Breaking Up the Logjam: Automated Customs Risk Management System Implementation in Georgia

How do you turn a confusing tangle of red tape into a smooth operation? In Georgia, the solution involved risk management, automation, and a good mechanism for public-private dialogue. Aggressive customs reforms powered Georgia’s leap ahead of 119 other countries on the World Bank Doing Business (DB) “Trading Across Borders” indicator, from No.149 in 2006 to No. 30 in 2010 (see table). This customs reform was a key component of the trade logistics reform introduced by the Government of Georgia and supported by the United States Agency for International Development (USAID) Georgia Business Climate Reform (GBCR) Project, implemented from September 2005 to August 2009. This SmartLessons captures some of what made this project a success.

Background

When GBCR began, customs administration was arbitrary, disorganized, nontransparent, and extremely unfriendly. Public opinion ranked customs the most corrupt agency in Georgia. Separate Tax and Customs Departments and Financial Police acted on overlapping mandates under completely separate authorities with little communication or coordination. Similar confusion among other agencies with responsibilities at the border, plus a complicated, ambiguous, and conflicting customs legal framework, made it all but impossible for traders to be customs-compliant.

Risk management—the process of allocating resources where the risks of noncompliance are greatest—did not exist in Georgia. Every

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Table: Georgia’s Progress in DB “Trading Across Borders” Indicators
import and export, regardless of the risk represented, was subject to physical inspection. Consequently, the time and costs associated with clearing goods were significant for both businesses and customs administration. Because everything was inspected, the superficial methods used in the process accomplished little other than to create opportunities for corruption. Electronic submission of documents was impossible, and the legal framework obscured the documents and procedures required for clearance. Customs officials were authorized to demand of traders any of 23 specifically identified documents, or anything else they wanted to require. Importers could not determine in advance what they had to submit or how much they had to pay, and customs did not follow the World Trade Organization customs valuation rules. Finally, there was no mechanism for communicating and sharing feedback between the private sector and customs administration to facilitate meaningful reform.

After several rounds of dialogue with the Ministry of Finance and the Revenue Service, the government decided to replace 100 percent of its physical inspections with a risk-based cargo selectivity system. The introduction of customs risk management significantly reduced petty corruption and, in combination with rational laws and procedures, allowed traders to comply voluntarily with revenue laws. Results included:

- **Customs Risk Management:** The risk-based cargo selectivity was fully implemented throughout Georgia by July 2008. The implementation began on February 1, 2008, and was systematically expanded to all customs clearance offices. Now, 90 percent of shipments are subject only to documentary review (“yellow channel”), reducing the time to clear most shipments by several days. The remaining 10 percent (recently reduced from 15 percent) are referred for physical inspection (“red channel”). This decision is based on a combination of risk criteria programmed into the UNCTAD (United Nations Conference on Trade and Development) ASYCUDA (Automated System for Customs Data) customs processing software and random selection. The automated selection of shipments for physical inspection focuses customs resources where the risk is greatest, makes the process more objective, and provides fewer opportunities for corruption.

In the first quarter of 2009, the automated cargo selectivity was expanded to exports and customs warehouses as well. The Revenue Service plans to introduce the “green channel” and “blue channel” for international and diplomatic organizations as well as for low-risk companies.

- **Authorized Economic Operators (“Gold List”) Program:** As part of the customs risk management system, the “green channel” (no physical or documentary checks) was implemented for Gold List program importers. The Gold List program provides simplified import procedures for high-value/high-volume traders—5 million Georgian Lari (GEL) of import value—with a demonstrated history of compliance. Simplified procedures include: a) immediate release of goods, which circumvents cumbersome formalities at the Inland Clearance Terminals; b) post-payment of customs duties for up to 30 days; c) electronic submission of declarations with no attached documents required; and d) advance declaration filing. Since November 2009, no customs guarantee is required for Gold List members.

Georgia’s Revenue Service originally implemented the Gold List program with strict requirements during a pilot phase. Companies approved were required to submit a customs guarantee (bank guarantee, insurance policy, deposit) of €100,000. Importers of excise goods are still required to submit a general customs guarantee, but the amount has been reduced to 100,000 GEL instead of €500,000. Moreover, since November 2009, the Gold List has been expanded from import to include customs warehouse regimes, with export soon to follow. The number of companies taking advantage of the Gold List program has grown tremendously, from the four companies that were part of the pilot group to over 200. The largest 100 importers in Georgia account for more than 40 percent of the volume, value, and number of import declarations filed.

**Lessons Learned**

1) **Implement comprehensive reforms.**

The scale of the increases in trade volumes and values and revenues noted above almost certainly resulted from the synergies of sweeping reforms that were taking place in every aspect of the business climate (see box), as well as the international publicity Georgia received as it rose from No. 112 on Doing Business 2005 to No. 11 in 2010.

**How GBCR Provided Assistance on Customs Risk Management**

Broad-based technical assistance helped lay the groundwork for risk management, create the organizational and physical infrastructure required, and then plan and implement effectively. It included the following:

- Legal drafting—GBCR legal experts supported the government’s proposal and review of multiple changes to the Customs Code, regulations, and procedures, to authorize and implement risk-based inspections and the Gold List program;
- Institutional development—The Revenue Service, supported by the GBCR team, created a Risk Analysis Department, which included specialists to analyze and recommend risk criteria and to be responsible for processing and evaluating Gold List applications;
- Capacity building—The GBCR project team worked hand in hand with the government to provide multiple risk management training sessions for Risk Analysis Department employees;
- Automation of cargo selectivity—GBCR closely collaborated with UNCTAD to input risk profiles into ASYCUDA, and developed an ASYCUDA module for simplified clearance procedures for Gold List program participants.
2) Combine technical assistance with procurement.

GBCR reserved $2.5 million of its $13 million four-year budget for procurements to support implementation of the reform initiatives it supported. This was crucial to success in reforming, particularly in automating business processes in the early days. As revenues rose, the government adjusted its budget priorities and the project substituted technical assistance for procurement activities.

Examples of procurements that were important for Customs Reforms:

• When the project started in October 2005, the Customs Department, Tax Department and real property registrar (National Agency of Public Registry) were all using unlicensed, out-of-date Oracle software. GBCR procured licensed Oracle software for all three agencies. Without licensed software, applicable regulations prevent technical assistance that violates intellectual property rights.

• GBCR issued a competitive tender for a customs time measurement study that provided a detailed baseline that identified bottlenecks and logjams at particular sites and with particular processes. This helped us identify issues and prioritize reforms. The methodology was subsequently exported by the Georgian provider on a similar project in the Caribbean.

• With GBCR support, Georgia’s Soviet-era Customs Code was replaced with much more modern legislation. Parliament passed the law in November 2006; it took effect on January 7, 2007. After passage of the law, the Ministry of Finance asked GBCR to organize training for about 500 customs officers before the law took effect on January 1. An emergency procurement to the American Chamber of Commerce in Georgia and Georgia American University resulted in successful training in modern facilities with computer labs.

• Other procurements included Web site development, and publication of brochures and educational materials.

As the examples above illustrate, the ability to procure goods and services in support of our technical assistance variously:

• Actually enabled us to provide technical assistance, as in the case of the Oracle software.
• Helped us and the government of Georgia identify and prioritize problem issues.
• Build capacity of customs officers; and
• Increase public awareness of reforms and requirements.

3) Streamline, and then automate.

Implementation of risk management occurred only after numerous customs business processes were revised and streamlined. Clearance procedures were simplified to include advance declarations, immediate release of goods for low-risk traders, and so on. Customs physical inspection procedures were optimized, and customs inspection selection was fully automated. Our experience of focusing on streamlining specific business processes to make them simpler, faster, and less costly, rather than investing in comprehensive top-down reforms of legal regimes, led us to the following conclusions:

• Ruthless transactional efficiency produces dramatic increases in transaction volumes and values. The examples of increases in total trade, value-added tax (VAT) revenues, and commercial trucks transiting Georgia are typical of what happened in every area we worked in. Whether it was business or property registration or construction permitting, in every instance in which the time and cost of a transaction was reduced, the volume and value increased.

• Petty corruption is somewhat a technical issue. According to annual surveys by the International Republican Institute, more than 90 percent of Georgians haven’t paid a bribe in the last year. The government attacked corruption on several fronts. Arrests were frequent and well publicized. Salaries were increased, and revenue officers were actually trained in how to carry out their functions. However, the government believed that the most effective strategy for virtually rooting out petty corruption was to eliminate regulatory complexity and ambiguity, and then to automate. Streamlining reduces opportunities for corruption. Automation increases the risk of discovery.

Note: Automated risk management reduced corruption risk in part by minimizing discretion for customs officers in making certain clearance decisions. Most of the decision making in Georgia now is concentrated in high-level management. The challenge is that the absence of discretion at lower levels can delay processing or produce unprofessional decisions. For example, decisions about customs valuations that confront line customs officers who lack discretion are sometimes either forwarded up to higher-level officials or decided by using inappropriate rules.

• Aggressive incrementalism reduces the time required for far-reaching reforms. Georgia rose from 149 to 30 on the DB “Trading Across Borders” indicator in four years by undertaking multiple reform wavelets. Hundreds of changes were made to laws, regulations, and business processes. It helped that most of the changes were to reduce complexity, expense, and delay. The project’s experience in this and other technical areas in which we worked is that each incremental change made the next easier.

4) Create a mechanism for public-private dialogue.

Initially, the private sector complained that frequent, aggressive changes to customs legislation made the trade-related environment less predictable, increasing risk. As the direction of change became clear, however, and with a larger role in shaping the reforms, the private sector became a vigorous advocate for reform. Business, initially distressed by the constant change, became its champion and enabler, providing literally hundreds of recommendations.
A key turning point was the creation of a mechanism for public and private sectors to talk coherently. Officials complained that dialogue with business was all complaints and special pleading, with no solutions. GBCR worked with AmCham Georgia to convene a public-private task force on customs issues. The customs working group surveyed businesses in order to discover the problems they experienced, identify the causes, and propose solutions that were then incorporated into amendments to the customs code and secondary legislation.

Government listened, and change happened even more often. The Ministry of Finance recently created a formal Business Advisory Council to enhance the dialogue, to provide businesses with a mechanism for providing feedback to the Ministry and to the Revenue Service, and to identify capacity deficiencies.

5) Transaction-based reforms build capacity faster.

When implemented top-down, regime change requires huge expatriate resources. It exhausts local partners, because the benefits seem so remote and debatable, and the theory requires huge investment to master. Transaction-based reform produces bigger results sooner. The principles are easier to understand and apply to diverse situations.

With GBCR support in mastering transactional efficiency, the capacity and professionalism of the Revenue Service in streamlining, automating, and developing and implementing the customs risk management program increased dramatically. Mid-level managers in particular were able to apply reform principles in new settings. GBCR also provided specialized training and mentoring in certain areas, such as the new risk analysis unit, focusing on the transactional principles. Now, a cadre of technically competent middle managers has emerged. Senior management increasingly trust these managers, and delegate greater authority to them to streamline and rationalize business processes.

6) Monetize the benefits of every reform.

To impact the DB “Trading Across Borders” rankings, customs reform requires perhaps more work, and over a longer period, than does any other indicator. On the other hand, it was GBCR’s experience that the monetized benefits of customs reform were significantly greater than in other areas. Monetizing early and often helps popularize customs reforms, and provides results for customs reformers to trumpet when senior officials complain about the lack of progress on Doing Business.

GBCR attempted to monetize the efficiency savings—to traders and government—from customs reforms implemented by the government with USAID support. Annual savings from customs reforms for which benefits could be monetized were about $388 million. For example, in September 2006, the project calculated savings to traders from reforms that reduced by one day the time it takes for a commercial truck to cross Georgia’s border. The $288 per day cost of operating a commercial truck, times the 139,000 truck crossings in the prior 12 months, produced an estimated annual savings of $40 million. Two years later, the volume of truck transits had grown to over 600,000 annually, generating an additional $133 million in annual savings.

Initially, measurement of monetized benefits was based on a methodology developed by the Dutch government to measure the costs to business due to administrative burdens resulting from government-imposed information-reporting requirements. This methodology has evolved into the well-known Standard Cost Model. In addition, we include direct financial impacts on the government and private sector that are not related to information requirements, including reducing or eliminating fees, and estimating the time value of money. The methodology was further refined to ensure that all parties affected by a reform initiative are at least identified, even if we are not able to quantify the specific benefit received. This objective...
About 90 percent of all shipments are cleared through the yellow channel, requiring only documentary checks.

The goal of implementing risk-based inspections and post-clearance audits encouraged the streamlining of customs procedures, which have been introduced for various customs regimes, including customs warehousing, inward processing relief, outward processing relief, temporary importation, export, re-export, and returned goods relief.

Documentation requirements have been clarified and dramatically reduced in number. Now, only two documents are required for export and three for import.

The simpler systems make it easier not only for businesses to comply, but also for the government to detect evasion. The risk-based inspections also identify about 100 percent more violations than physical inspections did.

Conclusion

The dramatic reductions in clearance times produced by streamlining customs procedures and introducing risk management between 2005 and 2009 directly reduced the cost of doing business for traders and the Revenue Service. They were accompanied by similarly dramatic increases in trade turnover from $3.4 billion in 2005 to $5.5 billion in 2009, and in VAT revenues (60–65 percent of which are collected at the border) from 1.3 billion GEL to 2.5 billion GEL. Key benefits included the following:

- The risk management system has reduced physical inspections to 10–15 percent for imports and 13 percent for exports.
- The time required for release of goods has decreased from three days or more to an average of two hours.

was achieved by standardizing the process of monetizing reform impacts rather than the specific calculation methods used, which vary depending on the initiative.