

# INVESTMENT CLIMATE IN PRACTICE

## TRADE LOGISTICS

### REFORMING CUSTOMS CLEARANCE IN PAKISTAN

Simple, fast, transparent customs clearance procedures encourage trade—and the resulting tariffs and related taxes raise government revenue and stimulate economic development. After outsourcing failed to make customs more efficient or increase revenue, in 2002 Pakistan began pursuing a modern single window system for customs clearance. In 2005 the system was introduced at the port of Karachi, replacing numerous procedures with one electronic declaration and sharply cutting customs processing times. Despite dramatically reduced tariffs, annual customs revenue grew dramatically after the reform—though tariff and customs reform have since stalled.

During the 1990s international trade and government tax revenues were stagnant in Pakistan. Average annual GDP growth exceeded 6 percent in the 1980s, but in the 1990s it fell to less than 4 percent, and the fiscal deficit and public debt rose sharply. In the 1990s more than 70 percent of Pakistan's tax revenue was related to imports, through customs duties, sales taxes, and income tax withholdings. Accordingly, the new administration that came to power in 1999 (headed by then President Pervez Musharraf) targeted improvements in trade and customs as part of its reform agenda.

Despite attempts at outsourcing, in the 1990s little progress was made on streamlining Pakistan's cumbersome customs regulations. Goods clearance involved more than a dozen government agencies and usually took more

than two weeks. An importer of something as simple as powdered milk was required to complete six copies of a bill of entry, which were then registered, manually checked against an import general manifest, and subject to 8–10 additional steps.

At one point in the 1990s, Pakistan's commercial judiciary had a backlog of more than 80,000 cases brought against the customs administration by traders and manufacturers. The country was also the leading source of tariff classification disputes referred to the World Customs Organization.

#### INEFFECTIVE OUTSOURCING

In the 1990s the Pakistani government outsourced customs clearance to two Swiss inspection

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This note is one in a series developed by the Trade Logistics team of the World Bank Group's Investment Climate Advisory Services. The series focuses on implementation aspects of recent trade reform initiatives and risk management issues. The Trade Logistics team advises governments in developing and transition economies on improving their import, export, and risk management systems and procedures to increase their potential for trade and investment.

Reforms sought to create a customs system that was Web-enabled, paperless, automated, and more transparent.

companies—Cotecna in 1990–91 and Société Générale de Surveillance (SGS) in 1995–97—with the goals of: raising government revenue through more effective collection of customs tariffs and related taxes, facilitating trade, and reducing corruption.

The government had predicted that outsourcing customs could double customs revenue, but the inspection fees charged by the outsourcers raised clearance costs by 2–3 percent for traders, and customs revenue did not increase. Meanwhile, clearance times did not improve, so complaints persisted about goods being held up at ports. In addition, the customs administration resented the presence of the Swiss companies.

In 1998 a rudimentary single window system, the Customer Service Center, was introduced. The center was run by a local firm under an outsourcing agreement. A small fixed fee was levied on each goods declaration to cover expenses, and while the center was an improvement over the previous system—eliminating 8–10 steps and introducing some automation and transparency—customs clearance remained predominantly paper-based and cumbersome.

Customs House Karachi, which handles 60 percent of Pakistan's imports and exports, then became the venue for a series of reforms, including:

- ❑ 1998: the Express Lane Facility was introduced to simplify examination procedures.
- ❑ 2000: the Electronic Assessment System began assessing duties based on risk profiles.
- ❑ 2001: a single goods declaration was introduced.
- ❑ 2002: risk-indicated selective examination started assessing risks in examination procedures.
- ❑ 2004: an automated clearance procedure was introduced.

Though these reforms simplified clearance procedures, most companies had to continue following arcane procedures because it was feared that fewer customs checks would lead some traders to try to cheat the system, resulting in lost revenue.

## BROAD TAX REFORMS LEAD TO SIMPLER CUSTOMS

As part of a structural adjustment program developed with the World Bank and International Monetary Fund, in 2001 Pakistan's Central Board of Revenue (now the Federal Board of Revenue) began simplifying tax laws. Reforms included introducing self-assessment for all taxes, including customs tariffs and related excise and value added taxes. With a few exceptions, the maximum tariff was lowered from 45 percent in 1998–99 to 25 percent in 2002–03. The number of tariff duty ranges was cut from 16 to 4, and tariff exceptions were reduced or clarified. Fifty years' worth of procedural notifications on tariffs were reviewed and updated to simplify customs declarations.

Clearance reform also occurred as part of customs administration reforms. In early 2002 a reform team of three mid-level customs officers was created to develop an all-encompassing, fully automated customs system. The team visited customs authorities that were using the United Nations Automated System for Customs Data (ASYCUDA)—designed to automate and administer core customs processes and obtain trade data to support government planning—but decided that the system did not meet all the needs of stakeholders in Pakistan. ASYCUDA was being used in countries with small customs operations, and the version available then did not enable the level of integration required with stakeholders such as carriers, commercial banks, and regulators. Furthermore, while the ASYCUDA software was free, hiring consultants to implement it would have been rather expensive.

The reform team decided that it would be better to adopt a system customized to Pakistan's needs, which the team described in a 4,000-page document. The team's vision was to create a customs system that was Web-enabled, paperless, automated, and allowed intervention by customs only through an automated risk management system.

The team wanted the system to provide real-time integration with other government authorities, to create an integrated tariff regime, as well as with other parties involved in the supply chain

and customs clearance (such as carriers, ports and terminals, non-vessel operating common carriers, freight forwarders, warehouses, customs brokers, and banks involved in collecting customs revenue). Finally, the new customs system was to be compliant with international best practices such as the Convention on Facilitation of International Maritime Traffic, World Customs Organization Data Model, revised Kyoto Convention, and post-September 11 security requirements.

The resulting Pakistan Customs Computerized System (PaCCS) was formally launched in 2005 at the port of Karachi.

### THE “80-20 RULE” AS APPLIED TO MANAGING CUSTOMS STAKEHOLDERS

Relatively few government agencies are involved in Pakistani customs (port authorities, State Bank of Pakistan, Central Statistical Office, Ministry of Commerce), so private companies are key stakeholders in customs reform. Pakistan’s strategy for stakeholder management involved using the “Pareto principle” (also known as “the law of the vital few” or “80-20 rule”), which states that for many events, 80 percent of the effects result from 20 percent of the causes. Studies by the small reform team found that of the 24,000 registered importers and exporters in Pakistan, 200 accounted for more than 70 percent of international trade. Shipping was also concentrated, with the top four shipping lines carrying more than 80 percent of business through Pakistani customs.

Winning the early support of key players in Pakistan’s private sector helped create momentum for broad participation. Key companies that embraced the single window included the port operator Karachi International Container Terminal Limited (KICTL) and American President Lines (APL), a major shipper. KICTL had already automated, and its management immediately recognized the potential of a fully automated, risk-managed customs system that worked 24/7 with the company’s servers using electronic data interchange—including the

benefits for KICTL’s competitive standing. Similarly, APL’s management immediately understood the savings that would result from ships not being tied up for days in the Karachi port. Other companies, seeing the enthusiastic participation of KICTL and APL, then became eager to participate.

Not all private actors were won over so easily. Some agents that served as intermediaries for traders remained committed to arcane practices, as did some traders that benefited from nontransparent procedures. While these critics account for just 10–15 percent of companies, and for even less of trade volume, they continue to be vocal opponents of customs reform.

Between 2002 and 2004 a series of seminars, workshops, and other sessions were conducted with key traders and shippers to develop new procedures and reach consensus. Having small teams manage the entire process helped expedite reforms. The key reform group made nearly all key decisions in the reform process. Active support and involvement from the top (such as the minister of finance and chair of the Federal Board of Revenue) greatly facilitated the reform implementation process.

While work on PaCCS was still at the conceptual stage and mostly being done at Customs House Karachi, two teams of two mid-level officers, selected by the head of customs, were stationed at the headquarters of the Federal Board of Revenue to simplify tariff and customs rules. This element of reform was independent of PaCCS and coincided with budget making exercises for fiscal 2001 and 2002.

### PAKISTAN’S SINGLE CUSTOMS WINDOW IN ACTION

PaCCS relies on self-assessments by filers, using software developed by vendors selected through the World Bank’s international tendering process.<sup>1</sup> Traders or their agents file declarations online and pay duties or taxes at any bank connected to PaCCS or by debiting their prepaid accounts with the government (Figure 1). PaCCS then generates an online receipt of the declaration,

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assigns a customs reference number, and verifies the declaration through its risk management system. The customs administration makes an online request to the filer if it requires any clarification or additional documentation, which can also be provided online.

PaCCS was designed to perform customs functions without manual intervention. Physical inspection of goods, if needed, can occur without the trader being present. Processing can take place in just a few seconds.

Importers file disputes electronically and can request reviews of any duty or other customs issue. If the problem is not resolved on first review, importers can request a second review and personal hearing with a mid-level manager at the Customs House. Although few disputes are not resolved by that point, importers can still clear cargo by filing security payments equivalent to the amount in dispute. The trader's funds are then

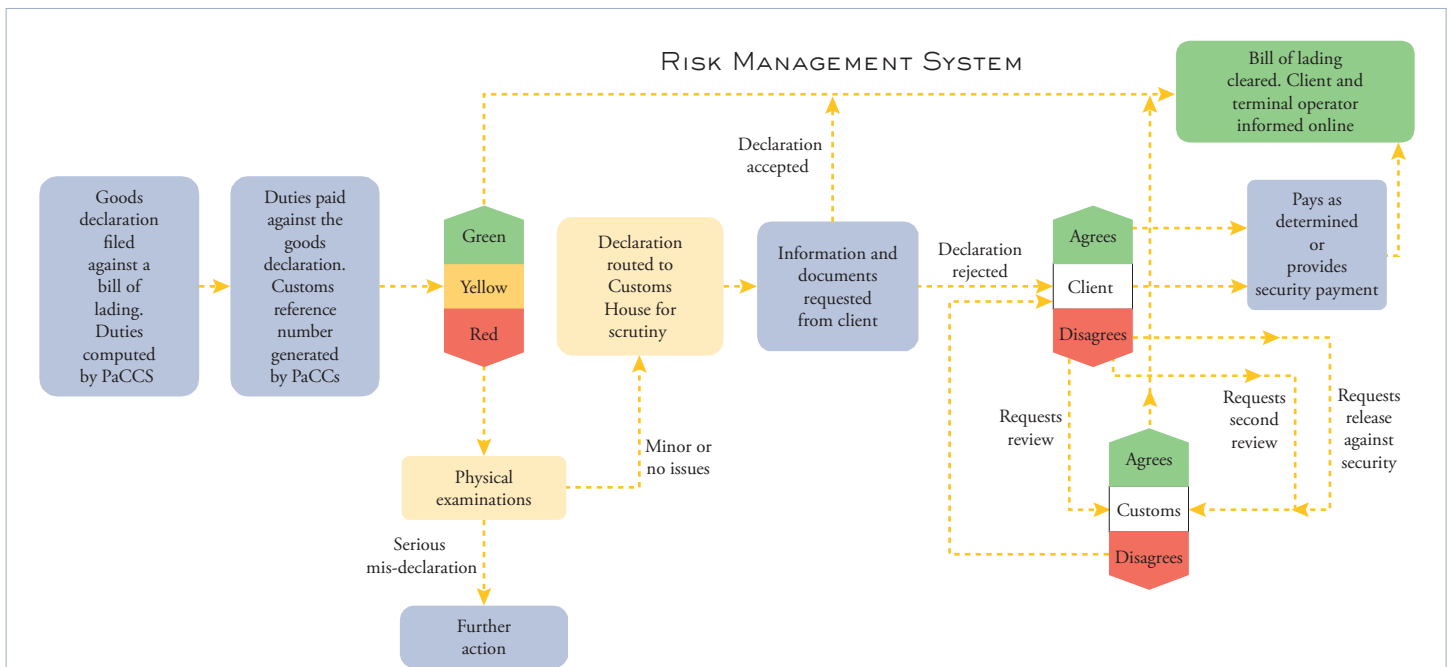
kept or released based on a final assessment by the Valuation Department.

## RESULTS OF IMPLEMENTING THE ELECTRONIC SINGLE WINDOW SYSTEM

The government and customs administration hoped that implementing a single window would:

- ❑ Lower the costs of doing business by reducing delays and demurrages, simplifying processes, and enabling just-in-time inventory.
- ❑ Increase government revenue through more reliable collection of customs duties and related taxes.
- ❑ Improve cash flow for businesses by expanding access to markets through simpler procedures and expediting rebates of export duties to traders.
- ❑ Reduce corruption.

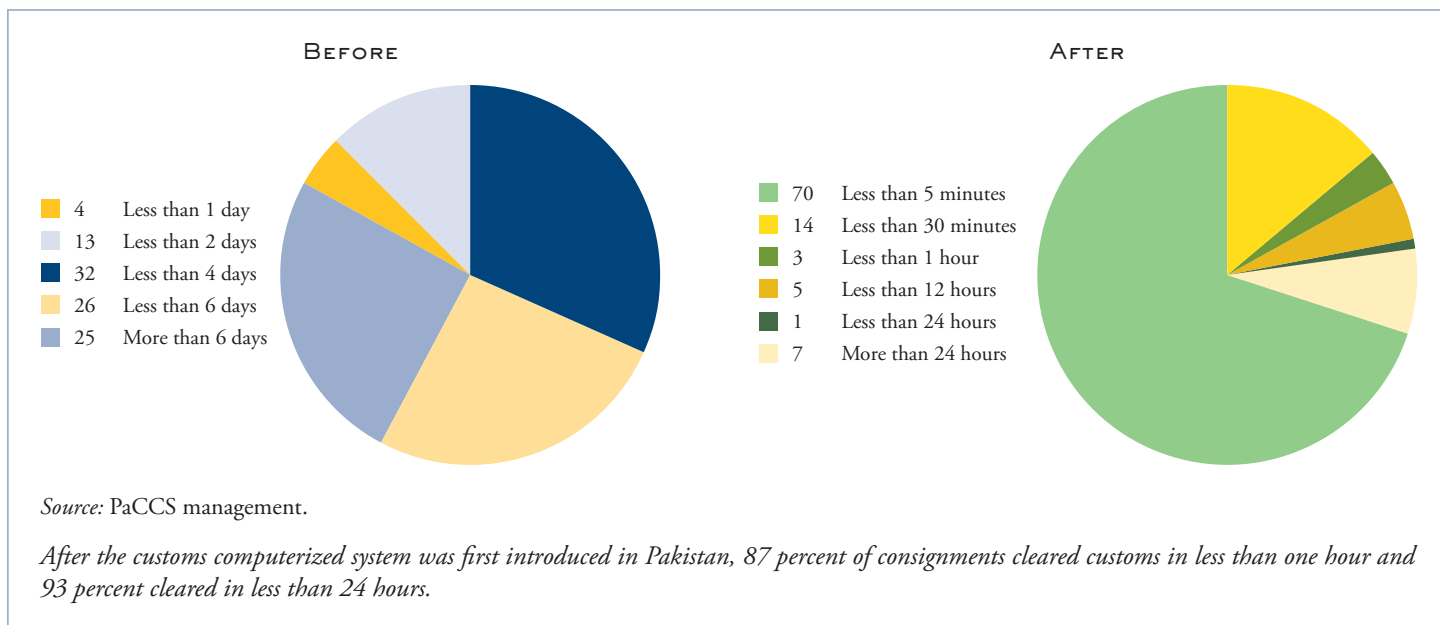
**FIGURE 1: PROCESSING OF GOODS DECLARATIONS FOR IMPORTS BY THE PAKISTAN CUSTOMS COMPUTERIZED SYSTEM**



Source: PaCCS management.

*When a goods declaration is filed, PaCCS computes the importer's duties, logs payment, assigns a customs reference number, and then either clears the goods declaration through customs or requires further scrutiny by customs.*

**FIGURE 2: CLEARANCE TIMES AT THE PORT OF KARACHI BEFORE AND AFTER REFORM**  
(PERCENT)



Customs processes at the port of Karachi have been simplified considerably since PaCCS was implemented. The port, once considered among the worst functioning in the world, is now competitive with any in the region—including those in India.

Under PaCCS one simple electronic declaration has replaced up to 26 clearance steps, 34 signatures, and 62 verifications. After the system was first introduced, 87 percent of consignments cleared the single window within an hour (Figure 2), though that pace has slowed considerably since some manual checks were introduced.<sup>2</sup> Rebates to traders are made automatically without their having to file claims, and refunds now take less than 2 days—compared with 90 before.

PaCCS also introduced more sophisticated risk management. It maintains a taxpayer compliance history for the past year, and taxpayers with higher compliance ratings are considered less risky. Conducting fewer examinations based on automated risk profiling greatly reduces processing costs for port operators, who can begin processing before shipments arrive, and for shipping companies, which no longer have to maintain ships at port while goods are cleared.

The single window system was designed to reduce corruption by eliminating contact between traders and customs agents. Pakistani officials estimate that 90 percent of corruption has been eliminated for goods passing through the single window system in Karachi (which accounts for 60 percent of Pakistan’s international trade). Collusion between taxpayers and tax collectors is largely mitigated by physical structures that separate taxpayers from examination and assessment areas. In addition, biometric identification and cell phone jammers are used to ensure that customs staff remains unaware of the identity of taxpayers.

The introduction of the single window, combined with the lowering and simplification of tariffs, has made traders more cooperative and reduced opportunities and motivations for bribery. As a result, despite sharp cuts in tariffs between 1998 and 2002, tariff revenue grew by more than 20 percent a year after reform (from fiscal 2003 until fiscal 2006).

### LESSONS FROM PAKISTAN’S EXPERIENCE

#### Carefully consider outsourcing

In Pakistan, outsourcing customs inspection and clearance raised costs for traders by 2–3 percent and

Tariff classification disputes nearly disappeared after tariffs were simplified.

did not achieve any of the intended goals. Customs revenue did not increase, trade was not simplified, and corruption may have intensified. Outsourcing also created resentment among customs workers, eroded domestic expertise, and stunted customs capacity building.

#### **Develop the legal and regulatory framework for reform**

To enable the single window, Pakistan had to enact more than a hundred changes to its Customs Act. Most involved the switch to electronic documentation—for example, revisions were needed on provisions requiring signatures, hard documents, and the physical presence of traders (or their agents) during goods clearance. Other steps included introducing a single goods declaration, implementing the World Trade Organization Agreement on Customs Valuation, and lowering the maximum tariff from 45 to 25 percent.

#### **Aim for a critical mass of reforms built on quick wins**

Limited reforms will likely not satisfy stakeholders or achieve reform goals, and implementing a single window can take several years—sometimes more. But reaching smaller goals along the way can help build momentum. In Pakistan one quick win involved simplifying, at relatively low cost and effort, arcane tariff rates and rules accumulated over 50 years. Though Pakistan had been the leading country in tariff classification disputes referred to the World Customs Organization, such complaints nearly disappeared after tariffs were simplified. Pakistan also introduced some risk profiling before introducing the single window, which reduced the volume of goods backlogged on docks awaiting inspection.

#### **Adopt a countrywide plan for reform while momentum is strong**

The increased transparency and accountability that accompany reform can threaten customs agents and authorities, as well as trader intermediaries and legacy vendors. Indeed, these vested interests have stalled further adoption of single window

customs reforms throughout Pakistan, reflecting the lack of a widespread PaCCS rollout plan from the outset. Today only 60 percent of Pakistan's international trade (what passes through the port of Karachi) goes through PaCCS. As a result, shipping lines and terminal operators must cater to dual processes and maintain a paper-based system, which raises costs.

#### **Maintain a stable but inclusive team for reform management**

Achieving a single window requires a dedicated management team working for a sustained period. This team must have ownership of the reform process and be motivated to overcome obstacles. Pakistan's reform management team may have been too small, possibly fostering resentment among trade and customs colleagues. Reform management teams should include as many stakeholders as possible to help minimize criticism after reforms and to sustain reform momentum as managers, policymakers, and administrations change.

#### **Use private sector champions and market forces to catalyze reforms where possible**

Pakistani reformers recognized early that international trade was highly concentrated among traders, shippers, and port operators. Winning early support from key companies drove momentum for participation in the single window because other companies became eager to maintain competitiveness—providing a lesson in how market forces can be harnessed to encourage reforms.

#### **Measure the results of reform**

Reform outcomes should be measured and benchmarked where possible. In Pakistan the key indicators of customs reform were the average time to clear goods and the number of court cases, referrals to the World Customs Organization, and days to refund trader duty drawbacks. Such data are often not available before an automated system is adopted, so determining reform results may require comparing anecdotes or surveys of traders and other stakeholders with hard data once the new system is in place.

## CONCLUSION

Many governments share the same basic goals for customs reform: facilitating trade while reducing corruption and increasing revenue from tariffs and customs-related taxes. Achieving these goals is more likely when reforms simplify procedures, clarify tariff structures, and minimize human interactions. Governments seeking a quick fix sometimes outsource customs functions to private companies—but this should be done with caution. Outsourcing was ineffective in Pakistan, where streamlined customs procedures and higher customs revenue were achieved only when a single window system for trade declarations was implemented in 2005.

Ideally, implementation of a single window should occur in the context of broader trade reforms. Tariff structures must be simplified, and duties should be low enough to encourage payment of tariffs and related taxes. A single window system must also allow electronic exchanges of documents and be supported by a legal and regulatory framework based on international standards.

A properly implemented single window system can deliver significant benefits. During 2002–07 Pakistan's single window system eliminated numerous procedures, and customs revenue soared because bribes were replaced by legitimate duties and related taxes at the port of Karachi.

But powerful vested interests can impede reform, especially as government administrations change. Thus reformers should act aggressively, while reform momentum is strong, and reform efforts should include as many stakeholders as possible to foster lasting support.

Since PaCCS was successfully implemented, there has been some rollback of automation in favor of more manual checking, and new management is conducting an audit to inform plans for further system rollout. *For more information, contact Uma Subramanian, Global Product Leader, Trade Logistics (usubramanian@worldbank.org).*

## ENDNOTES

- <sup>1</sup> These vendors include Microsoft, PWC Logistics of Kuwait (now Agility), and Accountancy Outsourcing Systems of Pakistan.
- <sup>2</sup> Since the introduction of these checks, only one-third of consignments are now cleared within one hour.

## IN PRACTICE

The *Investment Climate IN PRACTICE* note series is published by the Investment Climate Advisory Services of the World Bank Group. It discusses practical considerations and approaches for implementing reforms that aim to improve the business environment. The findings, interpretations, and conclusions included in this note are those of the author and do not necessarily reflect the views of the Executive Directors of the World Bank or the governments they represent.

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