

**Customs Valuation-
Challenges for the South Asian
Countries and way ahead with
special reference to
India**

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**Working Paper
Directorate General of Valuation
[March 2010]**

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Executive summary

Customs have a vital role to play in facilitating the ever increasing trade between the countries. The effectiveness and efficiency of the Customs can significantly affect the transaction cost of doing the business and hence the competitiveness of the country. Customs Valuation is one of the important aspects of overall Customs procedures as it affects the Customs revenue, which is likely to remain an important component of the overall Government finances for a number of developing and least developing countries in a foreseeable future. Customs Valuation should be fair, uniform and transparent so that it does not become a non-tariff barrier to international trade. WTO Agreement on Custom Valuation (ACV) has done a noteworthy work to harmonise the divergent Customs Valuation practices among different countries. Acceptance of transaction value by importing countries for the purpose of Customs Valuation is the basis of ACV. However, despite the ACV, the challenges to Custom Valuation are likely to remain as the subject of valuation is inherently intractable.

India signed the ACV in 1980; however, it was only in 1988 that Customs Act 1962 was amended to include the transaction value concept in the Customs Valuation Rules. The Customs Act nevertheless continued to have “notional value” concept. As a result Customs Valuation was a subject of numerous judicial disputes. The Indian Supreme Court ruled in the favour of transaction value in various pronouncements where Customs authorities pleaded for the notional value concept. It appears that a move towards full fledged transaction value regime was deferred, as it was feared that it may lead to a widespread undervaluation and thereby adversely affect the revenue collections. By 2007, as a result of progressive dismantling of tariff barriers, India’s dependence on trade taxes came down from one- third in 1990s to one-fifth by 2005. Further with introduction of Risk Management System (RMS) for Custom clearance and development of National Import Database (NIDB), Customs authorities got enough confidence to deal with the transaction value and therefore in 2007 the concept of transaction value was fully introduced in the Customs Act.

For South Asian countries in general and India in specific the challenges to Customs Valuation remain despite their signing the ACV. Some of the important challenges are slow judicial processes, administrative limitations, existence of a large informal economy and lack of any multilateral framework within ACV to share information regarding valuation in cases of doubtful nature. These challenges nonetheless, India in particular can take various steps to become further ACV compliant. Some of these steps are continuous updating of NIDB and fine tuning the RMS so that they remain worthwhile risk assessment and management tools in a dynamic international trade environment, training of officials in ACV and a formal engagement with private sector will also be useful to mitigate the divergent opinions and perceptions of Customs authorities and importers. India also needs to do away with fixing ‘tariff values’ for certain commodities, as they no longer serve the purpose they were meant for.

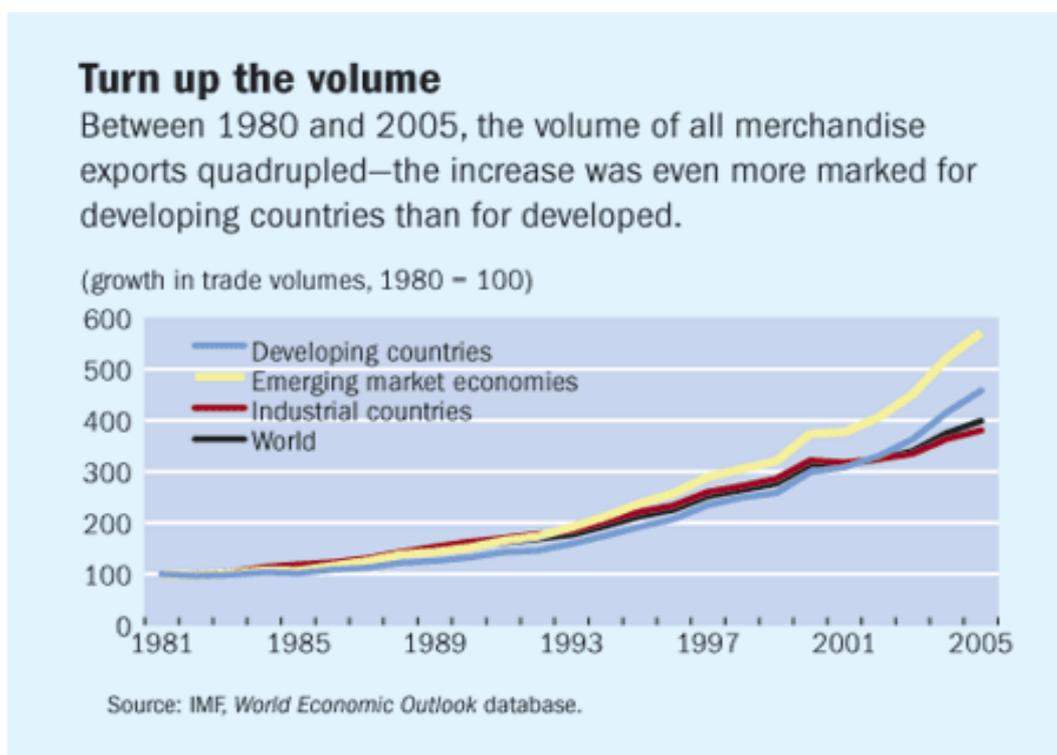
India is now the second largest growing economy after China. Both its imports and exports have grown and will grow rapidly in coming years. It is therefore imperative that institutions such as Custom which are at the cutting edge of international trade, imbibe the best international practises, not only in letter but also in spirit. Customs Valuation, though one of the Customs process, yet is significant enough to merit a special attention as it can impede international trade as well as adversely impact Government revenues. Developing countries in South Asia can ignore it only at their peril.

Introduction

For many decades now, international trade has been an engine of economic growth in many countries. The speed at which the goods move across the borders is critical to the country's competitiveness in international trade. This in effect means that the efficiency and effectiveness of the Customs, being an agency dealing with the goods crossing the borders of a country, can make a significant difference to the growth of its international trade. Customs at the border discharge numerous functions, such as collection of revenue, promoting security and enforcing other laws of the land.

World trade has grown exponentially since 1980's. As can be seen from the Figure 1 below, the increase has been more than five times in the last 25 years and it is more pronounced in the emerging markets.

Figure 1¹



The increase in volume of goods crossing the borders makes it impossible to physically check all the goods. Coupled with the resource constraints Customs organisations face, it is incumbent on the Customs to modernise themselves to brace up for the challenges they have to confront with. One of the important facets of Customs working is valuation of goods more commonly known as Customs Valuation primarily for the purpose of revenue collection. As majority of the duties are on ad valorem basis, as distinguished from the specific, it is essential that valuation of goods is done in a uniform and transparent manner so that on the one hand, Customs revenues are not jeopardised and on the other hand the flow of international trade is not hampered.

About this paper

The purpose of this paper is to highlight some of the challenges South Asian countries face in implementing the WTO agreement on Customs Valuation with special reference to India. It also makes suggestions for bringing India, further in conformity with the ACV. The paper is based on the my experience of working in Directorate General of Valuation (DGOV), discussions with my colleagues in the Customs and existing literature available on the subject. The structure of the paper is as follows: Part I contains this introduction and importance of Customs Valuation. Part II tracks the historical evolution of Customs Valuation; starting from Article VII of GATT to WTO Agreement on Customs Valuation. The salient features of the agreement are also included. Part III traces Customs Valuation in India, the role of Customs duties in India. It also dwells on the reasons for delay in implementation of ACV in India and what factors finally led to its implementation. This part also details on some of the challenges to implementation of ACV in South Asian countries in general and India in particular. Part IV provides some suggestions to make India further compliant with the ACV and improve its overall Customs Valuation procedures, finally leading to the conclusion.

Importance of Customs Valuation

Though significant trade liberalisation in past few decades has reduced the tariff barriers substantially, yet for a number of developing countries and least developed countries trade revenues remain an important component of their total revenues and will remain so in the foreseeable future. As can be seen from the table below till 2003, for other than OECD countries, the trade taxes vary from one fifth to one fourth of total taxes.

Table 1²

Show us the money
Taxes on trade are diminishing but still remain too high in most regions.

Trade taxes as a share of total tax revenue (unweighted average, percent)

	1980	1990	2003
OECD ¹	4.7	2.7	0.8
Africa	38.6	31.9	25.3
Asia and Pacific	29.0	27.6	19.0
Middle East and Central Asia	31.7	28.9	19.8
Western Hemisphere	24.9	14.3	12.4

Sources: IMF, *Government Financial Statistics* and *World Economic Outlook* (various issues); OECD, Revenue Statistics.
¹Organization for Economic Cooperation and Development, excluding Czech Republic, Hungary, Luxembourg, Poland, and Slovak Republic.

For South Asian Countries in particular, percentage of Customs revenues in Government revenues is even higher. For Bangladesh this figure was 42 percent of the total revenue³ in 2007-08. Apart from revenue considerations a transparent and uniform Customs Valuation

system ensures a level playing field for all stake holders. For example if an importer under invoices the goods not only does the Government loses revenue, but it also provides him with an unfair advantage over his competitor. An ill-conceived Customs Valuation system encourages corrupt practices that are detrimental to development of rule of law in the long run. It also undermines investments both foreign and domestic. Furthermore, even the Governments may misuse an arbitrary and opaque Customs Valuation system to negate the commitments made in the multilateral or bilateral trade agreements by using the reference prices or similar other fictitious and arbitrary Customs Values. Hence Customs Valuation has been subject of multilateral trade negotiations as it can constitute a non tariff barrier to international trade. In developing countries an arbitrary Customs Valuation system can become barrier to growth in international trade as well as jeopardise Government revenues, adversely affecting the fiscal situation and macro-economic stability.

A study conducted by Asia –Pacific Research and Training network on Trade (ART Net) in 2005⁴ of most problematic areas private sector faces in trade facilitation ranked Customs Valuation as number one or two challenging issue in all the countries surveyed. The study covered six countries of South East Asia, two of them China and India are the fastest growing economies of the world. The study, therefore, can very well be taken as representative of developing countries as a whole.

Table 2⁵ Comparison of the most problematic areas in conducting trade in Selected Countries

Problem	Overall	Bangladesh	China	Fiji	India	Indonesia	Nepal
Customs Valuation	1	1	2	2	1	3	2
Inspection and release of goods	2	2	6	5	2	2	1
Tariff Classification	3	3	5	3	3	4	3
Technical or Sanitary requirements	4	7	1	1	7	5	4
Payment of fees and penalties	5	6	4	8	6	1	n.a.
Obtaining an import licence	6	5	3	7	5	6	n.a.
Submission of documents for clearance	7	4	6	6	4	7	n.a.
Identification of Origin of the goods	8	8	8	4	8	8	n.a.

Historical Background of Customs Valuation- Part II

Article VII of GATT, 1947

Because Customs Valuation systems have a potential to affect international trade, efforts to harmonise and standardise valuation systems have been made since the beginning of 20th century. The first concrete step in this direction was the trade negotiations that led to General Agreement on Tariffs and Trade (GATT). Article VII of the GATT laid down the general

principles for the purpose of Customs Valuation. It stated that the value of the goods for Customs purposes should be based on actual value of imported goods or of like goods and should not be based on the value of indigenous goods or on arbitrary or fictitious values. The actual value should be derived from a sale or offer for sale under fully competitive conditions. The principles have guided further developments to standardise Customs Valuation systems since then.

Brussels Definition of Value (BDV)

The BDV introduced by World Customs Organisation (WCO) in 1950 was based on the concept of “normal value” – the price of goods in the open market between unrelated buyer and seller, under specified conditions of time and place. In practice as the bulk of imports take place under the conditions stated therefore as per BDV; the invoice price can be taken as basis for valuation. In case certain conditions are not met as in the case of related party transactions, or where declared price is apparently low, or in case of imports by agents, Customs can use some suitable basis to construe normal price using information available and taking in to account actual conditions of sale. This system of valuation gained prominence and by 1970s about 100⁶ countries had adopted BDV (many on de facto basis). However, USA and few other developed countries did not adopt it and continued to have their own valuation systems based on the positive concept of value. Further BDV application was not uniform and Customs rejected the invoice prices arbitrarily and uplifted the values on opaque criteria leading to lack of transparency and consistency in Customs Valuation. The notional ‘value’ also could not keep track of new products and price fluctuations. Moreover, few countries relied on minimum prices/reference prices to facilitate clearance of goods without enhancing their revenues. These problems with BDV led to inclusion of Customs Valuation systems in the agenda of Tokyo round of trade negotiations (1973-1979).

Customs Valuation Code at Tokyo round a precursor to Agreement on Customs Valuation

Tokyo round was launched to expand the world trade by removing the obstacles to trade. Difficult negotiations between developed and developing countries on the matter of Customs Valuation led to an agreement on implementation of Article VII of GATT in the form of a Customs Valuation Code. The Customs Valuation Code agreed upon was to give effect to the basic principles of Customs Valuation laid down in the Article VII of the GATT. The code is based on the positive concept of valuation, which implies that, but for few exceptions, the value of imported goods should be determined on the basis of price actually paid or payable. In the absence of non availability or non application of the price actually paid or payable that is the transaction value, five alternate methods are to be followed in a hierarchy to determine the value of the goods for Customs purposes. As the new proposal divested Customs authorities’ right to reject invoice values even when the prices appear to be out of line with prices of like goods, developing countries strongly opposed this system. They stated that such a system of valuation will adversely affect their Customs revenues as under valuation will go unchecked. Moreover they stated that their Customs administrations did not have the resources and infrastructure to implement the provisions of the code. As a stop gap arrangement developing and least developed countries were give more time to accept the valuation system.

Agreement on Customs Valuation (ACV) at Uruguay round

The Customs Valuation Code agreed upon at the Tokyo round was given a formal shape at Uruguay round of trade negotiations and came to know as Agreement on Customs Valuation (ACV) with some minor changes. The most important change was regarding Shifting the

Burden of Proof (SBP) at the behest of developing countries also known as Decision on SBP. SBP implied that in case where Customs have a reasonable doubt about the values declared by the importer, the burden of proof that the values declared are true is with the importer. If after the submissions of the importer, Customs on the basis of price information and other available data still have doubts about the declared values, the transaction value can be rejected and Customs can proceed sequentially to determine the value. All developed countries acceded to the ACV and the Uruguay round made it application mandatory for all the members of World Trade Organisation (WTO).

Box 1: ACV- At a glance

*The ACV consists of 20 articles. **Article 1 to 8** deals with methods to determine value of the imported goods. **Article 9** deals with currency conversion; **Article 10** is the confidentiality clause that binds Customs not to disclose the data given to them except to the extent required to be disclosed in the context of judicial proceedings; **Article 11** provides for appeal provisions against the orders passed by the Customs; **Article 12** requires that laws, regulations, judicial and administrative rulings shall be published in conformity with Article X of the GATT 1994; **Article 13** is regarding the provision in the legislation of the member countries for provisional assessment backed by adequate surety/deposit, pending final decision on valuation; **Article 15** defines identical, similar goods and related persons. **Article 16** explicitly provides for the right of the importer to get a written explanation from Customs about methodology adopted to value the goods ; simultaneously **Article 17** provide for right of Customs to satisfy themselves about the truth/ accuracy of any declarations/ statements presented for Customs Valuation purpose; **Article 18** establishes “Committee on Customs Valuation” for the purpose of consultation among members in the matters related to administration of ACV or furtherance of its objective with WTO as its secretariat. It also provides for constitution of “Technical Committee on Customs Valuation” under auspices of World Customs Organisation (WCO) to carry out specified responsibilities described in the agreement; **Article 20** contains Special and Differential Treatment (S&DT) clause where by developing and least developed countries are given grace period to delay implementation of ACV. It also provides for technical assistance to members countries on request on various aspect of implementation of ACV*

Details of Articles 1 to 8: Transaction value to be the basis of Customs Valuation

Articles 1 to 8 are at the heart of the ACV. They describe in detail how valuation of the goods for the Customs purpose should be determined. As per **Article 1**, Customs value of the goods to the maximum extent shall be the transaction value, that is, the price actually paid or payable for the imported goods and adjusted as per provisions of Article 8. The important proviso to the article is that buyer and seller are not related and where they are related the transaction value can be taken for Customs Valuation provided the relationship has not influenced the price (Article 1.2). Provision 1.2(b) of the article further explains that if the importer can show that the price declared approximates the transaction value or the Customs

value at or about same time to a sale between unrelated buyers of identical or similar goods for export to the same country of importation, the transaction value shall be accepted.

Article 2 provides that if the Customs value cannot be determined under the provisions of Article 1, the Customs value shall be the transaction value of **identical goods** sold for export to the same country of importation at or about the same time and at same commercial level and substantially same quantity as the goods being valued. **Article 3** states that where Customs value cannot be arrived at by application of Article 1 and 2, it shall be the transaction value of the **similar goods** sold for export to the same country of importation at or about the same time and at same commercial level and substantially same quantity as the goods being valued. As per **Article 4** the application of further Articles to determine the Customs value, that is Article 5 and 6 can be reversed at the request of the importer.

Article 5 explains the deductive method to arrive at the Customs Valuation of the goods whose value cannot be found by application of Articles 1 to 3. Under this article if the imported goods or identical goods or similar goods are already sold in the country of importation than the Customs value of the imported goods shall be the unit price of such goods sold in the greatest aggregate quantity to an unrelated buyer in and around the same time⁷ of the import after allowing for the prescribed deductions. Some important deductions as provided in the Article are profit and general expenses made in connection with sales, costs of transport and insurance, Customs duties and other national taxes paid on the goods. The provisions of Article 5(2) further state that in case the imported goods or identical goods or similar goods are not sold in the condition as imported than the Customs value⁸ shall be the unit price of the imported goods sold after processing in the greatest aggregate quantity to an unrelated buyer after making deductions for processing the goods and those provided in the Article 5(1) (a).

Article 6 explains the computed value method to determine the Customs value of the goods. As per this article Customs value of the good shall be based on the computed value. The computed value is calculated by adding the cost of material and processing, profits and general expenses usually reflected in the sale of the same class of goods. The note to the Article states that this method will generally be used where buyer and seller are related and the producer is willing to provide costing details to the Customs of importing countries. **Article 7** states that where Customs value cannot be ascertained on the basis of Articles 1 to 6, it shall be determined using reasonable means consistent with general provisions of this agreement and of Article VII of the GATT 1994 and on the basis of data available in the country of importation. The Article however explicitly provides that Customs value should not be determined on the basis of (i) selling price of imported goods in the country of importation (ii) price of goods in the country of exportation (iii) the cost of production other than computed value method under Article 6 (iv) the price of goods for export to a country other than the country of importation (v) minimum Customs values or arbitrary or fictitious values

Article 8 provides for certain inclusions to the value of the goods to arrive at the Customs value. These will be added to the price to the extent incurred but not included in the price. Some of these inclusions are commissions and brokerages, cost of containers, cost of packing, apportioned values of materials, components, tools, dies, and moulds; of design work, engineering and development where supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of the goods imported. Royalties and licence fees related to the goods being valued that the buyer must pay as a condition of sale of the goods are also to be included. The provisions of this

Article further provide that additions to the price shall be done only on the basis of objective and quantifiable data.

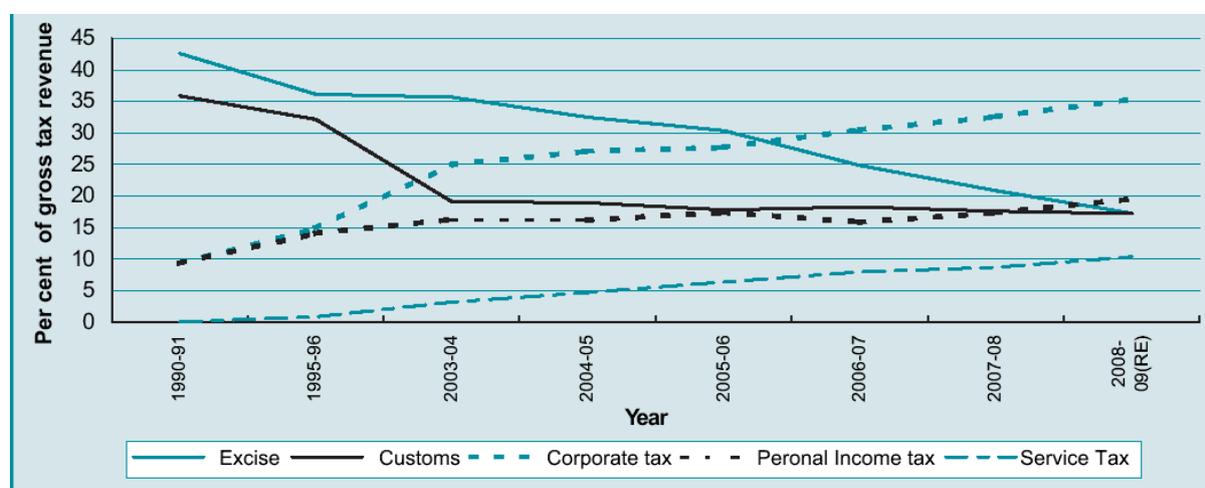
Customs Valuation in India - Part III

Significance of Customs revenues

Before going in to the details of Customs Valuation in India, it will be relevant to understand the significance of Customs revenues in India. Till the nineties India had tax structure that was skewed in favour of indirect taxes. Figure 2, graphically depicts the changes over a period of nearly two decades in Excise and Customs duties (both indirect taxes) as percent of gross revenues. As a high proportion of total revenue these taxes were high in early 90 but came down significantly by 2004.

Figure 2⁹

Trend of Major Taxes as percentage of Gross tax revenue



The sharp fall in Customs duties during the period 1995-96 to 2003-04 was due to tariff reduction in line with India's commitment at the WTO. Table 2 shows that percentage of Customs duties in the gross tax revenues was 32.1 in mid nineties; it came down to 18.9 in 2004-05 and thereafter has stabilised in this range. For the year 2008-09 as per the Revised Estimates (RE) this figure is 17.3. As a percentage of Gross Domestic Product (GDP) the Customs revenues were 3 percent in 1995-96 and in 2008-09 are indicated at 2 percent.

Looking at the trend of all taxes it is apparent that the personal income tax and corporate income tax have stabilised for the time being in the range 50 to 55 percent of gross tax revenues. The introduction of Direct Tax Code (DTC) may affect these figures over a period of time. Excise and Service tax combined are also around 30 percent for last few years, though the Goods and Service tax (GST) might enhance this ratio. The peak rate of Customs duty on non agricultural products is 10 percent and further scope for reducing Customs duties in the near future seems bleak. All in all, it will be reasonable to conclude that in the foreseeable future Customs revenues which are around one-sixth of total revenue at present will continue to remain an important component of gross tax revenues.

Table 2¹⁰

Tax revenue as a Percentage of gross tax revenue and of gross domestic product

	1995-96	2004-05	2005-06	2006-07	2007-08	2008-09 (BE)	2008-09 (RE)
Tax revenue as a percentage of gross tax revenue							
Direct (a)	30.2	43.3	45.1	46.4	49.9	53.1	54.9
Personal Income tax	14.0	16.2	17.4	15.9	17.3	20.1	19.5
Corporation tax	14.8	27.1	27.7	30.5	32.5	32.9	35.4
Indirect (b)	69.1	56.1	54.4	51.0	47.0	46.7	44.8
Customs	32.1	18.9	17.8	18.2	17.6	17.3	17.2
Excise	36.1	32.5	30.4	24.8	20.8	20.0	17.3
Service tax	0.8	4.7	6.3	7.9	8.6	9.4	10.4
Tax revenue as a percentage of gross domestic product*							
Direct (a)	2.8	4.2	4.6	5.3	6.3	6.9	6.5
Personal Income tax	1.3	1.6	1.8	1.8	2.2	2.6	2.3
Corporation tax	1.4	2.6	2.8	3.5	4.1	4.3	4.2
Indirect (b)	6.4	5.4	5.6	5.8	5.9	6.0	5.3
Customs	3.0	1.8	1.8	2.1	2.2	2.2	2.0
Excise	3.4	3.1	3.1	2.8	2.6	2.6	2.0
Service tax	0.1	0.5	0.6	0.9	1.1	1.2	1.2
Total#	9.3	9.7	10.2	11.5	12.6	12.9	11.8

Background of Customs Valuation in India

The provisions regarding levy of Customs duty were first codified in 1878 by the British in the form of Sea Customs Act of 1878. Section 29 provided for the declaration of the real value and the Section 30 of the Act defined the ‘real value’ which was deemed to be the wholesale cash price, less trade discount and import duties for like goods sold or capable of being sold in same quantity at the time and place of importation. The concept of real value laid down in the Sea Customs Act served the purpose for many years. However, with increase in number of products traded, the real value concept in the Act became increasingly untenable, particularly with regard to interpretation of terms such as ‘wholesale cash price’ and “or are capable of being sold”.¹¹

Multilateral trade negotiations in 1947 led to GATT and Article VII therein laid down the principles for Customs Valuation. Keeping in view the provisions of GATT and demand of the importers, in 1962 a new Customs Act was brought in to replace the Sea Customs Act, 1878. Section 14 of the Customs Act, 1962 provided for the valuation of goods for the purposes of assessment. It stated that the value shall be deemed to be the price at which such or like goods are ordinarily sold or offered for sale for delivery at the time and place of importation in the course of international trade, where buyer and seller are not related and price is the sole consideration for the sale. Section 14(2) provided for the fixation of “tariff values “or the assessment values for certain goods. Further Section 2(41) of the Customs Act 1962 defined in detail value for the purpose of assessment of goods. Customs Valuation Rules, 1963 were also notified to determine Customs value of goods under various conditions where the value could not be ascertained in normal circumstances.

In 1980, India signed ACV, however it availed an extension of five years under Article 20 of ACV and further 2 years to implement the changes in its Customs Valuation system. Finally India implemented the ACV in 1988. Section 14 of the Custom Act, 1962 was amended to include a new sub section 14(1A) that provided for determination of the price of imported goods in accordance with the Rules. Accordingly the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 were notified. The Valuation Rules, 1988, though not the exact copy of the ACV, contained all the substantive provisions of the ACV. Till 2007, India continued to have a deeming provision in the Customs Act, 1962 as well as the transaction value provision in the Valuation Rules, 1988. As a result Customs Valuation was being done primarily on deemed concept basis as that provision was provided in Section 14 of the Customs Act and Supreme Court of India in one of the cases¹² on Customs Valuation held rightly so that that provision of the Act will prevail over that provided in the Rules.

Revenue considerations and lack of experience with transaction value delayed implementation of ACV

It is apparent that the main reason for not incorporating transaction value concept in the Customs Act till 2007 was the apprehension that it may lead to wide spread undervaluation of imports and therefore adversely affect the revenue. The rejection of transaction value became quite widespread in 2001 when India amended its Customs Valuation Rules to implement Decision 6.1 regarding Shifting the Burden of Proof (SBP). The amendment provided that if Customs had reasonable doubt about the declared/transaction value of the consignment, it could be rejected and the burden of proof shifted to the importer. Due to frequent rejection of transaction value, some of the importers legally contested it. In *Eicher Motor Vs Commissioner of Customs*¹³, Mumbai, one of the important cases, where transaction value was rejected by Customs, Supreme Court of India held that “unless the price actually paid for a particular transaction falls within the exceptions laid down, Customs are bound to charge duty on the transaction value”.

This is also evident from the results of study on trade facilitation conducted in 2004-05 by Chaturvedi¹⁴ and compiled by Duval¹⁵ along with other South East Asian countries referred to in the beginning, where in Customs Valuation was identified as the number one problem for the trading community. The study by Chaturvedi further found that frequent rejection of transaction value by Customs, lack of expertise in the field officers among the significant issues of concern in Customs Valuation in India.

By 2007, the Customs revenue as percentage of gross revenue fell to 18 percent from highs of 32 percent in 1996. Moreover with transaction value already in the Rules since 1988, Customs officials developed an expertise with the support of NIDB to deal with transaction value. Accordingly a full-fledged move towards transaction value was made by amendment of Section 14 of the Act in 2007. A new set of Customs Valuation rules were notified known as Customs Valuation (Determination of Value of Imported Goods) Rules, 2007. However Government can still notify “values” for certain class of goods for Customs Valuation purposes.¹⁶

In Pakistan too, fear of large scale revenue loss was found be one of the main reasons for non implementation of ACV in its true sprits, despite Pakistan having adopting ACV in 2000. Moise (2004)¹⁷ found that Pakistan Customs arbitrarily uplifted Customs value. He also found that the justification provided to the importers for enhancing the values was inappropriate and adequate mechanism to resolve Customs valuation dispute was not present. He concluded that though Pakistan is de jure compliant with ACV, yet it “would take more time for adoption of new Customs Valuation practices and procedures”.

Building of NIDB and its use as risk management tool helped in implementing ACV

As per Article 17 of the ACV, Customs have right to satisfy themselves about the truth and accuracy of the values declared. For this purposes Customs Administration can set up a database of values of imported goods and use it for the purpose of verifying the declared prices of imports and as a risk assessment tool. India set up a Directorate of Valuation in 1997 with a mandate to build a comprehensive valuation database. Soon, thereafter National Import Database (NIDB) that captures Customs values of most of imports¹⁸ in to India was put in place. It analyzes the data with the help of software developed for this purpose. The analyzed data contains values of imported products /commodities, the declared prices of which are out of line with the average values. This information is then used by Customs formation over the country to ascertain the truth and accuracy of the declared values of various imported goods.

World Custom Organisation (WCO) has laid guidelines for development and use of a national valuation database as risk management tool. It reiterates that valuation database may be used only as risk assessment tool and its design should be primarily to assess the possible risk regarding truth and accuracy of declared values¹⁹. Further, it explicitly provides that the database should not be used to determine Customs value of goods as substitute value for imported goods or as a mechanism to establish minimum values. It also prohibits rejection of declared values solely on the basis of difference between the declared values and database values²⁰.

But Challenges to implement ACV remains

With amendment of Section 14 to include transaction value as the basis for Customs valuation, in most cases the transaction value is accepted as the basis for custom valuation. In cases where Customs have doubt about the veracity of the declared values either on the basis of NIDB data or any other information available and importer is unable to satisfy Customs about the truthfulness of the declared values, the transaction value is rejected in such cases and as per ACV the Customs value has to be determined sequentially by following the subsequent Rules. The experience with the use of NIDB however, suggests that contrary to the guidelines in most cases, the price information in the database is used to reject the transaction value and the database value is taken as Customs value. The importers accept the prices even if unwilling, because they do not want to delay clearance of their goods and incur demurrage. Moreover, delays can disrupt supply chains in production and delivery schedules.

Some of the challenges to Customs Valuation in South Asian Countries and especially in India

Existence of a large informal economy

Most South Asian countries including, India have a large informal sector consisting of traders whose record keeping is poor. Some of them have no fixed business locations or the addresses are changed frequently, mostly without intimation to authorities. As a major part of the imports especially consumer goods are made by them, it is not easy to institute post-audit controls that are contemplated in the ACV. Further experience suggests that invoices produced before Customs by such importers can be easily forged. Some fraudulent invoices are easy to detect while others not so easy. Transparency International in its 2009²¹ report ranked India at 84 among 180 nations on its annual corruption index. The index measures perceived level of public sector corruption in the country. Given the levels of corruption, frauds by traders by under invoicing can pose a significant strain on Customs administration and endanger revenues. The whole thrust of ACV to accept invoice prices for the purpose of

Customs Valuation thus become questionable. No wonder it took India around two decades to include the transaction value fully in the provisions of its Customs Act.

Tardy Judicial process

South Asian Countries have slow judicial processes. Indian Judicial system for example is plagued with abnormal delays. The average time for case disposal is as high as 15 years.²² Judicial delays cause cynicism among people about the institutions. Once adjudication proceedings are initiated it may take some times more than a decade before the case reaches the Supreme Court the highest court. Traders and importer being aware of these delays do not confront with the Customs even if they may have genuine grounds. They accept the Customs Values from NIDB or other sources as against the transaction values, as they are aware that the delays in clearance of goods will be more costly than accepting the higher price. The delays in judiciary also affect the interest of Customs adversely as some unscrupulous importers aware of this lacuna in the judicial system deliberately undervalue the goods and then keep on contesting it at various judicial forums and by the time case reaches the finality they disappear by transferring their assets and properties in other firms. So improving justice delivery system overall will have a salutary effect implementation of ACV.

Lack of formal arrangement at international level for sharing information related to Valuation²³

On India's initiative a proposal was submitted at Doha Ministerial Conference in 1981 for a formal arrangement within ACV framework, whereby Customs administration of importing countries could get price and related information from exporting countries on request in cases of doubtful nature. Though at the ministerial conference it was agreed to share the information, yet subsequent experience at WTO committee on Customs Valuation and at WCO policy commission indicates a major problems with implementing exchange of information among Customs administration. Major resistance in this regard has come from the developed countries due to various reasons. WCO, in 2002 prepared a draft guide to the exchange of valuation information, which contains an exhaustive list of actions on the part of importing countries before seeking information from the exporting countries. Despite efforts by WCO, a multilateral framework for sharing information by exporting countries in the context of implementation of ACV looks bleak. Bilateral agreements on mutual assistance seem to be more practical solution to sharing of information. The hesitancy on the part of exporting countries, mainly developed countries, to share information about valuation is one of the important impediments to the adoption of ACV in its true spirit by developing countries.

Administrative constraints

India's imports and exports have grown manifold in last two decades. The diverse nature of products imported and rapidly changing prices and different sale conditions for various transactions poses enormous challenge for valuation of the imported goods for the Customs administration. The urgency to clear goods adds another dimension to valuation of goods, where by any action has to be taken expeditiously as once goods are out of Customs control; it is not easy for Customs to track the goods/ importer. Though bringing major Customs Houses on Electronic Data Interchange (EDI), Risk Management Systems (RMS) has eased the burden on Customs, yet the imports from Non EDI station poses challenge for the Indian Customs administration, as most of the import data at these stations is not captured in the database and level of Customs expertise available at these stations is low. Moreover, application of Article 6 and 7 of the ACV is cumbersome. The computed value method provided under Rule 6 requires information from exporting countries, which as the

experience suggests, is not easily forthcoming. The application of the Articles of ACV is time consuming and will delay clearances leading to blame on Customs.

In case of Bangladesh, introduction of Automated System for Custom Data (ASYCUDA++) developed by United Nations Conference on Trade and Development (UNCTAD) and Direct Traders Input (DTI) automations has expedited the Customs clearances and made the Customs more transparent in their operations. As is apparent from the website of National Board of Revenue, Bangladesh, Customs have appointed Pre-Shipment Inspection (PSIs) agencies who certify valuation, classifications and other relevant details of imported goods and Customs based on the certification of PSI companies allow clearances unless they have information to the contrary. The role of PSI for Customs purpose is debatable with arguments on both sides²⁴. However the long term use of PSI agencies is certainly not good for developing capacities of Customs administration in Valuation and other related processes in these countries.

Box 2²⁵. What is Automated System for Customs Data (ASYCUDA)?

*ASYCUDA is UNCTAD developed automated Customs data management system that can handle all Customs clearance processes including electronic processing of declarations, risk management, transit operations in addition it collects statistical data for trade and fiscal policy analysis. **First version of ASYCUDA** was developed from 1981 to 1984 for West African countries to compile foreign trade statistics. The **second version** developed between 1985-95 introduced local area network and provided for a more powerful data transaction capacity through use of file server system. It automated most of the Customs clearance processes. **ASYCUDA++ is the third version** operational from 1992 has more features such as direct trader input, risk management, filing declarations via internet. The **latest version ASYCUDA World** introduced in March 2002 is compatible with major database management and operating system. It permits exchange of documents nationally between Customs and traders and at international level between different Customs administrations via internet. ASYCUDA represents UNCTAD's largest technical cooperation and capacity building program worldwide. **It is used or being implemented in more than 90 countries. More than 15 million Customs declarations are processed annually with ASYCUDA for both exports and imports.***

Further Steps that can be taken to improve the compliance with ACV- Part IV

As already stated, Customs revenues are and will remain an important component of total revenues for developing countries including India. With most duty rates being ad valorem, Customs Valuation will continue to pose challenges for Customs. Apart from revenue considerations, the Customs Valuation system should be fair and transparent to provide an enabling business environment. The ACV has done a commendable work in bringing harmonisation of the Customs Valuation practices of different countries so that they do not become Non-Tariff Barrier (NTB) to international trade. However, as enumerated above, implementing ACV is not easy in developing countries. Some of the recommendations/suggestions in Indian context with regard to ACV implementation are as follows:

Make NIDB comprehensive and update it regularly

The importance of having a database containing updated price information of various imported goods in context of Customs Valuation is well accepted. WCO has issued guidelines as to how to use the database as a risk management tool. A database with the Customs that is continuously updated serves as a deterrent to importer to undervalue. The effects of having a database can be seen in Indian context; almost 99 percent of Customs revenue realised is based on the transaction values. Data available with Directorate General of Valuation (DGOV) indicates that since last few years around one percent of Customs revenue realised is directly attributable to the use of information provided by NIDB. (Table 3)

Table 3²⁶: Revenue realised due to enhancement of declared values as a percent of total revenue

Year	Total Customs Revenue	Additional Revenue due to enhancement of values	% of Total Revenue
2006	648	4.5	0.70
2007	852	6.3	0.74
2008	1016	7.3	0.72
2009	994	7.3	0.73

Numbers in Column 2 and 3 in Billions of INR

NIDB has thus provided a salutary effect on declarations by importers, who being aware of the database with Customs do not undervalue rampantly. However, the database is far from perfect. There are issues with respect to quality of the data, which DGOV has been taking up with the field formations. Further the data captured is not comprehensive; most non-EDI locations imports and even sometime the imports from EDI stations are not captured due to software problems. This situations needs to be rectified with urgency for the database to serve as a risk management tool as well as act as a deterrent to undervalue.

Fine tune the Risk Management System periodically

In 2005, India introduced Risk Management System (RMS) for imported goods, the primary objective of RMS is “to strike an optimal balance between facilitation and enforcement and to promote culture of compliance. It is intended to improve the management of resources of the department to enhance the efficiency and effectiveness in meeting stakeholders’ expectations and to bring the Customs processes at par with the best international practices.”²⁷ The RMS has picked up well and provides facilitation to imports which are perceived to be low in risk. One of the important components of the risk is the value of the imported product/commodity. From the database that DGOV has developed, it provides valuation band for various sensitive products and commodities to the Risk Management Systems, so that where the declared values are lower than that indicated in the band, those products are not facilitated and are subject to further examination. With fast changing technology, this requires two things first the database should be updated to contain information about the changes in prices as well as changes in product description and second the specified products and commodities for which the price information is supplied is updated based on the risk perception.

Do away with the tariff values on specified commodities

As mentioned earlier Indian Government still has a power to notify minimum/reference values for certain class of goods. In exercise of power available under the Customs Act, it has notified few items for which tariff values are notified each month. These products/commodities are Crude Palm Oil, RBD Palm Oil, Crude Palmolien, RBD Palmolien, Crude Soyabean Oil, Brass Scrap (all grades), and Poppy seeds²⁸. In 2008-09, the Customs revenue from all the commodities on which tariff value has been fixed was INR 11.15 billions, which was approximately one percent of the total Customs revenue for that year. The Customs revenue from these commodities is marginal and there is no convincing ground for having minimum values on these commodities. Customs may be apprehensive that they may lose revenue as these are commodities are prone to undervaluation, but that is true for many other commodities. Moreover Customs now have a database and RMS to prevent gross undervaluation of any commodity. The contemporary international prices of these commodities are readily available and in case of doubt on valuation, Customs can use the power vested in them to reject the transaction value and go for alternate method of Valuation as per the ACV. Satapathy (2002)²⁹ advocated that reference prices should be to compare the truth and accuracy of declared values, in other words Customs may use them for their own information but should not use these prices for Customs Valuation purpose. The removal of tariff values will make India further compliant with ACV without any significant effect on revenue.

Regular training of officials doing assessment

Training of officials in Customs Valuation can significantly ease the challenges of implementing ACV. Experience suggests that, generally officials dealing with assessment are not updated with the ACV and related provisions of Customs Act. When the officers are themselves not fully aware/updated of the provisions of ACV and how to proceed systematically in case they have doubt regarding Customs Valuation, they cannot communicate it to the importers in a way that they do not feel harassed. Lack of trained manpower in Customs Valuation has also been highlighted as one the challenges to implement the ACV in case of Nepal³⁰. In India, DGOV has taken up the task of educating officers regarding ACV in general and provisions of Customs Act in particular and has/is organising workshops in various field formations. In this regards the efforts by DGOV needs to be intensified and supplemented by National Academy of Customs and Excise and its Zonal units to impart training and make assessing officers aware of the ACV and valuation tools including usage of database.

Formal consultation with the private sector regarding Customs Valuation issues

One of the important features of modern Customs administration is partnership with the private sector. It is the private sector which is affected most by the Customs procedures. Way back in 2002 Satapathy in his book³¹ in the context of implementation of ACV stated that 'there should be better cooperation and consultation between the importers and Customs'. He concluded that 'both (Customs and importers) must necessarily contribute to the decision-making process and share the responsibility to arrive at correct valuation'. In India, though there are trade facilitation committees where Customs and other stake holders meet periodically, but these are mostly driven by Customs with no real private sector participation. There is no formal consultation with importers on Customs Valuation procedures. It is therefore imperative that a formal partnership is forged between Customs and importers/traders. Workshops and seminars should be held whereby provisions of ACV and Customs Valuation procedures should be widely disseminated by Customs officers and Experts. The

expectation from the importers, their rights and responsibilities under the Customs Act and ACV should be highlighted in such workshops. With more and more importers opting for online filing of import documents, the awareness on the part of importers/agents about the importance of furnishing accurate description of goods and other related parameters will not only expedite clearance of the goods, but also make the database more reliable.

Give Post Clearance Audit the importance it needs

Technical note³² prepared jointly by UNCTAD and WCO on Post Clearance Audit (PCA) for Trade Facilitation Negotiations defines PCA as an “audit-based Customs control performed subsequent to the release of the cargo from Customs custody. The purpose of such audits is to verify the accuracy and authenticity of declarations and covers the control of trader’s commercial data, business systems, records, books”. PCA is a part of overall risk management in Customs operations and used properly it can expedite Customs clearances. Effective implementation of PCA is necessary to secure Customs revenue and other taxes while facilitating Customs clearance. The PCA in India is transaction based and experience suggests that it has not really picked up. Once the goods are cleared from the Customs control, importers normally do not attend to queries by the audit easily. India and other South Asian countries having large informal economies can benefit from dual PCA one for importers/traders having no record of previous imports with Customs or those who have been indicted in Customs frauds(which should be defined for this purpose) and other for established importers with impeccable track record with Customs. Transaction based control for the former and company based/importer based controls for the latter should be instituted. The transaction based control should be time bound and may be insisted on before clearance of goods. Company based audit controls can benefit from a trend in the transaction values over period of time. Inconsistencies found on comparison with the price information in the database can indicate undervaluation.

Make Special Valuation Branches (SVBs) effective

The SVBs specialise in investigation of transaction involving special relationships and certain special features having bearing on the value of imported goods. These are located in the four major Customs Houses. They deal with cases mainly involving related party transactions and such issues as payment of royalties, licence fees, supplies by importers. Article 1.2 of the ACV enjoins on the Customs not to reject transaction value merely on the grounds that parties are related; it must be proved that the relationship has influenced the price for transaction value to be rejected. Where such doubt exists the case is referred to the SVB. Experience, however, suggests that once a case is transferred to the SVB, it lingers on and the importer has to pay extra duty till the case is settled leading to blockage of his funds. Though the instructions³³ provide for completing the investigations and finalisation of assessment case within four months, but the time limit is hardly adhered to due to various reasons. One of the reasons it appears is that, the SVBs are not adequately manned. Further as per the data maintained by the DGOV, in majority of the cases referred to the SVBs, the declared values are accepted and in cases where the imported values are contested by the SVBs at the higher judicial forums only one percent sustains. It thus appears that the investigative skills of the officers in the SVBs need to be enhanced to make them truly effective.

Conclusion

Customs Valuation is one of the important steps in the overall Customs clearance process. A Customs Valuation system that is arbitrary and opaque can be harmful in many ways. One, it can have adverse effect on the Government revenues. Second, lack of transparency and discretionary powers to arbitrarily fix Customs Value, can increase potential for corrupt practices. Further it can delay the clearances of goods, disrupt the supply chains and there by impede the flow of international trade, ultimately hurting the economic growth. Therefore it is imperative that developing countries give due importance to Customs processes and procedures in general and Customs Valuation in particular. Some of the challenges to the implementation of WTO Agreement on Customs Valuation have been discussed with special reference to India in this paper.

As is evident the challenges to Customs Valuation remain and these challenges are such that they cannot be done away overnight as some of them are linked to broader macroeconomic framework of the concerned country. It is vital to be aware of these challenges so that they can be dealt with appropriately. Experience with the Technical Assistance (T.A) programs suggests that some of these programs do not take a holistic approach to Customs reforms in developing and least developing countries. The focus in these programs has been to make the recipient country compliant with the WTO agreement. However WTO agreement, say on Customs Valuation, does not touch upon various other Customs processes and other logistics/infrastructure issues that are equally important and need to be improved upon to make an impact on Customs efficiency and effectiveness as a whole. Finger³⁴ in fact, went on to say that “from the perspective of least developed countries need for Customs reform, the WTO agreement on Customs Valuation provides neither an appropriate diagnosis nor an appropriate remedy.” That may be an extreme view, but fact remains that Customs Valuation should not be seen in isolation from other Customs processes.

However, as discussed in this paper South Asian countries can take certain steps in the right earnest to improve their Customs Valuation practices. These steps include developing a database containing price information of imported goods, putting in place a risk management system and continuously updating it, providing training to the officials. Having a Customs Valuation system that is ACV compliant is in the interest of every developing country as it integrates them with the international trading community and allows them to take benefit of global markets. History has shown that no country has prospered in isolation.

The World Bank’s “*The Growth Report: Strategies for Sustained Growth and Inclusive Development*”³⁵, which looks at how developing countries can achieve fast sustained and equitable growth, while reviewing the growth strategies of countries which grew at or more than ten percent for more than a decade found that in all the cases countries prospered by serving global markets. Expanding markets means facing competition and being competitive, means delivering goods at the lowest cost. As has been indicated in the paper an efficient and effective Customs can play a significant role in reducing these transaction costs and make country cost competitive. A Customs Valuation system that is fair, uniform and transparent coupled with reform in other Customs processes can certainly improve the overall efficiency and effectiveness of Customs, so that while Customs safeguards national interest they facilitate trade as well.

End Notes

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- ¹ Walsh, James, 'New Customs' Finance and Development, March 2006, Volume 43, No.1
- ² Ibid
- ³ As per the figure available on the website of National Board of Revenue, Bangladesh <http://www.nbr-bd.org/customs.html>
- ⁴ UNDP (United Nations Development Program).2008. "Trade facilitation beyond the multilateral trade negotiations: Regional practices, Customs Valuation and other emerging issues", A study by Asia –Pacific Research and Training network on trade. Pg 237
- ⁵ ART Net Working Papers No. 4, 5, 8, 9 and 10, www.artnetontrade.org also ibid pg 237
- ⁶ Gooraman Adrien and Wulf Luc De, Customs Valuation in the developing countries and WTO valuation rules, Customs Modernization Handbook, the World Bank
- ⁷ As per article 5(1)(b) the maximum period that can be considered is 90 days
- ⁸ on the request of the importer
- ⁹ Economic Survey of India 2008-09: <http://indiabudget.nic.in/es2008-09/chapt2009/chap32.pdf>
- ¹⁰ Economic Survey of India 2008-09: <http://indiabudget.nic.in/es2008-09/chapt2009/chap32.pdf>
- ¹¹ Majumder. S.D, Customs valuation: law and practice, pg55, CENTEX Publications, 1996
- ¹² Ispat industries Vs Commissioner of Customs , Mumbai 2006(202) E.L.T. 561(S.C)
- ¹³ Eicher Tractors Limited Vs Commissioner of Customs , Mumbai .2000(122) E.L.T.321(S.C.)
- ¹⁴ Chaturvedi, Sachin (2006), "Customs Valuation in India: Identifying Trade Facilitation related Concerns", Asia-Pacific Research and Training Network on Trade Working Paper Series, No. 25, December 2006
- ¹⁵ Duval, Yann (2006), "An Exploration of the Need for and Cost of Selected Trade Facilitation Measures in Asia-Pacific in the context of the WTO Negotiations", Studies in Trade and Investment, No. 57, Economic and Social Commission for Asia and the Pacific, United Nations available at <http://www.unescap.org/tid/artnet/pub/wp1406.pdf>
- ¹⁶ Section 14(2) of the Customs Act, 1962 as it stands on date.
- ¹⁷ Moise, Evdokia (2004), "The WTO Customs Valuation Agreement: Bridging Law and Practice", World Trade Institute Customs Valuation Seminar 2004, Berne p. 9
- ¹⁸ Imports from few places that are not electronically connected are not captured
- ¹⁹ Para 10 of WCO Guidelines on development and use of valuation database
- ²⁰ Para 18 of WCO Guidelines
- ²¹ <http://www.2point6billion.com/news/2009/11/18/china-and-india-rank-in-the-middle-of-global-corruption-index-3056.html>
- ²² <http://www.barandbench.com/index.php?title=The%20art%20of%20seeking%20%27time%27%20-%20Adjournments%20tongue%20in%20cheek&page=brief&id=283&gn=1283&p=all>
- ²³ Based on Gooraman Adrien and Wulf Luc De, Customs Valuation in the developing countries and WTO valuation rules, Customs Modernisation Handbook, the World Bank, p.166
- ²⁴ Goorman (2004) p.168 onwards
- ²⁵ Based on Technical note No 21 prepared UNCTAD Trade Facilitation Negotiations available at <http://r0unctad.org/ttl/technical-notes.htm>
- ²⁶ Figures from Directorate General of Customs Valuation, Mumbai
- ²⁷ Government of India, Ministry of Finance, Central Board of Excise and Customs , Circular No. 43/2005-Cus dated 24th November, 2005, para 3
- ²⁸ Government of India, Ministry of Finance, Notification No. 20/2010- Customs (N.T), dated 15/03/2010, available at www.cbec.gov.in
- ²⁹ Satapathy, C. (2002), "Customs Valuation in India", Third Edition, MVIRDC, World Trade Centre, Mumbai,p162
- ³⁰ Rajkarnikar,P R " Implementation of the WTO Customs Valuation Agreement in Nepal: An Ex-ante impact assessment
- ³¹ Satapathy, C. (2002), "Customs Valuation in India", Third Edition, MVIRDC, World Trade Centre, Mumbai, p. 143-144
- ³² Technical note prepared jointly by UNCTAD and WCO on Post Clearance Audit for Trade Facilitation Negotiations available at <http://r0unctad.org/ttl/technical-notes.htm>
- ³³ Government of India, Ministry of Finance, Circular no. 11/2001- CUS dated 23/02/2001, para 10
- ³⁴ Finger, Micheal J.2000. "The WTO's special burden on less developed countries", Cato Journal, Winter 2000, 19,3: Alumni- ABI, pg 425
- ³⁵ The Growth Report available at http://www.growthcommission.org/index.php?Itemid=169&id=96&option=com_content&task=view

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