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Customs Capacity Building – a Development Agency Perspective

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DFID Background

Many thanks for inviting me to present some thoughts on customs capacity building, from an international development perspective.

Let me start by providing some background context. Between 2001 and 2006, DFID undertook 181 revenue-related projects or programmes across 44 countries, with a financial commitment of about £159 million. Customs reforms have always played a central role in DFID work on revenue. In the last twenty years DFID has undertaken at least 124 discreet projects focused on customs reform in developing countries and the overseas territories, at a total cost of over £70 million, ranging in size from a £1000 intervention in Vanuatu in 1987 to a single phase of reform in Mozambique costing over £15 million.

The principal aim of all this effort has been to support developing countries in improving their revenue-raising administration, with the emphasis on better organisational governance, human resource development and greater efficiency.

Revenue reforms supported by DFID have been particularly important in Africa: they were crucial for restoring public finances in the post-conflict contexts of Mozambique (where customs revenues, as a percentage of a fast-growing GDP, increased from 2.9% in 1996 to 5.8% in 2005, and hugely sped up the transit of goods); and Rwanda (where the Rwanda Revenue Authority doubled public revenue between 2002 and 2005 to 14% of GDP). In Asia, DFID has supported improved policy and administration in Pakistan, and significant state-level reforms in India.

Improving capacities to raise public revenue is indeed central to the UK's commitment to achieving the Millennium Development Goals (the MDGs). Under the 'Monterrey Consensus' agreed at the UN International Conference on Financing for Development in 2002, developing countries committed themselves to deliver 'effective, efficient, transparent and accountable' taxation systems, in return for increased international development assistance towards the MDGs.

Rising revenues combined with sustainable economic growth are the eventual exit strategy for developing countries out of aid dependency. Developing countries must be helped to deliver on this commitment.

So, donors need to consider if they should be doing more. According to the OECD, of the \$7.1 billion spent in 2005 on bilateral aid for government administration, economic policy and public sector financial management, only 1.7% went on tax- and customs-related assistance.

Perhaps the most prominent work that DFID has undertaken has been in helping a number of countries – especially in Africa - to establish unified revenue authorities and to given them more autonomy to facilitate reform, including the modernisation of human resource management. Experience with such reforms however has been mixed.

We have learnt that there are no universal silver bullets: success depends on the local conditions. An Autonomous RA is no guarantee for improved customs services.

It does not replace a modernization programme based on the introduction of simplified procedures, the strict enforcement of integrity policies, and the introduction of appropriate IT systems that deliver modern operating practices rather than speed up dysfunctional procedures. Much better standardised diagnostic tools and international benchmarks are needed to evaluate what works best in what contexts. [See L. Barbarone et al: *Reforming Tax Systems: The World Bank Record in the 1990s: World Bank 2003*]

DFID has also been supporting a number of important international initiatives that are directly related to customs. These include the Extractive Industries Transparency Initiative, the Investment Climate Facility for Africa, and the Aid for Trade programme.

Let me now turn to the importance of Customs for Economic Development. Sustainable economic growth is central to poverty reduction: a stable, transparent, even-handed revenue system is a key sign of governments' commitment to deliver prosperity for their populations.

Many entrepreneurs however face numerous hurdles to exporting or importing goods, including delays at the border, that can greatly increase costs or prevent trading altogether in the developing world. A need for many documents is associated not only with higher compliance costs but also with more corruption in customs. Faced with long delays and frequent demands for bribes, many traders may avoid customs altogether. Instead, they smuggle goods across the border. This defeats the very purpose of having border controls.

The *Doing Business* annual reports of the World Bank provide a snap shot of customs barriers to trade. So we find that the same product that on average takes 3 days to import into Singapore requires 64 days to get into Niger, and the cost of importing a container into Indonesia is ten times cheaper than into Chad; that while French customs need 2 documents, Mauritania requires eleven for the same shipment; that in Denmark it takes five days to export an item that in Kazakhstan requires an average of eighty-nine days.

So it is hardly a surprise to find that Africa's share of global trade is half today what it was 25 years ago.

Globalisation of course has had a major impact. As a result of trade liberalisation, taxes on cross-border trade - one of the main pillars of the tax system of developing countries twenty years ago - have been reduced, and trade tax revenues have decreased. This shift in focus to domestic revenue mobilisation remains problematic in many low-income countries. Trade taxes still account for a much larger proportion of tax revenues in (non resource-rich) developing countries (24.9%) as compared to developed countries (0.5%); the percentage for Africa is the highest (33%) among developing regions.

The shift from so-called 'easy to collect' revenues (such as tariffs) to 'hard to collect' taxes (such as VAT) has put strain on some developing countries. The net impact has been severe in several low income countries. The world's poorest countries have been struggling to recover the revenue losses due to tariff reduction, and are still dependent on trade taxes. The impact of liberalization is by no means universal, and the variation in Customs Revenue as a Share of Tax Revenue around the world is significant, ranging, according to World Bank figures for the year 2001, from an average of 28.7% for Africa to 1.1% for the OECD, with huge national variation: in Africa, for instance, between South Africa on 3% to Sierra Leone on 49.8%.

So, regional processes to facilitate trade are particularly important. Africa in particular has many small, often land-locked economies whose future prosperity and development will depend on better integration with the rest of the world economy, and require larger economies of scale provided by regional cooperation. Of Africa's 53 countries, 21 have a population less than 5 million.

However Africa is already awash with regional economic communities. There are over 30 regional economic communities in Africa today, including The Common Market for Eastern and Southern Africa and The Southern African Development Community.

But all regional economic communities are held back by some key challenges:

First - resources and capacity are short; and second - there are just too many regional economic communities: only six countries in Africa are members of only one regional economic community. Mali manages to be a member of seven. Customs officials have to deal with different tariff reduction rates, rules of origin, trade documentation, etc. Such dysfunctional multiplication of customs procedures ends up undermining the original purpose of trade facilitation or simplification.

So we are helping to promote customs harmonisation, for instance in the East African Community, through DFID support for the Investment Climate Facility for Africa. This has been achieved by eliciting the views of the private sector on customs administration, to propose specific recommendations for reform that respond directly to the needs of the private sector. Its success has prompted the regional follow-up programme in East Africa with the WCO which seeks to extend the gains already secured in Customs reform at national level, across the East African Community region.

Finally, regional economic communities face a Lack of political will that can create a huge gulf between what is said and what is done.

That last point brings me to the current focus of development agencies on revenues systems, as the heart of an effective state. Few governance challenges are as important as collecting public revenue, of which Customs are of course a cornerstone. And, as events in recent months have yet again shown, an effective state is central to sustainable economic development.

This focus was reiterated at the recent international conference hosted by the South African Revenue Service and sponsored by DFID that committed African tax administrations to a new approach that sees capacity building as first and foremost an exercise in state-building.

So the ability to collect public revenue is a core function of an effective state. There is a growing awareness that the state-building importance of revenue-raising in developing countries has been perhaps too neglected: how better governance may come about from the way in which revenues are raised and tax systems are implemented. Aid may, in some circumstances, be acting as a 'resource curse', weakening the incentive for governments to negotiate with their citizens to raise the taxes, and thereby undermining both the exit strategy from aid dependency and basic accountability mechanisms. If governments are not dependent on bargaining with their citizens to raise revenue, a core foundation for effective democracy is undermined.

Besides the wealth of historical evidence in Western Europe and North America for this 'No Taxation without Representation' argument, there are many remarkable pointers to the importance of taxation for state-building in developing countries. Let me mention just one: that the tax/GDP ratio is strongly and negatively associated with the incidence of conflict: as public revenues increase as a share of national economic output, conflict becomes less likely.

Effective government Bureaucracy in general is also often the product of an efficient Customs and Excise: history teaches us that the need to raise customs and excise revenues efficiently and effectively has always acted as a key incentive for states to create competent administration. 18th century British history illustrates the point: while corruption was rife in other branches of the civil service, the Excise in particular laid the basis for future civil service competencies by imposing high standards of probity and competence, and attracting highly capable employees.

This success can neatly be illustrated in the career of Thomas Paine, the leading British advocate of American Independence and the French Revolution, and author of 'The Rights of Man'. Paine entered the Excise service in 1762 but was dismissed three years later for making false records of visits to traders. Re-instated after a lengthy appeal, he then came close to overstepping emerging standards of civil service conduct by publishing a pamphlet advocating an increase in salary for Excise officers. No such pay award was granted, and his Excise career came to an end a few years later when he was discharged for being on leave without permission. Some Revenue Authorities in developing countries are still struggling to achieve that standard of probity and institutional discipline.

We are all well aware that major challenge for Customs agencies across much of the developing world is Corruption. In Bangladesh, for example, an OECD report estimated the revenue foregone in the year 2000 due to corruption and inefficiency in customs and in the income tax department amounted to in excess of 5% of GDP. In Russia, the Minister of Economy in 2005 stated that in the previous year his country had lost 4.5 billion US dollars in import duties for goods imported from Europe due to false customs declarations mainly linked to corruption.

Let me briefly touch on other State-building challenges where Customs are critical.

Customs authorities are of course increasingly concerned about non-revenue issues, such as border security and drug-smuggling. The challenge of terrorism needs no further elaboration, apart from to note that economic development does not take place in conditions of insecurity and fear; and improved security is, of course, not sustainable without long-term social, political and economic development.

But Customs of course impacts in many other ways in which effective states are the essential building blocks needed for development. Let me just mention one – the access of the poor in developing countries to proper medicines needed if people are to be economically productive. We know that up to one third of medicines being sold in the developing world are fakes, with untold damage to the lives and livelihoods of the world's poorest and most vulnerable people. The WCO is therefore to be congratulated on its leadership efforts, in partnership with the World Health Organisation, to stamp out counterfeit medical supplies. This complements the support of DFID to the Medicines Transparency Alliance which is seeking to promote good governance in medicines regulation and procurement.

Finally let me mention the most difficult context, of Fragile States, to which the international development agencies are paying much greater attention. Traditionally,

at early stages of development the taxation of imports and exports is the largest source of government revenue. Hence, it is always a priority in fragile states and post conflict contexts to strengthen the customs department. An effective and efficient Customs is central to revenue mobilization, as well as to securing the borders, facilitating trade and protecting society.

In Afghanistan, for instance, in 2004 DFID began a three year, £5 million programme of assistance to the Afghanistan Customs Department to help it improve its policy, organisation and management, human resource management, ethics and training, all with the overall aim of facilitating trade and investment to generate the revenues needed for the economic and social development of Afghanistan. Two years in, the programme was suspended in part due to perceived problems with corruption and uncertainty over political commitment to the reforms.

That example demonstrates yet again that Political Economy is central to all Customs Capacity Building: If the international development community has learnt any one key lesson of the last decade or so it is that capacity building and other reforms do not work without strong political commitment. Essential modernisation like ASYCUDA will of itself then have limited impact.

Customs reforms must be supported by a coalition of political leaders and the private sector with a shared vision of improving customs as part of broader aims of better governance, stronger economic growth and improved rates of poverty reduction that delivers the political stability needed for sustainable development. That is why it is essential for all customs capacity building reforms to be anchored in serious political economy analysis, such as for example is being done in the DFID-supported Bangladesh Investment Climate Reform Programme.

But in many contexts of fragile political development, political patronage has been a central mechanism for securing peace and the political stability needed for development.

So Customs capacity building reforms must be anchored in local political ownership for the necessary changes. As the World Bank guidebook to Customs reform concluded, *“Political support for customs is essential for the reform’s success. Only support at the highest level will enable customs management to overcome anticipated obstacles. Customs managers will need the explicit support of the political leadership.”*

So I hope this conference will address these political economy realities that underscore the importance of customs capacity reform for international development.

Thank you for your attention.