Region of the WCO in Mombasa. Moreover, KRA management has been eager to address the issue of integrity as a part of corporate culture, reflecting the wide-spread problem of corruption in developing countries. Based on the WCO tools to improve integrity in customs, in 2005 the KRA has developed the KRA Integrity Action Plan, which is applicable not only to customs but to the entire revenue authority. The Action Plan includes adequate human resource management and development, as well as the simplification of procedures that will reduce the opportunity for malpractice.

In this connection, the KRA has invested in human resource development in ensuring acceptable working condition, including the appropriate pay level and merit-based recruitment and promotion. Owing to the high pay level that it can offer as a semi-autonomous agency, the KRA was able to attract young, motivated people to join at the management level with good records of integrity. On the other hand, improving integrity at lower levels still poses a challenge. In fact, the KRA published disciplinary cases against its officers for their offences against the code of conduct. According to its public web site, the KRA handled 53 cases in the year 2204/05, of which 26 were customs-related cases. Many cases involved the facilitation of the release of goods without payment of duties.

All these measures were intended to restore the public confidence in customs administration, a vital precondition to get the support from the private sector to terminate the PSI program and regain the traditional role of customs. In a wider

context, the KRA embarked upon a comprehensive reform and modernization program, where the development of the professionalism of employees plays a central role.

(b) Improvement of compliance of importers

In the area of compliance by the private sector, the KRA has been active in sensitization of partnerships with the trade associations. It has developed a web site to share information and increase transparency. The KRA Integrity Action Plan has been promoted to invite the private sector to join the fight against corruption and develop a culture of compliance. Other measures such as the Tax Amnesty in 2004 were intended to bring the businesses in the informal sector into the formal sector with improved compliance and encourage them to provide accurate revenue-related information to customs. More importantly, the KRA established the Post Clearance Audit Section in customs in 2005 and has developed a manual of post clearance audit. The post clearance audit is expected to provide necessary information on importers' profile and encourage them to improve their compliance. It was however only when the termination of PSI service was in sight that this initiative was put in place. During the PSI era the government and the KRA did not necessarily feel the need to think about an alternate way to get information.

The KRA in turn is expected to take steps in providing the benefits of quicker clearance to importers with good compliance record. The PSI companies gradually introduced the selectivity system, but it was based on the documentary examination of all IDF forms. Therefore, the introduction of selectivity by PSI agencies was limited to physical inspection and this is far from a modern risk management system where both documentary and physical examination is selectively carried out based on risk assessment and the majority of goods are deemed compliant and released without further delay. Whereas deep-entrenched mistrust between customs officers and importers might be a first obstacle to overcome, the management understands the need to establish a partnership approach with business, which would require a change in mentality of both the public and private sector.

(c) Automation

In enhancing customs capabilities, the automation of customs procedures has been considered essential. Due to the out-dated Boffin computer system used by

customs, it was difficult to develop speedy processing of documents and a reliable database on which customs could base its activities. The KRA introduced the Simba (meaning “lion” in Swahili) 2005 computer system, which was developed from Senegal’s Gained 2000 system. It has started to show potential in reducing the manual transaction processes, speeding up procedures and capturing information. The introduction of the new IT system also coincided with the exit from the PSI regime, which indicated the willingness of government to invest in customs at the beginning of the post-PSI era. Along with its national roll-out, supported by extending a Wide Area Network (WAN) system of information and communication, it is expected to give a mid-term solution to the lack of communication among customs offices. Communication problems had hindered the dissemination of information, preventing uniform application of valuation and other customs system. The KRA took a phased approach in developing additional IT modules for the Simba 2005 system and is currently developing a risk management segment, supported by selectivity function based on an import database.

While the PSI companies transferred the valuation database at the end of their contracts in June 2005, the KRA moved away from the PSI-legacy database and established its own database, containing their validated import history, for the purpose of assessing valuation-related risk. However, at early stages of implementation there were complaints from the importers of used vehicles because of significant uplifts of price and resultant extra duties.²⁸⁴ They questioned the validity of price data contained in the valuation database of the Simba 2005 system – which would be based on local market price and not represent the transaction value of vehicles, according to importers. The valuation of used cars causes problems in many developing countries and the Kenyan Minister of Industry called for dialogue between importers and the KRA. In this regard, it would be vital to establish a market research function and post clearance audit to validate the declared value, which should be stored in the valuation database as reliable data. Another avenue to get necessary information for valuation is the exchange of information with foreign customs administrations. This is why the KRA has recently strengthened regional cooperation, especially with the members of the EAC in jointly fighting against customs fraud.

²⁸⁴ “KRA falsely accused by car importers, says Kituyi.” The East African (10 October 2006).

(3) Termination of the contract

In a favorable environment for trade liberalization and overall reform, the government has been supportive of customs reform and modernization, albeit largely driven by revenue concerns. Fortunately revenue collection has increased gradually from 122 billion KShs in 1995/96 to 298 KShs in 2005/06 despite the dismal economic performance over the same period. The government allowed the KRA to pursue the phase-out of PSI program in a wider context of customs reform. Actually, it has realigned its resources directed to customs, which resulted in the upgrading of the computer system and the purchase of X-ray scanners for securing and facilitating trade. It is also planned to introduce cargo tracking system, using global positioning systems to address the potential fraud in transit. The experience of neighboring countries, including Zambia and Uganda, that terminated the PSI contract without encountering much difficulty in keeping revenue collection encouraged the Ministry of Finance to critically review the need of PSI program. The trading community supported this movement as observing the improvement in customs performance.

When the last PSI contract came to an end in June 2005, the government did not renew the contracts and thus allowed customs to exit from the PSI service. However, the Kenyan Bureau of Standard (KBS) insisted that the inspection of inbound goods at export should be maintained to ensure their conformity with Kenyan standards of consumer protection. Thus, the PSI remains for imports into Kenya to ensure quality control of goods under the standard requirement.

Whether customs can meet the expectation of revenue enhancement without the assistance of PSI service remains to be seen. Immediately after the post-PSI phase, revenue performance remained poor, mainly due to the initial difficulties in managing the new automation system which was started at the same time as the termination of PSI service. Since then, the KRA have made efforts in enhancing coordination and sequencing of reform measures. The KRA continues its efforts in customs reform and modernization.

10. View of customs

The KRA estimates that the PSI service certainly contributed to the revenue increase by providing evidence of their uplifts of values in their reports at an initial stage of their service. However, many customs officers were often resentful that their core function had been taken over by the private sector. The occasional revelation of corrupt employees in the PSI companies added this dissatisfaction with PSI service.²⁸⁵ They identified several deficiencies in the PSI operations. They maintained that delay in issuance of Clean Reports of Findings has been a major technical barrier to trade. Therefore, they were critical of the KBS's decision to retain the PSI service for this standard purpose, which might impede the realization of full benefit in trade facilitation by the termination of customs-related PSI service. They also argued that PSI's uplifts were often arbitrary and difficult to sustain. This fact resulted in hidden costs to customs and importers who would spend time in dealing with disputes. In this connection, they pointed out that the PSI program could be easier to use under the BDV system, but it is less useful under the ACV system. CRFs generated by these companies are now only valuable as a risk management tool for comparison with identical or similar goods. In fact, one estimate reveals that 95% of CRFs conform to original invoice value in the last days of PSI program.

In preparing for the eventual termination of contracts at the end of June 2005, customs undertook several measures that gave them confidence. First, PSI offices for issuance of IDF were relocated to customs premises where customs officers had been attached to study their operations in preparation for taking over the IDF issuance and its risk management system. Second, they gained confidence through gradually taking over of destination inspections, by first allowing for joint inspections with PSI employees as stipulated in the 2001 contract, and then by carrying out inspection on their own in the 2003 contract. Third, in the absence of a formal audit arrangement in the contract of 2003, customs monitored their performance and maintained that they found out that customs would be able to function without PSI service.

The KRA top management understands, however, that it is vital to keep the reform process moving forward. It is important, even though it still has a long way to go before it is fully implement, and before they acquire the necessary knowledge and skill to discharge customs responsibilities in the post-PSI era. This is why they have

²⁸⁵ Okello (2001) *supra* note 278.

continued to develop 3-year Corporate Plan of KRA²⁸⁶ to explain the direction of customs reform to internal and external stakeholders.

11. View of trade

Business representatives had been concerned about the termination of PSI program, but they understood that hiring the private sector for the customs function should be seen as an interim measure. They agreed that significant progress had been made by the KRA in its modernization. Moreover, they found that the performance of PSI firms was not always satisfactory. They pointed out that it was expensive to the national economy and adding more costs of doing business. They maintained that the PSI providers, driven by revenue performance to seek the renewal of a contract and more commission, were often inclined to uplift values where possible.

While acknowledging the recent progress, businesses claimed that customs procedures are still cumbersome and time-consuming. It is obsessed with meeting the revenue target and pays little attention to facilitating legitimate trade or previous compliance record. They point out that after the termination of the PSI contracts, maintaining the accuracy of valuation database, especially in relation to the difference in origin, could be one of the biggest challenges for customs. They are concerned that there is too much emphasis on achieving revenue targets and this could result in KRA officers being engaged in uplifting of declared value, regardless of the true market value. In fact, they complained that the recently introduced valuation database on second-hand motor vehicles contained arbitrarily high prices, which could result in negotiations with customs officers in seeking mutually acceptable customs value. They regard this situation as akin to collusion between customs officers and traders in settling negotiations by bribes.

They note that customs is ill-equipped, including in the area of automated systems, and has difficulties in maximizing its full potential. By way of example, the installation of X-ray container scanners at the port of Mombasa in 2004 was seen a positive step for trade facilitation in using non-intrusive technology, enabling customs

²⁸⁶ The First Corporate Plan (2000/01-2002/03), the Second Corporate Plan (2003/04-2005/06) and the Third Corporate Plan (2006/07-2008/09).

to avoid the unnecessary physical inspection of cargo. However, the lack of transport such as forklifts to be used to move the containers inside the port yard has resulted in a long waiting time for cargo to be controlled, often for several days. They were afraid that this delay could be another source of corruption, because some traders would be ready to pay “facilitation fee” to customs officers to get their containers scanned earlier. They admit that this was caused mainly by the outdated port facility and not necessarily customs specific problem. Actually, some of them see more serious problems with other trade and transport-related agencies in terms of efficiency and integrity and would like to see customs efforts emulated by other sectors. While there is frequent media coverage of corruption in the public sector, its focus tends to be on expenditure side and the KRA has rarely appeared in the limelight in the recent days. However, they caution that customs officers are not free from petty corruption and maintain that the government must take a holistic and bold approach to improve the situation.

12. View of donors and lending institutions

The donor community confirms the view of the private sector that the current customs procedures contribute to excessive delay in clearance, while appreciating the recent progress in improving its operations. Donors have made their views known to the KRA that strong leadership would be essential in reinforcing the reform and modernization project. They support the accelerated reform process under the current KRA management. Taking into account their advice, the government and KRA management started to implement several measures, including replacement of customs computer system, installation of X-ray cargo scanners, establishment of detector dog unit, and the purchase of boats.²⁸⁷ They welcomed this policy change, in the preparation for and following the termination of the PSI program. Donors assessed that the KRA management had set its mind on a comprehensive reform, even if the reform process would likely take longer than expected. They wondered if the Simba 2005 computer project might require a longer time than initially anticipated to fully develop a database that could support an accurate customs valuation system, replacing the PSI service. They suggest that the government continue its commitment to a comprehensive customs reform program and support for the KRA in the post-PSI

²⁸⁷ “Mombasa port to go electronic in July.” The East African (21 March 2005).

program. They raise concerns that the revenue target set by the Ministry of Finance, often fixed at too high a level, might drive the KRA into seeking a set of short-term revenue raising measures, rather than a long-term and comprehensive customs reform.

The coordination with other government agencies is also essential in promoting trade facilitation. Encouraged by the donor community, Kenya undertook the Time Release Study in 2004 with the assistance of the WCO, measuring the time needed from the entry of cargo to the port to its release and at each step along the way in the effort to identify the bottlenecks in trade procedures. As expected, the outcome provides a basis for further improving customs procedures, including the need for enhancing risk and audit-based control in line with global standards. It also uncovered the involvement of other agencies in assuring the efficiency in border procedures, including the Kenya Bureau of Standards and Kenya Plant Inspection Service, as well as the relevance the Kenya Port Authority (KPA). To achieve significant improvement, it would be necessary to take a well-coordinated approach, involving all related agencies. Donors urge that the KRA take the lead in revamping trade procedures, including the full customs functions, following the termination of PSI contract.

Chapter 9 Case study – Bangladesh

1. Introduction and summary

This Chapter reviews the introduction of PSI in Bangladesh and its impact on customs operations. This case study is intended to support the overall thesis that contracting out of customs function evolved from unregulated privatization to more regulation through sustained efforts for better arrangements, and finally to the realization of the need to develop the state capacity. Bangladesh had a PSI contract with free competition at an early stage, resulting in the loss of revenue. It changed the contract design and reengaged with the PSI companies with more closely regulated contract at the current stage. At the same time, the case study supports this paper's argument that the PSI program requires certain conditions, including effective border control and appropriate compliance environment. It has had difficulties in fully developing a public-private partnership and in using the PSI service to support customs reform and modernization, caused by the lack of these conditions and the limitation in state capacity to manage the contract.

2. Economic environment

Bangladesh is the most populous Least Developed Country (LDC) with US\$470 as GNI per capita (2005)²⁸⁸, one of the poorest LDCs in Asia. It has a large informal sector, estimated to be 37.7% (2002/2003).²⁸⁹ According to WTO, the informal sector (covering agriculture, manufacturing, construction, trade, transport and other services) remains significant, involving up to 90% of the labor force.²⁹⁰ The export of ready-made garments has been the major source of the economy's growth, resulting in above 5% annual real GDP growth in the 1990s and the early 2000's. Exports are destined mostly for the U.S. and European Union markets, to which Bangladesh has privileged access by the General System of Preference. The 2000 WTO report notes that the phasing out of preferential access to these markets and the full integration of all textile and clothing products into the GATT 1994 at the beginning of 2005. This will

²⁸⁸ World Bank (2005) *supra* note 219.

²⁸⁹ Schneider (2004), *supra* note 220.

²⁹⁰ WTO Trade Policy Review – Bangladesh – Secretariat's Report, 7, August 2006 WT/TPR/S/168.

mean more competition from other competitive exporters, such as China and India, and will require Bangladeshi ready-made garments exporters to increase efficiency and improve product quality.²⁹¹ Main import products, reflecting this export structure, are machinery and transport equipments, petroleum and petroleum products, and textile yarns fabrics and made up articles and related products.

In other areas, however, until recently Bangladesh lacked inward investment, impeding its economic development. In the effort to create a favorable business environment, the government has pursued several important structural reforms, including dealing with the problem of loss-making state-owned enterprises, which constitutes a considerable drain on the government's budget.²⁹² Another priority in this regard has been improving institutions and administrative procedures that hinder the investment climate, including cross-border procedures. Bangladesh has a wide-spread governance problem that slows down the implementation of economic reforms. Economic reforms face broad-based resistance from many groups in the economy, where the civil service, businesses, professionals, trade unions and political parties have vested interests.²⁹³ Likewise, corruption is reportedly rampant in all levels of the society.²⁹⁴

3. Tax and tariff policy

The government sets the enhancement of revenue collection as a priority, since the ratio of government revenue to national economy is on the order of 10% (10.9% in 2004/05) which is extremely low compared to neighboring developing countries, 20% in India and 15% in Pakistan.²⁹⁵ This reflects poor tax compliance and weak tax administrations, including the lack of internal coordination and information sharing, weak audit capacity and poor taxpayer service, as well as a relatively small formal

²⁹¹ WTO Trade Policy Review – Bangladesh – Secretariat's Report, 13, May 2000, WT/TPR/S/68.

²⁹² Id.

²⁹³ US Embassy in Bangladesh, Bangladesh Country Commercial Guide 2003-2004, July 2003

²⁹⁴ The Transparency International rated Bangladesh 156th among 163 countries surveyed in the Corruption Perceptions Index 2006, *supra* note 222.

²⁹⁵ Asian Development Bank, Asian development Output 2006

sector and a comparatively large informal sector.²⁹⁶ The major portion of revenues still comes from duties, value-added tax (VAT) and other related taxes levied at the import stage, due to insufficient domestic infrastructure for tax collection. In fact, of the total national tax revenue in 2003, customs duty alone constitutes around 28%, which would rise up to 50% if other duties and taxes collected at the import stage are added. This revenue earning could have been still higher had the imports of around 40% under bond and another 18% of duty exempt imports, not been released without payment of duties and taxes.²⁹⁷ The recent IMF country report suggests that tax exemptions and incentives lead to potential revenue losses of 2% of GDP, and that there is scope to eliminate tax holidays and domestic VAT exemptions in the efforts to expand tax base.²⁹⁸

In the area of trade and tariff policy, Bangladesh maintained severe import controls, ranging from extensive use of non-tariff barriers to high and even prohibitive import duties, in an effort to reign in a worsening balance-of-payment situation following its independence in 1971. With the restoration of parliamentary democracy in 1991, economic reform with trade liberalization has gained momentum.²⁹⁹ As a result, the average weighted customs duty fell from 23% in 1993 to 11% in 2004. The supplementary duties that applied to luxury goods were rationalized and the rates were generally brought down. The number of goods subject to import quantity restrictions dropped from 325 in 1990 to 63 in 2006. Exchange rate management was gradually liberalized in the 1990's and finally moved to an open market exchange rate in 2003. Although tariff rates remain relatively high, mainly because tariffs are the principal source of government revenues, they have been reduced and streamlined in structure. The US Embassy explained that duty rates in 2003 were primarily defined along the following lines: 0-7.5% for manufacturing inputs, 7-15% for basic raw materials, 15-22.5% for intermediate products, and 22.5-32.5% for finished products.³⁰⁰ This reform in tariff structure has contributed to the increase in recorded imports ratio to GDP from 11.6% in 1990 to 19.8% in 2005.³⁰¹

²⁹⁶ IMF country report, No. 04/27 (17, February 2004).

²⁹⁷ Budget Speech 2004-05.

²⁹⁸ IMF country report, No. 06/406 (12, November 2006).

²⁹⁹ Nurun N. Rahman. "Policy Reforms and Trade Liberalization, 2005." *Available at* http://r0.unctad.org/ditc/tab/publications/nama/bangladesh_study.pdf (last visited 6 June 2007).

³⁰⁰ US Embassy in Bangladesh, *supra* note 293.

³⁰¹ Asian Development Bank, Key Indicators 2006.

In order to promote the ready-made garments and knitwear sector, the government introduced several fiscal and financial incentives, including Special Bonded Warehouse (SBW) facilities. Under the SBW scheme the ready-made garments and knitwear exporters are allowed to import their required materials duty and tax free to manufacture them into finished articles of clothing for exportation. Indeed, much of the import growth in the past was attributable to the activities of export-related manufactures, using SBW facilities. Both a bond operator and customs officers in charge keep records of the goods imported into and exported from the bonded warehouse to reconcile the movements of goods into and out of a bonded warehouse. However, the system is not foolproof and there are reports of significant amounts of revenue loss, due to illegal diversion of finished products from the SBW facilities to the local market without paying duty or tax.³⁰² This is why strengthened management of SBW facilities is considered one of the key measures to improving export competitiveness.

4. Customs profile

The National Board of Revenue (NBR) is the central authority for tax administration in Bangladesh since its independence in 1972. Under the Ministry of Finance (MOF), the NBR administers the Excise, VAT, Customs and Income-Tax services. The Customs wing is one of the 5 wings of the NBR, together with Direct Tax, VAT, Research and Statistics, and Administration. It is in charge of formulation of policy and administration concerning customs duty and related taxes and charges. There are approximately 3500 officers and clerks working for customs, but there has been no official recruitment of personnel since 1981. Vacancies were occasionally filled by transfer of personnel from outside the customs administration

Like other customs administrations, Bangladesh customs has a decentralized structure covering the entire territory. Under the MBR there are four major customhouses and thirty active land customs stations for import and export activities and for passenger movement across the country. Chittagong customhouse is the biggest station in terms of revenue and volume of cargo. Chittagong and Mongla

³⁰² Ian Thomas. "Special Bonded Warehousing in Bangladesh" Paper prepared for the World Bank (2003) quoted in Luc De Wulf & José B. Sokol *supra* note 9. at 278.

customhouses, located on the Bengal Bay, deal with sea cargo whereas Benapole customhouse, located on the land border with India, deals with cargo carried by truck. Dhaka customhouse deals with only air freight cargo. Besides cargo handling, a significant number of passengers are also handled by customhouses and customs stations.³⁰³

Taking into account the importance of customs duties as national revenue source, the main concern of customs is to achieve the revenue target set by the Ministry of Finance. At the same time, over-regulated and inefficient customs procedures are often identified as a major business impediment. In response to the growing need for efficient and effective customs operations, they undertook a Customs Administration Modernization project, supported by the World Bank. Automation and introduction of modern rules and regulations are the main objectives of the project. Reflecting this orientation, Bangladesh customs defines its mission as follows:

- Introduction of speedy customs clearance through automation of the process;
- Ensuring transparency in customs clearance process as well as in revenue collection activities; and
- Extending maximum possible facilities to the trade communities.

5. Challenge of customs valuation

Before the adoption of the WTO transaction valuation system, Bangladesh applied the Brussels Definition of Value (BDV) and used the normal price as a basis of valuation, defined in the Customs Code as “the price which they would fetch at the prescribes time on a sale in open market between a buyer and seller, independent of each other”. However, due to the poor level of compliance by importers, it was considered difficult to obtain accurate duty-related information from importers’ declarations. This is why minimum import prices were set as Tariff Values for a number of imported goods to counter fraud attempts by importers. The Tariff Values used to be set by the tariff Commission under the Ministry of Commerce with advice from the NBR. The initial aim of minimum prices was to provide tariff protection to

³⁰³ Bangladesh Customs website. *Available at* <http://www.nbr-bd.org/nbrweb/CustomsFiles/CustomsHomepage.asp> (last visited 6 June 2007).

domestic industry. When a declared value by an importer was higher than the corresponding Tariff Value, the declared value was accepted, and when the declared value was lower, the Tariff Value prevailed. The Tariff Value schedule included 977 tariff lines, accounting for 15% of total tariff lines.³⁰⁴ Tariff Values were reviewed by the National Board of Revenue every six months.

There were however practical difficulties in applying this Tariff Values system. It was a daunting task to continually update the list of minimum prices to accurately reflect the changing market prices. Moreover, the Tariff Values contained in the list were likely to be higher than market prices, as they were intended to provide tariff protection for domestic industry. Another problem was the single tariff value for a product, which did not allow the listed price to reflect differences in the prices of goods originating in different countries and having differences in qualities. These were the common problems inherent to the use of minimum prices as the basis of valuation. Furthermore, customs officers were increasingly faced with valuation of goods outside the narrow coverage of tariff value schedule.

Despite these difficulties, successive governments retained the system in combating attempts by fraudulent importers to evade high tariffs and taxes on imported goods, while at the same time recognizing the frequency of false customs declarations that went uncorrected by inefficient or corrupt customs valuation staff.³⁰⁵ In fact, the poor compliance culture in the business sector resulted in the asymmetry of information on valuation between customs officers and importers. This problem was exaggerated by the lack of capacity in customs officers and the weak institution in customs, which was often regarded as a major business impediment. Customs officers perceived that most importers attempted to lower their duty and tax liabilities by using fake invoices or lower the invoice prices in collusion with exporters. They spent an excessively long time checking documents and consignments, regardless of the degree of valuation risks involving specific consignments. This practice inevitably resulted in negotiations between customs officers and customs agents representing importers on payable duties, including value and classification of goods. Importers were forced to or willing to pay “facilitation fee” to speed up clearance procedures.

³⁰⁴ WTO Trade Policy Review (2006), *supra* note 290, at 39.

³⁰⁵ World Bank Report “Bangladesh Trade Liberalization, Its Pace and Impacts.” (23 November 1999).

This situation was exacerbated by the heavy involvement of employees of Clearing and Forwarding (C&F) agents in customs clearance. The C&F employees maintained close working relationship with customs officials in facilitating clearance. However, they were said to frequently represent the vested interests of their clients in getting prompt solutions to any clearance problems by interacting with customs officials. Actually, they were often found on the other side of the public counter in the long room, engaged in face to face negotiations with customs officials on the treatment of customs declarations. This could provide a breeding ground for illegal financial inducement. It is frequently pointed out that C&F agents served as brokers in settling duties to be paid between importers and customs officers, including the payment of bribery. It is also reported that when they requested the payment of bribes for customs officers, they often retained a substantial part of this illegal payment.

As a result, Bangladesh scores poorly in the business climate, including business regulations regarding trading across borders, in the World Bank survey. By way of example, the time for total import procedures, starting from the document preparation upon the conclusion of an import contract to the delivery of goods to the final destination, amounts to 57 days, compared to 43 in India, 39 in Pakistan, and 14 in the OECD countries.³⁰⁶ Another survey shows that importers of automobile parts and components blame cumbersome customs procedures and the lack of expertise of customs officers as the first impediment, exasperated by the lack of integrity and honesty within business environment.³⁰⁷ This survey also finds out that customs authorities fail to prevent smuggling of a significant volume of parts and components, which is a disadvantage for honest importers. Actually, one survey on Bangladesh-India trade in 1998 suggests that the value of unofficial commodity imports between the two countries could be at least as large as that of official trade or even twice that amount.³⁰⁸ This revelation puts in question the reliability of the entire trade and economic statistics, which should provide baseline data for customs efficiency.

Bangladesh customs authorities therefore have to deal with a wide variety of customs fraud, including falsified documents, misuse of bonded warehouses and

³⁰⁶ World Bank, *Doing Business 2006*. *Available at* <http://www.doingbusiness.org/EconomyRankings/> (last visited 6 June 2007).

³⁰⁷ International Trade Center "South-South Trade Promotion Program, Bangladesh, Supply and Demand Survey on Automotive Components." (August 2002).

³⁰⁸ Rahman and Razzaque. "Informal Border Trade between Bangladesh and India: an Empirical Study in Selected Areas." Asia Foundation, administered by Democracy in Development, Inc. (1998) as cited in World Bank Report (1999) *supra* note 305.

smuggling. Many observers identified high tariff and the remaining quotas as the background of these attempts to evade customs duties and taxes. At the same time, inefficient or corrupt customs officers, unfit to tackle the problem of smuggling and under-invoicing, were identified as another cause of revenue loss and an obstacle to a pro-business environment.

6. Introduction of voluntary PSI in 1993

Faced with the difficulties in valuation and supported by the advice from donors, the government introduced the PSI service on a voluntary basis in 1993 to address the concern of under-invoice and expedite customs clearance. In fact, the IMF and the World Bank made the introduction of PSI a condition to their loan to revive Bangladesh economy.³⁰⁹ These lending institutions wanted to introduce a mandatory PSI, but in the face of fierce opposition from customs officers who viewed it as a threat to their authority and employment, they went along with the government's proposal for a voluntary scheme. Importers were able to choose a PSI company from the list of authorized PSI entities by the NBR.

The PSI agencies examined goods destined for Bangladesh in the exporting country and certified the description, the tariff classification and the value of goods by issuing a Clean Report of Findings (CRF). The current transaction price in the country of export was used to validate the value. Initially, the coverage of PSI was limited to imports for which tariff values were not available. But in 1994 it was extended to all tariff value imports, whereby the PSI values were allowed to override the fixed tariff values. According to the World Bank, this increased the usage of the PSI to approximately 25% of all imports in 1995/96.³¹⁰

PSI-certified import shipments were allowed rapid customs clearance, which was initially perceived as an advantage for honest importers. However, it was pointed out that there had been little effect, if not damaging effect, in revenue enhancement. Whereas the voluntary PSI system was introduced to safeguard under-invoicing, there

³⁰⁹ Z.I. Chawdhay. "Country experience – Bangladesh" in the Commonwealth Trade and Enterprise Paper in Preshipment Inspection: Past Experiences and Future Directions Commonwealth Secretariat (2001)

³¹⁰ WTO (2000), *supra* note 291.

were allegations that prices certified by the PSI companies were often lower than actual prices. Under the voluntary scheme, importers had a greater incentive to use the PSI service when the transaction prices were lower than the minimum prices, which would explain these allegations. In addition, since importers were free to use a PSI company of their own choice, they preferred to choose a company which was ready to offer the most advantageous certification for them. Increasingly, dishonest importers started to exploit the PSI system for their profit. Indeed, there were many reported fraud cases where PSI agents abused the PSI system in issuing false certificates at the request of dishonest importers.³¹¹

According to Faizul Chowdhury, because of the lack of regulatory framework for accountability, the PSI companies were driven by a perverse competition among them to get more clients, and therefore colluded with tax-evading importers.³¹² He points out that the traditional bureaucratic system can monitor the appropriateness of the verification process by customs officers by seeking a satisfactory explanation from officers concerned if there is any deviation from the established procedures. By contrast, it was not easy for the government to monitor the verification process by the overseas agents of the PSI companies without any regulations. He observes that in colluding with importers, the PSI firms appear to have preferred under-invoicing rather than misclassification of commodity as the most suitable means for evasion. To illustrate the escalation of under-invoicing under the PSI regime, he shows the significant fall in price of imported spice Cardamom. While its international price remained in the range of \$ 4500 to \$ 5000 per metric ton throughout the period concerned, the price in the PSI's Clean Reports of Finding dropped from \$ 4541 in February 1995 to \$ 2415 in June 1995 and further down to \$ 1015 three weeks later. This fall in price in PSI reports caused similar downward trend in the price of non-PSI imports, as non-PSI importers could refer to the PSI authenticated price and claim their lower prices to be authentic. Chowdhury concludes that Bangladesh's decision to privatize part of customs system, which was aimed to overcome rampant corruption by customs officers, turned out to be a fatal remedy with institutionalization of evasion through corruption of PSI agencies.

Under the voluntary PSI system, when there was reason to suspect under-valuation, customs officers were not required to accept PSI certificates and sent

³¹¹ World Bank Report (1999), *supra* note 305, at 28.

³¹² Chowdhury. (2006) *supra* note 89 at 70-71.

them for review to the Appellate Tribunal, composed of NBR and other relevant ministries. As a result, there were numerous disputes among customs, the importers who invoked the PSI certificates, and the PSI companies. Recognizing this potentially large-scale revenue leakage for several items under the PSI regime, the government gradually narrowed the scope of items eligible for the PSI system. Finally, due to this malfunctioning of the system, the PSI service was virtually discontinued in 1997.

7. The compulsory PSI service and its development

To rectify the poor operation of inspection companies in certifying prices, donors advised the establishment of appropriate regulations to make the PSI program compulsory and the engagement of only reputable PSI companies for a short term. They also urged the government to automate and otherwise modernize the customs service itself.³¹³ There was a change foreseen in the valuation system by 2000, because Bangladesh signed the WTO Agreement on Customs Valuation as a part of the entire WTO Agreements in 1994. It had been granted a 5-year delay in full application of its provisions. The new valuation system required that dutiable value of imported goods be determined on the basis of transaction values. This was seen a challenge for the NBR to implement without incurring revenue losses. Accordingly, the Bangladesh government felt the need for external assistance to assure revenue while waiting for strengthening of the customs administration.

The government therefore decided to phase-out the Tariff Values system, which was incompatible with the WTO Agreement, and to engage the PSI services again in 2000. It was explained that the PSI system was designed to correct the institutional weakness of customs in introducing the new valuation system. Another objective was to reduce the corruption of some customs officers in cooperation with corrupt private sector traders. Importers were charged 1% of the CRF value to pay for the service. Approximately half of this amount was paid over to the PSI companies, with the remainder being transferred to the Treasury.

³¹³ World Bank Report (1999), *supra* note 290.

In more detail, Bangladesh engaged three companies – BIVAC³¹⁴, Inspectorate Griffith (later a part of BSI)³¹⁵ and ITS³¹⁶ – for a duration of three years. This time the PSI was compulsory for all the imports except goods free of duties and government imports, and each PSI company was given a specific geographical area of operation. This monopoly of region was intended to avoid the perverse competition among PSI agencies in offering lower prices in the attempt to attract importers as their clients. Moreover, a regulatory framework was established for greater accountability for PSI companies to make them abide by the relevant laws and regulations, enforced with penalties. In fact, the NBR detected cases of failure by PSI agents to properly report irregularity of consignments in value, quantity and quality, which resulted in substantial penalties imposed on PSI agencies.³¹⁷ Legal provisions were also made for auditing the performance of the PSI system.

The original PSI contract of 2000 expired in July 2003, but their licenses were extended several times after expiration, based on the recommendations of business and donors. This does not necessarily mean that the PSI service was satisfactory to traders, as repeatedly reported in the newspapers. Importers registered complaints regarding harassment and delay caused by the PSI companies, adding cost to business.³¹⁸ They also blamed PSI agents for not taking into account the global market price when issuing inspection certificates.³¹⁹ There were also allegations of flaws and fraudulent practices in the PSI system. To illustrate the allegations, the “Mercedes-Benz import scam” occurred in 2003, involving a container declared and certified by a PSI company as carrying iron scrap.³²⁰ Instead, two expensive vehicles along with a television, a refrigerator and an air conditioning system were found inside the container when customs officers opened it, as the importer failed to clear the item from the port within the specified time. The Customs Agent Association seized this opportunity to denounce that a large portion of PSI certificates, as much as some 33% in 2003, were found faulty on product price, quantity, as no PSI companies detailed the quality of the imported goods in their certificates. The PSI agency concerned, BSI-Inspectorate,

³¹⁴ A part of Bureau Veritas group (France).

³¹⁵ A part of British Standard Inspection group (UK).

³¹⁶ A part of Intertek Testing Services (UK).

³¹⁷ WTO (2006), *supra* note 291.

³¹⁸ “Businessmen’s Harassment by Preshipment Inspection.” News from Bangladesh (24 March 2005).

³¹⁹ “Importers Blame PSI for Delay, Harassment.” New Age (8 October 2005)

³²⁰ “Bangladesh Takes on Tax Dodgers.” BBC News (25 April 2006).

which issued the verification certificate for the container in question, was later replaced by the SGS.³²¹

Despite all these flaws and fraudulent practices, some powerful domestic business associations urged for continuation of the PSI program when their expiry dates approached on the ground that they would like to avoid customs harassment on imports.³²² On the other hand, the NBR recommended that the Ministry of Finance to cancel the PSI contract and re-introduce valuation carried out by customs officers. There were a series of exchanges of views between the government and the private sector in this regard, whether to renew the contract, including how to assess the performance of the PSI companies. Before the expiry of the extended program at the end of January 2004, the Finance Minister questioned the relevance of PSI system when the customs department had already upgraded its institutional capacity with computerization of customs procedures.³²³ He argued that the NBR was able to do the job instead of PSI companies as it has developed a valuation database and could obtain transaction values from internet.³²⁴ The businesses replied that the current valuation database was based on the Clean Report of Finding (CRF) data provided by the PSI companies and expressed concern over the view of the Ministry of Finance. In terms of the contribution to revenue collection, the trade community argued that the growth of collection of customs duties during the pre-PSI period (1997-98 to 1999-2000) was negative (minus 2.4%) while it was 9.45% in the post-PSI period (2001 to 2003).³²⁵ The Minister of Finance reportedly did not accept the notion that revenue income increased significantly after the introduction of PSI; rather revenue earning grew automatically with the growth of the economy and increase in import-export trade.³²⁶

In spite of this policy debate, the PSI program was renewed for a short period afterwards, waiting for a government policy determination. In addition to the trade community, the World Bank also reportedly observed that the NBR was not yet skilled

³²¹ “SGS India Takes over Preshipment Inspection Work for Export to Bangladesh.” Business Line (17 March 2005).

³²² “Business for Continuation of Preshipment Inspection.” The Daily Star (29 July 2003).

³²³ “Saifur Questions the Relevance of PSI again.” The Bangladesh Observer (15 January 2004).

³²⁴ “Business Propose Neutral Evaluation of PSI System by Non-NBR People.” The Daily Star (23 January 2004).

³²⁵ *Id.*

³²⁶ The Bangladesh Observer (2004), *supra* note 323.

enough for the job and that there should be an evaluation of the system.³²⁷ While there was no evaluation or audit of the PSI system to justify any policy direction, the government finally decided to offer a new tendering for PSI services in August 2005. As a result, four PSI companies, BIVAC, SGS, COTECNA and ITS, were awarded contracts for the continuation of the compulsory PSI program with geographic division for three more years. At the expiry of contracts of these contracts in 2008, the government renewed the contracts with BIVAC, SGS and ITS for another two years during which it is supposed to take necessary measures to terminate the exit from the PSI program, including the establishment of valuation database.

6. The assessment of the PSI performance

Under the BDV system where customs had a considerable authority to determine the value, CRF prices were often used as the direct source of value determination. On the other hand, under the WTO valuation system, customs officers are required to take the transaction value as the basis of valuation. It is only when the transaction value could not be used that customs officers may reject the invoice price and instead apply an alternative methodology to determine value in the strict order provided for in the WTO Agreement. The PSI-assessed price should be employed as a risk indicator to verify the applicability of the transaction value method. If the declared price differs from the CRF price, it might provide customs with reasons to doubt the accuracy of the declared price. Customs authorities cannot automatically determine the dutiable value based on the recommendation by PSI companies.

It is often reported however that the way in which Bangladesh uses the PSI program is not very different from that under the BDV system. In fact, after the introduction of a mandatory regime, the PSI value is usually accepted by customs officers as the basis of determining the value. Importers who disagree with the CRF valuation can appeal to a Review Committee, but they can do so only after the clearance of goods based on the PSI value and the payment of duties assessed by customs. The Review Committee is said to have settled the majority of the cases in favor of the PSI-assessed valuation. Importers have the opportunity to bring cases to the Bangladesh judicial system. It used to take a long time to settle these cases, which

³²⁷ "PSI Companies Get Extension up to June 30." The Daily Star (25 January 2004).

discouraged importers from using the system. Fortunately civil court procedures have recently gained in efficiency in dealing the customs cases and there are increasingly more appeals brought to court. While CRF prices are normally accepted, they are sometimes rejected and instead higher values are used when they are lower than earlier CRF prices on record for the same kind of goods with the same origin, contained in a value database. When the CRF price is lower than the invoice price, the latter is retained. It is a frequent practice that customs officers adopt whichever value is higher to get more revenue. The number of cases where customs did not accept PSI-assessed value was estimated at 10% of the total import. It was furthermore alleged that customs tended to uplift the declared value without giving sufficient reasons to importers. Importers often expressed their grievance that customs did not abide by the CRF prices, but this is often the case when there are higher reference prices available in the database. This practice has resulted in a large number of cases filed by importers to the Review Committees and further to the court.

Where this entire pattern seems to be clearly driven by the obsession for revenue, many observers point out that conformity with the WTO Agreement is questionable. This practice could be the cause of concern of importers under the eventual resumption of valuation by customs without the assistance of PSI service.

Although the PSI inspection is mandatory, there are many shipments entering Bangladesh without CRF. While no statistics are available, customs officers agree that the share of shipments arriving without CRF could be a high portion of total imports. This could be partly attributed to the belated submission of PSI certificates by the PSI companies. However, some importers are willing to pay a 25% fine for not providing CRF certificates, suggesting that they prefer absorbing this extra fine rather than undergoing the PSI procedure which could possibly lead to a rise in the certified price.

Moreover, the modus operandi of revenue fraud is not limited to documentary falsification where the PSI program can play a major role. Smuggling and the misuse of bonded warehouses are other sources of revenue leakage and could be used interchangeably with under-invoicing. Therefore there are limitations to the usefulness of the PSI service. With this caveat in mind, it is necessary to identify the contribution of the inspection companies to enhancing revenue. However, it is difficult to quantifiably assess the performance of the PSI service, because customs records only

CRF prices and not invoice prices. There is only anecdotal evidence for the amount of uplifting. Likewise, there is no record of the amount of duties uplifted, which should indicate whether or not the PSI reports are actually used. There has apparently been no internal or external audit carried out by the NBR on the performance of the PSI companies. Over the past four years the customs administration has failed to achieve the revenue target set by the Ministry of Finance. However, each year there has been annual increase of around 6-7% in revenue in the 2000's, in spite of the gradual reduction in tariff level. As shown in the below table, this revenue performance also reflects the rapid import growth of over 10% in the same period, except for a sharp drop in 2001/02 as a result of sluggish world economy, following the terrorist attacks on 11 September 2001.

In the absence of detailed trade data, it is difficult to assess if the revenue increase was achieved by natural growth of dutiable imports, as argued by the then Minister of Finance in early 2004, or by the effect of the PSI system as argued by those who favor the continuation of PSI program in 2004. When measured against the ratio to GDP, customs duties represent fairly stable figures, as shown in the table below.³²⁸ It remained the same at 2.2% from 1995/96 to 1998/99, and after a short fall to 1.8% in 1999/00, it regained the range of 2.0 to 2.2% for the period corresponding to the compulsory PSI program. Donors and observers often express their disappointment with the slow pace of revenue enhancement, despite several measures undertaken for tax and customs administration reform. The WTO reports that the slower than projected revenue growth reflected delays in the implementation of tax administration reforms and resulting lingering weakness in enforcement.³²⁹

(Table 6-1) Selected macroeconomic indicators, 1998-2005

	1998/9	1999/0	2000/0	2001/0	2002/0	2003/0	2004/0
	9	0	1	2	3	4	5
National accounts	<i>(Percentage change)</i>						
Real GDP	4.9	5.9	5.3	4.4	5.3	6.3	5.4
	<i>(Per cent of GDP, unless otherwise indicated)</i>						
Fiscal policy							

³²⁸ WTO (2006), *supra* note 290, at 3.

³²⁹ *Id.*

	1998/9	1999/0	2000/0	2001/0	2002/0	2003/0	2004/0
	9	0	1	2	3	4	5
NBR revenue	6.8	6.4	7.4	7.4	7.9	7.9	8.1
Custom duties	2.2	1.8	2.0	2.0	2.2	2.1	2.1
External sector							
Merchandise exports (% change)	3.5	7.9	12.6	-7.6	9.5	15.9	14.0
Merchandise imports (% change)	8.0	3.4	11.4	-8.7	13.1	13.0	20.6

In terms of trade facilitation, customs officers usually accept the certified value in the majority of cases and therefore consignments are cleared at a faster pace, provided the CRF certificates arrive on time and contain acceptable prices. Approximately 10% of the PSI imports are physically examined by customs and the remaining 90% are released on the basis of paper scrutiny.³³⁰ One survey of importers suggests that clearance time has dropped considerably from 10-12 days to 3 days on the average for imports using PSI.³³¹ On the other hand, the export procedure has become lengthy. Moreover, there is no guarantee that PSI companies will produce the CRF in time for clearance at destination. However, on balance, the PSI service is estimated to have brought a benefit to this area, because most of the goods are cleared from customs at a faster pace. The availability of PSI certificates has contributed to reducing the amount of negotiations that customs undertakes with importers, often represented by brokers.

In respect of the improvement in the integrity of customs officers, as the PSI companies certify the value and import documents, the arbitrary power of customs officers was reduced, thus resulting in less opportunity for harassing importers in examining the value and documents. However, in granting permission for clearance of each consignment, customs officers could continue to collect an informal toll from importers, often through C&F agents. A World Bank report revealed that "speed payments" (bribes) are required for certain transactions at the Port of Chittagong to get shipments through the clearance system in a reasonable amount of time.³³² Minimum

³³⁰ *Id.*

³³¹ Chawdhay (2001), *supra* note 309, at 95.

³³² World Bank "Bangladesh – Growth and Export Competitiveness" Report No.

speed payments are reported in the range of 2000 Taka per container at the customs and in the range of 1000 Taka per container at the port. Without paying this “fee” shippers can expect delays of one day to as much as several days or more, depending on the circumstances, according to interviews with them. As a result, the total cost of unofficial charges (bribes and related costs) amount to 12% of the total port-related charges, exclusive of duty and taxes. The World Bank report shows that while the NBR claims that 95% of all CRFs are good and should require no further inspection, customs authorities actually review nearly all CRFs, in spite of the high degree of accuracy, and often orders re-inspection. In a similar vein, Chowdhury points out ironically that re-introduction of PSI met with minimal protest from customs officers, implying that vested interest of corrupt customs officers was not affected by PSI.³³³ This fact could indicate that the main source of illegal revenue for corrupt officers to compensate their low salary might be from “facilitation fees” rather than collusion with importers on valuation, which would expose them to the risk of job security. Furthermore, reflecting the overall integrity situation of the society, he reveals that some cases have also been reported where importers submitted forged documents in collusion with PSI inspectors at the point of export.

7. The progress in customs modernization

The PSI program was intended to give the customs administration short-term relief to modernize and develop its own capacities. In fact, with the assistance of the World Bank, the Bangladesh government has embarked on a customs reform and modernization program, the Customs Administration Modernization project, phase 1 (CAM-1) in 1999. This project was incorporated into the overarching Bangladesh Export Diversification Project to promote exports through diversification of goods and overseas markets and to improve the business environment. At the planning stage of the Export Diversification Project, the World Bank conducted a survey of exporters needs and identified the weaknesses of customs administration as a critical obstacle to export growth and a priority policy reform. This why customs reform was incorporated as a sub-component, which has three key components of (i) streamlined export and

31394-BD, Poverty Reduction and Economic Management Sector Unit/ South Asia region (4 May 2005).

³³³ Chawdhay (2001), *supra* note 312, at 85.

related-import procedures; (ii) automation through the UNCTAD-sponsored ASYCUDA++ (Automated System for Customs Data); and (iii) strengthened management of Special Bonded Warehouse (SBW) to deter illegal diversion of the finished products from the SBW to the local market.

The CAM-1 project achieved a modest success, in rolling over the automation system in big customs houses in major ports. This automation project was a second try, as an earlier effort to introduce computer systems in the biggest customs houses in Chittagong in the mid-1990's was interrupted due to high opposition by customs officers and C&F (clearance and forwarding) agents. According to the assessment of World Bank, the share of clearance in the same day in those ports was reported to have increased from 50% to 99% for exports, and from 29% to 53% for imports.³³⁴ Furthermore, in order to reduce rent-seeking opportunities for customs officers and C&F agents, the "closed loop" system was developed to separate the two groups at customs offices, assisted by the introduction of computers. Naturally, since automation of customs procedures could result in the reduction of an opportunity for C&F agents to interact with customs officers, they were often the major force opposing the installation of computer systems, and thereby the "closed loop" system.

In this connection, the introduction of Direct Traders' Input (DTI) for the clearance of exports and temporary imports has helped significantly in reducing clearance time and the incidence of errors at the data entry level by customs operators.³³⁵ It enabled traders to enter their declarations into the system through their C&F (clearance and forwarding) agents' office at any time of the day. Work is underway to bring all imports under DTI and introduce remote DTI, enabling traders to enter declarations from their own offices using web technology. The automation also allowed customs officers to capture more trade information, which assists in the development of a database and the collection of trade statistics. The management of SBW was enhanced by the creation of a central unit and the streamlined of licensing procedures.

Another important step towards modern customs procedures was the introduction of a risk-based selectivity system for inspection. While all consignments

³³⁴ World Bank, "Implementation Completion Report on a Credit in the Amount of US\$ 32 Million to the Bangladesh for an Export Diversification Project" (15 April 2005).

³³⁵ WTO (2006), *supra* note 290, at 40.

currently undergo either to the yellow channel (documentary examination) or the red channel (physical inspection), the NBR has initiated the process of introducing the green channel facilities (no documentary examination or physical inspection) for selected importers with good compliance record. The NBR is working with trade associations to identify potential candidates for the facilitative measures that will further reduce clearance time and opportunities for rent-seeking.³³⁶

However, the customs reform project has encountered several difficulties. The frequent change of top management in the NBR and its staff rotation policy was not helpful in managing the reform project or in involving customs officers in the reform process. When new top management was appointed from the outside, the reform process had to be started afresh. In this connection, the Transparency International Bangladesh (TIB) criticized the customs administration for the absence of institutional discipline whereby career planning decisions, transfers and postings are made on the basis of pressures, gratification and other considerations instead of clearly established principles.³³⁷ It maintains that the situation is made worse by an absence of moral commitment on the part of customs officers, arising from the lack of direct and focused recruitment followed by training. In addition to this human resource management problem, the World Bank points out the identified weakness in managing the automation system. There were frequent changes in user requirements during project implementation, relocation of trained staff, and insufficient collaboration between the consulting firm in charge of ASYCUDA++ and another firm in charge of developing the complementary system for risk management.³³⁸

As a result of this management problem, it is difficult to confirm if the NBR has used the PSI program to get sufficient time to modernize its customs administrations. Instead, the reliance of the PSI program might have diverted the government from investing in customs modernization and lessened the pressure for reform from the NBR.

8. View of customs

³³⁶ *Id.*

³³⁷ Transparency International Bangladesh for the World Bank, *Corruption in Public Sector Departments: Its Manifestations, causes and Suggested Remedies*, 2002.

available on the website of Transparency international Bangladesh

³³⁸ World Bank (2005), *supra* note 334.

The PSI service is not popular among customs officers, as it is perceived as the threat to their position and employment. Customs staff at the NBR level are critical of PSI operations and urge the Ministry of Finance to phase-out the PSI program. They have a dim view on the PSI contribution to revenue. Some customs officers at the customhouse level find the CRF useful in their appraisal work. They acknowledge however that the dependence on PSI companies should eventually come to an end. They often argue that they do not receive sufficient support from the government, in terms of training and necessary infrastructure.

As part of the contract, PSI companies provide training programs related to risk assessment, fraud and post clearance audit. While the subjects of training were approved by the customs administration, the administration was not successful in monitoring the PSI-sponsored training. It is not mandatory for customs officers to take part in the training and there is no mechanism or incentive to encourage the active participation of customs officers. Another problem is the frequent change of personnel, involving the officers having received the training. They also point out the extremely low level of salary as a root cause. The establishment of a valuation database is often regarded as being the necessary element for customs to regain their traditional role in appraising the value. However, customs officers feel that the PSI companies have not transferred the necessary skill or tool to help the administration in developing a database. During the four years since 2000, service charges realized for PSI have been approximately Taka 8140 million, which is more than ten times the cost of collection incurred by the entire customs department.³³⁹ Many customs officers feel that the government could have invested in customs more substantially for its modernization, which could be a less costly and more productive solution.

9. View of trade

The representatives of the private sector complained that uplifts contained in the CRF certificates are rarely documented or notified to them. Moreover, they maintain that the Review Committee tends to be in favor of customs decisions based on the CRF. They nevertheless view the presence of the PSI companies inevitable under the current

³³⁹ Chawdhay (2001), *supra* note 312, at 85.

situation where there is not sufficient expertise in customs officers or well-functioning automated infrastructure. They express their concern that in the absence of a PSI contract they would be harassed by customs officers who are under pressure to uplift the invoice prices in order to achieve their assigned budget targets, coupled with possible rent-seeking behavior. There is a lack of mutual trust between customs and business. On the other hand, since the government heavily depends on import duties to generate revenue, there will always be a tendency on the part of commercial sector to avoid paying high customs duties, possibly in collusion with some customs officers. They reckon that eventually customs will regain its traditional role in valuation, but they noted that it would require substantial capacity building.

10. View of donors and lending institutions

The donor organizations including the World Bank and the IMF identified the need for enhancing the revenue function through institution building. In this respect, the World Bank has provided funds to the government of Bangladesh for modernization of customs and advised it to hire the PSI service. They are of the view that the PSI cannot be a permanent solution to manage the inefficiency of Bangladesh customs. While considering that the hiring of the PSI companies as an interim solution, they initially viewed the introduction of PSI as a force of change in organizational culture and an impetus for reform. However, in the absence of an evaluation of PSI performance by the NBR, they are currently of the opinion that they see no solid ground to judge whether a huge sum of public expenditure for the PSI companies was money well spent. They suggest that Bangladesh customs use the PSI program in a more beneficial way as a part of a wider capacity building program, if it hires the costly PSI companies.

Following the requirements of the IMF, the Government of Bangladesh stated its intention to “further strengthen the PSI, customs valuation process, and the post-clearance audit, with World Bank assistance” to augment customs collection, in its Letter of Intent and Memorandum of Economic and Financial Policies in May 2005³⁴⁰. Accordingly, the new PSI contract was awarded in August 2005. In the subsequent

³⁴⁰ IMF, Bangladesh “Letter of Intent and Memorandum of Economic and Financial Policies for April 2005 – June 2006” (26 May 2005).

statement to the IMF in January 2006 the government asserted that “For customs administration, an external audit of PSI companies will be initiated by end-April 2006.”³⁴¹ In the subsequent statement to the IMF in October 2006 the government declared that “For customs administration, we are preparing to issue a tender to hire an external auditor of PSI companies.”³⁴² These letters and memorandums indicated that the lending institutions believed that the PSI program of 2000 did not necessarily meet initial expectation and that under the new contract (of 2005) the PSI companies should be made accountable in order to maximize the benefit of the public-private partnership approach.

³⁴¹ IMF, Bangladesh “Letter of Intent and Memorandum of Economic and Financial Policies for 2006” (9 January 2006).

³⁴² IMF, Bangladesh “Letter of Intent and Memorandum of Economic and Financial Policies for 2006/2007” (5 October 2006).

Chapter 10 Case study – Togo

1. Introduction and summary

This Chapter reviews the introduction of the PSI program in Togo, its evolution, and its impact on customs operations. This case study is intended to support the overall thesis that the contracting out of the customs function requires an appropriate condition and mechanism of monitoring and regulation to realize its benefit. Togo has impermeable borders and neighboring ports in competition, which made it difficult for the PSI program to function. In response to the changing environment and needs of the government, the inspection industry developed the Destination Inspection, coupled with scanning service as a new form of public-private partnership in Togo. However, the inspection company has retained the examination of customs documents for the valuation purpose. Therefore, the challenge for customs remains in its capacity building in customs core competence.

2. Economic environment

Togo is a least-developed country in the Sub-Saharan African region. It is a narrow strip of land on Africa's west coast, sandwiched by Ghana and Benin, and linked to land-locked Burkina Faso. Since its independence in 1960, its economy recorded a strong growth up to the mid-1970's, thanks to its abundant low-cost phosphate, high commodity price for agricultural goods, and commercial activities. The government embarked on an ambitious investment program in the mid-1970's with the creation of public enterprises, monopolizing overseas sales of phosphate and agricultural products. However, the oil prices continued to rise rapidly whereas international commodity price for the products of Togo, such as phosphate, cocoa and coffee started to fall. Consequently the government was increasingly forced to rely on external borrowings, and as a result the economic situation deteriorated. In the 1980's the authorities introduced a series of structural adjustment programs to correct macroeconomic imbalances, which helped Togo to achieve economic liberalization and a quick recovery.

The political turmoil in the early 1990's however has hindered the economic development and aid flow. The social and political crisis in Togo started in 1992 when

a democratic movement was oppressed by the one-party political system that had dominated the country for more than 25 years. Following the collapse of the Soviet Union, the Western countries put pressure on Togo for democratic reforms with the introduction of a multi-party system. They suspended aid to Togo alleging human rights abuse and voting irregularities in 1993 when President Eyadema was re-elected. The long-standing sanctions from Western countries for more than a decade, together with diminished inward investment, resulted in the obsolescence of the infrastructure at the port and other transport facilities. With the end of disorder in 1994 and the devaluation of the currency, African Financial Community franc (CFA franc), there was an economic recovery for a short period. Economic growth has remained modest with an increase in poverty while the external assistance has remained low.

Togo is one of the poorest countries with US\$350 as GNI per capita (2005)³⁴³ with a large informal economy (estimated as large as 40.0% in 2002/2003)³⁴⁴. According to the WTO, the informal sector accounts for some 68% of economic activity and is responsible for about one third of turnover in business and transport.³⁴⁵ The political instability used to be the cause of the poor score in perception of corruption.³⁴⁶ Nowadays, its economy is heavily dependent on subsistence agriculture with cotton, coffee and cocoa. These cash crops represent the major exports, but the fluctuation of international commodity prices has had adverse effects. Main exports are cement produced in the free zone near the port of Lomé, followed by cotton and phosphates. Main imports are petroleum products, food products, machinery, and transport vehicles. The trade balance has remained in deficit for a long time. Another major economic sector is service related to transit trade with the land-locked countries in the Sahel region (Burkina Faso, Mali and Niger), linked by an important road network. The presence of a deep-watered port of Lomé is Togo's major asset and pre-disposed Togo towards commerce, as a natural corridor between the ocean and the land-locked countries of the Sahel. At the end of the 1980's the Autonomous Port of Lomé prospered as a sub-regional trade and financial hub. Lomé became the transit point for Niger by replacing the port of Cotonou in Benin, which was suffering from political chaos in the 1980's. However, when Togo suffered from violent political confrontations,

³⁴³ World Bank (2005), *supra* note 2199.

³⁴⁴ Schneider (2004), *supra* note 220.

³⁴⁵ WTO Trade Policy Review – Togo – Secretariat's Report, WT/TPR/S/166/Rev.1 (September 2006).

³⁴⁶ The Transparency International rates Togo 130th among 163 countries surveyed in Corruption Perceptions Index 2006, *supra* note 222.

accompanied by prolonged closure of the port of Lomé in the early 1990's, land-locked countries in Sahel shifted its transit route back to Cotonou and other ports in neighboring countries. The political crisis in Côte d'Ivoire since 1999 has again diverted many cargo ships from the port of Abidjan, the biggest and major transit port in West Africa, to other regional ports. In fact, the ports in Ghana, Senegal, and Togo recorded a considerable increase in transit trade volume. Nevertheless, the port of Tema in Ghana has an advantage over other ports as replacement to Abidjan, because of its advanced port facility.

After the death of President Eyadema in 2005, his son succeeded as President. Since then, a reconciliation talk between the government and the opposition progressed in 2006. Accordingly, the relationship with the European Union, its main donor, has considerably improved with the prospective resumption of aid. Togo belongs to the West African Economic and Monetary Union (WAEMU) in which the countries share a common currency, the CFA franc. The WAEMU is a customs and monetary union between eight members of the larger Economic Community of West African States (ECOWAS) with 15 members.

3. Tax and tariff policy

After the initial structural adjustment in the 1980's, Togo moved forward in the early 1990's with its macroeconomic stabilization and structural reform program in spite of the political mayhem in the early 1990's and the resultant lack of external funding. Following the devaluation of CFA franc in 1994, it adopted a comprehensive adjustment policy, supported by the IMF for the period of 1994-1997. Revenue enhancement is one of the priorities in achieving macroeconomic stability.

According to the IMF, the tax structure of Togo is typical of developing countries, with more reliance placed on indirect taxes than direct taxes. In fact, import duties and VAT are the two major sources, and account for 48% of the total revenue during 1994-98, as shown in the table below.³⁴⁷ Likewise, customs plays an important role in collecting revenue from international trade, accounting for 47% of total tax revenue during the same period. Compared to the period during 1985-90, the ratio of domestic

³⁴⁷ IMF Staff Country Report No. 99/54 "Togo: Selected Issues" (July 1999).

tax revenue to total tax revenue actually diminished from 56.7% to 53.3%. This decline mainly reflects the decrease in contribution of public enterprises, as a result of liberalization in the coffee and cacao sectors and the end of monopoly on cotton exports. Obviously, this fiscal loss was not compensated for by an expected increase in taxes on profits and income of private sector companies that had substituted them. Furthermore, the decline in the production of phosphate and its reduced international price resulted in the fall of contribution from the public enterprise specialized in the sector.

(Table 7-1)

Tax Structure in Togo before and after the political turmoil in the early 1990's
% of GDP (% of total tax revenue)

	1985-90	1993	1994-98
Total tax revenue	20.2 (100.0)	8.8 (100.0)	12.8 (100.0)
- Customs revenue	8.7 (43.3)	3.9 (43.7)	5.9 (46.7)
Import duties	5.1 (25.2)	1.7 (19.4)	2.3 (17.7)
VAT on imports	1.8 (18.3)	1.2 (14.1)	2.6 (21.0)
- Domestic revenue	11.5 (56.7)	5.0 (56.3)	6.9 (53.3)
Domestic direct	8.4 (40.7)	3.4 (38.3)	4.6 (34.6)
Public enterprises	4.6 (18.9)	0.7 (7.5)	1.7 (12.6)
Profit taxes	1.5 (9.4)	0.4 (5.1)	0.7 (5.8)
Income taxes	0.6 (6.7)	0.6 (7.3)	1.0 (7.9)
Domestic indirect	3.1 (16.0)	1.6 (18.0)	2.3 (18.7)
VAT	1.8 (9.6)	0.8 (9.3)	1.2 (9.3)
Petrol taxes	0.3 (1.5)	0.0 (0.2)	0.8 (6.3)

(IMF 1999, Togo: Selected issues)

The ratio averaged 20.2% during 1985-90, which was one of the highest in the WAEMU countries where the average ratio was 14.1% during the same period. However, it started to deteriorate from 1991, due to the political turmoil. In fact, it went down to as low as 8.8% in 1993, with reduced customs revenue as a result of the sharp contraction of imports by half and reduced domestic revenue reflecting a substantial decline in the contributions from public enterprises. Tax revenue began to recover in 1994 following the end of violence and devaluation of CFA franc. Moreover, a series of tax reforms and revenue-enhancing measures were initiated to overcome the

difficulties. The complicated general sales tax was replaced by VAT in 1995 and its rates (7, 18%) were unified to a single 18% in 1997, and the scope of exemptions was reduced. A Large Tax Payer Unit was created to modernize the assessment and collection of taxes from major tax payers, supported by computerization of the tax administration. The tax-to-GDP ratio of 12.8% during 1994-98 shows a clear improvement, but it is low compared to the average ratio of 14.6% in the other WAEMU countries during the same period, as shown in the table below. Many observers point out that the narrow tax base is the real challenge for the government, and then should be dealt with by putting the agricultural sector in the tax net, narrowing down exemptions, and taxing the informal sector. These are politically and technically difficult areas to tackle.

(Table 7-2) Tax revenue in the WAEMU countries
% of GDP

	1985-90	1994-98
Benin	9.6	12.5
Burkina Faso	9.4	11.3
Côte d'Ivoire	18.7	18.0
Mali	9.6	12.0
Niger	8.5	6.6
Senegal	14.3	14.9
Togo	20.1	12.8
WAEMU average	14.1	14.6

(IMF 1999, Togo: Selected issues)³⁴⁸

Togo pursued trade liberalization as part of its structural adjustment in the 1980's and then as part of regional economic integration in the 2000's. As a result, Togo removed most of quantitative restrictions on imports. Its tariff structure was simplified in 1997 from 5 rates (0, 5, 10, 20 and 35%) to 3 rates (5, 10 and 20%). Then, as a member of the WAEMU, it introduced the Common External Tariff in 2000 as the WAEMU moved to the full economic union. Consequently, Togo's simple average applied tariff rate went down from 16.5% in 1998 to 12.1% in 2005, representing trade

³⁴⁸ The table does not include the figures of Guinea-Bissau that joined the WAEMU in 1997.

liberalization mainly in non-agricultural goods.³⁴⁹ An export processing free zone was established in 1989 in an effort to promote investment by providing enterprises with tax and customs incentives. The transit of goods for land-locked countries in Sahel offers an important opportunity for economic activities in the port of Lomé. Direct transit is not subject to any tax, while re-exports are subject to 4% tax.

4. Customs profile

Under the supervision of the Ministry of Economy, Finance and Privatization, the Customs Department of Togo administers customs and other taxes collected at the borders. Its Customs Code dated 1966 is antiquated and the need for modernization is widely recognized. There are approximately 600 customs officials, but there has been no recruitment of personnel for many years. As a result, the structure has become top heavy, with more officers at senior positions than at the junior level. The Customs Department does not have its own training facilities and therefore sends its officers for training to customs schools in Belgium, France and Morocco. Like other customs administrations, Togo customs has a decentralized structure covering the entire territory. The major branches are at the port of Lomé and at the international airport in Lomé. There are many crossing points along its long border lines with Ghana, Burkina Faso and Benin, which could be used as smuggling routes, and thus provide a huge challenge to the Customs Department with its limited human resources.

The government acknowledges the need to modernize customs in order to improve the competitiveness of the port of Lomé as an entry point for West Africa, which will contribute to economic activities and ultimately revenue. Customs declarations are already computerized in major offices by the UNCTAD-sponsored ASYCUDA (Version 2), and the automation of the entire customs procedures is studied with the migration to the ASYCUDA ++ system.

In fact, Togo has kept its trade regime relatively open and competitive compared to other countries in the region. The World Bank “Doing Business” survey finds Togo

³⁴⁹ WTO (2006), *supra* note 345. Apart from customs duties, goods are subject to other duties and levies, including statistical fee, WAEMU and ECOWAS community levies, all of which would bring up the simple average tariff rate to 15.8%.

relatively well-positioned in Sub-Saharan Africa in terms of the time required for the entire import process, the number of import documents and import costs.³⁵⁰ Importantly, the official cost of compliance with trade procedures for Togo is low at the level of US\$695, when compared to the neighboring countries on the West African Coast. This reflects the low cost of port and terminal handling, as well as inland transportation and handling. However, this comparative advantage is said to have been eroding, due to poorly maintained port and transport infrastructure.

(Table 7-3)

World Bank “Doing Business 2006 – Trading across Borders (import)”

	Time for import (days)	Documents for import (number)	Cost to import (US\$ per container)
Togo	41	9	695
Ghana	42	9	842
Nigeria	45	13	1460
Benin	48	11	1452
Côte d’Ivoire	48	19	1395

(World Bank “Doing Business 2006”)

5. Challenge of customs valuation

The state treasury suffers chronic budget deficits and accumulated arrears in internal and external borrowings. Accordingly, tax and customs administrations are constantly under the pressure of achieving revenue targets. It has not been easy however to fulfill the dual objectives of enhancing revenue collection and keeping the trade regime attractive, which implies cost and speed. Actually, it has been common to observe the rampant informal trade sector circumventing customs control through unreported trade with next-door countries such as Ghana and Niger or sometimes political interference. Since its territory was artificially drawn up based on its colonial past, land borders in adjacent countries are difficult to guard from unregistered cross-border flow of goods. Some informal traders even reportedly exploited formal

³⁵⁰ World Bank (2006) *supra* note 306.

entry points of port to escape control. Likewise, goods stored in bonded warehouses, destined for transit or re-export, are often diverted into local market. There were attempts to exploit the exemption regime of customs duties by using political interference. Bonded warehouses have been liable to provide another opportunity for fraud, as transit is not subject to customs duties and taxes, and re-exports are generally subject only to a 4% tax. Therefore their diversion to domestic market is another lost opportunity for revenue collection. While the value of transit alone is almost equivalent to that of imports for domestic consumption, a recent survey reveals that only 40% of transit bound for Niger was actually recognized by the Niger customs authorities at borders. These fraudulent activities added further tax burden on the narrow formal sector.

Before the adoption of the WTO transaction valuation system in 2000, Togo applied the Brussels Definition of Value (BDV) and used the normal price as a basis of valuation. However, due to the poor level of compliance by importers, exasperated by a large informal sector, it was difficult to obtain accurate duty-related information from importers' declarations. Actually, customs officers perceive most importers as attempting to lower their duty and tax liabilities by using fake invoices or lowering the invoice price through collusion with exporters. In addressing this problem, many West African countries use a list of values applied to assess the value of goods coming into the country. While the list was supposed to be upgraded based on market research and import history, it was often difficult to maintain the accuracy of the values contained in the list, owing to the lack of necessary infrastructure, weak capacity of customs, and the poor compliance culture. Under these circumstances, customs officers were frequently engaged in lengthy verification to find acceptable value, regardless of the degree of valuation risks involving specific consignments. This practice could provide a background for negotiations on value and classification of goods and potential collusion between customs officers and importers, usually represented by customs brokers. Moreover, this situation provides instances where importers might be willing to or be forced to pay a "facilitation fee" to speed up clearance procedures.

It was in the context of structural adjustment reform during 1994-98 that the IMF provided technical assistance to strengthening the Togolese customs administration to address these challenges. These reforms included five components:

351

³⁵¹ IMF Staff Country Report No. 99/54 "Togo: Selected Issues" (July 1999).

- strengthening the surveillance of transit and warehouse operations to avoid diversion of goods to local market;
- tightening port security and customs procedures to deter smuggling;
- enhancing control on customs exemptions;
- computerizing customs procedures; and
- introducing an import inspection program for valuation.

The last point, concerning the import inspection program involves an inspection company to provide information on valuation and other revenue-related items of each consignment.

6. Introduction of PSI

With advice from the IMF, the government introduced the PSI service in 1995 as part of a structural adjustment reform to address the concern of under-invoice. COTECNA was awarded the contract in 1994 and started the PSI operation in 1995, which was renewed in 2002. Goods with value exceeding CFA 1.5 million francs (=2286 euro, CFA 1 million francs in case of land transport) were subject to PSI. Goods originating from ECOWAS, goods for transit and temporary importation, and other specified goods in the contract were exempt from inspection. The importer was required to complete an Intention to Import form and submit it to the PSI liaison office in Lomé. The PSI office in the country of shipment of goods examined documents, including price, and inspected goods to ensure its quality and quantity. It then issued a Clean Report of Findings named ADV (Attestation de Vérification), indicating tariff heading, customs value and the total amount of duties and taxes payable, for the importer and the attested final invoice for the exporter. In case of a refusal to certify, a Non Negotiable Report of Finding, called ARA (Attestation de Refus d'Autorisation) was issued. The attested final invoice was necessary for the exporter to receive the payment from the negotiating bank and the ADV was necessary for the importer to clear the goods through customs.³⁵² The PSI agency was also tasked to assist customs

³⁵² COTECNA data sheet for exporters, 2006 . *Available at* http://www.cotecna.com/COM/Images/Togo_datasheet.pdf (last visited 6 June 2007).

in establishing the value index, based on ADVs and its market research, which should serve as a reference tool for verification of value by customs.

The main breaches of customs regulations were found to be valuation (70%), quantity (15%), nature of goods (10%) and origin (5%). Consumer goods, such as rice, sugar and flour, were the major commodity for smuggling.³⁵³

The inspection company applied its risk assessment system and limited its physical inspection to selected consignments, as the manner of inspection was at discretion of the company. The PSI contract formalized the selective inspection at a later stage in 2002, resulting in a change of the fee arrangements. This formalization of selectivity reflects the trend of modern customs operations that is based on risk management whereby customs concentrates its resources on the high risk areas rather than an inefficient 100% inspection. The PSI agency clarified that goods considered moderate risk were subject to documentary examination for classification and valuation purpose (orange channel) while goods considered high risk were also subject to a physical inspection (red channel). The government initially paid fees to the PSI company at the rate of 1% of the f.o.b. (Free On Board) value of imports, with a minimum of CFA 80,000 francs per inspection. The WTO Secretariat appears to judge the minimum fee high, as it describes the fee as “between five and eight times the minimum levels beyond which the inspection is required”.³⁵⁴ With the formalization of selective selection, the fee was reduced by introducing the rate of 0.75% of the f.o.b. value of imports, with a minimum of CFA 70,000 francs per inspection for the orange channel whereas 0.8% of the f.o.b. value of imports, with a minimum of CFA 80,000 francs per inspection for the red channel. These fees were born by the government, financed by the special charges on imports, set at 0.75% of the f.o.b. value of all imports, including those not subject to PSI.³⁵⁵

Togolese customs officers were not bound to accept the value certified by the PSI agency, as they viewed certified prices as indicative value. In addition to the PSI reports, they verified declared values by using the value index of major products, established with the assistance of COTECNA, and domestic and world market prices. Since the coverage of the PSI reporting system is limited to 20-30% of imports, mainly

³⁵³ WTO Trade Policy Review, Togo, Report by the Secretariat 10 Dec 1999,31, WT/TOR/S/48

³⁵⁴ *Id.*

³⁵⁵ WTO (2006), *supra* note 345.

used by big companies, customs should employ these tools to complement the PSI service. Actually, more than half of all imports enter without ADV certificates. A mixed COTECNA/Customs Commission meets twice a month for the purpose of consideration and consultation. The use of an appeal procedures by importers who dispute the PSI certificate or customs valuation has been rare.

After the introduction of the WTO transaction value system, it was necessary to adapt PSI operations to the new valuation system. The PSI reports and the value index should be used as an assessment of the risk of undervaluation of invoices. The WTO Secretariat made a critical observation in 2006 on the performance of the PSI agency in applying the WTO Agreement on Customs Valuation. It points out that in spite of the claim by COTECNA, there are a few problems with the application of the WTO Agreement in practice, and therefore technical assistance is requested in this regard.

7. The assessment of the PSI performance

Customs revenue to GDP increased mildly in the period of 1994-98, together with other taxes, when the PSI service was introduced in 1995. This was considered mainly to reflect a “catch up” from the slump in revenue caused by the political turmoil during 1991-93. The level remains considerably low compared to the period before 1990, partly because of the reduction in tariff level. At the same time, the IMF constantly urges the Togolese government to strengthen tax administration, widen the tax base, and combat tax evasion. The PSI service was introduced in this context.

At an initial stage, the PSI agency established the value index, using its own data warehouse³⁵⁶ that was customized for Togolese customs. This database could be used as a valuation determination under the BDV system, and later as a risk assessment for valuation under the WTO valuation system. However, fraudulent traders were quick to adjust their declarations and supporting documents to change the names of suppliers, importers and the description of goods to conceal the identity of the transaction and thus make it difficult to compare the price of the consignment with poor data. In fact,

³⁵⁶ COTECNA advertises that its data warehouse contains over 2.5 million live price³ records with details classification, origin, dates, commercial terms and quality indicators. *Available at* <www.cotecna.com> (last visited 6 June 2007).

the PSI agency found it to be too resource-intensive to keep the price index accurate. Additionally, the difference between the price indicated in the PSI certificate and that of invoice was narrowed down considerably. The PSI agency claims that this trend could be interpreted as a success of PSI program, as it was assumed that traders adjusted the price level to that contained in the valuation database. Customs officers are not so sure of this explanation and doubt the validity of the PSI certificate. Accordingly, it is not rare that they uplift the declared value certified by the PSI agency.

There were several limitations to the use of the PSI service. The low coverage of imports by the PSI service has been problematical. Far less than half of the imports arrive with PSI certificates, partly because of the non-application of penalties for the avoidance of PSI service. As a result, only big business players tend to use the PSI program. There has been a talk of applying penalties, but the fear is of alienating traders, especially small and medium sized, from using the port of Lomé. Actually, the geographical condition does not always enable Togo to implement tight control over the cross-border movement of goods. Managing informal trade with neighboring countries was another weak point of the PSI program, as it would require a large-scale number of border posts to be installed along the border to effectively control illegal trade. In addition, the PSI service does not address the problems associated with transit, which is strongly suspected as a source of fraudulent activities diverting goods into the domestic market. While COTECNA implements the PSI program in all the three land-locked countries in the Sahel region (Burkina Faso, Mali, Niger), it is not in a position to exchange trade data between countries. Instead, it suggests monitoring and tracing the movement of consignments using satellite technology, which is for the time being too costly for these LDC countries.

The cooperation between the PSI employees and customs officers has been difficult to manage, as the latter resented that the former deprived of their professional pride, and security of employment and position. As a result, there has been no guarantee that the PSI certificates were fully utilized by customs officers, who often regarded the PSI service being imposed by higher authorities in the government and the international financial institutions. It has been a challenge for the top management of customs authority to ensure regular dialogue and consultation between the customs and the PSI agency. The relatively rare occasion of disputes with traders in respect of PSI certificates has not provided a sufficient opportunity for transfer of valuation expertise to customs officers.

It is difficult to assess the performance of PSI service in a quantifiable manner, as customs does not record the difference between the PSI-certified prices and invoice prices or the amount of duties uplifted. The absence of internal and external audit of the PSI program has been another difficulty. In addition, the lack of external funding, caused by political instability, prevented lending institutions and donors from analyzing the statistics and the performance of tax and customs administrations, as well as that of the PSI agency in Togo. There is only anecdotal evidences for the usefulness of the PSI program. The fact that PSI agents promoted the migration to the Destination Inspection program to overcome the problems it encountered could be construed as evidence of weakness PSI performance. In respect of the improvement in the integrity of customs officers, if properly used, the PSI service could address the asymmetry of information, albeit to a limited extent, and therefore it should be able to reduce the opportunity for improper interactions between customs officers and customs brokers in determining valuation. They could however continue to collect an informal toll of “speed money” to get shipments through the clearance system in a reasonable amount of time.

7. Evolution of Destination Inspection

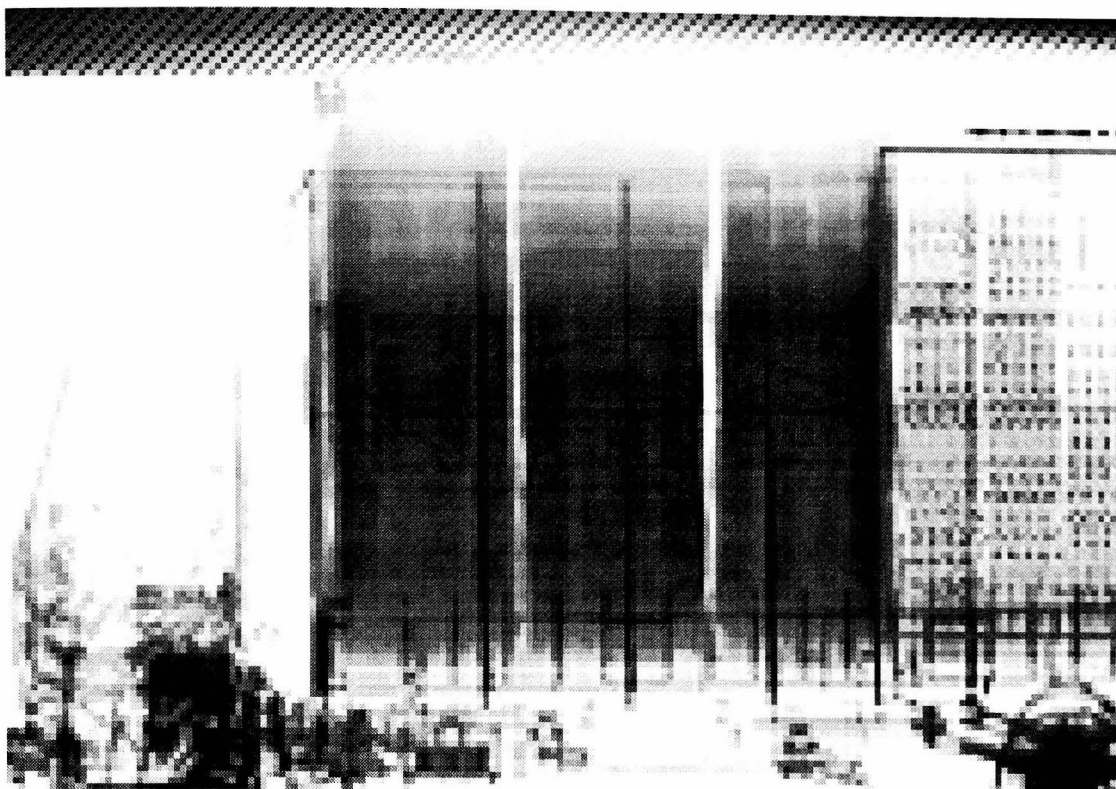
The traditional PSI system means that the PSI agency in the country of export carries out both documentary examination on classification and value and physical inspection of goods. Physical inspection was considered much easier to perform at the point of loading the container, especially at the exporter’s venue, in the exporting country than at the point of arrival in the importing country. Inspection at the importing country (destination) would require a resource-intensive and cumbersome process of unloading and then stuffing the container again and the necessary infrastructure for inspection at the port. However, destination inspection performed in the importing country is clearly outside the scope of the WTO Agreement on PSI. The Agreement notes that “this (pre-shipment) inspection is by definition carried out on the territory of exporter Members” and defines pre-shipment inspection activities as “all activities relating to the verification of the quality, the quantity, the price, including currency exchange rate and financial terms, and/or customs classification of goods to be exported to the territory of the user member.” Inspection at the pre-shipment stage was considered effective, but the PSI service encountered several difficulties in Togo.

Most of all, many consignments arrive without PSI reports. For such consignments, it was necessary to carry out inspection at the destination. In addition, containers could be tampered with after the inspection by the PSI agency.

On the other hand, the recent advancement of non-intrusive scanning technology enabled customs to detect irregularities of the content of cargo container by monitoring its image without opening the container. A truck loaded with a container can simply drive through a giant X-ray scanner and an image of the content of the container is instantly produced to verify if there is any anomaly, as shown below.³⁵⁷ It is useful in detecting difference of the content from the description of the declaration, especially in terms of concealed goods and quantity. Depending on the capacity of the X-ray scanners, customs can select containers to be monitored, based on risk assessment. If an irregularity is found, customs officers can unload the shipment from the container and verify the quantity and content. The use of X-ray scanners was perceived as improving control over containers, while facilitating legitimate trade by avoiding time-consuming de-vanning of a container to verify its content. The terrorist attacks on September 11, 2001 increased the awareness of security aspect of customs operations in preventing the terrorists from using containers to conceal explosives inside when attacking a country. This global concern promoted the use of non-intrusive inspection technology.

(Figure 7-1) Scanner Image sent to Customs for Analysis

³⁵⁷ COTECNA “Government Service – Risk management.” *Available at* COTECNA.com (last visited 6 June 2007).



The PSI industry carefully followed the application of scanning technology in developed countries and established a new business model of Destination Inspection, replacing the traditional PSI service. In this way, scanning at destination in the importing country replaced physical inspection at the loading in the exporting country. On the other hand, documentary examination usually continued to be assisted by the PSI office in the exporting country, as the overseas office has access to the price information obtained from the supplier and market research.

The first destination inspection was introduced in Ghana by the PSI agency (COTECNA) in 2000. It was much promoted as contributing to trade facilitation and security and therefore strengthening the position of the port of Tema in Ghana as the regional hub in West Africa. This new business model by the PSI company was introduced in other West African countries, following the experience in Ghana. The figure below shows an example in the port of Dar-Es-Salaam, Tanzania, operated by COTECNA. A van loaded with an X-ray scanner was installed at the port (right) and its X-ray arm moves along a truck loaded with a container (left) to scan the content, as shown below.³⁵⁸ Inside the van there are two customs officers and one employee of the PSI agency to monitor the image to decide whether they release the truck or instruct customs officers to carry out a physical examination of the container.

³⁵⁸ COTECNA “Case Studies – Destination Inspection, Tanzania.” *Available at* COTECNA.com (last visited 6 June 2007).

(Figure 7-2) A Mobile Scanner at Dar-Es-Salaam Port



The PSI agency stresses the involvement of customs officers and the transfer of know-how in the use of non-intrusive inspection technology. The scanner at the port of Lomé can scan 40 trucks a day. The selection of containers for scanning should be incorporated into the risk management strategy. The inspection company emphasizes that the scanner service plays a supportive role for the customs function, and it is up to customs to decide the way to utilize the technology, including the selection of containers to be inspected in the case of Togo.

While this inspection method is useful in discovering undeclared goods concealed in the container or the difference in quantity from the declaration, it is also used for valuation work where applicable. For example, the operator explains that scanned image enabled them to distinguish new pneumatic tires for vehicles from used ones. If the way of loading, as observed by scanning image, is different from the normal manner, it could be an indicator of involvement in informal trade, which could imply valuation fraud. Documentary examination is still the main part of price comparison, carried out at the PSI offices located in the country of supply. The new Destination Inspection is a mixture of the traditional PSI in the exporting country as far as documentary examination is concerned and the non-intrusive scanning inspection in the importing country. According to the contract concluded in 2006, the PSI agency purchased the scanner, and will own and operate it. This Build-own-operate (BOO) scheme was

awarded to COTECNA without tendering for the duration of seven years. The inspection fee is entirely born by the Togolese customs, which collects the corresponding charges from traders and is still making necessary adjustment of the level of charges. The Togolese authorities were not sure if they will ask for the transfer of the scanner by purchasing it at the end of the contract.

8. The progress in customs modernization

The PSI program was intended to give customs short-term relief to modernize and develop its own capacities. In fact, the introduction of a PSI program in 1995 was part of the IMF-led structural adjustment program in improving tax and customs administration, including further computerization of customs clearance. However, the continued political instability did not allow the Togolese Customs to initiate a comprehensive customs reform. The resultant suspension of external assistance by major donors made it difficult to get the necessary resources for customs modernization. Lending institutions also stayed away from engaging in a reform project in the absence of political commitment of the Togolese authority and the cooperation of donors.

Since its initiation in 1995, the PSI program has subsequently formalized selective inspection in 2002, and further evolved into the Destination Inspection in 2006. However, during this time period, the progress of customs reform has been slower than expected. The role-out of the automation system was based on the ASYCUDA version 2, which is considered useful for processing documents, but not sufficiently advanced for handling information, including risk management. Many user administrations of ASYCUDA version 2 migrated to the upgraded version ++. The Togolese Customs is also planning this migration with the prospective assistance of the donor community. The government appointed a new director general of customs who is a specialist in information and communication technology in 2006. It was with the recent progress in the direction of political stability, started in late 2004, that enabled the European Union and other donors to move towards the resumption of financial assistance.

Customs management expects that the question associated with transit could be tackled with close cooperation at the regional level, involving the land-locked countries. The Togolese customs started to talk with the authority for Niger for an exchange of

information in verifying the arrival of transit cargo from Togo to Niger. While there is a convention signed by 16 members of ECOWAS in 1982, establishing an ECOWAS inter-state road transit system, commonly known as the TRIE (Transit Routier Inter-Etats), it has been largely ignored, mainly due to the absence of a credible implementation mechanism, such as a guarantee system. Most of the transit arrangements are therefore implemented through bilateral agreements or national regulations. There has been talk of corridor project to facilitate transit by lending institutions and another on possible interconnectivity between the computer systems of the various customs administrations. However, any workable regional transit arrangement requires political will and commitment for regional cooperation, with an appropriate implementation system. For the time being, customs authorities in the region pursue a network of bilateral arrangements for information exchange. In fact, there exists strong rivalry among countries along the west coast of Africa in securing a large volume of transit trade for Sahel countries.

Another important aspect of customs modernization is the establishment of a consultation with the trading community. Customs reform and modernization is best achieved with support from the private sector. By way of example, further advancement in automation of customs procedures will require cooperation of the trading community in providing political and financial support, as it would affect the vested interest of customs brokers. While the dialogue with the trade was not necessarily well assured in the past, recent political progress is expected to provide a greater degree of consultation and communication with trade, and consequently a deeper understanding of the customs requirements for improved compliance.

As a result of this difficult political environment, it is difficult to confirm that Togo has used the PSI program to get sufficient time to modernize its customs administrations. Togo has yet to develop a credible exit strategy from the PSI program. Instead, some observers point out that the reliance of PSI diverted the investment in customs modernization and pressure for reform from both the government and the customs administration. The new Destination Inspection system has the potential for providing an opportunity for Togo to incorporate risk management into the new technology. The jury is out whether or not this new form of public-private partnership could compensate the expensive investment in support of building capacity in Togolese Customs.

10. View of customs

Customs officers are hostile and highly critical of the PSI service, considering it imposed by the higher authority in the government. They often refer to the fact that the same inspection company was awarded and renewed the contracts without tendering procedures as the outcome of the lobbying of the company with the higher political class. This perception prevents customs officers from fully utilizing the PSI certificates of value. Many of them have a dim view of the PSI contribution to revenue and favor the termination of the service. While acknowledging the need to improve their skills to increase revenue, they also suggest that the Togolese economy often depends on the purchase by buyers from neighboring countries and therefore there would be a limitation on strengthening taxation under the current sluggish economic situation.

There has been an effort to organize meaningful dialogue between customs officers and PSI employees to make the best use of the private sector service designated by the higher authority. Establishment of valuation database is often regarded as providing the necessary reference to regaining the traditional role of customs in appraising value. In this regard, customs officers feel that the PSI companies have not transferred the necessary skills or tools to help the administration in developing a database, partially due to the financial difficulties of the state to fund the transfer. The introduction of the Destination Inspection system in 2006 for the duration of seven years was greeted with mixed feelings by customs officers. While they welcome the scanning technology itself, they often viewed the contract as another attempt by the inspection company to get lucrative business.

11. View of trade

The representatives of the importers and exporters association expressed their concern on the activities of the informal sector.³⁵⁹ They claim that there are fraudulent activities even at the port of Lomé, in addition to the flow of smuggled goods at the land borders. This results in unfairly heavy duty and tax burdens on the formal sector. Moreover, transit is abused as the means of duty and tax evasion. They wondered if

³⁵⁹ Groupement des Importateurs et Exportateurs Liberaux

customs could provide an effective escort service of transit to the borders to ensure that they do not remain in the domestic market. Private sector people suggest that the level of duties, taxes and charges for port service should remain moderate to keep the formal sector alive. They point out the need for political commitment to tighten the control.

While acknowledging that there exists a problem of corruption with some customs officers, traders maintained that they find the real problem with other public sectors at the port, rather than with the customs. They were not well informed of the government policy on the port management and complained about increases in charges related to port activities. With regard to the PSI and its related activities, local importers were not supportive of these activities as they see the activities having little to do with the control over the informal trade. They were not impressed by the valuation work by the PSI agency as they were often overridden by the customs. They suggested that the public money should be used to address the real problems that legitimate trade encountered. Actually, they wondered if it might not optimize the use of public fund in improving the working condition of customs officers rather than investing in the inspection company.

At the WTO Trade Policy Review meeting on Togo in 1999 a critical view on the PSI activities was expressed.³⁶⁰ A discussant, representing the European Union, pointed out that Togo maintained far too many import barriers, specifically with the systematic intervention of a PSI company, which was costly and occasioned delays and extra formalities for operators, and which was needlessly retarding the changeover to the WTO transaction valuation system. The representatives of Hong Kong urged Togo to set up the time-limits given to the inspection company for the issuance of inspection certificates. The representative of Togo responded that the control of imports by PSI had been an IMF demand that had been very negatively received by importers. He maintained that it was to be reviewed for its effectiveness. After the WTO review session, Togo renewed the PSI contract to introduce the selective inspection in 2002, and then introduced the Destination Inspection program in 2006. However, the perception of the trade did not necessarily change in favor of the use of the private sector in customs.

³⁶⁰ WTO Trade Policy Review Body meeting – Minutes, 1999, WT/TPR/M/48

12. View of donors and lending institutions

The donor organizations including the World Bank and the IMF identified the need for enhancing the revenue function through institution building. In this respect, the IMF advised the hiring of a PSI service. However, in the absence of an evaluation of PSI performance, they are not in a position to endorse the current activities of the private sector in assuming part of the customs role. Lending institutions generally suggest that a user customs administration employs the PSI program in a more beneficial way as a part of a wider capacity building program, if it hires costly PSI companies.

Lending institutions urged that the PSI agency provide a more supportive role in assisting customs, but they are cautious about the Destination Inspection whether it is helpful for capacity building in customs for the following reasons.

First, the Destination Inspection involves the purchase of expensive X-ray scanning equipment, which requires certain conditions. While it may appear tempting to use a container scanner because it can process a greater numbers of containers than conventional techniques, it should be justified by the rate of detecting irregularities. As the WCO points out, good returns from investment only come from efficient and effective operation, soundly based on intelligence-led risk assessment and selectivity, and with trained and experienced image analysts.³⁶¹ Ideally, it is therefore essential for the risk management infrastructure to be in place before the introduction of scanning equipment. It was not confirmed if user-governments in West Africa meet this condition.

Second, the term of the contract is much longer than the traditional PSI, as a result of the BOT arrangement, or easily renewable, as a result of the BOO arrangement. However, there might not be much room for transfer of know-how by the operating PSI company. Scanning equipment is essentially operated by PSI employees, even if assisted by customs officers. Moreover, a monitoring image does not involve the more technical work of classification or valuation. They will be assumed by traditional documentary examination carried out in the exporting countries. Therefore the

³⁶¹ WCO "Container Scanning Equipment – Guide to Members on Administrative Considerations of Purchase and Operation," 2003.

Destination Inspection contract, which usually includes traditional documentary examination, has an effect of extending the term of traditional PSI work.

In sum, lending institutions take a cautious approach in judging if the Destination Inspection program provides value for money service. There is even a cynical view that while customs cannot get rid of the PSI companies, because of their well-established connection with the higher authority in the government, it would be beneficial for customs to turn the traditional PSI into a Destination Inspection system that can provide scanning equipment as an infrastructure improvement for modern customs operations.

Chapter 11 Comparative analysis of case studies

This chapter summarizes and analyzes comparatively the outcome of the four case studies, contained in Chapters 7 to 10. It examines the individual background of the four countries, determines what factors induced each state to adopt the PSI program, and shows how it evolved over the years. An assessment on the performance of inspection companies is presented in the areas of revenue collection, anti-corruption and transfer of skills. In the area of revenue enhancement, some countries are more successful than others, but the overall assessment remains mixed and unclear. With regard to customs reform, transfer of skill to customs officers from inspection companies was judged of little value and the PSI program was often alleged to have resulted in over-reliance on the service of the private inspection company at the expense of capacity building in customs. The PSI effect on corruption was reportedly limited as it deals with only certain aspect of customs operations. This chapter also reviews the institutional constraints on customs authorities in using the private sector service. Finally, it reviews the case study, using the analytical model offered by the existing literature discussed in the section three of the Chapter 4. The success factors, namely improvement in compliance environment of traders, customs reform project and integrity, were not necessarily found in the four case study countries in a satisfactory manner. This would explain the shift of inspection industry towards new services. After reviewing the Destination Inspection (DI) as an example of new service, this paper argues that the PSI program had changed over the years, but the difficulties have still persisted.

1. Economic environment

The four countries used in case studies for the PSI program were low income or lower middle income countries.³⁶² They suffered from macroeconomic instability with budget deficits that required revenue enhancement. A lack of infrastructure and social services, resulting from severe fiscal constraints, led to stagnant inward investment. This is why raising revenue collection was identified as one of the key strategic measures for economic growth in these countries. In the 1980's neo-liberalism gained

³⁶² GNI per capita in 2005 is \$350 for Togo, \$470 for Bangladesh, \$540 for Kenya and \$1320 for the Philippines. World Bank, *supra* note 2199.

power in developed countries, and this influenced the package of reforms that international financial institutions recommended for developing countries. They argued that market forces would bring efficiency in traditional government functions. Using this argument, inspection companies advised that by privatizing part of the customs function a developing country could improve revenue collection. This suggestion, supported by the international financial institutions, developed into the customs-type PSI program.

All four countries have governance problem in both the public and private sectors, that have often been identified as the cause of poverty. Whereas the public sector has weak institution with cumbersome regulations and insufficient enforcement capabilities, the private sector has poor compliance with laws and regulations. Consequently, each country has a large informal sector in their economy, representing more than a third of all economic activity according to the World Bank estimates.³⁶³ Corruption is reportedly rampant according to the Transparency International, and each of the four countries is rated low in its survey on corruption perception.³⁶⁴

2. Tax and tariff policy

The share of revenue collection in the national economy, measured by a revenue to GDP ratio, is often used to compare the effectiveness of tax and customs policy and its administration. Bangladesh, the Philippines and Togo suffer from a low revenue to GDP ratio, respectively 10.9% (2004), 12.3% (2004) and 12.8% (1994-1998) whereas Kenya maintains a relatively high ratio of 21.6% (2001).³⁶⁵ The four countries set improvement of tax revenue collection as one of their top priorities, and adopted such measures as broadening the tax base, strengthening the tax administration, and improving taxpayer compliance. However, their goals were often perceived as mid to long term solutions and governments were anxious to find short solutions, and this provided the ground for engaging PSI programs as a business model for a temporary

³⁶³ 38% for Bangladesh, 36% for Kenya, 46% for the Philippines and 40% for Togo according to Schneider (2004), *supra* note 220.

³⁶⁴ 156th for Bangladesh, 142nd for Kenya, 121st for the Philippines and 130th for Togo out of 163 countries surveyed in 2006

³⁶⁵ The average tax ratio to GDP for average OECD countries is 35.9% in 2005. according to the OECD Revenue Statistics, Paris. OECD, 2006.

solution. In spite of the declining ratio of customs duties in national revenue brought on by trade liberalization, customs revenue is still important in these developing countries, due to insufficient development of domestic tax bases and infrastructure. The Ministries of Finance set revenue targets and achieving these targets often became the main monthly or even daily goal of the customs administration. Hence, emphasis was put on addressing the problem of controlling undervaluation and misclassification which is one of the major modus operandi to evade tax liability.

The four governments implemented trade liberalization with varying degrees of openness under different industrial policies. In more detail, the Philippines started its trade liberalization in the middle of 1980's with the elimination of quantitative restrictions. Tariff reduction was accelerated in the middle of 1990's. This policy change, as well as the Asian economic boom, resulted in trade volume growth after 1987 and further accelerated in the 1990's. Kenya implemented a liberalization program in the 1990's with the removal of import-licensing requirements and foreign exchange controls in 1993, which led to a strong expansion of import volumes. Likewise, Bangladesh implemented a new trade policy in 1990 with much focus on promoting the export of ready-made garments, which brought about considerable import growth. Under the guidance of the IMF, Togo adopted a comprehensive adjustment policy in the mid 1990's which included some trade liberalization measures.

Along with trade liberalization, there has been a growing recognition that trade facilitation with efficient border procedures plays a vital role in promoting investment and economic growth. Streamlining customs procedures has gained importance, supported by the development of information technology.

3. Profile of customs

The four customs administrations are all under the supervision of the Ministry of Finance, which set improvement in revenue collection as their policy priority. On the other hand, they have distinct forms of organization with varying degrees of flexibility in management. The level of political support for their respective modernization efforts also differs even as they are all pursuing customs reform projects with enhanced use of information technology.

The Philippines established its Bureau of Customs (BOC) before its independence in 1947. While the BOC undertook a comprehensive customs reform driven by automation in the 1990's, securing political support for improving human resource management has been perceived as a challenge. The Kenyan Revenue Authority (KRA) was established as a semi-autonomous government agency in 1995, covering both customs and tax administrations. Compared with a traditional ministerial department, the KRA enjoys greater autonomy, including management, funding and personnel issues. This organizational arrangement was also meant to insulate customs from political interference. Bangladesh established its National Board of Revenue (NBR) upon its independence in 1972, comprising both customs and tax administrations. A Customs Administration Modernization project has been underway since the late 1990's, supported by the World Bank. Togo established its Customs Department upon its independence in 1960. With the recent prospect for political stability, a reform process is being planned with renewed political and external support.

4. Challenge of customs fraud

All four countries have struggled with fallacious declarations of value, which will be analyzed in the next chapter. However, under-invoicing is not the only method for evading tax liability. There are several ways of evading customs duties, especially in developing countries where tariff rates are high and therefore fraudulent activities can be expected to produce high profit margin. According to the WCO, there are six types of commercial fraud, related to evasion of duty and tax payment.³⁶⁶

(1) Under/Over-valuation: Under-valuation is to make a false declaration indicating a value lower than the actual transaction value to pay lower duty/excise taxes and/or evade import restrictions, such as an anti-dumping duty. Over-valuation is to make a false declaration indicating a value higher than the actual transaction value, often as part of a money laundering scheme.

(2) Misdescription: It is often associated with classification of goods into the category of lower tariff application or exemption.

³⁶⁶ WCO Commercial Fraud Typologies Summary. 2006, unpublished.

(3) Falsification of origin: It means any attempt to abuse preferential treatment of goods by falsified origin and/or customs documentary requirements.

(4) False declaration of quality and quantity: It may occur when any information furnished to customs authorities concerning the physical attributes, nature, volume, quantity or measures of goods declared is untrue.

(5) Smuggling and unauthorized release of goods under customs control: Smuggling is a customs fraud consisting in the movement of goods across a customs frontier in any clandestine manner. This type of fraud includes unauthorized removal of goods from customs warehouses, authorized processing plants, free trade zone and internal movement for transit.

(6) Off-record transaction: It is related to internal taxes and duties and usually occurs when smuggled goods are sold after being smuggled.

(7) End-use: National legislation may offer a zero or lower rate of duty on certain goods when imported for a specified end-use, but the goods could be used for other than the specified purpose.

The PSI program was considered effective in dealing with commercial fraud, involving falsified documents, that includes the types (1) to (4). In fact, Kenya has recorded a considerable increase in revenue following the introduction of the PSI program. However, when major problems of tax evasion are smuggling, abuse of transit or bonded warehouse, the role of a PSI program in revenue enhancement would be limited. Bangladesh and Togo are faced with the problem of smuggling with a permeable border situation. Moreover, there is an empirical analysis that when the Philippine government increased enforcement by expanding preshipment inspection to lower-value shipments, some of these imports shifted to an alternative duty-avoidance method: split of shipments into below threshold; and shipping via duty-exempt export processing zone.³⁶⁷ Furthermore, there were cases reported where inspected containers were tampered with and smuggled goods were concealed after their inspection at the point of shipment. These findings indicate the limitations of the PSI program.

³⁶⁷ Yang (2006), *supra* note 239.

5. Introduction and development of PSI program

Each of the four countries concluded contracts with inspection companies to enhance revenue collection, but subsequently they followed different paths. In this connection, the application of the WTO Agreement on Customs Valuation in 2000 had a profound impact on all of them.

The Philippines introduced the PSI program with partial geographical coverage in 1987 as a part of an economic reform plan. It was gradually expanded and became a system with global coverage in 1992, covering all goods above a pre-determined threshold from all countries of shipment. The period of this “comprehensive” PSI program largely coincided with the rapid economic growth and political stability under President Ramos (1992-1998). Customs reform with a significant focus on computerization was carried out under the political support of the President and the financial support of the World Bank. President Estrada in 1998 ordered a critical review of the PSI program, which was subsequently discontinued in 2000 when the Philippines implemented the WTO Agreement on Customs valuation.

Kenya introduced the PSI program for its customs service in 1994 under the BDV system when trade volume started to expand quickly as a result of trade liberalization measures and the abolition of foreign exchange control. Originally in 1988 the Central Bank employed the PSI service to protect the country’s foreign reserve from capital flight by detecting over-invoicing. Faced with the loss of commercial opportunity with the abolition of foreign exchange control in 1993, the PSI companies lobbied to shift their service to a revenue function assisting customs detect under-invoicing. The PSI contracts were renewed several times under the BDV and then under the WTO valuation system, introduced in 2000. In the efforts to ensure transfer of expertise, the KRA increasingly took part in the negotiation of PSI contracts and developed new forms of public-private partnerships. Accordingly customs officers gradually participated in and took over the PSI work to gain insight and knowledge. The PSI program was terminated in 2005.

Bangladesh engaged the PSI program on a voluntary basis in 1993 under the BDV system, recommended by the lending institutions. Since the PSI service was introduced on a voluntary basis, traders had an incentive to use the service only when the transaction prices were lower than the minimum prices. Moreover, as importers

were free to choose among multiple PSI companies, there was competition among PSI agencies in offering lower certified prices, which caused revenue leakage. With the recognition of the flaws of unregulated competition, the voluntary PSI service was practically abandoned in 1997. When Bangladesh started a comprehensive customs reform project with the support of the World Bank, the PSI service was re-introduced to address the institutional problem of customs in 2000. This time the PSI program was made mandatory and non-competitive by designating several inspection firms with each firm covering a specific geographical area. The contracts were continuously renewed and the current ones with three companies will expire in 2008.

Togo adopted the PSI program as part of structural adjustment with advice from the IMF in 1995. Later, the contract was renewed with the introduction of selective inspection, and in 2006 the PSI program evolved into the Destination Inspection system, supported by the installation of scanning equipment.

6. The assessment of PSI performance in revenue and trade facilitation

Since the PSI program is usually introduced as part of an economic policy package that has an impact on revenue, it is difficult to assess its contribution to revenue in isolation. With regard to the Philippines and Kenya, there have been academic studies that attempted to analyze its impacts on customs revenue. In these two countries the PSI service was introduced as part of a broader trade policy change and customs reform. The economic analysis therefore takes into account the growth in import, the reduction in tariff level and tariff exemption to single out the effects of enhanced customs enforcement, where the PSI program was presumed to play a central role.

In the case of the Philippines, the available analysis (1993-2002) is intended to measure the presumed positive influence of customs automation on revenue and the potential adverse consequence of the change in valuation method to the WTO system in 2000. The study concludes that automation did not necessarily bring improvement in revenue over the implementation years, but that the introduction of the WTO system did not lead to the loss of revenue either. This finding can be used to evaluate the comprehensive PSI program from 1992 to 2000. It was implemented over the same

years as automation and terminated at the same time as the implementation of the WTO valuation system. This analysis suggests that the introduction and the termination of the PSI program had limited effects on revenue. Other academic analysis also established the ambiguous nature of the PSI contribution to revenue enhancement. The BOC estimated the positive effects of PSI service at 2 billion peso per year in 1997. However, reaction to the PSI contribution, including the value of these estimated figures, remains ambiguous when the high cost of the PSI program is factored into the equation. In fact, when the PSI program was terminated, the allegation was that the Philippines did not get a good return on its expensive investment in the PSI contract, both in terms of revenue and the transfer of technology.

On the other hand, in the case of Kenya, a similar analysis suggests a sharp increase in revenue at the initial stage of the PSI program and a lasting consequence on the revenue level during the PSI period. Reduction in tariff usually has a negative effect on revenue, but the Kenyan analysis takes into account the positive effect of the PSI enabling traders to declare accurate value without paying prohibitively high duties. Under the WTO valuation system, however, KRA officers felt a diminishing usefulness of the program in terms of revenue collection. There was also a trend of decreasing differences between the price in the PSI report and that of the invoice over the years, as a result of adjustment by traders to the PSI value. In addition, there were reports from neighboring countries, including Rwanda, Uganda and Zambia, that they brought to an end PSI programs without a loss of revenue. These reports encouraged the higher authority of Kenya to support an exit from the program in 2005.

In the case of Bangladesh, the original PSI program in 1993 was considered a failure. Its voluntary nature induced inspection companies to offer undervalued certificates in an effort to attract client traders. This experience confirms that the use of market mechanisms without adequate regulation could bring about serious misconduct of traders and the resultant loss of revenue. While the WTO Agreement on PSI does not cover the design of a contract or its procurement policy, advisors from the lending institutions urged the Bangladesh authority to amend the situation by closing the window for undesirable competition. They also recommended that the government hire respectable companies from among the members of the International Federation of Inspection Agencies (IFIA), which developed the PSI Code of Practice in line with the WTO Agreement on PSI.

In the absence of economic analysis, it is difficult to measure the functioning of the current program in Bangladesh, re-introduced in 2000. There was a confrontation over its assessments between some of domestic trade associations and the then Minister of Finance. While the former argued in support of the positive contribution to revenue of the PSI, the latter expressed reservations. There is a clear need for baseline data to be made available if a policy debate is to be conducted in an objective manner. Despite the fact that Bangladesh has expressed its readiness to conduct an audit for the IMF for the last three years, there has been no audit of PSI performance available. There was furthermore no comparison of performance between the public and private sectors. Under such circumstances, it is difficult for customs officers to accept the outsourcing of their function and for the government to ensure cooperation with the PSI employees. On the other hand, many domestic industry members seemed to support the continuation of PSI program largely on the ground of avoiding harassment at the clearance stage. The NBR was not able to garner sufficient support from business for recovering its traditional customs function.

Togo does not have any economic analysis or audit of the execution of the PSI program. It is therefore difficult to assess performance, but the traditional type of PSI was not considered successful because of the large number of imports arriving without PSI certificates. This is why the program was modified to the Destination Inspection system in 2006, but the jury is still out on whether or not this new service gives value for money. This modification followed adoption by other administrations in the same region. It also reflects the difficulties in maintaining a traditional PSI service where the major modus operandi employed for tax evasion is smuggling and the misuse of the transit system. Ideally, this situation needs to be addressed by regional cooperation, as consignments could easily shift towards ports with loose control in the same region. In spite of this new appearance, the current contract includes documentary examination which follows the traditional PSI model for the time being.

In terms of trade facilitation, exporters initially complained that the PSI added another layer of cumbersome procedures. However, they became quieter after the implementation of the PSI Agreement. On the other hand, some importers found the PSI program useful to facilitate the movement of goods, compared to the time-consuming customs procedures. Other importers expressed their concern with the PSI program. In the Philippines, the then Commissioner of BOC indicated that the hiring of private companies was more useful in trade facilitation than revenue

enhancement. The most significant of these measures was the instruction that sealed containers were to be cleared straight through customs without physical examination. The PSI program also helped abolishing a legal requirement that 10% of all consignments must be inspected, allowing the introduction of more rational selective criteria for inspection. Nevertheless, the USTR repeatedly reported the arbitrary nature of PSI valuation and a problem with the slow appeal process in the Philippines. In fact, the appeal of 160 cases per week reveals the importers' dissatisfaction. In Bangladesh the domestic industry has been in favor of retaining the PSI service to avoid slow customs procedures on the import side, which might be an indication of mistrust between customs and the trading community. In Kenya the domestic industry also expressed concern over a delay in import procedures when the PSI contract was terminated. However, they also complained about the burdensome PSI procedures and accepted the termination of PSI program. In Togo, the PSI program was negatively received by the trade as another economic burden. It is yet to be seen if the Destination Inspection system can actually improve customs procedures in the importing country. The contribution of the PSI service in terms of trade facilitation could be linked to the actual and perceived integrity of customs administrations.

The performance of PSI programs should be assessed against cost of hiring private companies. While there has been fierce competition to win contracts among inspection companies, the market has been dominated by a small number of companies. This oligopoly allows them to retain knowledge and upper hands in negotiating contracts. Nevertheless, the PSI fees have gradually fallen over the years from well above 1% to less than 1%, prompted by the reduction in the market size and the adoption of selective inspection. The inspection industry nowadays offers a diversified range of services to respond to the changing needs and compensating the declining market size and the fee level for the traditional PSI service.

7. The PSI effect on corruption in customs

The contracting out of customs function to a private entity often reflected the public perception of the weakness of the customs institution. The perception of corruption played an important role in the policy decision to hire inspection companies. Reducing customs intervention was often considered a the remedy to integrity problem.

Poor compliance of traders and weak administrative capacity could easily result in collusion between customs officers and traders, which usually reflects an ethics-in-government issue within the country concerned. The customs corruption issue was often exacerbated by the heavy involvement of customs brokers in the clearance of goods.

Before the introduction of the PSI program, most importers used to experience lengthy clearance procedures to ensure the compliance with national laws, especially for revenue purposes. This is where traders with the intention of tax evasion try to bribe customs officers and get their cooperation in submitting falsified documents. Collusion between these parties defraud treasury of customs duties. While quantifiably reliable estimates are not available, anecdotal evidence holds that the PSI program reduced the opportunity for connivance or collusion between customs officers and traders. Importers have difficulties submitting under-valued invoice, unless they colluded with exporters and PSI agencies. While there were occasional reports of misconducts by PSI employees, the PSI program was expected to significantly reduce the opportunity for collusion between customs and the private sector.

There is nevertheless a limit to the usefulness of the PSI program in improving the integrity problem. It cannot deal with “facilitation fee” or “speed money” by which importers pay cash to get their shipment through the clearance system in a reasonable amount of time. Without the payment of a bribe, corrupt customs officers would delay the release of cargo. Since this type of rent-seeking does not involve the falsification of documents or containers at shipment, it is difficult to address this problem through the PSI program. Moreover, because a “facilitation fee” does not directly damage the treasury, it was often tolerated by the government and thus becomes more wide-spread. In fact, the USTR reported on significant “facilitation fee” requested by customs officers in the Philippines under the PSI regime.

Both the PSI program and automation were expected to reduce unnecessary interaction between customs officers and traders. At the same time, it was considered vital to address human resource management by strengthening internal controls and providing decent working conditions. In Kenya the KRA was able to pay high salaries and enhance discipline, which helped improve integrity of the customs department. At least customs was not singled out as an agency with an integrity problem. On the other hand, in the Philippines, customs workers resisted automation for fear of their

jobs, and potential loss of rent-seeking opportunities. In spite of the efforts by the BOC to modernize customs in the 1990's, the government failed to address the problem of extremely low levels of remuneration. Politicians even hinted that customs officers did not need increases in salary as they had another means to earn money. In Bangladesh it was reported that the re-introduction of the PSI service met little opposition where the NBR failed to persuade customs officers and customs brokers for acceptance of earlier automation in the 1990's. The PSI program might be considered less of a threat to misconduct than automation. In Togo traders suggest that improving working condition of customs officers could be more beneficial than hiring an expensive PSI service.

8. Transfer of knowledge and the relationship with customs modernization

The PSI service was intended to provide a short-term assistance to customs administrations while they developed the capacity to assume traditional functions. In fact, all four countries started the PSI program as part of a wider customs reform, often under the guidance of lending institutions. It was expected to transfer knowledge and expertise to customs officers. However, inspection companies did not prove to be willing to assist customs officers in gaining knowledge, because the transfer of skills would result in the loss of a lucrative market. It is therefore up to each government to incorporate the PSI program in a wider customs reform project. In reality, once the contracts with inspection companies were concluded, governments often considered that the problem had been solved, even though the PSI solution was meant to be a temporary one. Many advisers from the lending institutions urged governments to develop and implement an exit strategy from the PSI service. However, many PSI programs have actually stayed on for many years after the initial contract period.

The Philippines expected to gain skills and technology from inspection companies. The training and observation tour offered by the PSI agency as part of the contract was considered of limited value. Observers often estimated that ironically it was the numerous disputes on PSI reports that provided the opportunity for BOC officers to get skills transferred, as the complaints of traders on PSI-certified value were handled by the joint BOC-SGS committee. On the other hand, the reliance on the database of the PSI agency did not give an incentive to the BOC to develop its own database for

intelligence purpose. At the end of the contract, the BOC had difficulties receiving the transfer of the price database, due to the limited involvement of the BOC in negotiating the contract. Kenya learned this lesson quickly and the KRA was involved in the negotiation with the contract and ensured the transfer of the database developed by the PSI companies. Moreover, at the renewal of the contracts, the KRA was able to introduce selective inspection in the PSI work, and increase the participation of KRA officers in the PSI work. In this way, the KRA has taken over the PSI work in risk management and post-shipment inspection through the on-the-job training in the PSI local office.

Both the Philippines and Kenya pursued customs reform at the same time as the introduction of PSI program, in 1993 (global coverage) and in 1994, respectively. The Philippines launched a comprehensive customs reform including automation in 1992 while Kenya established the KRA in 1995. In the hindsight, however, their modernization processes could have been more advanced during the PSI engagement. It was only after the discontinuation of the PSI service in 2000 that the BOC built a valuation database and set up a post-clearance audit unit. Likewise, the KRA updated its automation system and initiated post-clearance audits in 2005, the year when the PSI contract was terminated. The exit from the PSI program could have been better incorporated into a proper sequencing of customs modernization. Reliance on the PSI service tends to delay the reform process.

In Bangladesh there has been limited linkage between the PSI program and customs reform. The government had not invested in customs for a long time, which worsened the relationship with trade. When the customs reform project was launched by a strong urge of the donor community in 1999, the lack of management skill, exacerbated by the quick turnover of the top management, affected the progress of customs modernization. There were often delays in installing information technology and in setting up risk and audit-based controls. This slow pace of modernization did not improve the perception of customs, which failed to gain the support from the local business community to exit from the PSI program. There has been little evidence that customs officers were motivated to gain knowledge from inspection companies, as they could become dependent on the price information provided by these companies. Similarly, there has not been obvious evidence for the transfer of expertise to the Togolese customs officers from the inspection company. After the conclusion of the PSI contract in 1993, the government did not sufficiently invest in customs for its

modernization, due to the political instability and the resultant lack of external assistance. It was only recently that customs reform and modernization has been planned with the update of automation system.

9. Typical views of customs staff

Customs managers have often acknowledged the usefulness of PSI service in enhancing revenue, particularly when they found difficulties in getting reliable price information on which to determine the value of goods. It was therefore important for them to ensure that customs officers effectively use this service, which has not been always the case. If it functions well to increase revenue, customs managers should be able to find time to concentrate their efforts on automation and other reform initiatives. They nevertheless acknowledged that there were limitations of this program, as those attempting to evade customs duties would resort to other modus operandi, such as smuggling. Moreover, they were aware of another risk in which customs officers might become dependent on the provided prices and less motivated in developing their own skills. Customs authorities admit that PSI firms were not necessarily keen in transferring skills and technology to them, due to their conflict of interest. They were often caught between a pressure from customs officers to terminate the contract and another pressure from the traders suspicious of customs capability to continue the program. Sometimes they had difficulties in terminating the contract because of the prevailing ill perception on customs. They welcome the installation of scanning equipment that the inspection industry promotes as part of the Destination Inspection, but its effectiveness in improving inspection capability in the importing country has yet to be confirmed.

At the operational level, customs officers are frequently hostile to the PSI program, usually expressing a dim view on its contribution to revenue enhancement. They feel humiliated about being deprived of their traditional function and threatened by job insecurity. In fact, the PSI program is normally a part of customs reform, which typically entails computerization and an attrition or redundancy plan of customs personnel. This negative or suspicious view has been amplified by the general lack of audit and transparency of the performance of inspection companies. It has been often difficult due to this perception for them to develop cooperative relationships with the

PSI regime. Furthermore, the long-term reliance on private companies often discourages customs officers in acquiring valuation skills. They usually expect strong leadership of customs managers to communicate the clear vision for customs reform, encompassing an exit strategy from PSI program. In the area of integrity, customs officers often mention cases of corruption, albeit anecdotal, involving PSI employees. To summarize, they are resentful of expensive fees paid to the private sector which cost several times more than the budget allocation for customs service. They argue that the huge amount of money would be best spent for customs modernization rather than hiring the private sector.

10. Various views of trade

The views of the trading community are well divided on a country-by-country basis and subject to the interest of stakeholders. The International Chamber of Commerce was concerned with complaints by exporters on the early PSI operations in exporting countries and contributed to launching the negotiations in the Uruguay Round. After the implementation of the WTO Agreement on PSI, there have been fewer complaints by exporters than before. On the importer side, some domestic industry members expressed a favorable view for the PSI service, in that it could streamline customs procedures by outsourcing valuation and classification to the private sector at the exporting country. Others expressed a negative view on the PSI operations, as it is a costly solution and traders often shoulder the final burden of these costs. They increasingly urge the states to focus more on customs reform than relying on private companies. The view differs on a country-by-country basis. When the customs administration starts customs reform in an effective way, the trading community generally supports these efforts rather than hiring private companies. While the cost of the PSI program is either born by the government or the trading community, the trading community always urges that governments should pay the fees for the service instead of trade. Even when the government shares the financial burden, in reality, it is often transferred on to trade through various government charges to fund the program. The trading community often complains about the lack of transparency, as they are not necessarily consulted or provided with information on the introduction and evolution of the PSI program.

A summary of the views of the case studies well reflects the divergence of the views held by the trading community. In the Philippines the PSI service had been frequently accused of arbitrary uplifts of prices by foreign traders before its discontinuation. Currently, the trading community generally supports customs reform by the BOC rather than going back to the PSI regime. In Kenya business expressed its dissatisfaction with the PSI service because of the high cost born by them. While acknowledging the significant progress made by the KRA in its modernization, they pointed out the need for further streamlining customs procedures and managing an appropriate valuation database following the termination of PSI contract. In Bangladesh some of the influential members of the business community expressed their preference for PSI service over its termination, on the grounds of weak institution in customs. In Togo the business community expressed strong reservation against the heavy charge by the government to finance the costly PSI and the subsequent Destination Inspection programs.

11. Institutional constraints

Drawing on the various changing views held by stakeholders, it would be useful here to examine the institutional constraints of customs authorities in realizing the benefit of the public-private partnership approach. They will be reviewed with the general institutional constraints in dealing with contracting out, presented in the Chapter 3, which include five areas: availability of efficient market; patronage system; private sector capabilities; loss of control; and the acceptance by the public sector.

First, the question arises if there is an efficient market and whether the private sector has the capacity to undertake activities in the customs area. It is often pointed out that the number of service providers equipped with a global network of inspection is limited and the fee structure remains similar. In spite of this oligarchic structure, there has been fierce competition to obtain contracts. Observers suggest that it is important however for user governments to understand what they can expect from the PSI program. Otherwise it will be a substantial constraint in properly using the private sector service. The scope of the PSI program is limited in that it can not prevent smuggling by crossing unguarded border points or abuse of transit and bonded warehouses. Moreover, there could be a shift in the types of fraud away from the ones

for which PSI service is designed to deter towards those beyond the reach of the PSI.³⁶⁸ Unless user governments understand these limitations, they might ignore the necessity to complement the PSI activities with strong state policies in these areas where the private sector does not have the competence. Furthermore, improving integrity is often perceived as a potential by-product, not as their core activity. The inspection industry shows potential for a positive effect on reducing the opportunity for a trader to present fraudulent document and/or to enter into negotiation with customs officers for its acceptance. On the other hand, it did not prove effective in deterring a more rampant “facilitation fee” type bribery, which does not involve the falsification of documents. It is essential for the PSI program to reduce opportunities with the reduction in opportunity for unnecessary interaction between customs officers and traders through automation and simplification of procedures. The inspection industry has also learned this lesson and is increasingly proposing supportive services rather than substitution to customs function.

Second, the patronage system or other institutional weaknesses severely damages the usefulness of the private sector. Political interference in awarding contracts would result in economically ineffective content of contracts and would damage the legitimacy of the PSI program. There are often rumors regarding possible financial deals at the higher level of government to allow for the conclusion of contracts, which would further alienate customs officers from the proper use of the PSI program. The donor community emphasizes the need to get appropriate contract design for the PSI service to use competition in the industry for the benefit of user governments.

Third, the efficiency of the private sector in relation to that of the public sector is not always clear. The performance of the PSI program in revenue enhancement varies from country to country and is difficult to isolate from other factors. The PSI program was usually introduced at the same time as economic reforms, which accompany increases in imports and reform in customs as positive effects on revenue, but also a reduction in tariff as negative effects. While the outcomes of economic analysis of the PSI performance have been mixed, the insufficiency of reliable baseline data does not assist decision-makers and stakeholders in making an informed decision. User governments are unwilling to or are incapable of carrying out audits on the PSI service whereas the inspection industry is not eager to show its performance in a verifiable way. It is often pointed out that the PSI service is not without flaw. While PSI employees

³⁶⁸ Walsh (2003), *supra* note 85, at 173.

are expected to ensure the compliance of all consignments, they do not necessarily inspect all containers with similar carefulness. There are cases where smugglers took advantage of this practice. Moreover, "inspected" containers could be tampered with afterwards to hide smuggled goods inside. This problem has forced some of the PSI industry to shift from the Pre-Shipment Inspection to the Destination Inspection. With regard to documentary examination, the discrepancy between the invoice price and the certified price tends to be increasingly narrowed as traders learn the acceptable range of price and gradually try to lower the range by declaring the lowest end of prices. Furthermore, fraudulent traders could frequently disguise the description of goods to prevent them from being compared with similarly priced data contained in the database.

Fourth, there are risk factors in using the private sector. These factors include protection of data, loss of control by the government, and over-dependence on the private sector. The Agreement on PSI includes a provision to ensure the protection of confidential business information. The lending institutions provide advice that it is critical in order to put the PSI program in the context of customs reform and the modernization project, which includes the exit strategy from the reliance on the PSI service. In fact, PSI contracts tend to be renewed and stay on longer than expected, although they were meant to be a short-term solution to provide time for modernization to customs. Moreover, there were cases where the introduction of PSI service resulted in a lack of government attention to customs reform and a delay in implementation of reform measures. In order to avoid over-reliance on the private sector, the international financial institutions suggest that there should be some essential elements incorporated in the reform project. The first element is a well-established management team headed by stable top-management, backed by political support. When top-management changes quickly, it becomes difficult to assure the consistency and sustainability of reform, most likely resulting in the continued dependence on the PSI program. The second element is the need for appropriate human resource management, including providing decent working conditions and career development. This is the basis for building capacity in the institution with improved integrity and capability in basing the customs system and procedures on international standards. The third element is the importance of external and internal communication, which makes the customs reform accountable to stakeholders who are expected to understand and cooperate in the process. It is with careful management of its perception that customs can get support for regaining its traditional function. The fourth element is

proper sequencing for the reform in combination with the well-prepared exit from the PSI program. The inspection industry has also learned this lesson and is increasingly positioning itself to provide more supportive service in capacity building.

Fifth, the lack of cooperation by customs officers with the PSI program is a big constraint. In this regard, customs administration is increasingly allowed to participate in negotiating the contract, which helps integrate the use of the private sector into the reform program by maximizing its benefit. Customs authorities expect that the contract includes transfer of expertise by on-the-job training, and by gradually assuming the work carried out by PSI agencies. Because of their fear of losing future markets by improving customs administrations, it is not realistic to expect the PSI companies to organize meaningful training in practically transfer the knowledge. Another important way of getting the expertise from the inspection industry is customs' involvement in dispute settlement between the PSI agency and the importer, as it will provide insight into the actual methodology used by the PSI employees. Customs management often tries to provide future perspectives of exit strategy and incentives to customs officers, who fear potential losses of positions and opportunities due to the contracting out of customs function. The lack of such approach has hindered the modernization efforts by customs administrations in the past.

12. Review of the case studies through the analytical framework given by the existing literature

The section 3 of the Chapter 4 summarizes the existing literature on the factors for success and failure and identifies the three areas that the PSI program influences to achieve the goal of revenue enhancement and capacity building in customs. They are improvement in compliance environment, administrative capacity in customs and integrity. Conversely, the lack of these factors would result in failure, according to the observers. This section reviews the case study using this model given by the existing literature. These factors of success were not necessarily found in these four countries, which would explain the termination of the traditional PSI program and the shift towards a new service. In essence, the user countries experienced their own poor assessment of the PSI program.

(1) Improvement in compliance environment

The existing literature provides four major features in improving compliance level of traders, as explained in the Chapter 4. They are (1) reduction in tariff level to liberalize trade; (2) ensuring effective use of PSI reports by customs officers through reconciliation with the prospect of early exit from the PSI program; (3) strengthening border control to avoid circumvention; and (4) enhance communication and education with tax payers.

Among the four case studies, Kenya experienced a qualified success in enhancing revenue while the Philippines experience increase in revenue at the initial stage, reflecting the varying degree of fulfilling the afore-mentioned features to improve compliance environment. Both countries pursued a comprehensive set of trade liberalization measures during the PSI period to facilitate improvement in compliance of traders. In fact one study observed the shift in duty payment record of Kenya towards higher duty imports over the period of trade reform. Both countries conducted extensive campaign to raise awareness of taxpayers to improve compliance through dialogue with traders and enhanced border control to avoid circumvention. The Philippines experienced the increase in smuggling after the introduction of PSI program, which actually shows the validity of PSI program, and subsequently took necessary measures to enhance border control. As Kenya has historically served as a hub port for East Africa, special care was taken to deter potential circumvention by strengthening port control. The reconciliation of PSI reports on valuation was made compulsory in the Philippines, but customs officers increasingly felt the waning effect of the PSI program, because of the change in the WTO rules and the accumulation of know-how, which made difficult to maintain cooperation between customs and inspection companies. Customs officers in Kenya greatly used PSI reports on valuation, which filled the initial shortage in valuation expertise in KRA. This difference in the use of PSI reports could possibly explain the difference in performance in revenue.

On the other hand, Bangladesh and Togo suffered from extremely poor level of compliance of traders and experienced less clear performance of the PSI program in the revenue area. Although both countries undertook trade liberalization, tariff level remained too high to improve compliance culture of the trading community. While the PSI reports on valuation were usually available for Bangladesh, the coverage of goods accompanied by the PSI reports in Togo remained as low as 20-30%. Moreover,

smuggling was rampant reflecting the long and permeable land borders with their neighboring countries, especially in Togo. Bangladesh made efforts in tightening the control over the bonded warehouse by computerizing the procedures, which used to be the major source of import diversion, but its common border with India remained problematic. Communication to raise awareness of taxpayers on compliance and the role of the PSI program remained insufficient.

(2) Improvement in administrative capacity

The existing literature stresses the importance of engaging the PSI program as part of improving administrative capacity in customs, as described in the section three of Chapter 4. It recommends four features of the relationship between customs reform project and the PSI program. They are (1) strong leadership; (2) computerization; (3) contract; and (4) transfer of skills.

The Philippines benefited from stable management under the same commissioner during the PSI period which facilitated to maintain a consistent vision in the customs authorities and to roll out the automated customs procedures. However, the government had taken a lead in concluding contract with an inspection company without properly involving customs, which caused problems at a later stage, especially in terms of transfer of skills, including valuation database. Therefore the PSI program was increasingly criticized for the insufficient value for money in capacity building. Kenya also benefited from stable management under the new administrative model of semi-autonomous revenue authority. It was careful in contract design in limiting the period and involving customs to ensure gradual transfer of skills. However, there was criticism that the Kenyan government should have invested in upgrading computer during the PSI period. In both countries there was accompanying improvement in administrative capacity in customs, but observers often comment that the exit strategy from the PSI program could have been supported with more financial support from the respective governments.

Bangladesh suffered from unstable management in customs with frequent change in the top management and consequently the progress of its customs reform project including automation was often delayed. After the major revamp in contract design in 2000, the contract has been extended several times without a clear exit strategy in sight. Computerization and other reform have been pursued independently from the PSI

program. Togo has suffered from political stability until recently, which undermined customs management to exert strong leadership. PSI contract was recently altered to Destination Inspection by the government. Transfer of skills proved to be limited under the traditional PSI contract, but it remains unclear whether the DI contract would address this problem.

(3) Improvement in integrity

The existing literature views improvement in anti-corruption as an important factor for success, as described in the section three of Chapter 4. It recommends that the government provide incentives for customs officers to preserve integrity and to support customs reform and cooperation with the PSI employees.

The Philippines experienced difficulties in securing cooperation of customs officers with the PSI program, computerization and other reform program, partly for fear of losing employment and possibly rent-seeking opportunities. The low salary level was often identified as one of the major sources of corruption. In response, the customs management embarked on internal campaign to address the concern of customs officers. A series of training sessions on integrity were also organized. However, the lack of support by the Parliament to increase the salary level of customs officers did not help to fight against corruption. Bangladesh and Togo also suffered from poor working condition which was not helpful in addressing the integrity issue.

On the contrary, Kenya provided direct incentives by substantial pay rise as a result of establishing semi-autonomous revenue authority. This model also enabled Kenya to dismiss corrupt officers, using the flexible human resource management. Another incentive was the anticipation of regaining the traditional function by gradually taking over the PSI program. Moreover, the fact that its neighboring countries, such as Uganda and Zambia successfully terminated the PSI service reinforced this anticipation.

(4) Overall assessment and the new services

This section has reviewed the case study of four countries using the analytical model identified by the existing literature. The factors for success contained in this analytical model seem to explain the performance of the PSI program in the four

countries to a certain extent. However, as shown above, this paper argues that it was not easy to find these factors in the four countries in a satisfactory manner. It maintains that this is the reason why the PSI program lost appeal and the number of user countries has declined or migrated to new services over the year.

As a general trend the inspection industry has recently shifted its business model to a Destination Inspection (DI), combined with scanner service. Togo is one such example. In terms of compliance environment, the DI could offer a wider coverage of goods to be controlled at the port of entry than the traditional PSI program. It could possibly avoid the problem of goods arriving without PSI reports. In fact, scanning of containers at the destination could replace the traditional physical inspection at the port of shipment in a more cost efficient way. It was often advertised that this type of service could bring back inspection of cargo from the hands of inspection companies at the port of shipment to the hands of customs officers at the port of destination. This efficiency gain will however depend on the selection method of cargo for scanning. Otherwise, a greater use of scanning is likely to cause congestion at the port of entry and jeopardize trade facilitation for legitimate trade. It is also promoted that since customs officers will work together on the ground with the employees of inspection companies in selecting cargoes and reading their images, there might be a greater opportunity for acquiring the know-how. On the other hand, inspection companies could secure the profit by supporting the maintenance and operation of scanning equipment. They suggest a concession from the government to finance, construct and operate the scanning facility for a period of sufficiently long years.

This paper stresses however that scanning itself does not necessarily improve customs valuation work as it deals only with the aspect of physical inspection. In other words, while physical inspection moves to the port of destination from the pre-shipment stage, documentary examination to determine the acceptability of declared value of goods normally stays in the hand of inspection companies at the port of shipment or at the headquarters of inspection companies. In fact, the challenge of customs valuation remains for user governments in the same manner as the traditional PSI service. Therefore this paper argues that the PSI service had evolved over the year, but the difficulties has persisted in using the private sector in customs valuation.

Conclusion

This paper reviewed the experience of selected developing countries on contracting out the core function of customs. This practice has been one of the important features of many customs operations in the developing world. Consequently, this study also covered the recent development of customs valuation in developing countries from a time when this function was often contracted out to the private sector, up to the present day where the practice of contracting out in a traditional manner is much less commonplace.

This paper appraised the evolution of the function of customs authorities over the years that had come to include a range of missions with regard to the cross-border movement of goods, including: revenue collection; protection of society from the inflow and outflow of prohibited or controlled goods; and assistance with economic development efforts. Customs' core working methodology however has remained the same: namely, the examination of documents that accompany the movement of goods; and the physical inspection of goods. Among the many missions of customs, revenue collection has been foundational. It plays a central role in many developing countries as a major source of national revenue. This importance suggests that lengthy procedures could be expected in the examination of documents and physical inspection of goods to verify the truth and accuracy of information on value and other attributes that impact tax liability. Therefore establishing standard practice for valuation has been essential for customs authorities, whereas avoiding arbitrary valuation method has been critical for the trading community. To this effect, two sets of international rules on customs valuation have been elaborated: the Brussels Definition of Valuation (BDV) of 1950; and the WTO Agreement on Customs Valuation of 1994. The difficulty has been that many developing countries found it difficult to get the information necessary for valuation purposes when implementing either of these sets of rules. As a result, some of these countries have contracted out the documentary examination and physical inspection to the private sector operatives in the exporting countries, a function called preshipment inspection (PSI). Using the private sector in one of the key functions of the state has generated much interest and debate in the trade and development communities.

Drawing on the available literature, this paper analyzed the difficulties that customs authorities had experienced. It was common for customs authorities to set up

lists of prices that were used as minimum values before the introduction of the WTO Agreement in Customs Valuation, but it was a significant challenge to keep the listed prices updated. The PSI program was supposed to provide a solution to this issue by correcting the asymmetry in information between customs authorities and importers. In addition, the PSI program was supposed to be isolated from a number of corrupting influences on customs, such as: (1) attempts by unethical people to bypass border regulations, (2) the use by customs of their discretionary power executed in close working relationship with the trading community, and (3) poor working conditions of customs officers. The PSI solution was expected to provide a remedy to the integrity problems by preventing attempted frauds by importers. In a similar effort, the “revenue authority model” was also promoted by the IMF to improve human resource management and working conditions.

The paper confirmed that the existing literature on PSI had shown the gradual development in the views of the IMF and the World Bank that had initially recommended the use of the PSI program to address the administrative weakness in customs. After a numerous efforts to improve the efficiency of the program, including contract design, the international lending institutions have come to realize that provision of information by inspection companies to customs officers alone would not suffice for improving customs valuation. Comprehensive capacity building with sustainable political support has instead been promoted as the key. While the main literature has continued to emphasize the usefulness of bringing market efficiency to the customs valuation field, this paper questioned the applicability of this theory as the developing world often lacked proper consideration of the conditions and constraints that prevail in the developed world.

The paper therefore argued that it would be necessary to review the evolution of neo-liberal privatization and new public management that was the driving force behind the use of market mechanism in the public sector. It summarized that the quasi-privatization of customs function had been initially encouraged by the line of early neo-liberal thinking that placed great faith in the reduction of government and unregulated privatization in the 1970's. However, excessive attention to competition and the free market have gradually led to a realization that this policy recommendation by itself would not guarantee economic success. Consequently a regulatory framework or state intervention was constructed to ensure a desirable mix of competition and cooperation, shifting the attention from government to governance. The practice and

techniques of market-oriented administrative reform, labeled “new public management”, gave birth to a variety of organizational hybrids between the public and private sectors, including privatization and contracting out regimes. However the outcome of this movement in developed countries had been mixed, in terms of the quality of service, the public sector morality, and the time and resources needed to negotiate and manage the partnership contracts. This evolution of public-private partnerships has had profound implications in the development policy area. The neo-liberal policy of deregulation and privatization was disseminated to developing countries from the 1980’s by the IMF and the World Bank. They advised recipient countries to use the private sector to tackle the problems of an inefficient and rent-seeking public sector, often as a condition of their loans. They advocated contracting out and privatization schemes as a stimulus to promote cost-saving, efficiency, flexibility and responsiveness in the delivery of public service. It was after a decade of experimental reduction in government that policy reformers became aware of the importance of strengthening governments, regulating market behavior, and the management of and monitoring of contracts. This critical view of new public management revived interest in the need to strengthen the administrative capacity of the state.

This analytical background of public institution was applied to the investigation of the evolution of customs valuation in developing countries. The inspection industry found a niche in the first wave of deregulation and privatization in the customs area in developing countries. They quickly turned preshipment inspection service from exchange control to a customs revenue purpose. The IMF and the World Bank supported this policy with the goal of improving inefficient customs administrations and upgrading the integrity of customs by reducing the level of government intervention. Then the paper surveyed about the development of regulation on the PSI program. Initially the need was brought up to regulate the PSI for exchange control, which had been criticized for being cumbersome and arbitrary in the 1980’s, led to the establishment of the WTO Agreement on PSI. The PSI Agreement was made applicable to the then emerging PSI service for customs revenue purpose, but it was also used to legitimize the PSI services function in the customs arena. Realizing the need for strengthening regulation and monitoring of the PSI service, the IMF and the World Bank suggested improvements to contracts to encourage competition and introduce ex-post reconciliation to strengthen monitoring. The WTO had reviewed the implementation of the PSI Agreement, with a significant focus on the PSI program’s revenue purpose, and made recommendations. The entry into force of

the WTO Agreement on Customs Valuation of 1994, which became applicable to most of developing countries in 2000, presupposes better compliance by importers and a stronger state capability on verification of importers' declarations. This change of valuation system from the BDV has had an impact on the use of private companies in customs valuation. Meanwhile, there has been a notable change in the policy of the lending institutions, taking a more cautious view in the use of PSI programs, and putting more emphasis on building capacity in customs administration.

With this experience and caution in mind, the customs community has been searching for alternative solutions to the PSI program. These alternatives include the exchange of information, the use of an electronic dataset and the establishment of a valuation database. These proposed measures are all technical tools that should be part of comprehensive customs reform. Inspection companies have also changed their commercial strategy since 2000 to focus more on "supportive" services for customs authorities rather than "substituting" for them. They have proposed new services, including risk management and selectivity, Destination Inspection with cargo scanning service. In fact, inspection companies have quickly changed their strategy in response to the change in market environment over the 20 years. They first transformed their service from exchange control to customs revenue purpose. Then, since the implementation of the WTO Agreement on Customs Valuation diminished their role – from that of the agent that determines value into an agency for making risk assessments – the inspection industry has been gradually moving away from the traditional PSI service. It is now offering new business models in support of customs authorities, such as Destination Inspection and scanning service. However, the new model does not automatically guarantee the success in improving administrative capacity. It is therefore up to the user governments to take a lead in implementing valuation and other essential business of customs. The jury is still out if this new approach brings about benefits to customs authorities in improving their capacity.

Observers in the lending institutions have often prescribed several factors for a successful use of the PSI program. The paper examined these factors for success and failure identified by the existing literature while pointing out the need of clearly defining the "success" or the goal of the PSI program. It suggested the need for the dual goal of revenue enhancement and capacity building. The conventional view tended to focus on revenue enhancement too much, which often created over-reliance on the PSI program. The paper also identified the areas in which the PSI program was

expected to exert influence and presented a model for analysis drawn from the existing literature. They include compliance environment, administrative capacity in customs and integrity situation. This model was used to select four countries for case study and to review their performance. In order to respond to the call for empirical study in the use of PSI service by the existing literature, the paper has looked into the experiences of four countries.

The Philippines was one of the earliest users of the PSI program and was viewed as a success case at the early stage. Although there was a growth in trade and revenue at the time of the PSI program, its contribution in revenue enhancement was less clear-cut than anticipated. Its potential benefit was undermined by an increase in alternate methods of tax evasion, such as smuggling, and the lack of state investment in customs authorities in improving human resource development. The transfer of skills from inspection companies to customs officers was considered insufficient and the necessary reform in customs was judged slower than expected. This delay in customs modernization was caused partly because of long-term reliance on inspection companies. As a result, the government and the trading community espoused a cautious view on the PSI program, and it was subsequently terminated when the Valuation Agreement was implemented in 2000.

In Kenya the impact of the PSI service was also regarded positively in contributing to revenue especially at the initial stage. Having learned lessons from other user countries, the Kenyan authorities limited the duration of their PSI contracts to two to three years and subsequently improved the contract's requirements to reduce costs and to ensure the transfer of knowledge throughout the four contracts engaged in between 1994 and 2005. Consequently, customs authorities gradually took over the valuation work and obtained a valuation database from the private companies. Kenyan customs also improved integrity in an attempt to gain the confidence of the trading community for the phase-out of the inspection company. The implementation of customs reform had been in progress since the reorganization of revenue authorities in 1995. However, to some extent the reliance on the PSI program delayed the reform process, which only gathered pace on the termination of the PSI contract in 2005. Actually, the renewal of information system, which took place when the PSI contract expired, could have been introduced during the use of PSI.

When Bangladesh introduced the initial PSI program it left the choice of inspection companies to importers, a decision that resulted in perverse competition among PSI agencies to attract importers by offering certifications with lower prices. With the support of lending institutions, Bangladesh re-engaged the PSI service in 2000 to prepare for the implementation of the WTO Agreement on Customs Valuation. They installed better regulations on the new PSI program to fix the problems that were previously experienced. In spite of this improvement in contract design, the performance of the PSI program was mixed in revenue, and customs modernization has been slower than expected. Moreover, Bangladesh was faced with the difficult geographical condition, resulting in weak border control, which worked detrimental to the PSI program. The poor working condition has not helped customs officers to develop cooperation with the inspection companies. In fact, there has been continuous debate on evaluating the performance of this PSI program between customs and trade, which made it rather difficult for policy makers to assess the value of the costly PSI service.

Togo initiated a PSI program in 1995 on the recommendation of the IMF. The goal was to recover revenue lost as a result of political turmoil in the early 1990's. However, the usefulness of the traditional PSI program was judged rather limited, because of the low level of consignments arriving at the destination with PSI certificates. The impermeable border and the regional competition among ports contributed to the weak enforcement of the PSI program at the borders. Mindful of the limitations of the traditional PSI program and the need to strengthen import control, the program was transformed into the Destination Inspection, another form of public-private partnership, with the extensive use of X-ray scanners to inspect containers on their arrival in Togo. However, this new service has still retained the documentary examination outside Togo and therefore did not necessarily guarantee the transfer of skills to customs.

As illustrated in the case studies of the four countries, customs administrations encountered institutional constraints in making the best use of the PSI contract. These include: (1) little recognition of the limitations on the program, which does not address smuggling, or a rampant patronage system, both of which can adversely affect the conclusion of contracts, (2) weak border control, (3) the lack of adequate audits comparing the efficiency of the public and private sectors, (4) the risk of over-reliance of the state on the private sector service, and (5) the difficulties in developing cooperative partnership between customs officers and employees of inspection companies, partly

caused by the poor working condition of customs employees. The paper also reviewed the performance of four countries, using the analytical model offered by the existing literature. This analytical model would predict that the PSI program is most likely to be successful when the user government (a) takes necessary measures to improve compliance environment of traders, (b) undertakes customs reform with necessary human, financial and technological resources, and (c) tackles integrity issue. Essentially, the four case studies show that these factors for success of the PSI program affect the performance of the PSI program, but they are not always easy to find in these countries. Therefore, the experience proved that the government could not entirely leave addressing the widespread problem of poor compliance and administrative weakness in the hands of the private inspection company. This paper maintained that the over-reliance on the private sector will be the principal factor for failure of the PSI program, because of the aforementioned institutional constraint inherent to the program. The inspection industry realized this feature and moved towards more supportive service for customs. It is up to user governments to employ the service of inspection industry to support capacity building of customs to ensure revenue enhancement in a sustainable manner while recognizing the merit and limit of the service offered by the inspection industry..

In summary, the paper argued that within a quarter of the century the PSI industry has evolved quickly to assist developing countries in customs valuation from the time of deregulation to that of building state capacity. At the early stage of deregulation the PSI program did not work as expected, because the internal capacity of user governments to oversee inspection companies was limited on one hand, and because inspection companies were not interested in capacity building in customs on the other. Therefore the government developed re-regulation of inspection industry while the inspection industry developed a variety of public-private partnership. Although the inspection industry has shifted to more “supportive” service, both the user government and the inspection industry have yet to prove the usefulness of the new program in enhancing capacity of customs in the valuation area.

Bibliography

“Agents Welcome Exit of Swipco.” The East African (5 February 2001).

Andersen, Ole, Johan. “Public-Private Partnerships : Organizational Hybrids as Channels for Local Mobilization and Participation ?” *27 Scandinavian Political Studies* (2004).

Anson, Jose, Cadot, Plivier & Olarreaga, Marcelo. “Tariff Evasion and Customs Corruption: Does PSI Help?” (August 2003) Policy Research Working Paper, World Bank

Asian Development Bank, Asian development Output 2006

Asian Development Bank, Key Indicators 2006.

Bangladesh Customs website. *Available at* <http://www.nbr-bd.org/nbrweb/CustomsFiles/CustomsHomepage.asp> (last visited 6 June 2007).

“Bangladesh Takes on Tax Dodgers.” BBC News (25 April 25 2006).

Bear, Katherine. Benon, Olivier, P. & Juan, R. Toro. Improving large Taxpayers’ Compliance: A Review of Country Experience. IMF Occasional Paper 215, Washington DC., IMF (2002).

Besley, Timothy. & McLaren, John. Taxes and Bribery: the Role of wage Incentives. 103 *The Economic Journal* (1993).

Bevan, Philippa. “Consultants and Change: What makes the Match Succeed?” 23 *Insights* (1997). *Available at* <http://www.id21.org/insights/insights23/insights-iss23-art05.html> (last visited 6 June 2007).

“Bhutto Clan Leaves Trail of Corruption in Pakistan” New York Times (9 January 1998).

BIVAC “Preshipment Inspection Service Flowchart” BIVAC.com (May 2007). *Available at* <http://www.bivac.com> (last visited 6 June 2007).

Buchanan, James, M. “Public Choice “Politics without Romanticism.” 19 *Policy* 16 (2003)

“Business for Continuation of Preshipment Inspection.” The Daily Star (29 July 2003).

“Businessmen’s Harassment by Preshipment Inspection.” News from Bangladesh (24 March 2005).

“Business Propose Neutral Evaluation of PSI System by Non-NBR People.” The Daily Star (23 January 2004).

Cabinet Office. Modernizing Government. Cm 4310, London (1999).

Chand, Sheftal K. & Moene, Karl O. Controlling Fiscal Corruption. 27 *World Development* (1999).

Chawdhay, Z.I. “Country experience – Bangladesh” in the Commonwealth Trade and Enterprise Paper in Preshipment Inspection: Past Experiences and Future Directions Commonwealth Secretariat (2001) *supra* note 278.

Chowdhury, Faizul, Latif. “Corrupt Bureaucracy and Privatization of Tax Enforcement in Bangladesh.” Pathak Shamabesh, Dhaka, Bangladesh (2006).

Clarete, Ramon, L. “Customs Valuation Reform in the Philippines” Background paper prepared for the World Development Report 2005 (2004). *Available at* http://siteresources.worldbank.org/INTWDR2005/Resources/477407-1096581040435/wdr2005_philippines_customs_reform2.pdf (last visited 6 June 2007).

Clarete, Ramon, L. “Philippines: Adopting the Transaction Basis for Customs Valuation” in (ed.) Peter Gallagher, Patrick Low & Andrew L. Stoler. Managing the challenges of WTO participation – 45 case studies, WTO, Cambridge University Press (2005).

Clarete, Ramon, L. “What Free Trade Meant for the Philippines” presentation

Corformat, François. “Are PSI Services Useful in Improving Revenue Collection and Promoting Customs Integrity – Viewpoint of IMF”. In Rege. Vinod, (ed.), Preshipment Inspection: Past Experiences and Future Directions, London, Commonwealth Secretariat (2001).

Corformat, François. Issues and strategies for technical assistance to developing countries, presentation at the WTO Seminar on Technical Assistance on Customs Valuation (6-7 November 2002).

Corformat, François. & Castro, Patricio. Computerization of Customs Procedures in Keen, Michael. (ed.) Changing Customs, Washington DC. IMF (2003) at 119-20.

COTECNA “Case Studies – Destination Inspection, Tanzania.” *Available at* [COTECNA.com](http://www.cotecna.com) (last visited 6 June 2007).

COTECNA data sheet for exporters, 2006 . *Available at* http://www.cotecna.com/COM/Images/Togo_datasheet.pdf (last visited 6 June 2007).

COTECNA “Government Service – Risk management.” *Available at* [COTECNA.com](http://www.cotecna.com) (last visited 6 June 2007).

COTECNA Guidelines for Exporters, March 2005. *Available at* www.cotecna.com (last visited 6 June 2007).

Croom, John. Reshaping the World Trading System: A History of the Uruguay Round. Geneva, WTO (1995).

- DeMartino, George, F. Global Economy, Global Justice. London and New York, Routledge, (2000).
- De Wulf, Luc. & Sokol, José. (ed.) Customs Modernization Handbook, Washington D.C. World Bank (February 2005).
- De Wulf, Luc. “Customs Valuation in Developing Countries and the World Trade Organization Valuation Rules” in (ed.) Luc De Wulf & José B. Sokol Customs Modernization Handbook Washington D.C. World Bank (2005).
- Dixon, John. Kouzmin. Alexander & Korac-Kakabadse, Nada. “Managerialism – something old, something borrowed, little new.” 11 *International Journal of Public Sector Management* (1998).
- Dutz, Mark. “The Use and Usefulness of PSI Services, in (ed.) Vinod Rege Preshipment Inspection: Past Experiences and Future Directions London, Commonwealth Secretariat (2001).
- Egan, Michael. “Regulatory Strategies, Delegation and European Market Integration.” 5 *Journal of European Public Policy* (1998).
- Emran, M. Shahe. & Stiglitz, Joseph, E. Price-neutral Tax reform with an Informal Economy. RePec (2003) at 1.
- Finger, Michael & Schuler, Philippe. Implementation of Uruguay Round Commitments: the Development Challenge. World Bank Policy research Working Paper 2215, Washington DC, World Bank, (1999).
- Finger, J. Michael. & Wilson, John S. Implementing a WTO Agreement on Trade Facilitation: What Makes Sense? World Bank Policy Research Working Paper 3971, Washington DC, World Bank (2006).
- Fisman, Raymond. & Wei, Shang-Jun. Tax rates and tax Evasion: Evidence from “Missing Imports” in China. 112 *Journal of Political Economy* (2004).
- Flynn, Norman. Public Sector Management. fifth edition, London, Sage (2007).
- Fougner, Tore. “The State, International Competitiveness and Neoliberal Globalization : Is There a future beyond « the Competition state » ?” 12 *Review of International Studies* (2006).
- Friedman, Milton. Capitalism and Freedom, 40th Anniversary Edition, Chicago and London, The University of Chicago Press (2002)
- G8 Gleneagles 2005 Summit Document “Reducing IPR Piracy and Counterfeiting through More Effective Enforcement.” (8 July 2005). Available at <http://www.fco.gov.uk/Files/kfile/PostG8_Gleneagles_CounterfeitingandPiracy.pdf> (last visited 6 June 2007)
- G8 Kananaskis 2002 Summit Document “Cooperative G8 Action on Transport Security.” (27 June 2002). Available at <<http://www.g8.gc.ca/2002Kananaskis/tranterror-en.pdf>>

(last visited 6 June 2007)

Garelli, Stéphane. "Competitiveness of Nations : The Fundamentals." *The World Competitive Yearbook 2000*, Lausanne IMD (2000).

GATT Minutes on the Negotiating Group on Non-Tariff Measures, Meeting of 22 and 25 February 1988, MTN.GNG/NG2/6

GATT Minutes on the Negotiating Group on Non-Tariff Measures, Meeting of 30 November 1989, MTN.GNG/NG2/14

GATT Minutes on the Negotiating Group on Non-Tariff Measures, Meeting of 21 March 1990, MTN.GNG/NG2/17

GATT Uruguay Round Negotiating Group on Non-Tariff Measures, Communication from Zaire, MTN.GNG/NG2/W/17 (July 1988).

Gille, Stephen. "European Governance and New Constitutionalism: Economic and Monetary Union and Alternative to Disciplinary Neoliberalism in Europe" 3 *New Political Economy* (1998).

Glenday, Graham. "Trade Liberalization and Customs Revenue: Does Trade Liberalization Lead to Lower Customs Revenues? The Case of Kenya." Development Discussion Paper No. 764, Harvard Institute for International Development (June 2004).

Global Forum on Fighting Corruption and Safeguarding Integrity II in The Hague, 31 May 2001 Annex to the Final Declaration: Report of Workshops, Available at <http://web.worldbank.org/WBSITE/EXTERNAL/WBI/EXTWBIGOVANTCOR/0,,contentMDK:20944440~menuPK:1962490~pagePK:64168445~piPK:64168309~theSitePK:1740530,00.html> (last visited 6 June 2007).

Government of the Philippines website. Available at <http://www.neda.gov.ph/ads/mtpdp/MTPDP2004-2010/PDF/MTPDP2004-2010.html> (last visited 6 June 2007).

Grimshaw, Damian, Vincent, Steve & Willmott, Hugh. "Going Privately: Partnership and Outsourcing in UK Public Services." 60 *Public Administration* (2002).

Grindle, M.S. "The good government imperative : Human resource organizations and institutions." In M.S. Grindle (ed.) Getting Good Government, Harvard University Press (1997).

Harvey, David. A Brief History of Neoliberalism. Oxford, Oxford University Press (2005).

Hodge, Graeme A. "The Risky Business of Public-Private Partnerships." 63 *Australian*

Journal of Public Administration (2004).

Hood, Christopher. "A Public Management for All Seasons." 69 *Public Administration* (1991).

"Importers Blame PSI for Delay, Harassment." New Age (8 October 2005)

International Chamber of Commerce "Rules of Conduct to Combat Extortion and Bribery" (Oct 2005). Available at <www.iccwbo.org> (last visited 9 June 2007).

International Labor Organization. Women and Men in Informal Economy – A Statistical Picture Geneva, ILO (2002).

International Monetary Fund. Bangladesh "Letter of Intent and Memorandum of Economic and Financial Policies for April 2005 – June 2006" (26 May 2005).

International Monetary Fund. Bangladesh "Letter of Intent and Memorandum of Economic and Financial Policies for 2006" (9 January 2006).

International Monetary Fund. Bangladesh "Letter of Intent and Memorandum of Economic and Financial Policies for 2006/2007" (5 October 2006).

International Monetary Fund. country report, No. 04/27 (17, February 2004).

International Monetary Fund. country report, No. 06/406 (12, November 2006).

International Monetary Fund. Dealing with the Revenue Consequences of Trade Reform (Background paper for Review of Fund Work on Trade) (2005).

International Monetary Fund. Staff Country Report No. 99/54 "Togo: Selected Issues" (July 1999).

International Monetary Fund. "Dealing with the Revenue Consequences of Trade Reform" (Background Paper for Review on Fund Work on Trade), Fiscal Affairs Department, (15 February 2005). Available at <<http://www.imf.org/external/np/pp/eng/2005/021505.pdf>> (last visited 6 June 2007).

International Monetary Fund. World Economic Outlook 1997. Washington DC (1997).

International Trade Center "South-South Trade Promotion Program, Bangladesh, Supply and Demand Survey on Automotive Components." (August 2002).

Isip, Irma. "SGS moves on to lab, techno testing." Malaya (1 July 2006).

Israel, A. Institutional Development : Incentives to Performance. Baltimore and London. John Hopkins University Press (1987) as quoted in Larbi.

Jenkins, Glenn P. "Modernization of Tax Administrations: Revenue Boards and Privatization as Instrument for Change" *Bulletin for International Fiscal*

Documentation (February 1994).

Jereos, Georges. Deputy Commissioner, BOC, WTO Workshop on Technical Assistance and capacity Building on Trade Facilitation, Geneva (10-11 May 2001). *Available at www.wto.org* (last visited 6 June 2007).

Johnson, Noel. "Committing to Civil Service Reform: the Performance of Preshipment Inspection under Different Institutional Regimes." World Bank Policy Research Working Paper No 2594 (April 2001).

Keen, Michael (ed.) Changing Customs: Challenges and Strategies for the Reform of Customs Administration, Washington D.C. IMF (October 2003).

Kenya Ministry of Planning and National Development website. *Available at* < http://www.planning.go.ke/publication/economic_recovery_plan.pdf > (last visited 6 June 2007).

Kidd, Maureen. & Crandall, William. "Revenue authorities: Issues and problems in evaluating their success" IMF Working Paper, WR/06/240 (October 2006).

Klitgaard, Robert. Cleaning up and Invigorate the Civil Service. 17 *Public Administration and Development* (1997)

Klitgaard, Robert. Controlling Corruption. California, University of California Press (1988).

"KRA falsely accused by car importers, says Kituyi." The East African (10 October 2006).

Krueger, Anne, O. "The Political Economy of the Rent-seeking Society." 64 *American Economic Review* (1974).

Lane, Michael H. Customs Modernization and the International Trade Superhighway. Westport, Connecticut, Quorum Books (1998).

Larbi, George, A. The New Public Management Approach and Crisis States. United Nations Research Institute for Social Development Discussion Paper No. 112 (1999).

Low, Patrick. Preshipment Inspection Service. World Bank Discussion Paper 278, Washington D.C. World Bank (1995).

Mann, Arthur J. "Are Semi-Autonomous Revenue Authorities Answer to Tax Administration Problems in Developing Countries? – A Practical Guide." USAID (August 2004).

Mascarenhas, R.C. "Building an enterprise culture in the public sector: Reforms in

Australia, New Zealand and Great Britain” 53 *Public Administration Review* (1993).

Mayntz, Renate. From Government to Governance: political Steering in Modern Societies. Summer Academy on IPR: Wuerzburg (2003). Available at www.ioew.de/governance/english/veranstaltungen/Summer_Academies/SuA2Mayntz.pdf (last visited 6 June 2007).

McCarten, William. Focusing on the Few: The Role of large Taxpayers Units in the Revenue Strategies in Developing Countries. Paper presented at the fourth Conference on Public Finance Issues in an International Perspective: the Challenge of Tax reform in a Global Economy at the Andrew Young School of Policy Studies, Georgia State University (2004) at 11.

Menardo, Amelia, A. Trade, Industry and Utilities Staff, National Economic and Development Authority (8-9 September 2004) APEC High-Level Conference on Structural Reform, Tokyo, Japan.

Mikuriya, Kunio. “Legal Framework for Customs Operations and Enforcement Issues.” In (ed.) Luc De Wulf & José B Sokol Customs Modernization Handbook, Washington D.C. World Bank (2005).

Mikuriya, Kunio. “The Customs Response to the 21st Century.” 1.1 *Global Trade and Customs Journal* (2006).

Milburn, Alan. “Speech of 22 May 2002,” as quoted in Flynn.

Mills, Anne. Improving the Efficiency of Public Sector Health Services in Developing Countries : Bureaucratic vs. Market Approaches. PHP Departmental Publication, 17, London, London School of Hygiene and Tropical Medicine (1995).

Ministry of Finance, Japan. “Time Release Study.” Presentation at the APEC Customs-Business Dialogue, Korea (September 2005).

“Mombasa port to go electronic in July.” The East African (21 March 2005).

“MPs targeted Swipco in amended Bill.” The Daily Nation (23 November 2000).

“Muddling along” Economist (22 June 2006).

“New Kenya Rules Slash Earnings for Verification Firms.” The East African (25 December 2000).

Newsflash, Philippine Headline News Online (8 March 2000). Available at <http://www.newsflash.org/2000/03/pe/pe001066.htm> (last visited 6 June 2007).

Ng, Willie. “Government case against SGS hits blank wall.” Manila Bulletin (11 Feb

2002).

Okello, A. "Kenya's Experience with Preshipment Inspection" Commonwealth Trade and Enterprise Paper in Preshipment Inspection: Past Experiences and Future Directions Commonwealth Secretariat (2001).

Önis, Ziya. "The Limits of Neoliberalism: Towards a Reformulation on Development Theory." 24 *Journal of Economic Issues* (1993).

Parayno Jr., Guillermo, L. "Philippines" in Luc De Wulf & José B. Sokol (ed.) Customs Modernization Initiatives, Case Study. Washington D.C. World Bank (2004).

Premfors, Rune. "Reshaping the Democratic State : Swedish Experience in a Comparative Perspective." 76 *Public Administration* (1998).

"PSI Companies get Extension up to June 30" The Daily Star (25 Jan 2004).

Rahman, Nurun, N. "Policy Reforms and Trade Liberalization, 2005." Available at http://r0.unctad.org/ditc/tab/publications/nama/bangladesh_study.pdf (last visited 6 June 2007).

Rahman and Razzaque. "Informal Border Trade between Bangladesh and India: an Empirical Study in Selected Areas." Asia Foundation, administered by Democracy in Development, Inc. (1998) as cited in World Bank Report (1999).

Rege, Vinod. Customs Valuation and Customs Reform. In Bernard Hoekman & Aaditya Mattoo. & Philip English. (ed.), Development, Trade and the WTO – A Handbook, Washington DC, World Bank, (2002) at 131.

Rege, Vinod. (ed.) Preshipment Inspection: Past Experiences and Future Directions London, Commonwealth Secretariat (2001)

Richard, Allen. Budgetary Reform in Central and Eastern Europe. OECD/SIGMA, *Public Management Forum* (2001).

Rose-Ackerman, Susan. Corruption and Government. Cambridge, Cambridge University Press (1999).

Ruggie, John Gerard. "International Regime, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order." 36 *International Organization* (1982).

"Saifur Questions the Relevance of PSI again." The Bangladesh Observer (15 January 2004).

Savas, E.S. A Typology of Market-Type Mechanism PUMA Market-Type Mechanisms Series, OECD, Paris (1989) as quoted in Larbi.

Schneider, Friedrich. The size of Shadow Economies of 145 Countries all over the World: First Results over the Period 1999-2003 IZA (Institute for the Study of Labor) Discussion Paper No 1431 (Dec 2004).

“SGS India Takes over Preshipment Inspection Work for Export to Bangladesh.” Business Line (17 March 2005).

Shende, Suresh N. Informal Economy, The Special Tax regime for Small and Micro Businesses: Design and Implementation. Paper presented at the third Regional Training Workshop on Taxation (UN and CIAT) (2002) at 9.

Smith, Adam. An Inquiry into the Nature and Causes of the Wealth of Nations (Wealth of Nations). London, Methuen and Co. Ltd., ed. Edwin Cannan, (First published: 1776).

Stiglitz, Joseph. Globalization and its Discontent. USA and Great Britain, Penguin Books (2002).

Taliencio, Robert. Designing Performance: The Semi-Autonomous Revenue Authority Model in Africa and Latin America. World Bank Policy Research Working paper 3423 (2004).

Thomas, Ian. “Special Bonded Warehousing in Bangladesh” Paper prepared for the World Bank (2003) quoted in Luc De Wulf & José B. Sokol.

Thurania, Francis, KRA, “Challenges to implement the Agreement on Customs Valuation.” WTO Seminar on Technical Assistance on Customs Valuation (6-7 Nov 2002).

Transparency International. Corruption Perceptions Index 2006. Available at [http://www.transparency.org/news room/in focus/2006/cpi_2006_1/cpi table](http://www.transparency.org/news_room/in_focus/2006/cpi_2006_1/cpi_table) (last visited 6 June 2007).

Transparency International, Global Corruption Barometer 2003.

United Nations Center for Trade Facilitation and Electronic Business (UN/CEFACT) Recommendation on Preshipment Inspection ECE/TRADE/237 (1999).

United Nations Conference for Trade and Development (UNCTAD) Technical Note, “Use of Customs Automation System” (October 2005). Available at http://r0.unctad.org/ttl/technical-notes/TN03_CustomsAutomationSystems.pdf (last visited 6 June 2007).

United Nations Economic Commission Europe (UNECE). Recommended Measure 8.2 in the Recommendation No 18 on “Facilitation Measures Related to International Trade Procedures,” (1982).

United Nations Environmental Program (UNEP) Press Release “Call for Global Action on E-Waste.” (1 Dec 2006). *Available at* <http://www.unep.org/Documents.Multilingual/Default.asp?DocumentID=496&ArticleID=5447&l=en> (last visited 6 June 2007)

United Nations. World Public Sector Report – Globalization and the State. New York (2001).

US Customs and Border Protection. “US Customs Service – Over 200 Years of History.” (2003) *Available at* <http://www.cbp.gov/xp/cgov/toolbox/about/history/history.xml> (last visited 6 June 2007).

US Embassy in Bangladesh, Bangladesh Country Commercial Guide 2003-2004, July 2003

United State Trade Representative. 1995 National Trade Estimate Report on Foreign Trade Barriers Washington D.C.

United States Trade Representative. 1999 National Trade Estimate Report on Foreign Trade Barriers Washington D.C.

United States Trade Representative. National Trade Estimate on Foreign Trade Barriers 2000 Washington D.C.

United States Trade Representative. 2002 National Trade Estimate Report on Foreign Trade Barriers Washington D.C.

United States Trade Representative. 2003 National Trade Estimate Report on Foreign Trade Barriers. Washington D.C. (2003).

United States Trade Representative. Foreign Trade Barriers Report 2005.

Van Der Geest, Willem (ed.) Negotiating Structural Adjustment in Africa, New York, UNDP (1994).

Van Rijckeghem, Caroline. & Weder, Beatrice. Bureaucratic Corruption and the Rate of Temptation: Do Wages in the Civil Services Affect Corruption, and by How Much? 65 *Journal of Development Economics* (2001).

Walsh, James, T. “Customs Valuation” in (ed.) Michael Keen Changing Customs Washington D.C. IMF (2003).

Walsh, James T. “The role of the Private Sector in Customs Administration” in (ed.) Michael Keen Changing Customs Washington D.C. IMF (2003)

Waweru, M.G. Commissioner general, KRA. “Tax Administration in Kenya: Problems

and Prospects” speech at the Federation of Kenya Employers (10 March 2004).

Widdowson, David. “Managing Risk in the Customs Context.” In Luc, De Wulf. & Jose B. Sokol, (ed.). Customs Modernization Handbook, Washington DC., World Bank, (2005).

World Bank “Bangladesh – Growth and Export Competitiveness” Report No. 31394-BD, Poverty Reduction and Economic Management Sector Unit/ South Asia region (4 May 2005).

World Bank, Doing Business 2006. *Available at* <http://www.doingbusiness.org/EconomyRankings/> (last visited 6 June 2007).

World Bank. “GNI per capita, Atlas Method” in World Development Indicators 2005. *Available at* <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GNIPC.pdf> (last visited 6 June 2007).

World Bank, “Implementation Completion Report on a Credit in the Amount of US\$ 32 Million to the Bangladesh for an Export Diversification Project” (15 April 2005).

World Bank “Needs, Priorities and Costs Associated with Technical Assistance and Capacity Building for Implementation of a WTO Trade facilitation Agreement – A Comparative Study Based on Six Developing Countries” (November 2006), presented at the World Bank seminar, organized at the WTO, 11 December 2006.

World Bank Report “Bangladesh Trade Liberalization, Its Pace and Impacts.” (23 November 1999).

World Bank. World Development Report 1993: Investing in Health. Washington DC (1993).

World Bank. World Development Report 1997: The State in a Changing World. Washington DC (1997).

World Customs Organization. “Annual Survey to Determine the Percentage of National Revenue Represented by Customs Duties” WCO HS Committee Document NC0806E1 (20 April 2004).

World Customs Organization. Commercial Fraud Typologies Summary. 2006, unpublished.

World Customs Organization. “Container Scanning Equipment – Guide to Members on Administrative Considerations of Purchase and Operation,” 2003.

World Customs Organization. Customs Valuation Considerations. Brussels (1999).

World Customs Organization. Kyoto Convention General Annex Guidelines, Chapter 9 “Information, Decisions and Rulings Supplied by Customs,” (2000).

World Customs Organization. www.wcoomd.org

World Trade Organization, Agreement on PSI.

World Trade Organization, Committee on Customs Valuation. Preshipment Inspection, Note from the Secretariat, G/VAL/W63 (31 March 2000).

World Trade Organization, Committee on Customs Valuation. Preshipment Inspection, Note from the Secretariat, G/VAL/W63/Rev.1 (30 March 2001).

World Trade Organization, Committee on Customs Valuation. Preshipment Inspection, Note from the Secretariat, G/VAL/W63/Rev.7 (12 June 2006).

World Trade Organization, Committee on Customs Valuation. Preshipment Inspection, Note from the Secretariat, G/VAL/W63/Rev.8 (September 2006).

World Trade Organization. Decision Adopted at the General Council on 1 August 2004, WT/L/579 (2 August 2004).

World Trade Organization. Minutes of the WTO Committee on Customs Valuation of 23 May and 22 July 2003, G/VAL/M/35 (30 September 2003).

World Trade Organization. Minutes of Trade Facilitation Negotiation Meeting of 7 June 2006, TN/TF/M/14

World Trade Organization Negotiating Group on Trade Facilitation Submission by EU, Chinese Taipei and Switzerland, TN/TF/W/109 (1 June 2006).

World Trade Organization. Report of the Working Party on Preshipment Inspection to the General Council, G/L/214 (1997).

World Trade Organization. Technical Committee on Customs Valuation Response to the Terms of Reference for the Work of the Technical Committee on Customs Valuation in Connection with Concerns on the Accuracy of Declared Value G/VAL/54 (16 May 2003).

World Trade Organization. Technical Committee on Customs Valuation Response to the Terms of Reference for the Work of the Technical Committee on Customs Valuation in Connection with Concerns on the Accuracy of Declared Value - Supplement G/VAL/54Suppl. 1 (13 October 2004).

World Trade Organization. Trade Policy Review – Bangladesh – Secretariat’s Report, 13,

May 2000, WT/TPR/S/68.

World Trade Organization. Trade Policy Review – Bangladesh – Secretariat's Report, 7, August 2006 WT/TPR/S/168.

World Trade Organization Trade Policy Review – East African Community Secretariat's Report Annex 1 Kenya WT/TPR/S/171/KEN (20 Sept 2006)

World Trade Organization. Trade Policy Review, The Philippines, Report by Secretariat, August 1999, WT/TPR/S/59

World Trade Organization. Trade Policy Review – the Philippines – Report by the Secretariat (21 July 2005) WT/TPR/S/149/Rev. 1.

World Trade Organization Trade Policy Review, Togo, Report by the Secretariat (10 Dec 1999), WT/TOR/S/48

World Trade Organization. Trade Policy Review – Togo – Secretariat's Report, WT/TPR/S/166/Rev.1 (September 2006).

World Trade Organization. Report of the Working Party on Preshipment Inspection G/L/300 (25 March 1999)

World Trade Organization. Working Party on Preshipment Inspection – Minutes of the Meeting of 6 and 8 October 1998 WTO document G/PSI/WP/M/7 (12 November 1998).

World Trade Organization, Working Party on Preshipment Inspection – Minutes of the Meeting of 11 November 1998 G/PSI/WR/M/8 (23 December 1998).

World Trade Organization, Working Party on Preshipment Inspection. “National Experience with the Agreement on Preshipment Inspection, Submission by Kenya.” G/PSI/WP/W/14 (Oct 1997).

World Trade Organization, Working Party on Preshipment Inspection. “National Experience with the Agreement on Preshipment Inspection – Submission by the Philippines” (29 May 1997) G/PSI/WP/W/4.

World Trade Organization Secretariat. The Doha Decision Explained. Available at <http://www.wto.org/english/tratop_e/dda_e/implement_explained_e.htm> (last visited 6 June 2007).

Yang, Dean. “Can Enforcement Backfire? Crime Displacement in the Context of Customs Reform in the Philippines.” (Sept 2006) Accepted for publication in *The Review of Economics and Statistics*. Available at http://www-personal.umich.edu/~deanyang/papers/yang_displacement.pdf (last visited

6 June 2007).