

LIMITED

CARIB/INT/L. 84/8

Date: 6 July 1984

ORIGINAL: ENGLISH

ECONOMIC COMMISSION FOR LATIN AMERICA
Subregional Headquarters for the Caribbean



THE CONCEPTUAL FRAME
OF THE ECCM
CUSTOMS UNION OPERATIONS

Prepared by
S. St. A. Clarke
Regional Economic Development Adviser

1000

1000

1000

1000

CONTENTS

	<u>Pages</u>
CUSTOMS UNION CONCEPTS - REVIEW	1 - 9
Purpose/Objectives - Nature/Criteria - Tariffs - Allocation of Customs Revenues - Customs Administration - Allocation of Authority - Inhibiting Factors	
THE EASTERN CARIBBEAN COMMON MARKET (ECCM)	9 - 16
Situation - Intra-ECCM Trade - Extra-ECCM Trade - Allocation of Customs Revenues - Other Conceptual Aspects - Customs Union Operations - Beyond Customs Union	
SUMMING UP	16 - 17



CUSTOMS UNION CONCEPTS - REVIEW

Purpose/Objectives

The establishment of customs union (and other special tariff arrangements) between politically independent states are often seen as at least a partial solution for many of the economic and political problems encountered in international relationships. The usual line of argumentation is that the customs union creates a wider trading area, removes obstacles to competition within the union, makes possible a more economic allocation of resources, and thus operates to increase production and raise planes of living. In addition, the customs union is considered to be conducive to the expansion of trade on a basis of multilateralism and non-discrimination among partners.

It is on the basis of such argumentation that sometimes the purpose of a customs union has been stated as essentially to permit (by virtue of a more extensive economic territory) a more developed division of labour better adapted to the existing natural and economic conditions, and consequently the potential to yield a more abundant and lower-cost production destined for the combined market. If this is so, then it may be expected that what would evolve is a greater degree of specialization, either because each country extends its production of those commodities for which it is better suited, or because within the same category of products the countries agree to specialize on specified types.

The generalization that the larger economic area of the customs union is conducive to increasing the potential and scope for internal division of labour has also been linked with the view that the customs union is a movement to promote change in the international division of labour. ^{1/}

But there also is the other view of customs unions as mechanisms for making higher protection feasible and effective for limited areas

^{1/} It should be noted that where this is an objective, the lower the rates of duty in the customs tariff, the less effect of this kind the customs union would have.

going beyond the boundaries of single states, and promoting greater self-sufficiency for the larger area because self-sufficiency for single states was clearly impracticable or too costly. (It would of course, also follow that under customs union there would be a decrease in the degree of self-sufficiency of each member, to the extent that specialization develops, although there is an increase in the degree of self-sufficiency of the customs union area as a whole.)

While each of these propositions would be true in some measure they do not apply equally to different customs union. For this reason it is desirable and necessary to examine the particular case before one can arrive at judgements of what the consequences may be.

Nature/Criteria

The exercise mandated by the OECS Authority is that there should be a higher level of customs union operation within the framework of the Eastern Caribbean Common Market.^{2/} Close reference to the detailed provisions in the ECCM Agreement reveals that it contains many elements that in their operation would go beyond customs union. Nevertheless, the efficacy of those elements much depend on the effectiveness of the customs union operation.

The traditional view was that a perfect customs union should meet three basic conditions:

- i) the complete elimination of tariffs as between the member territories;
- ii) the establishment of a uniform tariff on imports from outside the union;
- iii) apportionment of customs revenue between the members in accordance with an agreed formula.

^{2/} According to the usually accepted definitions, in a common market the members proceed beyond the requirements of a customs union to eliminate restrictions among themselves on international movements of factors of production; while in an economic union members proceed beyond the requirements of a common market, to unify their fiscal, monetary and socio-economic policies.

From time to time further criteria have been stipulated in customs unions negotiations such as:

- a) foreign goods requiring only one and the same customs declaration;
- b) all goods entering from outside the union being subject to the same customs regulations;
- c) goods imported into the union paying only once the rates fixed by the tariff common to the countries forming the union.

International law does not establish any definition of a complete customs union aside from what is stipulated in the General Agreement on Tariffs and Trade (GATT).^{3/} There it is stated that -

"For the purpose of this Agreement:

- a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that
 - i) duties and other restrictive regulations of commerce (except, where necessary, those permitted under Articles XI, XII, XIII, XIV, XV and XXX) are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and
 - ii) subject to the provisions of paragraph 9 substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union."

What has become generally accepted as constituting the format for customs union operations centre around this range of characteristics; but in practice there have been variations stemming from particular concessions that the involved countries are prepared to make.

^{3/} Article XXIV, Paragraph 8(a) of the GATT.

Historically, customs unions that have been established reflect the features of having: uniformity of export and transit tariffs; free exchange of the products of the united countries; uniformity of the external import tariffs of the participating countries and suppression of intra-union tariffs; pooling of customs revenues and their apportionment between the participating countries in accordance with a formula established in advance. However, there also have been cases where provision is made for the removal of tariffs between the members, and adoption of a common tariff against imports from the outside - but leave intact (except as subsequently altered by mutual agreement) the whole machinery of import limitations, import licenses, special license dues and administrative fees.

Tariffs

Decisions in favour of customs unions often have a proviso that the common tariff should not be "higher" than the tariffs of the member countries prior to the union. In fact this provision in the GATT is stated in the terms that the duties and other regulations on trade "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of trade applicable in the constituent territories prior to the formation of such union." To satisfy this requirement a commonly used approach is to average the national rates for each commodity group, so that some partners move up and others move down to arrive at the common rate.

It might, however, be immediately observed that even if the new tariff is made up of the lowest rates previously levied by any of the member countries on each class of imports, the common tariff may still be more restrictive in fact, than the previous tariffs, because customs unions operate to convert revenue duties to protective duties. For this reason, it is often assumed that in a customs union the purpose of the tariffs is protection, not revenue; and that either a tariff will be high enough to bring domestic production into being, or it will not be imposed at all.

It is not easy to distinguish sharply between revenue duties and protective duties. On the one hand, protective duties are those which operate to reduce imports, not only by making commodities of the specific kind involved more expensive to potential customers (and so lessening their consumption) but also, and chiefly by diverting consumption from imported commodities to the products of corresponding domestic industries.

On the other hand, revenue duties may be regarded as those duties productive of revenue which do not act as effective stimulus to the domestic production of commodities similar to those paying the duties. Even such duties, however, operate to increase the proportion of aggregate domestic consumption which is directed towards domestically produced commodities.

The substantial difference then between revenue duties and protective duties is that revenue duties have only a generalised protective effect, whereas protective duties have both this generalised effect and a special effect in stimulating the domestic production of commodities similar to those subject to the protective duty, (with the consequence that protective duties tend to be more effective than revenue duties as restraints on importation).

Allocation of Customs Revenues

Whenever customs revenues are very important the method of their allocation between the members of a customs union is likely to be a major issue. Generally, the greater the disparity in economic levels between the members, and the greater the differences as between the members in the normal consumption of imported commodities, the greater is likely to be the difficulty in finding a formula for allocation of customs receipts, which can be mutually acceptable.

Different approaches have been adopted in the past but none have been without problems. In the Zollverein,^{*} the simplest possible formula of allocation, which is, allocation according to population, was found to be

* Customs union of the German states in the nineteenth century.

generally practicable; but modification was necessary in at least two instances - in respect of members with relatively high per capita income levels, and in respect of members with specially important external trade relations.

In customs unions in which British Colonies have participated, (as well as in some other customs unions), allocation was in general according to the place of consumption of the dutiable goods. However, this formula could be difficult to apply either where imported raw materials are processed in one member territory for sale in another, or where wholesale distribution was concentrated in one territory.

Although allocation according to consumption has been the more favoured approach, customs unions that embrace contiguous countries still found it necessary to allocate a fraction of the receipts as compensation for administrative expenses to the territory or territories in which the import duties were actually collected. In some cases agreed percentages were applied, and in others lump sum per annum allocations were made.

The crux of the problem, however, is that when a common tariff is in operation, the question of transfer of customs receipts will arise mainly in the case where an importer enters goods for customs which will subsequently be sent on to another territory within the union. This is more so the case where the union countries are contiguous and customs boundaries between them are eliminated and also customs services.

Customs Administration

It is found desirable in some cases to merge in some degree or fashion the customs administration staffs of the participating countries. This comes not only from seeking greater administrative economies, but also from the fact that when the tariff wall is removed between countries, each is likely to acquire an active concern in the character and standards of customs administration in the other territories. If the countries are of comparable importance, this concern is greater depending on the extent of their differing economic interests and conditions, and differences in loyalties (as between sectors) in each territory.

Several degrees of merger of customs services have been distinguished:

- (1) Complete absorption by a dominant member of the responsibility for enforcement of the customs laws and regulations;

- (2) A merged central customs and administrative staff responsible to the customs union as a whole (and not to particular members);
- (3) Active participation by officers of more efficient members in the administration of the customs of other members;
- (4) Mutual supervision;
- (5) Complete autonomy of administration with reliance upon mutual integrity and submission to arbitration in case of disputes.

In this regard it should be noted that the greater the extent of unification in the customs services, the more important becomes the question of executive control of the customs administration.

Allocation of Authority

Aside from the day to day administration of customs, there still remain questions concerning the allocation of authority with respect to changes in tariffs, changes in customs codes, and the conduct of negotiations with outside countries on tariff matters.

There is the possibility of adopting terms of equality in tariff legislation and administration. By these arrangements changes in the tariff could be made only by mutual consent, and customs administration remains in the charge of the different states, subject only to an agreed common administrative code. In such situation, policy is decided by standard diplomatic procedures, all the members having equal status, and unanimity is required to institute tariff or administrative changes, and to negotiate effectively with non-member states.

There is also the possibility of the sovereign states comprising the customs union establishing a customs council which reaches decisions binding on all by majority vote. In this situation customs inspectors, instead of being local civil servants, become officers answerable to the council. And through the council negotiations are conducted with third countries, and commercial treaties concluded. This latter aspect is in some cases circumscribed where individual members are anxious to ensure for themselves greater freedom of action in negotiating commercial treaties with third countries.

Other features may be that the customs laws and administration should be "assimilated", with permanent conferences established to supervise the application of the tariff and of the customs regulations. But problems which cannot be left unsolved include:

- (a) harmony of relations with/against third countries;
- (b) procedures for tariff revision;
- (c) allocation of revenues from import duties collected in one country on goods destined for a partner.

Inhibiting Factors

Whether or to what extent intended objectives are realised depends on a range of circumstances, some of which could inhibit the customs union operation. For example, a significant economic consequence of a customs union is to make a country's territory an additional field of operation for the tariff protection of its partners' industries. This assumes some action for really opening the internal market in each country to competition from lower cost industries in partner countries. But if there is aversion to opening of markets to the competition from each other's industries, there will not be progress toward specialisation, division of labour and such derived economies as may have been envisaged.

Perhaps an even more central factor is the extent to which the yield from taxes on trade constitutes a high proportion of total revenue. If a customs union is established between countries which before had only revenue duties, and if all the duties levied by the customs union continue to operate as "revenue duties", an appraisal of the customs union would turn chiefly on its administrative economies, or conveniences, or on political aspects.

There are situations where economic factors are not on the whole such as to make specially close commercial ties between neighbouring countries genuinely attractive. They may be typically rival exporters of the same staple commodities; and also they may be poor sources of supply for the goods in most urgent demand from abroad. Further, the existence of price controls, subsidies, etc., make it extremely difficult if not impossible to completely remove trade barriers, unless the process is carried beyond the customs union stage. In addition, where there is heavy dependence on indirect taxation as a source for

government revenue, a good deal of the possible administrative economy of customs union is likely to be lost, if the establishment of uniformity of such taxes did not accompany formation of the customs union.

In some cases, there is not the possibility to create a full customs union, because it would involve the establishment of special institutions to perform functions that individual member countries do not have the capacity to undertake on continuing basis. Invariably this involves not only an additional money-cost but also the surrender of some sovereignty in legislative matters, which the countries may not be willing to concede.

It is against the background of this range of concepts that the ECCM customs union operations is being considered.

THE EASTERN CARIBBEAN COMMON MARKET (ECCM)

Situation

The framework for customs union operations determined by the ECCM Agreement approximates to the two main traditionally accepted criteria applying to customs unions, but is silent on some of the other traditionally accepted concepts and attributes. From the outset the ECCM arrangements required the abolition of import duties on goods consigned from one member state to another, which were deemed eligible for market area tariff treatment. Paralleled with this was the decision to establish a common customs tariff on goods originating in non-member territories and countries.

There were however no stipulations concerning the apportionment of customs revenues between the members on the basis of some agreed formula. Neither were there requirements for having the same customs regulations, or the use of one and the same customs declaration, or goods imported from outside paying only once the rates fixed by the common tariff.

Intra-ECCM Trade

The stipulations concerning intra-ECCM trade defined import duties so as to include any tax or surtax of customs, and in addition any other charges of equivalent effect - whether fiscal, monetary or exchange - which are levied on imports. Further non-application of import duties

in intra-ECCM trade was emphasised by the specific indication that this would also be the case for goods not produced in the importing country, and that the treatment of such products would be on the basis of non-discrimination among sources as regards any internal charges that may apply.^{3/}

In treating the effect of revenue duties and internal taxation on goods imported from partners, the provision expressly forbids the application of any fiscal charges in excess of what applies to like domestically produced goods. And the point is made too that no charges should be so applied as to afford effective protection to like domestic goods, whether directly or indirectly. Additionally, members are forbidden to apply fiscal charges to goods imported from partners which the importing country does not itself produce, in such a way as to afford effective protection to the domestic production of substitute goods.^{4/}

The provisions therefore sought to achieve:

- (i) Easy movement within the ECCM of goods of area origin; free of trade duties and charges whether applied directly or indirectly;
- (ii) Equality of treatment for partners' products on the same basis as that accorded to domestic products;
- (iii) Access to the domestic markets of the member countries, of goods produced in partner countries, under conditions where no protection is accorded to domestic producers of like goods or of substitutes.

These goods moving within the ECCM area, however had to conform to one of the following conditions: (that they)

- (a) are wholly produced within the market area;
- (b) fall within a description of goods listed in a process list;
- (c) contain materials imported from outside the ECCM that do not exceed sixty percent of the export price.

^{3/} ECCM Agreement article 5 paragraph 3.

^{4/} ECCM Agreement article 8.

In addition, these origin rules provide that seventy-three items which constitute the Basic Materials List, attached as schedule to the ECCM Agreement, would be regarded as originating wholly within the Eastern Caribbean Common Market.

Extra-ECCM Trade

In respect of trade with countries outside the ECCM, article 7 of the Agreement provided for the establishment of a common customs tariff. No criteria was set in the Agreement for determination of the common tariff, how it should be brought into effect, or how it should be administered. It is therefore worthwhile to recall that at the time of establishing the rates of duties for the ECCM common external tariff, although some difficulties arose from the existence of various preferential obligations, the prime consideration was to set up a tariff in conformity with the economic, developmental and financial interest of the countries in the ECCM group.

Although the ECCM territories were not bound in the free selection of duties for the common tariff, in the sense that they could make them higher if they so wished, in the absence of a better system the approach adopted was based on the arithmetical average of the then country rates, as far as was logically justifiable. In the process, practically all raw materials and social goods were made duty free; and for machinery and other production goods very little (if any) duties were provided. In addition the transitional arrangement was built into the common tariff that for some items special (national) duties would be retained to be gradually adjusted towards a common rate.

In the several areas in which the ECCM Agreement is silent the countries retained their individual treatment of extra ECCM trade relations, particularly in the application of charges having equivalent effect to customs duties, and also in the regulation and administration of trade. In such matters there is not uniformity throughout the ECCM area.

As regards the supplementary charges on imports, aside from consumption taxes which are applied by every one of the ECCM territories,^{5/} there are a range of taxes, duties and charges, the most popular of which are stamp taxes, stamp duties and package tax. Each territory legislates its own rate, presumably for revenue purposes. Account also has to be taken of the customs surcharges and surtaxes that have been applied to imports from time to time by some of the countries - in addition to the common tariff.

Concerning the regulation and administration of trade, each of the territories maintain a set of prohibitions, licensing, permits and special certifications. The groups of commodities to which they apply varies from territory to territory as do the specifics of the regulatory devices.

Allocation of Customs Revenues

The question of allocation of customs revenues was broached at least once in the early negotiations of the ECCM Agreement, but it did not become a subject of debate. Accordingly, there are no provisions within the ECCM for allocation of customs revenues; and there seems little present concern to consider it as an issue.

The rationale for this situation stems largely from the fact that the ECCM territories are not contiguous, and as such each and every one had to retain defined customs boundaries and operations. Further in each territory the bulk of imports have been for consumption within the territory, and not for transmission to some other destination territory within the ECCM area. It follows that "allocation of customs revenues according to place of consumption" is largely met by the logic of the situation, each territory retaining the collected customs revenues and defraying its own customs administration expenses.

There are however circumstances in which the allocation of customs revenues could become a matter for consideration among the ECCM territories. If the mechanisms for integration approach the point of operating a unified customs service, or/and if centralization of bulk purchasing of imports is adopted, or/and if importation for processing and shipment to other partners should develop in a polarised manner, there would need to be some adjustment to achieve a more equitable allocation of benefits among the countries.

^{5/} Consumption taxes were adopted by the individual territories to offset the revenue lost through application of the common external tariff.

Other Conceptual Aspects

There are no provisions in the ECCM Agreement corresponding to the concepts that foreign goods entering the ECCM area would (a) require only one and the same customs declaration and (b) pay only once the rates fixed by the common tariff. In practice these concepts are met wholly or largely by the regulations governing re-exports of goods, which are normally treated differently from retained imports. Invariably the arrangements are that re-exports are held in bond for onward transmission to the destination country, with customs duty paid at the destination.

Regarding the allocation of authority in customs matters, as already mentioned, each territory retains full administration of customs and legislative authority over those aspects on which the ECCM Agreement is silent. With regard to those matters provided in the Agreement, the Council of Ministers now superseded by the Economic Affairs Committee of the OECS as the principal organ of the common market, makes the decisions concerning intra-ECCM and extra-ECCM trade. There is no customs council as such, the common market policy and legislation including changes in the common tariff being arrived at by standard diplomatic procedures, requiring unanimity, all the members having equal status.

Customs Union Operations^{6/}

In implementing the provisions of the ECCM Agreement, import duties between the member territories were eliminated from the inception of the

^{6/} In treating the external trade of the OECS countries it is of importance to remember that each ECCM member country is also a member of the Caribbean Common Market (CARICOM) which in addition to the OECS countries include Barbados, Belize, Guyana, Jamaica, Trinidad and Tobago. In accordance with the area of origin criteria of CARICOM, OECS trade with those countries is also carried out free of import duties subject to the exceptions contained in Schedules III and IV of the Chaguaramas Treaty. The rates of duty applied to such goods qualifying under the area origin criteria of CARICOM are established by legislation in each ECCM member state.

ECCM,^{7/} and in 1972 a common external tariff came into effect. In its first formulation the ECCM common external tariff was a two column tariff with general and preferential rates; but this was changed to a single column tariff in 1976 to conform with the EEC/ACP relationships that emerged under the Lome II Convention. Subsequently, in 1979 the common tariff was updated to achieve a wider coverage of items. For a limited number of items individual ECCM countries were granted the right for a limited period, to apply special duty rates instead of the common ECCM rate. These special rates have been altered from time to time in the direction of the common rates, and the number of items attracting special rates have been gradually reduced.

Consistent with the application of a common tariff, the OECS countries observe a common set of principles for the interpretation of the tariff. These rules for interpretation are deemed to be an integral part of the tariff, and are set out in the notes that precede the schedule of rates of import duties.

In addition the common external tariff incorporates a List of Conditional Duty Exemptions and Reductions. This list contains the cases in which the governments of the ECCM countries may admit goods which are dutiable in the customs tariff, either duty-free or at a duty rate lower than the rates provided for in the common tariff. The goods granted such treatment need to be imported under the conditions specified in the list, which indicates the uses that would justify the special treatment.

All decisions concerning the granting of these exemptions and reductions fall within the exclusive competence of the individual governments, who are free to refuse the exemption, should they so decide. An important qualification is that the ECCM countries should withhold those benefits from goods or articles which are obtainable at comparable cost from a manufacturer in the ECCM area. It should be noted that the frame adopted for administering the common tariff does not include an agreed common administrative code, beyond the principles for interpretation of the tariff, and the List of conditional duty exemptions and reductions from the common tariff.

If one takes the view that the purpose of the common tariff is protection, and that either a tariff rate will be high enough to bring domestic production into being, or it will not be imposed at all, then the efficiency of the common tariff becomes an

^{7/} The ECCM Agreement was signed at Grenada, 11. June 1968, and came into force 15 July 1968.

important consideration. As far as can be ascertained, there has not up to now been a concerted effort to assess the ECCM common external tariff in these terms. It is therefore far from clear the extent to which the common tariff acts as a protective mechanism as against its operation as a revenue producer.

In short, the common external tariff (together with the principles for its interpretation and the list of conditional duty exemptions and reductions), presently constitute the main component of the customs union operations. All the other elements are at varying degrees of standardization and are administered individually by the member territories. However it should be noted that the ECCM Agreement provisions go much beyond purely customs union operation considerations.

Beyond Customs Union

Taken together the ECCM provisions can conveniently be looked at in terms of those that directly affect trade, and those that are intended to facilitate the production processes. While on the trade side the primary concern is the liberalization of movement of goods and creation of equal conditions for the products of all the participants in the ECCM, on the production side the provisions are geared towards greater freedom of movement of capital and labour.

Three situations obtain in the provisions relating to freeing the movement of these production factors, which can be classified according to:

- (i) where area conditions would immediately apply;
- (ii) where a common policy was to be established at a point in time;
- (iii) where there would be continuing review to achieve a high measure of harmonization.

Article 13(5) of the Agreement explicitly removes obstacles to movement of capital belonging to persons resident in the ECCM area. And Articles 13(6), 16 and 17 stipulate the adoption of common policies on foreign capital, agriculture and transport, while Article 12 seeks a phased removal of obstacles to the free movement of persons. In addition the Agreement has provisions for the review and progressive harmonization of monetary, and fiscal, and development policies; and sets out explicitly the objectives for a common industrial policy.

By providing for increasing inter-country mobility of the factors of production, capital and labour, the customs union operations are set in a context that go much beyond the concepts of customs union per se, where the adjustments (and benefits) are meant to be derived from trade and changes in the levels of output within and among the partner countries. (In fact it can be argued that the limit to gains from industrial production in a customs union is set by the degree of mobility enjoyed by the factors of production).

Summing Up

The conceptual frame of the ECOM customs union operations is one where provision has been made for the removal of tariffs among the members, and adoption of a common tariff against imports from the outside, but leave intact the individual national mechanisms on import limitations, import licenses, special license dues and administrative fees. Accordingly, each territory retained complete autonomy of customs administration, with reliance upon mutual integrity concerning the character and standards in the administration of customs. Consistent with this each territory retains the collected customs revenues, defraying its own customs administration expenses with no provision for any re-allocations.

With each territory retaining full legislative and administrative authority, policy affecting customs union operations is decided by standard diplomatic procedures, all the members having equal status. As a consequence, unanimity is required to institute changes in the common external tariff and in its administration, also in such matters as negotiating with non-member states on aspects that are approached collectively. At the same time, however, most areas of relationships with third countries are administered by the individual territories, thus retaining freedom of action for bilateral negotiation of commercial treaties with third countries.

It follows that aside from the implementational aspects of the common tariff, there are several non-tariff aspects that should be streamlined, if fuller customs union operation is to be achieved. These areas where greater uniformity would improve the customs union operation would include:^{8/}

^{8/} These aspects have been dealt with in separate papers.

- changes having equivalent effect to customs duties;
- the regulation of trade i.e. prohibitions, licensing, permits and special certifications affecting imports;
- administration of customs (particularly customs procedures and documentation).

Clearly the highest level of uniformity in the non-tariff aspects, and the greater the implementation of measures bringing standardization into third country relations, the higher the level of efficiency in the administration of the customs union that can be achieved.

The further question of the possibility of greater centralization in the administration of customs and in the customs authority, will very much depend on the extent to which the member countries are prepared to introduce modifications to the conceptual frame adopted in the ECCM agreement.

30

4

4

4