

# THE IMPLICATION OF CUSTOMS MODERNIZATION ON EXPORT COMPETITIVENESS IN CHINA

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## Introduction

Customs administrations shoulder regulatory responsibilities aimed at ensuring the security of international transactions; they also facilitate, to the greatest extent possible, international trade, particularly in today's competitive world. In fact, their functions go beyond trade facilitation per se. A customs administration can be said to perform four roles: policy advisor, policy implementer, trade facilitator and security provider.

The present study, based on the experiences of China Customs, aims to identify good practices in enhancing export competitiveness through customs modernization. The paper examines the link between customs operations and export competitiveness, reviews overall principles and patterns for customs modernization, and proposes relevant models. It then examines the modernization of China Customs, including its objective, strategy, major initiatives and measures, as well as the overall impact of a modernized customs on export expansion. Finally, some conclusions and suggestions are provided.

## A. Export competitiveness: Why customs?

International trade is a key driver of economic growth, development and prosperity. Globalization and regional integration further heighten the importance of incorporating international trade policies in national development strategies. Developing countries must integrate national economy into global markets if they are to reap the benefits brought about by trade liberalization and globalization. In terms of exports and their important role in economic development, many developing countries, especially those that have adopted outward-oriented development policies, have been striving to improve their trading environment and export competitiveness through the implementation of trade and transport facilitation measures.

The concept of export competitiveness encompasses differing definitions and interpretations from varying perspectives. Porter (1990) developed the "diamond model of national competitiveness" from the perspective of industrial cluster development, to identify four interlinked advanced factors for competitive advantage: (a) strategy, structure and rivalry of firms; (b) demand conditions; (c) related supporting industries; and (d) factor conditions. Porter argues that government, by formulating and implementing policies, can have a significant impact on the interaction among the four factors. The World Bank

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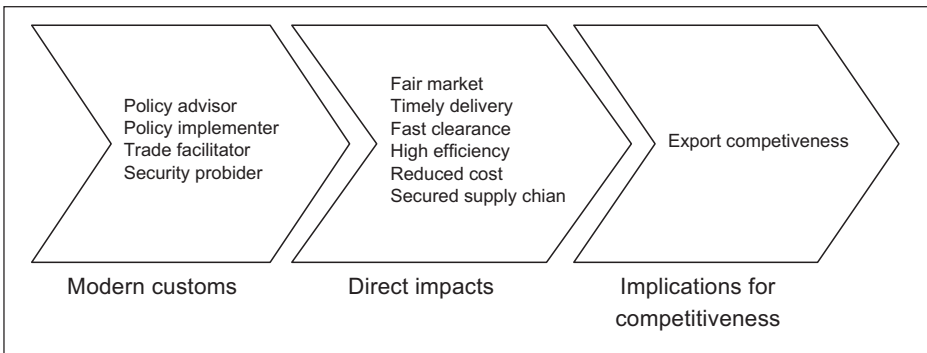
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(2007) has identified three pillars necessary to building an export competitiveness strategy: (a) establishing an incentive framework; (b) reducing trade-related costs; and (c) overcoming market and government failures. The efficiency of customs work has a significant impact on the reduction of trade related costs and the performance of trade administration. Along these lines, the International Chamber of Commerce (1999) has stated that customs administration is crucial to ensuring national competitive advantage in trade in three dimensions: clearance time, predictability and transparency.

A close link between export competitiveness and customs administration can be identified, as customs—one of the key government agencies—is uniquely positioned to control and regulate international trade. The World Customs Organization (WCO) (2008) notes that along with other government agencies, customs: (a) ensures the achievement of national economic, fiscal and social development objectives, (b) monitors the movement of goods, conveyances and people across frontiers, (c) ensures compliance with international trade agreements and gathers accurate trade statistics, and (d) contributes directly to national and international efforts to combat customs offences, particularly organized crime. Given such unique authorities and expertise, customs plays a central role in the security and facilitation of cross-border trade.

Based on the above discussion, a simple model regarding customs and export competitiveness can be developed. Generally speaking, the roles of customs include policy advisor, policy implementer, trade facilitator and security provider. The proper fulfilment of these roles may foster fair market order, ensure timely delivery and reduce cost, thereby helping business to streamline the supply chain and gain a competitive edge in the global value chain.

**Figure 1. The role of customs in enhancing export competitiveness**



## **B. Customs modernization: drivers and principles**

Organizations must re-engineer themselves to accommodate an ever-changing environment if they are to fulfil their mandates. This is particularly true for customs

administrations. For customs administration, modernization is not just an option—it is a necessity. At the threshold of twenty-first century, the International Chamber of Commerce (1999) urged Governments to modernize customs administration, as such modernization was seen as an important catalyst to economic development. The Chamber indicated that countries that recognized the competitive advantage of customs modernization would reap the lion's share of the rewards. The international customs community responded vigorously to this initiative, and two milestones demonstrated the concerted commitment to modernize customs administrations. First, in 1999 WCO adopted the revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures<sup>1</sup> which is seen as the blueprint for modern and efficient Customs procedures in the twenty-first century. The second milestone was the adoption of the Framework of Standards to Secure and Facilitate Global Trade<sup>2</sup> (SAFE Framework), which is aimed at achieving worldwide trade security and facilitation through customs-to-customs cooperation and customs-to-business partnership. To establish an effective and efficient customs system, WCO has identified the key external drivers which characterize the global trade landscape and context for customs modernization (see table 1).

**Table 1. External drivers and implications for customs**

<i>Drivers</i>	<i>Implications for customs</i>
<ul style="list-style-type: none"> <li>• Increased and more complex international trade</li> <li>• New trade and logistics models, such as just-in-time distribution</li> <li>• Increased security threats and organized crime</li> <li>• Higher expectations from both the public and private sectors</li> <li>• Ongoing trade facilitation negotiations</li> </ul>	<ul style="list-style-type: none"> <li>• Increasing workload and complex requirements, such as rules of origin</li> <li>• Pressure on supply chains, higher demand for fair trade practices</li> <li>• Vulnerable supply chain, balance between trade security and facilitation</li> <li>• Increased effectiveness and efficiency to meet the needs of the stakeholders</li> <li>• Need to adjust their policies and method of working in advance and be prepared for the implementation of the outcomes of trade facilitation negotiation</li> </ul>

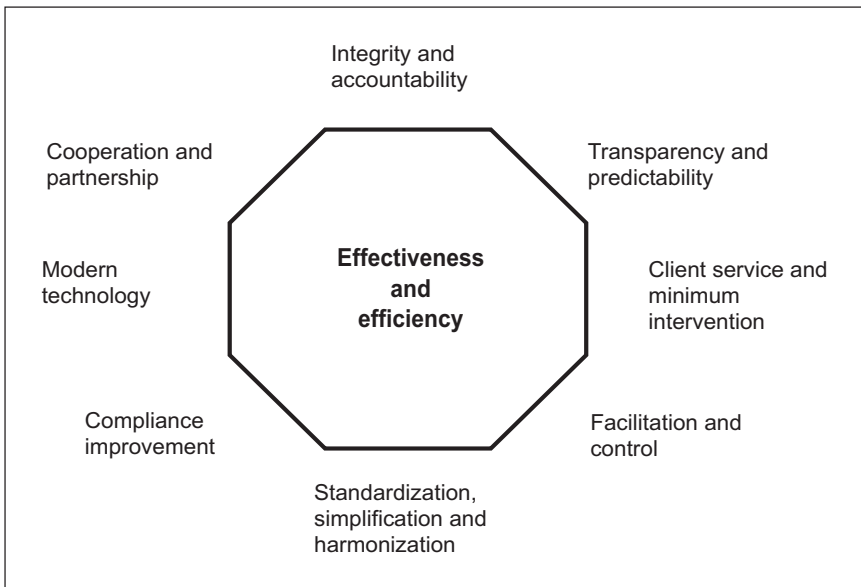
*Source:* World Customs Organization (WCO), *Strategic Plan 2006/2007–2008/2009 and Customs in the 21<sup>st</sup> Century: Enhancing Growth and Development through Trade Facilitation and Border Security* (WCO, 2008).

<sup>1</sup> Adopted at the ninety-third and ninety-fourth sessions of the Council of the World Customs Organization, Brussels, 24-26 June 1999 (see [www.wcoomd.org/kybodycontent.htm](http://www.wcoomd.org/kybodycontent.htm)), entered into force in 2006.

<sup>2</sup> The Framework was endorsed by the Council of the World Customs Organization during its annual sessions in Brussels, 23-25 June 2005 (see [www.vam.hu/loadBinaryContent.do?binaryId=15833](http://www.vam.hu/loadBinaryContent.do?binaryId=15833)).

It is obvious that modernization initiatives benefit customs administrations themselves as well as national development. De Wulf and Sokol (2004) as well as the International Chamber of Commerce (1997) have put forward insightful proposals on cross-cutting issues of customs modernization. The European Commission (2007) also laid down clear criteria on a modern customs administration, which were described in its *Customs Blueprints*. Given the unique settings, needs and priorities of each customs administration, the roadmap and process can vary. There are, however, some common criteria. Through extensive discussions and surveys, WCO (2005) identified the 13 elements of a modern customs administration; the elements can be regrouped into eight dimensions from the perspective of good governance (see figure 2).

**Figure 2. Modern customs: good governance**



Source: Based on World Customs Organization, *Customs Capacity Building Diagnostic Framework* (WCO, 2005).

The framework reflects the needs of stakeholders well, especially the expectations of traders. At the core is the effectiveness and efficiency of customs administration and service. In customs modernization, there are two areas in particular in which balance must be struck: (a) between effectiveness and efficiency; and (b) between security and facilitation. From this perspective, the Revised Kyoto Convention is mainly focused on trade facilitation, while the SAFE Framework addresses global trade security. While figure 2 may appear to reflect an “ideal” set of elements, it actually illustrates the current trend of customs administrations globally. The modernization of China Customs takes place in this broader context, but in its own way, as described below.

## **C. Customs modernization to enhance export in China**

The circumstances in which China Customs operates, since the beginning of twenty-first century in particular, have been characterized by opportunities and challenges. The accession of China to the World Trade Organization (WTO) in 2001 has led to the reduction of tax rates and the reform of the trade regulatory system. Due to the implementation of national opening-up and reform policy, over the past two decades foreign trade in China has witnessed a dramatic growth, and the structure of traded goods has also changed. The central Government has high expectations of customs performance, especially with regard to revenue collection and trade facilitation. However, more complex trade rules and control requirements make customs operations more challenging. Statistics (Liu, 2008) show that during the period from 2000 to 2007, the total volume of imports to and exports from China increased 358 per cent, while the customs staff and budget increased only by 25 and 30 per cent, respectively. In this context, both the public and private sectors place high expectations on customs administration for fast, transparent and consistent processing. However, customs faces a number of challenges, such as growing trade volume, the risk of smuggling, and rampant commercial fraud, and it is becoming increasingly difficult to handle the growing trade volume with limited resources. The pressure of stricter requirements, greater workload and higher expectations spurred China Customs to optimize resources and eliminate bottlenecks in administration. The external demands and internal needs make customs modernization a must.

### **1. Snapshot of the modern customs regime**

As the competent Government agency that supervises and manages all import and export goods entering into or exiting from the customs territories of China, China Customs, as stipulated in the Customs Law of the People's Republic of China,<sup>3</sup> has four mandates: (a) control inward and outward bound means of transport, goods and articles; (b) collect customs duties and other taxes and fees; (c) prevent smuggling; and (d) compile customs statistics and deal with other customs affairs. Accordingly, the main functions performed by China Customs include: customs clearance, revenue collection, control of processing trade and bonded areas, customs statistics compilation, audit-based control, anti-smuggling activities and port management coordination. With 41 customs regions, over 4,000 checking points and over 50,000 staff nationwide (China, 2008), China Customs is a ministerial-level Government agency (in many other countries, the customs administration is at the director-general level). Such status and organizational structure allows it to play a strong role in national policymaking and implementation.

The China Customs drive for modernization began in 1994. In 1998, China Customs decided to establish a modern customs regime, and formulated a two-step strategy to this end. By 2003, the goals of the first-step development strategy, which focused on the

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<sup>3</sup> Adopted on 22 January, 1987 at the 19<sup>th</sup> session of the Standing Committee of the 6<sup>th</sup> National People's Congress, and amended at the 16<sup>th</sup> Meeting of the Standing Committee of the Ninth National People's Congress on July 8, 2000.

reform of the customs clearance system, had been substantially achieved, and a modern customs regime, which featured better coordination among the different functions, was established (China, 2004). In 2004, within the overall framework of the Eleventh Five-Year Plan for National Economic and Social Development of China, China Customs adjusted and fine-tuned its second-step initiatives and launched the Second-step Development Strategy for the Establishment of the Modern Customs Regime (2004-2010) (China 2004). The target of the plan for the period from 2004 and 2007 was to enhance the modern customs regime to ensure that it: (a) supports the national agenda to establish a well-off society, (b) complies with the requirements of the socialist market economy, (c) is aligned with the international standards and practices in the customs area, and (d) strikes a balance between effective control and efficient control. China Customs has aimed to carry out the reforms in a comprehensive and coordinated manner. One of the core elements of the second-step reforms is to establish a risk management mechanism, thus making China Customs a “scientifically-based, service-oriented, efficiency-focused, integrity-minded, harmonious and smart” customs service.<sup>4</sup> The core elements and main initiatives of both steps are presented in table 2.

**Table 2. Modernizing China Customs: the two-step strategy**

<i>Phase</i>	<i>Core element</i>	<i>Main initiatives</i>	<i>Target</i>
I (1998-2003)	Customs clearance system reform	<ul style="list-style-type: none"> <li>• Modern customs legislation</li> <li>• Modern customs compliance management, computerization and application of information and communications technology</li> <li>• Modern customs processing</li> <li>• Enhanced logistics control and supervision</li> <li>• Post-clearance audit</li> <li>• Enhanced internal administration</li> <li>• Public relations</li> </ul>	“Limbs” function well (functions are carried out effectively and efficiently)
II (2004-2010)	Establish and enhance a risk management system	<ul style="list-style-type: none"> <li>• Comprehensive revenue collection regime</li> <li>• Efficient anti-smuggling enforcement</li> <li>• Modern customs control</li> <li>• Updated management of customs bonded areas</li> <li>• Smarter customs statistics</li> <li>• New model of post-clearance audit</li> <li>• Management of entry ports</li> </ul>	Smart in “mind” (risk management is implemented at all levels, modern technology plays a more important role)

Source: China, *Second-step Development Strategy for the Establishment of the Modern Customs System (2004-2010)* (China, 2004)

<sup>4</sup> See <http://english.customs.gov.cn/publish/portal191/tab3972/info69445.htm>.

It should be emphasized that a dynamic monitoring mechanism has been woven into the second-step action plan. Special task forces, both at headquarters and at the regional level, have been formed. Key performance indicators (13 sets) and sub-indicators have been established and are reviewed regularly (Liu, 2008). All the reforms have been translated into concrete actions in the annual plan and routine work of China Customs.

Based on the proposed models (figures 1 and 2), the following sections will examine how China Customs helps to promote exports by fulfilling its functions and implementing initiatives during the course of modernization.

## **2. Roles of policy advisor and implementer**

Customs agencies are generally seen as implementers of Government policy. China Customs appears not to be limited to that role. China Customs, taking advantage of its unique position and expertise, has committed itself as an active and accountable policy advisor. It has exercised this role at both the central and local levels. At the central Government level, recent efforts made by China Customs include: (a) participating in the planning of Chinese regional development strategies such as the country's Western Development Drive, the rejuvenation of Northeast China, and the Western Taiwan Straits Economic Zone (China, 2008), (b) serving as one of the lead agencies in international trade negotiations, such as the WTO negotiations on trade facilitation, as well as in regional and bilateral free trade agreements, (c) providing accurate and timely statistics related to international trade, and (d) participating in international trade dispute settlements. To spur local economies in China, local governments also consult closely with China Customs on relevant policies and treatments. All of the country's customs regions have tailored the national facilitative initiatives and measures to fit local demands within the overall customs laws and regulations.

The role customs plays in the control of international trade does focus on the implementation of relevant national policies. Major aspects relating to the promotion of exports include:

- (a) Helping to foster a fair market and encouraging export growth through the appropriate implementation of fiscal policies, such as export drawbacks and duties;
- (b) Carrying out national policies on industries, which further upgrades the export commodity structure and serves the national strategy of encouraging technological upgrading and innovation through effective control and responsive trade policy implementation.

## **3. Major facilitation measures**

In terms of enhancing export competitiveness, the role of customs focuses largely on trade facilitation. While it is quite difficult to identify the policies and measures which are geared towards exports in particular, the following initiatives implemented by China

Customs in its overall modernization enterprise are seen to have an identifiable impact on exports.

*Amending and enhancing the legal framework of customs.* To prepare for the accession to WTO, China Customs amended its Customs Law. Thorough research was conducted on international standards and best practices, and the amended law incorporated the key principles and standards of the Revised Kyoto Convention, such as balance between efficient operations and effective control, customs security, post-clearance audits and the application of information and communications technology (ICT) (China, 2000). Thus, a comprehensive customs legal framework was established as a solid basis for a modern customs regime.

*Streamlining customs procedures.* Organizationally, China Customs has streamlined its responsibilities among its headquarters, regional customs offices and customs houses with a view to fostering optimal control outcomes. In terms of operations, China Customs piloted and implemented elements such as: (a) pre-arrival declaration and/or clearance; (b) fast-lane and paperless processing; (c) advance ruling on classification and rules of origin; (d) a new model of the customs transit system; and (e) selective inspection based on risk management, all activities which are all aligned with international trends.

*Applying ICT and other modern technology.* To build a “smart” customs, China Customs has established “e-customs”, comprising three “Es”: (a) China E-port, which acts as a single-window system; (b) e-processing, through the H2000 Customs Clearance System; and (c) e-headquarters, through the HB2004 Customs Internal Administration System. Electronic processing greatly reduces the time, cost and complexities of international trade. Furthermore, China Customs is among the leading administrations that have introduced modern customs technologies such as non-intrusive inspection equipment, GPS, and smart customs seals. All these technologies help to effectively control logistics and facilitate legitimate cargo.

*Upgrading export processing control.* Export processing is significant in China; it amounts to over 50 per cent of total exports and imports in East China. Especially in recent years, China has been determined to upgrade export processing, transforming it from industries that are labour- and material-intensive to ones that are technology-intensive and knowledge-based. To cope with the requirements related to handling the products of the newer industries, China Customs has been integrating facilitative measures for special customs-controlled areas to enhance modern logistics, and has been shifting from paper-based to electronic-network controls.

*Enhancing customs-to-business partnerships.* To embody the principle of compliance and facilitation, in the 1990s China Customs initiated the Categorized Management of Enterprises, which was modified in 2008 to incorporate the scheme of authorized economic operators promoted by WCO. With reference to the Categorized Management of Enterprises, import and export enterprises are classified into five categories according to relevant criteria, including compliance record, internal control and trade volume. Highly reliable



enterprises can enjoy facilitative and preferential treatments. The benefits incurred to businesses are substantial.

*Pursuing the balance between facilitation and security.* Ensuring trade security and providing trade facilitation are the core issues for customs administrations throughout the world, and China Customs is no exception. Enhanced security in the international supply chain can give traders a more competitive edge in the global market. China Customs was among the first to adopt the WCO SAFE Framework; the concrete action plan has been integrated into the second step of the modernization process. China actively cooperates with the United States of America on the Container Security Initiative, the Megaports Initiative and other security initiatives. The China-European Union Smart and Secure Trade Lane pilot project started in 2007 and is at the forefront of customs-to-customs cooperation. All these efforts are aimed at ensuring that Chinese products reach consumers abroad more efficiently and at lower cost.

#### **4. Implications of customs modernization**

By the end of 2007, 85 per cent of the key performance indicator targets of the Second-step Development Strategy had been met. All export goods were being processed under the H2000 Customs Clearance System and the E-port was being widely used among exporters. Risk management covered nearly all customs operations, and about 60 per cent of declarations were being automatically processed by the risk-management platform. In terms of clearance time, 84 per cent of exports shipped by sea and 99.7 per cent of exports shipped by other means of transport could be released within eight working hours. The overall physical inspection rate was reduced to 3.41 per cent (Liu, 2008). Faster, predictable and transparent customs clearance greatly helps traders to lower costs and enhance their supply chain management.

The far-sighted strategy and comprehensive initiatives taken by China Customs help to create a trade-enabling environment. The efficient commodity processing by customs and other Government agencies definitely helps business to increase export competitiveness in an international supply chain. From 2000 to 2007, China experienced great leaps forward in export growth, with average annual increases of 26.04 per cent.<sup>5</sup> The export commodity structure was greatly optimized, with a substantial increase in the proportion of the weight of manufactured products and high-tech and high value-added products in the total export volume. The country's share of global exports increased from 2.8 per cent in 1996 to 7.3 per cent in 2005 (IMF, 2006). China ranks at 35 among 150 countries in terms of customs performance in the World Bank Logistics Performance Indicator (World Bank, 2007). Furthermore, in terms of the World Bank indicator entitled "trading across borders", the country ranks at 44 (World Bank, 2009), higher than its overall ranking in *Doing Business 2010*.

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<sup>5</sup> Calculated based on trade statistics compiled by China Customs.

## D. Conclusions

The China Customs experience shows that customs administrations can play a pivotal role in shaping national export competitiveness. The modernization of customs is a long-term and ever-evolving process that serves to support the national development strategy and respond to the needs of the stakeholders. Customs modernization in China, which has contributed to the enhancement of export competitiveness, can serve as an example for other developing countries in Asia and beyond. General conclusions that can be drawn include the following:

- (a) A close link between the role of customs and export competitiveness can be identified. The role of customs in enhancing export competitiveness is multifaceted; trade facilitation is a main component;
- (b) In customs modernization initiatives, generally, there are no distinct measures aimed specifically at promoting exports. Rather, improving overall effectiveness and efficiency requires comprehensive modernization initiatives;
- (c) Governments have an important stake in the modernization of customs administrations, which constitutes a priority of trade facilitation. Appropriate investment is required for effective and efficient cross-border trade management;
- (d) Customs should incorporate whole-government concepts into its operation by forging closer cooperation with other government agencies;
- (e) Balance between “effective control” and “efficient operations” in customs operations must be upheld. The tension between trade facilitation and security must be properly handled;
- (f) Customs modernization must be well woven into the national development agenda, and responsive to the needs of stakeholders;
- (g) Customs modernization should properly incorporate international standards and best practices, especially those developed by WCO, while adapting appropriately to each country’s unique setting;
- (h) Customs-to-customs cooperation and customs-to-business partnerships should be taken as basic pillars to secure and facilitate global trade.

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