The Contribution of Customs to Economic Competitiveness[1]

Introduction

To support the WCO Economic Competitiveness Package (ECP) and in response to a request from a WCO Member, this paper provides a brief survey of research that supports the notion that Customs contributes to economic competitiveness. The paper presents an analytical framework that Customs contributes to economic competitiveness through its trade facilitation, revenue collection, and social protection functions.

The Meaning of Economic Competitiveness

Before discussing how Customs can contribute, it is useful to articulate a general understanding of *economic competitiveness* as it is frequently unclear or misinterpreted in discussions on national public policy (Krugman, 1996:5-22, 88-101). Although the dictionary meaning of "competitiveness" is appropriate in the context of businesses, for the activities of nations it is less so.[2] At the firm level it means competition between businesses in the same industry, and in this context it truly is a competition. Businesses compete for customers; some businesses will fail if they do not obtain a sufficient number of customers or have too high operating costs (Krugman, ibid).

At the country level, however, competitiveness should not be understood to wholly mean contests between nations on economic or trade matters. Countries do not compete directly against each other in the sense that businesses do. While governments do pursue economic and trade policies that they believe will benefit their country, such policies may bring benefits to them individually but it will not bring advantages to them over other countries. International trade is not a zero-sum game where there are only winners and losers. Comparative advantage and mutually beneficial exchange can enable two countries to gain, rather than one country winning and one country losing. Thus, in the national context, economic competitiveness is more about strengthening economic growth and productivity rather than bilateral, regional, or multilateral competition.

Because competitiveness is a subjective not an objective term, it cannot be understood within a mathematical calculation of objective indicators. This differs from nomenclature such as unemployment, inflation, productivity growth, and GDP growth which can be measured objectively.

Several international indexes estimate economic competitiveness. Two of the best know competitiveness indexes are the World Economic Forum's (WEF) annual *Global Competitiveness Report* and the Institute for Management Development (IMD) which publishes its *World Competitiveness Yearbook*. The World Bank's *Doing Business* can also be seen as a competitiveness index. These indexes combine both objective and subjective perception indicators to arrive at national rankings. An example of a subjective indicator is surveying a group of importers on their opinion of the efficiency of the Customs procedures. The specific objective and subjective indicators that are selected for the index, and how they are weighted, determines the competiveness rankings.

[1] This working paper was prepared by the WCO Research and Strategies Unit. The views and opinions presented in this paper do not necessarily reflect the views or policies of the WCO or WCO Members.

[2] According to the Oxford Dictionary, "Competitiveness" is a derivative of "competition" which is defined as "the activity or condition of competing against others."

Evidence suggests that the competitiveness indexes are not particularly accurate, especially over the long term. Ståhle and Ståhle (2006:5) contend that "the overall rankings factually correlate rather weakly with the national economic performance: they correlate strongly with the present and the past few years, rather weakly with the longer period of past development, and not necessarily at all with the future success." Such indexes, however, can perhaps motivate countries to improve their business climate (Ireland, Cantens, and Yasui, 2011:6).

The WEF has defined competitiveness as "the set of institutions, policies, and factors that determine the level of productivity of a country" (Sala-i-Martín et al., 2008:3) and the IMD has defined it as "how a nation manages the totality of its resources and competencies to increase the prosperity of its people" (IMD, 2008:32). The European Commission in one publication defined economic competitiveness as "... a sustained rise in the standards of living of a nation and as low a level of involuntary unemployment possible" (European Commission, 2004, as quoted in Ståhle and Ståhle, 2006:3). These definitions show the subjective and varying understanding of the meaning of competitiveness.

While recognizing the difficulty in precisely defining competitiveness, this document suggests that competitiveness in the Customs context is *the contributions Customs can make to economic productivity growth*[3] *and rising standards of living in their respective country*.

While there is evidence that Customs can contribute to economic competitiveness directly and indirectly, this should not be inferred to mean that its contribution is massive. It is not. National economic competitiveness as defined in this paper can best be improved by macroeconomic policies and also by non-government factors, such as demographics, the weather, and entrepreneurial skill. In terms of government policies, the most crucial contributor to economic competitiveness, especially in times of economic distress, is appropriate fiscal and monetary policies (Blyth, 2013).

A Framework of How Customs Contributes to Economic Competitiveness

This document presents a framework where Customs can contribute to economic competitiveness in three broad ways. The first is trade facilitation, the second is revenue collection, and the third is social protection.

Trade Facilitation

Trade facilitation means making Customs procedures more efficient to enable lower trade transaction costs for businesses. The classic World Trade Organization (WTO) definition of trade facilitation is "simplification and harmonisation of international trade procedures. Trade procedures include the activities, practices and formalities involved in collecting, presenting, communicating and processing data and other information required for the movement of goods in international trade".[4] Some trade costs caused by Customs (and other border agencies) are inevitable as border regulations are mandated by government to assist in the achievement of various public policy objectives. Thus, the more efficient (facilitative) Customs can be in applying controls, the lower the transaction costs.

Others define trade facilitation more broadly by also including transport inefficiencies and costs (which are generally caused by deficient infrastructure or transport vehicles, dynamics which are not directly related to border procedures). Sourdin and Pomfret (2012:3)

[3] *Economic productivity growth* is the ratio of outputs to inputs in production and directly impacts the level of economic growth.
[4] See WTO website, http://gtad.wto.org/trta_subcategory.aspx?cat=33121.

defined trade facilitation as “reduction in trade costs” where trade costs mean “the difference between the costs of domestic and international trade other than those costs such as import duties. Trade costs include transport costs and the costs of clearing borders . . .”

The International Convention on the Simplification and Harmonization of Customs Procedures, better known as the Revised Kyoto Convention (RKC), is the international standard for making Customs regulatory procedures as efficient as possible. The RKC elaborates upon several important principles, including transparency and predictability of Customs actions; standardization and simplification of the goods declaration and supporting documents; simplified procedures for authorized persons; maximum use of information technology; minimum necessary Customs control to ensure compliance with regulations; use of risk management and audit based controls; coordinated interventions with other border agencies; and partnership with the trade.

There is a growing body of published research that shows empirically how Customs, through trade facilitation, can reduce trade transaction costs and thus contribute to economic competitiveness. While it is outside the scope of this paper to present at length the detailed evidence, it cites to the leading literature and presents some of it in Table 1.

Table 1 – Trade Facilitation Empirical Literature

Literature	**Analysis on trade facilitation**
Hummels (2001)	“Links trade facilitation measures to tariffs, finding that each day saved in shipping time (due in part to faster customs clearance – a trade facilitation category) is worth a 0.5 percentage point reduction of ad valorem tariffs.” (quote from Wilson, Mann, and Otsuki, 2005)
Wilson, Mann, and Otsuki (2005)	“Based on the specific simulation design, improvement in all four forms of trade facilitation of the ‘below-average’ countries ‘halfway’ to global average yields an increase in global trade of $377 billion.”
Engman (2005)	“[Q]uantitative studies have shown that reductions in trade transaction costs through trade facilitation measures may bring as significant welfare gains as tariff liberalisation.“
Milner, Morrissey, and Zgoyu (2008)	“The review above establishes that there is a body of evidence to show that improved trade facilitation can: • Significantly lower trade costs, especially reducing time; • Bring about significant increases in the volume of trade, imports and exports, that may be even greater than the direct gains from trade policy reform; • Allow for increases in government revenue and collection efficiency; • Generally contribute to welfare improvements and economic growth.”
Li and Wilson (2009)	“For Asian countries, we find that improvement in trade facilitation indicators tend to increase the probability that firms will become exporter as well as their export propensity. In particular, increasing policy predictability and enhancing IT services are the most

	effective."
Persson (2010)	"Estimation results suggest that if export transaction costs – proxied by the number of days needed to export a good – declined by 1 per cent, the number of exported differentiated and homogeneous products would rise by 0.7 and 0.4 per cent respectively. Policy simulations further illustrate that if all countries were as efficient at the border as the most efficient country at the same level of development, the number of exported differentiated and homogeneous products would increase by 64 and 29 per cent respectively."
Djankov, Freund, and Pham (2010)	Trade facilitation support exports: "Our estimates imply that each additional day that a product is delayed prior to being shipped reduces trade by more than one percent."

There is also evidence that the quality and reputation of a particular Customs can also contribute to the popularity of a port and thus as a platform for growing international trade. A World Bank (2004) study of different seaports indicates that the requirements imposed by Customs and the level of its efficiency and effectiveness "frequently impose constraints on the port's ability to compete with rival ports for market share." In providing several examples, the study shows that the economic performance of a country can improve if port operations are smoother thereby making them more attractive to economic operators.

Trade facilitation can result in faster clearance and shorter dwell times for legitimate trade. Raballand et al. (2012), in a study of port dwell times in Sub-Saharan Africa (SSA), demonstrated the many factors that can improve port efficiency and increase their attractiveness. For instance, the port of Durban, South Africa reduced its dwell time from seven to four days due to a wide range of measures, including a comprehensive Customs modernization reform. This reduction more than doubled the capacity of the container terminal without any investment in physical extensions. The study contends that "local populations pay twice for long dwell times: as taxpayers, because more physical extensions and infrastructure are public investments, and as consumers, because inefficiencies and rents in the port are charged to the final user of these services" (Ibid: 98). Therefore, the major finding of the study is that reducing dwell times through resolution of structural problems, such as rents through Customs clearance, poor handling and Customs broker inefficiency, will have a long-term positive impact on the port operations and should be tackled before investing in the physical extensions of storage.

Revenue Collection

The second factor, *revenue collection*, is more indirect in terms of its contribution to economic competitiveness but also important. Revenue collected by government has long been viewed as the necessary ingredient for state authority. John Locke wrote about the need for government revenue to protect property rights (Locke, 1824, as discussed in Karras, 2010: 65). Adam Smith wrote about government existing to provide justice, defense, public works, and education services (Smith, 1776, as discussed in Karras, 2010: 63).

To improve economic productivity and competitiveness, it is important to have a society that is stable, educated, and healthy. Without public goods, a nation will have difficulty in achieving productivity growth and rising living standards. Thus, the logic here is that although Customs does not decide the uses for public funds, it is the primary collector of the revenue necessary to pay for public sector functions, and thus contributes to economic competitiveness.

Most developing countries rely on Customs duties rather than income tax to fund government functions. Without the revenue collected by Customs administrations, developing countries would have a more difficult time in funding government. Although most developed countries no longer have Customs duties as the primary funder of expenditures, all once did. Indeed, developed countries built the state authority and infrastructure needed for economic competitiveness using the revenue collected by Customs.

Even in a free market system, there are some public goods that must be paid for by revenue collected by government because there is insufficient profit incentivization for the private sector to deliver it. In other words, government intervention is frequently necessary in instances of market failure (Smith and Wahba, 1994: 2). Evidence suggests that education, defense, security, health care, and infrastructure are more efficiently and effectively delivered by the government.

While there is not a consensus on this topic, there is a rich body of research in support of the notion that public expenditure contributes to economic growth if it is applied appropriately. While it is outside the scope of this paper to provide an exhaustive list of such research and detailed analysis, a few examples are cited here.

Smith and Wahba (1994:10) state that “investment in human resources contributes to the enlargement of productive capacity by improving the quality of the labour force.” Spending on infrastructure also supports economic competitiveness. As Stern (1990) contended, “capital utilisation is likely to be low where the electricity supply goes off frequently, the road system is weak and it is difficult or impossible to get a telephone.” In an empirical study, Cooray (2009) describes Easterly and Rebelo (1993) finding “a positive association between public investment and economic growth, in particular transport and communication.” Cooray (2009) found in a study of 71 economies “that both public spending and good governance can improve growth outcomes” and that “human capital is also found to significantly and positively affect economic growth.” According to Loto (2011), “Devarajan et al. (1993) using a sample of 140 ECD countries found that expenditure on health, transport and communication have positive impacts on economic growth.”

Social Protection

The third factor, *social protection*, includes functions such as counter-terrorism and interdicting the movement of illicit goods such as narcotics and counterfeits. Customs can contribute to economic competitiveness by protecting society with respect to national security and deterring the cross-border trade in dangerous and unsafe products.

In the wake of 9/11, some Customs administrations adopted counter-terrorism regulations[5] and the WCO adopted the SAFE Framework. In pursuing the objectives of the SAFE Framework, Customs seeks to prevent terrorist caused cataclysms that can negatively impact economic competitiveness. Moreover, when disasters do occur, Customs can contribute to facilitated import of emergency relief supplies which can support resilience and returning to a path of competitiveness.

Many Customs administrations and the WCO are active in combating the trade in counterfeit goods which harms government revenue collection efforts, rights holders, and people who consume fake medicines. Combating the movement of counterfeit goods is thus a means for Customs to support public-sector budgets, fair competition, health and safety.

[5] For example, the U.S. Customs Service launched the Customs to Trade Partnership Against Terrorism (C-TPAT), the Container Security Initiative (CSI), and the 24-hour rule.

The OECD (2008:134) suggests there are a number of direct and indirect economic effects of the trade in counterfeit goods and they are replicated in Table 2.

Table 2 - Impacts on Competitiveness from the Trade in Counterfeit Goods

Impact Categories	**Specific Effects**
General socioeconomic effects	• Reduction in incentives to innovate • Possible negative effects on medium to long term growth rates • Increase in flow of financial resources to criminal networks • Small, negative effects on levels of foreign direct investment flows; possible effect on structure of foreign direct investment • Negative effects on trade in products where health and safety concerns are high
Effects on rights holders	• Reduction of rights holders' sales volume • Downward pressures on prices • Erosion of brand and firm value • Diminished flow of royalties due to rights holders
Effects on consumers	• Substandard products carry health and safety risks ranging from mild inconvenience to life-threatening situations
Effects on government	• Lower tax revenues • Costs are incurred for enforcement and public awareness initiatives, and for development and maintenance of legal frameworks • Bribery and extortion of government officials to facilitate counterfeiting and piracy operations weaken the effectiveness of public institutions charged with law enforcement and related activities

Source: replicated from OECD (2008:134)

Although it can hypothesized that these Customs social protection instruments contribute to economic competitiveness by preventing harm, it is more difficult to show their impact empirically. Because of methodological challenges in estimating what would have been lost economically without the security public good, presenting empirical evidence of what this factor contributes to economic competitiveness is limited. One example is the increased scrutiny of trade at the U.S. borders with Canada and Mexico following 9/11 did lead to delays in Customs clearance which negatively impacted some businesses in these countries at least in the initial aftermath (Andreas, 2003:7-8).

Measuring the economic cost of IPR smuggling and its impact on economic competitiveness is also difficult. While contending that the volume and negative impact of counterfeiting is sizeable, the OECD report points out that empirically measuring the economic impact of the trade in counterfeit goods is difficult for a number of reasons, including the clandestine nature of the activity.

Conclusion

In response to a request from the WCO Membership during the development of the WCO Economic Competitiveness Package, this paper presents a framework with supporting research on how Customs can contribute to economic competitiveness. The working paper begins by defining economic competitiveness in the Customs context as the contributions Customs can make to economic productivity growth and rising standards of living in their respective country. It then proceeds to conduct a brief survey of literature on how trade facilitation, revenue collection, and social protection contribute to economic competitiveness.

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