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## RAISING THE PORTCULLIS

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The portcullis is the traditional symbol of Customs. It is a symbolic representation of a nation's ports, that is, the gates through which international trade must pass. For centuries, the role of gatekeeper has fallen to Customs<sup>2</sup>.

The Customs Co-operation Council (now known as the World Customs Organization), was an early proponent of the need for Customs authorities to reconsider their traditional approach to international trade control and to abandon the 'gatekeeper' mentality that has dominated their thinking for hundreds of years<sup>3</sup>. Such a mentality often sees Customs intervene in commercial transactions simply for the sake of intervention. They have the authority to do so, and no one is keen to question that authority.

In this day and age, however, social expectations no longer accept the concept of intervention for intervention's sake. Rather, the current catch-cry is *intervention by exception*. Intervention when there is a legitimate need to do so. Intervention based on identified risk.

At the same time, the trade facilitation agenda is gaining increasing momentum, as 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 agenda is heavily reliant on the ability of Customs to raise the portcullis in an effort to achieve an effective balance between trade facilitation and regulatory intervention. This paper examines the fundamental elements of the reform process.

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<sup>2</sup> See for example Pond, C.C. 1992 *The Portcullis*, Factsheet No.12, Public Information Office, House of Commons, London.

<sup>3</sup> See for example Hayes, T. 1993 *Can EDI Eliminate Customs?* Address by Mr T.P. Hayes, AO, Secretary General, Customs Co-operation Council, to the Pan-Asian EDI Summit, Kuala Lumpur, Malaysia, July.

## **Facilitation and Control**

Customs administrations around the world are responsible for implementing a broad range of government policies in areas as diverse as revenue collection, trade compliance and facilitation, protection of society, cultural heritage, intellectual property, collection of statistics and environmental protection.

Some such responsibilities are often carried out on behalf of other government ministries and agencies, 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.

The underlying principles governing the effective management of such responsibilities are no different from those applying to any other form of management. The uniqueness of Customs management stems from the context in which the various management responsibilities are performed, including the regulatory and commercial environment in which Customs operates.

It has been suggested that import and export duties were first introduced by the Romans<sup>4</sup> and no doubt the Customs officials of the day had a responsibility to ensure that the right amount of duties were collected and that would-be smugglers were brought to account. It would be a fair assumption that a few officials also sought to collect a little extra for their own pockets. On the other side of the counter 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. It is therefore 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.

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 and Customs administrations around the world have been required to continually adapt their methods of operation in an effort to maintain their effectiveness and relevance. For example, the emergence of wide-bodied aircraft, shipping containers, e-commerce and the increasing complexities of international trade agreements have all impacted on the way in which Customs administrations have fulfilled their responsibilities, and Customs administrations world-wide have seen a dramatic increase in workload across all areas of activity, fuelled by the

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<sup>4</sup> See Smith, G (1980) *Something to Declare*. George G. Harrap Co., London.

technological advances that have revolutionised trade and transport. 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.

When examining the issues of trade facilitation and regulatory control, it is therefore 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 the facilitation of trade and regulatory intervention

### **WTO Trade Facilitation Agenda**

Achieving such a balance can provide significant flow-on benefits for national economies, and the issue of trade facilitation has consequently been added to the WTO agenda, with many countries now re-assessing their legislative and administrative approach to the regulation of international trade. 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”.<sup>5</sup>

Following extensive consultation with commerce and industry, the WTO identified the following broad areas of concern at the international level:<sup>6</sup>

- 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, and
- lack of co-operation and modernisation amongst Customs and other government agencies, which impedes efforts to deal effectively with increased trade flows.

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<sup>5</sup> Paragraph 21 of the Singapore Ministerial Declaration, adopted on 13 December 1996.

<sup>6</sup> 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.

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.<sup>7</sup>

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).

The Doha Ministerial Declaration included the following decision in relation to trade facilitation:

Recognizing the case for further expediting the movement, release and clearance of goods, including goods in transit, and the need for enhanced technical assistance and capacity building in this area, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations. In the period until the Fifth Session, the Council for Trade in Goods shall review and as appropriate, clarify and improve relevant aspects of Articles V, VIII and X of the GATT 1994 and identify the trade facilitation needs and priorities of members, in particular developing and least-developed countries. We commit ourselves to ensuring adequate technical assistance and support for capacity building in this area.<sup>8</sup>

The Articles referred to relate to Freedom of Transit (Article V), Fees and Formalities connected with Importation and Exportation (Article VIII) and Publication and Administration of Trade Regulations (Article X).

The fifth Ministerial Conference, which was held in Cancún, Mexico in September 2003, was unsuccessful in achieving agreement on these matters. However, it was subsequently decided that negotiations on trade facilitation would continue, and on 31 July 2004 the General Council agreed to adopt the 'July Package' that will now guide the next phase of the WTO Doha Round negotiations. It includes:

Trade Facilitation: taking note of the work done on trade facilitation by the Council for Trade in Goods under the mandate in paragraph 27 of the Doha

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<sup>7</sup> World Trade Organization (2002) *Trade Facilitation: Overview of Trade Facilitation Work*. World Trade Organization, [www.wto.org/english/tratop\\_e/tradfa\\_e/tradfac2\\_e.htm](http://www.wto.org/english/tratop_e/tradfa_e/tradfac2_e.htm)

<sup>8</sup> Paragraph 27 of the Doha Ministerial Declaration, adopted on 14 November 2001.

Ministerial Declaration and the work carried out under the auspices of the General Council both prior to the Fifth Ministerial Conference and after its conclusion, the General Council decides by explicit consensus to commence negotiations on the basis of the modalities set out in Annex D to this document.<sup>9</sup>

Annex D requires a negotiating group on trade facilitation to aim to clarify and improve relevant aspects of Articles V, VIII and X with a view to further expediting the movement, release and clearance of goods, including goods in transit. It also requires the group to aim to enhance technical assistance and support for capacity building in the area of trade facilitation, recognising in particular that developing and least-developed countries are dependent upon technical assistance and support for capacity building if they are to fully participate in and benefit from the negotiations.

WTO Members have since put forward a broad range of proposals in response to the Annex D requirement, in an effort to clarify and improve the GATT Articles<sup>10</sup>.

### **WCO Reform Agenda**

For some years now the issues identified by the WTO have been high on the agenda of the WCO, as evidenced by the provisions of the revised International Convention on the Simplification and Harmonization of Customs Procedures (the revised Kyoto Convention). The Convention, which entered into force on 3 February 2006, is described by the WCO as 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<sup>11</sup>.

Essentially, the Convention is intended to promote the achievement of a highly facilitative international travel and trading environment while maintaining appropriate levels of regulatory control across all member administrations. It is designed to provide the underlying conditions and instruments to help contracting parties to achieve a modern Customs administration and to make a major contribution to the facilitation of international trade by:

- eliminating divergence between the Customs procedures and practices of contracting parties that can hamper international trade and other international exchanges,
- meeting the needs of both international trade and Customs authorities for facilitation, simplification and harmonisation of Customs procedures and practices,
- ensuring appropriate standards of Customs control,

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<sup>9</sup> Paragraph (g) of the decision adopted by the General Council of the WTO on 1 August 2004.

<sup>10</sup> These proposals have been compiled by the WTO in document TN/TF/W/43 (as revised).

<sup>11</sup> 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.

- enabling Customs authorities to respond to major changes in business and administrative methods and techniques,
- ensuring that the core principles for simplification and harmonisation are made obligatory on contracting parties, and
- providing Customs authorities with efficient procedures, supported by appropriate and effective control methods<sup>12</sup>

The development of the revised Kyoto Convention has incorporated important concepts of contemporary compliance management. These include the application of new technology, the implementation of new philosophies on Customs control and a willingness to engage private sector partners in mutually beneficial alliances with Customs authorities. Central to the new governing principles of the Convention is a required commitment by Customs administrations to provide transparency and predictability for all those involved in aspects of international trade. In addition, administrations are required to:

- commit to adopt the use of risk management techniques,
- co-operate with other relevant authorities and trade communities,
- maximise the use of information technology, and
- implement appropriate international standards.

In relation to the concept of Customs control, the WCO states:

The principle of Customs control is the proper application of Customs laws and compliance with other legal and regulatory requirements, with maximum facilitation of international trade and travel.

Customs controls should therefore be kept to the minimum necessary to meet the main objectives and should be carried out on a selective basis using risk management techniques to the greatest extent possible.

Application of the principle of Customs controls will allow Customs administrations to:

- focus on high-risk areas and therefore ensure more effective use of available resources,
- increase ability to detect offences and non-compliant traders and travellers,
- offer compliant traders and travellers greater facilitation, and
- expedite trade and travel.<sup>13</sup>

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<sup>12</sup> World Customs Organization (1999) *International Convention on the Harmonization and Simplification of Customs Procedures (as amended)*, General Annex, Standard 6.2, Brussels, known as the revised Kyoto Convention.

<sup>13</sup> Revised Kyoto Convention, Ch.6, p.9.

It is considered that the GATT Articles and the Standards of the revised Kyoto Convention are fully compatible. As stated by the WCO:

All the legal provisions and the principles in the WCO instruments are compatible with, and complementary to, the three GATT Articles referred to in the context of trade facilitation in the Doha Ministerial Declaration. There is a clear recognition that Customs procedures and their implementation exert a great impact on world trade and the international movement of goods across borders.

The GATT Articles set out the high principles for formalities and procedures for movement of goods, transit of goods and publication and administration of trade regulations. On the other hand, the instruments of the WCO - including the Kyoto Convention through its legal provisions and implementation guidelines - provide the basis and practical guidance and information for the implementation of these high principles.<sup>14</sup>

For this reason, a key initiative of many international organisations in their efforts to progress the trade facilitation agenda has been to promote full compliance with and accession to the revised Kyoto Convention.

### **Achieving the Balance**

In seeking to manage compliance in a way which provides an appropriate balance between regulatory intervention and trade facilitation, Customs must simultaneously manage two risks – the potential for non-compliance with relevant laws, and the potential failure to provide the level of facilitation expected by their Government.

It is a commonly held belief that facilitation and control sit at opposite ends of a continuum, and it is often assumed that, as the level of facilitation increases, so the level of control decreases. Similarly, where regulatory controls are tightened, it is commonly assumed that facilitation must suffer as a result. This is an extremely simplistic view as it assumes that the only way in which a process may be facilitated is by loosening the reigns of control. Such a contention is fundamentally flawed, as the concepts of facilitation and control represent two distinct variables, and consequently it is possible to achieve high levels of both.

Effective application of the principles of risk management is the key to achieving a balance between facilitation and regulatory control and, as an agency's use of risk management becomes more effective (for example, through a more systematic and sophisticated application of the principles of risk management), an appropriate balance becomes more achievable.

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<sup>14</sup> Trade Facilitation Issues in the Doha Ministerial Declaration Review of the GATT Articles, Article X: Communication from the WCO to the Council for Trade in Goods dated 11 July 2002.

The underlying elements of a risk-based compliance management strategy have been well documented<sup>15</sup>, and contrast starkly with the elements of the traditional 'gatekeeper' style, which typically include:

- Legislative base provides for a 'one size fits all' approach to compliance management
- Onus for achieving regulatory compliance is placed solely on the trading community
- 'One size fits all' compliance strategy
- Control focus
- Enforcement focus
- Unilateral, 'dictatorial' approach
- Focus on assessing the veracity of individual transactions
- Inflexible procedures
- Focus on real-time intervention and compliance assessment
- Lack of/ineffective appeal mechanisms
- Indiscriminate intervention or 100% check
- Physical control focus
- Focus on identifying non-compliance
- Post-arrival import clearance
- Physical control maintained pending revenue payment
- No special benefits for recognised compliers.

A risk-managed approach, on the other hand, has the following characteristics:

- Legislative base provides for flexibility and tailored solutions to enable relevant risk management & administrative strategies to be implemented
- Legislative base recognises responsibilities for both government & the trading community in achieving regulatory compliance
- Strategy dependent upon level of risk
- Balance between regulatory intervention and trade facilitation
- Dual enforcement/client service focus
- Consultative, cooperative approach
- Focus on assessing the integrity of trader systems and procedures
- Administrative discretion

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<sup>15</sup> See Widdowson, D. (2004) 'Managing Risk in the Customs Context' pp. 91-99, in: Luc De Wolf & Jose B Sokol (eds) *Customs Modernization Handbook*. World Bank, Washington DC.

- Increased focus on post-transaction compliance assessment
- Effective appeal mechanisms
- Focus on high-risk areas, with minimal intervention in low risk areas
- Information management focus
- Focus on identifying both compliance and non-compliance
- Pre-arrival import clearance
- Breaks nexus between physical control and revenue liability
- Rewards for recognised compliers.

The various elements of each style of compliance management can be broadly grouped into four main categories, comprising 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 has chosen to adopt. For example, an appropriate basis in law must exist to enable Customs to break the nexus between its physical control over internationally traded goods and the revenue liability (i.e. Customs duty and other taxes) that such goods may attract. This does not necessarily imply, however, that such a differentiation must be explicitly addressed in the relevant statutory provisions. For example, if the legislation itself is silent on the relationship between Customs control over cargo and revenue liability, sufficient scope is likely to exist for administratively flexible solutions to be implemented.
- Underpinned by the relevant legal provisions, the various elements of the administrative and risk management frameworks employed by Customs essentially 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 essentially represents an enabler which, while not critical to the achievement of a risk management style, serves to enhance significantly the effectiveness and efficiency of risk- based compliance management.

## **Two Key Elements**

A fundamental element of a risk-based compliance management approach is the need to balance enforcement with client service. In calling for an urgent international process of regulatory reform, the OECD stated that such reform should include more flexible approaches to regulatory compliance management, with the longer-term goal of shifting governments “from a culture of control to a culture of client service”<sup>16</sup>. Such a cultural shift requires regulatory authorities to accept the view that strategies other than control strategies represent legitimate means of mitigating the risk of non-compliance.

While this is but one of the many elements of a risk-based compliance management strategy, it is critical to achieving an effective balance between facilitation and regulatory intervention. Indeed, it is of critical importance to ensure that the commercial sector is provided with the ability to comply with Customs requirements. They need to know the rules. If they don’t know, then how can they be expected to comply? While ignorance of the law may be no excuse, it explains many instances of non-compliance, and consequently the need to provide meaningful advice to those who are being regulated is essential.

Another key element, and one which is often overlooked, is the need to focus on identifying both compliance and non-compliance. Traditionally, Customs administrations have tended not to focus on compliers, mainly because the only recognised ‘result’ of compliance assessment activities has been the identification of non-compliance, together with the associated enforcement action (such as prosecution and/or monetary sanction). The saying, “if it isn’t counted, it won’t get done” applies aptly to this situation – in other words, if management focus is solely on the identification of non-compliers, then the identification of compliant traders will not be considered to be important by their staff.

However, for every complier that is identified, the population of non-compliers must reduce by one. Furthermore, if a significant company (e.g. a major importer, exporter, manufacturer, etc.) is identified as being highly compliant, the overall consequence of potential non-compliance will reduce significantly. That is why some administrations direct a significant compliance assessment effort towards their top 100 companies (in terms of significance to their regulatory charter). Assessing the compliance levels of such companies, regardless of the result, provides administrations with a clearer picture of compliance levels and the potential impact of non-compliance. This in turn greatly assists in determining where future compliance resources should be directed.

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<sup>16</sup> OECD (1997) *Report on Regulatory Reform: Synthesis*. Organization for Economic Cooperation and Development, Paris.

## **Emerging Imbalances**

Despite the fact that many Customs administrations have now responded to the call for a more balanced approach, there is evidence to suggest that some economies are seeking to tilt the balance heavily towards regulatory intervention in the name of supply chain security. To some extent this is to be expected in the current climate of heightened security concerns. However, we are witnessing situations in which very high levels of control are being imposed on the international trading community on the incorrect premise that such action is required by initiatives such as CSI<sup>17</sup> and the WTO Framework of Standards<sup>18</sup>.

It is of concern that an administration may seek to impede the facilitation of legitimate trade in such a way, bearing in mind that, in the current international climate, it takes a very brave soul to actively oppose the imposition of regulatory requirements that are allegedly introduced for the purposes of national security.

A more general area of concern is the proliferation of Free Trade Agreements which incorporate rules of origin that are specific to a particular agreement. This trend is increasing the diversity of rules applying to international trade, which is in direct contrast to the hard-fought initiatives aimed at harmonising and simplifying Customs and other trade related procedures, such as tariff classification<sup>19</sup> and Customs valuation<sup>20</sup>. As a consequence, the process of cargo clearance is becoming more complex as Customs seek to ensure compliance with the disparate rules contained in the growing number of trade agreements. There is no doubt that this trend is retarding progress against the international trade facilitation agenda.

## **Conclusion**

In a rapidly changing world of new and emerging technologies, heightened commercial imperatives, and changing social expectations, governments are committed to providing the international trading community with increased levels of trade facilitation.

Achievement of the international trade facilitation agenda is heavily dependent upon the ability of Customs to raise the portcullis to the extent that an appropriate balance is achieved between trade facilitation and regulatory intervention. Whilst in most cases the ability to do so is directly within the control of Customs, in other cases it is not. It is therefore incumbent upon Customs administrations and the WCO to lobby for international agreements which support global trade facilitation through the ongoing harmonisation and simplification of regulatory procedures.

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<sup>17</sup> Container Security Initiative.

<sup>18</sup> For example, in 2005 one administration erroneously advised traders that 100% scanning of containers was mandatory under CSI.

<sup>19</sup> Convention on the Harmonized Commodity Description and Coding System.

<sup>20</sup> Agreement on Implementation of GATT Article VII.