

**CUSTOMS ADMINISTRATION REFORM
AND MODERNISATION IN ERITREA**

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DECLARATION

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I, the undersigned, hereby declare that the work contained in this thesis is my own original work and that I have not previously in its entirety or in part submitted at any university for a degree.

Signature:

Date:

SUMMARY

This thesis offers a descriptive study of the empirical customs issues that are required to reform the Eritrean Customs Administration towards its alignment to the global situation. The first chapter as a general introduction encompasses the background, the research premise and the methodology adopted. The second chapter discusses public service reform by putting emphasis on institutional and regulatory reform as framework of analysis. The intention is to review the generic characteristics of public service reform as macro-environment of customs administration in order to analyze the attributes of the general context shared by customs as a public service.

Considering customs as a component of the broader environment of public service, the third chapter of the thesis focuses on the contemporary body of knowledge of customs administration that serves as a conceptual framework and micro-analysis of customs. In this section, the core issues and priorities of customs' service modernisation are highlighted; customs' best practices, standards and procedures as seen from the perspective of the new challenges of globalisation are also reviewed. From these reviews chapter three underlies two basic facts. First it is justified that raising customs' operation to a uniform, high standard procedure and achieving excellence in the customs service is a prerequisite for trade and tourism in general and promoting export in particular. Second, investment decisions will be made on the basis of a country's ability to provide an environment that is conducive to maintain a reliable, low-cost flow of goods and components with minimal trade barriers.

Furthermore, the international trade, social and economic environments are in fact changing. World economies and communities are becoming more reliant on cooperation, partnerships, understanding and harmonisation. Factors such as growth in trade volume and tourism, trade liberalisation and investment, falling transport and communications costs and increasing international competition are driving customs administrations world-wide to change their traditional procedures.

More importantly, customs administrations are expected to manage ever-increasing complexities and levels of transactions with static or ever-decreasing resources. Similarly, customs are requested to strike and maintain the right balance between control and facilitation. Hence, this thesis builds on the premise that Eritrea should align its customs administration to the global situation as an essential institution of national and international policy by reforming and modernising its management methods and operational procedures.

In the above idea, while reform measures in customs administration are aimed at identifying alternative ways and means of achieving greater efficiency and effectiveness in the service delivery, customs modernisation implies the change in or adoption of best management practices, standards and procedures facilitated by up-to-date information technology, in order to bring the full benefits of customs as contributor to economic growth in Eritrea.

This positive correlation between effective customs administration and the economic growth ensured – *inter alia* through increased volume of trade and tourist flows as well as direct foreign investment – constitutes the bases for reviewing the Eritrean economic background in the fourth chapter, as a macro-context and as a guide for the required reform and modernisation measures in Eritrean customs. The rationale is that any national public sector reform strategy is unlikely to succeed unless it actively takes into account the macro-environment as determinant factor and point of departure in deciding the type of policies, institutions, and resources required for a reform at micro-level. As a result it can be said that the state reforms that have already been carried out in Eritrea are designed to create a favourable atmosphere, among others for the three core potentials for economic growth in Eritrea, namely investment, export and tourism. However, these potentials collectively request customs modernisation for their positive contribution to the Eritrean economy.

Subsequently, the aforementioned background brings into perspective the need for reform and modernisation measures in the face of the challenges of globalisation and in line to the intent of the macro-policy reforms and identified potentials of the Eritrean economy. Therefore, the thesis analyzes in the fifth chapter the customs practice in Eritrea. And thereafter, it is concluded by the two underpinning parameters as essentials for transforming the practice of customs in Eritrea. First, institutional transformation is required in the sense that one of the critical capabilities that have lacked is the ability to formulate and analyse policies. Typically this implies that customs has been lacking institutions and their infrastructure along with the human resource base that reflects the specialisation that is needed. Second, regulatory transformation is required in the sense that there should be an updated enabling environment in place as an instrument to implement policies.

OPSOMMING

In hierdie tesis word verslag gedoen oor 'n deskriptiewe navorsingstudie ten opsigte van die empiriese doeane-kwessies wat nodig is om die Eritrese doeane-administrasie te hervorm ten einde dit in lyn te bring met die situasie wêreldwyd. Om dit te kan doen, word die hervorming van die staatsdiens in die tweede hoofstuk bespreek en word klem gelê op institusionele en regulatoriese hervorming as raamwerk vir die analise. Die bedoeling is om 'n oorsig te verkry van die generiese kenmerke van staatsdienshervorming as makro-omgewing van doeane-administrasie ten einde die eienskappe te analiseer van die algemene konteks wat deur doeane, as staatsdiens, gedeel word.

In die derde hoofstuk van hierdie tesis word aan doeane as komponent van die groter omgewing van die staatsdiens aandag gegee, en word daar ook op die kontemporêre kennisgeheel van doeane-administrasie wat as konseptuele raamwerk en mikro-analise van doeane dien, gefokus. In hierdie afdeling word die kernvraagstukke en prioriteite ten opsigte van die modernisering van die doeannediens belig. Doeane se beste praktyke, standaarde en prosedures, soos gesien vanuit die perspektief van die nuwe uitdagings van globalisering, word ook in oënskou geneem. Volgens hierdie oorwegings is daar twee feite grondliggend aan Hoofstuk 3. Eerstens is dit verantwoordbaar dat verbetering van die werkswyse van die doeane tot 'n uniforme, hoëstandaardprosedure en die bereiking van uitmuntendheid in die doeannediens 'n voorvereiste is vir handel en toerisme in die algemeen en vir die bevordering van uitvoer in die besonder. Tweedens sal beleggingsbesluite geneem word op die basis van 'n land se vermoë om 'n omgewing te verskaf wat bevorderlik is vir die instandhouding van 'n betroubare laekostevloei van goedere en komponente met 'n minimum handelsbeperkings.

Verder is internasionale handel sowel as die sosiale en ekonomiese omgewings besig om te verander. Wêreldekonomieë en -gemeenskappe raak al meer afhanklik van samewerking, vennootskappe, begrip en harmoniëring. Faktore soos die groei in handelsvolume en toerisme, handelsbevryding en belegging, dalende vervoer- en kommunikasiekoste en toenemende internasionale mededinging dwing doeane-administrasies wêreldwyd om hulle tradisionele prosedures te verander.

Belangriker selfs is dat daar van doeane-administrasie verwag word om steeds toenemende kompleksiteit en transaksievlakke met statiese en geleidelik kwynende hulpbronne te behartig. Insgelyks word van doeane verlang om die regte balans tussen beheer en fasilitering te verkry en te handhaaf. Hierdie tesis bou dus op die premis dat Eritrea as 'n essensiële instelling van

nasionale en internasionale belang sy doeane-administrasie op een lyn moet bring met die situasie wêreldwyd deur hervorming en modernisering van die bestuursmetodes en operasionele prosedures.

In die bostaande gedagte impliseer modernisering van doeane die verandering in of aanpassing van bestebestuurspraktyke, standaarde en prosedures gefasiliteer deur byderwetse tegnologie, alhoewel hervormingsmaatreëls in doeane-administrasie op identifisering van alternatiewe middele tot groter doeltreffendheid en doelmatigheid ten opsigte van die dienslewering gemik is om daardeur die volle voordeel van die doeane se bydrae tot die ekonomiese groei in Eritrea te verwesenlik.

In die vierde hoofstuk maak die positiewe korrelasie tussen effektiewe doeane-administrasie en ekonomiese groei, wat onder andere deur verhoogde volume in die handels- en toeristevloei sowel as direkte buitelandse belegging verseker is, die basis uit vir hersiening van die Eritrese ekonomiese agtergrond. Hierdeur word 'n makrokonteks verkry om as gids te dien vir die vereiste maatreëls vir hervorming en modernisering in die Eritrese doeane. Die beredenering hiervoor is dat dit onwaarskynlik is dat enige nasionale openbaresektorstrategie sal slaag tensy dit die makro-omgewing, as deurslaggewende faktor en vertrekpunt in die besluit ten opsigte van beleide, instellings en hulpbronne wat benodig word vir hervorming op mikrovlak, daadwerklik in gedagte hou. As gevolg hiervan kan gesê word dat staats hervorming wat reeds in Eritrea teweeggebring is, ontwerp is om 'n gunstige atmosfeer te skep, onder andere vir die drie kernmoontlikhede vir ekonomiese groei in Eritrea, naamlik belegging, uitvoer en toerisme. Gesamentlik vereis hierdie moontlikhede egter modernisering van die doeane indien hulle 'n positiewe bydrae tot die Eritrese ekonomie wil maak.

Die voorafgaande agtergrond bring dus nou die behoefte aan maatreëls vir hervorming en modernisering in perspektief, met die oog op die uitdagings van globalisering en gevolglik die bedoeling van die makro-beleidshervormings en geïdentifiseerde moontlikhede vir die Eritrese ekonomie. Daarom analiseer hierdie tesis in die vyfde hoofstuk die doeanepraktyk in Eritrea. Daarna word die verslag afgesluit deur die twee stawende parameters as grondtrekke vir hervorming van die doeane-praktyk in Eritrea. Institusionele hervorming is eerstens nodig in die sin dat een van die kritieke bevoegdhede wat tot dusver ontbreek het, die vermoë is om beleide te formuleer en analiseer. Dit impliseer duidelik dat dit die doeane tot dusver ontbreek het aan instellings en hulle infrastruktuur tesame met die menslikehulpbronnbasis wat die vereiste spesialisering weerspieël. Tweedens word regulatoriese transformasie benodig in die sin dat daar 'n bygewerkte bemagtigende omgewing moet wees as 'n instrument om hierdie beleide te implementeer.

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LIST OF ABBREVIATIONS

COMESA	= Common Market for Eastern and Southern Africa
EPLF	= Eritrean People's Liberation Front
EU	= European Union
FDI	= Foreign Direct Investment
GATT	= General Agreement on Tariff and Trade
GDP	= Gross Domestic Product
GNP	= Gross National Product
GSE	= Government of the State of Eritrea
HS	= Harmonised System
ICC	= International Chamber of Commerce
ICSID	= International Convention on the Settlement of Investment Disputes
IMF	= International Monetary Fund
IT	= Information Technology
MIGA	= Multilateral Investment Guarantee Agency
MOF	= Ministry of Finance (Eritrean)
SITC	= Standard International Trade Classification
WCO	= World Customs Organisation
WTO	= World Trade Organisation

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CHAPTER 1

GENERAL INTRODUCTION

1.1 INTRODUCTION

Over the past three decades numerous governments all over the world have been subjected to criticism launched from all points of the political spectrum. Critics have alleged that governments are inefficient, ineffective, too large, too costly, overly bureaucratic, overburdened by unnecessary rules, unresponsive to public wants and needs, secretive, undemocratic, invasive into the private rights of citizens, self-serving, and failing in the provision of either the quantity or the quality of services needed by the taxpaying public (Osborne & Gaebler, 1993; Jones & Thompson, 1999, cited in Jones, Guthrie & Steane, 2001:1).

Furthermore, the critiques promoted reform movements essentially on the grounds that public service needs reinvention and institutional renewal. In this, as remarked by Jones *et al.* (2001:19), the sought reforms in generic terms have been capacity building institutionally and providing institutional remedies in the management of governance systems in the quest of coping with the ever changing global situation. In view of that, this paper gives an analysis of institutional and regulatory issues that are required in reforming the Eritrean customs administration towards its modernisation.

Most importantly, in the face of rapid changes in international trade, globalisation and information technology (IT), customs administrations are obliged to take into account these new developments and to modify their procedures and practices accordingly. The pressure as a result of globalisation is particularly high regarding change and IT's facilitation to cope. As Held and McGrew (2000:3) remarked globalisation has an undeniably material contribution in so far as it is possible to identify, for instance, flow of trade, capital and people across the globe that obviously influence customs.

As Bell (1997, cited in Pratt & Poole, 1999:537) noted, though domestic causal factors might be more significant than external factors in the development and implementation of particular policies, nonetheless customs administration is demonstrably an area that is significantly affected in its operations by the impact of the external factors – international trade and globalisation – rather than by the impact of domestic factors. Furthermore, the progress in the different kinds of facilitative infrastructures – physical (such as transport and banking), normative (such as trade rules) and symbolic (such as English as a lingua franca) is establishing the preconditions for

regularised and relatively enduring forms of global interconnectedness, consequently demanding parallel modernisation from customs side.

To this end, customs administration by being aligned to the global trend as affected by and effecting public agency and operation is expected to contribute to domestic priorities and to address complex international trade and border crossing issues without putting the prosperity of the nation at risk by driving away businesses and investment. Hence, to reduce the customs intervention in the international trade to a minimum, modern customs administrations must develop among others comprehensive and transparent customs legislation, simple up-to-date procedures, advanced customs compliance and revenue control strategies accompanied by technology. It is in the light of the aforementioned issues that this thesis strives to describe the best practices that could be adopted by the Eritrean customs.

1.2 BACKGROUND OF THE STUDY

In 1991, thirty years after its annexation by Ethiopia, Eritrea regained its freedom. Then, as a result of a referendum held in 1993 the country achieved its statehood as Africa's youngest nation. Therefore, from the outset it is not difficult to imagine the severity of the effects of war, neglect and deprivation to the institutions and public services of Eritrea. As a consequence of the legacy from the past, the reality was an economy that is heavily regulated and centrally planned in its orientation.

In response to the monumental task of rehabilitating an economy devastated by war and the laying of new foundations, the long-term development strategy that Eritrea mapped out from the very beginning has hinged on two pillars: sustainable growth led by the private sector and an export-oriented economy (World Bank, 1994:31). To this effect, a liberal macro-economic policy that enhances the goals of economic recovery and development by encouraging foreign direct investment was issued in 1994 in coordination with the World Bank (US State Department, 1999:2).

In addition the Eritrean government has taken genuine and practical steps towards establishing a market economy and promulgated an investment code in 1994 that offers significant incentives to foreign investors (Eritrea 1994a) along with major reductions of customs duties and taxes through Customs Tariff Regulations No. 18 of 1994 from pre-independence punitive levels (Chand, Van der Heeden, Potter, Walsh & Sarraf, 1993:2). Furthermore, the strategic location, an eager inexpensive labour pool, minimal corruption, and recent steps by the government to streamline the civil service can be considered as contributors to Eritrea's objectives to attract private investors and to expand trade, apart from the state reform measures.

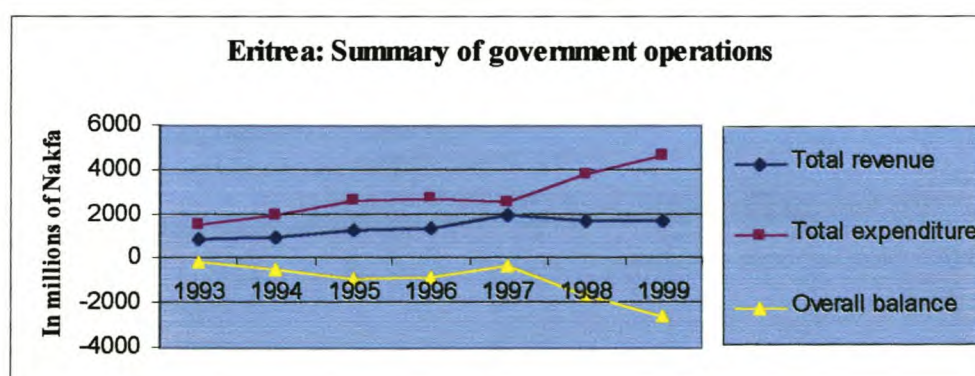
However at this juncture of its economic history, where the country is faced with the tremendous task of rebuilding and transforming the economic policies from the misguided state in which these were before independence, the Eritrean government finds itself in great need of mobilising financial resources (as shown in Table 1 & Figure 1) and allocating these resources efficiently, thus requiring a well organised fiscal system. In doing so, as one of the primary fiscal institutions, the Eritrean customs administration itself becomes a target for transformation.

Table 1: Eritrea: Summary of government operations, 1993-1999

	1993	1994	1995	1996	1997	1998	1999
Total revenue	890,6	950,7	1320,2	1371,6	1967,4	1751,2	1700,1
Total expenditure	1559,0	2005,7	2680,0	2721,5	2588,8	3832,2	4628,7
Balance	-668,4	-1055,0	-1359,8	-1349,0	-621,4	-2081,0	-2928,6
Grants	507,0	626,0	491,0	508,6	290,4	458,4	376,7
Overall balance	-161,4	-429,0	-868,8	-841,3	-331,0	-1622,6	-2551,9

Source: IMF Report No.98/91(1998:62); IMF Report No.00/55 (2000:38). All figures are in millions of Nakfa¹.

Figure 1: Eritrea: Summary of government operations, 1993-1999



In line to this background, as well as from the perspective of globalisation, four generic factors are identified as a rationale for this study, as discussed below.

¹ Nakfa is Eritrean currency that has been introduced since November 8, 1997. Prior to 1997 the Ethiopian Birr was the common currency for both countries. Thus, all amounts/figures prior to 1997 in this study count in millions of Birr. At the time of introduction the exchange rate of Nakfa was 1Nakfa=1Birr and 7.2 Nakfa=1 US \$.

1.2.1 International economic relations and trade

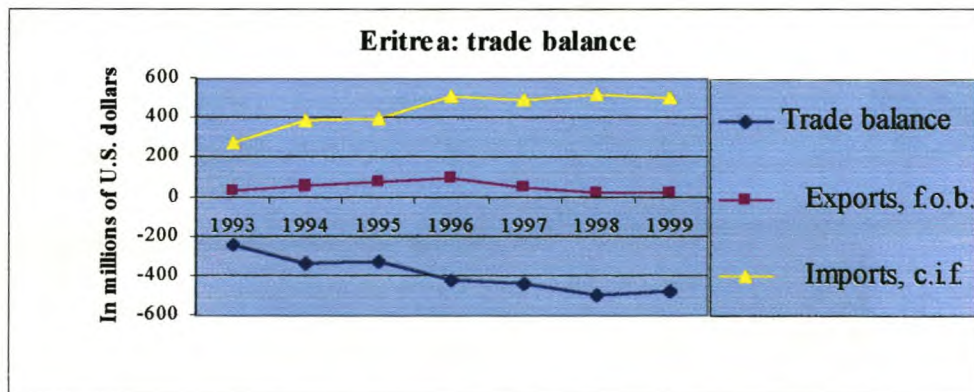
When the trade balance is taken into account as depicted in Table 2 & Figure 2, Eritrea is a net importer country. It imports exceedingly more than it exports. To correct this imbalance, the Eritrean government has charted a new and open investment policy by its Investment Proclamation No. 59/1994 (Eritrea 1994a) congruent to the macro-economic policy of the country (Eritrea 1994b). It is hoped that such an undertaking would attract investment of foreign capital, particularly into the industrial sector of the economy so as to support the manufacturing goods for export.

Table 2: Trade balance of Eritrea, 1993-1999

In millions of US\$	1993	1994	1995	1996	1997	1998	1999
Trade balance	-239,0	-331,4	-323,2	-418,5	-441,1	-498,9	-480,7
Exports, f.o.b.	36,1	64,5	80,6	95,3	53,5	27,9	26,3
Imports, c.i.f.	275,1	395,9	403,8	513,8	494,6	526,8	506,9

Source: IMF Report No.98/91(1998:76); IMF Report No.00/55 (2000:52)

Figure 2: Trade balance of Eritrea, 1993-1999



However, as Gurunlian and Orthlieb (2001) point, trade facilitation is a critical element in any country's economic infrastructure. Particularly in this era of just-in-time manufacturing and distribution, a facilitative customs environment for imports and exports is increasingly an important factor in the investment decisions of the private sector.

1.2.2 Regional integration

As part of its overall national development strategy, Eritrea has sought to broaden its relations with other countries in the world, in particular with its immediate neighbours. To this end, Eritrea was formally admitted into COMESA on 8 December 1994.

This new partnership is expected to give Eritrea excellent opportunities for increased trade, investment and technology transfer and managerial skills among others. However, it also poses serious challenges that need to be overcome if Eritrea is to benefit from all the opportunities provided under COMESA.

The challenges for Eritrea include the need to strengthen its institutional framework to deal with COMESA matters, and numerous institutional issues related to the participation in the COMESA Free Trade Area and other cooperation agreements. Thus new regional and international trade agreements, designed to facilitate trade, add new requirements and complexity to customs responsibilities. These new responsibilities and the increased workload have overwhelmed many customs administrations that have tried to cope with it by means of traditional programmes and responses.

1.2.3 Establishment of economic free zones

Eritrea has declared the establishment of economic free zones by Proclamation No. 115/2001, by which Eritrean nationals and foreigners alike, without any preferential treatments whatsoever, are granted permission to open businesses free of any form of taxation (Eritrea 2001b). The economic strategy so promulgated by the Eritrean government is expected to stimulate production of goods for export purposes as well as for domestic consumption. In turn such free economic zones demand modern customs administration.

1.2.4 Reductions in taxes

Recently the Eritrean government announced a proclamation to amend taxes (Eritrean 2001c) in which among others customs duties and taxes are significantly reduced for the second time since independence. The old taxation system, which ranged from as low as 2% to as high as 200%, is now reduced to a maximum of 25%, with the lowest end of the tax bracket being 2% under the Customs Tariff Regulations No. 52/2001 (Eritrea 2001a). Regarding interregional trade, Eritrea has furthermore already applied 60 to 80% tariff reductions from the COMESA's objective of trade liberalisation to reduce tariff by 100% by October 2000 (European Union 2000:8; COMESA 2000a). All these measures are projected to encourage foreign direct investments and to expand trade. However, besides the cutting down of tariffs, the need to modernise customs administration as facilitative institution, by adapting to customs best practices and by undertaking timely reform becomes paramount.

Furthermore when we zoom in on the Eritrean customs, it is easy to figure out two issues that need to be balanced through change stand out. On one side many customs procedures are outdated and cumbersome, but deeply entrenched. Changes are not easily made. Information

technology support for basic customs functions is limited. The necessary linkages to other agencies do not exist. Resources regarding staff and budgets are severely constrained. As a developing country however, Eritrea places a very high priority on maximising revenue collection. Customs duties and other import taxes remain significant, as shown in Table 3.

Table 3: Government tax revenue, 1993-2001

Types of revenue	1993	1994	1995	1996	1997	1998	1999	2000	2001
	In millions of Nakfa								
Tax revenue	517,6	657,5	715,6	830,4	959,4	976,9	1018,6	1032,3	1407,5
Import duties, taxes	178,1	187,1	224,9	269,7	298,7	266,1	263,2	263,6	384,4
Customs duties	73,7	80,2	136,0	167,8	184,2	167,3	162,0	159,8	195,6
Sales and other taxes	104,4	106,9	88,9	101,9	114,5	98,8	101,2	103,8	188,8
Import duties, taxes	34%	28%	31%	32%	31%	27%	26%	26%	27%

Source: IMF (1998:64); IMF (2000:40); Brondolo, St. Louis and Bosch (2001:7). The revenue and tax figures for the year 2001 are projections.

The other side of this issue is the private sector. Whilst there are many honourable and law-abiding importers who voluntarily pay their dues, unfortunately there are also evaders and avoiders. Customs procedures, irrespective of their lack of sophistication and lack of IT support, have to enable customs administrations to detect these wrong-doers, particularly where there is revenue at stake. Unfortunately, it is often the case that the law-abiding suffers as much as the evaders from the delays and the costs of customs procedures.

Therefore, modernisation in the prevailing customs practice of Eritrea could create opportunities for the private sector to demonstrate that it is the engine for Eritrea's economic growth, aided by a discriminatory customs regime applied with a light hand – except when the heavy hand of the law is needed. It could also create opportunities for customs to demonstrate that it knows when and to whom to apply each kind of hand – in this way making its small but important contribution to protecting the government's need for revenue on the one hand and, on the other, its need for economic growth which is enabled by trade facilitation.

To sum up, an important objective in customs reform should be to encourage voluntary compliance with the law. Those who demonstrate the least risk will thereby reap the greatest benefits, whilst the opposite will also be true. This fundamental change in perspective will not occur easily for either stakeholders or for customs, but we all agree that this change is essential if Eritrea is to prosper as a small but growing trading economy. It is in this context and the apparent change process that the issue of reform and modernisation of customs administration in Eritrea therefore becomes relevant and indispensable.

1.3 PROBLEM STATEMENT

As Englander (2001) quoted, the World Customs Organisation (WCO) has the following official statement:

Customs administrations play a vital role in the growth of international trade and the development of the global marketplace. The efficiency and effectiveness of customs procedures can significantly influence the economic competitiveness of nations. In a highly competitive world environment, international trade and investment will flow toward efficient, supportive and facilitative locations. At the same time it will rapidly ebb away from locations, which are perceived by business as bureaucratic and synonymous with high costs.

On the basis of this context, the current research strives to look at the following research questions:

- What are the ways and means Eritrea needs to achieve effective, efficient and economic customs administration in the quest of substantiating its macroeconomic policy of creating a favourable investment environment and export promotion?
- How could Eritrea be able to provide standardised customs services so that the country could align itself to confront the increase of new trade and tourist flows, the new developments in international trade, and to gain competitiveness in the global context?
- What are the available customs best practices that could provide lessons to the Eritrean customs administration in fulfilling its primary tasks – trade facilitation, revenue collection and public welfare protection?

1.3.1 The unit of analysis

In this research, the current practices to be analysed are those practices of the Eritrean Customs Department at the Massawa Seaport and the Asmara Airport.

1.3.2 The research premise

The basic premise of this paper is that *there is now increasingly clear world-wide evidence on the significance and positive correlation between efficiency and effectiveness of public institutions and economic growth.* For this reason the working premise of this research is that *institutional and regulatory customs reform and modernisation measures in Eritrea in line with international best practices will lead to efficient and effective customs services promoting economic growth.*

1.3.3 Independent variables

The best customs practices, international standards of customs operations, binding multilateral agreements and conventions are the basic affecting variables. In general, those institutional and regulatory variables, which when deliberately implemented in line with the international best practices make a difference in the prevailing performance, are the independent variables of this study. These are *inter alia* change in legislation, use of information technology, simplification and harmonisation of procedures, and human resource management and training.

1.3.4 Dependent variables

In this study the effects of deliberate action, such as speeded up releases of goods, reduced customs administrative costs among others are the dependent variables. In general the following expected outcomes of customs reform and modernisation could be regarded as the dependent variables of this research:

- the efficient and effective facilitation of legitimate trade and travel while ensuring compliance;
- the efficient and effective public protection ensured by the enhanced customs control of all imports and exports, and
- all revenues due to the state.

1.3.5 Research objectives

In search of a solution for the research problems and premise as established, this study endeavours to achieve the following objectives:

- 1) to review and analyse the relevant literature that makes it possible to identify the gap between the contemporary customs body of knowledge and actual practice in Eritrea;
- 2) to assess and identify the international Customs-related agreements, conventions and declarations that could be adapted as a means of modernising customs in Eritrea;
- 3) to conduct a comprehensive study of the actual practice of the customs administration in Eritrea;
- 4) to justify the research premise and to lay the ground for future research, and
- 5) to generate recommendations as an outcome of the research that are relevant for the present day needs and priorities of the Eritrean customs administration.

1.4 RESEARCH DESIGN AND METHODS

Firstly the research problem was established and formulated. That was followed by the formulation of the premise and the setting of objectives. In the premise there are two sets of variables encompassed. According to Welman and Kruger (2001:13) *variables* are observable characteristics or empirical factors that can affect the outcome. In this regard the variables identified are all the measures taken by customs reform and modernisation intervention (*i.e.* the empirical factors) on one side, and the expected efficiency and effectiveness in customs (*i.e.* the outcome) on the other. Welman and Kruger (2001:13-14) regard *independent variables* as a course or an input and *dependent variables* as an outcome or an effect. The relationship between the variables identified in this research is direct, because whenever the independent variables change positively the dependent variables follow suit.

In order to address the abovementioned design, this research is empirical and applied in nature. It is *empirical* because it will use a literature review of existing data or documentary sources to answer the exploratory and descriptive research questions (Mouton, 2001:148). Also as Brynard and Hanekom (1997:5) stated, it is *applied research* as the research problem is selected on account of the practical value the research would have in a particular Eritrean situation, and it is to be undertaken specifically to solve some problem or other.

As a result of these facts, the method of research practiced will be secondary data analysis from books, journals, periodicals, internet sources, along with proclamations, legal notices and documents (prepared by the Ministry of Finance (MOF), the World Bank, the International Monetary Fund (IMF) country staff and technical assistance missions) of the current Eritrean customs practice that stretches in time from 1993 to 2001. In addition, interviews conducted with customs officers are used as supplements for the documents.

1.5 CONCEPTUAL DEFINITION

For the objectives of this thesis the following concepts serve as working definitions:

- **Customs:** According to the legal text of the World Customs Organisation (WCO, 2000c:2) *Customs* is the government service which is responsible for the administration of customs law and the collection of duties and taxes and which also has the responsibility of application of other laws and regulations relating to the importation, exportation, movement or storage of goods.

- **Modernisation:** Modernisation in customs administration is improvement in customs performance by continuously aligning and updating the customs organisation to the international best practices, procedures and standards, and adopting information technology for better facilitation. To this effect, customs modernisation encompasses the actions and measures that take into account the lessons of the past and the realities of the present in shaping the future of the customs. Collectively, by customs modernisation it is intended to achieve excellence in efficiency and effectiveness of customs service delivery, so that a country's customs administration fits in the globalisation scenario of the world economy.

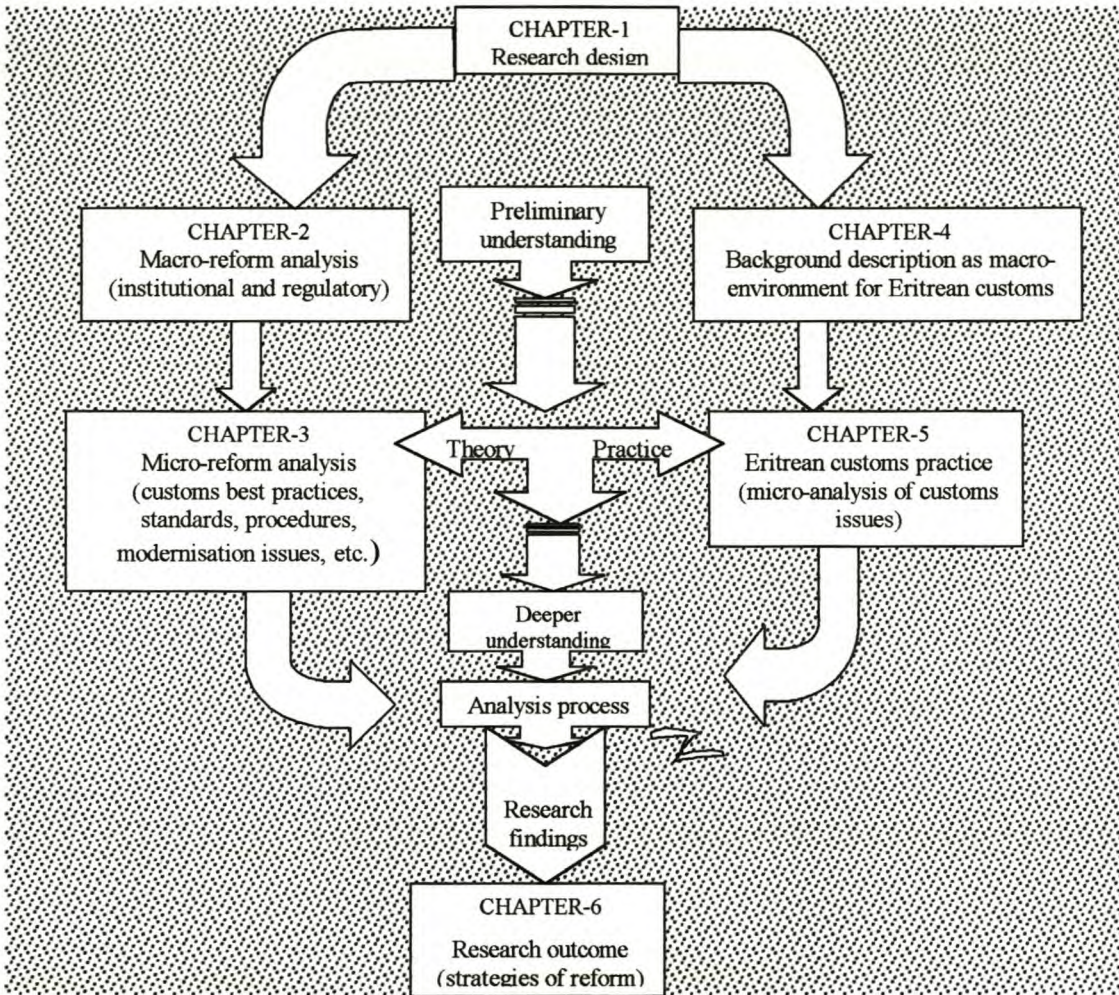
1.6 ORGANISATION OF THE THESIS

The overall purpose of this thesis is to describe standard customs practices for the Eritrean customs administration. In order to achieve this objective, the research has been organised as follows:

The first chapter encompasses an introduction, the background, and research premises of the study as well as the design of the research and the methodology adopted. The second chapter is devoted to a literature review on public service reform, putting emphasis on institutional and regulatory reform as frameworks of analysis. The intention is to review the generic characteristics of public service reform as macro-environment within which customs administration as public service shares the attributes of this general context.

The third chapter will focus on the contemporary body of knowledge of customs administration to serve as a conceptual framework. This literature review section of the thesis covers customs best practices from the perspective of the new challenges of globalisation, and discusses the core issues and priorities of the modernisation process of customs. In the fourth chapter the economic context of Eritrea as macro-environment of the current customs administration in Eritrea will be examined. The fifth chapter will contain the micro-analysis of the actual customs practice in Eritrea along with the outcome of issues and findings for reform. The sixth chapter, as concluding section, will deal with the summary of the core ideas of the thesis and will end the research by prescribing strategies of reform by way of recommendations as solutions to the research question that was raised.

Figure 3: Synopsis of the thesis



1.7 SUMMARY

International trade, social and economic environments are changing. World economies and communities are becoming more reliant on cooperation, partnerships, understanding and harmonisation. Factors such as growth in trade volume, trade liberalisation, falling transport and communications costs and increasing international competition are driving customs administrations world-wide to change their traditional procedures.

More importantly customs administrations are expected to manage ever-increasing complexities and levels of transactions with static or ever-decreasing resources. Concurrently, customs are requested to strike and maintain the right balance between control and facilitation. Hence, the fundamental thinking that Eritrea should align its customs administration as essential institution of national and international policy to the global situation by reforming and modernising its management methods and operational procedures constitutes the theme of this thesis.

CHAPTER 2

THE CONTEXT OF PUBLIC SERVICE REFORM

It is not about weeding the garden; it is about creating a regimen that keeps the garden free of weeds, (Osborne & Plastrik, 1997:11), in explaining reform.

2.1 INTRODUCTION

Though the timing, the pace, the extent, the nature, the reasons and the impact could differ remarkably across the world, countries have placed reform on the policy agenda for good governance in the public entities, regardless of their political nature or character (Walter, 1998:7). Public service administrative reform has a broad meaning which includes those efforts which demand major innovative² changes, or which lead to it in the bureaucratic system of a country to transform the ineffective and inefficient existing and established practices, behaviours and structures within it (Khan, 1997:59).

As Kotze (1997:21) articulated, administrative reform is based on the assumption that ... *there is an alternative that will improve the status quo*. In this context reform measures in customs are aimed at identifying alternative ways and means of achieving greater efficiency and effectiveness in the customs services, whereby modernisation of customs implies the change in or adopting of modern technology, management practices and standards in order to bring the full benefits of modernisation.

According to Norris (2000:28) reform in general reflects a weakening of trust in the existing institutions' ability to identify, formulate, design, and implement approved policies properly. However, as Pereira and Spink (1999:3) stated, the content of policy is important, but it is clear that policies, however good, would not serve their intended purposes unless the institutional and regulatory underpinning to manage them is appropriately available. That is, the effective capacity of government has to transform its policies into reality.

In the Eritrean case, the institutions and organisations inherited and developed over the past three decades seem unprepared and even unfit for the current times (World Bank, 1994:98-99). Urgent action is therefore needed now if prospects are to improve. How to make this enabling environment available and in particular the analysis of the reform content as macro-context for

² *Innovation* implies the generation, acceptance and implementation of new ideas, processes, products or services and the capacity to change or adopt these (Khan, 1997:60).

the intended thesis of customs reform and modernisation is the purpose of this chapter. First a brief overview of the parameters, drivers, definition and components of reform in governance that have riveted attention would be presented. In the next section the emphasis will be on a few conceptual perspectives on institutional and regulatory reform as elements of the larger reform context that will follow. These perspectives might be useful as a baseline tool for analysing the practice in Eritrea.

2.2 PUBLIC SERVICE REFORM PARAMETERS

When it comes to public service reform, the first challenge is to come to an agreement on the range of public service reform parameters. The size and cost of many public services are excessive in relation to the national economies of the relevant countries. Also, public services in many countries cannot perform their critical, let alone their routine tasks, with a reasonable degree of efficiency. The growing concern is therefore with containing the size and improving the performance of the public services. This is the new wisdom of less but better management (Nunberg and Nellis, 1995).

Another attitude looks at the challenge of public service reform from a governance perspective. It rests on the premise that the state will focus more on the supervision of provision and less on direct involvement in production (Dia, 1993:4). To that extent, there is a similarity with the idea of doing less but doing it better. What differ, are the targets of intervention to achieve that end – doing less but doing it better. Four interventions are identified in the governance approach to public service reform, namely:

- institutional performance;
- supportive incentive performance;
- performance of core functions, and
- quality of service delivery.

In the above context, *institutional performance* encompasses the governance question, the role of the state, the rule of law, public accountability and so on. *Supporting incentive performance* involves the rewards and sanctions involved in encouraging personnel to perform as well as the simple but burdened question of decent pay levels within a rational pay structure, administered with openness and transparency. *Performance of core functions* centres on national economic and policy management and doing that which matters in all areas of government. It concerns resource mobilisation, budgetary processes, policy management and the regulatory framework.

The result of all this is, or should be, an improvement in the *quality of service delivery* (McGill, 1997:256).

Thus, two sets of parameters have been outlined in the quest for an underlying concept of public service reform. The first set supports the cost-containment argument in the context of national revenues. The second is more process-dominated, identifying the basic characteristics of the public service as a system, which converts public resources into valued social goods and services. In this thesis both the cited parameters of reform, condensed into institutional and regulatory reform approaches, are going to serve as useful points of consideration in the reform analysis.

2.3 DRIVERS OF PUBLIC SERVICE REFORM

Public service reform, if generally defined, could be taken as change within public service organisations that seek to improve their performance. As such, public service reform has been an ongoing process since the inception of institutions that we might now label “public service”. However, for the purposes of this research, *public service reform* is typically defined more narrowly, for which, among others, three overarching and interlinked causes could be identified.

According to the new public management-reformer countries (Cheung, 1996:40), these are –

- crisis in the public service that encompasses reforms that have been driven mostly by factors such as government oversize, macro-economic and fiscal crises;
- renewed ideology, such as the new right ideology, and
- political will and power that covers party-political incumbency in favour of cutbacks.

2.3.1 Crisis in the public service

As Pereira and Spink (1999:6-8) acknowledged ...*if all had been well in the public service, no consistent trend, let alone ideology of reform would have emerged. However, a perception of problems with the public service, even of crisis in some countries, emerged particularly during the 1970s and 1980s* According to the World Bank (2000: vii) the theme that caught the attention of policy makers in the 1980s, following the end of the international debt crisis, was structural adjustment. For this reason, highly indebted countries have engaged in fiscal adjustment, trade liberalisation, privatisation, and deregulation since the mid-1980s. In the 1990s, the emphasis has changed to administrative reform, although structural adjustment remained a major objective. The perceived problems were focused on *inter alia*:

Inputs: In a number of countries, the public service was seen to require unsustainably large and/or unsustainably increasing public expenditure. Klitgaard (1991:2) reflected on this by stating that ... *over time the state grew. It became inefficient and corrupt. It no longer played its role. In fact, it became a negative force. The state retarded the economy and through deficits created inflation and the conditions for corruption and bribes...*

Processes: There was concern about examples of waste, delay, mismanagement and corruption within the public service, all of which contributed to inefficiency in the conversion of public expenditure into public services. In particular, public servants/officials were seen as sometimes making decisions in their own interests rather than in the interests of the public (Heeks, 1999:10). That public servants were able to do so was seen as a twin failure. Firstly it was a failure of centralisation that made decision-makers too remote from the locus of decision information and action (World Bank, 1996a:34). Secondly it was a failure of unaccountability that made decision-makers too remote from those outside the organisation who were affected by their decisions (Kotze, 1997:22-23).

Outputs: Finally, there was a perceived problem with outputs. The dilemma here is simple and direct. What matters most about the performance of government agencies is whether they solve the problems for which they were created. Concerns were widespread in a number of countries in that the public service was not delivering what it should, from adequate services to a hundred other responsibilities. The sense of difficulties came to cover both *what* the public service was doing, i.e. the public service's role, and also *how* it was doing it, i.e. public service organisation and management (Kettle, 1999:51).

2.3.2 A renewed ideology

If there had been no ideological peg on which to hang many of the trends of change within the public service, reform measures would have been less clearly recognised and probably less strongly promoted. Such a peg emerged slowly after the Second World War and has been gathering pace from the 1970s in the form of “neo-liberalism”. According to Pereira and Spink (1999:8) the ideology of neo-liberalism arose as a reaction against the fiscal crisis of the state and so became identified with expenditure cuts, or downsizing the state. In that way neo-liberalism provided a substantial theoretical framework that can be used to justify a set of public service reforms.

Pereira and Spink (1999:2) explained that ... *people realised the structural adjustment was not enough. The neo-liberal assumption behind the reforms – that the ideal was the minimal state, committed only to guaranteeing property rights, leaving to the market the full coordination of the*

economy – proved unrealistic. This is asserted by Przewski (1999:18) who described that ... *the neo-liberal view popular in the 1980s even in the absence of 'traditional' failures, markets are efficient now appears dead, or at least moribund.*

However, according to Heeks (1999:10) and Przewski (1999:15-19) three particulars flow from this viewpoint:

- that wherever possible, there should be a “rolling back of the state” in other words, the replacement of the state with privately owned institutions;
- that the main justification for the continued existence of the state is its role in helping markets to function more efficiently. That is as stated in Przewski (1999:17) ... *markets when ever possible, the state when necessary,* and
- that where state institutions remain, they should, wherever possible, be opened up to true or quasi-market forces of competition.

Neo-liberalism therefore had something to say, not just about the role of the public service, but also about the way in which the public service might be organised and managed. At this point it is worth mentioning the popular adage (ADB, 1999:40) ... *market-friendly government is only possible if you assume that the government and the private sector are opponents by nature.*

Furthermore, according to Klitgaard (1991:232) there are many reasons in support of the increasing interest state reform is receiving in the 1990s. Most important, under the new strategy the state intervenes less in the economy, but it does not disappear, and rather remains inevitably a principal actor. In affirming this, Klitgaard concluded as follows:

Now comes the time for adjusting to reality. Weak markets and ineffective governments: these are the realities to which development strategies must adjust. This means that the debate over the role of the state must go beyond the battle over how much government, how much market. If the economic reforms are to endure, they must go deeper than declaring markets to be free. Beyond market versus state we find market and state, indeed market thanks to state; and we must turn to the challenge of making both market and state work better.

2.3.3 Political will and power

Though a sense of crisis and an ideology of reform are necessary, but at the same time they are not sufficient conditions for reform. There must also be a third element, the political will and power to enact reform. According to the World Bank, Grindle & Thomas, Heeks, Kotze and

Rose-Ackerman among others, the following four main components of the political economy that can influence reforms can be identified in most countries. These are:

The public at large has often borne the brunt of public service crisis, has typically longed for reform, but has had only limited political capacity to have those reforms enacted (World Bank, 1996a:137; Heeks, 1999:11).

Politicians, public servants and the media have often been divided, with conflict between those supporting and those resisting reform. Realistically, reform will not occur unless powerful groups and individuals inside and outside government support it. Those who expect to lose from reform can be outvoted and outmanoeuvred, or they can be cooped up or compensated to accept change (Grindle & Thomas, 1991:134)

Local and global capital has sometimes been separated, but has more generally sought reform in the belief that this will reduce business costs and increase transaction speed (Heeks, 1999:12).

International organisations for developing countries, the reason for reform might be cutting costs, making the system more efficient among others, but the method of getting there, it is suggested, is different. In some countries, particularly the developing and transitional economies, international organisations have a role to play. These agencies have the political power to pursue reform because many countries, struggling with both international trade and domestic spending deficits, have had to request external sources of financial assistance. Since the 1970s, such requests have often been met with “conditionalities”. These are requirements by international finance organisations for changes in the recipient country's economic and institutional structures (Kotze, 1997:24). However, one stereotypical outcome of these institutions has been a process of reform that is driven largely from outside the public service realities of the recipient country.

So, for developing countries, the public service reform agenda presents a major challenge because, even with the best intentions, it is not normally initiated internally. Given that contention, an added difficulty is that there is no standard approach to public service reform. In itself, this is reasonable in that any country should be permitted to construct its own reform agenda (Nunberg and Nellis, 1995; McGill, 1997: 255).

2.4 PUBLIC SERVICE REFORM COMPONENTS

According to the aforementioned reasons of public service reform, where public service crisis prompts the call "Something *should* be done", the renewed ideology provides the response "Something *can* be done" and, in some situations, political driving forces press, "Something *will* be done". This "something" has come in the form of various measures that fall collectively under the heading of *Public Service Reform*. In generic terms, as Przeworski (1999:15) put it ... *the goal of state [public service] reform is to build institutions that will empower the apparatus to do what it should while impeding it from doing what it should not*

Thus, in discussing public service reform, one must first address the components of reform that governments strive to achieve. Even though there are no consistent menus, typical components included are:

➤ **Increased efficiency and effectiveness**

These components focus on improving the input/output ratio within the public service. The rationale of such reforms is to address the large size of public service expenditure and/or the inefficiency of many of its processes. For example customs compliance could be furthered if there is an effective customs administration. But an *effective* customs should not be confused with an *efficient* customs. An administration could be *efficient* in that its operation costs are very low, yet at the same time it could be *ineffective* if it is unable to enforce compliance (Silvani, 1994:274).

➤ **Simplification**

The rationale of such reforms is to reduce the costs of centralised decision-making, and to create more flexible and responsive decision-making. For instance, an essential precondition for reform of customs administration is the simplification of the customs system to ensure that it can be applied effectively in the generally "low-compliance" contexts of developing countries (Bird & De Jantscher, 1994:3).

➤ **Increased accountability**

The implication here is making public service staff more accountable for their decisions and actions. The rationale of such reforms is to increase the pressure on staff to perform well, to make them more responsive, and to reduce inefficient and corrupt practices. For instance, customs officers with discretion but without the necessary guidelines could grant exemptions for those who have not entitled to it, could add extra delays, could

overestimate the value of goods, and could applied higher rates in an attempt to extract payoffs (Rose-Ackerman, 1999:20).

➤ **Improved resource management**

This could be done by increasing the effective use of human, financial and other resources. The rationale of such resource management reforms is clear from their definition. This definition often includes a refocusing of the way the performance of these resources is planned, measured and managed (Heeks, 1999:13).

2.5 PUBLIC SERVICE REFORM: WORKING DEFINITION

Because of the specific condition in which post-independence Eritrea finds itself, the required reform is expected to be in essence nothing short of “reinventing the public institutions”. To achieve this, it seems worthwhile to define *reform* in a radical approach in this section in such a way that it fits the required reinvention in Eritrea. The aim is to reflect that, let alone a country that is deliberately neglected together with its far-reaching negative effects; countries with centuries of independence are in quest of radical public service reform.

Most published accounts of administrative reform incorporate stories that purport to interpret the origins and significance of changes. According to Caiden (1991:1) ... *inherited administrative systems were proving to be sluggish, inflexible and insensitive to changing human needs and circumstances* This is to suggest that, beginning in the 1980s, administrative states of every type were widely perceived to be insufficiently responsive to global changes in markets, fiscal capacity, technology, politics and public attitudes.

In line with Caiden’s account Hummer (1994:12) explained that ... *bureaucracy has a backward-looking orientation in which agencies define needs not by projects for the future but by standards of policies and programs defined in the past, and orientation that puts them immediately at odds on a very fundamental level with the more forward looking premises of reinvention [reform]*.

The following is a typical statement of the problem as articulated in Norris (2000:1):

The administrative state³ – as defined by Wilson and its other intellectual founders – has been characterised in part by failures to develop workable public policies and implement them in ways that obtain concrete improvements. The call to ... public administration to jettison its outmoded thinking and to reshape its future by improving its performance, its

³ For the purposes of this literature review, unless otherwise stated the words *administrative state* and *bureaucracy* will be used as synonymous or interchangeable.

image, its reputation, and its modus operandi is the culmination of decades of public dissatisfaction, professional discontent, and intellectual criticism. It echoes universal unhappiness with the administrative state and its failure to keep abreast of the times.

These failures, as further argued by Pereira and Spink (1999:98), have led to a series of initiatives planned or at least premeditated systematic changes in administrative structures or processes aimed at effecting a general improvement in administrative output or related characteristics. One such initiative is the movement of "reinventing government" that calls for competitive, decentralised, result-oriented government to meet the needs of customers rather than those of the bureaucracy (Osborn & Gaebler, 1993:321).

Regarding reinvention, Ingraham (1996a:454) pointed out that reinvention is only the latest initiative in the enduring cycle of reform. Whereas Osborne and Gaebler (1993:331) and Cheung, 1996:38) claimed that ... *the rise of a new entrepreneurial government was an inevitable shift rather than a temporary fad, in government after government and public system after public system, reinvention is the only option left.*

Therefore, before moving on the strategies of reform to make the basis for reform clear, it becomes necessary to ensure that the vision of the reinvention movement and the direction in which it is headed, are clear by explaining what is included and what is excluded. Toward that end and in elaborating the meaning of public service reform by way of reinvention, Osborne and Plastrik (1997:10) explained as follows:

Reinvention is not concerned with changing the political system, although political reforms may be needed to create a structure in which reinvention can be enacted and implemented effectively. Reinvention does not include bureaucratic reorganisation- the moving of boxes on and organisational chart. Instead, it concerns restructuring public organisations and systems by changing their purposes, their incentives, their accountability, their distribution of power, and their cultures, although reorganisation may be necessary in some instances to help achieve these primary goals.

Osborne and Plastrik clarified further:

Reinvention is not about cutting waste, fraud, and abuse, although a reduction in these three significant public concerns may result from reinvention, nor is it about eliminating deficits. Reinvention, rather, is about creating public organisations that constantly look for ways to become more efficient. "It is not about weeding the garden; it is about creating a regimen that keeps the garden free of weeds." Reinvention strives not simply to make organisations more efficient for the sake of being more efficient but with the broader goal in mind of making them

more effective, meaning to say not only cheaper government, but government that works (Osborne & Plastrik, 1997:11; see also Norris, 2000:66)

Moreover, as Norris (2000:66) described citing Osborne and Plastrik:

Perhaps most importantly that reinventing government is not synonymous with downsizing government. Some public organisations, would be more effective with smaller budgets and staffs, others would not. Part of reinventing government is finding, for any particular organisation, the size that maximises performance. But just as form should follow function, size should follow strategy. “Downsizing is like removing grains from a pile of sand: afterward, it’s still a pile of sand. Reinvention is like mixing the sand with carbon or magnesium and blasting it with intense heat: afterward, it is pure silicon.” Nor is reinvention synonymous with privatisation as the competition and the customer choice is that forces improvement, not simply private ownership.

In summary, in the light of the background as discussed above and as Norris (2000:9) tried to point out, reinventing government is a well established political programme that has been pursued in a number of forms throughout the twentieth century. Many of these political programmes share similar goals of economy, efficiency, and efficacy, but suffering largely from a persistent inability to achieve these goals except in some diffuse, piecemeal, incremental ways.

Furthermore reinventing the public service should be a strategic approach that produces the best products or services possible, like in TQM (**T**otal, **Q**uality and **M**anaged). Shaw (1994:182) tried to detail this as follows:

It must be **TOTAL** in that it applies to –

- All parts of the organisation, its suppliers as much as its own departments, intangible services as much as physical products, everybody – clerks, operators, managers, policy-makers, chief executive, etc.

It must have the primary focus on **QUALITY** through –

- Continuous, measured, improvement in the quality of the systems the primacy of the customer as the judge of the organisation’s success.

It must be **MANAGED** –

- As a structured, monitored programme of change, by continuously improving the processes implemented by all managers, but led by the top managers.

Moreover, to come to the point of clarity in defining what reform or reinvention of public service means, this paper pursues the definition of Osborne and Plastrik (1997:13-14) as conclusive and encompassing the intent of this research. *Reinvention* is ... *the fundamental transformation of public systems and organisations to create dramatic increases in their effectiveness, efficiency, adaptability, and capacity to innovate. This transformation is accomplished by changing their purpose, incentives, accountability, power structure, and culture...*

The discussed conceptual framework on parameters, drivers, components and definition of public service reform implicitly encompass institutional and regulatory elements of reform. Again, both these institutional and regulatory components will be manifested in this research as the main ingredients of customs reform and modernisation. For this the following consecutive subsections touch lightly on institutional and regulatory reform concepts. This is done to point out generic issues that fit into the research and to use it as framework for the reform analysis.

2.6 PUBLIC SERVICE REFORM: INSTITUTIONAL APPROACH

2.6.1 Public institutions: working definition

As the French philosopher Montesquieu put it ...*at the birth of societies, it is the leaders of the state who create institutions; afterwards, it is the institutions that shape the leaders* (Adamolekun & Morgan, 1999:584). There is a real sense in which this perceptive observation is applicable to Eritrea, a newborn state from the ravages of three decades of destruction in every walk of life. This makes reform analysis in any public service in Eritrea likely to take into account the issue of institutional reform.

Following Lin and Nugent (1995:2306-2307), it is useful to think of *institutions* broadly as *a set of humanly devised behavioural rules that govern and shape the interactions of human beings, in part by helping them to form expectations of what other people will do*. Furthermore, according to the World Bank (2000:7) public institutions could be defined as *the rules of the game* and the mechanisms through which these institutions are monitored and enforced. These rules of the game emerge from formal laws, informal norms and practices, organisational structures, and routines in a given setting, and the incentives they create shape the actions of public policy-makers, public officers, overseers, and providers of public services.

Moreover, institutions are the set of restrictions subject to which society moulds individual and organisational interaction. But institutions are not pre-designed or constructed either by will or by decree, but evolve within a historical social context. Each country has its own specific institutional system that, to a large extent, determines incentives for economic, political, or social

interaction and the national potential for economic efficiency and effective public service delivery. Besides that institutions overlap with, but are not synonymous with organisations; they are affected by policy design but are broader in scope and less subject to frequent changes than most policy frameworks (World Bank, 2000:xii)

Distinguishing between institutions and organisations makes it possible to understand the value and functionality of institutions properly. With reference to the difference Catalá (1999:158) explains as follows:

Efficiency and service delivery in human interactions depend not only on the institutions but on the organisations as well. Human interaction is not moulded only by the rules of the game. The most characteristic feature of institutions is that they have no specific purposes; their function is to ease human interaction. Organisations have two characteristic features: they pursue specific ends and are, or can be, created, directed, modified, or suppressed by will or by order. In other words, the problem for institutions is inter alia to determine whether to encourage or discourage economic efficiency and service delivery – and to what extent. The problem for organisations is to know how to maximise their usefulness, either in compliance with the existing rules of the game or when the object is to change those rules.

2.6.2 Institutional reform

In broad terms, governance is about the institutional environment in which citizens interact among themselves and with government agencies. For this, dysfunctional and ineffective public institutions and weak governance⁴ are increasingly seen to be at the heart of the development challenge. In addition, it is a common experience of developing countries to see misguided resource allocation, excessive government intervention, and arbitrariness and corruption deterring effective, efficient and economic public service delivery efforts in numerous settings (ADB, 1999:3-4).

Against this background, as Corkery (1995:43-44) put it, the importance of well-performing public institutions and good governance⁵ for development have come to the fore as critical elements. It has also become obvious that neither good policies nor their implementations are

⁴ In the World Bank's 1992 report *Governance and Development*, governance was defined as *the manner in which power is exercised in the management of a country's economic and social resources for development* (see also ADB, 1999:3).

⁵ The World Bank's 1994 report *Governance: The World Bank's Experience* stated, *Good governance is epitomised by predictable, open, and enlightened policymaking (that is, transparent processes); a bureaucracy imbued with a professional ethos; an executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law* (see also ADB, 1999:8-12).

likely to emerge and be sustainable in an environment with dysfunctional institutions and poor governance. At the same time it is also clear that reforming public institutions is a complex and difficult task, both technically and politically. Yet it cannot be avoided (see also ADB, 1999:41).

As noted by the World Bank (1996a:11), there is now clear worldwide evidence on the significant and positive correlation between quality of public institutions and economic growth, i.e. *...public institutions shape the economy as well as reverse it, and a sine qua non for sustained and equitable growth is a highly efficient and effective government and governance.* This makes institution reform and building in the widest sense essential within which reorientation, and strengthening of the institutional framework at all levels becomes a process of all times.

According to Catalá (1999:150) institutional reform is not simply a matter of changing the ways in which public hierarchies are arranged, or doing structural adjustment, as these in themselves are insufficient to ensure the goals of development, legitimacy and governance. Rather, achieving these latter goals could only stem from a reform of the broad arrays of rules governing the game and that shape the incentives and actions played by political, economic and social actors, including the “voice” mechanisms that promote the rule of law and the accountability of government to its citizens. Hence institutional reform is establishing institutionality. Consequently, as Pereira and Spink (1999:139) stated, institutional reform poses a challenge to try and to find a way in which the necessary capacity can be provided by recognising the innate need for time to change attitudes, internalise new approaches, and adapt ideas and systems to a new situation.

Moreover, as institutional reforms are associated with improving public bureaucracies at large, two arguments come into view. The first is the need for institutional reform to be regarded within a specific context. Khan (1997:60) described “context” as one of the main factors for the success or failure of major institutional reform efforts by emphasising on the need to take cognisance of the specific surrounding social, political and economic conditions, which significantly influence the reform cycle.

Further in this view, it is believed that different strategies of reform may be appropriate for different organisations and for different types of policies. This “horses for courses” approach to change has by no means produced reliable laws for organisational performance; in addition, clear cases of successful change have occurred outside the parameters arising from the conventional wisdom about change. Everything else being equal, internal and more importantly bottom-up changes will be more enduring, simply because these changes can be expected to match the

needs of a particular organisation better than any imposed change (McGill, 1997:255; Peters, 1998:186).

The other argument of improving public bureaucracies, from the perspective of universality is that in public bureaucracies or public management, there is a strong suggestion, if not an outright assertion, of a convergence in the forms and aims of governance, its institutional development or reform. According to Ingraham (1996b:4), despite obvious differences in national experiences ...*the commonalities are more important than the differences...* One advantage of the commonality of issues is that there is some kind of experience to be gained from virtually all of the issues. A slightly weaker version of this argument, according to Fosler (1999) is that, because of the globalisation that engulfed the world in virtually every dimension of life, all governments face the same challenges and tasks and the same paradigm of change, even if their responses differ. In other words, the sovereignty of institutional reform has been shattered by globalisation in its many guises. Hence the suggestion of “one change fits all” mindset approach and appreciation of best practices in institutional reforms tends to dominate.

However, while globalisation may induce convergence to a single governance system, there are equally powerful inertial forces that inhibit such convergence. A change in governance systems is difficult because it requires simultaneous changes in institutions, laws and enforcement agents and in addition many special interest groups in society may oppose the change. Such complementarities, social structure and cultural factors suggest that there can be many optimal governance systems that are structurally different but equally effective. The “convergence” to a single governance system may be only *de jure*, rather than actual adoption in practice, or *de facto*. Finally, the convergence observed in practice appears to be driven more by economic interdependence among countries rather than the desire to adopt a global standard (ADBI, 2001:2).

In line to the above, Henry Mintzberg (cited in Savoie, 1998:222) has remarked that one can ...*no more prescribe the best way to run all organisations than prescribe one pair of glasses for all people...* Empowerment and de-layering, for example, may make sense in one government agency, but not in another. Mintzberg further explains that ...*the beginning of practical wisdom for public managers is not to ask: what are the so-called best organisations are doing. Rather, they should begin by asking: What this particular organisation needs, given its purpose, history and current circumstances.*

In summary, when regarding institutional reform – although each country has its own resources where each must face specific and particular challenges and opportunities, and establish its own strategy and differentiated priorities – it is necessary that a large portion of the institutional goals can and should be shared. Apart from any other considerations sharing experience provides a wealth of knowledge. The only requirement is that the experience that has been gained in another environment needs to be interpreted in one's own circumstances. Interpretation is important even where the input is highly technical. For example in the case at hand, a computerised system for customs procedures could be fairly neutral, but it still needs to be reinterpreted in the light of local attitudes and circumstances if it is to be transplanted successfully (Catalá, 1999:152).

2.6.3 The centre stages of institutional reform

It is widely accepted that economic development is primarily the result of investment in capital, labour and entrepreneurship, among others. More recently, it has also been associated with the process of globalisation and innovation, and the appropriateness of institutional structures (Konstadakopulos, 2002:100).

In addition, shaping institutions that develop processes and incentives and which also provide good policies are not enough *per se*. To pursue policies, capacity should be built in which effective reform is required. Only through institution building are countries able to achieve the ultimate goals of effectiveness and efficiency in their public service delivery (Kettle, 1999:71).

In general while institutional development cuts across all the functions of the public service, namely, policy-making, service delivery, and oversight and accountability, institution-building components exist concurrently in almost all reform initiatives with the focus of building effective integrated institutions. This makes reforming the public service possible in such a way that it enables government to work better and to cost less which is a two-fold challenge. In the next section two aspects will be discussed, namely (a) institution development and (b) capacity building (World Bank, 2000: xii).

2.6.3.1 Institutional development

According to Buyck (1991:5)...*institutional development is the creation or reinforcement of the capacity of an organisation to generate, allocate and use human and financial resources effectively to attain development objectives, public or private. It includes not only the building and strengthening of institutions but also their retrenchment or liquidation in the pursuit of institutional, sectoral, or government-wide rationalisation of expenditure.*

Buyck suggests that operationally institutional development is typically aimed at improving and strengthening the following:

- internal organisational structures;
- management systems, including monitoring and evaluation;
- financial management (budgeting, accounting, auditing procedures) and planning systems;
- personnel management, staff development and training;
- inter-institutional relationships;
- institutional structures of sub sectors or sectors, and
- legal framework and Government regulations and procedures.

Certain authors present a similar checklist in the context of defining institutional development. Gray, Khadiagala and Moore (1990) argue that institutional development implies more than the mere strengthening of organisations that will facilitate policy implementation and completion. Rather institutional development comprises strengthening legal and para-legal systems; the internal organisation and distribution of functions; physical and financial capacity for policy implementation; personnel policies and reward systems, and competency and skills levels in the institutional environment (Gray *et al.*, 1990:12).

Paul (1990) presents his own operational checklist for institutional development. This checklist covers -- an analysis of workforce inadequacies, including skills, coordination problems, gaps in planning, monitoring and evaluation systems; weak local capacity; need to restructure or decentralise organisations; problems of financial management (cost recovery and support systems, budgetary controls); constraints on compensation and incentive structures; lack of attention to demand for project services; autonomy issues (Paul, 1990:7).

Horberry and Le Marchant, (1991) contribute to the definition of institutional development. *The main objective of institutional development is to create or strengthen the capacity to manage ... programmes - developing structures which strengthen the responsibility for the environment, and which provide incentives for individual and collective action ... it requires a long term view (as opposed to merely policy formulation) ... it must be tailored to suit the local political, economic and cultural conditions. Suitability to the local situation is especially important in developing countries where institutions are unique, complex and deeply traditional ...* (Horberry & Le Marchant, 1991:385).

Blase (1986), goes into some detail on the institutional building process. Citing the Inter University Research Programme on Institutional Building scholars, Blase put it as follows: *institutional development is the planning, structuring and guidance of new or reconstituted organisations which (a) embody changes in values, functions, physical and/or social technologies; (b) establish, foster and protect normative relationships and action patterns, and (c) attain support and complementarities in the environment* (Blase, 1986:332).

Finally, Israel (1987) suggests that institutional development ...*refers to the process of improving the ability of institutions to make effective use of human and financial resources ...* He contends that the mistake, even in recent practice, is that for ...*most institutional development strategies, the emphasis is still on planning and appraisal but not on implementation; on investments and policies but not on operations* (Israel, 1987:1).

Together with the above concepts, *institutional infrastructure* is used to cover the organisation structures, human resources, and systems and procedures necessary for the administration and management of government policy within the specific environment or societal norms – political, legal, cultural – in which the organisations have to function and to discharge their roles.

To sum up, *institutional development* is concerned with the development of an institutional infrastructure, together with the institutional capacity, which is the potential to perform and operationalise effectively the various elements of the institutional infrastructure in managing public policy. It can involve the creation of new organisations, restructuring of existing ones, human resource development, and new systems and procedures. The word *institutional*, therefore, covers people, the organisations in which they work and the systems they operate (Corkery, 1995:44-45). In the light of this context customs reform and modernisation becomes a typical institutional development issue.

2.6.3.2 Capacity building

Institutional development is sometimes used interchangeably with *capacity building*, a term that has become increasingly common in recent years. According to the World Bank (2000:13) the meaning and scope of *capacity building* can, however, be ambiguous. If narrowly defined as the provision of training and materials to build skills within organisations, *capacity building* is only part of the challenge of reforming public institutions. Conversely, when more broadly defined to include reforms of incentives and building effective and accountable institutions to address development issues as well as strengthening skills and resources, the term *capacity building* is essentially synonymous with the concept of *institutional development*.

UNDP defines *capacity building* as the ...*sum of efforts needed to nurture, enhance and utilise the skills of people and institutions to progress towards sustainable development...* (Cited in Clark, 2000: 77). Moreover, UNDP (1991) suggests that institutional building strategies should tackle key functions through standard interventions, as follows:

- 1 *On functions*: applied analytical capabilities; planning and programme design capacities; management and implementation capacities; monitoring and evaluation capacities.
- 2 *On interventions*: changing management strategy; improving efficiency and effectiveness of management processes; changing systems structures; matching missions to environmental demands; changing management structures (UNDP, 1991:51-52).

In public service reform programmes, institutional development could be articulated in two ways. First, the process has to shift from a management consulting approach to a more exploratory style of organisational analysis. Secondly, the analysis had to follow the institutional development agenda of reviewing functions, generating the resulting structures, reviewing the planning and budgetary capabilities and assessing the need for legal and regulatory reform. Here a significant change in working practice is required.

The management consulting style is common practice. The consultant conducts the analysis through data collection and interviews, synthesises the material in order to draw conclusions, and then submits the report with recommendations. Invariably, the client is in a take-it or leave-it situation. The change in working style is therefore to introduce the exploratory and iterative characteristics of the institutional development process. In this way the needy take ownership of the analytical process (McGill, 1997:259-260)

Pertaining to capacity building, all countries to some extent and developing countries especially, are caught in a dilemma. On the one hand they all need to develop capacity to keep up with the advances in this turbulent age, due the fact that planning for the future is more demanding than ever. On the other hand developing countries often have a more fundamental need – the capacity to manage the day-to-day affairs of the country. However, despite the acknowledged difficulties in doing so, it is necessary to find some ways of expediting the process of development of institutional capacity for policy management (Corkery, 1995:48)

Again, deciding what resources to call on requires knowledge of what is needed and of what is available. This may seem a very obvious statement, but the reality does not always reflect that this is done. Here it becomes essential to have a concept of the role of the state and the functions it has to perform.

Even though there is no universally agreed definition for the role of the state, each country should necessarily delineate individually what the state is expected to do in discharging that role before trying to determine the institutional capacity and infrastructure needed to support it. This notion is reflected by the president of Eritrea, in an opening speech at the Development Partners' Conference held on 11-13 September 2001. In a keynote address the president noted that, "*Parallel with the reforms of structural adjustment we undertook far-reaching political and administrative measures with a view to ensure a lean and effective government. To this end, the public service was restructured by re-focusing the mandate of government ministries to four core functions: policy formulation; regulation; research and human resource development.*"

However, reviewing the capacity requirements of central government is not only a question of looking at the internal functions of the central ministries and agencies. It should also take account of the roles of other actors and stakeholders in the policy management process. This involves asking about the relationships government has with other parts of the economy and with the international institutions so that the needs to manage these relationships can be identified and met (Clark, 2000:77). Finally, it is necessary to have an existing institutional capacity – now present or attainable – so as to be able to define what the gap is that needs to be filled (Corkery, 1995:49)

2.6.4 Why an institutional focus in public service reform?

The recent revival of institutions as a focal point for research and policy is not only a reflection of the need to tackle the complexities of public action. Rather, as Catalá (1999:151) stated, it is a result of *...the growing consciousness that the greatest weakness in regard to the challenges of current development is not so much lack of natural, economic, or human resources, but the inadequacy and inefficiency of the institutions that manage the productivity of such resources...*

Hence institutional approach to public service reform provides some guidelines for the kinds of institutional change that may therefore be necessary. Much of the argument rests on the need to conceive of knowledge systems in evolutionary terms because, if the world in a socio-economic sense is changing rapidly, there is not enough time to reflect gently on *what is*. On the contrary, the crucial issue will be to devise ways of keeping on top of situations that are changing at rates that have become much faster than anything we have known before i.e. *What is very quickly becomes what was* (Clark, 2000:76).

Development is therefore no longer a question of improving existing organisations, but a question of redefining or repostulating the “rules of the game” that determine which organisations and actors will participate and the position of each participant in the process of

collective action. This approach has developed analytical tools that focus on the incentives and information that shape decision-making by public actors and enable them to open the black box of “the state”. The problem of development is therefore no longer a problem of governing, but a problem of governance, i.e. the institutional system (formal and informal) that limits the action of governing actors (governmental and nongovernmental) relevant to authoritative determination and the allocation of public assets and resources (Kooiman, 1993 cited in Catalá, 1999:148-151; Metcalfe, 1993; Osborne and Gaebler, 1993).

If the institutions that countries use to govern themselves were perfect and would ensure that the private rewards of government decisions were aligned with the social costs and benefits, the distinct incentives of public actors would not matter. But the institutions of governance are imperfect because of the following reasons:

- Those who suffer from poor policies generally lack the power and information to impose costs on the policy-makers who designed them, particularly in governments without meaningful checks and balances.
- Multiple actors (cabinets, political parties, legislatures) often provide input to decision-making regarding policy and bargaining processes. Together with this, where institutions are weak, policy-making and resource allocation typically proceed in non-transparent ways, with decisions generally skewed in favour of their private interests and those actors who are well connected to centres of power over others.
- Even if policy-makers agree on the socially optimal policy, their control over bureaucratic officers is always imperfect – and can be exceedingly weak in developing countries, especially countries in transition, like Eritrea.
- Institutional obstacles may obstruct feedback from beneficiaries that could improve policy implementation.

The demand for institutional change therefore could be derived from the perception that the new institutional arrangements will make it possible to generate gains that would be impossible to generate within the current institutional framework. For that reason, by better understanding how institutions shape public action and by undertaking more empirical analysis to measure the economic costs of poorly performing public institutions, one could be in a better position to help improve governance and public service performance through institutional approach (Catalá, 1999:164; World Bank, 2000:8).

2.6.5 Interaction of institutions and policies

A focus on institutions complements but is broader than the efforts to foster policy reform. Besides, both policies and institutions have independent impacts on development performance. Yet while “first-generation” economic reforms have proceeded rapidly in many settings over the past 15 years as manifestation of policy reforms, institutional reform has moved far more slowly, and weak institutions have become the main constraint to more robust and sustained growth in many settings. This needs policies and institutions to complement each other and closely interlink in several ways, e.g.

- Policy design should take institutional capacity carefully into account. When institutions are weak or dysfunctional, simple policies that limit administrative demands and public discretion work best. Where institutions are stronger, more challenging public initiatives can be effective. For that matching policies and institutions is the key (World Bank, 2000:7)
- Policies do not emerge from a vacuum but generally are the result of bargaining among contending groups – with the interplay among them shaped by the institutional and political “rules of the game”, so that one should be able to help improve policy outcomes by directing attention not just to the policies themselves, but to the “rules of the game” that shape policy outcomes (World Bank, 2000:9)
- The causation also works in reverse: policy choice can significantly influence the way institutions develop. A decision to reduce tariffs or move from highly varied to uniform tax rates can dramatically shift incentives and responsibilities within customs and tax administrations, making it harder for officers to extract bribes in return for lower taxes. This is one example of why economic reform is a key pillar of an anticorruption programme (World Bank, 2000:9)

2.6.6 Customs policy, customs administration, and institutional reform

As a conclusion this sub-topic discusses institutional reform in the light of the perspectives of this research thesis. For understandable reasons it makes little sense to discuss customs policy and customs administration in isolation from one another. This is to say that customs policy should not be designed without looking carefully at administrative capacity, and the other way round. In turn both the development of customs policy and administrative capacity are encompassed in institutional development and further reform of it.

When customs is weak – specifically in administrative capacity – fiscal policies need to be simple and transparent. For example, rates of import duties, such as customs tariffs, sales tax, and excise tax should be as few and as low as possible. The reason is that multiple rates force customs officers to differentiate goods and inevitably leave room for uncertainty and bargaining. Again high rates provide greater incentives for the evasion of customs and greater room for bargaining and corruption. In addition underpayment of customs duties could be facilitated by ineffective customs control.

These loopholes together with the lack of clear guidelines often provide customs officers with extensive discretionary power. Hence the judgment of officers could encourage corrupt payoffs designed to evade tariffs. A corrupt customs system that favours some groups and individuals over others in turn could make it difficult to put a country on a sound fiscal basis. Hence a well working customs system, i.e. one that is transparent and accountable, would only be possible when customs policy is aligned to the available enforcing capacity, where the main tool is reform in an institutional setup (Rose-Ackerman, 1999: 20).

On the other hand, to provide effective customs services that facilitate trade, there is a need to reduce the Customs-related controls. This in turn requires policy wise and institutional change. Hence modern customs is required to institutionalise certain measures, e.g.

- uniformity in documentation and inspection procedures;
- to adopt risk management techniques and audit-based controls;
- making use of maximum practicable information technology (Edmonson, 2002:35);
- an authorisation for legitimate traders, allowing them to cross national borders with minimal interference;
- the use of significant customs self-assessment and random checks, and
- the use of pre-arrival declarations and post-release audits that enable customs to keep most people out of the physical investigation net altogether and to concentrate their resources on the key target of illegitimate trade among others.

These measures enable efficient utilisation of the limited customs administrative capacity redirected on high-risk commodities and people (WCO, 2000b:9; ICC, 2001a).

Furthermore, for instance, computerising a customs system with unreasonably complex design and without simple up-to-date procedures might be a misuse of scarce resources. In addition, rather than training many administrators and auditors to enforce a complex customs, one should

first consider how to simplify and lessen the administrative load through changes in institutional design. This demonstrates that efforts to strengthen the institutional capacity should not be undertaken without a careful look at customs policy.

Finally, both appropriate customs policy and efforts to strengthen customs administration might fail if the broader institutional setting reinforces counterproductive norms and incentives. In many transition economies, for example, systemic corruption, discretionary and often arbitrary imposition of rules, and an absence of accountability mechanisms are prevailing.

As a result, if rule of law is undermined at large, neither the public nor the government could expect themselves or others to abide by the prevailing regulations. When it comes to customs, the result is among others widespread illegal trade, public safety at stake, customs evasion, large “unofficial” economies, and macro-economic instability. In such a setting marginal changes in customs policy or customs administration are unlikely to have much impact. The only answer is rather likely to lie in more fundamental institutional reform in the overall public service (World Bank, 2000:10)

2.7 PUBLIC SERVICE REFORM: REGULATORY APPROACH

2.7.1 Regulations: working definition

In recent decades there has been an extensive debate about regulation, deregulation and new forms of regulation. Nevertheless, there is no generally accepted definition of regulation applicable to the very different regulatory systems in countries. A helpful introduction to the basic themes is provided by Francis (1993:5) who defines *regulation* as ...*state intervention in private spheres of activity to realise public purposes...* He pointed out that regulation is frequently associated with the attempt to correct market failure, in particular the control of monopoly.

For purposes of this work however, the concept described by OECD (1997:6) will apply. According to the OECD *regulation* refers to the diverse set of instruments by which governments set requirements for enterprises and citizens to achieve public policy objectives. Regulations include laws, formal and informal orders and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to which governments have delegated regulatory powers. Added to this, *regulations* in its broadest sense covers all government legislation, policy and associated activity (Collins, 1993:329; McGill, 1997: 263).

In the same line World Bank (1996b:72-73) defines *regulation* from political economy perspective as that brings a sustained and focused control exercised by a public agency over activities that are valued by the community. According to (Francis, 1993:6; OECD, 2000:9) regulations fall into three categories:

- **Economic regulations** intervene directly in market decisions such as pricing, competition, market entry or exit. Reform aims to increase economic efficiency by reducing barriers to competition and innovation, often through market liberalisation and economic integration, deregulation, use of efficiency-promoting regulations, and by improving regulatory frameworks for market functioning and prudential oversight (OECD, 2000:9).
- **Social regulations** protect public interests such as health, safety, the environment, and social cohesion. The effects of social regulations might be seen as secondary concerns or might even be undermined, but can be substantial. Reform aims to verify the need of such regulations and to design regulatory and other instruments that are more flexible, simpler, and more effective for compliance at lower cost (OECD, 2000:9).
- **Administrative regulations** ensure the implementation of the economic and social regulations. Besides the paperwork and administrative formalities or the so-called "red tape" as part of the administrative regulations that enable governments to collect information and design proper trade and fiscal policies. Hence, reform aims at eliminating those regulations no longer needed, streamlining and simplifying those regulations that are needed, and improving the transparency of their application (OECD, 2000:9).

2.7.2 Regulatory reform

Obviously, governments can be effective only if regulations achieve their policy objectives. Otherwise the result would be like the Chinese proverb denotes "*Ill made legal shoes pinches the citizen's foot*" (World Bank, 1996a:72). This means that too often the result of regulations have been disappointing and at times characterised by failures.

More importantly, despite the fact that *inter alia* the changing circumstances, inadequate compliance, and improper regulations underlie many such failures, efforts tend to produce calls for more regulations with little assessment of the underlying reasons for failure. Based on this observation, former vice-president Al Gore (cited in Kamensky, 1998:72) pointed out that *...in creating a government that works better and costs less the problem is not lazy or incompetent people; it is red tape and regulations so suffocating and that stifled every ounce of creativity....*

In line with the aforementioned practice, globalisation, which is seen as a changing condition, is urging states to change their institutional and regulatory management capacity to cope with its impacts. The central problem in this is that governments have failed to keep pace with change. Although regulations are essential tools for securing justice and protecting welfare, traditional administrative control and oversight processes are not suitable for ensuring that expanding regulatory powers are used cost-effectively and coherently to achieve those aims.

Among others, changing economic and social conditions – globalisation, cultural diversity, new technologies – require broad changes in the style and content of regulations, but governments have failed to react. Regulatory regimes are increasingly technocratic, and too vulnerable to certain interest groups that used regulation to appropriate advantages for themselves. Thus against this background fundamental structural reform of national regulatory systems seems clearly overdue (Steane & Carroll, 2001:31).

For this, governments have to respond rapidly and effectively in terms of regulations, among others, if they are to be able to meet the continuing needs of the societies for which they are responsible. The OECD (1997) *Report on Regulatory Reform* argues that a central requirement for successful government response to the challenge of globalisation is effective regulatory reform and the development of a more efficient, less intrusive public service regulatory capacity.

Here reform, composed of all contextual matters that govern the institution, can mean revision of a single regulation, the scrapping and rebuilding of an entire regulatory regime and its institutions, or improvement of processes for making regulations and managing reform. Even further deregulation is part of regulatory reform and refers to complete or partial elimination of regulations in a given public service to improve economic performance. Likewise regulatory and procedural reforms are required to reduce the regulatory costs and to boost efficiency in services, stimulate innovation, and help improve the ability of economies to adapt to change and to remain competitive by identifying impediments to current and possible future operations, without ignoring the need for a well functioning government that regulates and protects market failures (Collins, 1993:329; McGill, 1997: 263).

As a matter of fact, in the last decade the scope, speed and consistency of structural reforms by multiple governments were remarkable. As a result accumulated rigidities and practices of decades were re-assessed, and many rejected. In addition, the awareness of the excessive role of the state in the economy, has led to broad policy and institutional changes in favour of transparency, public service efficiency and market competition (Shelton, 1997).

Together with these structural reforms, regulatory reform also became a formidable task as it transforms countries to reduced red tape, and institutes stronger accountability in the public service among others. Further, in an era of competitive global markets and rapid technological change, governments need to improve their understanding of the costs and benefits of regulation. For that, as a tool regulatory impact analysis, which is the systematic assessment of positive and negative impacts of regulation and alternatives, could help governments to reduce regulatory costs on businesses, while maximising the effectiveness of government action in protecting public interests (Stoler, 2002).

However such regulations could only function properly if, among other things, effective and efficient regulatory capacity is put in place. Therefore, part of the emphasis of legal and regulatory reforms in strengthening governance should be on implementation and enforcement. A sound reform policy should combine mandatory and voluntary requirements in order to achieve adherence to sound governance in practice. Furthermore, there should be balanced and progressive enforcement from the introduction of regulations to ensure their adoption in practice. In addition the quality of enforcement should be evaluated on a continuing basis (ADB, 2001:12-15).

2.7.3 Customs administration and regulatory reform

An important criterion for the success of customs regulatory reform is whether customs regulatory systems accomplish their policy objectives in terms of facilitation and control. This has prompted most governments to examine how they can achieve their policy objectives cost-effectively through better regulation and different mixes of policy tools. This focus is reflected in the customs regulatory reform approach that turned to “regulatory quality management” in order to improve the efficiency, flexibility, simplicity, and effectiveness of individual customs regulations and customs non-regulatory instruments.

Further, regulatory reform is now entering another phase – the management of regulation – to improve the total impact of customs regulatory systems in achieving their social and economic goals. In customs this is seen in the three categories of regulations, i.e.

- **Economic regulations:** From the scope of this thesis, regulations such as import taxes and duties as well as customs formalities and procedures constitute the economic regulations that intervene directly in the flow of goods and people across the borders of countries. These regulations serving trade policies affect market decisions such as pricing, competition, market entry and exit, foreign direct investment and international trade at large (Stigler (1975) cited in

Dewing & Russell, 1997:271). Therefore, improving the total impact of these economic regulations is a primary focus of the customs regulatory reform.

- **Social regulations:** Customs regulations are also social regulations in that they are designed to protect public interests such as health, safety, the environment, and social cohesion by controlling the borders from illegal and sub-standard commodities and others (Lave (1981) cited in Dewing & Russell, 1997:271). Thus, managing these social regulations in such a way that they achieve their social goals is another focus of customs regulatory reform.
- **Administrative regulations:** From customs administration perspective, these regulations are those that enable customs to accomplish two main tasks. The first is the fiscal task that regulates the assessment and levying of customs duties, taxes and other duties on importation. And the second is the non-fiscal task that regulates compliance with a wide range of prohibitions, restrictions and special measures of control in respect of specific goods intended for import or export (Van Kuik, 2001). These administrative regulations basically guide the core functions of the whole customs operation. Their reform with the focus on their effective and efficient management, is therefore one of the items on the agenda of the customs modernisation process.

Moreover, evaluating and taking steps to avoid potential failures of regulatory compliance should therefore be an integral part of regulatory reform. Improving compliance involves a detailed understanding of the context in which regulation operates. Regarding regulatory compliance OECD citing analysts put it as follows: *...regulation refers to sustained and focused control exercised by a public agency over activities that are socially valued. The reference to sustained and focused control by an agency suggests that regulation is not achieved simply by passing a law, but requires detailed knowledge of and intimate involvement with, the regulated activity* (OECD, 2000:10). In the light of this background, if a government wants to improve customs regulatory compliance, it must understand what is going on in the real life and use that understanding to inform regulatory design. This context again leads customs regulations to be analysed in view of the globalisation trend.

As Catley (1996, cited in Pratt & Poole, 1999:534) stated, it has become clear that since the 1980s nations have found it increasingly difficult to avoid integrating into the evolving economic system due to basic advances in technology, transport and telecommunications. The expansion of trade in volume has also proved the decisive necessity of standardised regulations for establishing globally aligned economy. As a result and in the bid to modernise the customs across the board, progressive trade liberalisation and rule-making efforts, regulatory reform in terms of both design and compliance becomes crucial.

However, despite the successful reductions in traditional tariff barriers to international trade, it still has become increasingly apparent to world business as the engine of economic growth that customs regulations and procedures which are designed supposedly to facilitate the flow of trade are among the most significant remaining non-tariff barriers to global commerce (ICC, 1997).

In summary therefore, when regulatory reform is approached from the angle of the focus of this thesis, it is used to refer to the changes required to improve regulatory quality by enhancing the performance, cost-effectiveness, and related government formalities in customs administration without compromising customs compliance and trade facilitation. Further regulatory reform in customs encompasses many pragmatic steps that could contribute to solid international trade performance, regulatory management of economic and social adjustment to changing conditions, and improved efficiency of customs services alongside applying standardised customs practices by adopting multilateral conventions and agreements (Edmonson, 2002:35). Hence the importance of regulatory reform in bringing about effective, efficient and economic customs administration is crucial.

2.8 SUMMARY

From the perspective of public service reform drivers, the reform required in the Eritrean public service could be seen as derived from the inherited crises and to some extent the political will of post-independence rebuilding. The fact is that the Eritrean public service has experienced major distortions in the last fifty years. During this time, the development of the nation in general has not only been arrested but it has actually regressed. Thus, the prevailing public service environment reflects, in its various facets, the deep scars left by deliberate destruction and neglect (Haregot, Stanley, Doctoroff & Yosef, 1993:15)

In turn the crisis background brings the reason that the current public service problems have been the result of the absence of many years of an overall institutional framework to devise, support and monitor public service policies, legislation and programmes in a coordinated and comprehensive manner (World Bank, 1994:195). This constitutes the base for the fact that the public service reform required in Eritrea should be approached from institutional and regulatory reform parameters, as this chapter's review implies.

Moreover, public service reform, as the creation of an enabling environment, entails the need for laws to regulate society and the creation of institutions to ensure consistent application and enforcement of laws (ADB, 1999:15). This enabling environment in turn, at macro-level, becomes the background to create a catalyst government with a steering role. By *steering* is meant the policy and regulatory function (Osborn & Plastrik, 1997:347), which is the emphasis

of the current chapter. And *enabling environment* at micro-level is about creating a public entity like customs administration with a rowing role.

Rowing function in customs implies the tasks and procedures of the customs operation. Hence, reform in the rowing function of customs becomes the choosing of the methods that best meet the needs for efficiency, effectiveness, accountability and flexibility in customs service delivery and customs compliance tasks in a fast changing world. For this reason the next chapter deals with the conceptual framework of customs as a review of the micro-environment. Moreover, the discussion treats customs administration as a public entity and as extended arm of government – with a rowing function that enables the realisation of the steering function of state macro-reforms and tries to identify the ways and means of effective and efficient customs administration, collectively named *best practices*, in the light of the globalisation process.

CHAPTER 3

THE CONCEPTUAL FRAMEWORK OF CUSTOMS

3.1 INTRODUCTION

We either change to meet the demands of new times or we vanish to be replaced by others more open to adventure (Frank Ogden, cited in WCO, 1996)

The previous chapter was devoted to a literature review on public service reform, putting emphasis on institutional and regulatory reform as frameworks of analysis. The intention was to review the generic characteristics of public service reform as macro-environment of customs administration, in order to be able to analyse the attributes of this general context that are shared by customs as public service.

This chapter focuses on the contemporary body of knowledge of customs administration to serve as a conceptual framework and micro-analysis of one component of the broader environment of public service. This literature review section of the thesis discusses the core issues and priorities of the modernisation process of service delivery by customs and covers customs' best practices from the perspective of the new challenges of globalisation.

The globalisation process, leading to an extraordinary increase in the international flow of people, goods, capital and information, has changed the role of the government radically in the last decade of the 20th century. Governments' performance review is pushing up toward reform and modernisation. As a result, governance nowadays is a strategic issue more than ever (Englander, 2001:3). The motivation for this concern in the last decade has sprung largely from its analysis of globalisation and how the institutional and regulatory management capacity of states has to change to cope with its impacts (OECD 1996, cited in Steane & Carroll, 2001:30).

Consequently, customs organisations in this new environment are obliged to be more effective in the protection of the economy, but at the same time act in order to encourage the economic growth. Moreover, the WCO believes that customs administrations throughout the world will in the future be operating common procedures using internationally accepted trading instruments such as the *WTO Valuation and Origin Agreements* and the *Harmonised System of*

Nomenclature, and based on a revised and in parts obligatory, *Kyoto Convention*⁶ *Customs Formalities* will be largely transparent to international traders (WCO, 1996).

Hence, the challenge countries face is making this vision of the future a reality. Customs is an essential instrument of national and international policy that must manage ever-increasing complexities and levels of transactions with ever-decreasing resources. The world is changing and customs administrations will have to deal with increasing volumes of international trade with either static or declining resources. Therefore, new customs procedures must be developed or existing customs procedures must be re-engineered to meet the demands of this evolving international trading environment (ICC, 1999).

For this, the analysis of the customs contemporary body of knowledge as a conceptual framework will be the concern of this literature review chapter. Therefore, in search of the ways and means that modernise customs administration, *inter alia* customs multilateral agreements and conventions, standards and procedures, adaptable best practices and experiences will be used as base-line references.

3.2 CUSTOMS AS INSTRUMENT OF PUBLIC REVENUE

In general, taxation is the chief means by which governments finance their expenditure and it also forms a major component of the revenue side of the government budget. Taxation differs from other sources of government revenue in that its compulsory nature and the power to tax is ultimately enforced by state coercion of its citizens. (Levačić, 1987:82; Gildenhuis, 1997:214)

According to Gildenhuis (1997:214-215) taxation is characterised by the absence of a direct *quid pro quo*. This means that a taxpayer does not receive an equal value of collective services for each monetary unit of tax paid. On the other hand, taxation serves three primary functions: generating enough revenue to finance the costs of collective services; redistributing income and wealth, and the economic regulation function by reducing private spending together with the issues raised concerning the use of taxation as a policy variable contributing to the stability of the economy.

In reference to this background, import duties usually consist of customs duties, surcharges and anti dumping duties on imports and may serve as sources of revenue or as instruments for protecting domestic industries against foreign competition (Gildenhuis, 1997:355). Specifically,

⁶ The Kyoto convention is designed to simplify and modernise customs administrations around the world. The convention was drafted in 1999 at a World Customs Organisation meeting in Kyoto, Japan. To date WCO has 161 member countries of which Eritrea is one.

customs duty is tax paid to government when one takes particular goods from one country to another (Cambridge Dictionary, 1995:398). According to the World Customs Organisation (WCO, 2000c:2) *customs duties* means the duties laid down in the customs tariff to which goods are liable on entering or leaving the customs territory. In this regard Article 2 of the Eritrean legal notice of Customs Tariff Regulations No. 52/2001 stipulates customs duty interpreted as *duties levied on imported goods* whereas Article 4 states that *all exportations from the state of Eritrea shall be free from customs duty* (Eritrea 2001a). Further discussion of customs duties will follow in Chapter five.

According to WTO (1998:37) customs duties can be designated in either specific or *ad valorem* terms or as a combination of the two. In the case of a specific duty, a concrete sum is charged for a quantitative description of the good, for example US \$1 per item or per unit. The customs value of the good does not need to be determined, as the duty is not based on the value of the good but on other criteria. In this case, no rules on customs valuation are needed and the *Valuation Agreement* does not apply. In contrast, an *ad valorem* duty (tax rate) depends on the value of an item. Under this system, the customs valuation is multiplied by an *ad valorem* rate of duty (e.g. 5 per cent) in order to arrive at the amount of duty payable on an imported item (see also Gildenhuis, 1997:357; Black, Calitz & Steenekamp, 1999:117).

3.2.1 Customs valuation

Customs valuation is a customs procedure applied to determine the customs value (tax base) of imported goods (objects of taxation). If the rate of duty is *ad valorem*, the customs value is essential to determine the duty to be paid on imported goods (WTO, 1998:37). The customs value on imported goods is determined mainly for the purpose of applying *ad valorem* duties. It constitutes the taxable basis for customs duties. It is also an essential element for trade statistics, for monitoring quantitative restrictions, tariff preferences and for collecting international taxes (WCO, 2000g).

The GATT Valuation Code was originally created in 1979 during the Tokyo Round of Multilateral Trade Negotiations with a view of ensuring that non-tariff barriers, one of them being arbitrary customs valuation regimes, which were prevalent at that time, and which would not derogate the effect of tariff concessions. As a result GATT Article VII article (2) (a) stipulated that *...the value for customs purposes of imported merchandise should be based on the actual value of the imported merchandise on which duty is assessed, or of like merchandise, and should not be based on the value of merchandise of national origin or on arbitrary or fictitious values...* (Antweiler, 1998; WTO, 1998:37)

Later on, the *WTO Valuation Agreement*, formally known as the *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (GATT)*, replaced the GATT Valuation Code as a result of the Uruguay Round Multilateral Trade Negotiations, which created the WTO in 1994 (Wilkinson, 2000:60; WCO, 2000g). The agreement establishes a customs valuation system that primarily bases the customs value on the transaction value of the imported goods – except in specified circumstances – which is the price actually paid or payable for the goods when sold for export to the country of importation and which is generally shown on the invoice together with certain adjustments.

In line with the above context, the Eritrean new *Customs Proclamation No. 112/2000* stipulates the valuation system in accordance with the WTO Valuation Agreement in articles 18-28. However, it is not implemented yet, subject to article (2) (3), though accepted in principle and enacted. In addition to the requirements of valuation, classification of the goods in a standardised way is also a prerequisite for modern customs administration practice, both for facilitation and for revenue collection objectives. These issues of valuation and classification are to be discussed further in Chapter five.

3.2.2 Customs tariff nomenclature

According to Article 1(a)-(b), the definition of the international convention (WCO, 1986) the *Harmonised Commodity Description and Coding System*, commonly referred to as the *Harmonised System (HS)*, is the nomenclature comprising the headings and subheadings and their related numerical codes. The section, chapter and subheading and *customs tariff nomenclature* is the nomenclature established under a given legislation for the purposes of levying duties of customs on imported goods.

The objectives of HS are to facilitate international trade by contributing to the harmonisation of customs and trade procedures, the collection, comparison and analysis of statistics, in particular those on international trade, to reduce the expense incurred by re-describing, reclassifying and recoding goods as they move from one classification system to another in the course of international trade, and to facilitate the standardisation of trade documentation and the transmission of data. In addition it is developed by considering the changes in technology and the patterns of international trade along with maintaining a close correlation between the *Harmonised System* and the *Standard International Trade Classification (SITC)* of the United Nations.

On top of that HS is a multipurpose international product nomenclature developed by the World Customs Organisation (WCO). It comprises about 5 000 commodity groups, each identified by a

six digit code, arranged in a legal and logical structure and supported by well-defined rules to achieve uniform classification. The system is used by more than 177 countries and economies as a basis for their customs tariffs and for the collection of international trade statistics. In addition, over 98 % of the merchandise in international trade is classified in terms of the HS. The HS is therefore a universal economic language and code for goods, and an indispensable tool for international trade.

3.3 CUSTOMS AND THE MODERNISATION ISSUES

3.3.1 The phenomenon of globalisation

One of the most important phenomena of the modern world is globalisation. Globalisation, in its modern form, started with the voyages of discovery in the 15th century. *Globalisation* is one of the central concepts in the current analysis of the economy and society. The term was first used more than 40 years ago, but up to the early 1990s the term was still used sparingly. By 2000, no speech was complete without it – even if those who used the term agreed on little more than the fact that we now all live in one world (Valaskakis, 1999:153).

So what does globalisation mean? Most often, as Valaskakis (1999:154) and Snyder, 1999:334-340) stated, the term is synonymous with the privatisation or extraordinary expansion of the global market place, and the increasing interrelationship of the lives and futures of individual and countries, including politics and economics issues. The new actors now dominating the world stage and upstaging the old have one thing in common: they are principally from the private sector. As Andrews (2001:17) stated that with “...*today everything being privatised now the fear is that globalisation will mean not a greater choice but a greater, blind uniformity...*”

From a customs perspective, while trade and empire were the drivers of globalisation in the earlier part of the 20th century, in the last decade the new drivers were technology and capital flows. For instance, currently industrial globalisation is obvious in many corporations of different national origins all over the world. It is hard to find a country, industrialised to any degree, which does not have the familiar corporate logos of world-leading firms prominently displayed on billboards and buildings (Fjelstad, 2000:76; Kyloh, 2001).

There is a perception, and often a reality, of global integration of communication (such as telephony, the Internet, airline networks), culture (such as literature, movies, popular and classical music), entertainment (such as sports and television), and economics (trade, capital flows, integrated production). However, globalisation is much more than that. It is an ideology that defines basic expectations about the roles and behaviours of individuals and institutions, the

impact of Internet on all areas of management from hiring and purchasing to organisational structure and leadership (Landry, 2002:26).

At the core of the globalisation movement (Auberton-Herve, 2000:26) the communication revolution has strongly developed over the last decade: a lightning-fast communication, especially the Internet, meaning the speeding up of communications. In fact, many communications improvements have been taking place over the last century, but the contemporary speed of change, the enlargement of capacity for information transmission and the proliferation of communications media have not been experienced before. As predicted by Moore's law, data processing and data communications revolutions have significantly altered and will continue to alter the structure of the macro-economy (DeLong, 2002:163)

From an economic perspective, globalisation is viewed as a process that can lead to fully internationally integrates markets, with free movement of goods, services, labour and capital. This implies a single market in inputs and outputs and full national treatment for foreign investors (and nationals working overseas) so that, economically speaking, there are no foreigners. It can be "*the borderless world*", radical progress and modernity, and of life beyond the limits of the traditional nation-state (Kyloh, 2001). The old ways of doing things are simply no longer relevant, markets have changed, borders have changed and cultures have changed. The evolution of the communication revolution is afoot, and its effects are spreading rapidly. (Bush & Holzer, 2001:3).

So, according to Valaskakis, the "*liberalisation revolution*" (Valaskakis, 1999:155), entails a freeing up of markets and a reduction in the role of government in terms of ownership and control over production of goods and services, with an inclination towards a free movement of goods, services, labour and capital. Globalisation is being accompanied by a massive and continual downsizing of governments, both in terms of resources and in terms of influence (Valaskakis, 1999:155). It is true that the globalisation has been significantly retarded by the combined impact of protectionist trade policies in many developing countries (though a considerable number of these are now being liberalised), and discriminatory trade barriers (tariffs and quotas) rose against their products in developed countries.

But the process continues as has been manifested in successive rounds of multilateral and regional trade liberalisation. The world-wide economic integration within the framework of Free Trade Agreements or Customs Unions, has been a major force in reform, and international liberalisation has resulted in booming trade volumes, as we can see in Table 4 that compares the growth of total GDP and total imports of the world, in 1990, 1995 and 2000 (considering 1990

equal to 100). During the last decade, the percentage of growth of the international trade (88%) is bigger than the percentage of growth of gross domestic production (25%) in the world. This suggests how international trade is growing exponentially with the globalisation process (Englander, 2001:7).

Table 4: Growth of total GDP and total imports of the world

Year	Total GDP in the world (1990=100)	Total imports in the world (1990=100)
1990	100	100
1995	107	147
2000	125	188

Source: Englander (2001:7)

In addition to the increase in international trade, Andrews (2001:21) pointed out:

... economic globalisation happens on capital movements. That also influences the trade, for example, in the role of the multinational companies, moving towards internationally integrated production in some fields. And we have also, maybe the most truly global market – in the sense of globally integrated systems and complete economic integration – resulting in instant mobility of capital and globally uniform prices in the financial markets.

To sum up, as Wade (1996:62) put it...*the broad picture is clear: world trade in goods and services, foreign direct investment and increased financial flows all suggest growing interdependence, and this interdependence affects all the society. And the government is not out of that environment, on the contrary is on the frontline...*

3.3.2 Globalisation and the new role of customs

There are several specific ways in which globalisation is having a profound implication for the way in which business is transacted and the way government is organised and structured. All these ways have accumulated into a fundamental transformation of governance, a transformation that poses substantial challenges for public institutions and how we manage them. And, it is important to say, there are good reasons to believe that a reversal in this tendency is highly unlikely, though not impossible (Kettle, 2000:23).

The performance of any government, in other words, its effectiveness, efficiency, responsiveness and accountability as stipulated in article 11 of the Eritrean Constitution (Eritrea 1997b), depends on facing all these changes in the environment and preparing for the future.

Globalisation defines the agenda for governance in the early twenty-first century. It is a challenge for government, not only to devise new strategies for managing public programmes effectively in the context of globalisation, but also to build the capacity for implementing policies in the same context (Wade, 1996:83).

According to Cable (1999:18) and Ernst and Ozawa (2002:547) national economies are also more and more interconnected, as customs duty rates are dropping worldwide and as the cross-border information flow is increasing, whether the policy-makers want it or not. For example, because of the electronically-driven commerce – the e-commerce – there is a growing trade over the internet. And, the cost of government processing to industry is becoming an issue of greater concern to government, international organisations, and businesses.

On the other hand, this whole process of freedom of movement has also contributed to an increase in the rate of many security problems for a nation. As the barriers to commerce come down, it becomes more difficult to stop traffic in goods or services, organised crime, terrorism, immigration, fraud, contraband, smuggling, violations of intellectual property rights, and many other crimes related with the customs organisations (Nurton, 1997:31; McGrath, 2000:127).

Customs organisations throughout the world hold a unique position within a country's government and within the international community. Customs is often the first contact foreign businesses and travellers have with the government. A satisfactory encounter with customs can encourage continued commercial activities. For this reason, Customs, as an agency positioned on a country's international borders, looking both inward and outward, is facing a challenge of working to protect the national economy while helping to encourage dynamic solid economic growth (De Devila, 1997:3; Lane, 1998a: 32).

As world trade has grown, so too has the complexity and workload of customs. Now more than ever before, it is one of the key goals of customs to reconcile the facilitation and control of trade. This means processing the exponential growth in legitimate trade and combating an array of threats to our national security and society such as food safety, hazardous materials, cultural heritage, and trafficking in weapons and munitions. Besides, new regional and international trade agreements, designed to facilitate trade, add new requirements and complexity to customs responsibilities. Hence, as trade expands, it will become even more necessary for governments to modernise and streamline their procedures if they want to operate in the global economy and not get sidelined by it (Nurton, 1997:33; Trunick, 1997:44; Clark, 2001).

Thus, globalisation affects customs activities with the increasing demand for customs from government, importers, exporters, brokers, travellers, carriers and the society in order to play a

major role in enforcing laws at the nation's borders for higher revenue, faster service, more reliable information, better statistics, increased protection of the economy, health and safety, environmental and agriculture controls, and improved enforcement performance by preventing the entry of contraband. At the same time, with the explosive growth of international trade, in terms of volume and complexity, travels and tourism, there is additional pressure on the customs organisation, budgets and staffing, that is putting the capabilities of all customs services to the test (Trunick, 1997:46; Lane, 1998a:35).

Despite the perception that many countries and their customs administrations have regarding the roles of ensuring compliance and enforcing the nation's laws as contradictory, the new responsibilities and the increased workload are overwhelming for customs that already had difficulties in coping with traditional programmes and responses. In order to keep pace with the increases in trade and travel and to meet the higher expectations, customs must handle the rapidly expanding and the increasingly more complex workload by achieving higher levels of compliance and by clearing the legitimate cargo timely. Customs must simultaneously achieve the objectives of lower cost, quality service, and speed. However, in order to attain this level of performance, customs will have to change the way they do business and should adopt modern business techniques including intelligent application of technology

3.3.3 The need for modernisation of customs services

Customs is an important agency of every government, but is particularly important in emerging economies. Over six trillion dollars worth of goods and billions of travellers cross international borders each year. The world's customs administrations process these goods and merchandise on both entry and exit. Hence, for most travellers, businessmen, and importers customs creates the first impression of each country.

As a result, many companies see customs' role in the import process as vital to the success of their business operations. If customs is courteous, prompt, knowledgeable and honest, the impression will be favourable; otherwise if customs stands in the way of faster processing and shipments delivery, if it is slow, inept and corrupt, or fails to conform to international customs standards, the agency becomes a hindrance, not an aid, to commerce. The result will be that the importer will be reluctant to trade, invest, or return (Lane, 1999:1).

In the light of this background and in order to face this new scenario regarding the World economy, modernisation of the customs services is the way to achieve excellence in customs procedures. Also taking account of the lessons of the past and the realities of the present, governments must shape the future of Customs. To face rising workloads and expectations with

little prospect of bigger budgets, customs therefore has had to look to technology to meet its mission (Kettle, 2000:25; Englander, 2001:13).

Automation plays a very important role in this modernisation process. Many countries have already developed automated systems supporting import and export procedures. Dean (2000:52) has suggested that automation would have significant benefits for customs, as the administration of the future will rely on accurate and timely information to carry out its function, with more accurate and timely statistical information.

So, as technology plays an increasing role in the customs procedures, the adequate management of that statistical information becomes of critical importance. For this Lane (1998a:41) noted that *...more than simply automation of the procedures, the path customs must follow is to increase reliance on the use of intelligence as a tool for greater selectivity in the inspections and audits...* Thus Cable (1999:31) remarked that *...it is currently necessary to assist the customs data management, in order to change the face of customs enforcement with the emphasis on flexible, risk based and targeted operations and heightened intelligence as the principal weapon to identify fraud and smuggling and the effective deployment of limited human and technological capital.*

In line with this, risk management allows customs administrations to better target their resources towards those areas where most attention is demanded thus enabling them to maintain and increase their efficiency and effectiveness. In addition, applying risk management for trade compliance and control, enables customs administrations to demonstrate and ensure the best available outcomes for the country within the constraints of the resources they are given (Kettle, 2000:26). The importance of risk management is in using strategic intelligence to support the effective achievement of organisational objectives. In the enforcement context, strategic intelligence will provide customs administrations with a timely insight of current and emerging trends, threats to public safety and avenues for change to policies, strategies and legislation (Trunick, 1997:45; McGrath, 2000:133).

Many customs administrations are also embarking on a new era of performance measurement as a way of guiding the effectiveness of their initiatives and efforts that will increase the demands for risk assessment skills. They are introducing management audits as a means of quantifying the movement of goods and travellers in order to aid the allocating of resources and to measure results (De Devila, 1997:4).

Furthermore, the philosophy and practice of total quality management (TQM), which establishes an environment of continuous improvement, drives public institutions to focus on results, and

customers among others. The implementation of this enabling process will play a pivotal role in customs managerial practices in the years ahead by providing leverage for reform that could intensify the velocity of customs modernisation. Besides that, the utilisation of TQM can streamline customs processes, instituting a culture of continuous improvement and a commitment to improve cost, quality, and speed in customs processes. Ultimately, TQM sets the stage for the automation of the improved processes and for ISO9000 certification (Shaw, 1994: 182-183; Lane 1999:8).

According to Osborne & Gaebler (1993:172) ... *'TQM' stands at the head of the traditional organisational chart and customers are the most important people for an organisation; those who serve customers directly are next; and management is there to serve those who serve customers.* Therefore, in this new philosophy, developing industry partnerships should be another target for Customs.

This means that, as Kelly (2001:48) acknowledged, customs must remove barriers to get closer to their customers. Customs administrations have to change the way they conduct business, starting out from the assumption that importers and exporters are customers and should be treated as partners, not as adversaries. However, not only is improving service to customers a major challenge, but it is also necessary to ensure the importers, exporters, brokers and carriers compliance with customs.

As a result, and as indicated in *The Journal of Commerce* a prior disclosure programme, for example, can stimulate the compliance, because it makes the participants of the foreign trade work together with the customs service. The goal is higher compliance, that is to say, to have a permanent process where the trade entities establish procedures or evaluate existing procedures to maximise trade compliance (Dean, 2000:54; IFCBA, 2002).

Partnerships are important not only with the importers, exporters, brokers, and carriers, but also with other government agencies and closer co-operation between customs administrations themselves. The WCO stimulates this dialogue, exchange and sharing of information between customs officers throughout the world. That is why the acceptance and implementation of international customs standards on value, classification of origin, and harmonisation of procedures becomes essential for a closer relationship (Cable, 1999:29).

3.3.4 The benefits of customs modernisation

Successive multilateral and regional trade negotiations have brought tariffs down and other trade barriers are eliminated or reduced to their lowest levels in this century. On the other hand as Maria Cattai (1998) pointed out ...*inevitably, this unprecedented liberalisation has drawn*

attention to other practical obstacles to the free flow of goods across borders – like rocks revealed by an ebbing tide...

Regarding the remaining practical obstacles McGrath (2000:141) added his emphasis as follows:

The most effective barrier to globalisation is not to be found in halting the WTO's expansion or in demanding debt forgiveness by the World Bank. As any logistics professional can attest, the most pernicious barriers to trade with less-developed countries are non-transparent customs rules; poor logistics infrastructure; and good, old-fashioned corrupt border officers...

This suggests that the biggest remaining non-tariff barriers are cumbersome customs regulations and procedures that have failed to keep up with the expansion and increased complexity of trade and globalisation at large. Thus *...examples of customs modernisation that can bring the full benefits of modern technology and management practices to bear on a daily reconciliation of the control requirements of customs and the imperatives of trade in a global economy...* are required (Cattai, 1998).

Against this background, ICC (2001a) stresses that *...modernisation of a country's customs administration benefits trade, investment and economic growth, while modernisation of a trading partners' customs is necessary to ensure full realisation of trade benefits...* Experience is also revealing that as the world moves towards further trade liberalisation, customs modernisation is more and more important to each country's interest in attracting foreign direct investment. In particular, customs modernisation will greatly assist developing countries in their export promotion efforts to integrate their small and medium-sized companies into the most prized and competitive global markets.

When looking further in the list of details regarding the benefits as mentioned for countries, Dean (2000:57) explained that multinational and other companies increasingly look for the existence of business-friendly policies in deciding where to invest. Conversely, countries that fail to keep pace with world class standards for customs administration will find that investors simply cannot afford the high logistics costs imposed by customs inefficiencies and high tariff barriers. Thus, countries will find foreign direct investment migrating to nations with more sophisticated customs administrations. Moreover, customs inefficiency imposes a significant tax, hidden but very real, on consumers and traders – taxes of which "revenues" are not realised by the government, but which rather comprise a dead waste to the economy (ICC, 1999; Ernst & Ozawa, 2002:550).

It is also noteworthy that customs revenues have increased with modernisation efforts because greater volumes of trade are processed more efficiently. According to Molla (2001) the accelerating trend toward trade liberalisation, both globally and regionally, puts customs modernisation at the heart of a mutually beneficial "race to the top" in a form of interdependent link, is explained in four steps as follows:

- Increasing levels of trade liberalisation became a worldwide reality through regional or multilateral trade agreements and negotiations that reduced trade barriers.
- Hence, it eases the need to invest behind tariff barriers and to support rapid expansion of foreign direct investment. Investors are therefore freer to seek business-friendly environments, rather than being forced to invest behind high tariff barriers in each country where they hope to do business.
- Accordingly, countries that modernise their customs administrations, namely those that reduced barriers across national borders, are seeing increases on flows of foreign direct investment.
- Again, further improvement of customs administrations enables extra trade liberalisation by ensuring higher rewards of negotiated trade concessions. In turn higher levels of trade liberalisation increase the competitive benefits of customs modernisation, and so on.

As a result, countries that are early in recognising the competitive advantage of customs modernisation will reap the lion's share of the rewards. Experience in the developed world includes several examples of smaller countries that have taken advantage of such factors as favourable location, modern transportation and trade, culture and services industries to rank among the largest trading economies. These successes would not have been possible without modern customs services. Further there are some more recent examples in the developing world that are following this pattern.

In summary, while this worthy interdependence encompassing trade liberalisation, foreign direct investment, and customs modernisation benefit all who participate in it, the costs of non-participation will become increasingly burdensome in terms of lost investment and increasing economic isolation. Governments therefore have an important stake in the modernisation of their customs administrations. As the world moves increasingly toward trade liberalisation, the cost of tolerating an inefficient customs administration is becoming too great to bear.

3.4 CUSTOMS REFORM: STATING THE CAUSES,

CONSEQUENCES AND VARIABLES

In its most simple terms, proceeding from Nurton (1997:36), it can be said that the goal of customs is to ensure that all imports and exports comply with the laws and regulations. In other words, customs must create, with a comprehensive and timely action, a responsive knowledge management capability in order to increase compliance with the laws of a nation at its borders. In addition, in most cases the vision of a customs service is to be more responsive to clients' needs and supportive of government goals, adhering to world's best practices.

Most customs administrations are responsible for economic, social and administrative roles among others. Table 5 gives a summary of the main customs functions in the context of globalisation, in which customs is expected to be efficient and effective (Garcia, 1999:9; Englander 2001: 12 and Jereos, 2001).

Table 5: Main roles of customs' administrations

Category	Functions
<i>Economic roles</i>	Assess and collect appropriate duties, taxes, fees and penalties due on the foreign trade, and protecting the government revenue.
	Facilitate legitimate trade, travel and tourism.
	Interdict and seize trafficking in narcotics, other contraband and smuggling.
	Combat violations of intellectual property rights as well as frauds and money laundering.
<i>Social roles</i>	Enforce the protection of the environment as well as health and public safety from illegal imports.
<i>Administrative roles</i>	Promote a uniform and transparent system for customs.
	Process persons, baggage, cargo and mail in accordance with laws and regulations.
	Collect accurate import and export data for compilation of international trade statistics.

Although all the objectives are important, revenue mobilisation particularly for less developed countries like Eritrea is a critical task (as discussed in the *Background of the study* in section 1.2.4). Customs administration reform therefore focuses primarily on the legislative and procedural changes required to secure revenue in the most effective and efficient way possible. Reforming customs procedures, directly improves tax returns by enabling effective collection of import duties, notably through automation, harmonisation of information requirements and risk-assessment methods, reduced levels of evasion, under-declaration, fraud, and collusion with customs officers, and allows comprehensive, correct and prompt duty calculation and tax collection, with obvious benefits for the public purse (Stoler, 2002).

From this view changes that support more effective revenue collection also support the other objectives of trade policy administration and protection. To realise the benefits of customs modernisation in achieving its core objectives, it therefore becomes necessary to analyse the causal factors that serve as prerequisites for customs reform as derived from the influential role of the globalisation process and as a result of the interdependence of economies.

As Kyloh (2001) suggests, these are –

- (1) the expansion in the volume and variety of cross-border transactions in goods and services as a result of the trend toward trade liberalisation;
- (2) the dramatic increase in international capital flows and also the more rapid and widespread diffusion of technology as a result of Foreign Direct Investment (FDI), and
- (3) the national competitive advantage in trade facilitation issues.

These conditional factors will be discussed in section 3.4.1 (*Conditional Factors for Customs Reform*).

Further, according to Walsh (2001:5) and Lane (1999:2) there are among others four major elements that should be included in a strategy designed to develop a modern customs administration. These are:

- (1) appropriate and transparent legislation;
- (2) simple, up-to-date procedures;
- (3) revenue control strategy based on an assessment of risk and selective controls targeted at high-risk goods and enterprises including effective post-release control as its centrepiece, and
- (4) measurement, as key to improved performance.

These elements will be discussed in section 3.4.2 (*Customs Reform Priority Components*).

Furthermore, in the issue of customs reform, institutionalising constitutes a corner stone in consolidating a customs modernisation programme by introducing improvements in three general areas or variables, namely –

- (1) the fundamental processes of customs administration;
- (2) the enablers of customs operations, and
- (3) the introduction of advanced processes of customs management.

These variables will be discussed in section 3.4.3 (*Institutionalising Customs Modernisation*).

When considering reform of customs administration, each country should therefore make a conscious decision to align this with international standards and practices in order to integrate fully into the world trading community.

3.4.1 Causes: conditional factors for customs reform

As discussed in the previous section, under the influential role of the globalisation process and as a result of the interdependence of economies, the conditional factors causing customs reform are, among others –

- the trend towards trade liberalisation;
- foreign direct investment and business environment, and
- the national competitive advantage, reviewed in the following sections.

3.4.1.1 The trend towards trade liberalisation

The initial condition for the realisation of the customs reform/modernisation is a trend towards trade liberalisation, and it is clear that this condition still holds in today's world. Trade liberalisation at the multilateral and regional levels is progressing at an accelerated pace. The Uruguay round and creation of the WTO have resulted in substantial, continuing tariff reductions, and ongoing work in the WTO will further enhance market liberalisation on many fronts.

The reduction of tariff and other trade barriers during successive GATT rounds has therefore increased the focus of commercial attention on the serious practical constraints that still delay transactions at many national frontiers. On the other hand the presence of WCO and its conventions, such as the Kyoto, are rapidly changing the customs landscape across the board by

exposing the customs administration procedures to the demand of more efficiency (Cattai, 1998; ICC, 1999; ICC, 2001a).

In addition, the demand for, and ability to supply, as well as rapid trade movements have been greatly increased by multi-modal through-transport, and electronic commerce, and is reflected in globally integrated, just-in-time supply and distribution systems. However, the benefits of trade liberalisation flowing from successive rounds of multilateral negotiations and globally integrated trade continue too frequently to be frustrated by cumbersome trade procedures – and in particular, by antiquated, slow and bureaucratic customs procedures that impose heavy costs on businesses and on consumers (ICC, 2001a; Soysal, 2001).

For liberalisation developments to have maximum benefit, they should accordingly be accompanied by the rigorous and efficient application of simple, predictable and uniform controls by customs and the other official bodies that operate at the borders. Further new negotiations should develop comprehensive, transparent and effective multilateral rules to simplify and modernise trade procedures – to the advantage, in particular, of developing and transition economies, and of small and medium-sized enterprises as well (ICC, 1999). For instance, as Woo and Wilson (2000:11) also stated, adoption of the valuation agreement will lead to more transparent and consistent determination of the value of imported goods, thereby providing greater certainty for importers, exporters and manufacturers on their costs related to imported finished goods and components.

However, the benefits of trade liberalisation, particularly accompanied by customs reforms are not exclusive to the business community. Trade liberalisation reform can generate significant welfare gains for the economy as a whole. But, as Finger and Schuler (2000) point out, *...trade facilitation issues are more difficult to reform than mere tariff rates, but are probably becoming more important as tariffs fall and global supply chains come to dominate production and trade...*

In the case of Eritrea, trade liberalisation is facilitated by regional arrangements, such as the *Common Market of Eastern and Southern Africa (COMESA)*. COMESA, which replaced the former *Preferential Trade Area (PTA)* in December 1994, in its bid to contribute to the downward pressure on trade barriers, has promised to remove all internal tariffs, and all countries were supposed to have their tariffs reduced by 80% in October 1996. COMESA further intended to introduce a common external tariff structure in 2000 to deal with all third-party trade, and to have all trade procedures and further trade barriers considerably simplified (COMESA, 2002a).

Accordingly Eritrea, through its amended *Customs Tariff Regulations* (Eritrea 2001a) including four other countries (Comoros, Sudan, Uganda and Zimbabwe) has reached this level. Therefore as discussed earlier, in order to realise the full benefits of market liberalisation in Eritrea non-tariff barriers should accompany the removal of tariff barriers through measures of reform and modernisation in customs administration, as discussed in Chapter five.

At the same time, economic turbulence has the potential to arouse protectionist sentiments that are self-defeating and which lead to a vicious circle that can trigger world-wide trade wars and economic depression. Customs frequently is a favoured tool of protectionists, therefore, countries must guard against employing their customs administrations as barriers to trade (ICC, 1999).

3.4.1.2 Foreign direct investment (FDI) and the business environment

Traditionally, foreign direct investment has been driven in substantial part by the need to invest under the cover of tariff barriers. High trade barriers in a country create an incentive for investment to serve consumers of that country without depending on efficiency of the workforce, availability of world-class material suppliers, access to other markets, or the maintenance of an effective system of commercial law (McGrath, 2000:127).

Moreover, in the past the advantages to be gained from economies of scale were overwhelmed by the construction of small, inefficient plants in each of several markets that could have been served collectively by a single, scale-efficient factory. But markets that were traditionally protected by trade barriers often fall behind world standards, because the goods and services they provide are not tested by international competition (ICC, 1999). This indeed brought with it the necessity of opening markets together with the need to align globally.

When tariff and non-tariff barriers to trade are removed, investment decisions increasingly are made on the basis of the ability of the market to provide an environment that is conducive to the establishment and maintenance of a world-class manufacturing operation to serve the regional market and often to produce for world-wide export. Workforce availability, a stable economic system and an effective legal system all assume greater importance in making investment decisions. Equally important is logistics – the ability to maintain a reliable, low-cost flow of raw materials and components into a manufacturing facility, and an effective system to distribute finished products flowing out of the facility (Basu & Srinivasan, 2002:88)

However, with the more aggressive trade negotiations and more liberal markets, businesses continue to face tough trade challenges due to lack of a harmonised world-wide customs process that allows for the efficient flow of goods across all borders. For this, companies considering

investment abroad take into account a whole host of factors. One of these is efficient and reliable customs clearance. Customs clearance and the efficient flow of goods in and out of the host country can easily shift the investment decision between competing parties (Kelly, 2001:48).

When it comes to Africa, although the volume of FDI has increased strongly since the mid-1980s, Africa has been unable to keep the pace with other regions in attracting its share of new direct investment.

To sum up the issue of FDI, Basu and Srinivasan (2000:91) concluded:

A critical mass of mutually reinforcing measures must be in place before countries can claim a larger share of FDI flows. Among others firstly, customs union and other regional organisations seem to have positively influenced FDI inflows, since investors can gain easier access to markets. Secondly, eliminating regulatory and other obstacles like reduced tariff barriers, political stability and sound economic policies and implementing supporting structural reforms tailored towards private-sector development are essential to attracting these capital flows. In addition, since political stability is a vital determinant of where investors will choose to set-up their operations overseas, progress toward conflict resolution is essential. Customs reform aimed at providing efficient and effective services therefore becomes indispensable.

3.4.1.3 National competitive advantage

The ability to maintain a reliable, low-cost flow through efficient movement of goods to and from a manufacturing facility and country at large is critically important. Any world-class manufacturing facility should have access to world-class sources of raw materials and components. This facilitation issue *inter alia* consists of the simplification of customs procedural and administrative impediments, reducing barriers to the mobility of business people, simplification of standards and conformance technical regulations or in popular jargon “*cutting red tape*” (Woo & Wilson, 2000:2).

Certainly, many inputs could be available locally in quantities and quality necessary to support such manufacturing. However, no single market, either developed or emerging, can produce all of the world-class inputs necessary for a complex manufacturing operation. Thus, aided by rapid improvements in the speed of information exchange, global corporations are creating sophisticated international supply chain management systems to move goods quickly and economically around the world. Then countries that stop or slow down these supply chains will be left out of the process. Against this background trade facilitation and access to imported raw

materials and components is an important consideration in investing as well as enhancing competitive advantage of a given country (Basu & Srinivasan, 2000:92).

Concisely, among others, the following critical components could be taken as contributing towards the national competitive advantage that could be achieved through customs administration reform and modernisation:

- **Clearance time.** In order to support world-class manufacturing, customs clearance time must be measured not in weeks, or even days, but in hours. Any customs administration that can provide reliable, timely customs clearance, or immediate release based on pre-clearance, creates an enormous competitive advantage in attracting manufacturing (ICC, 2001a; Stoler, 2002).

The ability of multinational companies to track their components and parts at any point in their global networks should translate into faster customs clearance times. There is no reason why customs administrations should not work more closely with global logistics companies and expedited delivery (courier) services, for example, in developing systems to move goods more efficiently across borders (Cattai, 1998; Woo & Wilson, 2000:8).

- **Predictability.** Delayed delivery of a key input can shut down an entire manufacturing line, at enormous cost. Unpredictable delivery due to customs administration can require the maintenance of excessively large "safety stock", with unacceptable inventory carrying-costs. As a result, arbitrary or unpredictable customs clearance delays are incompatible with efficient manufacturing. In addition to cost, this makes the lack of shared confidence between traders and customs officers one of the most important barriers to customs modernisation (Cattai, 1998; Gurunlian & Orthlieb, 2001).

Dean (2000:52) remarked in illustrating predictability as follows:

The time it takes to get a part from a supplier along the border to an auto plant can be as short as five minutes. As a result, manufacturers no longer stockpile large quantities of parts in warehouses near assembly plants. General Motors keeps only several hours' worth of inventory at its plants, says Kevin Smith, the company's director of customs administration. Trucks are arriving every hour basically carrying an hour or two hours worth of material for immediate manufacturing. Managing large inventories is very costly. Plus, things happen to stuff that sits in inventory.

- **Transparency.** Arbitrary or unexplained changes in classification or valuation of goods can disrupt logistical flows and marketing plans, thereby seriously detracting from efficient operation. In this regard ICC (1997) recommendations for transparent conduct by customs with easily accessible procedures and regulations, including – an open, independent and economic

appeal process of customs decisions which also is open to all importers is worth considering. Besides as (Antweiler, 1998) put it, there is a customs transparency obligation under article X of the *General Agreement on Tariffs and Trade*, to reduce customs-related barriers to trade that require due consideration.

3.4.2 Consequences: customs reform priority components

As Soysal (2001) pointed out, customs are the doors through which all the international trade has to transit which could be both a good service for the international community or a barrier. Moreover, the dynamics of the international trade, with sustainable increases of goods traded and the sustainable increases of human flows are demanding more from customs administrations. Hence, customs as a strategic public institution needs to be modern, efficient, transparent and accountable.

Otherwise, an inefficient customs administration could be the bottleneck of the future effective integration in the global economy of the countries. As Lane stated (cited in Garcia, 1999:10) "*... building a better customs organisation and streamlining the system for processing goods across international borders will not automatically propel a nation to the top echelon of industrialised nations. But also as mentioned earlier a slow, inept, corrupt, unreliable, or inconsistent customs regime that fails to conform to international customs standards will certainly condemn a nation to the bottom rung of the economic ladder.* Therefore, the simplification of customs procedures has potential for considerable savings in time, money, as well as in human and other resources and could result in substantial benefits for all economies.

For instance, the savings potential through enhancement of trade facilitation can be a considerable portion of the value of the goods traded, often exceeding the costs of tariffs and other duties and charges. Accordingly, unlike the latter, costs incurred through inefficiencies in the transaction chain are dead-weight losses for the economy (Gurunlian & Orthelieb, 2001). This background together with the pressing influence of the causal factors makes reform an inevitable priority. Therefore, the following four components of reform, among others, stand at the forefront of customs modernisation.

3.4.2.1 Appropriate and transparent legislation

Many tariffs are characterised by complex rate structures and/or high tariff rates without economic justification. In turn, high tariff rates increase the incentives to evasion (through under-valuation, misclassification, and outright smuggling) and the pressure for exemptions. Again, the multiplicity of rates facilitates evasion through the incentives and opportunities for the importer to classify imports in the lower rate categories, and requires extra vigilance and

control by the customs administration. Hence, successful reform of a country's system of revenue collection should permit a reduction in nominal rates of tariffs and taxation. This may permit an escape from the trap where high rates lead to evasion, and in which evasion leads to higher nominal rates and even more evasion (Rose-Ackerman, 1999:45).

In addition, a country's economic characteristics and international trade relations may make some degree of complexity unavoidable. For example, preferential trade arrangements or implementation of a customs union introduces a degree of complexity in customs administration through the need to apply differential tariff rates in order to validate the origin of imports (Garcia, 1999:10). But whatsoever the reason, facilitation of trade requires fundamental changes in customs legislation. Otherwise an old legislation that does not meet recent requirements of the international trade could cause loss of time for both traders and customs organisations. Contemporary legislation, on the other hand, must create a balance between customs control and trade facilitation and must be in harmony with other agreements and conventions in which a country is taking part (Soysal, 2001).

Furthermore, Woo and Wilson (2000:7-8) also underline that nowadays, in spite of the successful efforts of multilateral institutions such as WTO, WCO and ICC in reducing traditional tariff barriers and providing standardised customs regulations and procedures, customs administration still ranks among the most significant remaining non-tariff barriers to global commerce. In this the most complications for customs administration result from restrictive and protective foreign trade policies, an irrational tariff structure, and lack of coordination between domestic indirect taxes and the import tariff regulations (see also Claypole & Trudel, 2001:40)

For this, one solution, according to Rose-Ackerman (1999:44), is to clarify and streamline the necessary laws to reduce officer discretion and to make monitoring simpler and less arbitrary. But in her argument on *Reform of Public Programs* Rose-Ackerman also stated that, as many regulatory programmes could have strong justifications, they ought to be reformed and not eliminated.

While customs legislation is among the oldest in the world, over the years and especially in the last few decades, it has been dictated to adapt to far-reaching developments in technology, international trade, and the economic environment in general. However, when it comes to the case of the tariff and trade laws, experience shows that operational inefficiency in many customs administrations results from the application of antiquated provisions in the customs code. This is clearly supported by the experience of the customs administration of Eritrea. The code that had stayed in use was that of 1947, amended over the years with the addition of various regulations,

such as for instance valuation regulations of 1952. Thus the old customs code was one of the main bottle necks for the operations of a modern and efficient customs service in Eritrea (Chand, Van der Heeden, Potter, Walsh & Sarraf, 1993:24). This situation remained until the new *Customs Proclamation No. 112/2000* was dispensed. This issue is discussed further in section 5.3 (*customs legislation*)

As a result Walsh, (2001:6-7) stipulated clearly the problems frequently encountered in the legislation and resulting from the failure to update the customs code to allow for the changes that impede the reform of the customs administrative system. These problems are among others:

- (1) the requirement that every single importation be physically checked;
- (2) the requirement for paper documentation and signatures;
- (3) inadequate provisions for the reporting of goods by transportation companies;
- (4) lack of clear treatment of the various customs regimes (e.g., temporary importation);
- (5) inadequate valuation provisions;
- (6) lack of authority for customs administrations to audit the books and records of traders, and
- (7) out-of-date penalty provisions (see also Claypole & Trudel, 2001:45).

According to IMF report of Eritrea's customs (Goorman, Firestone & Cunningham, 1994:4) these problems stayed among the main obstacles of customs reform and modernisation in Eritrea until the advent of *Customs Proclamation No. 112/2000*.

The International Chamber of Commerce (ICC, 2001a) therefore recommends that the impact of customs-related regulations on trade could be reduced where appropriate, by focusing on transparent conduct by customs, with easily accessible procedures and regulations, including an open, independent and economic appeal process of customs decisions and being open to all importers as one of the key trade facilitation objectives.

3.4.2.2 Simple and up-to-date procedures

Trade liberalisation accompanied by facilitation, namely tariff reduction and efficiency in customs operations and reduced import costs in general have beneficial impacts on income and also on GDP. In this regard Finger and Schuler (2000:5) remarked, “...even though the estimated gains from ‘full’ trade facilitation are smaller than the gains from total tariff elimination, trade facilitation i.e., through simple, up-to-date procedures, has a large undeveloped potential for the improvement of economic efficiency and productivity.”

Adding to this, Woo and Wilson (2000:8-9) state that customs administrations in most developed countries understand that the costs imposed by inefficient procedures may be as costly as the trade taxes that they collect. It is argued that business and industry organisations have long argued that trade facilitation is an important issue and estimates of the “deadweight costs” of paperwork range from 5-15% of the landed value of all merchandise.

According to Walsh (2001:8), prior to the elimination of border controls among European Union member countries, the costs of these controls were between 3 and 4 percent of the total trade, compared to a time when no customs duties were being collected on trade among member countries. However, there is less appreciation of the scope and significance of these costs in customs administrations in developing countries. Therefore, there is strong case to be made for the private sector to be closely consulted in the initiatives of designing simple up-to-date procedures and for governments to adopt more of a “transaction cost” mentality in dealing with facilitation issues.

On the other hand, a growing proportion of the movement of goods and services across international borders as a result of the global integration of supply, production and distribution systems are demanding a speedy customs clearance as a major issue for businesses. In this context, simple, transparent, predictable and uniform customs controls, honestly and efficiently applied, are essential to ensure that the effects of global trade liberalisation have a positive impact at the level of the individual international trade transaction.

In support of this, Van Kuik (2001) explains the experience of the Netherlands’ customs as follows:

Really what we want to continue to do in the future is to carry out our control and enforcement functions in such a way that trade is least hindered by our interventions. To that end we are in constant dialogue with our "clients" and collect as much information as possible to know them and to ensure that their goods flow better. This allows us to grant sometimes very simplified procedures for the most compliant/reliable clients. These procedures in turn require fewer resources from us and that means that we can address the real risks better with less resources. In other words: better enforcement allows for further facilitation. Facilitation in the form of simple and transparent rules and procedures, by the way, also enables better enforcement.

For that reason, firstly, the design of the customs procedures should be based on an assessment of risk and selective controls targeted at high-risk goods and enterprises. Administrations that have not implemented this approach continue to impose high, unwarranted costs on their importers and exporters. Hence the continued application of the cumbersome procedures reduces the

competitiveness of the industries concerned, thereby impeding the economic growth of the country. At the same time there is evidence to suggest that these outdated types of control are much less effective than the risk-based, selective controls that are in place in modern customs administrations (Walsh, 2001:9).

Secondly, in introducing simplified procedures and an approach that target large importers (either in volume or frequency) who have a good compliance record prove effective. A case analysis undertaken during the IMF mission (IMF, 2001) demonstrated that,

Out of total imports 9 importers represented 21 percent of the import transactions. The impact of developing new procedures for these importers, based on reduced levels of physical inspections and post-release controls with audit was self-evident – the largest contributors to the economy would immediately benefit from reduced costs of customs intervention; significantly fewer staff would be required for physical and documentary control; and customs control resources could be redirected to high risk goods and traders (Global Logistics, 2001:67)

Thirdly, in modern customs administrations, the basic approach to control has changed from 100 percent pre-clearance control to a heavy reliance on post-release review. The change has been driven by two factors: (1) the dramatic increase in trade (as shown in Table 6 and Figure 4) with the value of world trade 50 times higher in 1999 than in 1960, and (2) the increased complexity of world trade, both in terms of the types of goods being traded and the terms and conditions related to import and export transactions (Mongelluzzo, 2001:29-30).

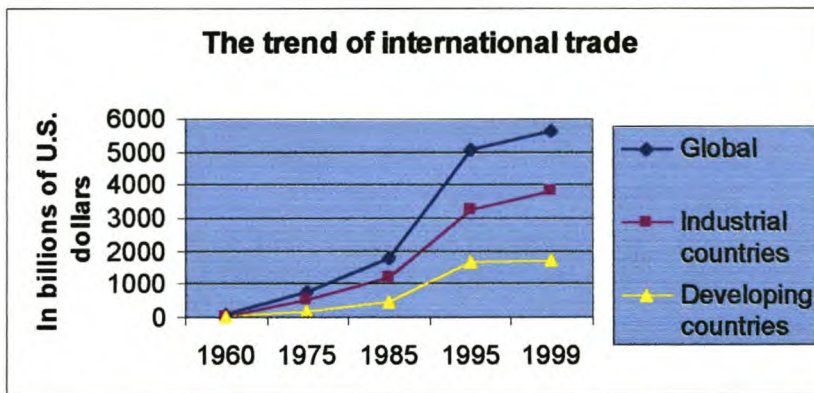
Table 6: The value of international trade, 1960-1999

	1960	1975	1985	1995	1999
Global	119	806	1 809	5 068	5 644
Industrial countries	77	543	1 263	3 302	3 836
Developing countries	29	229	489	1 690	1 745

Source: IMF Direction of Trade Statistics (see Walsh, 2001:9). Figures in billions of US \$.

Accordingly, many customs administrations have now designed systems and procedures that provide for certain basic verifications to be completed when the goods are under customs control and supplemented by audit-based controls that are undertaken after the goods have been released. Again one IMF's mission (IMF, 2001) found that, "...with a staff of only 22, one division was responsible for generating US \$70 million in assessments from post-release activities over a five-year period. Over the same period, hundreds of staff members were involved in conducting physical inspections, prior to release, at a cost of millions of dollars to the trade community with no significant violations detected..."

Figure 4: The trend of international trade, 1960-1999



Fourthly, post-release reviews should be designed to identify and correct inconsistencies in the application of the legislation and procedures at the time of release of goods. Typically, a selection of declarations is made for an in-depth review based on criteria designed to identify high-risk transactions. For example, declarations that claim zero rates may be misclassified for tariff purposes, claims for duty and tax exemptions require special attention, and drawback claims require verification (Morton, 2002:26-30).

Lastly, in order to improve competitiveness, the modernisation of customs administration activities should be based on selective, risk-based controls that allow the majority of shipments to enter the economy with a minimum of delay. In turn, this should be supported by post-release controls that rely on documentary checks and the audit of the books and records of traders. This is clearly reflected in the *Eritrean Customs Proclamation No. 112/2000*, article 67 sections (1)-(4), a provision that stipulates the requirement for keeping accounts, books and records for a period of five years for post-release inspection and audit purposes (Eritrea, 2000). By using this approach, the administrations will achieve the two objectives of improving revenue collections and providing better service to the trade community.

3.4.2.3 Improving competitiveness of the trade community

One of the most important issues that would be addressed when one undertakes a review of customs administration is the time taken to release goods from customs control. There are, of course, several issues to be addressed when reviewing release times and it is important to remember that it is not only the customs administration that influences the time taken. Trade facilitation as a whole has therefore the potential to be greater than the sum of its parts (Van Kuik, 2001).

For example, a study of cargo clearance times for goods arriving by sea showed that customs procedures are only one aspect of the overall efficiency of the cargo clearance process. Among the main factors relating to how fast the goods can be released into the economy are the following:

- a) the efficiency of the ports in unloading, handling, and storing goods;
- b) incomplete documents;
- c) red tape involved in releasing goods from go downs;
- d) documentation errors;
- e) payment hold-ups;
- f) deliberate delays in delivery, even after the release of goods by customs officers, and
- g) time elapsed in the unloading-to-warehouse and time-in-warehouse stages of the process (Woo & Wilson, 2000:4; Walsh, 2001:10-11).

In addition, the customs administration is, more often than not, responsible for administering the legislation of other government departments. Thus, the relationship between standards/technical regulations and customs administration is also instructive. For example, the customs administration identifies goods that require certificates for health or agricultural purposes. At this point, often enforcement of the regulations of other government departments is more important than the revenue that is collected from the goods. Again, the introduction of diseased plants may do great harm to the domestic agriculture industry; if the customs administration is not able to identify that the goods require inspection by the appropriate department (Van Kuik, 2001).

In this respect the IMF study (2001) conducted recently in one country reported the following:

Customs declarations are now processed using computers and selectivity techniques have been introduced to identify high-risk consignments for physical inspection. The average

processing time for customs declarations has been reduced from six days to less than one day. More than 70 percent of the shipments are released without physical inspection and the objective is to reach 85 percent. Nevertheless, the average time spent in the port is still 10 days, due not to delays in customs processing, but inefficient port procedures and the difficulties importers had in arranging credit from local banks.

In other instances, it is possible to identify many other causes of delay. For example, if the legislation required the keeper of the warehouse (mostly state-owned) to provide more days free storage, instead of the more normal days, it is encouraging importers to leave goods at the airport or seaport for longer.

A trade facilitation initiative should therefore encompass the entire trade transaction cycle rather than focusing individually on, for example, standards, harmonisation or customs modernisation alone. Meeting this objective will be difficult as it involves a diverse set of actors, but on the other hand there is a limited prospect of a breakthrough in trade facilitation initiatives unless the old vertical or “stovepipe” approach to trade reform is augmented by a horizontal approach to removing the impediments to trade (Woo & Wilson, 2000:5).

In this context, Van Kuik (2001) introduces the concept of *single window*. In essence this concept means that all data in respect of a consignment entering a country should be lodged with one agency. Clearly, when one is talking about goods, the only logical agency is customs. Customs should also have the primary responsibility to check the data and to perform the necessary control measures; unless these require such specific skills that only a specialised agency can carry them out properly. In those cases customs will need to co-ordinate these control measures with possible own control measures and see to it that the control measures are carried out as soon as possible in order to allow rapid clearance of the goods.

Moreover, as noted in Woo and Wilson (2000:6), many developing economies have established cargo clearance automation as a priority. However, this has in many cases been limited to functions directly performed by customs services, leaving a range of other authorities involved in the clearance system unable to provide the same level of service. Therefore, the need for system integration extends beyond government agencies and should eventually include other players involved in trade, including: transportation companies, customs brokers, forwarders and banks.

To sum up, even though modernisation in customs administration in developing countries concentrates primarily on revenue enhancement, the issue of competitiveness should be addressed very seriously. From a business perspective, customs facilitation is about reducing transaction costs in cross-border trade, without compromising the need for consumer protection, health, safety, or public security. The transaction cost approach appeals to businesses because

this approach treats the trade process in its entirety rather than as discrete, self-contained elements *inter alia* as customs procedures, standards and technical regulations. Such a perspective attempts to identify cost savings throughout the transaction cycle, rather than looking at efficiencies in only one part of the cycle. From a public policy perspective, this way of thinking might be described as a “trade facilitation mentality”, because it looks for complementarities and synergies in a variety of trade facilitation issues, rather than focusing on improving efficiencies in single areas.

3.4.2.4 Measurement as key to improved performance

There is an old adage saying that “that which is measured, improves.” Unfortunately, until recently, measurement was seldom applied to customs on a systematic basis and the measures that were applied were generally the wrong measures. As Brondolo *et al.* (2001:48) put it, measures of customs performance that relate to the mission of customs, namely, enforcement, compliance and facilitation have now been identified and are the key to achieving customs mission. Among others the main ones are:

- Clearance and cycle times for processing cargo;
- Compliance with all government laws at the border;
- Costs for clearing customs for government and industry, and
- Conformity with international customs standards and conventions.

As customs gains experience of these measuring techniques, it will be demonstrated that the only way to achieve high compliance is by greatly facilitating legitimate trade.

In order to establish a comprehensive customs measurement programme, the best approach is to start with two measures. The first is the cargo clearance time measure. The WCO has developed a *customs Clearance Time Measurement System* that will help customs establish a baseline for clearance times. Once this baseline is established, customs can begin analysing its existing processes to determine the cause of delays in customs processing that unnecessarily lengthen the process. With the knowledge of its clearance time performance and the cause of delays, customs can begin to develop plans to speed the process and publish standards for cargo clearance (Lane, 1999:3). In this regard, as Goorman *et al.* (1994:31-36) reported, customs administration practice in Eritrea indicates, frequently delays *inter alia* from redundant processes, absence of advanced entry-filing procedures, excessive paperwork, lack of effective automated systems, and reliance on intensive physical inspections approaching 100%. This issue is reviewed further in section 5.5 (*The import declaration process*)

The second area that has almost never been measured by customs is the rate of compliance of traders in international commerce. The lack of required information on the compliance of importers is the source of many problems for Customs. Compliance is the primary measure of effectiveness of customs. In the absence of overall knowledge of trade compliance, customs feels obliged to inspect all or as close to 100% of merchandise as possible intensively. These intensive inspections are not only a major cause of the delays and high costs for government, but are also a major impediment to achieving higher compliance. As a result, the customs enforcement and compliance paradox is realised in such a way that customs wastes time and resources in inspecting cargo of compliant importers and exporters that could otherwise have been used to pursue violations and violators (Englander, 2001:16-17).

By applying statistical techniques to the inspection process, customs could determine the level of overall compliance and the compliance level by company, commodity, country and industry. Using this information, customs can then substantially reduce inspections on complying entities and concentrate its resources on the non-complying cargo and importers and working to improve that compliance level (ICC, 2001a; Jereos, 2001; Molla, 2001).

Taken together, these two measures of compliance and clearance times can help customs to develop a strategy that will improve both compliance and facilitation. Achieving high compliance and facilitation is the definition of a modernised world-class customs.

To sum up, the monitoring of programmes and measurement after implementation is a must to ensure that customs processes are indeed abreast of the changes that inevitably must come with the changing times and in order to ensure that it is effective and facilitative regarding the clearance of goods at the borders. An effective monitoring programme will therefore sound the alarm bells that tell whether the system that was obtained is now incapable of handling the volume of trade passing through the process or otherwise. Such a close monitoring and timely measurement will hopefully make the good system better and the better best.

3.4.3 Variables: institutionalising customs modernisation

A customs modernisation programme can be instituted by introducing improvement among others in four general areas, namely –

- improving the fundamentals;
- implementing enablers;
- introducing advanced processes, and
- implementation and integration.

3.4.3.1 The fundamentals

There are three fundamental processes upon which every customs modernisation programme must build, namely:

(1) A complete assessment of the internal and external environment in which customs must operate in the future and the development of a strategic plan to guide the change process and meet the challenges of the future. This will be discussed under the subheading of *customs reform and a diagnostic assessment*.

(2) Development of customs expertise and core competencies in the technical areas of value, classification and procedure and an investment in training to maintain the expertise and competency. This will be discussed under the subheading of *customs reform and human resource development*.

(3) A commitment to integrity and a plan and organisation to root out corruption. This will be discussed under the subheading of *customs reform and corruption*.

▪ **Customs reform and a diagnostic assessment**

Every customs modernisation programme begins with a detailed assessment of the state of customs and the environment in which it operates. The assessment should be a comprehensive analysis of trade volumes and patterns, changes in transportation practices, current strengths and weakness and new technology. As a result of this assessment customs develops a strategic plan to address the issues and meet the requirements placed upon it by the government and industry. This approach takes into account that the customs administration functions well only if all its parts function in harmony. Here the objective will no longer be confined to developing some specific capabilities within the customs administration, but it will be to develop the whole organisation to face the challenge of the future (WCO, 1996). This approach is applied in this thesis in the analysis of Chapter five.

▪ **Customs reform and human resource development**

Van Kuik (2001) advises regarding expertise that a crucial early step in every modernisation initiative is to address the human resource and core competency issue. Every administration must possess world-class expertise in the areas of customs valuation, classification, procedure and origin. An ongoing training programme to cultivate these skills is essential, along with a training academy to maintain and deepen knowledge of customs and international trade. A human resource programme with particular focus on middle management to recruit and maintain

a capable professional staff is also necessary. This deliberate choice enables customs administration to bring about sustained change in the organisation.

Frederickson and Perry (1998:142) warn that when institutionalising change, change agents must be wary of the possibility that turnover in appointed leadership may bring change effort to a sudden halt. Unless permanent staff members are invested in change, an event such as the departure of a political appointee could have disastrous results, short-circuiting the institutionalisation of reform. The best way to overcome the liability of discontinuities such as an executive's departure is to give career employees significant roles and responsibilities in institutionalising change.

Concerning capacity building Clarke (2001) suggests that expertise often lies in government – customs people, trade people, finance ministry people, and so on – and should be used more systematically in project delivery. Government experts not only have the right expertise; they also provide continuity. One of the benefits, for example, of having customs officers train other customs officers is that they build continuous links between individuals and administrations that are needed for longer term maintenance of programmes and the overall trade relationship between those countries. Moreover, Van Kuik (2001) advocates that there is a need in the field of capacity building for close coordination with other organisations involved in trade facilitation, like World Bank/IMF, WCO, UNCTAD and UN/CEFACT. Some of these organisations have extensive technical experience in this field and have "products" that can be delivered off the shelf so that there is no need to reinvent wheels.

▪ **Customs reform and corruption**

The adage *an ounce of prevention is worth a pound of cure* by an anonymous writer is a good starting point here. However, despite this fact, until recently segments of the economic literature were presenting a romantic view of corruption, according to Tanzi and Davoodi (2001:89). For example, in various theoretical studies it was argued *inter alia* that corruption removes or relaxes government imposed rigidities, greases the wheels of commerce, etc. Again, this romantic view has now been changed by a more realistic view and reform is suggested as a cure.

Regarding a commitment to integrity, Yin (1981) (cited in Frederickson and Perry, 1998:140) stated that “...introducing new work practice is only part of the change equation. Equally important is eliminating the old practices...” Hence, every effort must be made to avoid contradictions between existing work practices and the values advanced by the change. One area that can be riddled with inconsistencies is the incentive structure. Changes to work structure and procedures must be accompanied by an incentive system that supports them. Nothing will

dampen enthusiasm for change more rapidly than an incentive structure built around the old way of doing things (Frederickson and Perry, 1998:141). Hence, anti-corruption measures should go parallel with the incentive structure.

When it comes to customs administrations and in view of the large amounts of money and contraband goods that customs officers encounter, there is a continuing concern about the integrity of customs and the vulnerability of customs officers to corruption. The WCO's *Arusha Declaration* adopted in 1993 acknowledges that "...corruption can destroy the efficient functioning of any society and diminish the ability of the customs to accomplish its mission..." Concerning its source, Johnston (2001b:19, citing Klitgaard, 1988) stipulates a well known equation, namely "*corruption equals monopoly plus discretion, minus accountability minus salary*" This simple framework provides a useful tool both to identify causes of corruption and to combat corruption, because corruption thrives where there is discretion and monopoly, where accountability is weak and public servants are poorly paid (see also world Bank, 1996a:67).

For developing countries, revenue collection remains an essential function of customs. Wherever there are inefficient and unpredictable customs controls, they are often compounded by corruption. As a result trust is then destroyed and revenues lost. In addition, as corruption involves agents of the state who should be dependable guardians of the law, customs corruption is particularly destructive. Corruption is a significant handicap to economic development in many countries. The risk of delays and exposure to demands for illegal payments therefore deter foreign companies from setting up production or processing plants, causing incalculable damage to a country's ability to attract foreign direct investment (Cattai, 1998; Johnston, 2001:161a).

As a result, the reform and modernisation of customs systems, with an emphasis on transparency and integrity, are still urgently needed in many countries. For that reason, members of the WCO, of which Eritrea is a member, should implement fully the *Arusha Declaration* of 1993 and the *Columbus Declaration of 1994* and should also cooperate to ensure that transparency and integrity feature in all international trade transactions (USIA, 1998).

Of course, customs does not exist in a vacuum. Again as Jain (2001:4) stated "...although corruption makes itself visible as an economic transaction it would not exist if the political institutions were able to exert the necessary influences and controls..." Based on this context, reform of customs requires the political will and long-term commitment of top-level government officials in order to succeed. Assuming that support and a framework are provided from the top, Lane (1998b; 1999:8) recommends the following actions to establish a foundation for a customs system characterised by integrity and competence:

- pay a salary that is consistent with a professional position of honour and trust, that will attract high quality personnel, and that will support a reasonable standard of living without the need for supplementary income;
- establish high standards for recruits and check background, finances, and references prior to employment;
- simplify the tariff and customs procedures and ensure transparency in all customs matters.
- establish internal controls and audit systems to prevent breaches of integrity and trails to identify and uncover violations;
- publish standards for cargo clearance and all customs services and provide appeal mechanisms for customs decisions;
- automate customs processes, building in controls, and utilising systems for direct deposit of customs duties and fees to financial institutions;
- develop a code of conduct, core values and a table of discipline that address integrity at all levels of the organisation;
- establish a system to oversee and protect the integrity of the organisation, its systems, and employees. Create an environment in which importers and carriers feel safe in bringing integrity issues to the attention of management, and
- make it clear to the trade community that corruption on the part of customs or the trade will not be tolerated. Ensure that appropriate sanctions are in place for customs or business violators.

Instituting practices, such as those outlined above, will establish an environment and reputation for integrity and will pay dividends in economic terms. Multinational businesses and investors will identify such countries as desirable locations for trade and investment. Failure to institute such behaviour will have the opposite effect.

3.4.3.2 The enablers

Among others there are two main processes that will enable customs to achieve levels of efficiency and effectiveness that were not possible in the past, namely:

(1) Automation and information technology, which provide the foundation for transforming customs into an information-based organisation, replacing inspections and manual interventions

with risk management approaches. This will be discussed under the subheading of *customs reform and information technology application*, and

(2) Data analysis skills to use the information in customs databases to gain insight into customs and the trade community performance. This will be discussed under the subheading of *customs reform and data analysis*.

▪ **Customs reform and information technology application**

The use of information technology is one of the most important revolutions that customs administrations have ever witnessed in this century. The development of new technologies and telecommunication infrastructures helps customs administrations to lower the costs of receiving and disseminating information. To perform procedures in an electronic environment also strengthens national and international coordination together with the provision of more effective customs control and simplified procedures that cause trade facilitation. Among others the two main benefits of IT application are 1) more effective control, and 2) more efficient customs clearance

Effective customs control in order to prevent duty/tax evasion, fraud and smuggling is customs' main aim. Given limited customs resources, it is not possible, or indeed feasible, to examine every consignment that enters a country. Thus, in carrying out their control function, customs should be selective. Risk assessment and selectivity criteria, in order to identify consignments for examination and documents for checking, can be applied in a manual system. Where, however, the functions of cargo control and/or goods declaration processing have been automated, such selectivity can be carried out on a much more informed and thorough basis. Intelligence gathered by customs can be fed into the computer system and should be taken into account when selectivity processing is taking place. The probability of uncovering fraudulent practices is therefore increased in an automated environment, where selectivity profiles can be analysed more systematically, more accurately and in more timely manner (WCO, 2000a:8).

The efficient processing of goods declarations is the other main benefit of automation, by providing among others a) increased productivity for both customs and trading partners; b) better use of resources; c) reduction in costs to both customs and trading partners by expedited release of goods, more accurate and timely information, better enforcement capabilities, and d) less congestion at ports and airports.

Automation of customs procedures in conjunction with electronic exchange of information, such as cargo data and goods declarations, enables pre-arrival information processing. This processing of regulatory information in advance of the arrival of the physical goods in the

customs territory using electronic commerce techniques, allows customs to verify the information and to carry out an initial risk assessment on the consignment. With the information already available, decisions on the release status of the goods can be transmitted immediately after the arrival of the goods (WCO, 2000a:8-9).

In general, information technology provides the foundation for transforming customs into information-based organisations. As Soysal (2001) spells out, the introduction of new technology changes the content of work in customs administrations, and this has many crucial implications for the way it is supervised and controlled and the way the management is organised. The use of new technology in customs, first of all, reduces the need for the personal supervision of daily operations and results in a flatter organisation structure with fewer layers of management.

▪ **Customs reform and data analysis**

Having established a foundation for increasing customs effectiveness by process improvement and more sophisticated information technology systems, customs should establish expertise in data analysis. By instituting this enabling process, customs can then begin to replace manual labour and physical inspections of goods with analytical approaches to achieving customs goals. Data analysis expertise will reduce the costs of compliance for both government and industry, increase compliance with customs and other agency laws and facilitate the increasing volume of trade (Claypole & Trudel, 2001).

Moreover, customs is the primary source of international trade data. Information held manually is bulky and time-consuming to evaluate and organise properly. It is almost impossible to extract meaningful and related data from a variety of files without a very labour-intensive exercise. This is the principal difference between data handled manually and data held in an IT system.

The automation of customs systems allows the customs immediate access to up-to-date information and, with the application of management information systems (MIS), the possibility to manipulate this information in a meaningful way. Customs automation also enables more effective post-audit control at national and local level. Another advantage is that data captured electronically is likely to be more accurate than data handled manually, as a result of validation and credibility checks built into the automated capture process. This in turn will ensure that any data analysis carried out will be more accurate than data captured manually (WCO, 2000a:9).

In addition, automation allows customs administrations to establish a national database of information on all transactions and movements, which can be updated and used for rapid

information sharing and identification of changing risk areas. It can also provide a database of all risk profiles, which would form the basis for a selectivity module within an automated clearance system (WCO, 2000b:17)

3.4.3.3 The advanced processes

By improving the fundamentals in the area of customs expertise and competencies and instituting the enabling processes to convert customs to an information-based organisation, the stage has been set to introduce more advanced approaches to customs management. Among others the main advanced approaches are (1) risk management, which allow customs to facilitate high compliance importers and concentrate on known and potential violators, based not on intuition but on compliance measurement, and statistics and (2) an audit approach whereby customs reviews the systems of importers and exporters to determine their adequacy on providing accurate data to customs. All these will be reviewed as interdependent processes under the sub-headings of *customs Modernisation and Risk Management Process* and *Risk Assessment and Selectivity* respectively.

▪ Customs modernisation and risk management process

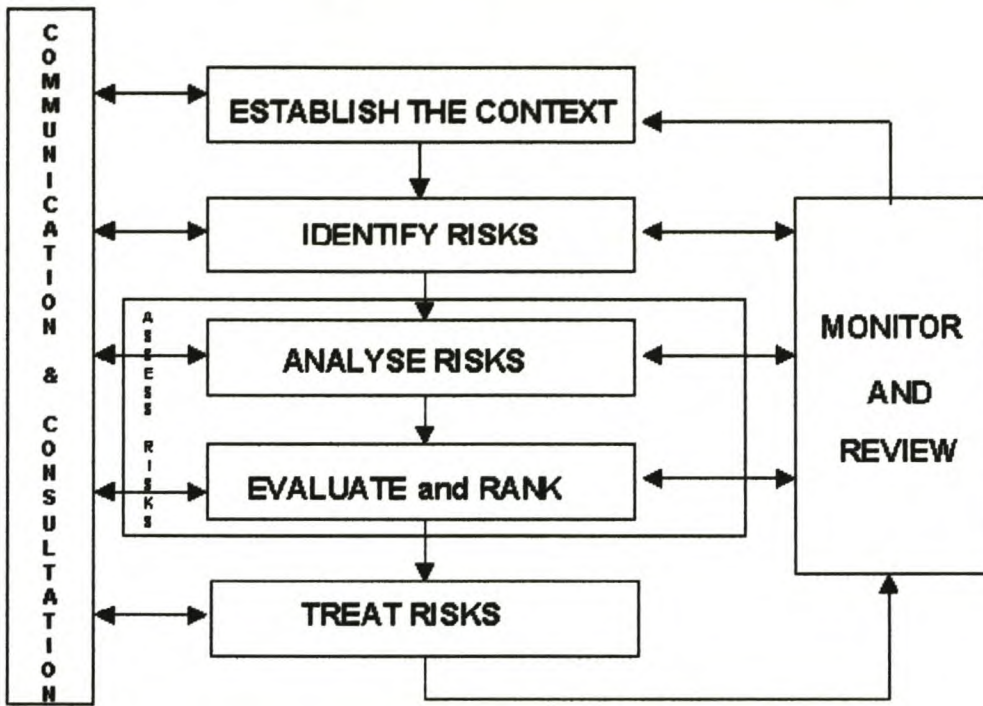
Customs administrations world-wide are struggling to resolve an apparent paradox. On the one hand, customs administrations have to apply efficient and effective controls in order to fulfil the responsibility to collect revenue while at the same time implementing trade policy, safeguarding the public, managing the increase in world trade and tourism, reduced customs personnel, and on the other hand offering trade facilitation to legitimate traders, travellers and carriers (WCO, 2000b:6).

In essence, the challenge is to deliver better enforcement with more facilitation and less bureaucratic red tape, all at a reduced cost. This seems impossible. But firstly re-engineering the customs administrative process to adopt information technology and, secondly sound risk management and co-operative effort between customs and the trading community in working towards a shared vision for a business process tailored to the real needs of industry and government, could resolve the contradiction between the need to control and to facilitate (Vassarotti, 1998).

In customs, *risk* can be defined as the potential for non-compliance with customs laws, which would result in loss or injury to trade, industry, or the public (WCO, 2000b:47). Therefore, *risk management* is the application of management policies, procedures and practices to the tasks of identifying, analysing, assessing, treating and monitoring risk as depicted in Figure 5. Risk

management therefore is a logical and systematic process, which can be used when making decisions to improve the effectiveness and efficiency of performance (APEC, 1997).

Figure 5: Risk management overview



Source: (AS/NZS 4360, 1995; WCO, 2000b:10)

Furthermore, risk is characterised by the fact that it is partially unknown, and that it increases with lack of knowledge, and changes with time, but is also manageable. Managing risks is a natural reaction to minimise the level of potential harm that comes from not knowing what the future might hold (Englander, 2001:16). Therefore, through the customs risk management process, information is constantly analysed to determine what merits attention. By doing so, customs consciously dedicates more resources to some areas and less to others. Besides, whether an importer's cargo is inspected at the port, or supporting documentation is reviewed afterwards, all findings of compliance as well as violations are recorded and analysed within the risk management process (WCO, 2000b:46).

In addition, as the work of a customs administration involves dealing with a multitude of transactions taking place within a restricted environment, it is simply not practicable or even possible for everything to be checked and approved in a timely fashion. The fact is that based on experiences one can perceive that some importers and some imports present a much more significant risk than others, and therefore, it is clearly more effective to perform extensive,

thorough reviews on a smaller percentage of imports and systematically lessen the oversight of compliant customers (ANAO, 1997).

The problem is then how to ensure that the goals and objectives which customs administrations world-wide are accountable for are met when only a fraction of the workload can be addressed through direct intervention. The solution lies in adopting a methodology, which will allow customs to identify that percentage of transactions, which most need attention, thereby, allowing efforts and limited resources to be focused where they will have the best results.

This method requires applying a systematic risk analysis to deal with and to identify those cargo transactions and people movements that poses an inherent compliance or enforcement risk. Customs risk management therefore, improves the quality of customs controls, information and accountability, and promotes the concept that low risk cargo and compliant importers benefit by expedited customs release procedures (Vassarotti, 1993; Jordan Customs Department, 2000).

In customs activities, the risk inherent to operations can be divided on at least two dimensions, which are referred to as the *objective risk* and *subjective risk*. The objective component of customs risk is estimated as a function of the goods characteristics or the attributes of the operation itself. This can be determined by combining aspects like the nature of the goods, tariff classification and system, the means of transportation, country of origin and packing methods, among others.

The subjective component of the customs risk on the other hand derives from the combination of attributes that allow the characterisation and identification of the behaviour of the intervening agents in the operation. Hence subjective customs risk is determined by the combination of the risk related to all intervening agents, especially those with direct participation, like importer, carrier, and the customs brokers (Lanna, 2000:5-6).

For customs the biggest trade facilitation challenge in the coming years is how to effect customs clearance on legitimate imports and legitimate exports within the hour from lodgement and possibly even before arrival of the importation. Given the huge volume of transactions and international movements that customs must deal with and the time and resource pressures under which it operates, it is natural to be selective in what to check and what to ignore. Virtually every customs administration in the world uses some form of risk management techniques. The two important and concurrent tools in risk assessment to attain these goals are: 1) selectivity and 2) post-entry audit (Vassarotti, 1998).

▪ **Risk assessment and selectivity**

From the customs point of view, the use of information technology is an effective tool for risk management. It enables a more rapid analysis of selectivity criteria than would be possible manually. An automated selection operation allows customs administrations to subject declarations to a series of selectivity filters. As mentioned earlier, the selection routine is based on objective parameters (Lanna, 2000:5-6), which are manually inserted individually or in a combined way, aiming to detect operations the nature of which demands a stricter control and a subjective parameter is used to identify the code of the intervening agents. Each parameter or combination of parameters is associated with an examination channel/lane, which determines the procedures to be adopted in the checking (Vassarotti, 1993).

Once shipments are screened against predetermined risk criteria, they are directed towards the appropriate channel. "Green channel" imports are released with no or minimal documentation checks and no physical inspection of the goods is required, so goods are automatically cleared (Lanna, 2000:2-3; Jereos, 2001; Molla, 2001). According to Jordan customs Department (2000), for example "green channel" procedures are –

- for specific lists of commercial importers that have been found to be compliant and which benefit from expedited release;
- for unconditionally duty-free goods;
- for goods that have been determined to be risk-free, such as goods imported by the embassies, ministries, public security agencies, and
- for goods entered by major industrial corporations and institutions concerned with the national economy and that encourage investment and promote economic welfare.

The "yellow channel" is for those transactions that constitute a medium risk and which require the examination of full documentation only, and, if necessary, it may be upgraded to the "red channel" (Lanna, 2000:2-3; Jereos, 2001; Molla, 2001). According to Jordan Customs Department (2000) for example, the "yellow channel" procedures are –

- certain medium risk commodities that may be exempt from duties and taxes and which require customs review of certain documents to make that determination either based on origin or other evidence, and
- those declarations that have deductions or amendments to the declared value and that may have an assigned risk concerning currency conversion and declarations that are

subject to guarantees or deposits and which are also considered to be medium risk and require some level of scrutiny.

The “red channel” imports – about 10 to 12% of the total – receive full documentation check and physical inspection of the goods. The “red channel” is intended for high-risk declarations that require scrutiny and physical examination (Lanna, 2000:2-3; Jereos, 2001; Molla, 2001). According to Jordan Customs Department (2000) for example this procedure is for –

- companies or persons who have been placed on the black list for gross customs violations;
- goods that by their nature may require physical examination to determine the value, such as used or refurbished goods;
- red channel review may also be generated for goods that may require additional analysis to determine tariff classification;
- goods that are subject to high customs duties and taxes;
- goods from specific countries for which a pattern of violation has been previously determined;
- sensitive goods that may have security concerns;
- goods on which there is information about potential for unlawful import or commercial fraud;
- temporary import, export or re-import of goods may be designated for this additional scrutiny, and
- declarations selected at random for further scrutiny. This is a safeguard to identify potential concerns or violations that were not previously documented.

To enhance facilitation further, for example as practiced in Philippines, it is also possible to embark on a “super green channel” facility which allows pre-qualified accredited importers to bring in their imports without delay in the sense that the accredited importers, having established their faultless *bona fides*, may release their imports immediately, since shipments of “super green channel” users are no longer subject to being selected. Effectively they are exempted from the application of the selectivity system although random inspections at importer’s premises are an option left open for customs to avail of as necessary (Jereos, 2001).

In general, the selectivity system has been useful for adapting the volume of examination to the available workforce and, at the same time, providing a faster clearance. This is confirmed by Vassarotti (1998) who stated “...*risk management allows customs to be more accurate in*

identifying risk transactions; the result is less intervention in the flow of freight across the border, more predictability and fewer unexpected delays. In short, the vast majority of cargo is facilitated and any cargo delayed is cargo, which is very likely to constitute a real risk...”

The use of risk management can also help the public sector to determine where the greatest areas of exposure to risk exist, and can support management in deciding how to allocate limited resources effectively. In managing risk a balance must be struck between costs and benefits, as clearly it will not be cost effective to address all risks equally (WCO, 2000b:10).

▪ **Risk assessment and post-entry audit**

The method of risk assessment must be complemented by a post entry audit system, which means that checks on importations will have to be done *post facto* rather than upfront during entry. Realistically no selectivity is fail-proof and therefore, aside from a sophisticated selectivity system, a very good and reliable post-entry audit system should likewise be firmly in place to back up the “failures” of selectivity (Jereos, 2001).

Post-clearance audit focuses on persons involved in the international movement of goods. It is practiced to verify the accuracy of green channel and a sampling of yellow (if necessary also red) channel clearances. It is an effective tool for customs control because it provides a clear and comprehensive picture of the transactions relevant to customs as reflected in the books and records of international traders (ANAO, 1997).

At the same time post-entry audit enables customs administrations to offer the trader facilitation measures in the form of simplified procedures, e.g. periodic entry system. In addition a sub-system could also be developed that would enable the importers’ declared values to be checked against pre-set criteria, such as a range of values for particular goods from particular countries – both as part of the assessment process and as part of the post-clearance audit (WCO, 2000b:23; Molla, 2001).

Thus, better trade facilitation will depend heavily on whether or not the post entry audit process is firmly in place, reliable and effective. The comfort such a system will give customs as a safety net to recover “lost” revenue at the borders will also act as a deterrent against technical smuggling as well as to demonstrate that the benefits of complying with the customs laws are financially more rewarding, by way of reduced costs, more sales, and increased profits, than the benefits of evasion and avoidance (ANAO, 1997; Molla, 2001).

In general the risk management process, as a dynamic system, needs constant change and expansion of criteria for refinement purposes. There should be a great interest on the part of

customs authorities to refine their selective system further and to employ the techniques of risk management (Vassarotti, 1998). However, there are certain steps that need to be considered in the development of a strategic risk management concept.

The first step for a customs administration is to look at the customs context and to define the role of customs, the national priorities and the expectations of the public and the private sector. This step will also require the creation of a multi-disciplined risk group, determining operating procedures and cataloguing existing sources of data or information that could help in identifying risks and determining priorities.

The second step is to analyse the information and identify industry sectors, commodity areas, or control risks, such as high duty, valuation, goods subject to trade agreements, sensitive goods, etc. and to research existing databases and records on commodity and trader histories. The final step is for management to initiate an action plan and to work with the risk management group to develop processes that can be best applied in the national environment (Jordan Customs Department, 2000).

In summary, risk management delivers benefits to traders and governments. It is particularly useful for customs administration. Sound risk management means that good, accurate decisions are possible about which transactions and movements should be checked more closely and which can be allowed to proceed without intervention. As a result trade and travel are facilitated. At the same time, customs enforcement and compliance are improved.

3.4.3.4 Implementation and integration

The key to the success of any customs modernisation programme in order to attain the interrelated and interdependent goals of reform is management oversight of the implementation process and integration of its various components.

To this end, as Clarke (2001) stated, governments should be committed at a political level to reform. If they are not, then the programmes could be taken for granted and are not integrated into reform plans, and so do not lead to long lasting improvements. Hence Clarke advocated for governments to have the sense of ownership at large. In addition Frederickson and Perry (1998:134) remark that ownership is best ensured where a) a government has a visible and high-level commitment to reform, and b) employee participation is in place, at least at the method of implementation, to allow for greater employee “ownership” of the change sought and a greater likelihood that its adoption will be successful.

According to Wise (1996:397), “...when frontline employees consider themselves engaged in decision making and responsible for organisational outcomes, their commitment to achieving organisational goals is enhanced...” Ownership also means that a variety of players in the country need to be involved in the planning and implementation of programmes, such as industry federations, consumer groups, chambers of commerce, and so on. This increases both the quality and the acceptability of customs reform programmes.

By implementing a programme such as outlined above, these goals can be achieved without increasing customs staffing. Implementation and integration do not start at the end of the process, but at the beginning. As customs goes about the difficult process of reforming and transforming itself, it must also meet the ongoing and increasing demands to serve the public, collect the revenue, and meet new requirements imposed by policy-makers and trade agreements. Executive management must provide the political will and support to carry out the reform while continuing to meet daily operational requirements (Soysal, 2001).

In the end, a streamlined and modernised customs not only improves facilitation and compliance. It is also an important factor in making the country a preferred location for trade and investment. Approximately 30 to 40% of trade is now between related parties. Multinational companies now have great flexibility in deciding the location of major manufacturing and distribution centres that create both jobs and exports. A customs that is modernised, facilitative, automated, and consistent with international standards, can be a competitive advantage in the global economy, ultimately leading to increased prosperity (Lane, 1999:10).

3.4.4 Successful customs modernisation: the case of Peru

Peruvian customs is a case in point. Over a period of years, Peru transformed its customs administration and processes – by their own admission one of the world’s worst – to one of the best. In Peru, a customs that was slow, corrupt, inept and not in conformance with world customs standards is now approaching world-class status. Just over five years ago Peruvian customs had a well-earned reputation for corruption and incompetence. New leadership was introduced with a charter to reform and modernise. Among others Peruvian customs fired corrupt employees, instituted a test for competence, provided training for remaining employees, hired new professionals, established standards for cargo clearance times, simplified the tariff, and reduced duty rates.

The results were inspiring (see Table 7 and Figure 6). The following can be seen as a summary of the achievement of the Peruvian customs over a five-year period through a process that continues to this day and is leading towards ISO 9000 certification:

- over the five-year period imports doubled;
- the tariff was simplified and duty rates reduced by 45%;
- staffing was reduced by approximately 30%;
- cargo inspections were reduced from nearly 100% to a maximum of 15%;
- cargo release times were reduced from an average of 30 days to one or two days for red channel cargo (i.e. cargo to be inspected) and frequently the same day release for green channel cargo, and
- hence the workload doubled and revenue collections quadrupled in the face of lower duty rates.

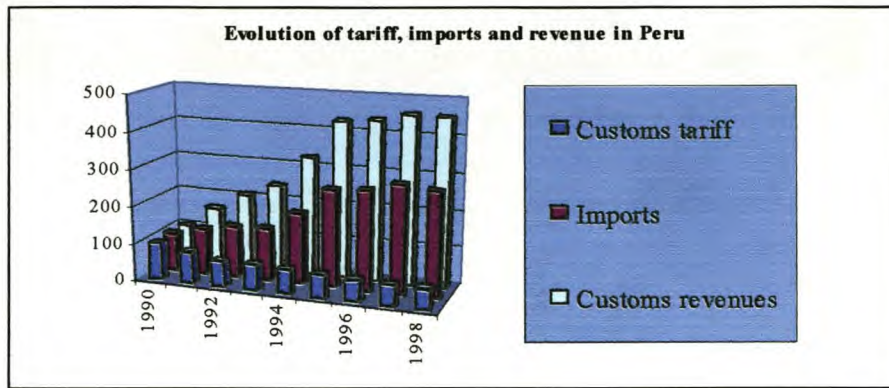
Table 7: Evolution of tariff, imports and revenues in Peru

Years	Customs tariff	Imports	Revenue
1990	100	100	100
1991	85	123	160
1992	70	137	205
1993	69,5	141	240
1994	65,5	192	324
1995	61,2	265	427
1996	57,4	270	435
1997	54,9	293	454
1998	54,9	282	453

Source: Garcia (1999:11). The figures are in percentage, with 1990 =100

Peru took ownership of its customs corruption and competence problems, and today it is a model for other customs administrations around the world. The Peru example is a real world demonstration that a customs administration can handle an increased workload, reduce staffing and costs, replace manual inspections with information and risk-based approach, substantially improve facilitation, and improve compliance and revenue collections. Peru is an example that can and should be replicated (Garcia, 1999:11-12; Lane, 1999:4).

Figure 6: Evolution of tariff, imports and revenues in Peru



3.5 THE CHANGE MANAGEMENT

“There is nothing more difficult to arrange, more doubtful of success, and more dangerous to carry through than to bring about changesThe innovator makes enemies of all those who prospered under the old order, and only lukewarm support is forthcoming from those who would prosper under the new (Niccolla Machiavelli, The Prince (1513), cited in Sanders, 1998:29)

In the last few years, with the advent of globalisation, much emphasis has been placed on the management of change to cope with, among others, the increasing global competition, customer or client requirements, accelerating technological change and the information revolution (Dutfield & Eling, 1994b:95). The literature reviewed so far indicates that the modernisation of customs administration requires a comprehensive change in the institutional and regulatory make-up by adopting best practices that fit into a given customs situation as well as by converting customs administration to an information-based organisation. However, in order for change to take place in such intended way and with better results, the following key attributes of change should be addressed and managed within the environment to be changed:

- **Change and top management support**

As Lovell (1994:40) stated “...endeavours to change may easily fail because of an inability to attract support and manage the internal political environment surrounding the change...” In such situations top management support becomes extremely important if not crucial, particularly when the change affects the whole organisation or when increased resources are necessary (Lovell, 1994:43). The reason is that a champion of change at the highest level could signal the status and importance of the reform throughout the organisation. Thus support for change is one side of the coin.

▪ **Change and resistance**

It is believed that resistance to change is one of the most ever-present organisational phenomena. A number of authors have defined resistance. For example, Ansoff (1988:207) defines *resistance* as a multifaceted phenomenon, which introduces unanticipated delays, costs and instabilities into the process of a strategic change, whilst Zaltman and Duncan (1977:63) define *resistance* as any conduct that serves to maintain the *status quo* in the face of pressure to alter the *status quo*.

Thus, resistance, in an organisational setting, is an expression of reservation, which normally arises as a response or reaction to change (Block 1989:199). This expression is normally seen by management as any employee actions perceived as attempting to stop, delay, or alter change (Bemmels & Reshef, 1991:231). Resistance therefore is most commonly linked with negative employee attitudes or with counter-productive behaviours.

In the light of this context, it is obvious that this big change in customs faces challenges and resistances by personnel in the organisation and industry with a stake in the current system. Jereos (2001) exemplified this by what happened in the Philippine Bureau of customs as follows:

In the early 90's we were grappling with the problem of how to improve the delivery of our services to our clients and stakeholders. Automating customs processes was (and still is) the answer. When it was introduced in the bureau of customs, bureau personnel, importers and brokers having been used to the manual method of procession, raised varying degrees of resistance to the introduction of computerisation into the customs processes. Hindsight revealed to us that the majority of those resisting were suffering from insecurity due to the perception of job loss/loss of security/replacement via automation and in sum, a fear of the unknown. Thus we had to launch an aggressive change Management Program to allay these fears.

▪ **Change and its consequences**

Against this background, overcoming resistance requires a process of prudent change management. Organisations can be changed, but change must be approached carefully with implications for both individuals and groups within the organisation. As Bernard (cited in Lovell, 1994:59) noted, "...the power of managers may appear to flow from higher authorities in the organisation, but true power is obtained by gaining the support of subordinates..." Successful change agents therefore are capable enough to defuse the most vocal resisters to change by accommodating their demands in a manner that does not violate the intent of the reform effort. Resistance to change should be taken seriously and met head-on. A genuine

understanding of the resistance and its origins will inform the change process and increase its likelihood of adoption and success (Frederickson & Perry, 1998:132).

▪ **Planning and change**

On the other hand, the change process must be planned by developing an action plan that identifies who is to do what, when, where and how. The plan needs to take into account as much detail as possible, difficulties and uncertainties and ideally contingency plans. So often the move from the present position to the desired future state will not happen easily and automatically but rather through carefully directed activities and continual cycles of reviewing progress and learning from the work undertaken (Lovell, 1994:58; Smith, 1994:26). Hence the management of change must be sufficiently resourced and must not be interrupted by daily operations of the organisation. It should be never forgotten that managing the process of change is a totally different activity from the general management. As a result, it may be necessary to develop a structure outside the regular organisational structure during the change period (Shaw, 1994:190).

▪ **Uncertainty, communication and change**

It has also become apparent that people do not resist change *per se*; rather they resist the uncertainties and potential outcomes that change can cause. Given that change is frequently messy, chaotic, unpredictable and painful, it is vital to ensure that a communication process is established that enables individuals/employees to cope with the stresses and strains that will have to be managed (Dutfield & Eling, 1994a:76). Regarding uncertainty Soysal (2001) states as follows, “*Uncertainty created by ‘Change’ creates ambiguity and presents unknowns that cause anxiety, which in turn tends to increase the probability of resistance to change*”.

According to Savoei (1998:227-228) communication is a very crucial feature for explaining the nature of and the reasons for the change. This should be done as early as possible in the change process in order to minimise the opportunity for ambiguity, rumours and distortions to breed and as a result to complicate the change process. The benefits of the change must be clearly communicated to stakeholders, those both internal and external to the transformation, which have an interest in either the process or the outcome.

Moreover, planned change requires intervening in the functioning of an organisation. These interventions in turn, can have many unpredictable consequences. In this, understanding how employees of the organisation will react is of paramount importance. In this respect, Frederickson and Perry (1998:142-143) point out as follows, “*...change agents need to address employee concerns at multiple levels. At the political level, tactics of resistance need to be anticipated and responded to, for the reason that those who have power in the current situation*

may resist change because it threatens that power; at the emotional level, employees' natural apprehensions concerning what change will mean for them must be addressed; and at a practical level, employees should be provided with the skills that will be required to perform any new tasks..”

▪ **Confidence and change**

A successful implementation of transition also requires the individual to be confident about himself/herself and not to step back in case of any threats. Change means that individuals or groups will have to find new ways of managing their own environments – ways that might not be as successful as those currently used (Dutfield & Eling, 1994b:97). Adopting new customs processes, standards and technology into an organisation may also mean changing policies and procedures and motivating individuals and groups to carry out their jobs in a totally new way. Specifically the fear of new technology can create big problems in many cases, and therefore those affected by the technological change should be helped to accept and adjust to it through an intensive training programme (Wittles & Lovell, 1994:38; Frederickson & Perry, 1998:137).

▪ **Monitoring and reinforcing change**

The final action step for managing transition involves monitoring and reinforcement of the change. When changes have been introduced into an organisation, it is very important to check after a suitable time to see if they are working well and giving benefits that are purported. If something is going wrong modifications should be made immediately. On the other hand, if the changes are working well and the benefits can be demonstrated, this information must be used to tell everyone to reinforce the transition in the organisation (Dutfield & Eling, 1994b:102-104).

3.6 SUMMARY

To recapitulate the whole idea of reform and modernisation in customs administration, it becomes worth mentioning the concept of globalisation again. From a wider angle globalisation has been variously conceived of as time-space compression – referring to the way in which instantaneous electronic communication erodes the constraints of distance and time on social organisations and interaction; accelerating interdependence – understood as the intensification of enmeshment among national economies and societies such that events in one country impact directly on others; a shrinking world – the erosion of borders and geographical barriers to socio economic activity and interregional connectedness (Jameston (1991); Robertson (1992); Scholte (1993); Nierop (1994); Albrow (1996), cited in Held and McGrew, 2000:3).

When focused more on the economic side, globalisation is usually defined as an expansion in the volume and variety of cross-border transactions in goods and services, a dramatic increase in international capital flows and also the more rapid and widespread diffusion of technology. These cross-border flows of trade and technology are facilitated among others by a) reductions in trade barriers through regional or multilateral trade agreements; b) rapid expansion of foreign direct investment by multinational companies; c) reduced barriers to international capital transfers, resulting in massive equity funds and other speculative financial flows across national borders, and d) modern communication facilities resulting in a dramatic increase in the speed of such transfers (Kyloh, 2001).

In light of the global context therefore, customs modernisation could have three important implications to the success of economic growth. First, customs modernisation will be an important enabler of trade liberalisation. Thus, raising the efficiency of customs to a uniform, high standard is a prerequisite for achieving full economic integration. Second, customs administration will be an increasingly important element in the competition to attract foreign direct investment. Third, the conclusion of an effective economic integration in line with effective customs administration in its turn accelerates further growth in the volumes of cross-border trade in goods, business and tourist travel, and it also boosts investment. This interdependence therefore makes national stakes in efficient customs operations to become immense.

In conclusion therefore, it could be said that customs reform and modernisation measures can make unparalleled contribution to a country's economic performance. This positive correlation between effective customs administration and the economic growth of a country ensured through increased volume of trade and tourist flows as well as foreign direct investment constitutes the basis for reviewing the Eritrean economic background in the next chapter, as a macro-context for the required reform and modernisation measures in Eritrean customs.

CHAPTER 4

CONTEXT OF THE ERITREAN ECONOMY

4.1 INTRODUCTION

Eritrea, a small country in the Horn of Africa, declared its independence from Ethiopia in 1993 after a thirty-year war. The war left Eritrea's infrastructure, as well as many of its most vital institutions, destroyed. The central focus of this chapter is therefore to assess the economic context of Eritrea so as to develop insight into the macro-environment, of which customs administration is a component. The rationale in this research work for the assessment is that any national public sector reform strategy is unlikely to succeed unless it actively takes into account the macro-environment as determinant factor and point of departure in deciding the type of policies, institutions, and resources required for a reform at micro-level.

The Eritrean Customs Administration as an instrument of trade and fiscal policy operates, among others, within the broader political, economic and social environments. There are two approaches and two lines of literature in the analysis of a given environment or organisation. The first approach assumes that an environment/organisation exists, and attempts to model its consequences. This represents a **macro**-approach and it is used to review the Eritrean economy in bird's eye view in this chapter. The emphasis is on three departure points namely (1) foreign direct investment, (2) export and (3) tourism as components of the economy that demand well performing modernised customs administration in their realisation as potential contributors to the Eritrean economy. These broader environments therefore, set the direction and purpose for the Eritrean customs in such a way that customs does not become a bottleneck.

The second approach attempts to find the root cause of the environment/organisation. It is a **micro**-approach. Micro-approach in organisations starts with the analysis of the practice at the grass roots level and evolves to the analysis of various vertically related relevant issues. In the case in point, micro-approach considers the place of customs administration as that could hamper or facilitate the intended economic growth; therefore it will serve as an approach for the next chapter. The micro-approach is harder, and in many ways more constrained than the macro-approach, as it has to rely on the underlying micro-structure. However, the micro-approach has a very significant benefit in defining the reform structure when harmonised with the context – that is the macro-environment.

4.2 POLITICAL HISTORY

Eritrea, in its present geographical shape, came into being on January 1, 1890 as a colony of Italy, when Italy set the boundaries and started to colonise the area for a period of more than fifty years until 1941. Named after an anonymous classical history of the region, Peryplus of the Red Sea, Eritrea was Italy's first African colony (Garcetti & Gruber, 2000; Joireman, 2001:3). Until the coming of the Italians, raids and plunders by local chiefs on one hand and by Turkish, Egyptian and Abyssinian invaders on the other were very common. These invasions exposed the Eritrean societies for centuries to misery, suffering and poverty (IRD/UNICEF, 1993:22).

During the Second World War, Eritrea was the first Axis territory to fall to Allied forces when Allied troops, meeting relatively little resistance from Italian forces, successfully invaded Italian East African colonies in 1941. During that war Eritrea became an important centre for British and American operations in the region. For the next eleven years, i.e. until 1952, Eritrea technically remained an Italian colony administered by British authorities who established a protectorate over Eritrea under the UN mandate (Negash, 1999:314).

In the decolonisation process, after some years of intense deliberations to decide on the fate of Eritrea, the United Nations General Assembly adopted resolution 390 A (V) to federate Eritrea with Ethiopia, guaranteeing Eritrea some democratic rights and autonomy under the overarching authority of the Ethiopian emperor (Haregot, Stanley, Doctoroff & Yosef, 1993:28; IRD/UNICEF, 1993:25; EU, 2000:5). This action made Eritrea to be one of the few African colonies that never enjoyed independence after the occupying colonial power ended its rule, and thus did not experience the usually swift independence achieved by most other African colonies

The Eritrean-Ethiopian federation was formally initiated on September 11, 1952. For the first time Eritrea existed as a political entity, free from European rule. Just as significantly, autonomous Eritrean institutions and symbols arose from the federation agreement. Most prominent of these was an Eritrean government with a chief executive and civil service, a popularly-elected assembly, and an independent judiciary. National symbols, including an Eritrean flag, were a source of common pride and a locus of political identity for the Eritrean population (Haregot *et al.* 1993:28)

However, the federation agreement was politically a flawed arrangement and structurally it was unstable. In this regard, Joireman (2001:5) articulated the following statement: "*Ethiopia had no experience with federalism or, for that matter, with democracy. It was a highly centralised authoritarian state. While Eritrea relatively was a democratic state complete with its own constitution and laws*". Furthermore, as Garcetti (1999) expressed, "*Ethiopia's strong interests*

in having access to the sea and Haile Selassie's state-building and nation-unifying projects were incompatible with Eritrean autonomy". As a result of these pressures, the ten years of the Eritrean-Ethiopian federation were marked by the systematic violation of rights granted by the UN and a steady erosion of Eritrean autonomy through the actions of the Ethiopian state. In 1962 Ethiopia unilaterally abrogated the federal status and annexed Eritrea, turning it into one of its fourteen provinces (Negash, 1999:314).

Nevertheless, as Joireman (2001:6) put it, the years of federation were important in the struggle for Eritrean independence as it united Eritreans in their desire for independence. Accordingly, after the failure of years of peaceful protest and especially by the time Ethiopia completely annexed Eritrea as fourteenth province, the seeds of armed rebellion were already in place (1961), a situation that led to the 30 year-long war of independence.

On 24 May 1991, 30 years after the devastating war for independence, the Eritrean People's Liberation Front (EPLF) liberated the entire country. The then Provisional Government of Eritrea announced that a referendum would take place within two years to decide on the future status of Eritrea. Accordingly, the internationally supervised referendum was held on 23-25 April, 1993 and the voters provided an overwhelming mandate for national independence. That is, from 98,5% of registered Eritreans, 99,8% voted "yes" for independence, and Eritrea was reborn as an independent and internationally-recognised state and formally inaugurated the *de facto* independence on 24 May, 1993 (IRD/UNICEF, 1993:27-28; EU, 2000:5; Garcetti & Gruber, 2000; IGAD, 2000:2).

4.3 BACKGROUND OF THE ERITREAN ECONOMY

The five decades of Italian rule in Eritrea forged a new political and territorial entity. That is, it not only fixed an external boundary where only loose and fluid boundaries had existed before, but also served to initiate the dismantling of the internal barriers separating the various social, religious, and ethnic groups of Eritrea. As a result of this, the terrain barriers between the highlands and lowlands were bridged by developing the infrastructure of the country – a superior road and rail system, cableway (71 km long and with loading capacity of 720 tons per day) telephone networks, among the best in Africa, and by building industries and developing market-based economy (IRD/UNICEF, 1993:23; Negash, 1999:319-320).

Furthermore, the establishment of new towns and the expansion of existing ones created common spaces for social, economic, and political interaction among the Eritrean population. This together with the developments that took place during the British administration constitutes the initial period (1890-1952) of the modern Eritrean economy that evolved within those six

decades, as discussed in subsection 4.3.1 (*Evolution of the Economy: During Italian and British Administrations*) Since the middle of the previous century, i.e., from 1952 onwards, the structure and activities in the evolution of the Eritrean economy have been primarily characterised by the federation and annexation of Eritrea by Ethiopia, and the resulting struggle for national independence (see subsection 4.3.2 [*Evolution of the Economy: During Federation and Annexation by Ethiopia*]) and by the subsequent achievement of political and economic autonomy, as discussed in subsection 4.3.3 (*Evolution of the Economy: Post-Conflict Reconstruction and Recent Developments*), respectively. In general from a long-term perspective, economic policies pursued under the Italian, British and Ethiopian rule had profound effects on the evolution of the Eritrean economy.

4.3.1 Evolution of the economy: during Italian and British administrations

4.3.1.1 Italian rule (1890-1941)

The Italians developed light industry and commercial agriculture in Eritrea, such as tobacco processing, meat canning, and button manufacturing plants, and cement, salt, and potash factories. However, the Italians never developed industrial enterprises in Eritrea that might compete with Italian industries (Negash, 1999:318). In this period, and with about 70 000 Italian settlers in Eritrea, the aim of the economic policy was primarily to benefit the settlement population and to provide export to Europe and East Africa. Further, Eritrea experienced a rapid expansion of its economy and infrastructure, particularly in the 1930s, as Italy used Eritrea as a base for its imminent invasion of Ethiopia (IRD/UNICEF, 1993:23; Garcetti & Gruber, 2000).

At the end of the 1930s, more than 600 construction organisations and some 730 companies producing industrial goods existed in Eritrea. In addition, some 850 registered transport companies and about 2 200 trading companies were active (World Bank, 1994:3). Moreover, regarding trade, Negash (1999:318 [citing Negash (1987) and Mesghenna (1988)]), put it as follows:

The colonial power greatly benefited from its trade with the colony by adopting a protectionist policy. Italy imposed an ad valorem tax at the rate of eight percent or more on foreign products entering Eritrea while exempting its own goods coming into the colony. Italy also applied a quota system and used price discrimination in its trade with the colony. Under this system goods imported from Italy to Eritrea were sold at higher prices than goods from other countries. Conversely, Eritrean goods were sold at much lower prices to Italy than to other places.

The exports to Italy included cotton, coffee, tobacco, citrus fruit, sisal, cereals, fish, salt, potash, and gold. Imports to Eritrea included foodstuffs, textile, chemical, metallic, and woodwork products. The Italians looked on Eritrea as a transfer point for transit trade with countries neighbouring Eritrea such as Ethiopia, the Sudan, and those in the Arabian Peninsula. Eritrea absorbed a large amount of Ethiopian exports. Further, imports from Ethiopia and from the Arabian Peninsula were exported overseas through the Eritrean Port of Massawa (Negash, 1999:319-320).

4.3.1.2 British rule (1942-1952)

With the coming of British administration the Eritrean economy transformed through three phases, each reflecting an economic policy driven by the prevailing interest of the British. When the British defeated Italy and took over Eritrea in 1941, the Eritrean economy was at a standstill because of the war. However, as the British reconsidered the economy to support the war effort, the war-related projects created jobs and led to the revival of former light industries and the emergence of new ones (Travaskis (1975), cited in Negash, 1999:321).

As a result, hundreds of factories were either built or kept running during the early period, before the end of the Second World War, bringing even more Eritreans into the workforce. Besides that, substantial British and American military expenditures were made on ports, air bases, ammunition plants and storage depots by which the economy was boosted further (World Bank, 1994:3). During this period, Eritrea continued to be a successful exporting nation. For instance, at the time of the Second World War, when imports to the Middle East and East African markets were cut off from Europe, Eritrean industries stepped in to supply these markets. But this war-based growth of the economy only lasted for a short period, from 1943 to 1945 (Travaskis (1975) cited in Negash, 1999:322).

While the British geared the economy of Eritrea to their war needs, a second economic policy started to stem from the transient nature of the British occupation of the territory. The British did not commit themselves to major public investments, but looked for means to increase revenues for their administration. As one commentator observed, *“since they had no reason to subsidise an occupied territory, for which they are care-takers..., they had to sort out the problem by resorting to every reasonable means of increasing revenue and reducing expenditure.”* The British achieved these objectives by measures such as increasing taxes and imposing new fees on the Eritrean population and raising rates of duties on imported goods (Tsegai, 1981:146-148; Travaskis (1975) cited in Negash, 1999:323).

The British developed a third economic policy after the Second World War. The justification for their plan was to portray the future independent Eritrea as economically non-viable. To bolster this contention, they began to destroy its economy. They removed or sold an estimated £86 million worth of industrial plant and equipment, including port facilities at Massawa and Assab, factories producing cement, potash, salt, and railway equipment. The sales were made to the Sudan, Saudi Arabia, Egypt, Yemen, Malta, Israel, Italy and Pakistan, among others.

The dismantling of the plants and equipment, together with tax increases, led to economic crises and unemployment, thus adding fuel to the political consciousness and the formation of political parties with agendas for the country's future (Tseggai, 1981:150-153; Negash, 1999:323-324). As a foundation for the political consciousness created under the British rule, Firebrace and Holland (1984, cited in Negash, 1999:325) also discuss the creation of a distinct national identity in Eritrea, which was to become the basis for future demands of nationhood under Italian rule.

This historic economic situation made Eritrea among others a nation of skilled people with wealth of experience in entrepreneurship, commerce, and international trade. Also, the rapid expansion of the infrastructure and modernisation together with the overall economic development of the Italian and British period gave birth to the Eritrean Customs as practice and institution and shaped it.

4.3.2 Evolution of the economy: during federation and annexation by Ethiopia

4.3.2.1 Federation period (1952-1962)

As shown earlier during the period of the external rule as an Italian colony in the late 19th and first half of the 20th century and as a British protectorate during and immediately after the Second World War, Eritrea was established as a major economic force in sub-Saharan Africa, with a strong economy and well developed infrastructural, industrial and trade base (Emerton & Asrat, 1998:8-9).

However, following the end of the war contraction of investment started to appear and during federation it was further reinforced and entered into a long-term decline. Particularly, when Eritrea fell under the economic policies and a strategy followed by central Ethiopian government, the attitude towards Eritrea was totally negative. In elaborating this fact, Garcetti (1999) explained as follows: "*Ethiopia started to be in charge of a sharp decline in the Eritrean economy as Haile Selassie pursued development of Ethiopia with special focus on Addis Ababa and its environs at the expense of incorporating Eritrea. This was seeing as a way of helping pursue such strategies of economic development through the absorption of its relatively richer northern neighbour*".

According to the policy of weakening the Eritrean economy then, enterprises were asked to relocate to Ethiopia. Several key industries were closed and moved to Addis Ababa, the capital of Ethiopia. Their foreign owners were instructed to make the move or have their property confiscated. Moreover, foreign investment in Eritrea was discouraged. Enterprises that continued to operate in Eritrea stagnated due to a lack of basic supplies and infrastructure, such as electricity. These economic policies forced many foreign businesses to immigrate to other countries (Tseggai, 1981:155-156; Negash, 1999:325).

4.3.2.2 Post annexation period (1962-1991)

For Ethiopia, occupying Eritrea was not an end in itself. Ethiopia's ultimate objective was to take Eritrea's natural wealth, to exploit its comparatively developed economic resources and skilled workforce, and to gain access to the Red Sea. There were over seven hundred enterprises in Eritrea before annexation, and this number continued to decline during annexation due to the relocation of the enterprises to Ethiopia. Concurrently, thousands of skilled Eritrean workers emigrated to Ethiopia and other neighbouring countries, as many economic activities were shifted to Ethiopia (Tseggai, 1981:161-167; Negash, 1999:325).

In short, Eritrea subsidised the development of the modern sector of the Ethiopian economy. The old feudal economy of Ethiopia experienced an unprecedented transformation after it had incorporated the modern sector of the Eritrean economy, while the Eritrean economy faded away as a result. As the war for the independence of Eritrea intensified, the economy suffered even more. Especially after the Ethiopian military overthrew the emperor in 1974, it brought the main industrial plants, financial institutions, and transportation services under its control.

Moreover, under the military *Derg* regime (from 1974-1991), Ethiopia became subject to centrally planned policies and the regulations of a command economy⁷. As part of this regime most private assets in Eritrea were nationalised and private sector initiatives discouraged, and all sectors of the economy were subjected to heavy state control (World Bank, 1994:4).

Eritrea became increasingly marginalised in economic terms due to the overall stagnation of the Ethiopian economy, increasing neglect of Eritrea by the *Derg* regime, as well as because of the deprivations and disruptions caused by protracted fighting. Particularly, as Ethiopian political and economic influence decreased and the level of fighting for independence intensified starting from 1977 and continuing during the 1980s, industries closed down, institutions and infrastructure degenerated, national output declined sharply and there was severe structural

⁷ The *Derg* regime (1974-1991) that came to power by a *coup d'état* in Ethiopia, nationalised virtually all economic activities and subsequently introduced central planning as a basis to run the economy (IMF, 1998:4).

retrogression. During this period no concerted independent economic activity beyond basic production and subsistence agriculture could take place (Emerton & Asrat, 1998:8-9).

All in all, Eritrea's industrial growth has declined, deprived of the necessary infusion of new capital and technology as well as replacement of the existing capacity as a result of a deliberate deindustrialisation policy. In addition, the centrally planned policies and lack of foreign exchange to import essential inputs, the increase in the balance of payments and public sector deficits, the rise of unemployment and the decline in trade and production had a devastating effect on the economy and society of Eritrea. The once skilled and industrious modern workforce and the managerially, professionally and technically rich human resources had been extremely weakened due to coerced transfer to Ethiopia or immigration. The Ethiopian economy at large stagnated and with this the Eritrean economy reached a standstill.

4.3.3 Evolution of the economy: post-conflict reconstruction and recent developments

Although Eritrea was well advanced relative to other sub-Saharan African countries, decades of war, neglect, deprivation, lack of resources and inappropriate policies prior to 1991, have resulted in a weakened economy, damaged and decaying infrastructure, deterioration in the human resource base at independence. Along with the shattered economy and society, the provincial administration in Eritrea had little autonomy and policy-making capability. As a result, Eritrea has inherited withered institutions and instruments that were geared for managing a command economy (Haregot *et al.* 1993:16; World Bank, 1994:3).

Most public sector enterprises were non-operational, relying on outdated technology, weak management capacity and poor knowledge of markets and lack of access to foreign exchange. There was little private sector activity. However, since independence the economy has undergone reconstruction, and has been steadily growing and diversifying. A national strategy for growth has been promulgated which incorporates increasing deregulation, liberalisation and privatisation of the economy (Emerton & Asrat, 1998:9).

On the other hand, the independence of Eritrea provided the government with an opportunity to define a vision and a strategy for making up for decades of lost growth, and for catching up with the more successful developing nations. As Eritrea is also starting from scratch, it has an opportunity to learn from the experience of others, to assess what has worked elsewhere and what could be adapted to suit the Eritrean condition. To this effect, the government's development efforts and priorities since independence has been concentrating on rehabilitating and rebuilding war-damaged and destroyed economic and social infrastructures, creating and

strengthening the institutions of a new state, with a high priority on developing its own capacity to manage policies.

While the initial focus was on building upon the existing institutions, selected institutional restructuring and new policies that are more appropriate to a peacetime economy are also being introduced. In line with this, as World Bank (1994:9) reported, the government of Eritrea has stated its intent to adopt economic policies to move to a market economy, open to external trade, and to provide a strong role for the private sector. For this, as a crucial instrument and initial step, the laying down of a macro-policy and legislative ground-works for development, as discussed in section 4.4 (*Macro-economic policies and strategies*) took place. Additionally, the macro policy developed further into a new *National Economic Policy Framework and Programme* (NEPPF) and was made public in 1998, putting a strong emphasis on a market-based, export-oriented strategy, which was led by the private sector (EU, 2000:6).

In a short period Eritrea therefore made significant progress in restructuring state level institutions, establishing key elements of a functioning government, eliminating a number of restrictive policies from the colonial period, and expanding investment in human capital. Parallel to that, economic growth has averaged over four percent in the years 1993-1999, after declining by over one percent per annum during 1985-1993. In general the pace of growth was promising as discussed in section 4.5 (*Pace of the Eritrean economy*). However, overall realisation of the NEPPF was hampered by the war with Ethiopia in 1998-2000 with its grave consequences as reviewed in section 4.6 (*Future prospects of the Eritrean economy*)

4.4 MACRO-ECONOMIC POLICIES AND STRATEGIES

The overriding objective of the macro-policy (Eritrea, 1994b; Negash, 1999:329; IGAD, 2000:3) is that "... *the creation of a modern technologically advanced and internationally competitive economy within the next two decades...*" In achieving this objective, the macro-policy document, adopted in 1994 with further improvements over time, outlined a blueprint for Eritrea's national economic growth strategy in certain key areas.

Primarily, the macro-policy document embarks upon an economic reform programme aimed at initiating the transition towards a liberalised market economy with a focus on infrastructures among others. Secondly, it aims to eliminate many of the restrictive economic practices and controls established under the centrally planned *Derg* regime. And thirdly, it follows the guiding principles of human-centred, efficient, sustainable and equitable development. As a result the Eritrean economy is now characterised by an increasing degree of openness (Emerton & Asrat, 1998:10; US State Department, 1999:2).

Table 8: Summary of economic reform processes

Sector	Reform
<i>Public sector and fiscal management</i>	The role of the public sector is being redefined and the fiscal system has improved, with a hard budget constraint being imposed on all public sector enterprises to replace a system of allocating funds to ministries as needs arise (Emerton & Asrat, 1998:10). A series of tax reforms – the first in 1994/1995 and the second in 2001 – have been implemented, and parallel to that the tax base strengthened, resulting in increased government revenues (Eritrea 2001c).
<i>Private investment</i>	Commercial procedures and practices are being introduced and competition is being increased with the growing liberalisation of the economy. Properties that were nationalised in the former centralised economy are being returned to private owners (Privatisation proclamation No. 83/1995) (Eritrea 1995). A liberal investment code (Eritrea 1994a) has opened all sectors of the economy to private domestic and foreign investment and also aims to attract inflows from expatriate Eritreans. Foreign ownership of enterprises is allowed and investments are guaranteed against nationalisation, confiscation and other non-commercial risks (US State Department, 2000:22)
<i>Financial services, monetary and exchange rate</i>	The financial and banking systems have been deregulated, and private foreign and domestic banks are now permitted to operate in Eritrea. Until the end of 1997 Eritrea used the Ethiopian Birr as legal tender, and key elements of monetary and exchange rate policies were influenced by the macro-economic strategies pursued by Ethiopia. In 1997 a new financial frame work introduced a currency, the Nakfa, and established financial institutions (Eritrea 1997c), notably the Bank of Eritrea (Eritrea 1997a) (IMF, 1998:4; EU, 2000:6)
<i>External trade</i>	All public sector import and export agencies have been dismantled. All quantitative restrictions on imports have been eliminated and most tariff rates have been reduced. Now the highest import duty on consumer goods is 25% and on capital goods and spare parts 2%. Restrictions on exports have been also discontinued and all export taxes were dismantled (Eritrea 2000). Export license fees have been reduced and were made easier to obtain. Exporters are now allowed to retain 100% of their foreign exchange earnings (World Bank, 1994:10; Emerton & Asrat, 1998:10).

The macro-policy also underlined that the private sector will lead an export-oriented and market-based economy, and efforts will be made to establish Eritrea as an international and regional financial centre. The government will also adopt monetary and fiscal policies for the mobilisation and allocation of resources in order to stimulate growth. The policy also pledges to encourage domestic and foreign direct private investment, and to liberalise trade (Eritrea, 1994b:10-12, also

cited in Negash, 1999:329). To this end, a number of reforms have been implemented as summarised in Table 8.

Under these macro-economic conditions and with the rehabilitation and expansion of the physical infrastructure the industrial sector, the services sector including the sub-sectors of wholesale and retail trade, transport and communications, construction, financial and tourism services as well as investments in other sectors were growing before May 1998. For the future as well, export oriented foreign direct investment and tourism sectors are expected to be major sources of economic growth in Eritrea as discussed in section 4.7 (*Future prospects of the Eritrean economy*). In this context, customs reform can be seen as extended fine tuning of the macro-policy and further strengthening of the fiscal management.

4.5 PACE OF THE ERITREAN ECONOMY

According to the World Bank (1994b:4-6) real GDP contracted by 0,7 percent per annum during 1984/1985 to 1989/90. This was further intensified during 1990/91 with a negative annual growth rate of 7,2 percent. Since 1992, the Eritrean economy has recovered considerably, thanks to the rebuilding of the infrastructure and the improved availability of essential imports following the major economic reforms shown in Table 8.

Table 9: Gross domestic product by sector, 1993-1999

	1993	1994	1995	1996	1997	1998	1999
<i>Agriculture</i>	12,7	16,1	11,2	9,8	9,3	16,1	16,0
<i>Industry</i>	20,7	19,1	22,7	27,4	29,5	27,4	27,3
<i>Distribution services</i>	43,6	41,9	39,3	40,1	38,6	32,1	31,6
<i>Other services</i>	23,0	22,9	26,8	22,7	22,5	24,4	25,0
<i>Annual GDP growth</i>	-2,5%	9,8%	2,9%	6,8%	7,9%	3,9%	3,0%

Sources: (IMF, 1998:49 & IMF, 2000:24). The figures are in percent of GDP at factor cost.

According to IMF Staff Country Report No. 98/91 and No. 00/55 (IMF, 1998:4 & IMF, 2000:24), real GDP growth averaged above 4 percent annually during 1993-96 as depicted in Table 9. In 1997, the economy continued its strong recovery, and real GDP growth is estimated to have been 7,9 percent. The expansion in the economy was mainly supported by growth in the industry and services sector (trade and transport, communication) that made an important contribution to GDP, along with that of the agricultural sector, though the agricultural sector's share is small and volatile (see also Emerton & Asrat, 1998:9; US State Department, 1999:2; EU, 2000:6; IGAD, 2000:2;)

But, even though it improved significantly since Independence, the economic situation in Eritrea is still characterised by a number of constraints and weaknesses and the country still faces the massive task of reconstruction. For instance, in 1998, economic growth dropped to a mere 3%, as a result of the decline in economic activities caused by a border war with Ethiopia (IMF, 1997). The consequences of this war will be discussed in section 4.6 below.

4.6 FISCAL DIMENSION OF THE ERITREAN ECONOMY

When rehabilitation and reconstruction come into perspective, there are among others two pressures that could be expected. The first is that a strong expenditure puts pressure on the recurrent budget from expanding social and economic services, and the other is expenditure pressure on the capital budget from the increasing number of intended development projects. However, despite that fact, it is also a common wisdom to maintain a prudent fiscal policy while meeting critical social and economic needs. Doing so assists in establishing the credibility of the government's policies and provides an enabling environment for growth.

As Addison and Murshed (2001:5) stated, “...*post-war governments hope for a large fiscal peace-dividend. But among others, demobilisation and the creation of a smaller and professional military are expensive and they limit the size of the fiscal peace dividend in the immediate post-war years – unless external aid is forthcoming...*”

Similarly, in reporting the post-independence fiscal management, the IMF Country Staff Reports described the following: The fiscal outcome during 1993-96 was determined mainly by the one-off massive expenditure programmes⁸ peaking at 7,3 % of the GDP in 1995, and undertaken to rehabilitate and reconstruct the economy, as well as the reforms in the public sector. The overall deficit including grants doubled in 1995 to about 19 % of the GDP before moderating slightly to 16,4 % of the GDP in 1996. But in 1997 the fiscal deficit was sharply reduced to 6 % of the GDP (see Appendix 1), as the ambitious expenditure programme for rehabilitation and reform was completed. This decline is proved by the decrease in recurrent expenditure which had averaged about 38 percent of the GDP over 1993-1996 to about 24 % of the GDP in 1997 (IMF, 1997:7; IMF,1998:6)

⁸ The ambitious expenditure programme included road repair and construction; rehabilitation of power generation and transmission; civil service retrenchment of some 10 000 people; demobilisation and settlement of over 54 000 ex-combatants; compensation of war victims (payments to bereaved families) and resettlement of about 190 000 returning refugees. The wage bill in particular, grew very rapidly as a result of compensation of retrenched workers and substantial wage and salary increases, some of which included significant back pay (IMF, 1998:5)

On the other hand, total revenue increased by 43 %, as the government undertook measures (as shown in Table 8) to increase revenue collection during this period (see Table 3 and Appendix 1). As a result, total revenue, which had averaged about 26 % of the GDP between 1993-96, increased to about 33 % of the GDP in 1997 (IMF, 1998:6). However, the course of progress was interrupted by the outbreak of war in May 1998, which is a shock for the Eritrean economy that slowed down from shooting. During the conflict, the fiscal deficit, including grants increased from 6 percent of GDP in 1997 to 59 percent in 1999, before falling somewhat in 2000 (Brondolo *et al.* 1998:6).

Moreover, the border conflict with Ethiopia has greatly slowed the Eritrean economy in addition to the disruption of trade relations between the two countries. A weak export-base and extreme dependency on imports of mainly capital goods that are necessary to rehabilitate the country's infrastructure and industrial base, have resulted in a large trade deficit in hard currencies. As a result, the trade deficit in 1998 was estimated at about 60% of GNP (US State Department, 1999:5-6).

In the same way, according to the IMF Country Staff Report (1997:7; IMF, 1998:66; IMF, 2000:42; Addison & Murshed, 2001:6), before the war together with the costs of the new defence force and the settlement of the army's wartime pay arrears, Eritrea's military spending averaged 15-23 per cent of the GDP between 1993-94, and continued with a declining trend, reaching as low as 3,4 percent of the GDP in 1997. When war broke out in 1998, it sharply increased and reached 17,2 percent of GDP in 1998. That is, 62,4 percent and 60,5 percent of total government spending in 1998 and 1999 respectively, as shown in Table 10 and Figure 7.

Table 10: Defence and social services spending

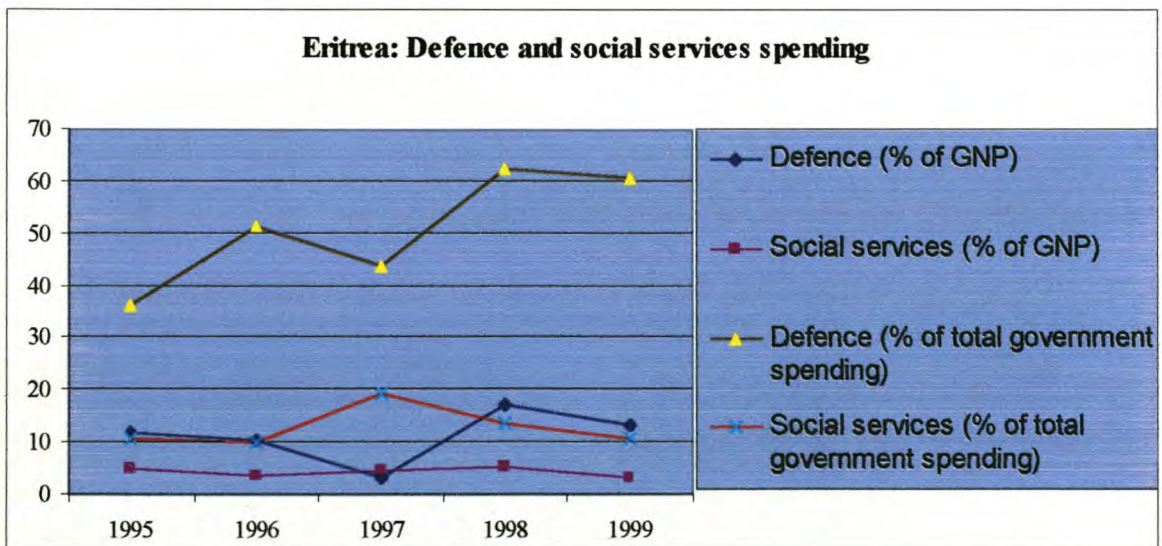
	1995	1996	1997	1998	1999
<i>Defence (% of GNP)</i>	11,8	10,4	3,4	17,2	13,2
<i>Social services (% of GNP)</i>	4,9	3,7	4,7	5,4	3,4
<i>Defence (% of Total Government Spending)</i>	36,1	51,4	43,9	62,4	60,5
<i>Social services (% of Total Government Spending)</i>	10,6	9,9	19,3	13,8	10,6

* The figures for 1999 include only the months from January to October.

The conclusion that could be drawn is that Eritrea certainly cannot achieve its development objectives while defence takes an extraordinarily significant share. Positive fiscal effects are eventually forthcoming if and only if peace prevails. Among others the underlying reasons of war effects, as expressed by Addison (1998 cited in Addison & Murshed, 2001:8) are the following:

- firstly, war increases uncertainty. This is often magnified by policy reversal (or simply policy chaos), which becomes more common in wartime. Therefore the investment decisions of economic agents – communities, the private sector, and government itself – become skewed towards activities with short-term returns;
- secondly, communities focus on subsistence activities to meet their immediate needs, switching away from investments with longer term returns;
- thirdly, the private sector concentrates on commerce, both internal and external, and in safe areas, which needs less fixed capital than production to take advantage of the economic rents generated by war, and
- lastly, public investment stalls, as public spending is redeployed to war and government employees focus on their own survival, reducing their incentive to maintain institutional capital for the long term and their resistance to corruption declines.

Figure 7 Eritrea: Defence and social services spending



With the signing of a peace accord in December 2000, Eritrea is emerging from a period of conflict which put severe pressure on its public finance. Hence strengthening of public finance is essential to the government’s goals of achieving macro-economic stability and economic development. To this end, actions will be needed that place the fiscal system on a sound basis.

Hence among others, further strengthening of tax and customs administration, as well as reforms in the revenue and expenditure management systems are required. In this context and at the micro-level the role of standardised customs operations could have an important impact in the economic activity as a means of increasing the trade activities and tourism flow together with foreign direct investment for generating export commodities as discussed in section 3.4 (*Customs reform: stating the causes, consequences and variables*)

To sum up, in restoring the fiscal deficit and in achieving the required level of growth as well as in making hard choices and priorities of implementation, fiscal discipline is a crucial factor. Fiscal discipline builds trustworthiness that rewards external assistance. As 'the country commercial report' by US State Department (1999:5-6) witnessed, despite the war multilateral lenders have been impressed with the government's efforts at fiscal discipline and are becoming more generous in providing external financing needed for reconstruction and development.

4.7 FUTURE PROSPECTS OF THE ERITREAN ECONOMY

When the issue of comparative economic advantage comes into perspective, Eritreans agree that the country's strategic location can play a major role in its economic development. Eritrea has direct access to major world shipping lanes through the Red Sea, making import and export trade convenient and cost-effective. The strategic location also puts the country in a good position to be a hub for production, distribution, and financial services for the region.

These economic activities involve the development of infrastructure such as storage facilities for goods to be exported and imported to and from the region, efficient transportation and telecommunication networks, and adequate supplies of water and energy. These activities in turn lead to the development of technically-skilled workforce, transfer of technology, and efficient public administration, all of which also require great investment in education (World Bank, 1996b). Together with the aforementioned economic activities, the role of customs administration becomes significant. Customs administration therefore as facilitating and enforcing institution, if well aligned concurrently with the other developments could be able to accommodate the following three main focal points of the Eritrean economy.

4.7.1 Promoting export

Eritrea is suitably located for foreign trade activities. Historically Eritrea, with its strategic location and easy access to the markets of the Middle East and the rest of Africa, has been a trading nation. In the 1940s Eritrea's export base was relatively diversified, while transit trade through the ports of Massawa and Assab became increasingly important (Negash, 1999:320). According to the World Bank report (1994:31), Eritrea apparently earned nearly hundred million

US \$ worth of foreign exchange per annum from exports in the early 1970s. In the 1980s and 1990s, however, exports declined dramatically. In 1992, the level of exports had fallen to under ten million US \$. However like the rest of the economy, the export sector suffered from the liberation war and inappropriate policies of the past.

Likewise, as foreign trade activities have been dominantly run by foreigners, beginning with the Italian colonialism, it seems that a vacuum has been created after the liberation of the country. Thus, the vacuum needs to be filled through active and efficient involvement of Eritreans in foreign trade activities. The government has been actively encouraging trade activities. It has lifted duties on export items and the import taxes have been reduced substantially (IRD/UNICEF, 1993:199).

On the other hand, as export expansion has been a hallmark of all fast-growing economies, promoting export of goods and services will be critical for the Eritrean economy. In this effort, what is demanded from Eritrea as the World Bank (1996) pointed out is that it should continue to implement and deepen its policies towards a liberal trade regime, to promote foreign and domestic investment, and maintain a pragmatic exchange rate policy along with rehabilitation of critical overall infrastructures. Because of the small size of the Eritrean economy, significant economic growth and transformation can only take place if Eritrea exploits its inexpensive yet industrious labour force, all opportunities for export of goods and services, both traditional and new, and is open to foreign investment (US State Department, 1999:2).

There are several reasons why an export led growth strategy would be appropriate for Eritrea (Eritrea, 1994b:30-31; Negash, 1999:343). The following reasons could *inter alia* be identified:

- Eritrea could take advantage of its strategic location in the north-eastern part of Africa and a long history of sea-trade through the two ports of Massawa and Assab;
- Eritrea has the potential for expanding exports, as evidenced by its past performance and industrial tradition, as discussed in section 4.3.1 (*Evolution of the economy: during Italian and British administrations*) although re-establishing the export base will take time;
- Eritrea could take advantage of the skill, knowledge and wealth of its expatriate community;
- Eritrea has a small domestic market with a population of 4,5 million. Once domestic needs have been met, export expansion would become the main engine of growth;

- since decades of war and neglect have deprived Eritrea of the necessary infusion of new technology and skills as discussed in section 4.3.2 (*Evolution of the economy: during federation and annexation by Ethiopia*), openness to international markets could be a major channel for technological improvements, and
- the foreign exchange needs of the country are immense and makes it necessary for export earnings and private foreign investment to fill the gap, as discussed in section 4.3.3 (*Evolution of the economy: post conflict reconstruction and recent developments*).

4.7.2 Promoting investment

As discussed in section 4.4 (*Macro-economic policies and strategies*), the Eritrean government, in coordination with the World Bank developed, a liberal economic macro-policy as an initial step to foster its goal of economic development with enough consideration for foreign investment. For this, Eritrea has adopted liberal investment policies while shifting its emphasis from centralised control. Accordingly, the government has issued its Investment Proclamation No. 59/1994 (Eritrea 1994a), in consistence with its rational development strategy, aimed at developing an outward looking private sector led market economy. As a result of decades of lost opportunity, investment Proclamation No. 59/1994 is expected to stimulate the mobilisation and the development of capital, technology, and skilled workforce that Eritrea lacks, from domestic and foreign sources.

In its investment incentives designed to promote investment and economic growth through liberal trade, Proclamation No. 59/1994 offers low rates on import tariffs for manufacturing inputs according to the tax code (Customs Tariff Regulations No. 18/1994 and later No. 52/2001). Similarly, Investment Proclamation No. 59/1994 provides for a nominal customs duty of two percent on imports of capital goods and industrial spare parts. Raw materials and intermediate inputs are taxed at three percent, while duties and taxes on inputs and other materials used for exports are rebated (article 8 (2) of Investment Proclamation No. 59/1994).

Eritrea's export trade is even more liberal. There are no duties or taxes on exports, which is indicative of the export-oriented economic policy of the government (article 8 (3) of Investment Proclamation No. 59/1994). In addition, the Bank of Eritrea, for example, is obliged to give priority to exporters in the allocation of foreign exchange. Moreover, investors may retain up to one hundred percent of their export earnings in Eritrea (article 11 (3) of Investment Proclamation No. 59/1994). The investment code offers no pre-requisites for joint venture. Thus, foreign investors are allowed to maintain one hundred percent ownership of their investment (article 11 (4) of Investment Proclamation No. 59/1994).

Moreover, unlike many other developing countries' investment codes, Eritrean Investment Proclamation No. 59/1994 does not differentiate between local and foreign investors, and treats domestic and foreign investors equally in getting access to land, utilities and other production units. All areas of investment are open to both domestic and foreign investors (article 5 (1) of Investment Proclamation No. 59/1994). The only exception in the proclamation restricting foreign investment is the provision that reserves domestic retail and wholesale trade, import and commission agency solely for Eritreans (article 5 (2) of Investment Proclamation No. 59/1994).

Furthermore, the government has already taken genuine and practical steps towards the privatisation of state-run enterprises (Privatisation proclamation No. 83/1995), and for further liberalising the country's foreign exchange market, Eritrea issued the Financial Institutions Proclamation No. 74/1997, opening the banking and insurance sectors to the private sector and the national bank of Eritrea adopted a free-floating exchange rate. According to this regulation each bank will set the exchange rate where anyone can convert Nakfa to hard currencies freely. Regarding conversion and transfer policies, the investment proclamation also allows all foreign investors to remit freely profits and dividends in foreign exchange. In accordance with the regulations by the Bank of Eritrea, expatriate employees are guaranteed to remit savings from their salaries (US State Department, 1999:7). To sum up, in promoting investment, Eritrea has the following key relative advantages:

- 1) Eritrea's regulatory system is fair and honest. Business negotiations and transactions are fairly transparent. Government laws and policies on labour, health and safety, insurance, and finance do not impede investment (US Department of State, 1999:23)
- 2) Corruption is not an impediment to FDI. Eritrea takes stringent legal measures against corruption. In 1996 the Eritrean Government (GSE) established a special court that deals with cases of corruption and embezzlement.
- 3) Eritrea is a signatory of the *Multilateral Investment Guarantee Agency* (MIGA) for its investment insurance programmes and the *International Convention on the Settlement of Investment Disputes* (ICSID) (US State Department, 1999:24). Thus, article 15 (2) of Investment Proclamation No. 59/1994 guarantees protection against political risk through MIGA. Membership entitles foreign investors in Eritrea to get insurance against political risk for their investments. Eritrea joined MIGA to further its goals of collaboration with other sovereign states and competent international organisations in the monetary and financial arena. The admission of Eritrea to MIGA, given the growing role of the agency, helps to make a positive impact on FDI decisions in Eritrea (Negash, 1999:363)

4) Despite skilled workforce scarcity in many fields, Eritrea has an inexpensive, but highly motivated, industrious and disciplined workforce and the country enjoys labour peace. In the light of the aforementioned facts, Eritrea already has been winning reputation. A clear indication of this, as explained in *Eritrea: Country Commercial Guide for fiscal year 2000* (US State Department, 1999:3) is that both the *Wall Street Journal* and the *Christian Science Monitor* have reported the country as being a “*stable and promising environment for private sector investment.*”

4.7.3 Promoting tourism

Eritrea has potential for a tourist industry. Eritrea’s strategic location on the Red Sea coast and diverse marine life, untouched beautiful beaches and numerous of small, sunny Red Sea islands, nine nationalities/ethnic groups with different languages, fascinating cultures and traditions combined with its political stability and a low crime rate, provide in the country’s favour the setting for a potentially rewarding tourist industry. Besides, Eritrea’s close proximity to both Europe and the Middle East, air connections, the abundance of historical and archaeological sites, and rich supply of natural resources and beauty that can be enjoyed by all visitors add to the attractiveness of the country. This confirms that the prospects for increased growth in tourism are very high (US State Department, 1999:14; Negash, 1999:334).

However, as with other sectors of the economy, the border war with Ethiopia has greatly damaged the tourism industry. The number of visitors declined by over 60% in 1998, resulting in a substantial loss of foreign currency earnings as shown in Table 11.

Table 11: Inflow of non-residents and investment in tourism

Visitors in millions	1995	1996	1997	1998
<i>Total number of visitors</i>	0,692	0,889	0,409	0,187
<i>Total number of Eritrean visitors of the Diaspora</i>	0,482	0,561	0,293	0,053
<i>Total number of non-Eritrean visitors</i>	0,254	0,328	0,116	0,134
<i>Total investment in millions</i>	US \$25	US \$25	US \$15.2	N/A

Source: Eritrean Ministry of Tourism, cited in US Department of State (1999:15).

To sum up, the tourist industry has not been developed but the potential is there. Thus, development of this sector of the economy, which started after liberation, will take time and will require significant capital investment.

4.8 SUMMARY

The generation-long war for independence and neglect and decades of lost opportunities for growth have left the Eritrean economy, the infrastructure, and human resources of that country in a state of ruin. The government has inherited a heavily regulated and centrally planned system together with degraded fiscal institutions. Accordingly, the transition towards building new institutions and developing new instruments for managing a peacetime market-based economy, as well as for fully rehabilitating the economy and society will take time.

On the other hand, the broad picture is clear: world trade in goods and services, foreign direct investment, increased financial and tourist flows all suggest growing interdependence, and this interdependence affects the whole society. In the light of this interdependence the government is not out of that environment, on the contrary it is on the frontline. As a result of the fact that interdependence is unavoidable, and recognition of export expansion as a main engine of growth in Eritrea, the government of Eritrea has already initiated several measures to promote exports through policy reforms and rehabilitation efforts. For instance, the economic reforms carried out by the government so far have greatly improved the regulatory environment for exports. However, the current low level of export suggests that there is more to be done in order to expand this export potential of Eritrea.

Encouraging greater FDI could be a way for overcoming export constraints by setting up new enterprises with new equipment, technology and work practices, in addition to supplying the Eritrean market (World Bank 1994:32). As US State Department (1999:22) confirmed, political stability, an eager and inexpensive yet industrious labour force with a strong work ethic, minimal government corruption and recent steps of streamlining of the civil service by the government on one hand. Capitalising on Eritrea's strategic location for exporting finished goods to international markets on the other, contribute to this as being incentives to Eritrea's attractiveness to both private investors and lenders.

As discussed in the current chapter, the state reforms that have already carried out are designed to create a favourable atmosphere among others for the three core potentials for economic growth in Eritrea, namely investment, export and tourism. However, these potentials collectively require the modernisation of Eritrea's customs if they are to contribute positively to the Eritrean economy. Therefore, in line with the macro-policy reforms and identified potentials of the Eritrean economy, reform and modernisation measures in customs come into perspective. The next chapter will focus on the analysis of the current Eritrean customs practice in order to be able to identify the measures required for customs reform and modernisation in Eritrea.

CHAPTER 5

ANALYSIS OF CUSTOMS PRACTICE IN ERITREA

5.1 INTRODUCTION

As discussed in section 4.1 (*Introduction to the context of the Eritrean economy*), in this chapter the micro-approach is used to analyse the customs practice at the grass roots level. Therefore, this chapter contains the analysis of the actual customs practice in Eritrea. The outcome of the analysis, as the purpose of this empirical research, will be to recommend issues and findings as options for reform measures. In the light of the reviewed conceptual framework of customs in the previous chapter, the objective of these suggested measures of reform is to serve as fine-tuning of the macro-economic reform undertakings. Moreover, when seen from the perspective of efficiency, effectiveness and accountability in the delivery of public service in general and customs service in particular, the recommended measures of customs reform are aimed at satisfying the constitutional obligation of improving public performance.

In this regard the Constitution of Eritrea (Eritrea 1997b: 10), as a foundation for “*What should the state do concerning competent public service*” prescribes the following:

- *the civil service of Eritrea shall have an efficient, effective and accountable administrative institution dedicated to the service of the people*[article 11(1)], and
- *all administrative institutions shall be free from corruption, discrimination and delay in the delivery of efficient and equitable public services.*[article 11(2)]

This plainly indicates that reform as instrument of effectiveness and efficiency in service delivery and as a means of adapting to a changing situation has regulatory roots.

5.2 ERITREAN CUSTOMS: GENERAL

▪ Customs functions

The Eritrean customs administration plays an integral role in the facilitation of movement of goods and persons entering or exiting the borders of the country. Depending on the customs mandate and priorities in accordance with Customs Proclamation No.112/2000 (Eritrea 2000), customs core functions are to:

- a) Administer trade policy measures and industry protection schemes by enforcing customs as well as related trade laws;
- b) Collect duties and taxes;

c) Administer community protection by ensuring the social welfare of the citizens of the state by controlling the import and export of prohibited and restricted goods;

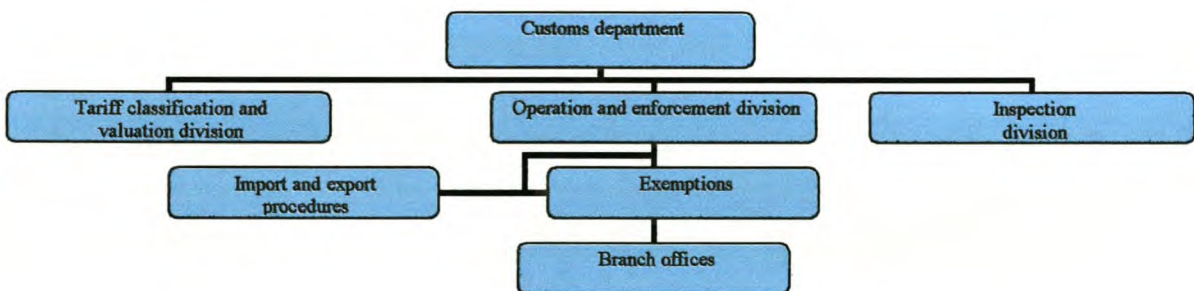
d) Ensure timeous clearance of goods and to facilitate the speedy movement of travellers through Eritrean borders (MOF, 1995; MOF, 2001:54).

Moreover, the passing of the Customs Proclamation No. 112/2000 that came into effect on 23 October 2000 effectively made the organisation an authorised body to administer the provisions of the proclamation as Department of Customs of the Ministry of Finance, by superseding the former Proclamation No. 145/1955 introduced during federation period⁹ and all amendments thereof.

Customs organisation

Currently, at head office level the department of customs is managed under the leadership of a director general who reports directly to the minister (article 5 of Customs Proclamation No.112/2000). The three key divisions that are responsible for the main customs tasks are: customs operations and enforcement division, tariff classification and valuation division and inspection division, as shown in Figure 8 (MOF, 2001).

Figure 8: The current organisational structure



Arrival of goods/passengers in Eritrea:

Goods arrive in Eritrea by one of the following modes of transport: air, sea, road, rail or post. In order for customs to collect any revenue due to the state and to ensure compliance with national legislation, the importer must declare to customs what he/she has brought into the country and the mode of transport utilised. Most traders are located in Asmara and clear goods through the

⁹ Tseggai, (1981:155) and Negash, (1999:324) discuss the weakening of the Eritrean government's economic power, when the Eritrean government had deprived from the sources of revenue, such as customs, by the government of Ethiopia).

port of Massawa, or the railway station and the airport in Asmara. Approximately 90% of the goods entering Eritrea come through the port of Massawa. However, not all shipments are cleared in Massawa, as some of the shipments are sent for customs clearance at the Asmara railway station.

The majority of importations and exportations are finished goods destined for the consumer market (see Appendix 2, 3, 4 & 5). Among these markets, post-independence trade with Ethiopia stayed dominant until 1998. Thereafter it showed dramatic change, as shown in Tables 12 & 13.

Goods and passengers that arrive at or depart from the State of Eritrea, formally pass through approved places of entry at land border, inland offices, airports and harbours. Thus, apart of the headquarters in Asmara, the customs department consists of all the major entry/exit customs stations (as shown in Table 14) in the country as branch offices, of which the most important are the ports of Massawa and Assab (see Figure 9: Map of Eritrea).

Table 12: Exports 1993-1998

Exports	1993	1994	1995	1996	1997	1998
<i>Total of all exports</i>	209,2	397,1	528,8	520,4	375,3	196,9
<i>Export to Ethiopia</i>	130,4	207,5	354,2	335,9	238,1	52,2
<i>Export to Ethiopia as a percentage of the total</i>	62,3	52,3	67,0	64,5	63,5	26,6

Source: Customs office (IMF Report No. 98/91, 1998:77; IMF Report No. 00/55, 2000:53). The figures are in millions of Nakfa (*see footnote-1*).

Table 13: Imports 1993-1998

Imports	1993	1994	1995	1996	1997	1998
<i>Total of all imports</i>	1022.8	1993.1	2535.5	3062.8	3062.0	2693.0
<i>Imports from Ethiopia</i>	66.4	90.9	146.8	261.7	274.6	24.9
<i>Imports from Ethiopia as a percent of the total</i>	6.5	4.6	5.8	8.5	9.0	0.9

Source: Customs office (IMF Report No. 98/91, 1998:78; IMF Report No. 00/55, 2000:54). The figures are in millions of Nakfa (*see footnote-1*).

Table 14: Approved places of entry/exit

Operation spots	Customs office and border between Eritrea and –
Land border posts	<i>Sudan</i> — Ghirmaika, Tesseneay <i>Ethiopia</i> — Omhajer, Adiquala, Seneafe, Bure <i>Djibuti</i> — Ghahro
Inland customs offices	Asmara railway Asmara post office Aqurdet
International airports	Asmara airport Massawa airport
International harbours	Red Sea—Massawa port, Assab port, Erafaile, Tio and Ghelealo

Figure 9: Map of Eritrea



5.3 CUSTOMS LEGISLATION

The Eritrean customs administration stayed operating on the basis of the customs Law used under the Ethiopian Administration until superseded on 23 October, 2000. The basic customs Law that had been in use, dated back to 1955, with changes and complements by various amendments and regulations thereof (Goorman *et al.* 1994:51; MOF, 1995). However, according to the discussion in section 2.7 (*Public service reform: regulatory approach*), a central requirement for successful government response to the challenges of globalisation is effective regulatory reform and the development of a more efficient, less intrusive public service regulatory capacity. Similarly, as indicated in section 3.4.2 (*Consequences: customs reform priority components*) an old legislation that does not meet the recent requirements of the international trade causes loss of time for both traders and customs organisations. A contemporary legislation, on the other hand, should create a balance between customs control

and trade facilitation and should be in harmony with other agreements and conventions in which a country is taking part.

In the light of the aforementioned, the regulatory framework of the Eritrean customs was fraught with loopholes. Among its shortcomings were inadequate provisions for the inward reporting of goods by carrier; a lack of clear treatment of the various customs regimes; inadequate valuation provisions, including lack of clarity as regards the exchange rate to be used for converting values expressed in foreign currency to values expressed in domestic currency, and above all the legislation was not providing for any enforcement provisions that would allow customs to take punitive action against importers who have circumvented the law (Goorman *et al.* 1994, 51; Brondolo *et al.* 2001:45).

Moreover, the customs tariff classification that stayed in operation was based on the *Standard International Trade Classification* (SITC), utilising a limited number of commodity categories. This classification system was not in conformity with the standard international practice, as most countries use the *Harmonised System* (HS) which was discussed in section 3.2.2 (*Customs tariff nomenclature*). The adoption of the HS is a prerequisite for the modernisation of tariff and statistical systems and enables the implementation of computerised import declaration processing (Chand *et al.* 1993:21; Goorman *et al.* 1994:38; MOF, 1995).

❖ Depending on the aforementioned legislative practice the following findings and issues could therefore be deducted:

• ***Customs administration cannot operate in a modern environment with out the necessary legislative framework.*** The Eritrean customs procedures that were based on outdated legislation were long and cumbersome, requiring importers to take many unnecessary steps in order to gain release of their goods. The very different ways in which modern customs administration is conducted, requires a legal mandate not found in the law stayed in application. Therefore the enactment of a more appropriate legislative framework and associated regulations remained as a critical step towards modernisation of the customs administration in Eritrea.

Accordingly, customs Proclamation No. 112/2000 was enacted. It contains a number of measures to modernise the customs administration, including provisions for the processing of declarations (articles 13-15), for the *Harmonised Code System* for classification of goods (article 16) and its supplementary Legal Notice No. 52/2001 for customs tariff regulations and classification, for the introduction of the GATT methods of valuation of goods (articles 17-26), provisions for enforcement (articles 61-63) and exchange rate (article 32), among others.

Furthermore, along with the HS tariff classification, the rates of duty has been reduced significantly in the range that was formerly as high as 200%, and since 1994 that had stayed as high as 50%. Currently it is between 2% and 25%. However, in spite of the new provisions, some aspects, such as HS based statistical information is still lacking. As a result, customs does not have statistics on the value of imports by tariff heading and therefore is not able to determine with any precision the impact on revenue of the change of rates and exemptions, among others. This practice compromises timely analysis and decisions on customs issues as discussed in section 3.4.3 (Variables: institutionalising customs modernisation).

- ***In line with the new legislation, the customs staffs are to require restructuring and substantial training before the new act can be put into practice.*** Training preparations and restructuring will be required before many of the provisions of the new proclamation can be brought into operation. For instance, training is needed in the newly introduced customs practices, such as on the topics of valuation and on the rules of origin and on *Harmonised Tariff Nomenclature System* that should be performed by the research and planning division, as shown in Figure 10. Organisational restructuring is also needed for a customs enforcement division, which is not in the current organisational structure (see Figure 10).

- ***In the scope of application and coming into force of Customs Proclamation No. 112/2000, article 2(3) still suspends most of the newly introduced provisions.*** The reporting of imported and exported goods (articles 13-16), the provisions of valuation, origin of goods and calculation of duty (articles 17-32), the provisions of drawbacks and outward processing (articles 54-56), the provisions of enforcement and powers of officers (articles 61-64) are for instance the main ones that haven't yet come into effect. Unless these provisions become effective sooner, no adaptive measures are possible to shift the current customs practice.

- ***The new proclamation gives the relevant minister discretion to prescribe and specify enforcement orders, regulations and legal notices when he/she deems it necessary.*** However, the Eritrean customs lacks customs publications, releases and public relation activities, and more importantly, lacks customs education, among others, to update the public and the stakeholders of changes and effects on the regulatory environment. In that case either the proclamation needs to be full-fledged by means of amendments and appendices as the only source of public information without leaving room for ambiguity, or the public relations task should be reconsidered.

5.4 ORGANISATION AND HUMAN RESOURCE

Customs had its own autonomous administration in the pre-independence era. That is, the department was made up of three divisions, each with its own administrative, legal and statistics, planning and research staff to support it. After independence a general restructuring programme of the government was undertaken during 1994-1995. As a result, important staffs like administration, legal, research and training were centralised under the ministry of finance's central office. (MOF, 2001:52).

The organisational structure as reflected in the organisation chart is not fully in effect yet due to staffing problems. Moreover, because of the action taken, the structure became fragmentary and failed to provide adequate conceptual and operational support for effective management (Goorman *et al.* 1994:42). For example, after restructuring the primary task of the customs department was concentrated in drafting the customs law, regulations and guidelines. This important task reveals the need for having a legal staff within the customs department. In addition, it became difficult to perform recruiting, budgeting and activities such as purchasing in a much centralised administrative situation, which is performed currently at ministry head-quarter level (MOF, 2001:52).

Furthermore, there is a separate agency for customs security and surveillance functions, referred to as the Finance Police. This customs enforcing agency operates independently from the Customs Department and reports directly to the Minister of Finance. Though the staffs of the finance police are assigned to customs service and located at all customs stations with the primary responsibility for security and customs enforcement, the finance police has its own organisational structure and is not fully integrated into the customs organisation (Goorman *et al.* 1994:42; MOF, 1995; Brondolo *et al.* 2001:46).

Across the country, the customs department has an authorised staff of 360 officers, but as indicated in table 15, only 164 of these positions are presently filled. Furthermore, functional descriptions for the existing organisation have not been fully developed yet. Moreover, in the area of human resource base, the main problems are first, the scarcity of trained and experienced personnel, and a shortage of staff as regards to surveillance and security, i.e. finance police and second low salaries (MOF, 1995; Brondolo *et al.* 2001:46).

In addition in the current staffs, a large part of the personnel consists of newcomers, mainly officers transferred from other ministries, graduates and former freedom fighters with no previous customs training or experience. According to customs department's human resource assessment report, only about 25% of the total staff has any experience in customs work.

Though the headquarters has arranged for some basic training of newcomers by senior headquarters' officers, an appropriate training system is lacking. The lack of trained personnel largely impedes the proper functioning of the service and the efforts to strengthen and modernise it (Goorman *et al.* 1994:44).

Table 15: Customs department staffing levels

Location	Headquarters	Asmara airport/rail way/post office	Port Massawa/Assab	Other entry points	Total
<i>Authorised position</i>	72	60/39/6	39/46	98	360
<i>Positions filled</i>	52	38/32/5	17/5	15	164
<i>Vacancies</i>	20	22/17/2	22/41	83	196

Sources: extraction from MOF, (1995); Brondolo *et al.* (2001:41); MOF, (2001:86).

As regards management reporting, though there is a requirement for stations to provide monthly reports to headquarters, during which time customs stations submit to the director general some basic statistical information, such as the number of declarations processed for that month, headquarters does not set any formal performance targets for customs stations to achieve. Hence, it seems there is no clear linkage between staff numbers and workload in individual stations (Brondolo *et al.* 2001:47).

Moreover, if the customs department does not have a comprehensive system of performance measurement, there is little data available to assess the effectiveness and efficiency of customs administration fully. One of the indicators of performance (see Brondolo *et al.* 2001:48) is the amount of time required to clear goods once an importer has submitted an import declaration. Currently the system of customs declarations in Eritrea relies almost exclusively on manual processes. This will be discussed in section 5.5 (*The import declaration process*). However, this declaration system could not be considered to be robust and would quickly collapse once trade volumes increased. Hence performance measurement in the clearance cycle is one of the proper steps towards addressing this issue.

One of the advantages of the clearance cycle time approach to facilitation is that it is performance-based, and it permits flexibility for each customs station/branch office to implement changes adapted to its particular environment, rather than trying to apply rigid formulas that could work in some customs stations but not in others. In general, it is critically important to put a measurement system in place so that customs can demonstrate with concrete objective that it leads the way to achieve the real advance in trade liberalisation.

- ❖ Depending on the aforementioned organisation and human resource base the following findings and issues could therefore be deducted:

- ***In times of continuous change it is necessary to bring about a flexible organisation structure suitable for the specific institution.*** Therefore, to bring the organisational set-up of the Eritrean customs up-to-date and in line with its required functions and tasks, the following organisational structure is proposed.

1) **The operations division** is responsible to administer all entry points as branch offices of Sea Operations, Air Operations and Road/Rail Operations (see Table-14) and is responsible for performing tasks such as import-export processing, administering warehouses and duty free shops, temporary admissions, drawback and outward processing, exemptions, activities of clearing and forwarding agents. The formerly mixed function of customs enforcement, as shown in MOF (2001:54-55), needs to be a division on its own (see Figure 10).

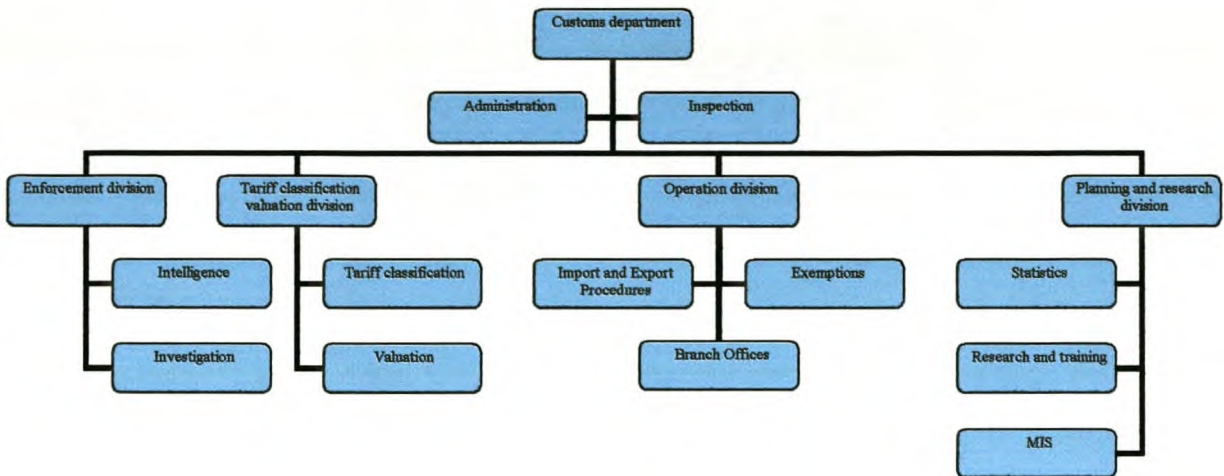
2) **Customs enforcement division**, which should be responsible for the tasks of enforcement programmes such as intelligence, audit, inspection and investigations in accordance with customs Proclamation No. 112/2000, article 62-64 of enforcement and article 67 of post-release auditing provisions.

3) **The tariff and valuation division** is responsible to manages and to coordinate all customs functions related to auditing, refunds, tariff classifications and valuation rulings and appeals among others as indicated in MOF (2001:55). This division will be basically responsible for articles 16-36 of Customs Proclamation No. 112/2000 and Customs Tariff Regulation No. 52/2001.

4) **Planning and research** will be responsible for the customs Management Information System (MIS) and for translating legislation into operational policies and procedures as well as ensuring standard application of law, policies and processes by way of continuous training for staff members. In addition this division organises and analyse all statistical data of revenues, impact of tariff rate changes and exemptions, among others.

- ***An integrated enforcement substructure is responsible for enforcement.*** Even though the enforcement function is traditionally an integral part of any modern customs administration; it is not explicitly recognised as a function of the customs department in Eritrea. Instead, the enforcement function rests with finance police, who operate independently (Brondolo et al. 2001:47). In contrast, most countries with effective customs administrations do not have a finance police, but instead assign enforcement responsibilities to the customs Department (WCO, 2000b:29).

Figure 10: Proposed organisational structure



From this situation two basic problems emanate that reduce the efficiency and effectiveness in customs administration. These are a) related to line of command b) related to selective inspection and post-release audit procedures.

a) While at first glance the existing arrangement seems to work well, the lack of integration causes management problems. For example, the Director General for Customs at central level has to go through the central and local chief of the finance police each time staff has to be assigned to security/surveillance or certain administrative tasks. Such an arrangement hinders administrative efficiency and stands against the principles of line of command.

In general therefore, the lack of an adequate organisational structure could greatly hamper customs in their efforts to operate efficiently in the face of an increasing work volume and the responsibility of customs due to the expected expansion of import and export trade. This, among other shortcomings, shows that the restructuring programme did not give customs adequate power to perform its activities.

b) The finance police have become involved in a front-end customs process, which frustrates the attempts of customs to implement new procedures. In the best practices of customs administrations, as discussed in section 3.4.3 (*Variables: institutionalising customs modernisation*) to deliver better enforcement with more facilitation and less bureaucratic red tape, all at a reduced cost, procedures that grant selective inspection and post-audit privileges to pre-authorised importers are recommended. These procedures provide expedited clearance of goods but with the requirement that the company/trader report any discrepancies that he/she

becomes aware of. If no discrepancies are reported by the company/trader, but are later found through customs' audit activities, the importer would be penalised.

However, this procedure can be frustrated by the actions of the finance police who may, as a result of their own enforcement activities at the customs station, seize goods on the spot. In this way, the lack of coordination between the two agencies clearly is a counter-productive outcome and presents an obstacle to the modernisation of customs administration.

• *The staffing situation in the customs department will become more pressing once trade resumes on normal bases.* The immediate staffing requirements for customs need to be reassessed in terms of quality and quantity if customs is to improve among others, the trading competitiveness as discussed in section 3.4.1. (*Causes: conditional factors for customs reform*). There are a large number of vacancies and, as a result, thinly stretched operations are expected in many stations. The scarcity of personnel makes it also impossible to establish or strengthen customs surveillance in ports and other customs areas and to organise a minimum of anti-smuggling operations, both of which are necessary but at the moment non-existent or extremely weak.

As discussed in section 3.4.3 (*Variables: institutionalising customs modernisation*), regarding salaries and as a result of the critical behaviour of customs and risks of corruption, salary is one of the elements of motivation and integrity that should become centre of attention. In emphasising this point, Rose-Ackerman (1999:72) stated that, because customs agents control something that firms' value-access to the outside world, businesses and individuals might collude with customs agents to lower the sums collected and to expedite services. Especially if public sector pay is very low, corruption is a survival strategy. This makes customs administration always sensitive and troublesome.

Thus, paying a salary that is consistent with a professional position of honour and trust, that will attract high quality personnel, and that will support a reasonable standard of living without the need for supplementary income is recommended in the best practices of present times customs as discussed in section 3.4.3 (*Variables: institutionalising customs modernisation*). However, in the light of this context, apart from the general civil service salary scale, no attempt or no special consideration is given to the salary scale in the Eritrean customs.

In reference to the issues of workforce and structure, the ICC's customs guideline (ICC, 1997) could be remarkable as a base-line. The guideline underlies that *...a modern, efficient and effective customs administration employs a highly professional workforce, which is recruited competitively, well trained, adequately paid and screened for enforcement risks, with written*

standardised job descriptions and objectives, supporting transparent career development and promotion policies...

• **Formal performance targets for customs stations need to be established and monitored by headquarters.** As discussed in section 3.4.2.4 (*Measurement as a key to improve performance*) modern customs administrations rely on a comprehensive set of measures to monitor performance and they also seek to ensure that the staff level is consistent with workload across customs stations. The ability to measure performance is a prerequisite for achieving progress in terms of efficiency and effectiveness. Primarily, customs authorities need two basic parameters to measure their performance systematically. One is the cycle time between the arrival of goods and the release of these goods from customs. The other is compliance, which is a critical mission for customs. By using both measurements customs can ensure that modernisation initiatives are complementary and mutually supportive of enforcement and facilitation.

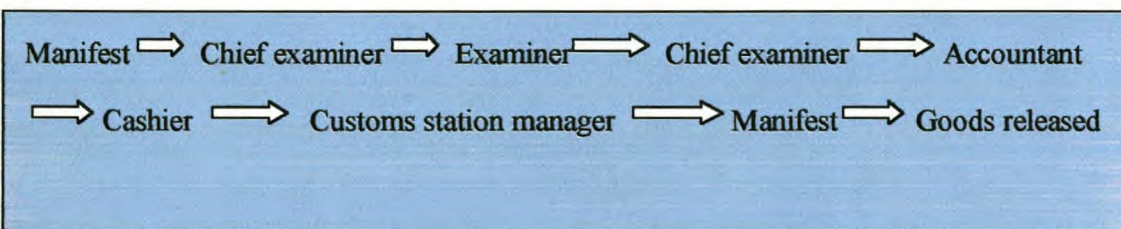
5.5 THE IMPORT DECLARATION PROCESS

The following describes the current situation and issues for each functional area in the import declaration process.

5.5.1 Goods declaration preparation and submission to customs

Importers/agents are not required to make a self-assessment to customs of the goods they wish to import. Only limited information is required to be written on the declaration form before it is submitted to customs Manifest. Thereafter the Eritrean customs examiner describes the goods and the chief examiner classifies them and determines the value for duty, and calculates the duties/taxes payable by the importer. For these functions to take place the following process is followed:

Figure 11: Clearance procedure



These significantly increases customs' workload and slows cargo clearance times (Goorman *et al.* 1994:34; Brondolo *et al.* 2001:49; Issac, 2002).

The best practice in this regard, as is the case in most countries, is simply validating customs declarations that have been fully completed by importers/agents. The WCO in its *General Guideline Annexure* promotes self-assessment as standard practice (WCO, 2000d: 6; WCO-*Formalities*, 2000:9). Similarly, the customs Proclamation No. 112/2000 article 15(4) prescribes goods declaration to be completed by the importer/exporter though self-assessment is not mentioned. However, it is still not in effect subject to article 2(3).

Once the declaration form is completed and the officer (chief examiner) is satisfied that the values and all documentation required has been submitted, the entry package is passed on to an accounting unit to produce the required payment slips (Brondolo *et al.* 2001:49). Similarly in the accounting unit, the current process is characterised by duplication of controls between the accounting and cashiers sections along with a cumbersome and ineffective system of receipts and ledgers (Goorman *et al.* 1994:37). The package of documents is then put into the clearance agent's box at the customs station. Declarations having a value of under Nakfa 5 000 (Eritrean currency) are paid at the station, while those over Nakfa 5 000 must be paid at the Commercial Bank of Eritrea. The release of the goods is completed when the bank receipt is presented to customs (Brondolo *et al.* 2001:49; Issac, 2002).

Furthermore, the existing declaration form does not conform to international standards and the common market to which Eritrea belongs – COMESA – , in terms of layout and content, and will need to be revised to permit the eventual computer processing of data (Goorman *et al.*,1994:34; Brondolo *et al.* 2001:49). The declaration also requires an inordinately large numbers of copies to be completed (i.e., nine) which is against the requirement adopted in the harmonisation process of COMESA that includes the following:

- 1) reducing to a minimum the number of trade documents;
- 2) reducing the number of national bodies required to have the documents, and
- 3) harmonising the nature of information required on the documents (Goorman *et al.* 1994:34; COMESA, 2000b)

In the light of COMESA's efforts to simplify and harmonise trade documents and procedures, Eritrea is still one of the member countries that uses several customs declaration forms and the country is therefore called upon to change and move forward. At a workshop organised by the COMESA Secretariat on the way to come to an agreement of the need of using a single customs document, held in Lusaka, Zambia, from 2 October to 4 October 2000, the delegate from Eritrea informed the meeting that *...the customs administration in Eritrea agreed in principle to use a*

single document but the customs department is still experiencing administrative problems implementing it... (COMESA, 2000b).

Conversely, at present twelve member countries of COMESA – even Eritrea's neighbouring countries – are using COMESA's single customs document (COMESA-CD) adopted by the Council of Ministers in 1997 (see Appendix 6). This single customs document is believed to be a simple, user-friendly form that reduces administrative costs and which could easily also be automated in addition to its conformity to other forms based on the United Nations Standards format (COMESA, 2000b).

5.5.2 Performance of customs agents

Until recently, only the Eritrean Shipping and Transit Services Agency operated as clearing and forwarding agent. But since 1994 customs has begun to license private agents. However, customs agents lack adequate knowledge of customs laws, procedures and requirements to operate effectively under the self-assessment system (Goorman *et al.* 1994:35). Taking into account this loophole, Customs Proclamation No. 112/2000 article 65(4) provides the requirements that qualify a clearing and forwarding agent for permits. However, the provision is not in effect subject to article 2(3). Therefore, unless mechanisms are put in place and give effect to article 65(4), so that all agents attain and maintain a high level of professionalism, customs will become increasingly overburdened with carrying out all the administrative requirements of import/export declaration preparation and processing, while the volume of trade transactions increases.

5.5.3 Declaration acceptance and registration

Under the current system importers/agents are required to take their declaration from customs officer to customs officer through the entire process. This not only congests the limited space available in the customs office, but increases significantly the opportunity for collusion between customs officers and the trader (Goorman *et al.* 1994:36, MOF, 1995).

Current paper flow and procedures also need to be streamlined. For example, in the current practice it is required that all declarations be presented first to the chief examiner. Not only is this initial review an inefficient use of the chief examiner's time, the same declaration returns to this same individual and the head manager of the customs office no less than three additional times before the consignment is finally cleared (Goorman *et al.* 1994:36, MOF, 1995; Issac, 2002).

On the other hand, under current arrangements the state-owned Petroleum Corporation is not required to present customs declaration of petroleum imports to the customs department. Instead, the corporation offloads the incoming vessels and directly distributes the petroleum products to the distribution outlets (Brondolo *et al.* 2001:49).

5.5.4 Declaration assessment and physical inspection

Given that there is no self-assessment of declarations, customs examiners are currently required to inspect 100 percent of all consignments physically, (though some are only partially inspected in the first instance), and record their findings on the declaration form. These results are then used by the chief examiner to determine the tariff classification and value for duty and fully examine only if problems are found (MOF, 1995; Brondolo *et al.* 2001:49).

This high rate of physical inspection, combined with the time-consuming task of assessing duties/taxes payable, places an unnecessary heavy workload on customs' limited workforce. In addition, various checks and balances built into the current system do not provide the level of control warranted by the effort to administer them (Goorman *et al.* 1994:36; MOF, 1995).

However, in relation to the up-to-date customs practice and as discussed in section 3.4.3.3 (*The advanced processes*), it is simply not practicable or even possible to undertake a 100 percent physical inspection and to approve the passage of the cargo in a timely fashion. From experience one can perceive that some importers and some imports could present a much more significant risk than others, therefore, it is clearly more effective to perform extensive, thorough inspections on a smaller percentage of imports and systematically lessen the oversight of compliant customers.

5.5.5 Post-clearance review of declarations

Although import declarations are now sent from customs branch offices to headquarters, the limited number of experienced personnel in the division for tariffs and valuation at headquarters' prevents any meaningful secondary review of declarations. Without a selective and independent post-clearance review of declarations by personnel specialised in classifications and valuation, there can be no guarantee that consignments are being correctly and consistently assessed and that the maximum revenue is being collected (Goorman *et al.* 1994:38; MOF, 1995).

5.5.6 Passenger processing

Arriving and departing passengers at the Asmara Airport experience significant delays and inconvenience caused by –

- 1) 100 percent physical inspection of all arriving baggage and physical intrusion by customs;

- 2) immigration and customs declarations, having to be completed only after arrival, and
- 3) a cumbersome customs declaration form, whereby individual dutiable items must be individually classified and subjected to specific duty/tax rates.

There is also no exemption level for returnees, or even if there is, it is not publicised. In general one can safely say that the current system does not translate into efficient control nor leaves a favourable first and last impression on visitors to Eritrea (see also the discussions of *The need for modernisation of customs services* in section 3.3.3) (Goorman *et al.* 1994:50; MOF, 1995).

5.5.7 The control over goods in transit

A review of procedures at the port at Massawa and the railway station at Asmara revealed the following weaknesses in control over transits, raising concern that transit goods could be diverted or substituted and revenue lost:

The customs Transit form, accompanies the goods during transit, frequently lacks a full and complete description of both the consignments and their quantities. Consequently, when the goods arrive at the inland clearance office, where customs performs a 100 percent inspection of arriving cargo against the transit documents, frequently customs can not effectively detect shortages or substitutions. Although a copy of the transit document is returned to the office of transit commencement, there is no systematic matching of these copies in order to verify the conveyance completed transit. It was also revealed that the time allowed for the transit to be completed is not strictly controlled by customs (Goorman *et al.* 1994:33; MOF, 1995).

Customs cannot currently escort or undertake adequate surveillance on transit consignments. Since the vast majority of transit cargo is non-containerised, it would, therefore, be easy to remove or substitute goods during transit without customs detection. In addition, as neither the importer/agent nor the carrier is currently required to post financial security with customs to cover duties/taxes payable, should an entire conveyance of goods never complete the transit then customs may have difficulty recovering the duties/taxes payable (Goorman *et al.* 1994:33; MOF, 1995).

- ❖ Depending on the aforementioned declaration processing system the following findings and issues could be deducted:

- ***The current declaration process is cumbersome and inefficient for both customs and importers/agents and must be modernised and streamlined.*** This, among others, requires that the process should – reduce the administrative burden on scarce customs personnel; reduce cargo clearance times; reduce the opportunity for collusion between traders and customs; strengthen

controls for ensuring that duties/taxes are properly assessed, collected and reported, and to prepare for eventual computerisation.

- ***Customs formalities should apply to all imports, including petroleum products.*** Arrangements that do not complete customs declarations hinder proper administration and statistical reporting. In countries with effective customs administrations, all imports must be reported to the customs department in a prescribed manner and should contain such information as is required by customs.

- ***Agents and importers need to complete the declaration forms themselves.*** Customs officers are completing most of the customs declarations on behalf of importers and agents. This consumes the already limited customs resources and is contrary to the discussions in sections 3.4.1 to 3.4.3 of internationally accepted practices. Moreover, under modern procedures, information from declaration forms is entered into a computer system by data entry operators and subsequently verified by customs officers. Thus, completion of the declaration by the importers/agents is a prerequisite by itself for an automated system to be introduced in the Eritrean customs.

On the other hand, the Eritrean Customs Department is weak in public relations. Accordingly no efforts are made in promoting self-assessment and other customs issues. Therefore, it is worth considering publications that give an overview of self-assessment and customs practices in order to provide clients with pertinent information thereby, facilitating improved service to businesses as well as the public. Such publications could provide the reader with basic information of the Eritrean customs organisation, and its vision, mission, values, mandates and priorities. It could also include an outline of the core customs procedures and could highlight one's obligations to ensure compliance with the law. Further, for attracting investors and to exploit the internet fully opening of the customs web site could facilitate the availability of customs information and could keep Eritrea abreast of its neighbours.

- ***The declaration forms do not conform to international standards and can not be adapted to a computer environment.*** The declaration form must be redesigned to conform to international standards in terms of content and format. Such an arrangement is a good administrative practice and would facilitate the adoption of computerisation. In this regard Eritrea, as a member country of COMESA, is expected to adopt the COMESA-CD, i.e. a single declaration format as a suitable model.

● ***In the declaration process, along with compliance and facilitation issues in customs administration, developing industry partnerships should become another target.*** It means that customs must remove barriers to get closer to their customers. Customs administrations have to change the way they conduct business, taking the position that importers and exporters are customers who should be treated as partners and not as adversaries. Not only is improving service to customers a major challenge, but the compliance of importers', exporters', brokers' and carriers would also be improved.

5.6 CUSTOMS VALUATION

The present practice for the valuation of goods – for the purpose of charging duties and taxes – is to accept the reported selling price recorded on the invoice as long as the invoice meets some basic information requirements. The required information includes the date, name and address of the exporter and importer, unit value of the goods traded and a clear description of the goods, weights or volumes, the signature of the seller and, most importantly the importer should use letter of credit for the foreign currency obtained for the imports. If an invoice belongs to an importer of *Franco Valuta* (someone who collects foreign currency from the informal/black market for his/her imports), the invoice is suspicious and therefore the price is determined by comparison to like or similar goods as described in a price profile (Brondolo *et al.* 2001:50, Petros, 2002).

In addition to this, customs also accepts directly the value, provided that the invoice has been authenticated by the chamber of commerce in the country of export. Moreover, the invoice or transaction price is accepted only if it is higher than the price for like or similar goods as described in a price profile (Goorman *et al.* 1994:40). In addition to this, matters are more complicated when it comes to the validity of invoices as many small importers do not buy from known company outlets (MOF, 1995).

Price profiles are issued and maintained by customs' headquarters, although there is no mechanism to ensure that each price on the profile has been regularly reviewed and updated. Goods are organised into various commodity groupings that lack further specification and which make the valuation more difficult. Example of commodity groupings in the price profile includes automobile spare parts, textiles, foodstuffs, sanitary goods, building materials, and machinery, among others. In addition, the price profile is a public document in that it is available at the chamber of commerce and customs allow traders to view it in the customs office. It is therefore little wonder that the invoice price is rarely higher than the profile price. Once the

price is determined and became disputable, there is to date no avenue of appeal beyond the headquarters level (Goorman *et al.* 1994:40; Brondolo *et al.* 2001:50; Petros, 2002).

Further, when staff in a customs station cannot find a like or similar commodity in the profile, the issue is referred to headquarters where staff members from the tariff and valuation division determine the value by researching price lists or making comparisons to selling prices on the local market. As this price research takes time, the importer is obliged to pay higher store costs or is allowed to pay an amount of money enough to cover the tax duty plus financial security to obtain clearance of his/her consignment while headquarters is making its decision. This renders the customs administration inefficient and for most importers it impacts negatively upon cost-competitiveness. Another disputable aspect of the valuation process is that the quality of goods is most often not taken into account. Thus goods differing in quality are valued similarly (Petros, 2002).

❖ Depending on the aforementioned customs valuation practice the following findings and issues could therefore be deducted:

● ***The current valuation procedures by which customs determines value for duty are ambiguous and are not in full conformity with internationally accepted methods of valuation.***

The present valuation practice does not ensure that duties/taxes are assessed based on accurately determined value. This problem is addressed in the new Customs Proclamation No. 112/2000 articles 18-28, which is in accordance with the GATT valuation system (WTO, 1998:39).

This system as discussed in section 3.2 (*Customs as instrument of public revenue*) provides alternative methods for determining the value of an import, as well as the conditions that should be met for applying each method. The standard practice in valuation uses the following sequence: (1) the transaction value of the goods; (2) the transaction value of identical goods; (3) the transaction value of similar goods; (4) the deductive value of the goods, and (5) the computed value of the goods.

The GATT methods form an internationally accepted system of valuation and provide a consistent method that the importing public can count on. In accepting these methods, the relevant customs department would no longer use its price profile database to determine the value of goods; instead, this database could then be used to help determine the reasonableness of the reported transaction value and whether another valuation method would be more appropriate.

However, though the GATT Valuation Method is accepted and enacted in Customs Proclamation No. 112/2000, it is not in effect to date subject to article 2(3) that particularly mentions articles 18-28 among others.

- ***Customs generally does not question the value of goods if, the invoice has been authenticated by the chamber of commerce in the country of export or is accompanied by a letter of credit from the importer's bank.*** This is a questionable practice since there is no guarantee that the relevant chamber of commerce is aware of the actual value of the commodity or that the right amount as credited by the bank is paid. For this the only solution is to implement the GATT valuation methods that eliminate the aforementioned requirements (namely producing authenticated invoice or letter of credit).

- ***The price profile is not reliable enough due to lack of assurance of frequent renewal and regular follow-up.*** This makes the price profile out-dated, while its availability to the public could enable importers to submit an invoice price similar to that of the profile.

- ***There is no avenue to appeal a valuation determined by customs, beyond the headquarters of the relevant customs department.*** The customs authority has however already made moves to address this issue in accordance with the new Customs Proclamation No. 112/2000 articles 35-37. The provision of these articles allows for determinations made by customs' headquarters to be appealed further to an independent fiscal or other competent tribunal.

- ***The Eritrean customs valuation method as an outdated, time-consuming, disputable practice and as the main obstacle of trade facilitation at large should be abandoned.*** Implementing the WTO valuation method as standard practice makes it possible to collect the right amount of duty due to the state along with trade facilitation benefits as discussed in section 3.3.4 (*The benefits of customs modernisation*). Hence, training in customs valuation as part of the WCO technical assistance package to member countries is highly required to bring Eritrean customs in line with the valuation provisions in articles 18-28 of Customs Proclamation No. 112/2000.

5.7 CUSTOMS TARIFF NOMENCLATURE

The Eritrean post-independence customs tariff nomenclature practice was based on the SITC classification that utilises a limited number of commodity categories. This classification system was not in conformity with the standard international practice, as most countries use the *Harmonised System* (HS) (Goorman *et al.* 1994:38; MOF, 1995).

As discussed in section 3.2.2 (*Customs tariff nomenclature*) the Eritrean customs adopted HS. For that reason, the new Customs Proclamation No. 112/2000, article 16 stipulates that declarations should be based on the classifications under the nomenclature of the *Harmonised System*, as provided under the schedules of the Customs Tariff Regulations No. 52/2001. These regulations have been effective since October 2001. Therefore, the adoption of the HS will serve as a proper step and prerequisite for the modernisation of the Eritrean tariff valuation and statistical systems and implementation of computerised import declaration process.

❖ Depending on the aforementioned customs tariff classification practice the following findings and issues could therefore be deducted:

● ***The Eritrean Customs Department needs to publicise and to distribute the current tariff nomenclature as a public document and should make it easily accessible for importers/exporters.*** The tariff nomenclature enables customs internally to decrease the unnecessary uncertainty in classification of goods and to deter potential dishonesty on the part of customs officers, for example, when dealing with travelling importers not familiar with the official tariff rates to be applied.

● ***Eritrean customs needs to join the list of countries, which is available for example on the WCO web site, when applying the HS, by notifying the secretary general of the HS convention in order to inform the international trade operators.*** According to the HS convention (WCO, 1986), a developing country which elects to apply the *Harmonised System* partially or fully under the provisions of the convention shall, on becoming a contracting party, notify the secretary general of those subheadings which it applies thereafter the date when this convention comes into force in that relevant country and also of those the country will not apply.

● ***Customs department further needs to arrange for technical assistance regarding the HS convention.*** To this end it is already stated in article 5 of the HS convention (WCO, 1986) that “...developed country contracting parties shall furnish to developing countries that so requested, technical assistance on mutually agreed terms in respect of, *inter alia*, training of personnel, transposing their existing nomenclatures to the *Harmonised System* and advice on keeping their systems so transposed up-to-date with amendments to the *Harmonised System* or on applying the provisions of the convention...”

● ***Customs tariff nomenclature is one of the customs areas that require proper training.*** For that reason, initial training regarding tariff nomenclature is taking place to familiarise customs officers with the new environment of HS. To date, 84 customs officers have already been

trained, according to Shaebia News (2002) and Hadas Eritrea (2002). This should be intensified further and deeper until the proper expertise gets reflected on effective administration of goods classification.

5.8 CUSTOMS ENFORCEMENT

When customs staff discovers undeclared or fraudulently entered goods, the current practice is to simply assess and collect any additional taxes and duties payable. So far the department has not had legal capacity to sanction. The responsibility for enforcement activities has been assigned to the Finance Police (Brondolo *et al.* 2001:51).

While provisions for enforcement are available in articles 61-64 of the new Customs Proclamation No. 112/2000, the responsibility of enforcement is not explicitly assigned to finance police. Rather it simply mentions “*customs officer*” as implementer of the provisions. On the other hand, the finance police is independently organised outside the customs department. This makes the enforcement responsibility vague in the new proclamation. Moreover, subject to article 2(3) of Customs Proclamation No. 112/2000, the provisions for enforcement and powers of officers are to come into effect on the date or dates specified by the minister by legal notice, which to date has not been specified.

On the issue of customs control and enforcement, exemptions from duties on account of different objectives, is a common practice. Similarly, exemptions as regards Eritrean customs are frequently granted on an *ad hoc* basis – even though there is no legal basis for exemptions – and there does not seem to be a comprehensive programme to control such exemptions (Brondolo *et al.* 2001:51). Hence, various duty exemption regimes are in effect¹⁰. In addition, customs have difficulty in administering some of these exemptions strictly at time of clearance due to lack of personnel and other limitations. This is especially the case for returning refugee effects where customs offices do not have guidelines to assist them in deciding which personal effects may be exempted and in what quantity (Goorman *et al.* 1994:41).

Similarly, there was a fiscal incentive in accordance with Investment Proclamation No. 18/1991 article 8(1-5) that provides a list of capital goods and raw materials exempted by the investment

¹⁰ The following is a sample of duty exemption regimes that are in existence: passenger and personal effects, religious and charity organisations, government departments, the Eritrean Aviation/Maritime Authorities, diplomatic goods, effects of returning refugees, goods imported under the authority of The Eritrean Relief and Refugee Commission, capital and raw materials approved by the investment centre and other goods covered by agreement with international organisations (Goorman *et al.* 1994:41).

centre. But as Goorman *et al.* (1994:41) reported, customs was neither aware of what criteria the centre uses to determine whether goods are exempted, nor whether such goods were subject to any quantity, time or end-use limitations. Customs was not verifying that such goods were not diverted to other purposes and whether it might not have the potential for abuse or loss of revenue.

To improve the vague situation in the past, article 8(2) of the current Investment Proclamation No. 59/1994, superseding the former, provides for a nominal customs duty of two percent on imports of capital goods and industrial spare parts and three percent on raw materials and intermediate inputs, while the proclamation provides no exemption from import duties on the material and equipment inputs to production (Negash, 1999:353). However, other exemptions are granted simply on the basis of a letter from the requesting government organisation/agency (Goorman *et al.* 1994:41; Brondolo *et al.* 2001:51).

❖ Depending on the aforementioned customs enforcement practice the following findings and issues could therefore be deducted:

● ***A modern customs administration requires an enforcement capability.*** The Eritrean customs administration requires experienced customs staff to conduct the intelligence and investigation works involving customs infractions. Such positions require higher levels of skills than those of station officers. In a modern customs department, there would be an enforcement division responsible for the direction of all enforcement activities at the customs stations with line authority over the intelligence and investigations programme (see Figure 10). Furthermore at present, risk management as advanced practice of customs control and enforcement process characterises modern customs administrations, as discussed in section 3.4.3.3 (*The advanced processes*)

● ***The customs department requires the authority to apply penalties against offenders.*** Under existing arrangements there is nothing customs can do to discourage non-compliance by importers, apart from collecting the tax and duties on undeclared goods. Even the finance police have little enforcement powers apart from confiscating goods. The lack of an appropriate sanction regulation obviously creates strong incentives for non-compliance (Brondolo *et al.* 2001:52). The new Customs Proclamation No. 112/2000, however, has introduced a range of administrative, civil, and criminal sanctions against offenders, even though these are not yet in effect. There should therefore be first, clarity of enforcement responsibility between the finance police and customs, if finance police is to continue its enforcing function; secondly, the option of

creating an enforcing division under the customs department should be considered; and thirdly, the implementation of the enforcement provisions of the new proclamation should be facilitated.

● ***High-risk selective examination practices are needed for an effective enforcement strategy.***

The Eritrean customs department cannot continue to examine every shipment of goods entering the country. As trade increases, it will be impossible for customs to examine every shipment even partially. It is therefore important to implement a more selective enforcement strategy targeted at high-risk shipments as discussed in section 3.4.3.3 (*The advanced processes*) In this regard the Kyoto convention calls for countries to adopt risk management techniques and audit-based controls, making “...*maximum practicable use of information technology...*” (Edmonson, 2002:35; WCO, 2000b:9). In modern customs administration, selection systems rely on the following types of designations to identify high-risk goods: tariff classification number, value, country of origin, importer and exporter (WCO, 2000b:12).

● ***An effective customs system requires a strong mechanism to control exemptions.*** The present *ad hoc* manner, in which exemptions from customs duties and taxes are granted, provides little control and is a potential source of revenue leakage. The current system of exemptions therefore needs proper handling and statistics to show how much revenue is being foregone through the exemptions.

5.9 COMPUTERISATION OF CUSTOMS PROCESSES

Globalisation and liberalisation of trade have increased the potential for international trade to become an unprecedented engine of growth and an important mechanism for integrating developing countries and economies in transition into the global economy (Held & McGrew, 2000:5). Amid this accelerated interdependence, the most overpowering concern of any institution becomes survival, as nothing could be accomplished if the institution itself were not to survive.

However, survival is only possible when the institution is able to adapt to the changes in its environment. Some examples, among other dynamic factors, are a change in policy, new technologies, new or amended legislation. Change therefore brings about adaptation, and only through adapting is an institution able to survive (Fox, Schwella & Wissink, 1991:165). In the light of this fact, although plans for computerisation have been under consideration and new legislation in the process of implementation, the administrative procedures of the Eritrean

customs administration at present are carried out on a manual basis. As a result, accurate and timely management information reports are lacking (Brondolo *et al.* 2001:53).

Management information reports are vital not only to the effective and efficient administration of customs, but also to economic and fiscal management. Despite this fact, firstly, the Eritrean customs department is still depending on manually produced basic management information reports, by compiling data from goods declarations sent to headquarters. Revenue monitoring reports are now being produced on the basis of SITC commodity groupings as the trade statistics reports themselves are based on SITC. However, because these reports are based on raw data submitted from customs offices, data accuracy remains a serious concern.

Secondly, there is still an acute lack of operational reports to assist managers at both the customs offices and headquarters levels in measuring workload and performance. Without such reports it will be difficult for customs management to ensure that its limited resources are deployed both efficiently and effectively. Thirdly, the most important measure to increase the efficiency of performance of the customs service will ultimately be the computerisation of its operations – i.e. adapting new technology (Goorman *et al.* 1994:48; MOF, 1995; Brondolo *et al.*, 2001:54).

Therefore, firstly the introduction of computerisation without preliminary and sometimes thorough reform would be inappropriate and even counterproductive. As Wafa (2001) remarked, reform must precede computerisation. Similarly, many of the Eritrean customs issues and findings contained in this report that are related to modernisation of import declaration procedures, revising the declaration form, adopting HS and introducing self-assessment are prerequisites to implement any customs computer system. Indeed, such activities are the most difficult and time-consuming activities associated with implementing any computer system. Secondly, it will also be important to have the proper physical environment for computerisation that requires reorganising the infrastructure of customs offices.

Several customs administrations around the world face many of the same constraints, and it is for this reason that UNCTAD developed the ASYCUDA (Automated System for customs Data) computer system. As part of its efforts to improve the economic performance of the continent, UNCTAD has already installed, or is currently installing, its *Customs Reform Modernisation and Automation Programme* in 27 African countries of which Eritrea is one. Even UNCTAD (1997) reported in its *Note to Correspondents No. 26* Eritrea as the most recent country to adopt ASYCUDA. The project was scheduled to begin in July 1997 and was to be introduced at

customs headquarters in Asmara and at Massawa Port, and later at Asmara Airport and Assab Port. But to date nothing has taken place.

❖ Depending on the aforementioned customs computerisation situation the following findings and issues could therefore be deducted:

● ***Management information reports should be based on a well established computer system in order to be able to provide more accurate and up-to-date trade statistics for government analysis and planning.*** However, because the reports are based on raw data submitted from customs offices, data accuracy remains a serious concern. For instance, basic revenue monitoring reports and trade statistics should be prepared based on the modern HS classification.

● ***The implementation of the ASYCUDA system will first require streamlining of customs operations.*** The introduction of computerisation, without redesigning the existing inefficient manual procedures and work processes, would be inappropriate and would not only give the desired result but would be counterproductive. The automation of customs operations can only be accomplished in a successful manner in the context of a plan beginning with the streamlining of control and clearance procedures, and the streamlining of the administration's management capabilities. In reforming existing customs practices further, the Eritrean Customs Department should adopt modern business process re-engineering techniques to identify inefficient and/or redundant activities for streamlining or elimination.

● ***The Eritrean Customs Department must ensure that a proper physical infrastructure is in place to support automation.*** Buildings and offices must have proper ventilation, furniture designed to hold computers and printers, uninterrupted power supplies, cables for local networks, etc. Many of the present customs facilities are unsuitable and will require considerable renovation before they can accommodate the installation of computers.

● ***The Eritrean Customs Department needs to adopt the ASYCUDA system as the best way to meet the demands of international trade.*** As new challenges will be presented to customs with the expected increase in the volume of goods to be traded, and the broadened scope of activities into diverse areas, the use of an international system that employs internationally accepted practices is not merely optional, but requirement. The Eritrean Customs Department should use the ASYCUDA system as a foundation to introduce more reforms with substantial impact on the movement of goods across its borders.

5.10 TRAINING AND INFRASTRUCTURE

Compared with a modern customs administration, the overall level of technical and administrative skills of staff in the Eritrean Customs Department is low. Customs officers have never received any training in basic customs procedures. Rather, new officers are being trained informally on the job by senior staff, if time allows. To date there is no structured programme to train staff nor does the department have any suitable training facility (Brondolo *et al.* 2001:54). Hence, in order to obtain some adequate training facility along with technical training support, it will be important to approach international organisations, such as the WCO or training will have to take place through bilateral arrangements with other customs administrations.

Physical infrastructure of the Eritrean Customs Department is subject to damage, deterioration and general neglect and the Department suffers from lack of basic office supplies and furniture. There is also an absence of vehicles, patrol boats, radio equipment, X-ray machines, etc. (Goorman *et al.* 1994:45; MOF, 1995; Brondolo *et al.* 2001:54). Thus rebuilding the basic infrastructures necessary to support customs administration is urgently required to be in line with the modernisation efforts, if customs is to proceed with the procedural reforms necessary to increase revenues and to support the enforcement efforts of the finance police among others.

❖ Depending on the aforementioned customs staff training level and the infrastructural availability, the following findings and issues could therefore be deducted:

- ***A formal and structured approach to train customs staff is required to ensure that staff skills and knowledge meet the needs of a modern customs administration.*** At present, there are no formal training programmes for customs staff nor are there any mechanisms in place to assess staff performance and competence. Hence, in order to achieve the best results in training, a specialist training coordinator that assists management to evaluate training requirements, identify the training needs of customs, prepare instructional material for the various training courses and that coordinate training activities will be worth considering. While most of the training can be handled by the local staff, it will be better to employ technical assistant experts to handle the courses on GATT valuation and HS classification.

- ***The Eritrean Customs Department requires a proper training facility with suitable equipment.*** So far the department has no training facilities of its own. However the pressing requirement of customs modernisation and reform will create the need for substantial training of most customs staff, which gives rise to the need for customs to have its own training facility.

● **Customs infrastructure in general needs to be matched to the modernisation demand.** Many customs buildings require upgrading to accommodate the installation of ASYCUDA. The customs operations at the main point of entry of goods, Massawa Port, are not conducive to effective handling of goods. For example, the lighting and working conditions of the warehouse are poor and the absence of proper air conditioning equipment especially during summer period makes the working conditions unbearable. The railway warehouse in Asmara is also in poor condition. Besides, the overall office facilities, furniture and equipment do not meet the requirements for computerisation. Furthermore, customs stations lack basic equipment for normal operations, such as photocopiers and fax machines in remote stations so that they could not be able to communicate with the headquarters.

5.11 CUSTOMS WAREHOUSING SYSTEM

In the area of storing imported goods or goods destined for exportation, three major problems exist which will have to be addressed in the long-term interest of the Eritrean import and export trade and the efficiency of the Eritrean Customs Administration. These are: a) the hybrid nature of the existing warehousing system which is not conducive to efficient customs administration; b) the lack of bonded warehousing system, which puts Eritrean importers and exporters at a disadvantage *vis-à-vis* their foreign competitors, and c) the system of having customs operate the warehouses, presently applied at some customs stations, shifts customs from their normal functions (Goorman *et al.* 1994:46).

In customs systems world-wide, there are two types of warehouses. The first is in terms of the Kyoto Convention (WCO, 2000f:3) the *temporary storage* also called *arrival warehouses* or *transit sheds*. These type warehouses are used to deposit goods after unloading from ship/plane and to store them for a limited period of time pending lodgement of the importer's declaration for a customs regime (WCO, 2000f:3). The second type of warehouses according to Kyoto Convention (WCO,2000e:4) are *bonded warehouses*, usually located outside the customs compound, in which importers can store goods under bond for an extended period of time without payment of import duties and taxes. These two different kinds of storage require two different customs control systems.

In Eritrea there appears to be no distinction between arrival and bonded warehouses. Goods unloaded in the arrival warehouse at the port, railway and airport are for instance allowed to be stored there for up to six months, giving these warehouses to some extent the function of bonded

warehouses (Goorman *et al.* 1994:47). In this regard the Kyoto Convention on temporary storage (2000:8) states that “...*the period of temporary storage allowed in many administrations is 15 days, a longer period sometimes 45 days, is often allowed for goods arriving by sea...*”). According to the South African Revenue Services (SARS) an importer/ agent is for instance allowed seven days in which to clear goods from the time it has landed (SARS, 1999:10).

Compared to the practices mentioned therefore, the time limit for temporary warehousing needs adjustment. The six months allowed for goods to be declared by the importers after arrival is too long and results in the following problems, namely – a) unnecessary complication of customs documentary and physical control systems; b) manifests may remain open for up to six months after arrival, awaiting a goods declaration before customs may consider the cargo as unclaimed and thereby be available for auction; c) goods are more susceptible to theft, disappearance and fraud, and d) increased congestion in the port, thereby hampering trade.

The current hybrid character of the arrival warehouses causes problems of documentary and physical control for customs and could result in contraband and revenue loss. If such practices are continued, it would not be possible to apply controls separately relating to arrival, clearance of imports, and to bonded warehouses. Some of the arrival warehouses in Eritrea are presently owned and/or operated by customs. This is for example the case with the warehouses of the railway station which are owned by customs and the new warehouse facility at the airport which is owned by the Civil Aviation Authority, but leased and operated by customs (Goorman *et al.* 1994:47).

In the practice of modern customs, however, owning and operating warehouses should not be part of the responsibilities of customs, which should be confined to the surveillance, examination and release of goods (WCO, 2000e:5-7). Articles 47-49 of the new Customs Proclamation No. 112/2000 provide requirements and qualifications necessary for permits for the operations of arrival or bonded warehouses. If implemented as intended, this could solve the hybrid issue of warehouses, their ownership and operation and could also encourage solving the lack of warehouses by private sector investors, at the same time allowing customs to focus on its core functions.

- ❖ Depending on the aforementioned customs warehousing practice and situation the following findings and issues could therefore be deducted:

- ***In terms of the Kyoto Convention the Eritrean Customs Department needs to differentiate between temporary and bonded warehouses.*** For efficient customs administration, the arrival warehouses in the seaports, at the airports and railway stations should be used for their intended purposes. This means reducing the time limit within which the goods in arrival warehouses need to be declared for a customs regime and removed.

- ***Customs should not be diverted from its core functions regarding the operation and ownership of warehouses.*** Customs should not operate warehouses so as to avoid potential conflict of interest and to avoid liabilities related to lost or damaged goods, as that would divert customs from its prime tasks of revenue collection and enforcement. Thus arrival warehouses should be operated either by Asmara airport or Massawa port authorities and customs should limit itself to the surveillance, examination and release of goods.

- ***Generally bonded warehouses do not exist in Eritrea. This puts the Eritrean importers and exporters in a position of disadvantage.*** If properly used, bonded warehouses can facilitate trade and industry in allowing goods to remain stored for an extended period of time until the importer/exporter wishes to ex-warehouse them upon payment of applicable duties and taxes for home consumption, re-export them, and send them to another bonded warehouse (WCO, 2000e).

Bonded warehouses are an efficient way for importers to accrue the advantages of purchasing in quantity, while having a readily available stock, without having to pay all applicable duties and taxes on those commodities until such time as they are going to be used. From this it is clear that the purpose of bonded warehouses and the controls required by customs are different from those of arrival warehouses. One can therefore say that the absence of a bonded warehousing system deprives trade and industry of the above mentioned benefits (WCO, 2000e).

5.12 SUMMARY

The Eritrean Customs Department is playing a key role in achieving fiscal and trade policy objectives in a nation which is at this stage under rehabilitation. On the other hand, in fulfilling these policy objectives, the department has inherited serious problems and is still engaging with them at present. In the face of the challenges of globalisation, economic liberalisation and integration the two basic parameters of reform are therefore highly required in transforming the practice of customs in Eritrea.

Institutional transformation is required in the sense that one of the critical capabilities that have been lacking is that of being able to formulate and analyse policies. Typically this implies that customs has been lacking institutions and their infrastructure along with a human resource base that reflects the specialisation needed. This is to say that running an institution requires both workforce with the right skills and their organisation into an efficient machine along with motivation and incentives that would promote the desirable outcome.

Regulatory transformation is required in the sense that there should be an updated enabling environment in place as instrument to implement policies. At the most fundamental level, the department has been lacking a clear regulatory framework that guides its operations and procedures. One of the most important is the elimination of outdated and intrusive customs control. The difficulties caused by the old legislation of customs should be reviewed or substituted in order to reflect new priorities and methods.

Customs declarations continue to be filled out mainly by customs officers rather than by importers, all shipments undergo 100 percent examinations regardless of their compliance risks and the valuation practice is cumbersome. If customs is not aligned to the global situation and streamlined through proper regulatory regime, outdated procedures will eventually become entirely impracticable as the economy develops and the number of transactions expand.

Current organisational and managerial arrangements present other obstacles for effective customs administration. For example, enforcement operation is assigned to the finance police currently administered under a separate jurisdiction. Moreover, the customs department lacks an adequate performance measurement system to assist in managing the operations of the field offices. Customs is further hindered by an almost complete lack of computer systems, apart the limited automation of existing administrative office procedures. In addition, the human resource base and physical infrastructure at large constrain effective customs operation. Therefore, to surmount the many challenges highlighted above, customs administration in Eritrea will require a paradigm shift.

CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

6.1 GENERAL

Customs occupies a central position in Eritrea in so far as the international trade process, investment decisions and tourism flow are concerned and is, therefore, an important consideration in the management of our national economy. Eritrea has therefore to make a deliberate effort to remain relevant in the shifting sands of the new millennium. One of the most important priorities in the deliberate effort is how to face and prepare the Eritrean Customs Administration, namely – a) to handle both the traditional functions as well as the new responsibilities in the rapidly changing circumstances, and b) to execute these functions without hindering the process of international trade, investment decisions and tourism flows, which are the major priorities of the Eritrean economy.

Lane (cited in Garcia, 1999:10) stated

"... building a better customs organisation and streamlining the system for processing goods across international borders will not automatically propel a nation to the top echelon of industrialised nations. But also as mentioned earlier a slow, inept, corrupt, unreliable, or inconsistent customs regime that fails to conform to international customs standards will certainly condemn a nation to the bottom rung of the economic ladder..."

In the above context however, the researcher supports the fundamental premise of this thesis, namely *[T]here is now increasingly clear world-wide evidence of the significance and positive correlation between efficiency and effectiveness of public institutions and economic growth.* Likewise, in applying the working premise that *"...appropriate institutional and regulatory customs reform and modernisation measures in Eritrea will lead to efficient and effective customs services..."*, two questions arise before a conclusion is possible, namely, *is there a need for reform and is the outcome possible?* Similarly, two basic facts are obvious in the Eritrean customs practice. First, the service has lagged far behind other countries and second, the ground for reform exists.

6.2 SUMMARY OF ISSUES, FINDINGS AND RECOMMENDATIONS

● Legal bases for customs administration

➤ Issues and findings

1. Customs administration cannot operate in a modern environment without the necessary legislative framework.
2. In line with the new legislation, restructuring and substantial training of the customs staff are necessary before the new act can be put into practice.
3. The application of the key provisions of customs Proclamation No. 112/2000, are prevented by article 2(3).
4. The Eritrean customs lacks customs publications, releases and public relation activities and more importantly, lacks customs education, among others, to update its stakeholders.

➤ Recommendations

1. The enactment of a more appropriate legislative framework and associated regulations is a critical step towards modernisation of the customs administration in Eritrea.
2. Training is necessary especially in the face of the newly introduced customs practices such as valuation, rules of origin and *Harmonised Tariff Nomenclature System*.
3. Unless the key provisions become effective, no adaptive measures are possible in current customs practice.
4. Either the customs proclamation, as the only source of public information, should have to develop completely without leaving room for ambiguity or the customs public relations (PR) task should be reconsidered.

● Customs organisation and management

➤ Issues and findings

1. Under the current structure, the customs department and the finance police as enforcing agents are separate bodies. From this two basic problems emanate that reduce the efficiency and effectiveness in customs administration. These are: A) related to line of command B) related to selective inspection and post-release audit procedures.
2. There is a staffing scarcity that could become more pressing once trade resumes on a normal basis
3. Currently there are no formal performance targets for customs stations.

➤ Recommendations

1. Customs administrations should not have a finance police, but instead assign enforcement responsibility to their customs department. The lack of coordination between the two agencies clearly is a counter-productive outcome and presents an obstacle to the modernisation of customs administration. If customs is to introduce a selective inspection and post-release audit, the finance police should stop seizing goods on the spot as a result of their own enforcement activities.
2. More personnel should be appointed. The scarcity of personnel makes it impossible to establish or to strengthen customs surveillance in ports and other customs areas and to organise a minimum of anti-smuggling operations, both of which are necessary, but now non-existent or extremely weak.
3. Performance measures must be introduced. The ability to measure performance is a prerequisite for achieving progress in terms of efficiency and effectiveness.

● Declaration process of customs

➤ Issues and findings

1. The current declaration process is cumbersome and inefficient for both customs and importers/agents and should be modernised and streamlined.
2. Agents and importers are not acquainted with self-assessment or retrained to do self-assessment, so that they are not able to complete the declaration forms themselves.
3. The declaration forms do not conform to international standards and cannot be adapted to a computerised environment.
4. Customs administration has weak partnership relations with stakeholders in the declaration process.

➤ Recommendations

1. Redesign the declaration process in such a way that strengthens assessment, collection and all imports/exports must be accounted for the customs, *inter alia* for the purpose of complete and reliable statistical information.
2. Self-assessment should be one of the priorities in customs in order to use the already limited customs resources efficiently
3. The declaration form must be redesigned to conform to international standards in terms of content and format and eventual computerisation.
4. Customs must remove barriers to get closer to their customers. Customs administrations have to change the way they conduct business, taking the position that importers and exporters are customers and should therefore be treated as partners, not adversaries

● Customs valuation

➤ Issues and findings

1. The Eritrean customs valuation method is outdated, time-consuming, a disputable practice and the main obstacle of trade facilitation at large.
2. The current price profile is not reliable enough due to a lack of frequent review and regular updating.

➤ Recommendations

1. The GATT methods are the internationally accepted system of valuation and they provide a consistent method that the importing public can account on. Thus, the GATT Valuation Method enacted in Customs Proclamation No. 112/2000, articles 18-28, should be implemented.
2. The price profile, if improved and updated as database, should be used to help determine the reasonableness of the reported transaction value and to confirm whether another valuation method would be more appropriate.

● Customs tariff nomenclature

➤ Issues and findings

1. There is unnecessary uncertainty in goods classification and an associated potential for dishonesty on the part of customs officers.
2. There is a scarcity of HS information that should be available for the internal and external trading community.

3. Eritrean customs is in need of technical assistance in applying HS effectively.

➤ **Recommendations**

1. The customs department needs to publicise and to distribute the current tariff nomenclature as a public document and to make it easily accessible to importers/exporters.
2. Eritrean customs needs to formally apply the HS by notifying the Secretary General of the HS convention so that the international trade operators could be informed.
3. Customs department further needs to arrange for technical assistance regarding the HS convention.
4. Customs tariff nomenclature is one of the customs areas that require proper training. Intensified and deeper training is therefore required until the proper expertise on effective administration of the classification of goods is achieved.

● **Customs enforcement**

➤ **Issues and findings**

1. The Eritrean customs administration lacks an enforcement capability.
2. The customs department lacks the authority to apply penalties against offenders.
3. High-risk selective examination practices are needed for an effective enforcement strategy.
4. An effective customs system requires a strong mechanism to control exemptions

➤ **Recommendations**

1. The customs administration should use experienced customs staff to conduct the intelligence and investigation works involving customs infractions. These types of positions require higher level of skills, than the station officers.
2. There should be therefore, first clarity of enforcement responsibilities between finance police and customs, if finance police is to continue its enforcing function; second, the option of creating an enforcing division under the customs department would be worth noting; and third, the implementation of the enforcement provisions of the new proclamation should be facilitated.
3. It will be impossible for customs to examine every shipment even partially. It is therefore important to implement a more selective enforcement strategy targeted at high-risk shipments by adopting risk-management techniques, audit-based controls, and making maximum practicable use of information technology.
4. The exemption practice needs proper handling and statistics to show how much revenue is being foregone through the exemptions.

● **Computerisation of customs**

➤ **Issues and findings**

1. Customs reports are based on raw data submitted by customs offices, thus data accuracy remains a serious concern.
2. In reforming existing customs practices the customs department should adopt modern business process re-engineering techniques to identify inefficient and/or redundant activities for streamlining or elimination.

3. Many of the present customs facilities are unsuitable and will require considerable renovation before they can accommodate the installation of computers.

➤ **Recommendations**

1. Management information reports should be based on a well established computer system in order to be able to provide more accurate and up-to-date trade statistics for government analysis and planning.

2. The customs department needs to adopt the ASYCUDA system, as the best way to meet the demands of international trade. However, the implementation of ASYCUDA will first require streamlining of customs operations.

3. The customs department must ensure that a proper physical infrastructure is in place to support automation.

● **Training and infrastructure**

➤ **Issues and Findings**

1. At present there are no formal training programmes for customs staff nor are there any mechanisms in place to assess staff performance and competence.

2. To date customs has no training facilities of its own.

➤ **Recommendations**

1. A formal and structured approach to train customs staff is required to ensure staff skills and knowledge and to meet the needs of a modern customs administration.

2. The customs department requires a proper training facility with suitable equipment.

3. Customs infrastructure in general needs to be matched to the modernisation demand.

● **Customs warehouses**

➤ **Issues and findings**

1. There are no bonded warehouses in Eritrea. This puts the Eritrean importers and exporters in a position of disadvantage. In addition and according to the modern practices and Kyoto convention, the customs department needs to differentiate between temporary and bonded warehouses.

2. The administration of warehouses by customs could create potential conflict of interest and liabilities related to lost or damaged goods, or that would otherwise shift customs from its prime tasks of revenue collection and enforcement.

➤ **Recommendations**

1. Eritrea must establish proper warehouses. Bonded warehouses are an efficient way for importers to accrue the advantages of purchasing in quantity, while having a readily available stock, without having to pay all applicable duties and taxes on those commodities until such time as they are going to be used.

2. Customs should avoid potential conflict of interest and liabilities related to lost or damaged goods that could arise from its warehouse operation. More importantly customs should not be diverted from its core functions regarding the operation and ownership of warehouses.

6.3 CONCLUSION

The increase in numbers and the scope of challenges that the customs organisations throughout the world face will continue in the new millennium. National governments therefore need to recognise that if they invest in modernising and reforming their customs administrations, there will be a short-term payoff in revenue collection and a long-term payoff in national prosperity. Modernising and reforming are part of a changing process that enables customs to change with the global trends and to achieve further gains in efficiency and effectiveness.

However, to reach the excellence level customs administrations strive to achieve, namely, speedy processing and higher security in foreign trade among others, an adaptive learning process as a core tool for reform and modernisation, should be used by customs. For this to happen customs administrations need, as Catalá (1999:170) remarked, “...to start with a thorough understanding of what exists on the ground and emphasise ‘good fit’ rather than ‘any one-size-fits-all’ notion of ‘best practice’ – as each national or local context calls for specific strategies and solutions...” This adaptive process should be done with the complete involvement of all the participants of the international trade process, right from the managers and employees of customs departments, to the importers, exporters and brokers in order to do it effectively and to trace those problems to their institutional roots.

To be effective, this adaptive learning process should be formal, universal and systematic, and it should be applied in a disciplined manner. And, since the future is never absolutely known, and because best practices can change over time, results and experiences should be fed back into the process to narrow the knowledge gap and to better predict future requirements.

Eritrea is a country which is involved in the globalisation process, and as with many other countries, it seeks to improve the international trade, foreign direct investment and tourism flow, in order to achieve economic growth and development. Thus the process of modernisation of the Eritrean customs service should be a priority for the Eritrean government.

There are many other aspects that should be improved in order to give the adaptive reform and modernisation process the best opportunity to succeed. *Inter alia* –

❖ Legislation

One of the most important aspects regarding reform and modernisation is the elimination of antiquated, archaic and intrusive customs control. Difficulties caused by archaic legislation should be reviewed or substituted in order to reflect new priorities and methods of carrying out the customs function. The legislation, which customs applies for the community, needs to be easily understandable, applicable and needs to be fraud-proof as possible.

❖ **Human resource base**

Another aspect is the human capital policies. It is recommended to have strong recruitment policies, training services and performance evaluation systems. Special attention should be given to developing customs expertise. The increase in the demand for new skills will lead to the increase in the need for training staff to do new jobs and for retraining staff to perform differently.

The professional know-how of the employees is a key to a successful modernisation of customs. As customs places greater reliance on post-release audits, audit skills will be required. Expertise in classification, value, origin, inspection, and enforcement is needed as more administrations become knowledge-based, and information management skills will be increasingly in demand. Computer knowledge is already essential for customs officers, because information technology became a part of the day-to-day operation of modern customs computer-based systems that are employed in all offices. These skills will need to be sharp and effective to ensure proper compliance.

❖ **Customs enforcement**

To be effective regarding the enormous growth in trade, modern techniques have to be applied to simplify procedures and to focus controls where they are needed and where they would be most effective. Control procedures have changed since the days when control basically involved a physical check in nearly all cases or at random. In particular post-release/import controls, audit and risk analysis are techniques that are becoming more widely used and more sophisticated. These techniques are allied to the use of computers.

❖ **Benchmarking**

In customs administration the initiatives of identifying, adopting and deploying “best practices” promote continuous improvement in customs operations. Benchmarking is the most cost-effective way of introducing and spreading best practices to all customs administrations, and it is done by comparing one part of an administration with another to see who does something best and how. Benchmarking exercises ensure that information about better practices is used to implement change, with the aim of improving the effectiveness of procedures on a long-term basis

❖ **Measurement**

Performance measurement of results provides a mechanism for assessing progress and areas for improvement. However, although it is extremely important, it is difficult to achieve in practice. Initial systems for measuring results therefore need to be straightforward and should be based on sampling techniques, in order to keep the administrative burden to a minimum.

❖ **Risk management**

Customs has to be able to manage risk. Risk analysis helps customs deal with illegal activities whilst reducing the burden on legitimate operators. It is a means of targeting controls to the best effect. It allows customs to characterise the nature and likelihood of threats from those consignments, which perhaps because of their value, origin or importer, present a certain risk and give customs the best opportunity to concentrate on them. Risk management involves an analysis of what the possible risks are and an assessment of the effects of such risks. In doing so, the key risk factors have to be clearly described or characterised and communicated to the operational staff.

❖ **Customs integrity**

The integrity of the organisation as a whole and the individual offices of custom in particular is a very important variable in the efficient and effective service delivery of customs. Hence customs administrations should act to avoid and/or punish corruption. The automation process, the trade compliance and risk management process should act strongly in that direction, and should be supported by the education and communication policies. However, all these policies should act together to achieve synergy.

In summary, it is concluded that there are many policy options to enable customs administration to act as significant contributor to economic growth. The most important lesson that not only customs, but all government agencies have to follow, is to become learning organisations. With the capacity to learn, adapt, change, and grow, all the other challenges can be faced. The creation of a learning environment benefits all those involved. As a result of this environment, an exchange of the valuable accumulated experience and information available among the individuals who work in the customs administrations becomes a powerful way of enabling groups to take better decisions, to act faster and with greater confidence, and to be more innovative.

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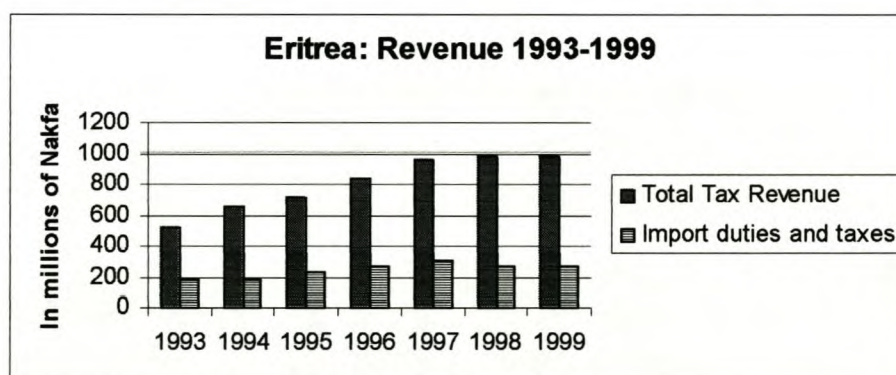
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APPENDICES

Appendix 1-a: Eritrea: selected indicators of government operations, 1993-1999

	1993	1994	1995	1996	1997	1998	1999
(Percentage change)							
Total revenue	82,3	6,7	38,9	3,9	43,4	-11,0	-2,9
Tax revenue	73,9	27	8,8	16,0	15,5	1,8	0,6
Total expenditure	112,2	28,6	33,6	1,5	-4,9	48,0	20,8
(In percentage of GNP)							
Total revenue	28,7	21,6	28,4	26,7	32,9	29,5	24,9
Tax revenue	16,7	14,9	15,4	16,2	16,1	16,4	14,4
Total expenditure	50,2	45,5	57,6	53,1	43,3	64,5	67,9
Overall cash balance excluding grants	-21,5	-23,9	-29,2	-26,3	-10,4	-35,0	-43,0
Grants	16,3	14,2	10,6	9,9	4,9	7,7	5,5
Overall cash balance including grants	-5,2	-9,7	-18,7	-16,4	-5,5	-27,3	-37,4
GNP at current market price in millions of Nakfa	3,109	4,407	4,650	5,128	5,975	5,942	6,817
Source: Ministry of Finance and staff estimates cited in (IMF, 1998:63; IMF, 2000:39). Figures for 1999 are preliminary estimates.							

Appendix 1-b: Eritrea: government revenue 1993-1999



Appendix 2: Eritrea- commodity composition of exports, 1993-1998

Export commodity composition	1993	1994	1995	1996	1997	1998
	Amount in millions of Nakfa					
Food and live animals	27,8	117,7	141,3	92,4	81,3	58,3
Beverages and tobacco	8,7	9,2	19,7	26,2	8,9	0,2
Crude materials	76,6	132,1	156,1	123	129,5	89,6
Mineral fuels and related	0,0	0,0	0,1	0,2	0,1	0,1
Animal & vegetable oils, fats, waxes	0,1	0,0	2,2	2,6	1,4	0,0
Chemicals and related products	6,2	7,5	12,0	13,4	8,2	4,1
Manufactured goods	52,9	67,8	100,3	88,3	64,3	26,1
Machinery and transport equipment	3,5	11,7	20,2	27,7	10,8	4,7
Miscellaneous manufactured articles	33,5	51,1	76,9	146,6	70,9	13,8
Total export	209,2	397,1	528,8	520,4	375,3	196,9
Of which to Ethiopia	130,4	207,5	354,2	335,9	238,1	52,2
In percent	62,3	52,3	67,0	64,5	63,5	26,6

Source: Customs Office cited in (IMF, 1998:77; IMF, 2000:53). Nakfa is Eritrean currency that has been introduced since November 8, 1997. At the time of introduction the exchange rate of Nakfa was 1Nakfa=1Birr. All amounts/figures prior to 1997 count in millions of Ethiopian Birr.

Appendix 3: Eritrea-commodity composition of imports, 1993-1998

Import commodity composition	1993	1994	1995	1996	1997	1998
	Amount in millions of Nakfa					
Food and live animals	166,4	426,2	426,7	542,9	599,9	460,1
Beverages and tobacco	35,9	43,3	10,7	23,5	22,4	20,2
Crude materials	31,3	49,1	65,9	116,5	67,7	43,7
Mineral fuels and related	6,8	12,9	48,2	39,5	52,5	41,3
Animal & vegetable oils, fats, waxes	10,7	33,3	28,8	55,0	57,6	71,3
Chemicals and related products	56,4	120,3	144,2	209,7	182,8	152,2
Manufactured goods	222,2	320,5	478,1	733,8	678,5	642,4
Machinery and transport equipment	381,9	752,6	1166	1091,1	1158,2	1030,1
Miscellaneous manufactured articles	111,2	234,9	166,9	250,8	242,7	231,4
Total Imports	1022,8	1993,1	2535,5	3062,8	3062,0	2693,0
Of which: Ethiopia	66,4	90,9	146,8	261,7	274,6	24,9
In percent	6,5	4,6	5,8	8,5	9,0	0,9

Source: Customs Office cited in (IMF, 1998:78; IMF, 2000:54). Nakfa is Eritrean currency that has been introduced since November 8, 1997. At the time of introduction the exchange rate of Nakfa was 1Nakfa=1Birr. All amounts/figures prior to 1997 count in millions of Ethiopian Birr.

Appendix 4: Eritrea-direction of exports, 1993-1998

Destination	1993	1994	1995	1996	1997	1998
	Amount in millions of Nakfa					
Belgium	0,0	0,0	0,0	0,1	0,0	0,2
Djibouti	0,0	0,7	1,4	2,2	2,7	0,5
Ethiopia	130,4	207,5	354,2	342,4	238,1	52,2
Germany	1,4	0,1	5,0	1,0	2,1	3,6
Italy	5,4	10,2	15,2	22,3	18,3	10,4
Japan	0,0	16,3	6,3	0,0	0,0	26,0
Korea	0,0	0,2	0,0	0,0	0,0	0,0
Netherlands	0,2	0,0	1,6	1,3	1,4	5,7
Saudi Arabia	3,6	50,3	15,9	20	7,3	2,3
Sudan	46,6	57,9	76	51,5	62,3	53,5
Sweden	0,6	0,0	0,1	0,6	0,0	0,0
U.A.Emirates	0,1	0,0	1,3	1,3	0,9	14,3
United kingdom	0,0	10,2	1,8	4,0	1,8	2,0
United States	0,0	1,2	0,6	39,9	3,2	4,0
Yemen	0,0	7,4	27,4	0,0	0,2	0,8
Other	21,0	35,1	22,0	33,8	37,0	21,4
Total	209,3	397,1	528,8	520,4	375,3	196,9
(In percent)						
Belgium	0,0	0,0	0,0	0,0	0,0	0,1
Djibouti	0,0	0,2	0,3	0,4	0,7	0,3
Ethiopia	62,3	52,3	67	65,8	63,5	26,5
Germany	0,7	0,0	0,9	0,2	0,6	1,8
Italy	2,6	2,6	2,9	4,3	4,9	5,3
Japan	0,0	4,1	1,2	0,0	0,0	13,2
Korea	0,0	0,1	0,0	0,0	0,0	0,0
Netherlands	0,1	0,0	0,3	0,2	0,4	2,9
Saudi Arabia	1,7	12,7	3,0	3,8	1,9	1,2
Sudan	22,3	14,6	14,4	9,9	16,6	27,2
Sweden	0,3	0,0	0,0	0,1	0,0	0,0
U.A.Emirates	0,1	0,0	0,2	0,2	0,2	7,3
United kingdom	0,0	2,6	0,3	0,8	0,5	1,0
United States	0,0	0,3	0,1	7,7	0,9	2,0
Yemen	0,0	1,9	5,2	0,0	0,1	0,4
Other	10,0	8,8	4,2	6,5	0,8	10,9
Total	100,0	100,0	100,0	100,0	100,0	100,0
Source: Customs Office cited in (IMF, 1998:79; IMF, 2000:55). Nakfa is Eritrean currency that has been introduced since November 8, 1997. At the time of introduction the exchange rate of Nakfa was 1Nakfa=1Birr. All amounts/figures prior to 1997 count in millions of Ethiopian Birr.						

Appendix 5: Eritrea- origin of imports, 1993-1998

Origin	1993	1994	1995	1996	1997	1998
	Amount in millions of Nakfa					
Belgium	14,3	66,5	64,3	84,1	26,8	47,3
Djibouti	11,3	29,8	41,1	78,6	79,0	57,3
Ethiopia	66,3	90,9	146,9	261,8	274,6	25,0
Germany	79,4	147,4	142,5	217,0	168,4	152,7
Italy	136,9	431	459	429,1	420,1	469,8
Japan	2,6	34,4	58,9	111,2	125,5	107,1
Korea	1,3	16	58,1	126,0	...	118,4
Netherlands	22,0	107,8	60,3	49,4	51,2	60,1
Saudi Arabia	282,5	328	490,4	465,6	480,2	15,4
Sudan	53,4	51,7	71,1	97,9	20,3	22,0
Sweden	25,9	16,1	31,7	19,3	22,9	19,0
U.A.Emirates	96,6	178,6	236,9	365,9	402,0	436,8
United kingdom	29,7	79,1	78,5	68,5	142,1	120,5
United States	11,4	35,3	93,8	83,1	96,4	113,9
Yemen	12,5	20,5	19,6	3,1	5,4	11,4
Other	176,9	360,1	482,4	601,8	747,3	916,4
Total	1023,0	1993,2	2535,5	3062,9	3062,2	2693,1
(In percent)						
Belgium	1,4	3,3	2,5	2,7	0,9	1,8
Djibouti	1,1	1,5	1,6	2,6	2,6	2,1
Ethiopia	6,5	4,6	5,8	8,5	9,0	0,9
Germany	7,8	7,4	5,6	7,1	5,5	5,7
Italy	13,4	21,6	18,1	14	13,7	17,4
Japan	0,3	1,7	2,3	3,6	4,1	4,0
Korea	0,1	0,8	2,3	4,1	0,0	4,4
Netherlands	2,2	5,4	2,4	1,6	1,7	2,2
Saudi Arabia	27,6	16,5	19,3	15,2	15,7	0,6
Sudan	5,2	2,6	2,8	3,2	0,7	0,8
Sweden	2,5	0,8	1,3	0,6	0,7	0,7
U.A.Emirates	9,4	9,0	9,3	11,9	13,1	16,2
United kingdom	2,9	4,0	3,1	2,2	4,6	4,5
United States	1,1	1,8	3,7	2,7	3,1	4,2
Yemen	1,2	1,0	0,8	0,1	0,2	0,4
Other	17,3	18,1	19,0	19,6	24,4	34,0
Total	100,0	100,0	100,0	100,0	100,0	100,0
Source: Customs Office cited in (IMF, 1998:80; 2000:56). Nakfa is Eritrean currency that has been introduced since November 8, 1997. At the time of introduction the exchange rate of Nakfa was 1Nakfa=1Birr. All amounts/figures prior to 1997 count in millions of Ethiopian Birr.						

Appendix 6: COMESA - CD

COUNTRY.....

COMESA CUSTOMS DOCUMENT FOR IMPORTS/EXPORTS/TRANSIT/WAREHOUSING

Item No 01	1. Exporter/Consignor		A.N	2. Clearance Office Code		3. Regime Code	4. Frontier Office/Port of Exit		FOR OFFICIAL USE DECLARATION NO & DATE											
	9. Importer/Consignee		A.N	5. Manifest No.		6. Date Arrival/Dep		7. AWB;B/L No.		8. Voy/Flight/Veh Reg No/Vess										
	18. Declarant/Agent		A.N		19. CWC/1 st Dest.		20. Declarant References		21. Valuation method/ruling											
	24. Mode of Transport		25. Nationality transport		26. Place of Discharge/Loading		27. Terms of Delivery		28. Terms of payment		29. Estimated period in warehouse/Transit									
	30. Location of Goods		31. Warehouse Code/name/address		32. Other information		33. Vehicle Owner/Driver		34. Via (Countries of Transit)		35. Seal Nos.	36. Total Gross Weight								
	a. Shipping Marks & Nos./ Container No.		b. CPC		c. Commodity Code		d. Net weight Kg		e. Goods Description		f. Currency	g. Exchange Rate	h. Invoice value		i. Customs value					
	r. Licence No.		s. Licence val./quantity		t. value/quantity deducted		u. Type of package		v. Number of Packages		w. Attached documents		j. 1 st Supplementary Quantity		k. Country of Origin		l. 2 nd Supplementary Quantity		m. Gross weight Kg	
	n. freight		o. Insurance		p. Other Costs		q. Preceding document Ref.		REVENUE INFORMATION		y. Duty/ Tax Type		Duty/ Tax Base		aa. Rate	bb. value for Duty/Tax	cc. Duty/Tax Due	dd. Total Duty/tax due this item	z. Attached documents	
	37. SUMMARY TOTALS		i		ii		iii		iv		41. Other Charges		Code		Amount					
	38. Total This Page																			
39. Other Pages																				
40. Totals																				
42. Grand Total (Duties, taxes and Other Charges)																				
47. DECLARATION																				
I/We.....the undersigned of.....(company name) being the agent/principal of.....(importer/exporter) do hereby declare that the information and particulars declared herein are true and complete.																				
Signature.....		Date		Place		Tel/Fax:.....														

REVERSE OF COMESA CUSTOMS DECLARATION – COMESA-CD

42. 1st Transit Country		43. 2nd Transit country	
OFFICE OF ENTRY I have examined the packages specified on this declaration and found them to conform to the description given Seals <input type="checkbox"/> On means of transport <input type="checkbox"/> On package Date, Signature, Stamp	OFFICE OF EXIT Means of Transport/Packages/ Exported with Seals intact <input type="checkbox"/> intact <input type="checkbox"/> affixed Date, Signature, Stamp	OFFICE OF ENTRY Means of Transport/Packages/ Imported with Seals intact Additional seals Numbers <input type="checkbox"/> No <input type="checkbox"/> Yes National Transit Requirements satisfied Documents checked Date, Signature, Stamp	OFFICE OF EXIT Means of Transport/ Packages/ exported with Seals intact <input type="checkbox"/> National Transit Requirements satisfied Date, Signature, Stamp
44. 3rd Transit Country		45. Country of Destination	
OFFICE OF ENTRY Means of Transport/Package/ Imported with Seals intact Documents Checked Additional Seals Numbers <input type="checkbox"/> No <input type="checkbox"/> Yes Date, Signature, Stamp	OFFICE OF EXIT Means of Transport/Packages/ Exported with Seals intact National Transit Requirements satisfied Date, Signature, Stamp	OFFICE OF ENTRY <input type="checkbox"/> Transferred to office of final Destination <input type="checkbox"/> Transit Operation Completed	OFFICE OF FINAL DESTINATION Means of Transport/ Packages /Imported with Seals intact Documents Checked Transit Operation Completed Date, Signature, Stamp

ACTIVITY GRID

Action Type	Authority	Date/Time	Computer Message or Code	Input By (Name and Initials)	Date/Time
Document Examination Details				Signature Time, Date, Stamp	
Goods Examination Details				Signature Time, Date, Stamp	
Query & Amendment Details				Signature Time, Date, Stamp	
Post Entry Adjustment Details				Signature Time, Date, Stamp	

COMESA-CD CONTINUATION SHEET

Item No	a. Shipping Marks & Nos./ container No.		b. CPC		c. Commodity Code		d. Net weight Kg	
	e. goods Description		f. Currency	g. Exchange Rate	h. Invoice value		i. Customs Value	
			j. 1 st Supplementary Quantity		k. Country of Origin	l. 2 nd Supplementary Quantity	m. Gross weight Kg	
			n. Freight	o. Insurance		p. other Costs		q. Preceding document Ref.
	r. Licence No.	s. Licence Val./quantity	t. Value/Quantity deducted	u. Type of Package	v. Number of Packages		w. Agreement Code	
REVENUE INFORMATION								
	x. Duty/Tax Type	Duty/Tax Base	aa. Rate	bb. Value for Duty/Tax	cc. Duty/Tax Due	dd. Total Duty/Tax due this item	y. Attached documents	
	i							
	ii							
	iii							
	iv							
Item No	a. Shipping Marks & Nos./ container No.		b. CPC		c. Commodity Code		d. Net weight Kg	
	e. goods Description		f. Currency	g. Exchange Rate	h. Invoice value		i. Customs Value	
			j. 1 st Supplementary Quantity		k. Country of Origin	l. 2 nd Supplementary Quantity	m. Gross weight Kg	
			n. Freight	o. Insurance		p. other Costs		q. Preceding document Ref.
	r. Licence No.	s. Licence Val./quantity	t. Value/Quantity deducted	u. Type of Package	v. Number of Packages		w. Agreement Code	
REVENUE INFORMATION								
	x. Duty/Tax Type	Duty/Tax Base	aa. Rate	bb. Value for Duty/Tax	cc. Duty/Tax Due	dd. Total Duty/Tax due this item	y. Attached documents	
	i							
	ii							
	iii							
	iv							
Item No	a. Shipping Marks & Nos./ container No.		b. CPC		c. Commodity Code		d. Net weight Kg	
	e. goods Description		f. Currency	g. Exchange Rate	h. Invoice value		i. Customs Value	
			j. 1 st Supplementary Quantity		k. Country of Origin	l. 2 nd Supplementary Quantity	m. Gross weight Kg	
			n. Freight	o. Insurance		p. other Costs		q. Preceding document Ref.
	r. Licence No.	s. Licence Val./quantity	t. Value/Quantity deducted	u. Type of Package	v. Number of Packages		w. Agreement Code	
REVENUE INFORMATION								
	x. Duty/Tax Type	Duty/Tax Base	aa. Rate	bb. Value for Duty/Tax	cc. Duty/Tax Due	dd. Total Duty/Tax due this item	y. Attached documents	
	i							
	ii							
	iii							
	iv							

ACIS: ERITREAN STUDENTS, NOV 01

Name	"Maria"	"The country"	"That meal"	"Cloze"	Compre- hension	Discourse	Evidence	Essay	Oral
Amanuel Habte Ghebretsadik	6	10	7	13	6	1	8	4	
Aron Hailemichael Gotiom	8	5	5	15	3	0	10	4	
Aron Mebrahtu Yohannes	10	10	5	12	7	0	0	3.5	
Bereket Ghezae Ghebru	9	7	3	16	6	2	4	5.5	
Berhane Tekle Weldeghiorgis	8	7	2	13	6	3	8	3.5	
Biniam Ghorghorios Brhane	9	10	4	16	5	3	8	5	
Daniel Rezene Mekonnen	9	10	3	14	4	2	4	4.5	
Debessay Fesehay Kassa	10	10	6	16	5	2	10	4.5	
Efrem Ocubamicael Negash	10	10	7	16	1	1	8	4.5	
Faniel Sahle Habtemicael	10	8	8	19	5	2	10	5.5	
Fanuel Mesfin Mebrahtu	9	9	6	15	6	3	7	3.5	
Jemal Adem Mohamed Naser	9	10	4	15	4	4	10	4	
Mengistu Ghebreyesus Woldu	9	10	5	14	7	2	6	4	
Negassi Ghebrealfa Kahsai	10	10	6	15	4	2	9	4.5	
Samuel Bizen Abraha	7	10	6	13	6	3	10	5	
Solomon Haile Ghebremedhin	8	7	3	13	3	1	6	4.5	
Teclesenbet Abraham Berhane	9	8	2	14	2	0	0	4	
Tedros Goje Tesfai	9	10	5	16	4	1	0	4	
Tekeste Tsehaye Gebremedhin	9	10	6	15	3	2	0	4	
Tesfamariam Kifle Hagos	9	8	4	12	3	1	4	4.5	
Wesenseghed Hagos Wolderufael	9	10	5	15	5	2	2	4	
Yonas Yohannes Desta	10	10	6	16	7	1	0	4	
Zerai Ghebretensae Manna	9	7	1	12	5	0	0	3	
Zemichael Fesahatsion Weldeghebriel	8	7	1	14	4	4	2	4	

Median

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