CUSTOMS PARTNERSHIPS: A TWO-WAY STREET

Paper presented to the European Customs Conference

Organised by the European Forum for Foreign Trade, Customs and Excise

Bonn, Germany

10 June 2005

David Widdowson[1]

A key element of contemporary regulatory compliance management is the emphasis on establishing a relationship between industry and customs that is based on partnership and trust. That is, a relationship which reflects a mutual commitment to accountability and improving compliance. Such partnerships, by definition, must be a two-way proposition, since a partnership implies two or more parties working together in order to achieve common goals and objectives. This paper examines the degree to which the partnership approach may be used to effectively manage regulatory compliance.

Needs and expectations

Customs administrations around the world are responsible for managing a broad range of risks as they seek to fulfil their responsibilities in areas such as revenue collection, the administration of trade policies and border controls, community protection, and the facilitation of trade. Often, they are required to also manage risks on behalf of other government departments and agencies with policy responsibility for areas such as health, immigration, agriculture, trade, environment, and trade statistics. This is usually achieved through the implementation of a diverse range of agreed control regimes, with customs having responsibility for the administration and enforcement of relevant regulatory requirements at the point of importation and exportation. These 'border control' responsibilities stem from the more traditional customs role of collecting duties on internationally traded commodities at the point of importation and exportation.

Import and export duties have been with us since Romans times, and no doubt the 'customs officials' of the day had a responsibility to ensure that the right amount of duties was collected, and that would-be smugglers were brought to account. It would also be fair to assume that a few officials also sought to collect a little extra for their own pockets. On the other side of the counter, there would have been many honest traders who would render to Caesar that which was Caesar's, and some not so honest traders who would seek to render as little as possible. Therefore, it is probable that the Romans faced the same types of challenges that are being faced by customs administrations around the world today - customs officials seeking to ensure that the law is upheld; traders seeking uninhibited passage of their cargoes; and honest traders seeking recognition of their good track record of compliance.

---

[1] Dr David Widdowson is CEO of the Centre for Customs and Excise Studies and Adjunct Professor in the School of Law, University of Canberra, Australia.

What has changed, and changed dramatically, is the trading environment – the manner in which goods are carried and traded, the speed of such transactions, and the sheer volume of goods that are traded around the globe. In the past few decades, there have been a number of significant changes in global trading practices which have caused both regulators and the trading community to continually adapt their methods of operation in an effort to maintain their effectiveness and relevance. The emergence of wide-bodied aircraft, shipping containers, e-commerce, the increasing complexities of international trade agreements, and the threat of terrorism have all affected the way in which international trade is conducted and regulated.

Nevertheless, the basic elements of customs administration remain essentially the same – government officials are seeking to enforce the law and traders are seeking to minimise government intervention. In any examination of customs policy and practice, it is important to recognise these differing needs and expectations of customs and the business community.

On the one hand, traders are looking for the simplest, quickest, cheapest, and most reliable way of getting goods into and out of the country. They are looking for certainty, clarity, flexibility, and timeliness in their dealings with customs. They are also looking for the most cost-effective ways of doing business. Customs authorities, on the other hand, are seeking to prevent smuggling, detect contraband, and ensure compliance with revenue, licensing and other legal requirements; and they, too, are looking for the most cost-effective ways of doing business. Consequently, traders are driven by commercial imperatives, while customs organisations are primarily driven by the law. What customs administrations are now seeking to achieve is an appropriate balance between trade facilitation and regulatory control.

Facilitation and control

Achieving this balance between trade facilitation and regulatory control can provide significant flow-on benefits for national economies. Consequently, the issue of trade facilitation has been added to the WTO agenda, with many countries now re-assessing their legislative and administrative approach to the regulation of international trade.

In particular, the Doha Ministerial Declaration and subsequent decisions of the General Council of the WTO have sought to intensify international commitment to further expedite the movement, release, and clearance of internationally traded goods, including goods in transit. The success of the trade facilitation agenda is heavily reliant on the ability of customs administrations to achieve an appropriate balance between facilitation and regulatory control, particularly in the current climate of heightened international security concerns.

Specifically, the Singapore Ministerial Declaration directed the Council for Trade in Goods to ‘undertake exploratory and analytical work, drawing on the work of other

relevant international organizations, on the simplification of trade procedures in order to assess the scope for WTO rules in this area.[2]

Following extensive consultation with commerce and industry, the WTO identified the following broad areas of concern at the international level:[3]

- excessive government documentation requirements
- lack of automation and insignificant use of information technology
- lack of transparency: unclear and unspecified import and export requirements
- inadequate customs procedures; particularly audit-based controls and risk assessment techniques
- lack of co-operation and modernisation amongst customs and other government agencies, which impedes efforts to deal effectively with increased trade flows.

The concerns identified by the WTO serve to highlight a number of potential weaknesses in the way in which governments, and more specifically customs administrations, approach the task of monitoring and regulating international trade. According to the WTO, the costs of import tariffs are often exceeded by the losses incurred by the international trading community as a result of slow clearance procedures, opaque and unnecessary documentary requirements, and lack of automated procedural requirements. [4]

The nature of the issues identified by the WTO may be considered to fall into a number of broad categories, including statutory requirements (e.g. government requirements, transparent regulatory provisions, clearly specified import and export requirements); administrative requirements (e.g. documentation requirements, clear administrative procedures, audit-based controls and administrative cooperation); technological capabilities (e.g. automation and use of information technology); and risk management practices (e.g. audit-based controls and risk assessment techniques).

International blueprint

In June 1999, the Council of the WCO approved the revised International Convention on the Simplification and Harmonization of Customs Procedures (the Revised Kyoto Convention) which seeks to address concerns such as those raised by the WTO. The Convention has been developed in the face of mounting pressure from the international trading community to minimise the level of customs intervention in cargo movements, and to maximise the level of trade facilitation. Since the time of its inception, of course, international events have placed further pressures on security aspects of the international supply chain.

[2] Paragraph 21 of the Singapore Ministerial Declaration, adopted on 13 December 1996.
[3] Statement by the Chairman of the Council for Trade in Goods on 18 March 1998, summarising the outcome of the WTO Trade Facilitation Symposium held in Geneva, 9-10 March 1998.
[4] World Trade Organization 2002, *Trade facilitation: overview of trade facilitation work,* World Trade Organization, available at: <www.wto.org/english/tratop_e/ tradfa_e/tradfac2_e.htm>.

According to the WCO, the Convention represents the international blueprint for prudent, innovative customs management, and is designed to maintain the relevance of customs procedures at a time when technological developments are revolutionising the world of international trade and travel.[5]

In describing the key provisions of the Convention, the WCO comments that the General Annex to the Convention recommends that a modern customs administration should implement standard, simplified procedures; continuous development and improvement of Customs control techniques; maximum use of information technology; and a *partnership approach between Customs and Trade* (emphasis added).[6]

Interestingly, the Convention itself doesn't actually refer to the concept of partnerships, although the general intent of the WCO may be gleaned from one of the Convention's General Principles:

> The Customs shall institute and maintain formal consultative relationships with the trade to increase co-operation and facilitate participation in establishing the most effective methods of working commensurate with national provisions and international agreements.[7]

Many customs administrations are now adopting the so-called partnership approach and, increasingly, the concept is being incorporated into national legislation. In South Africa, for example, statutory provisions have been introduced that allow the Commissioner of Customs to confer accredited client status on certain members of the trading community, and to enter into individual agreements with them.

Risk management

Through the provisions of the revised Kyoto Convention, the WCO is attempting to achieve universal adoption of a risk-managed style of regulatory compliance, the underlying elements of which are summarised in Table 1. The table compares key elements of a risk-managed style of compliance management with the more traditional 'gatekeeper' style, which is typically characterised by indiscriminate customs intervention or a regime of 100 per cent checks. Similarly, payment of duties and other taxes is a prerequisite for customs clearance under the gatekeeper model, and such clearance is invariably withheld until all formalities and real-time transactional checks are completed.

[5] World Customs Organization 2002, *Kyoto 2000: The International Convention on the Simplification and Harmonization of Customs procedures (Revised) - pathway to efficiency and effectiveness in the customs environment,* World Customs Organization, Brussels.
[6] A brief overview of the Revised Kyoto Convention, *The Kyoto Convention: customs contributing to the development of international trade,* can be found on the WCO website: <www.wcoomd.org>.
[7] Standard 1.3.

Table 1: Compliance Management Styles[8]

	Traditional 'Gatekeeper' Style	↔	**Risk Management Style**
Legislative Framework	Legislative base provides for a 'one size fits all' approach to compliance management	↔	Legislative base provides for flexibility and tailored solutions to enable relevant risk management & administrative strategies to be implemented
	Onus for achieving regulatory compliance is placed solely on the trading community	↔	Legislative base recognises responsibilities for both government & the trading community in achieving regulatory compliance
	Sanctions for non-compliers	↔	Sanctions for non-compliers
Administrative Framework	'One size fits all' compliance strategy	↔	Strategy dependent upon level of risk
	Control focus	↔	Balance between regulatory control and trade facilitation
	Enforcement focus	↔	Dual enforcement/client service focus
	Unilateral approach	↔	Consultative, cooperative approach
	Focus on assessing the veracity of transactions	↔	Focus on assessing the integrity of trader systems and procedures
	Inflexible procedures	↔	Administrative discretion
	Focus on real-time intervention and compliance assessment	↔	Increased focus on post-transaction compliance assessment
	Lack of/ineffective appeal mechanisms	↔	Effective appeal mechanisms
Risk Management Framework	Indiscriminate intervention or 100% check	↔	Focus on high-risk areas, with minimal intervention in low risk areas
	Physical control focus	↔	Information management focus
	Focus on identifying non-compliance	↔	Focus on identifying both compliance and non-compliance
	Post-arrival import clearance	↔	Pre-arrival import clearance
	Physical control maintained pending revenue payment	↔	Breaks nexus between physical control and revenue liability
	No special benefits for recognised compliers	↔	Rewards for recognised compliers

Enablers

IT Framework	Legislative provisions provide the trading community with electronic as well as paper-based reporting, storage and authentication options. Such provisions should enable regulators to rely on commercially-generated data to the greatest extent possible
	Appropriate communications and information technology infrastructure to provide for automated processing and clearance arrangements. Regulators should seek to achieve maximum integration with commercial systems
	Consultative business process re-engineering prior to automation

[8] Widdowson, David 2004, 'Managing risk in the customs context', in Luc De Wolf & Jose B Sokol (eds), *Customs modernization handbook,* World Bank, Washington, DC, pp. 91-99.

A risk-managed approach, on the other hand, is characterised by the identification of potentially high-risk areas, with resources being directed towards such areas, and minimal intervention in similarly identified low-risk areas. Such regimes adopt strategies that break the nexus between physical control over goods and a trader's revenue liability, and permit customs clearance to be granted prior to the arrival of cargo.

The various elements of each style of compliance management can be broadly grouped into four main categories: a country's legislative framework, the administrative framework of a country's customs organisation, the type of risk management framework adopted by a country's customs organisation, and the available technological framework. Collectively, the four categories represent key determinants of the manner in which the movement of cargo may be expedited across a country's borders, and the way in which customs control may be exercised over such cargo.

An appropriate legislative framework is an essential element of any regulatory regime, since the primary role of customs is to ensure compliance with the law. Regardless of the compliance management approach that it is supporting, the legislative framework must provide the necessary basis in law for the achievement of the range of administrative and risk management strategies which the administration chooses to adopt.

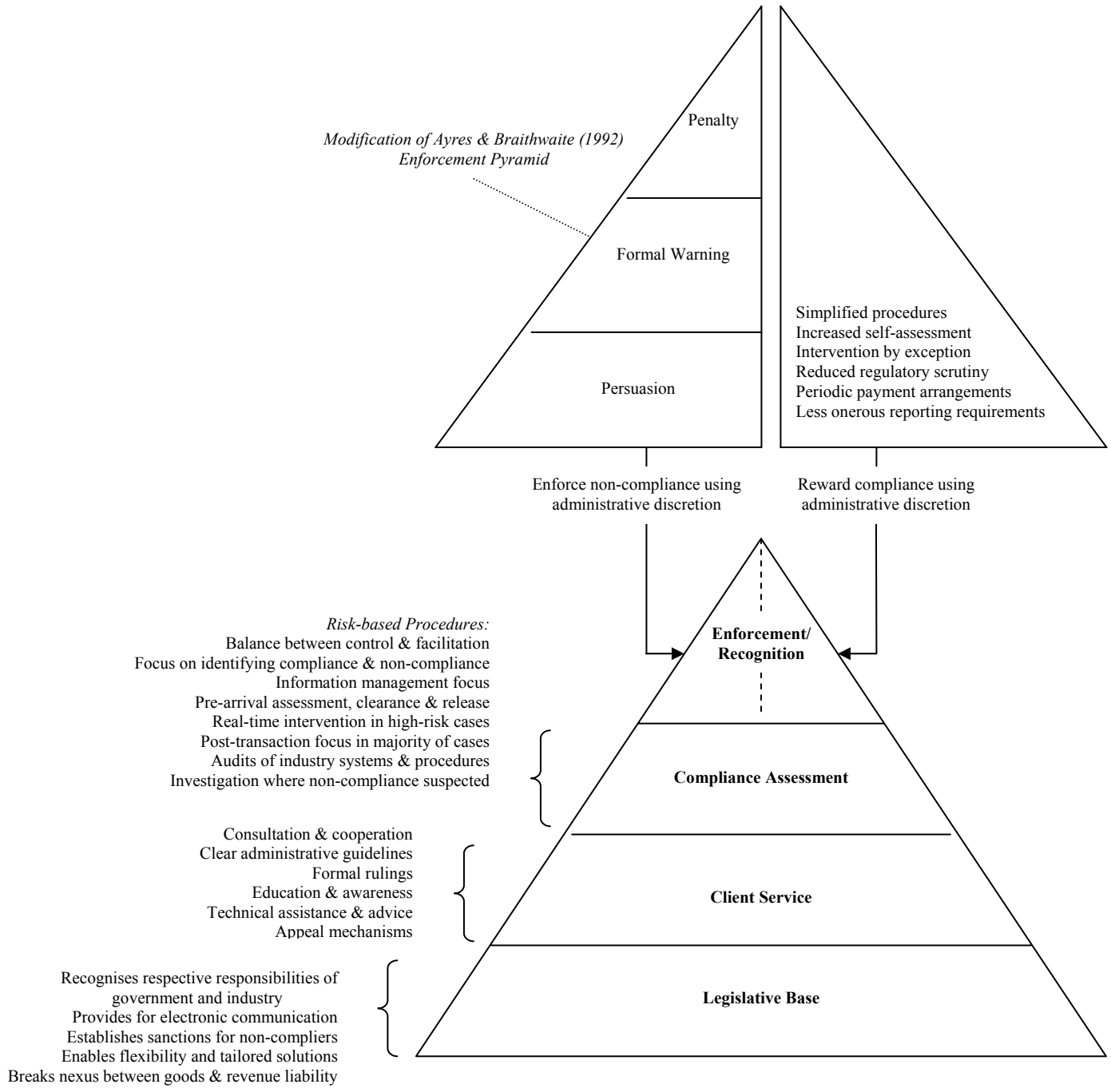
Underpinned by the relevant legal provisions, the various elements of the administrative and risk management frameworks employed by customs reflect the underlying style of compliance management being pursued by the administration, with an increasing manifestation of the adoption of risk management principles as the administration moves away from the traditional, risk-averse 'gatekeeper' style of compliance management to a more risk-based approach.

The available technological framework represents an enabler which, while not critical to the achievement of a risk management style, serves to enhance significantly an administration's ability to adopt such a style.

Achieving the balance

The Risk-based Compliance Management Pyramid (see Figure 1) draws together the various elements of a risk management style (i.e. those on the right hand side of Table 1) to provide a structured approach to the management of compliance. It provides a logical framework for demonstrating the way in which various types of risk-based strategies, including non-enforcement strategies such as self-assessment, may be used to effectively manage compliance.

Figure 1: Risk-based Compliance Management Pyramid[9]



[9] Widdowson, David 2004, 'Managing risk in the customs context', in Luc De Wolf & Jose B Sokol (eds), *Customs modernization handbook,* World Bank, Washington, DC, p. 96.

Fundamental to this approach is the need to provide the commercial sector with the ability to comply with customs requirements. This involves establishing an effective legislative base (the first tier of the pyramid) and an appropriate range of client service strategies (the second tier), including effective consultation arrangements and clear administrative guidelines. Such strategies are necessary to provide the commercial sector with the means to achieve certainty and clarity in assessing their liabilities and entitlements.

At the third tier of the pyramid, the elements of compliance assessment come into play, including risk-based physical and documentary checks, audits, and investigations. Such activities are designed to determine whether a trader is in compliance with customs law.

At the peak of the pyramid are strategies to address both identified non-compliers and recognised compliers. Strategies for the identified non-compliers include a range of enforcement strategies,[10] whilst strategies for the recognised compliers include increased levels of self-assessment, reduced regulatory scrutiny, less onerous reporting requirements, periodic payment arrangements, and increased levels of facilitation. The strategies for recognised compliers may be formalised in a *partnership arrangement* between customs and industry (see 'Partnership approach').

In the process of assessing the level of compliance, customs will encounter two situations, that is, compliance and non-compliance. The non-compliance spectrum will, in turn, range from innocent mistakes to blatant fraud. If the error nears the fraudulent end of the spectrum, some form of sanction will need to apply, including administrative penalties or, in the more severe cases, prosecution and licence revocation.

Before determining the need for or nature of a sanction, however, it is important to identify the true nature of the risk by establishing why the error has occurred. For example, the error may be the result of a control problem within the company, due to flawed systems and procedures, or it may be the result of a deliberate attempt to defraud. On the other hand, the relevant legislation may be unclear or the administrative requirements may be ambiguous. The type of mitigation strategy that customs should employ to ensure future compliance will depend on the nature of the identified risk. Unless the error is found to be intentional, it may be appropriate to address systemic problems within the company, or to provide the company (or perhaps an entire industry sector) with advice on compliance issues, or provide formal clarification of the law through binding rulings or other means.[11]

In this regard, it is important to recognize that different solutions will be required to address 'honest mistakes' on the one hand, and deliberate attempts to evade duty on the other. For example, industry familiarisation seminars and information brochures may

[10] See Ayres, Ian & Braithwaite, John 1992, *Responsive regulation: transcending the deregulation debate,* Oxford University Press, New York.
[11] See Widdowson, David 1998, 'Managing compliance: more carrot, less stick', in Chris Evans & Abe Greenbaum (eds), *Tax administration: facing the challenges of the future,* Prospect, Sydney, pp. 99-104.

adequately address errors that result from a lack of understanding of the relevant regulatory provisions. However, if someone is actively seeking to commit revenue fraud, seminars and information brochures will have absolutely no impact on their activities. Indeed, such members of the trading community are likely to have a very good understanding of their obligations and entitlements. To treat the risks posed by such individuals (or organisations, for that matter), a rigorous enforcement approach is likely to be required.

Partnership approach

The introduction of an industry partnership concept is based on the premise that companies with a good record of compliance require less regulatory scrutiny than those with a history of poor compliance. A key element of the strategy seeks to provide highly compliant companies with more latitude to self-assess their revenue liability, by relying primarily on their internal accounting systems and procedures. This, in turn, provides compliant companies with a high degree of flexibility in the way in which they demonstrate their compliance with the relevant regulatory provisions. From a customs perspective, a key benefit of such an approach is the willingness displayed by industry to invest in those systems and procedures which impact on their compliance levels, in order to achieve the benefits of the partnership arrangements.[12]

The effectiveness of such arrangements hinges on a working relationship between customs and industry that is based on partnership and trust. That is, a relationship which reflects a mutual commitment to accountability and improving compliance. Such partnerships must be a two-way proposition, with costs and responsibilities for both parties. Companies which propose to enter into such partnerships are generally required to transmit electronically import and export information to customs, demonstrate a history of providing customs with accurate and timely information about their transactions, establish a good record of compliance with the import and export requirements of other relevant government agencies, and demonstrate that their in-house systems and procedures will ensure that their established compliance record will continue. Generally, this requires them to open their operations to analysis by customs auditors, and advise customs of any changes to their systems or operations which may impact on the initial customs assessment of their level of compliance.

On the other side of the partnership equation, customs administrations should seek to create an environment in which companies can maximise their entitlements, and meet their obligations for revenue payment and trade compliance with minimal commercial impact. Equally, they should provide companies with the means to achieve certainty and clarity in assessing their liabilities and entitlements, to allow them to conduct subsequent business without fear of additional imposts after the transaction is concluded and the opportunity to recover costs has passed. In other words, no unpleasant surprises.[13]

[12] See Widdowson 1998.
[13] See Widdowson 1998.

Consistent with the cooperative, consultative approach which a partnership program is intended to achieve, industry should be invited to play a major role in identifying the range of incentives which may be made available under such an arrangement. Such incentives usually include facilitated clearance arrangements, an entitlement to self-assess, reduced regulatory scrutiny, and the ability to report cargo and pay duties and taxes on a periodic basis. The ability to account for cargo and acquit duty liability on a periodic basis can provide significant commercial benefits to traders who import thousands of consignments a year, and who may have previously been required to report each transaction to customs on a shipment-by-shipment basis.

Provided such outcomes can be achieved for the mutual benefit of both customs and industry, the partnership approach is destined to succeed. However, if the anticipated benefits fail to materialise for either one of the parties, the relationship is likely to sour, particularly when would-be participants have made a significant investment in the initiative. Given that one of the parties to such a partnership is a regulatory authority, it is hardly surprising to learn that the benefits which fail to materialise are generally to the detriment of industry. For example, concerns have been raised over the Australian Accredited Client Program's failure to deliver on key benefits that were initially envisaged.

Conclusions

Achievement of the international trade facilitation agenda is heavily dependent upon the ability of customs administrations to reduce the regulatory impost on the international trading community, whilst achieving and maintaining appropriate levels of control. Recognising the different needs and expectations of customs and the business community, the WCO encourages its members to implement a partnership approach between customs and industry by introducing a risk-managed style of regulatory compliance. Such an approach is an effective way in which customs may regulate highly compliant members of the international trading community, provided the theory is properly translated into operational reality.