

# **CUSTOMS VALUATION SYSTEM IN ETHIOPIA**

**A Research Project submitted to the graduate studies of the Addis Ababa University in Partial  
Fulfillment for the requirements of MSc degree in Accounting and Finance**

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*June 2009*

*Addis Ababa  
Ethiopia*

## ***Abstract***

*The study assessed the customs valuation system applied in Ethiopia and investigated the existing problems in the system. The methods adopted in the study include documentary analysis, in-depth interview and self administered questionnaires. The results suggested that the Customs Valuation System in Ethiopia does not provide fair, neutral and uniform valuation and does not effectively protect traders from risk of arbitrary valuation by the customs officers. There is also risk of revenue loss to the government due to underinvoicing of imports by the traders since controlling mechanisms such as Post Clearance Audit (PCA) are not adequately developed. Therefore, the Government of Ethiopia needs to strengthen the controlling mechanisms within the customs valuation system since duties and taxes on foreign trade contribute the significant portion of its tax and duty revenues.*

## **Acknowledgment**

My sincere gratitude goes to my advisor Wollela Abehodie (PhD) for her invaluable comments and suggestions. She granted me far-reaching advices and eternal supports sacrificing her precious time. I would be thankful for Addis Ababa University for the financial assistance provided. I would also like to thank Ato Yohannes Mehtebe, Ato Yared Wondweson, Ato Betremariam Melese, Ato Mikias Tesfaye, Ato Abdulaziz Temam, and Ato Muez G/ Sellasie for their supports and assistances during data collections process. Furthermore, I would like to be grateful about the encouragements and comments supplied by my friends Abreham Demissie, Mebratu Leake and Melese Sitotaw.

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## **Abbreviation**

ACV	Agreement on Customs Valuation
ASYCUDA	Automated System for Custom Data
BDV	Brussels Definition of Value
CARICOM	Caribbean Common Market
CIF	Cost Insurance and Freight
CIQ	China Inspection and Quarantine Bureau
COMESA	Common Market for East and South Africa
CUCAS	Customs Union of Central African States
DTI	Distance Trade Input
EEC	European Economic Community
ERCA	Ethiopian Revenues and Customs Authority
ETB	Ethiopian Birr
FOB	Free on Board
GATT	General Agreement on Tariff and Trade
HS	Harmonized System
LC	Letter of Credit
MNE	Multinational Enterprise
MoFED	Ministry of Finance and Economic Development
MOTI	Ministry of Trade and Industry
PCA	Post Clearance Audit
PSI	Preshipment Inspection
UAE	United Arab Emirates
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
US	United States
USD	United States Dollar
VAT	Value Added tax
WCO	World Customs Organization
WTO	World Trade Organization

## **Chapter one: Introduction**

Customs valuation is the determination of the amount up on which the rates of duty and tax are applied in order to calculate the value of customs taxes liability of a tax payer. While these rates are unambiguously fixed by the statute in a tariff schedule, the declared value of imported goods may vary from transaction to transaction. The fluctuating tax base has important implications for the customs tax policy of a country. An importer engages in under invoicing and misrepresenting the value of shipment to reduce his/her duty and tax liabilities. Unless the under invoicing practices are detected and remedial actions are taken, the government revenues are lost and the importer receives unfair advantages over its competitors. The other main issue in customs valuation relates to related parties transactions. The difficulties pertinent to related parties pricing appear due to the fact that intra-company prices do not represent appropriate value. Customs value should not be arbitrary, fictitious, or based on indigenous goods. It should rather be real based on actual value of the imported goods or identical goods. If the actual value is not determinable, customs value should be based on the nearest ascertainable equivalent of such value using prescribed criteria. The chapter presents the research problems, the objectives of the study, its significances, scope and limitations, and the organization of the paper. Accordingly, in section 1.1 research problems are discussed. In section 1.2 the objectives of the study are shown and the methods used are stated shortly in section 1.3. The significances, and the scope and limitations are explained in section 1.4 and section 1.5, respectively. Finally, the organization of the study is presented in section 1.6.

## **1.1 Statement of Problem**

Indirect taxes contribute the momentous portion of tax revenues in developing countries in general and Ethiopia in particular. Custom duties and import taxes are among the important indirect taxes levied on imported commodities in Ethiopia. Customs valuation plays crucial role for the government in calculating duty and tax revenues and creating leveled play-ground among the traders in the country. Despite the fact that foreign trade taxes and duties provide significant revenues to Ethiopia, there is serious and complex problem of underinvoicing of import values by importers. Duties and taxes escape the net resulting in gross economic distortions such as uneven playing field and unfair competition for legal traders. Such circumstances also result in loss of revenues to government. Albeit customs valuation is a fundamental factor for facilitating trade and generating revenue, adequate investigations pertaining to customs valuation operations in Ethiopia were not conducted. Taking these facts in to account, the study attempted to assess the customs valuation system applied in Ethiopia and the prevailing problems in the system.

## **1.2 Objective of the study**

The study on customs valuation in Ethiopia was conducted to assess the customs valuation system currently applied in Ethiopia and to identify the problems in the system. In particular, the research project attempted to achieve the following specific research objectives:

- to portray rules and procedures followed in determining customs value;
- to delineate the currently applied customs valuation system in Ethiopia;
- to identify the customs declaration procedures for import transactions;
- to appraise the significances of duties and import taxes on foreign trade;
- to analyze and describe customs assessment processes and importers opinion on the valuation process;
- to evaluate the effectiveness of the customs valuation system in trade facilitation and creating fair competition among traders;
- to point out the control mechanisms used for ensuring that the customs valuation rules and directives are properly followed;
- to identify the common ways of underinvoicing import values by importers in Ethiopia; and
- to discover the customs operational problems in Ethiopia.

### **1.3 Methodology**

Considering the nature of the study and the type of data required, in this study the investigator employed the survey approach, in-depth interview, and documentary analysis for gathering data from different sources. Self administered survey questionnaires were used for gathering data from selected importing companies and customs clearing agents residing in Addis Ababa. Two customs valuation officers from each branch offices (Bole Airport and Kaliti) who have willingness, adequate qualification and reasonable experience and the tariff and goods valuation director at head office were interviewed. In addition to the in-depth interview conducted with the customs valuation officers, the study demands looking at legislative documents and the records of ERCA. As a result, the researcher used documentary analysis as for this purpose. Regarding data analysis, this study mainly employs descriptive analysis.

### **1.4 Significance of the study**

Customs valuation in Ethiopia needs special attention as customs duties and import taxes contribute the largest portion of indirect tax revenues in the country. Customs valuation also plays crucial role in smoothening the progress of international trades (imports and exports). Despite the aforementioned fact, customs valuation system in Ethiopia has various operational problems and lacks adequate control mechanisms. This study identified the problems in customs valuation system and forwarded suitable remedial actions in order to alleviate the problems. For the country's government in general and ERCA in particular, the outcome of this research project provides valuable information as it pinpointed areas of customs operation that should be improved. Although customs

valuation is a vital issue to be studied, review of literature revealed that very few endeavors were made by other researchers pertaining to customs valuation system in Ethiopia. Therefore, this study might serve as initiative for other researchers to further investigate customs valuation operations in Ethiopia.

### **1.5 Scope and limitation of the study**

ERCA collects taxes and duties levied on various goods imported for business as well as personal purposes. However, this study covers only customs valuation of commercial commodities. In addition, the study did not consider the whole customs assessment operations of ERCA, but merely its customs valuation systems. ERCA currently has 5 regional branch offices, 2 special branch offices, 2 offices of coordination. The research focused only on the operation of two regional branch offices located at Addis Ababa (Bole Airport and Kaliti). Customs valuation matters peculiar to the excluded branches might not be addressed in the study. The study is not without limitations. Although the common ways of underinvoicing were investigated, the study did not analyze the significance of government revenues vanished due to underinvoicing of by importers. Furthermore, examination of the customs valuation operating efficiencies was not included as it was beyond the study's objective.

## **1.6 Organization of the study**

In its main part, the paper comprises five chapters. The first chapter introduces some essential points about the project including problem statements, objectives, significances, scope and limitations. The second chapter presents theoretical and empirical review of literature on the subject of customs valuation. In the third chapter, the methodologies applied in the study are thoroughly explained. The fourth chapter shows the results of the study and discusses them in detail. Finally, the conclusions and recommendations are presented in chapter five.

To conclude, the sections included in this chapter described the problem statement, objectives, significances, scope and limitations of the study, and the organization of the paper. In light of this, the next chapter shows the empirical and theoretical literatures related to customs valuation.

## **Chapter two: Review of literature**

Customs valuation is the procedure used by customs officials to determine the value of the imported goods for the purposes of calculating the right import duty. The customs value is essentially the transaction value that an importer pays for the goods, but can include other additional costs such as commission, packaging and royalties. Where an ad valorem tariff applies to goods, customs officials need to know the value of the goods in order to work out the amount of duty the goods are subject to. The question of value arises only in cases of ad valorem tariffs, as opposed to specific tariffs. This is because specific tariffs are levied on specific amounts of goods and the tariff amount does not depend on the value of the good concerned. In the case of ad valorem tariffs, the tariffs are levied as proportions of the value of the good. Hence, determination of customs value is important.

Customs valuation is distinguished from commercial valuation. It is concerned not only with the transaction between the buyer and the seller but with all issues related to transactions between them. An important issue in customs valuation is thus the need for a valuation standard, which constitutes the customs definition of value. As stated by Goorman and Wulf (2005), the World Trade Organization (WTO) agreement on customs valuation, Article VII of the General Agreement on Tariffs and Trade (GAAT), is presently the last instrument in a series of efforts to come up with an internationally acceptable customs valuation system.

Customs valuation of goods is an important aspect of trade facilitation. Walsh (2003) noted that it is also important element for other functions including statistics, quota and licensing arrangement, and the application of preference systems. As mentioned previously, custom duties are levied mostly on an ad valorem basis and custom valuation is usually the basis on which tariff and tax liability is calculated. Hence it is important to establish generally acceptable rules and system for the valuation of imported goods.

This chapter is dedicated to review related literatures in the area of customs valuation. Accordingly, the theoretical and empirical facts pertinent to the study are discussed looking at studies conducted by different individuals, books and other materials. In the subsequent sections, the significance of customs valuation, international valuation standards, methods of customs valuation, impacts of customs valuation on international trade and choice of transportation, and the customs valuation in Ethiopia are discussed, in that order.

## **2.1 Significance of customs valuation**

Most import tariffs are based on ad valorem duties, that is, a rate expressed as a percentage of the value of the imported goods. Customs valuation is the determination of the amount upon which the rate of duty is applied. While these rates are unambiguously fixed by statute in a tariff schedule, the declared value of imported goods may differ from transaction to transaction. This has three important implications for tariff policy, as pointed by Goorman and Wulf (2005). First, an importer may engage in under invoicing and not declare the full value of the shipment to reduce his duty liability. Unless the underinvoicing is detected, government revenue is lost and the importer receives an

unfair advantage compared to its competitors. Second, government can take advantage of the valuation system to increase or decrease duty liabilities for revenue or protective purposes, thereby offsetting tariff concessions made under multilateral or bilateral trade agreements. Third, undervaluation and overvaluation are used for capital flight.

The increased importance of customs valuation is a feature of the development of modern customs tariff system. In the past, the usual purpose of imposing import duties was to raise revenue (Bashar 1999). In more recent time, the purpose of imposing import duties has begun to turn towards protection and encouragement of home industry and as the "ad valorem" system has been found to be more suitable for this purpose (for various reasons including fluctuating prices and the need to take into account gradations of quality) and its use has become widespread. According to Bashar (1999), this development has greatly extended the field of customs valuation and has included in it many classes of merchandise entailing special valuation problems. More adequate and precise valuation procedures have thus become necessary.

Empirical studies also revealed that there has been a remarkable increase in extra revenue realized by governments because of enhancement of declared transaction value. According to Chaturvedi (2006), in India, during 2003-04 the reported value of under valuation was USD 38.6 million. Similarly in the year 2005-06 an amount of USD 91 million of extra revenue was realized by enhancement in value of imported goods. Therefore, empirical facts also provide supportive evidences regarding the significances of customs valuation systems.

## **2.2 International valuation standards**

Customs valuation systems have been the subject of a number of international harmonization and standardization efforts. International efforts toward harmonization began in the early 20th century, but significant results did not come until the 1947 General Agreement on Tariffs and Trade (GATT). As pointed out by Goorman and Wulf (2005), the first significant international agreement on customs valuation was reached at the 1947 GATT negotiations that established principles to be adhered to by trading partners. These principles, embodied in GATT's Article VII, emphasize that customs value should not be arbitrary, fictitious, or based on value of indigenous goods. These principles have remained the basis for customs valuation since then.

In the context of the above introduction on the international valuation standards, the following discussions briefly present the different international standards formulated in different years.

### **Brussels Definition of Value (BDV)**

The first international standard based on the GATT valuation principles, the BDV, was introduced in 1950 (Goorman and Wulf 2005). The BDV is based on the concept of “normal price” – the price that the goods would obtain under open market conditions between unrelated buyers and sellers under specified condition of time and space. Where the invoice price cannot be used, such as with transactions that are not an arm’s length, with goods on consignment, with importation by agents and concessionaries, or when the declared price is suspiciously low, customs can use another can use another suitable basis to construe the normal price, using available information and taking into account the

actual conditions relating to the transaction being valued (Goorman and Wulf 2005). This flexibility is severely restricted under the ACV.

BDV acceptance represented substantial progress toward the international standardization of valuation systems. According to study conducted by Goorman and Wulf (2005) in 1970, about 100 countries applied the BDV (many on a de facto basis), and several economic associations had adopted it as their valuation standard- the European Economic Community (EEC), Customs Union of Central African States (CUCAS), and Caribbean Common Market (CARICOM). However, a number of important trading countries did not adopt the BDV and continued to apply their own systems, largely based on the positive concept of value. Some others adopted the BDV when it was extended to cover FOB countries. The above mentioned study also stated that the BDV itself was not always applied uniformly, and traders complained about discretionary and unjustified rejection of the invoice price and uplifting of the declared value by customs. In addition, many countries relied on reference prices for protective purposes and for facilitating customs clearance without endangering budget revenues. Negotiations on customs valuation were therefore included in the negotiations on nontariff barriers at Tokyo Round GATT negotiations.

### **The Tokyo Round and the Agreement on Customs Valuation**

The purpose of the negotiations on customs valuation at the Tokyo Round was to arrive at a fair, uniform, and neutral standard of value that precludes the use of arbitrary or fictitious values, conforms to commercial realities, and does not act as a barrier to trade (Shin and Yukyun 2007). Following difficult negotiations between industrialized and

developing countries, agreement was reached on a new valuation standard, the Agreement on Implementation of Article VII of the GATT. The study by Shin and Yukyun (2007) revealed that developing countries entered the negotiations by fully supporting the EEC valuation draft proposals, mainly based on the BDV. But the EEC, following separate understanding with the United State, dropped its support for the BDV and opted for the positive concept of valuation. This concept provided that, with few exceptions, the value should be determined on the basis of the price actually paid or payable for the imported goods. The exceptions were listed, as were the five alternative methods that were to be applied in strict hierarchical order when the primary method, the transaction value, could not be applied.

### **The Agreement on Customs Valuation (ACV)**

The Agreement on Customs Valuation came into force replacing the Tokyo Valuation Code and it forms part of the set of agreements that are presently mandatory for WTO members. According to Rege (1999), the agreement uses transaction value, that is the price actually paid or payable for the good, as the main basis for customs valuation. In cases where the transaction value does not reflect the correct value of the good, the agreement lays down five additional bases of valuation to be applied sequentially. These are transaction value of identical goods, transaction value of similar goods, deductive method, computed method, and fall-back method. In addition to these, the agreement also incorporates provisions defining the terms used in it, provisions on currency conversion, right of appeal of importers, clearance of goods on providing guarantee, and special and differential treatment of developing countries.

The ACV is designed to promote a fair, uniform and neutral system for the valuation of goods for customs purposes that precludes the use of arbitrary or fictitious customs values (Sandler 2005). The agreement on customs valuation plays an essential part in ensuring that the correct duties are paid on imports, rather than duties based on minimum values. A key objective of the agreement is to ensure that the basis for valuation of goods for customs purposes is, to the greatest extent possible, the transaction value (the price actually paid or payable for the goods when sold in the importing country). Sandler (2005) also noted that some adjustments to this value can be made. Other costs that are incurred by the buyer but are not included in the price actually paid can be included in the customs value. These adjustments can include such costs as commissions and brokerage, royalties and license fees, and the cost of packing, whether for labor or materials.

According to study by Polyakov and Shewarega (2006), the ACV incorporates a number of provisions providing special and differential treatment to developing countries. Article 20 (1) of the Agreement provides for delaying its implementation for a maximum period of five years to developing countries which did not accede to the Tokyo Round Customs Valuation Code. As the agreement came into force in 1995 this period has ended for countries that are original members of the WTO. However, new acceding developing countries have been granted such transitory periods to bring their customs operations in compliance with the agreement. Article 20 (2) allows the same developing countries to delay the implementation of the computed method of valuation for a further three years after they start implementing the ACV. Polyakov and Shewarega (2006) also points out that additional preferential treatment provisions are included in the Agreement. Such

preferential treatment requires the provision of technical assistance to developing countries by conducting studies in areas identified as being of potential concern including those related to importation by sole agents, sole distributors and sole concessionaires.

The researcher will review the different valuation methods and their most important feature in the following section.

### **2.3 Methods of determining customs value**

WTO customs valuation rules emphasize that customs value should be based on the actual value of the imported goods or like goods. Generally, the customs value of all merchandise budgeted to a country of importation will be the transaction value, price actually paid or payable, for the goods (Sandler 2005). If the transaction value cannot be used and found, then certain secondary bases are considered in order of precedence: transaction value of identical merchandise; transaction value of similar merchandise; deductive value; and computed value. The order of precedence of the last two values can be reversed if the importer requests. In the subsequent parts of this paper, each of this method is described in detail.

#### **2.3.1 Transaction value method**

The transaction value system stipulates that the transaction value method must be used wherever possible. This method bases the customs value on the “price” paid for the imported goods (Ghimire et al. 2005). Certain amounts not included in the price such as transportation, insurance, packing charges, royalties and license fees, assists, and other payments may have to be added to arrive at the precise customs value. According to

Sandler (2005), there are three requirements, which must be met in order to use the transaction value method. They are:

1. The goods must be subject to a sale;
2. The sale must be for export to the importing country; and
3. The price paid or payable must be determinable.

The Transaction Value System includes the determination of Customs Value and various deductions and additions to the Price Paid (Ghimire et al. 2005). Besides the price the importers are paying for the goods, other expenses are also incurred in relation to the goods but not included in the price. The amount paid to the supplier may not include amounts on which the duty has to be paid. The “price actually paid or payable” is defined as the total payment made or to be made by the buyer to or for the benefit of the seller for the imported goods. It is important to understand that the “invoice” amount is not necessarily the “price actually paid or payable as” that term is defined. It is, therefore, important that customs official include in the price actually paid or payable all elements of it.

Looking at the additions to the price paid reveals the following details. There are a number of charges which must be added to the price actually paid or payable and thus will be included in the customs value of the goods even though they are not part of the “invoice” price of the imported goods and are normally charged separately under a different contract (Jovanovich 2002). These charges include:

- cost of transport, excluding inland freight;
- loading, unloading, and handling charges at the place of shipment;

- cost of insurance;
- commissions including indenting commissions and brokerage;
- cost of containers;
- cost of packing, labor and material;
- royalties and License Fees paid by you that are related to the goods as a condition of sale, no matter when or whom;
- goods or services, commonly referred to as “assists” provided free or at a reduced cost by the buyer directly or indirectly to the seller. Examples of assists are moulds, tools, dies, raw materials, designs and;
- any additional payment based on the resale, use or disposal of the goods that is made to the seller directly or indirectly by the buyer.

Under this method, as noted earlier, deductions are also considered. The price, for the purpose of value for duty, is the importer’s net price at the time of importation. The buying commission (or discount) shown on the invoice is excluded and the net amount payable is the purchase price and the value for customs purposes. On the other hand, if the commission or discount is in the form of rebate payable at a later date if certain conditions are met, it will be included in the transaction value (Walsh 2003).

This method has its own limitations. As stated by Jovanovich (2002), the transaction value method cannot be applied in some circumstances. It cannot be used if (1) there are restrictions on the disposition or use of the goods by the buyer other than those imposed or required by law, those that limit the geographical area in which the goods may be resold, or those that do not affect the value of the goods; (2) the sale or price of goods is subject to a condition or consideration for which a value cannot be determined with respect to the goods being valued; (3) there are any subsequent payments to the seller by

the buyer unless an appropriate adjustment can be made; (4) the buyer and seller are related. This limitation will not be applicable if the importer can demonstrate that the declared customs value approximates a “test value” or demonstrates to Customs’ satisfaction that the price has not been influenced by the relationship.

Customs administrations have the right to request further information in cases where they doubt the accuracy of the declared value of the goods. If customs officials are still in doubt, the agreement provides them with a number of options such as identical goods method, similar goods method, deductive method, computed value method, and fallback method to be applied in this order:

### **2.3.2 Identical goods method**

If the customs value of the imported goods cannot be determined according to the price paid or payable, the customs value is determined on the basis of the transaction value of identical goods sold for export to the same country of importation and exported at or about the same time as the goods being valued. In applying this method, the transaction value of identical goods in a sale at the same commercial level and in substantially the same quantity as the goods being valued is used to determine the customs value (Jovanovich 2002). Where no such sale is found, the transaction value of identical goods sold at a different commercial level and/or in different quantities, adjusted to take account of differences attributable to commercial level and/or to quantity used, the adjustments referred to can be made on the basis of demonstrated evidence which clearly establishes the reasonableness and accuracy of the adjustment, whether the adjustments lead to an increase or a decrease in the value.

### **2.3.3 Similar goods method**

If the customs value of the imported goods cannot be determined under the actual price and identical goods methods, the customs value is determined on the basis of the transaction value of similar goods sold for export to the same country of importation and exported at or about the same times as the goods being valued. Where no such sale is found, the transaction value of similar goods sold at a different commercial level and/or in different quantities adjusted to take account of differences attributable to commercial level and/or to quantity, is used (Jovanovich 2002). According to WTO customs rules, if, in applying this method, more than one transaction value of similar goods is found, the lowest value is used to determine the customs value of the imported goods.

### **2.3.4 Deductive method**

Jovanovich (2002) noted that if the imported goods are sold in the country of importation in the same condition as when imported, the customs value of the imported goods under the provisions of this method is based on the unit price at which the imported goods or identical or similar imported goods are sold in the greatest aggregate quantity, at or about the time of the same time.

### **2.3.5 Computed method**

As made clear by Jovanovich (2002), the customs value of imported goods under the provisions of this method is based on a computed value. Computed value consists of the sum of:

1. The cost or value of materials and fabrication or other processing employed in producing the imported goods;
2. An amount for profit and general expenses equal to that usually reflected in sales of goods of the same class or kind as to goods being valued which are made by producers in the country of exportation for export to the country of importation;  
and
3. The non-FOB costs or value of all other expenses necessary.

### **2.3.6 Fallback method**

If the customs value of the imported goods cannot be determined in terms of under the provisions of methods, (actual price, identical goods, similar goods, deductive and computed methods), the customs value is determined using a reasonable means consistent with the principles and general provisions of the Agreement and of Article VII of GATT 1994 and on the basis of data available in the country of importation (Walsh 2003).

## **2.4 Customs valuation and transfer pricing**

Several key industries feel that efforts need to be made to explore the possibility of convergence between customs valuation procedures and transfer pricing norms, the lack of which is increasing litigations in different countries (Chaturvedi 2006). In the Tokyo Round Agreement in 1979 and subsequently in Article VII of GATT, 1994, there is hardly any reference to transfer pricing though it does make a case for arms length price for customs valuation (Satapathy 2001). In light of the fact that, with the fast expansion of intra-firm trade there is a growing need to explore the gap and interplay between customs valuation and other commitments like direct taxation between related parties.

Some companies also raised the expectation that the government should ensure greater convergence of rules and administrative practices in this area (Chaturvedi 2006).

By taking advantage of differences in taxation rates (Customs duties and Corporate tax), Multinational Enterprises (MNEs) in practice distribute their tax liability to reduce their overall tax burden and increase profitability. Kirby (2007) noted that as the number of international transactions between related parties (between parent company and their affiliates or between affiliates) is increasing, Transfer Pricing becomes an important issue for both MNEs as well as for Customs and national Tax authorities.

A phenomenon that commonly prevails is that tax and customs administrations are each pulling the importer/taxpayer in opposite directions (Jovanovich 2002). This results from the fact that a lower value for imported goods will result in higher potential profit and income tax revenue from the resale of such goods to unrelated customers. In contrast to this, the higher the dutiable value of the imported goods, the greater the customs duty revenue on the goods for the customs authorities. Thus, tax administrations will generally insist on a low transfer price and customs administrations on a high import price to ensure each revenue department maximizes their revenue stream from the import transaction. As stated by Jovanovich (2002), the end result is that the importer/taxpayer could be squeezed in the middle if neither customs nor tax law recognized transfer pricing as agreed to under the other disciplines. As set out above, the origin and development of the income tax transfer pricing regimes compared to those of the customs valuation system have been radically different, leading to tax and customs laws and authorities often having contrasting objectives and applying different principles. These

inherent differences create barriers for the process of harmonizing the existing tax and transfer pricing valuation methods and principles.

## **2.5 Customs valuation and international trade**

Since the launching of the WTO negotiations on trade facilitation, it is being realized that as most of the other pieces fall in place, one of the most significant challenge emanates from customs valuation (Chaturvedi 2006). As stated by Leopoldskron (2007), it has become increasingly clear that not only market-access barriers but also inefficient and outdated border clearance processes limit international trade. The aim of the Doha negotiations on Trade Facilitation is to ease these border constraints by promoting measures that would simplify and harmonize international trade procedures. This means cutting red-tape, reducing delays, and increasing transparency at borders in order to facilitate countries' participation in international trade.

Studies have shown that reductions in transaction costs through trade facilitation measures may bring gains on the order of those projected for tariff liberalization (or even higher). The World Bank estimates that total trade transaction costs are likely 10- 15 percent of the total value of the goods traded. Bringing the countries whose trade-facilitation capacity is below average even halfway up to the average level could increase overall trade by some USD 377 billion annually. Inefficient borders also add considerable time to business transactions (Leopoldskron 2007). The study by Leopoldskron (2007) also portray that documentation procedures and the time spent in customs and inspections together account for 75percent of the total time it takes to import goods. For perishable

goods such as agricultural products, reducing the time spent at borders would be particularly beneficial.

In India, a survey conducted in 2004-05 on trade facilitation, identified customs valuation as the key problem for trading community. Much before accessing to the WTO Agreement of Customs Valuation, India accepted the concept of 'transaction value' as a primary method for valuation. It was done as part of the GATT valuation implementation in August, 1988 itself (Chaturvedi 2006). As part of this, the customs department is bound to accept the value stated by the importer through the invoice unless the department has additional information to substantiate under invoicing. Some importers take advantage of this legal situation and undervalue their imports with fake invoices knowing that customs authorities may not be able to place them.

The promotion of a unified customs valuation by the WTO is an important step in fostering efficient international trade. The standards of fairness, consistency and non-discrimination are key factors in the implementation of a unified order in customs policies. For developing countries that are members of the WTO, they are given five years to make the necessary adjustments in applying the code. Crucial areas that need to be addressed include customs personnel training and education of private traders. In addition, customs valuation cases serve as reference points (Shin and Yukyun 2007). According to Chaturvedi (2006) the underinvoicing of imported goods is an extremely serious and complex problem that negatively impacts on national economy in several ways. It means that the duties and taxes escape the net and result in gross economic

distortions. This also leads to an uneven playing field, unfair competition and is disadvantageous to goods manufactured in the country.

## **2.6 Customs valuation and transportation costs**

According to the study conducted by Erzan and Yeats (1990), in establishing the value of imports for tariff assessment, most countries apply duties either to the CIF or the FOB value of the traded good. One effect of using the far more common CIF base is to place a disproportionate burden on countries that have higher freight and insurance costs. Distant countries often not only pay higher transport costs, but are further penalized by disproportionate tariff costs that worsen their competitive disadvantage. The f.o.b. valuation procedure does not penalize traders for their location, but applies a nominal tariff rate directly to the export costs of each country.

## **2.7 Nature of underinvoicing**

Valuation fraud is a serious problem in most countries particularly in developing countries that have relatively high rates of duties and other various taxes on imported goods. It is often exacerbated by a generally poor level of tax compliance through-out the country, a tendency for many importers to deliberately maintain poor records and the existence of special relationship with suppliers. WTO valuation rules require an administration to accept the declared transaction value (even when clearly unreasonable), unless the authenticity of the supporting invoice can be unequivocally disproved by the authorities. Developing countries are of the view that requiring customs to accept the transaction value reflected in invoices submitted by importers would impede detection of

cases in which imported goods were undervalued to reduce the incidence of duties (Rege 2002). Evasion of duty through undervaluation or misdescription of imports is an acute problem for custom administration in developing countries. King (2003) estimated a widespread underinvoicing in Nepal and also indicated lack of effective valuation procedure in place in Nepal. The transaction value system also was introduced without adequate preparation, without putting into place the necessary procedural and organizational framework, without adequate training and without an adequate value information system (King 2003). Filmer (2003) on the other hand reports the views of trading community that there is a threat at declaring a higher value and delaying clearance to extract illegal payments from the traders. Ghimire et al. (2005) reports under invoicing of goods, discretionary power of customs officials and limited data base for value appraisal as the major problems of customs valuation. A limited database for value appraisal is considered as a violation of ACV. A perception survey conducted by Filmer (2003) has also identified custom valuation as one of the major issues of trade facilitation in Nepal.

## **2.8 Customs valuation in Ethiopia: an overview**

In the previous sections the different international customs valuation standards set in different years, valuation methods, underinvoicing cases and other related issues have been discussed. In light of this, it may be important to review literatures related to the customs valuation practice in Ethiopia. This section is devoted to discussing the customs valuation practice in Ethiopia.

Review of legislative document prepared by Federal Democratic Republic of Ethiopia (2008) reveals that ERCA is the main organ that is responsible for the Customs operation in Ethiopia. Previously it was the Ethiopian Customs Authority that oversaw the Customs operation in Ethiopia. But, since the second half of 2008, the Ministry of Revenue has been reorganized as the Ethiopian Revenues and Customs Authority by proclamation number 587/2008 or 587/2000 EC.

Polyakov and Shewarega (2006) noted that the current system of customs valuation reflects the experience of developed countries (the US, in particular) and is based on built-in incentives for compliance by importers and on the use of electronic information management. Trade in these countries takes place in large-scale lots, and duty rates are generally low. Moreover, importers themselves normally conduct the valuation process. It is not viable to apply ACV in a non-compliant environment. Unfortunately, such environment is prevailing in Ethiopia today. Polyakov and Shewarega (2006) also noted that undervaluation is generally the rule of the game for smaller importers (comprising up to 90 percent of all importers in Ethiopia) who generally trade small lots, with variable consignment contents. This makes the customs valuation systems currently applied more susceptible of undervaluation and poor compliance by importers.

In the previous sections the researcher has discussed the important issues related to customs valuation systems. To sum up, most import tariffs are based on ad valorem duties. Where an ad valorem tariff applies to goods, customs officials need to know the value of the goods in order to work out the amount of duty to be imposed on the goods. International efforts towards harmonizing customs valuation practices began in the early

20th century, but significant results did not come until the 1947 GATT. This agreement was followed by the 1950 convention on the valuation of goods for customs purposes, establishing the BDV and the 1979 agreement on implementation of article VII of the GATT, resulting from the Tokyo Round. WTO customs valuation rules emphasize that customs value should be based on the actual value of the imported goods or like goods. If the transaction value cannot be used and found, then certain secondary bases are considered in order of precedence: transaction value of identical merchandise; transaction value of similar merchandise; deductive value; and computed value. Most customs authorities have considered related party prices for the importation of goods as being acceptable without much enquiry. In fact, not much effort has been made by customs administrations to check the bona fides of related party contractual prices. On the other hand, customs valuation systems determine international trade practice by a country as it is the basic element of trade facilitation.

The customs valuation system in Ethiopia is in line with the ACV. The current system of customs valuation reflects the experience of developed countries which is based on built-in incentives for compliance by importers and on the use of electronic information management. It is not feasible to apply ACV in a non-compliant environment since evasion of duty through undervaluation or miss-description of imports is an acute problem for custom administration in developing countries. This makes the customs valuation systems currently applied in Ethiopia more susceptible of undervaluation and poor compliance by importers.

To conclude, there are few studies conducted in Ethiopia related to customs valuation. Even though there are some studies, they dealt only with the legal aspects and policy issues of the customs valuation. None of these studies make assessment of operational issues and practical problems related to the customs valuation. This study mainly aimed to make assessment on operational activities and to examine the difficulties associated with customs valuation in Ethiopia. Therefore, the grand research questions of this study relate to the manner in which ERCA determines Customs values practically and the main problems of the Customs valuation systems applied in Ethiopia. The methodologies applied to address these grand research questions are shown in the next chapter.

## **Chapter three: Research design**

In the context of the grand research questions developed through the review of the literatures in the previous chapter, this chapter presents the research methods. Accordingly, the first section (section 3.1) presents the research questions. Section 3.2 briefly shows the philosophy of the two main research approaches namely quantitative approach and qualitative approach. Finally, section 3.3 presents the research methods adopted in this research.

### **3.1 Research questions**

As shown in chapter two, the grand research questions of this study inquire about the operations of customs valuation systems currently applied in Ethiopia and the existing problems in the customs valuation system. The study on customs valuation system in Ethiopia is an endeavor to describe the procedures, rules, methods, and significance of the customs valuation system applied in ERCA. It also incorporated other related issues such as import transactions, natures of importing firms, perception of importers on the customs valuation practice, the performance of the system, control mechanisms within the and operational problems.

In line with the aforementioned grand research questions, the following specific research questions were developed.

- what are the rules and procedures followed by ERCA in customs valuation?
- how significant are the duty and import tax revenues collected by ERCA?
- how does the Authority practically perform customs assessments?

- is the custom valuation system operating effectively?
- are related parties transactions (transfer pricing) matters properly addressed in the customs valuation system?
- do most importers in Ethiopia report the correct country of origin?
- does the system entail adequate control mechanisms?
- does the customs valuation system in Ethiopia practically facilitate trade?
- what are the ways of underinvoicing made by importers in Ethiopia?
- what are the main problems of the Customs valuation systems applied in Ethiopia?

### **3.2 Philosophy of research methods**

After developing the research questions, it is important to identify the sources data, methods of data collections and analysis. As stated by Kothari (2004), a research method is the arrangement for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. In the interest of science, the design of research methods has to be based on an acceptable and justifiable ground. According to Patton (1990), purpose is the controlling force in research. The decisions about methods of data collections, measurement, sources of data, method of analysis, and reporting depend on the purpose and the objectives of the research. Therefore, researchers need to get clear understanding about the purpose and objectives of the study before going for designing research methodology.

Patton (1990) also noted that data collection options and strategies for any particular applied research inquiry depend on answers to several questions including: what kinds of

information are needed? How is the information to be used? For what purpose is the study being used? What resources are available to conduct the study? Answers to these questions determine the kinds of data that will be most useful and the type of research method (qualitative, quantitative and mixed method) appropriate in a particular study. The choice of alternative research methods leads directly to consideration of the relative strengths and weaknesses of qualitative, quantitative methods, and mixed method. Qualitative methods permit the researcher to study selected issues in depth and detail (Patton 1990). Approaching data collection without being constrained by predetermined categories of analysis contributes to the depth, openness, and detail of qualitative inquiry. Quantitative methods, on the other hand, requires the use of standardized measurements so that the varying perspectives and experiences of people can be fit into a limited numbers of predetermined response categories to which numbers are assigned. Quantitative approach involves the generation of data in quantitative form which can be subjected to rigorous quantitative analysis in a formal and rigid fashion (Kothari 2004). According to Goode and Hatt (1986), the advantage of a quantitative approach is that it is possible to measure the reactions of people to a limited set of questions, thus facilitating comparisons and statistical aggregation of the data. By contrast, qualitative approach typically produces a wealth of detailed information about a much smaller number of people and cases. This increases understanding of the cases and situations studied but reduce the ability to generalize. On the other hand, mixed research tries to mix the best of qualitative and quantitative research approaches into research studies. In its philosophy, mixed research takes an eclectic, pragmatic, and commonsense approach, suggesting that the researcher mix quantitative and qualitative in a way that works best for the given

research question being studied in a particular context. According to Myers (2002), the mixed approach uses both deductive and inductive methods, obtains both quantitative and qualitative data, attempts to corroborate and complement findings, and takes a balanced approach to research.

Qualitative methods are first and foremost research methods. They are ways of finding out what people do, know, think and feel by observing, interviewing and analyzing documents (Patton 1990). According to Patton (1990), qualitative approaches are particularly applied in practical situations such as process studies and evaluation, formative studies for program improvements, evaluating individual outcomes, case studies to learn about special interest, comparing programs to document diversity, implementation evaluations, legislative monitoring, and a study on system perspectives and theory. The study on customs valuation systems in Ethiopia investigated the customs valuation processes and evaluated the effectiveness of the processes. Process evaluations are aimed at elucidating and understanding the internal dynamics of how a system, organization or relationships operate. Process studies for systems evaluation focus on the following kinds of questions: what are the things (people experiences) that determine the system? How participants operate in the system? What are the strength and weakness of the system? What is the nature of staff-client interactions? Qualitative approaches are highly appropriate in studying processes because depicting process requires detailed description; the experience of process typically varies for different people; process is fluid and dynamic and participants' perceptions are a key process consideration (Patton

1990). Therefore, the researcher of this study has believed qualitative approach to be appropriate for the study and applied it accordingly.

Qualitative approaches consist of three main kinds of data collection methods: (1) Survey methods; (2) direct observations; and (3) documentary analysis. The data from survey approaches consist of direct quotations from people about their experiences, opinions, feelings, and knowledge. The data from observation incorporate people's activities, behaviors, actions, and the full range of interpersonal interactions and organizational processes that are part of observable human experiences. Documentary analysis in qualitative enquiry yields excerpts, quotations from organizational records, memoranda and correspondences, official publication and reports, and personal diaries (Kothari 2004). Selecting the data collection methods is one of the major points at which safeguards against bias and unreliability would need to be introduced (Goode and Hatt 1986). Each of the various methods of data collection has its peculiar advantages and limitations. In selecting methods of data collection, the researcher should consider the nature of the problem, the scope of the study, the nature of respondents, type of information needed, and the degree of accuracy required. Once a method is chosen, tools for collecting the information must be devised. If samples are to be taken from targeted population, the researcher needs to decide about the sample size and sampling techniques. Finally, the data collected has to be processed and analyzed in appropriate ways that ensures realization of the study's objectives.

In the subsequent sections, the researcher explains the sources of data, the methods of data collection, sampling techniques and types of analysis suitable for and employed in the study in light of the aforementioned research philosophies.

### **3.3 Research methods adopted in this study**

Cooper (2005) affirmed that researchers must consider the purpose, scope, authority, audience and format of the source in selecting the source of data. Keeping these facts in to account, the investigator, in this study, used customs valuations officers of ERCA working in regional branch offices, tariff and goods valuation vice director in the main office, accounts and finance manager of importing companies, assessors of customs clearing agents, customs valuation legislative documents (proclamations and regulations), and customs valuation manuals as sources of data. Most of the data needed for answering the investigative questions about customs valuation system in Ethiopia are qualitative in nature. The data had been obtained by communicating with those individuals working in the area of customs valuation and with businesses which are legally obligated to pay customs duties (importers). It is also important to give consideration for what the rules and regulation of the country state regarding the customs valuation process and its supporting procedures. In addition to the above mentioned sources, the researcher used other sources for acquiring more data needed for the undertaking. Such data were found from ERCA records, fiscal reports of MoFED, policy manuals, memoranda and correspondences, legislative documents, and official publication and reports.

The investigative questions leave the option of choosing among survey approach, observation approach or documentary analysis. Surveying is more efficient and

economical than observation as well chosen questions can yield information that would take much more time and effort to gather by observation (Wilkinson and Bhandarkar 1999). Considering the nature of the study and the type of data required, in this study the researcher employed the survey approach, in-depth interview, and documentary analysis for gathering data from the above mentioned sources. In the next subsections, the researcher discusses these methods as well as the method of data analysis in order to rationalize the grounds for choosing them.

### **3.3.1 Survey method**

The survey approach involves surveying people and recording their responses for analysis. The greatest strength of the survey as a primary data collecting approach is its flexibility. It does not require a visual or other objective perception of the information needed by the researcher. Abstract information of all types can be gathered by inquiring others. Researchers seldom obtain much information about opinions and attitudes except by surveying. According to Cooper (2005), survey method is more appropriate for getting opinions and expectations of individuals. Therefore, collecting information about the customs valuation system's operation is more viable through surveying people who works on the system.

Cooper (2005) also noted that the survey approach enables the researcher to collect more detail information from the informant by communicating with them about the topic under investigation. Furthermore, since most of the data needed for the study were expected to be gathered by communicating with customs valuation officers, assessors and importers, the researcher found survey approach to be the appropriate one. The most appropriate

applications for survey approach are cases where participants are uniquely qualified to provide the desired information. The individuals to be included in the survey are expected to be qualified to deliver the desired information since they are the main participants in the customs valuation system. The major weakness of survey approach is that the quality and quantity of information secured depends heavily on the ability and willingness of participants to cooperate. Often, people refuse fail to reply to survey questionnaires. Some people may fail to see any value in participation; they may be suspicious of the survey for some reason. The issue of customs valuation is quite important to the clearing agents as well as importers. In order to control biases of the participants due to their special interest in the subject matter, the researcher had dealt the investigative questions sensitive to clearing agents and importers with the customs valuation officers of ERCA. Regarding their ability to provide quality and quantity data, the respondents included in the survey were dependable individuals shouldering immense responsibility of customs valuation in customs assessment in clearing agents, and finance matters in importing companies. For further information it is advisable to look at respondents profile in chapter 4. The investigator tried to clearly specify the purpose and contribution of the study to stimulate the willingness of the respondents. Therefore, the researcher believes that the respondents' ability and willingness in supplying data do not impair the quality of the undertaking.

Self administered survey questionnaires were used for gathering data from selected importing companies and customs clearing agents residing in Addis Ababa. Two sets of questionnaires were vigilantly designed and distinguished in order to assure that the write

questions are addressed to the right person. The accountants/finance managers of importing firms and assessors of customs clearing agents are expected to have reasonable knowledge of the subject matter (customs valuation). Keeping this fact in to consideration, the questionnaires were filled out by these individuals. The researcher believes that the viewpoints of importers on customs valuation system were addressed via questionnaire dealt with accountants/finance managers of importing firms. Since there are many importing firms as well as customs clearing agents, given limited amount of time and money, it would be difficult to include all of them in the data collection process. As stated by Cooper (2005), a researcher must judiciously select sample size of a study, keeping in view the nature, scope, and object of enquiry, availability of funds, availability of time, and precision required. Accordingly, the researcher contacted 24 selected importers and 31 assessors in customs clearing agents using self-administered questionnaires.

### **Sampling techniques**

The basic idea of sampling is that by selecting some of the element in a population, the researcher may draw conclusion about the entire population. There are many good reasons for sampling including greater speed of data collection, greater accuracy of results, lower cost, and availability of population elements. Sampling possesses the possibility of better interviewing, more thorough investigation of missing, wrong or suspicious information and better processing that is not possible with complete coverage. Moreover, it may not be important to interview or send questionnaires to all persons in the sample frame if one finds adequate information by asking few individuals. In view of

that, the investigator surveyed 24 importing firms and 31 assessors in customs clearing agents.

A variety of sampling techniques are available. The one the researcher should select depends on the requirement of the project, its objectives, and the fund available. The members of a sample are selected either on a probability basis or some other non probability means. Regarding the sampling techniques, for selecting importing firms and customs clearing agents, random sampling was used in this research. 24 importing firms were randomly chosen for collecting data through survey questionnaires. In similar fashion, about 31 assessors were randomly selected from different customs clearing agents. Selecting a respondent from each of the above groups randomly reduces the bias of the researcher, enables to gather opinions of diverse assessors, and makes sure of incorporating the attitude, expectation, and satisfaction of different importers.

### **3.3.2 In-depth interview**

In-depth interview is a two-way conversation initiated by an interviewer to obtain information from a participant. The interviewer generally controls the topics and pattern of discussion. The greatest value of this method lies in the depth of information and detail that can be secured. Personal contact with participants might elicit richer and more detailed responses. It provides an excellent opportunity to probe and explore questions (Cooper 2005). Taking these opportunities in to account and believing that more data can be realized through in-depth interview with individuals who directly participate in the customs valuation system, in-depth interview had been executed by the investigator. Two customs valuation officers from each branch offices (Bole Airport and Kaliti) who have

willingness, adequate qualification and reasonable experience and one tariff and goods valuation director at head office were interviewed. As per ERCA statistical report (2004), activities performed in these two branch offices cover more than 80 percent of country's customs operation. Since most of the import transactions in Ethiopia get customs clearing services at branches located in Addis Ababa, the investigator believes that wide-range of data about customs valuation activities were obtained.

### **3.3.3 Documentary analysis**

Written evidences have direct function of providing facts/figures and indirect function of enabling to project understanding into other times and places. One particularly rich source of information about many processes is process records and documents. The nature of process records and documents will vary from process to process, but in contemporary society all processes leave a trail of paper that evaluators can follow and use to increase knowledge and understanding about the process (Patton 1990). Researchers making assessment on systems should attempt to anticipate as many different sources as possible. The ideal situation would include access to all routine records on clients, all correspondence from and to system staff, financial and budget records, organizational rules, regulations, memoranda, and any other official documents generated by the systems. These kinds of records and documents provide the researcher with information about many issues that cannot be observed and take place before the assessment began.

One of the best uses of documentary analysis is to get a behind-the-scene look at system processes and how the system functions. Process data permits judgments to be made

about the extent to which the system or organization is operating the way it is supposed to be operating, revealing areas in which relationships can be improved as well as highlighting strengths of the system that should be preserved. Process descriptions are also useful in permitting people not intimately involved in the system to understand how the system operates. The study on customs valuation systems entail examining the records, documents, and reports of ERCA as well as assessing the rules and regulations of the country associated with customs valuations processes. In addition to the in-depth interview conducted with the customs valuation officers, the study demands looking at legislative documents and the records of ERCA. As a result, the researcher considers documentary analysis as fitting research method for this purpose.

#### **3.3.4 Method of data analysis**

Data analysis involves the computation of certain measures along with searching for patterns of relationships that exists among data groups. In the process of analysis, relationships or differences supporting or conflicting with the central issues of the study should be subject to statistical tests of significance to ascertain realistic results and reach logical conclusion. According to Kothari (2004), data analysis may be categorized as inferential (statistical) analysis and descriptive analysis.

Regarding data analysis, this study mainly employs descriptive analysis. Descriptive analysis provides profiles of organizations, processes, systems, or other subjects of any multitude of distributions of characteristics such as size, composition, effectiveness, efficiency and other variables. It is used, in this study, for describing how the customs valuation system operates, for elucidating its effectiveness and existing problems. The

performance of the customs valuation system was evaluated by comparing the plans (budgets) and actual performance of ERCA for the last five fiscal years (2002/2003-2007/2008). Effectiveness customs valuation system provides adequate customs revenue for the government while creating leveled play-ground for all importers and facilitating international trade. In view of this, study analyzed the effectiveness of the customs valuation system in accomplishing its purposes by considering its ability to facilitate international trade, convenience to importers, objectivity and availability of adequate control.

To conclude, it is worthwhile to summarize the issues included in this chapter. The grand research questions of this study inquire about the operations of customs valuation systems currently applied in Ethiopia and the existing problems in the customs valuation system. To address the grand research questions self administered questionnaires, in-depth interview, and documentary analysis were adopted. Accordingly, the results obtained by the study are discussed in the next chapter.

## **Chapter four: Results and discussions**

Customs valuation entails the determination of the amount upon which the rates of duty/tax are applied in order to calculate the value of duties and taxes on imported goods. While the duty/tax rates are unambiguously fixed by the statute in a tariff schedule for any imported commodity, the declared value varies from transaction to transaction for the same item. The fluctuating import value has important implications for the duty/tax revenue from foreign trade in a country. An importer may engage in under invoicing and misrepresenting the value of shipment to reduce his/her duty liabilities. Unless the under invoicing practices are detected and remedial actions are taken, the government revenues will be at risk and the importer receives unfair advantages over its competitors.

As shown chapter one, the main objective of this study is to assess the customs valuation systems applied in Ethiopia and to pinpoint the pitfalls of the system. In order to achieve this research objective self administered questionnaires, in-depth interview and documentary analysis were adopted. Specifically, in-depth interview was conducted with 4 customs valuation officers and customs valuation and tariff classification director of ERCA. Two sets of self administered questionnaires were also developed and distributed to 24 importers and 31 transitors for gathering their opinions of the customs valuation system. To supplement the data obtained through in-depth interviews and self administered questionnaires, various relevant data were extracted from annual financial reports of ERCA, ERCA's customs directive documents, Ethiopian Customs legislative documents, and fiscal reports of Ministry of Finance and Economic Development

(MoFED). The purpose of this chapter is, therefore, to present the results of the various methods adopted in the study. Further, this chapter tries to analyze the results of the current study in the context of the literature reviewed earlier and the socio economic realities in Ethiopia. Accordingly, the first section presents the customs valuation rules in Ethiopia. Section 4.2 shows the import trade practices and related customs declaration. The duty and import tax revenues, their significances and revenue performances of ERCA are, then, discussed in section 4.3. After discussing the results of documentary analysis in the first three sections, the remaining part of the chapter deals the outcomes of the in-depth interview and survey with importers and transitors. Hence, section 4.4 provides the customs valuation and duty assessment process in ERCA. Section 4.5 presents the outcome of survey with importers and customs clearing agents. Section 4.6 describes underinvoicing of import trade in context of Ethiopia. Customs operational problem, investigated through in-depth interview and survey with importers and clearing agents, are explained in section 4.7. Finally, the chapter concludes by the summarizing the main findings in section 4.8.

#### **4.1 Customs valuation rules in Ethiopia**

ERCA<sup>1</sup> operate under the mandates given to it by proclamation No. 587/2008<sup>2</sup> and regulations issued by the Council of Ministers. The customs law put the valuation system that has been applied in Ethiopia since the 1997. The current valuation system applies new customs rules promulgated under proclamation No 622/2009. The customs laws authorize ERCA to issue directives necessary for the implementation of proclamations and the regulations issued pursuant to it. Accordingly, the authority has issued customs directives and distributed to the respective customs stations for implementation.

According to the customs law of Ethiopia, the primary basis for customs value is transaction value as defined in Proclamation No 622/2009. The customs value for imported goods is the actual total costs of the goods up to the first entry point to the customs territory of Ethiopia. For the application of the transaction value method, the importer has to produce the seller's invoice and other relevant supporting documents for the price and costs he/she has paid or payable for the seller and other clients related to his/her transaction. The legislation also states that unless certain relationship and other factors that influence the price have been found, the transaction value is required to be

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<sup>1</sup> According to proclamation No. 587/2008, the Ethiopian Revenues and Customs Authority is established as an autonomous federal government agency having its own legal personality. The Authority shall be accountable to the Prime Minister.

<sup>2</sup> The laws repealed by proclamation 587/2008 are Articles 9(8), 20 and 33(9) of the Definition of Powers and Duties of the Executive Organs of Proclamation No. 471/2005; the Re-establishment of the Federal Inland Revenue Authority of Proclamation No. 367/2003; and Articles 3 to 11 of the Re-establishment and Modernization of Customs Authority Proclamation No. 60/1997 (as amended).

accepted. Where the transaction value cannot be determined there should normally be a process of arrangement between the customs administration and importer with a view to arrive at a basis of value and in order to apply either the identical or similar goods transaction value. According to Proclamation No. 622/2009, where customs value cannot be determined on the basis of the transaction value of the imported goods or of identical or similar imported goods, the deductive value, computed value methods, or fallback methods respectively are applied. For the application of transaction value method certain conditions must be satisfied. As put in the Ethiopian customs law, the conditions deemed to be essential for applying the transaction value are the following.

- the transaction is not concluded between the buyer and the seller;
- customs has found is certain relationship<sup>3</sup> between the buyer and the seller
- the seller imposes restrictions as to the disposition or use of the goods
- the agents of the seller import goods on consignment basis
- the legal personality of the importer and the supplier is not different;
- the goods are imported by legally represented individuals of the supplier;
- the value of the goods shows significant difference from that of identical goods;
- the documents required by ERCA are not fully produced; and
- the value declared by the importer is found to be fraudulent.

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<sup>3</sup> According to Ethiopian customs rules persons shall be deemed to be related only if they are officers or directors of one another's businesses; they are legally recognized partners in business; they are employer and employee; any person directly or indirectly owns, controls or holds 5 percent or more of the outstanding voting stock or shares of both of them; one of them directly or indirectly controls the other; both of them are directly or indirectly controlled by a third person; together they directly or indirectly control a third person; or they are members of the same family.

When applying the above mentioned valuation methods, adjustments to the price actually paid or payable should be made in cases where certain specific elements which are considered to form a part of the value for customs purposes are incurred by the buyer but are not included in the price actually paid or payable. The following costs, to the extent that they are incurred by the buyer but are not included in the price actually paid or payable, are added in determining customs value.

- Commissions and brokerage, except buying commissions;
- The cost of containers which are treated as being one for customs purposes;
- The cost of packing whether for labor or materials;
- Royalties and license fees related to the goods being valued that the buyer pays;
- The value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller.
- The cost of transport of the imported goods to the port or place of importation;
- Loading, unloading and handling charges of the imported goods to the port and
- The cost of insurance.

The customs proclamation of Ethiopia has also specified the costs that shall be deducted to calculate customs value. Item deducted from the transaction value include costs for damage routes, costs for damages in warehouse, and the value of dangerous goods destroyed.

The conversion of currency<sup>4</sup> is necessary for the determination of the customs value. The rate of exchange to be used is the official exchange rate declared by the National Bank of Ethiopia on the day of accepting the customs declaration by the Authority. Regarding the confidentiality of information, the rule states all information which is by nature confidential or which is provided on a confidential basis for the purposes of customs valuation shall be treated as strictly confidential by the authorities concerned. The authority does not disclose confidential information without the specific permission of the person or government providing such information, except to the extent that it may be required to be disclosed in the context of judicial proceedings. Importers have also the right to appeal to The Federal Government Revenues Board. In the course of determining the customs value of imported goods, if it becomes necessary to delay the final determination of such customs value, the importer of the goods can clear them from customs by providing sufficient guarantee in the form of a surety, a deposit or some other appropriate instrument, covering the ultimate payment of customs duties for which the goods may be liable. In this section, the customs rules applicable in determining customs value are presented briefly. The next section discusses the import trade procedures required to be followed by importers in Ethiopia.

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<sup>4</sup> The National Bank of Ethiopia (NBE) uses a system called inter-bank exchange, where the commercial banks in Ethiopia bid to purchase foreign currency and this rate is used as the currency exchange rate by NBE. The exchange rate is fixed on a weekly basis. With respect to publicity of conversion rate NBE publicizes conversion rates as they are changed (Polyakov and Shewarega 2006).

## **4.2 Import trade in Ethiopia: Procedures**

Since import trade is the main source of duty and import tax revenues in Ethiopia, it is important to look at the import procedures in relation to the pre-shipment inspection, the modes of payment allowed for import, documentation requirements to effect payment, and customs declaration procedures. These points are explained shortly in the next subsections.

### **Preshipment inspection (PSI)**

The documentary analysis revealed that goods imported are not required to be inspected prior to shipment except when they are imported from China or the importer and the supplier have agreed to do that. The Ministry of Trade and Industry (MOTI) has made arrangements with China Inspection and Quarantine Bureau (CIQ) so that the latter would carry out the inspections prior to shipment and issue the quality certificates. Preshipment inspection certificate is one of the documents required to effect import payment from China. Preshipment inspection requirement<sup>5</sup> on all goods purchased from China has been implemented starting from January 1, 2007. The Pre-shipment inspection certificate<sup>6</sup> requirement is mandatory for all import purchases made from China in excess of USD 2,000. Banks are required to insert requirement in the Letter of Credit (LC) and also to insure that purchase order transmitted clearly depict to have CIQ inspection

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5 The WTO Agreement on pre-shipment inspection, negotiated under the Uruguay Round, recognizes the need of developing countries to have a recourse to PSI to verify quality, quantity, or price of imported goods (Goorman and Wulf 2005)

6 According to Goorman and Wulf (2005), under traditional PSI programs, PSI company inspects the goods in the exporting country before they are shipped to the importing country; checks their quality, quantity, price, and tariff classification. In some programs the duties and taxes are computed. The PSI Company issues a verification report, which is provided to the importer and included in the customs declaration at import.

requirements. Banks cannot accept documents without CIQ certificate if goods are imported from China. In the event of any discrepancy<sup>7</sup> on the CIQ certificate issued or if goods are imported without being inspected the case shall be referred to Quality and standard Authority of Ethiopia. MOTI has issued its mandate to Quality and Standards Authority of Ethiopia to examine the nature of discrepancies and to issue its decisions by looking into the cases as may be appropriate.

### **Mode of payment and documentation requirements**

According to ERCA's directive of import transactions, the Mode of payment allowed for import in Ethiopia are letter of credit, cash against document, and advance payment up to USD5000. Foreign exchange can be availed by commercial banks to any importer provided he/she can present import license issued by MOTI, industry license issue by MOTI (if applicable) or investment license issued by Investment Agency. Applications submitted for import should be accompanied by the Performa invoice / contracts from suppliers stating the type of commodity, quantity of the commodity, price per unit, FOB amount<sup>8</sup>, freight if any, other charges. No insurance payment is allowed for payment in foreign exchange so that the importer makes insurance arrangement locally.

As revealed by documentary analysis, the letter of credit or purchase order must clearly show the documents required to be presented by the supplier to effect the payment. The mandatory documents for effecting payment include: final invoice (commercial invoice);

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<sup>7</sup> Yang (2003) presents evidences that if PSI is introduced as an isolated initiatives, smugglers will find ways to reduce their duty burden, either by splitting up shipments to stay below the threshold set for PSI inspection or importing through export processing zones, where leakage controls may be loose.

<sup>8</sup> FOB amount is the invoice value excluding the freight in, insurance costs and other related charges paid by the importer

original sets of bill of lading, airway bill, truck way bill, railway Manifest (depending on the mode of transportation); country of origin invoice; packing list; and certificate of quality where appropriate.

### **Customs declaration procedures**

Ethiopian customs law states that customs declaration<sup>9</sup> can be made in written form, orally, or electronically. Customs declaration presented in written form is filled in the declaration form, signed, and contain all the particulars necessary for completing customs formalities<sup>10</sup>. Customs declarations, together with all documents required to be available for the completion of customs formalities are, then, presented by the importer or his/her agent. The customs declaration procedures for imported commercial goods are arranged in such a way that clearing documents comply with desired controls through Distance Trade Input (DTI) registration made by transit firms in behalf of the importer. The face-  
vet officer receives two copies of the required documents from the transit firm and examines for reliability. The original copy is send to Post Clearance Audit<sup>11</sup> (PCA) department and the copy is presented to customs valuation officers. The valuation officer looks into the price database for verification and computes the taxes and duty value to be paid by the importer. The customs clearing procedures of ERCA at Bole Cargo are shown in work flowchart as follows.

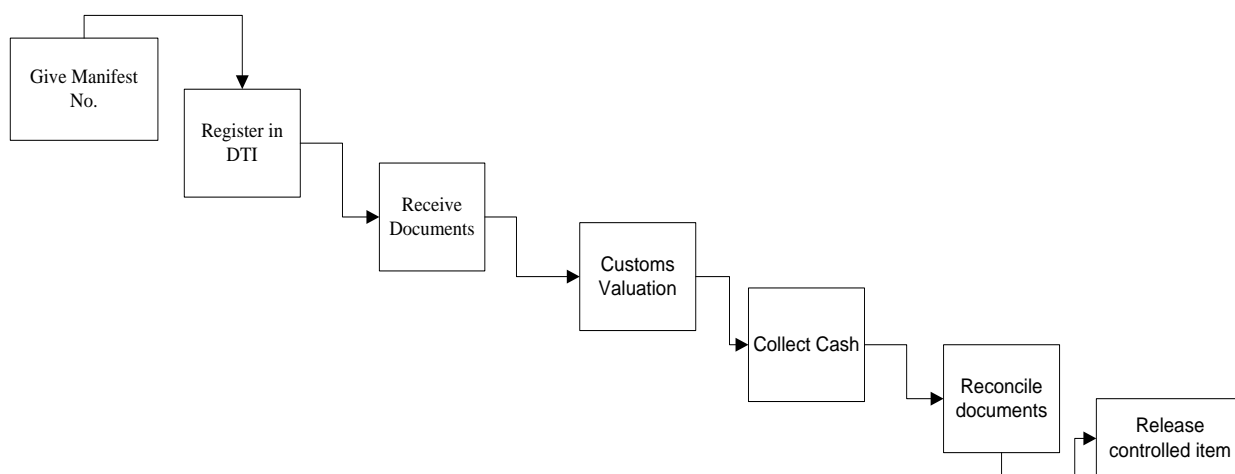
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<sup>9</sup> Customs declaration means a form or document prepared by the Authority in which details of imports are described for the accomplishment of customs formalities.

<sup>10</sup> Customs formalities mean any customs operations carried out in connection with importation from the time of arrival at the customs port until released from the customs control.

<sup>11</sup> Post Clearance Audit means a process which enables the Authority, after the release of goods, to verify the accuracy of custom declarations through examination of the books, records, business systems and other relevant customs commercial data.

Figure 4.1: Customs clearing procedures of ERCA at Bole Cargo



Source: ERCA customs clearing procedure manual

This section described the important procedures and requirements in the import transactions. In light of this, the subsequent section provides the revenue from import trade, their significance and revenue performances of ERCA in the last few years.

### 4.3 Foreign trade tax revenues: significance and performance

Before going straight to the customs assessment procedures, it is crucial to get acquainted with the significance of foreign trade revenues and revenue performances of ERCA for the few years. As part of documentary analysis, an endeavor to analyze the significances and revenue performances of duties and taxes on foreign trade was made. On the basis of the data found from ERCA and MoFED, the outcomes are presented in this section.

Developing countries are profoundly concerned with taxes on foreign trade since the majority of their revenue comes from indirect taxes on foreign trade. Import trade taxes levied by ERCA include customs duty, excise taxes on imported goods, and VAT on

imported goods. The Authority also generates revenues from non tax sources such as PSI services, confiscated properties sales, warehouse rental, and published documents. ERCA (former Ethiopian Customs Authority) collects tax revenue from export trade on only some products. This is due to the fact that the government has removed taxes and duties on most of exported items to encourage export activities. Table 4.1 below shows the duty/tax revenues collected from foreign trade for the last six fiscal years (2002/03 up to 2007/08).

Table 4.1: Duty/tax revenue collected from foreign trade activities (in millions of ETB)

Revenue Items	Fiscal Years					
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Customs Duties	1,695.00	2,425.84	2,514.77	2,954.20	3,298.46	3,891.67
Excise tax	333.65	554.40	760.84	643.60	857.60	1,028.40
VAT	1,604.05	2,278.23	2,504.94	2,989.20	3,540.60	4,069.70
Surtax	-	-	-	-	-	2,703.30
export taxes	1.15	-	-	-	-	-
<b>Foreign trade taxes</b>	<b>3,633.85</b>	<b>5,258.47</b>	<b>5,780.55</b>	<b>6,587.00</b>	<b>7,696.66</b>	<b>11,693.07</b>

Source: Fiscal reports of MoFED and own Computation.

As depicted in table 4.1, the total revenue collected from foreign trade has been increasing from year to year. The total revenue has changed from a minimum of ETB 3,633.85 million in the year 2002/03 to ETB 11,693.07 in the fiscal year 2007/08. The standard deviation of the total foreign trade revenue for the year 2002/03 to 2007/08 was about 2765.06 implying great deal of variation in the revenue over periods. Each of the tax/duty revenue items from foreign trade has also increases by a significant size for the

periods under consideration. To look at the correlation of these items, the correlation matrix shown in Table 4.2 was prepared.

Table 4.2: Inter-revenue item correlation matrix as per Pearson's correlation computation

Description	Duty	Excise	VAT	Total revenue
Duty	1.00	.940	.996	.960
Excise	.940	1.00	.941	.918
VAT	.996	.941	1.00	.951
Total revenue	.960	.918	.951	1.00

Source: Fiscal reports of MoFED and own computation

In the years under study, the correlation of any tax/duty revenue from foreign trade and the total amount as well as any two revenue items was extremely higher. Higher correlation values show strong association among variables. It also entails the fact that the changes in each were slightly different. All of the items have shown significant variations in the period studied. When we compare the allied variation of each revenue item and total revenue, the one with highest value is customs duty. The relationship between total duty/tax revenue from foreign trade and customs duty is the strongest of all others. The correlation analysis revealed the same fact as the information provided in table 4.1 earlier. Keeping the above results in to account, the significances of these revenues and revenue performances of ERCA are analyzed and described in the next subsections.

### **4.3.1 Significance of tax and duty revenues from foreign trade**

In order to finance recurrent budgets, the Ethiopian Government relies largely on tax revenues. In developing countries<sup>12</sup> in general, and in Ethiopia in particular, significant amount of tax revenues are derived from indirect taxes. Out of the indirect tax revenues, more parts are attributable to duties and taxes on imported goods. Taxes and duties on foreign trade take the loin-share. In light of increasing global integration of foreign trade various governmental policies need to be launched to provide policy support and facilitate work for customs valuation. ERCA has started several initiatives like the establishment of Price Data Base and Automated System for Customs Data (ASYCUDA). ERCA has also begun a weekly Television program to improve the awareness of taxpayers in particular and the society in general. Despite this fact, more work needs to be done for securing the taxes and duties collectible from foreign trade.

Out of the total revenue generated in each of the year under consideration, the major portion comes from taxes. The contribution of taxes for the total revenues has been highest (81.32 percent) in fiscal year 2003/04. The lowest percentage of tax revenue (69.79 percent) to the total revenue was occurred in the year 2002/03. Out of the total tax revenue collected in each year the significant portion is mobilized from foreign trade taxes. The percentage of foreign tax revenues to total tax revenues was highest (62.21 percent) in the fiscal year 2003/04 and lowest (53.87percent) in the year 2002/03. The performance of the revenue collection from direct tax, domestic indirect taxes, and foreign trade taxes has shown improvement year after year. Tax/duty revenues from

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<sup>12</sup> According to Chaturevedi (2006) , in India, the share of indirect taxes declined from 78 per cent to 56 per cent while that of the direct taxes went up from 19 per cent to 44 per cent in the period from 1990/91 to 2004/05

foreign trade have been increasing on average by 27.5 percent. It was ETB 3,633.85 million in the year 2002/03 and it became ETB 11,693.07 million in the fiscal year 2007/08. Foreign trade taxes performance showed a significant increase of ETB 3504.0 million (42.8 percent) compared to the level of the same period of the previous fiscal year.

Table 4.3: duty and taxes on imported goods compared to total (in millions of ETB)

Revenue Items	Fiscal Years					
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Direct taxes	1,662.76	1,512.52	1,685.55	2,182.81	2,784.93	3,969.65
Domestic indirect taxes	1,449.50	1,682.99	1,894.26	2,533.94	3,155.66	4,226.49
Foreign trade taxes (FTT)	3,633.85	5,258.47	5,780.55	6,587.00	7,696.66	11,693.07
Total tax revenues (TTR)	<b>6,746.11</b>	<b>8,453.08</b>	<b>9,360.30</b>	<b>11,303.75</b>	<b>13,637.25</b>	<b>19,889.21</b>
Non tax revenues	2,920.86	1,941.22	2,373.38	3,829.17	3,293.15	5,605.82
Total revenue (TR)	<b>9,666.96</b>	<b>10,395.20</b>	<b>11,733.7</b>	<b>15,132.92</b>	<b>16,930.40</b>	<b>25,495.03</b>
Percentage of TTR to TR	69.79	81.32	79.77	74.70	80.55	78.01
Percentage of FTT to TTR	53.87	62.21	61.76	58.27	56.44	58.79

Source: Fiscal reports of MoFED and own computation

As shown in the table 4.3, the contribution of foreign trade taxes and duties in revenue performance of the country is indisputably momentous. On the other hand, these revenues are the function of the customs value (tax base) and the duty or tax rate. As the rates are clearly stipulated in the customs law of the country, the revenues highly depend on the determination of value for customs and taxes purpose. ERCA mobilize revenues from foreign trades in the form of customs duty, excise taxes, VAT, surtax and withholding taxes. All of these sources are based on customs value determined through the customs

valuation system. Therefore, Understatement of customs value decreases foreign trade taxes revenues proportionately.

#### **4.3.2 Revenue performances**

To appraise the revenue performance of ERCA in relation to foreign trade activities, it is important to analyze the accomplishment percentage by comparing the actual result with the budgets for different years. Revenue performance relies on the applicability of appropriate customs valuation system on foreign trade transactions. Unless customs valuation systems operate accurately, the government may lose revenues because of underinvoicing made by traders. The actual revenues and the budgeted revenues from foreign trade for recent five consecutive years have been shown in table 4.4.

The revenue accomplishment percentage of ERCA on foreign trade was high in the fiscal year 2003/04 and 2004/05. In these years (2003/04 and 2004/05), the Authority generated revenue exceeding the budgeted amounts. However, from fiscal year 2005/06 onwards the revenue performance had been declining, 95.64 percent in the year 2005/06 to 87.96 percent in the year 2007/08. Taxes and duties from imported goods depend mainly on volume and amount of import trade. Overall, the actual revenues had been increasing during the years under consideration but the rate of increase in actual revenues was less than the rate at which budgets were increased. During the Ethiopian fiscal year 2007/08, percentage of accomplishment was less than the other years. This may imply the fact that foreign trade activities were below the planned level.

Table 4.4: Actual foreign trade tax revenue as compared to the budget (in million ETB)

Revenues	Fiscal Years				
	2003/04	2004/05	2005/06	2006/07	2007/08
Actual revenue	4686.09	5744.60	6586.90	7698.00	11693.00
Budgeted revenue	4228.30	5025.60	6887.10	8237.00	13294.00
Variance	457.79	719.60	(300.20)	(539.00)	(1601.00)
Level of Accomplishment	<b>110.83</b>	<b>114.31</b>	<b>95.64</b>	<b>93.46</b>	<b>87.96</b>

Source: ERCA's annual reports and own computation

#### 4.4 Customs valuation and duty assessment

In the preceding three sections, the outcomes of documentary analysis related to the customs valuation rules, import trade procedures, and foreign trade duties and taxes were presented. The remaining parts of the chapter consider the result of the survey conducted by the investigator. As already mentioned in the chapter three, in-depth interview was carried out with four customs valuation officers and valuation and tariff classification director. In addition, two sets of self administered questionnaires were used to collect supplementary information from importers and transitors. Hence, the outcomes of the intensive discussions with the director and the valuation officers are briefly described in this section.

According to the information provided by the custom valuation and tariff classification director, the customs valuation method applied in Ethiopia has been made to be in line with the WTO valuation agreement. Previously, in the fiscal years 1999/2000 to 2003/04, customs valuation and classification of goods was done by a foreign contracted company. The government of Ethiopia outsourced the customs valuation, tariff classification, and

preshipment inspection services to foreign company. The contractual agreement between the government and the foreign company was not only to provide the mentioned services but also to build the capacity of Customs Authority by training employees and other infrastructures. After June 2004, ERCA is performing valuation and classification of goods by its own staff. Overall responsibility has been given to Valuation Tariff and Classification Department of the Authority. The following discussions briefly presents the results of the interview with director and customs valuation officers in respect of customs valuation process and issues related to the price database.

#### **4.4.1 Customs valuation process**

Customs valuation consists of the procedure undertaken to assess the customs value of goods. For the purpose of customs valuation, ERCA uses price database containing price information for different items, which is used to crosscheck the invoice value presented by importers. The price database is supposed to be quarterly updated but, according to in-depth interview conducted with valuation officers, updating quarterly has not been made in most of the times. The database will be available both for customs valuation officers and declarants. As a base of duty assessment, the Authority applies FOB value for some exported goods and CIF value for imported goods. The legally stipulated duty rates are multiplied by FOB value for the exported goods and CIF value for imported goods to determine the duty liability of the trader. Amounts of freight and insurance are also collected separately for each item making possible reporting of prices/actual cost of goods. For imported items, which are transported by airplane, one-third of their freight costs are taken for calculating customs value. In cases of importer's failing to provide

freight cost information or the Authority doubting the amount, the valuation officers considers 10 percent of the invoice price as freight cost. If the importer does not present insurance documents and the amount, 5 percent of the invoice value plus the freight charge is taken as insurance cost for customs valuation purpose. For imported items both country of origin<sup>13</sup> and consignment are captured and stored for documentation. For indentifying a country of origin, the standard rules<sup>14</sup> of origin are applied and most of the importers are asked to present certificate of origin and other documents not only for statistical purpose but also primarily for valuation activities. The discussion with the director revealed that all of the above mentioned operations are performed in conformity with the directive issued by the Authority. However, customs valuation officers apply personal judgments in some events giving a room for subjectivism. In cases where the invoice values are doubtful and prices of imported goods or similar goods are not found in the price data base, customs valuation officers commonly apply price found in internet rather than going for the other methods shown in the customs rules.

Currently, ERCA uses Automated System for Customs Data (ASYCUDA<sup>++</sup>) for duties and taxes assessment. As per the in-depth interview with valuation officers, before the introduction of the automated system, duties and tax assessments have been performed manually using desk calculators. As a result, the annual foreign trade statistics was not up to date and revenue collection was lagging and cumbersome. The automated system

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<sup>13</sup> When a product is produced in a single stage or is wholly obtained in one country, the origin of the product is relatively easy to establish. However, in cases where two or more countries have taken part in the production of the good, the rules of origin define the method by which it can be determined in which country the particular product has been subject to a substantial transformation.

<sup>14</sup> The international Conventions on Simplification and Harmonization of Customs Procedures define the three main techniques for the determination of origin: change of tariff classification, value-added, and specific manufacturing process.

brought a drastic revolution towards more simplification of Customs procedures. The benefits realized from the automation include significant reduction in the clearance time, availability of different type of reports to all customs station with no time limit; linking of all customs stations to central server that enable them to access standard procedure and tariff rate produced from the system, acceleration of cash collection, enhancement of working environment, timely availability of import and export trade statistics, and data quality control.

Importers in Ethiopia are required to pay customs duty, withholding tax, excise tax (if applicable), VAT and surtax. The customs duties are calculated by multiplying the CIF value of the goods with legally stipulated duty rate. The excise taxes are determined by applying the appropriate tax rate to sum of CIF value and customs duty liability. For calculating VAT on import, the Authority sums the CIF, customs duties, and excise taxes and multiplies the result with a fixed tax rate of 15 percent. Surtaxes are computed by multiplying the tax rate of 10 percent with the sum of CIF, customs duty value, excise tax amount, and VAT amount. Therefore, in determining the customs duties as well as taxes on imported goods, CIF value is the basic input of the system. The duty rates and tax rates are legally set and already integrated with the automated system. In the process of duties and taxes assessment, the main factor is the CIF value since the rates are fixed for all transaction of the same import item. As a result, misstatement of CIF affects not only the customs duty but also the taxes on imports.

#### **4.4.2 The price database**

After July 2004, the Government of Ethiopia decided to switch from preshipment system of inspection to destination inspection system. Accordingly, Ethiopian Customs Authority began performing tariff classification, customs valuation, and destination inspection functions. To control underinvoicing of import values, the then Ethiopian Customs Authority issued Directive No. 10/2004 for the preparation and implementation of price database. The responsibility of preparing and updating the information in the database was given to Customs valuation and tariff classification department. The purpose of the database was to enable the Authority crosscheck the invoice price presented by the declarant with the price of identical or similar goods in the database and to prevent inconsistency in customs valuation due to information gap among different branches of the Authority. The database contains minimum prices and reference prices putting them in to two sections. The minimum prices are applicable on imported goods with high customs risk<sup>15</sup> such as textile products, shoes, electronic products, and spare parts of vehicles. For other imported items with low customs risk, the database is used for reference and invoice values in the range of 5 -10 percent below or above reference price is acceptable. The minimum price, determined based on prices of identical or similar goods imported in the past, is not applied on the above mentioned goods if they are imported by sole agents. Transit firms prepare declaration for imported goods considering the minimum prices and customs staffs verify the correctness of the declarations. If the price of identical or similar goods with imported item is not found in the price database,

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<sup>15</sup> ERCA analyzes customs risks taking in to account the products history of underinvoicing, taxes and duties rates, and the value of import. In addition, it considers the international trends for some items classified as high customs risk

the transaction value provided is accepted to avoid clearing delay but the Authority goes for further investigation. For each of imported item with high risk, the larger of transaction value (invoice value) or price in the database is used for customs and taxes assessment.

The product information kept in the price database includes product's tariff number (code), the country of origin, product description, unit of measurement and acceptable price. Customs valuation and tariff classification department of the Authority gets the information needed for updating the database mainly from monthly reports send by branches offices and from customs automation and data analysis department.

#### **4.5 Outcome of survey with importers and customs clearing agents**

As shown previously, in this study surveys (using self administered semi-structured questionnaires) were conducted with 31 assessors in different customs clearing agents (traditionally referred to as transitors) and 24 accountants/finance managers in importing firms. Beginning with the profile of the respondents, this section discusses the opinion of importers and customs clearing agents based on the data collected via self administered questionnaires.

##### **Profile of respondents**

Examination of the level of education of respondents revealed that about 87.5 percent of accountants/managers and 92.5 percent of the assessors included in the survey have educational qualification of college diploma and above. Regarding their educational

backgrounds, both groups of respondents appeared to be qualified enough to understand the underlying concepts and give reasonable responses. In view of the educational level of respondents, it is believed that the lack of respondents' understanding about the issue under study is likely to have no adverse impact on the quality of data obtained from them.

Table 4.5: Respondents' educational qualification

Educational profile	Accountants/Finance		Assessors of customs clearing	
	Frequency	Percentage	Frequency	Percentage
12 completed	3	12.5	3	9.7
College diploma	9	37.5	9	29.0
First degree (BA)	11	45.5	17	54.8
Masters and above	1	4.5	1	3.2
Others	-	-	1	3.2
Total	24	100	31	100

Source: Survey results and own computation

Furthermore, about 83.3 percent of importing firms' accountants/finance managers and 74.5 percent of assessors in the target customs clearing firms had two and more years of work experience in the respective organizations. Since these individuals acquire practical exposure on the subject matter, their contributions for the effectiveness of the study are unquestionable.

Table 4.6: work experience of the respondents

Work Experience	Accountants/Finance		Assessors of customs clearing	
	Frequency	Percentage	Frequency	Percentage
Less than 2 years	4	16.7	8	25.8
2-4 years	9	37.5	10	32.3
5-7 years	9	37.5	8	25.8
8-10 years	1	4.2	3	9.7
Above 10 years	1	4.2	2	6.4
Total	24	100	31	100

Source: Survey results and own computation

In their forms of organizations, the majority of the firms addressed by the research were private limited companies. About 29.2 percent of the importing firms and 38.7 percents of the customs clearing agents are under the others category representing mainly private limited companies, except very few governmental clearing agents.

Table 4.7: Forms of the organizations included in the study

Form of organization	Importers		Clearing agents	
	Frequency	Percentage	Frequency	Percentage
Sole proprietorship	5	20.8	8	25.8
Partnership	5	20.8	8	25.8
Corporation	7	29.2	3	9.7
Others	7	29.2	12	38.4
Total	24	100	31	100

Source: Source: Survey results and own computation

The investigator has also examined how long the importing firms have been engaged in international trade (particularly import trade) and for how long the customs clearing agents have done the clearing services. Questionnaires filled out by individuals chosen from the respective groups portrayed that out of the total respondents dealt with of the respective group, about 71.8 percent of importing firms and 67.7 percent of clearing agents have more than 4 years of operational experience. A large share of respondents, i.e., 62.5 percent of the importing firms under investigation, delegated the customs clearing activities to customs clearing agents. In customs clearing agents, either assessors (valuation officers) or operational managers are directly responsible for customs valuation and tariff classification functions.

#### **4.5.1 Nature of importing firms and customs valuation implications**

Based on the questionnaires randomly distributed to importing firms, the investigator identified some important points related to importing firms in Ethiopia. The majority of importing firms were independent importers. Of those surveyed, about 41.7 percent of the importing firms were independent importers, 20.8 percent were agents of foreign company, 16.7 percent were subsidiaries of multinational companies, 12.5 percent were sole distributors of multinational companies and 8.3 percent were others. Customs valuation procedures become complicated when there are certain relationships between the importers and the suppliers. For agents of foreign companies, subsidiaries of multinational companies and sole distributors the customs valuation issues must be given particular attentions since there exists intercompany interests. Especially for the

subsidiaries, the customs valuations agenda conflicts<sup>16</sup> with the aspects of transfer pricing. In such cases, the invoice prices may be highly susceptible for adjustments with the intention of maximizing the aggregate profitability of the multinational company. Related parties are in a position to manipulate their profits and prices to ensure the most favorable tax and customs treatment for their transactions.

In terms of the continent the products are imported from, as the survey with importing forms revealed considerable number of the respondents stated that they acquire imported goods from Asia, particularly from China and United Arab Emirate (UAE). According to importers' responses collected via questionnaires, 66.7 percent of importers acquire majority of import items from Asia, 20.8 percents of them from Europe, and the remaining 12.5 percent acquire from South America and North America. On the other hand, the investigator has gathered the opinion of customs valuation officers/directors of ERCA and assessors of customs clearing agents regarding countries from which underinvoicing of customs value occurs frequently. The in-depth interview with valuation officers/directors and questionnaires filled by assessors demonstrated that underinvoicing take places repeatedly on goods imported from China and UAE. About 64.5 percent of the assessors noted that underinvoicing occurs on goods imported from Asia, and 29.0 percent of them stated it occurs on goods imported from Europe. The remaining 6.2 percent of them suggests underinvoicing customs values arises more on goods imported from South and North America. Taking in to account the volume of import trade and the

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<sup>16</sup> A phenomenon that commonly prevails is that tax and customs administrations are each pulling the importer/taxpayer in opposite directions (Jovanovich 2002).

underinvoicing risks associated with Asian Nations, ERCA needs to pay particular attention to imports from these countries.

In the effort to comprehend the importance of customs valuation for the importing firms, the investigator inferred that payments for duties and taxes are vital to the firms. Duties and taxes paid on imported goods are major expenditure items in 62.5 percent of the surveyed importing firms. Furthermore, about 58.2 percent of the importers consider transportation and insurance costs as significant components of import value computed for customs valuation purpose. When assessing customs duties and import taxes on CIF value, the customs and duty liabilities of importer increase proportionately with increase in freight charges and insurance costs. Therefore, the burden<sup>17</sup> of increase in insurance costs and freight charges on an importer is double, the costs themselves and the duties/taxes on them.

#### **4.5.2 Customs valuation systems control mechanisms**

In the previous subsections, the natures of importing firms and the implications on customs valuation process are discussed. In view of this, the control mechanisms devised and implemented in the process are presented here. An essential element of customs administration is ensuring the implementation of customs rules and regulations. The in-depth interviews with the directors of ERCA on one hand, and importers and customs clearing agents via questionnaire on the other, revealed the existence of distrust of the latter group by customs officials. Out of the assessors contacted during data collection,

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<sup>17</sup> Erzan and Yeats (1990), one effect of using the far more common CIF base is to place a disproportionate burden on countries that have higher freight and insurance costs

only 26 percent of them agree with the availability of adequate control mechanisms in the customs valuation system. On the importers' opinion, the control mechanisms applied by ERCA are not still safe and sound. Only 29.1 percent of the importers agreed with the adequacy of the control mechanisms. The reasons for this may be the lack of objectivity in the customs procedures, which made it difficult and complex to devise effective control means. Only 29.1 percent of the importing firms and 32.2 percent of the assessors agreed with the existence of objectively stated valuation procedures in Ethiopia. Feeble control function makes it possible for traders to evade paying duties and for valuation officers to engage in malpractices. Even though various attempts are made to eradicate these deep-rooted problems, the current customs valuation system does not ensure proper enforcement of valuation rules and regulations. However, most of the transitors seem comfortable with the documentation systems employed by ERCA for capturing and reporting foreign trade transactions. With the proposition putting ERCA's documentation system effective, 42 percents of the assessors had agreed, 32.3 percent of them were neutral and only 25.9 percents disagreed. The importers' positions on documentation system were a little bit different from that of assessors. About 45.9 percent of importers agreed with the proposition, 8.2 percent were neutral and 45.9 percent had shown disagreement. Overall, the reality in the documentation implies availability of certain weaknesses in record keeping which is attributable to most organizations in Ethiopia.

Furthermore, there is risk of revenue loss to the government due to underinvoicing of imports by the traders since controlling mechanisms such as PCA are not adequately developed. According to the in-depth interview with valuation officials, in Ethiopia PCA is in infant

stage and other customs valuation facilities in terms of importers' voluntary compliance, data base, infrastructures and skilled manpower are still inadequate. Although customs operating situations have been now improved, there are still many irregularities that need to get remedial actions.

#### **4.5.3 Customs valuation and trade facilitation**

The survey result implied that the customs valuation system in Ethiopia does not encourage compliance with valuation rules by providing proper invoice prices as the only requirement from the importer is to pay the balance of taxes and duties required to be paid. It would actually even discourage legitimate importers as there is a chance that the underinvoicing may go unnoticed, giving underinvoicing traders the edge over their legitimate duty paying competitors. Therefore, the Customs Valuation System in Ethiopia does not provide fair, neutral and uniform valuation and does not protect traders from risk of arbitrary valuation by the customs officers. In-depth Interviews with the ERCA on the one hand, and data collected from importers and customs clearing agents on the other, revealed the existence of recurring underinvoicing by some traders leading to unfair play ground for genuine traders.

The investigator tried to identify the effectiveness of the valuation system in creating fair play ground among traders. Out of the importers surveyed, only 33.4 percent agreed with its being effective, 45.9 percent disagreed and 20.8 percent were neutral. On the transitors' side, those agreed with the effectiveness of valuation system in creating fair trade were 25.8 percent, those disagreed accounts to 51.6 percent and the remaining 12.9 percent were neutral. Therefore, on the effectiveness of valuation system, the positions of

both groups of respondents recline on the disagreement side. To detect the prevalence of import undervaluation and the importers compliance to the system's requirements, the investigator undertook gathering of assessors' opinions. The preponderance number of them, 51.6 percent, has the opinion that there exists more undervaluation. The assessors had also been given the chance to evaluate the compliance of importing firms to the customs declaration requirements of ERCA. Analysis of the overall position of each respondent using Likert scale produced that 61.3 percent of assessors were proponents of the proposition considering most importers being compliant and the remaining 38.7 percent were against to the proposition.

The time taken for customs clearance is an important factor in trade facilitating function of the Authority. In an endeavor to investigate the average time consumed in customs clearance and the fairness/reasonableness of the time taken, certain information concerning attitude has been found from transitors and importers. The majority, about 64.5 percent, of transitors replied that the average clearing time is less than 5 days while only 33.33 percent of importers said the average time is less than 5 days. The detail information on the responses is shown in table 4.8.

In order to understand the correlation of the average clearing time replied by the two groups of respondents, correlation analysis has been done. The computation of Pearson coefficient of correlation produced value of 0.749 implying stronger positive relationship among the responses of transitors and importers. Regarding the fairness of the time taken in customs clearance, 29.2 percent of importers and 45.2 percent of transitors replied that it is not fair and reasonable while 41.6 percent of importers and 38.8 of transitors replied

that it is fair and reasonable. The remaining percentages for each group hold neutral attitude on the clearance time.

Table 4.8: average time required in customs clearance process as replied by respondents

Average clearing time	Transitors		Importers	
	Frequency	Percentage	Frequency	Percentage
Less than 5 days	12	64.5	8	33.3
5 to 15 days	8	25.8	8	33.3
16 to 30 days	3	9.7	6	25.0
More than 30days	0	0	2	8.3
Total	31	100	24	100

Source: survey results and own computation

To examine whether importers' overall attitudes on the customs valuation systems is related with the time taken for clearance, the researcher conducted bivariate correlation analysis. The value of Pearson coefficient of correlation was found to be 0.381. Therefore, as per the result of correlation analysis, the importers' overall attitudes (as computed by Likert scale) are less positively related with their attitude on the fairness of custom clearance time. Most importers gave value for factors other than the clearance time in their evaluation of customs valuation system. Of the other factors incorporated in determining the combined position of the importers, the availability of in-build incentive for compliance and achievements in facilitating trade are expected to bear the significant role since they are more important to importers.

Table 4.9: Importers' and transitors opinion on fairness of the customs clearing time

On the fairness of the customs clearing time	Transitors		Importers	
	Frequency	percentage	Frequency	Percentage
Strongly disagree	4	12.9	2	8.4
Disagree	10	32.3	5	20.8
Neutral	5	16.1	7	29.2
Agree	10	32.3	5	20.8
Strongly agree	2	6.5	5	20.8
Total	31	100	24	100

Source: survey result and own computation

#### **4.6 Underinvoicing of import value**

With the intention of reducing the payments for duties and taxes, importers usually declare invoices containing small product price. The ways of under-invoicing may vary depending on the nature of the importing firm, the type of product imported, and the product's country of origin. According to the in-depth interview with customs offers/directors and questionnaires answered by transitors, the commonly occurring ways of under-invoicing in Ethiopia are adjusting invoice price, using third country's certificates of origin, and falsification of product's grades. Out the total transitors surveyed, about 51.6 percent replied that adjusting invoice price is the most common way of under-invoicing, 38.7 percent mentioned using third country certificate, and the remaining 9.7 percent mentioned falsification of grade.

Table 4.10: common ways of underinvoicing by importers

Common ways of underinvoicing	Transitors' responses	
	Frequency	percentage
Using third country certificate	12	38.7
Adjusting invoice price	16	51.6
Falsification of grade	3	9.7

Source: survey result and own computation

To look at those factors exacerbating the under-invoicing propensity of importing firms, the existence of relationship between importers and their supplies as well as the accessibility to import from different countries at different price have been taken in to account. About 42 percent of the assessors believe most importing firm in Ethiopia acquire goods from affiliated suppliers, 19.3 percent of assessors disagreed with this idea, and the remaining 38.7 percent were neutral. Since the result implies the existence of relationship in many of the importing firms and their foreign vendors, care need to be given in customs valuation as well as profit taxation. Taxes and duties evasions in developing countries become common due to higher tax and duty rates and more costs items (such as insurance and freight charges) are included in the taxable/dutiable amount.

Regarding the accessibility products imported to Ethiopia, about 75 percent of the importers and 93.6 percent of the assessors replied that an importer can get identical or similar products from different countries at different price. On the other hand, the opinion of the assessors on importing firms' efforts to declare correct country of origin demonstrated fairly enough compliance level in reporting trustworthy information. About 58.1 percent of the assessors stated that most importers declare correct country of origin.

This diminishes underinvoicing cases attributable to using third country of origin. However, since there is client-business relationship between the importers and transitors, the later do not want to give importers lower points in their evaluation.

#### **4.7 Customs operational problems**

Besides the deep-rooted underinvoicing problem and relatively lower level of compliances by importers, the study examined the custom operational problems by means of in-depth interview with customs officers/directors and surveys conducted with importers and clearing agents. The problems identified were concerning the lag in updating of database, ASYCUDA++ operation, unorganized customs directives, lack of importers' compliance, shortage of adequate and skilled manpower, vague to identify sole agents, and corruption in the system. Each of these problems is described in the paragraphs.

##### **Data base problem**

The authority uses a price database for verifying the reliability of the invoice presented by importers. However, it is not updated timely and is not complete. Prices of imported items may fluctuate at startling rate as it is sensitive to different economical and technological factors. Despite this fact, the database used for reference is lagging far behind the real world phenomena. The Authority ratified to update the price database in each three months but in actual practice it waits for far more than three months. The price for some goods also shows redundancy of the initially set amount without adjustment for revision at different times. This decreases the quality of information in the database and

weakens its role of verifying the correctness of the invoice value. In addition to this, the database does not contain information pertaining to some imported goods which makes it incomplete to handle all import transaction. In cases where product information is not found in the database, delay in clearing happens to importers as it lengthens the process by demanding the involvement of the main office. Furthermore, in its manual system the authority kept had been keeping records about different import/export transactions, but it lacks a systematic way to retrieve information on such documents when required. Therefore, getting old records of different years is cumbersome.

#### **Problems associated with ASYCUDA<sup>++</sup>**

The price Database is not integrated with ASYCUDA<sup>++</sup> system used for customs and taxes assessment. In order to assess taxes customs and taxes, the assessors must switch from one computer program to another program. This creates unnecessary complication to the assessors and time lag in customs clearing process. Many assessors of customs clearing firms and valuation officers of ERCA have mentioned this problem as the main headache of the customs assessment system.

#### **Lack of refined and organized directives**

At different times, the Authority issued directive to be applied in the customs valuation systems. Directive issued for customs valuations are not refined and arranged properly for serving as reference for customs officers. For some transactions, customs valuation officers must simultaneously check database, directives, and letters send from head

office. This causes unnecessary delays in customs valuation process and complicates the work done by valuation officers.

### **Less compliance by transitors/importers**

Some customs clearing firms do not provide complete documents in behalf of the importers and do not properly follow up declaration process. Most importers do not have adequate knowledge on customs clearing requirements. Importers' inadequate awareness on customs process and transitors negligent actions creates obscurity in the operation of the Authority. When processing declaration documents for importers, some transit firms deliberately made delay with the intention of getting some financial benefits. Most importers cannot provide original documents immediately for customs valuation since the original document are kept with their banks in letter of credit (LC) system. Therefore, the Authority is forced to accept copy of the original documents for customs valuation along with additional deposit balance for safety. Less compliance by importers may be, to some extent, because of lack qualified staffs that have adequate awareness about the valuation process. In an attempt to look at the availability of qualified individuals in importing firms, the investigator has found that many importers lack such individuals. About 37.6 percent of customs assessors believe that importers lack knowledgeable staffs that review customs document, 32.2 percent have the opposite opinion and the remaining 32.2 percent were neutral.

### **Lack of competent and sufficient manpower**

Inadequate administrative capacity, including difficulties in ensuring proper data gathering and analysis, computerization, hiring and training of qualified personnel, and establishing organized database management systems principally constrained the customs valuation operation of ERCA. As a result, the Customs valuation and Tariff Classification Department does not have qualified and enough manpower to update the database regularly and timely. The department also performs other routine works in addition to its function of updating price information. However, the absence of manpower considerably constrained the department from achieving its objectives.

### **Ambiguity to distinguish sole agents**

The authority entertain importing firms which are sole agents based on the invoice price they provide. The minimum price principle does not apply for sole agents. On the other hand, the directives set by ERCA do not put clear criteria for identifying sole agents and this creates perplexity in the customs valuation process.

### **Corruption in the valuation system**

Customs valuation systems applied in Ethiopia is highly suspected of corruption since it entails subjective assessment by customs officers in certain circumstances. Even though the government exerted plenty efforts to control and reduce the malpractice in customs valuation function, according to in-depth interview with customs directors and the

questionnaire filled by assessors, still there are cases handled in unfair and reckless manner.

#### **4.8 Summary of findings**

As pointed out in near the beginning of this chapter, a newly issued customs proclamation, Proclamation 622/2009, is currently applied by ERCA to determine customs values. The Ethiopian customs law establishes a customs valuation system that primarily bases the Customs value on the transaction value of the imported goods, which is the price actually paid or payable for the imported goods, plus certain adjustments. In cases where the customs value cannot be determined on the basis of the transaction value, it is determined using the transaction value of identical goods; the transaction value of similar goods; the deductive value method; the computed value method; and the fall-back method, in hierarchical order.

As discussed in this chapter, customs duties and imports taxes in Ethiopia have been significantly increasing in the years under investigation. Duties and import taxes were about ETB 3,633.85 million in Ethiopian fiscal year 2002/03 and ETB 11,693.07 million in the fiscal year 2007/08. They had mounted more than three times in six consecutive years. Despite this fact, there are still indicators showing the government's loss of duties and customs revenues due to underinvoicing by importers. The survey analysis indicated that a high concentration of underinvoicing had been detected in imports from selected countries (China and UAE) while other countries were thinly reported on with regard to occurrences of such economic offences. As per the in-depth interview with customs and director and valuation officers, the extent of under-invoicing is so high that customs

revenue is likely to rise significantly when evaded customs values are properly assessed and taxed.

Importer may engage in under invoicing and not declare the full value of the shipment to reduce his duty liability. Unless underinvoicing of import values is not identified and controlled, the government encounters loss of duties and taxes revenue and the importer receives an unfair advantage compared to its competitors. In this regard, the Customs Valuation System in Ethiopia does not provides fair, neutral and uniform valuation and does not protects traders from risk of arbitrary valuation by the customs officers. There is also risk of revenue loss to the government due to underinvoicing of imports by the traders since controlling mechanisms such as PCA are not adequately developed. This chapter has presented the result of the study in detail. In the context of the results shown in this chapter, conclusions and recommendation are presented in the next chapter.

## **Chapter five: Conclusions and recommendations**

As discussed in chapter 4, customs duties and import taxes constitute the lojn share of the indirect tax revenues in Ethiopia. Despite this fact, the customs valuation system applied in entail certain operational problems that need to be solved by ERCA in collaboration with the Ethiopia Government. This chapter presents the conclusions and recommendation of the study. Therefore, section 5.1 portrays the conclusions made based on the result found in the previous chapter. Section 5.2 explains the recommendations forwarded by the investigator to get rid of customs operational problems.

### **5.1 Conclusions**

The Customs value on imported goods is determined mainly for the purpose of applying ad valorem duties and import taxes. It constitutes the taxable basis for Customs duties and import taxes. A newly issued customs proclamation, Proclamation 622/2009, is currently applied by ERCA to determine customs values but new customs regulation is not yet issued by council of ministers for detailing its implementation. The Ethiopian customs law establishes a customs valuation system that primarily bases the Customs value on the transaction value of the imported goods, which is the price actually paid or payable for the imported goods, plus certain adjustments. In cases where the customs value cannot be determined on the basis of the transaction value, it is determined using the transaction value of identical goods; the transaction value of similar goods; the deductive value method; the computed value method; and the fall-back method, in hierarchical order.

The study claims that customs valuation is vital factor in the process of generating government tax revenues and facilitating foreign trade activities. Erzan and Yeats (1990) also indicated the significance of customs valuation for assessment of duties and import taxes. Customs duties and imports taxes in Ethiopia have been significantly increasing in the years under investigation. Duties and import taxes were about ETB 3,633.85 million in the Ethiopian fiscal year 1995 and ETB 11,693.07 million in the fiscal year 2000. They had mounted more than three times in six consecutive years. Despite this fact, there are still indicators showing the government's loss of duties and customs revenues due to underinvoicing by importers.

The Customs Valuation System in Ethiopia does not provide fair, neutral and uniform valuation and does not protects traders from risk of arbitrary valuation by the customs officers. There is also risk of revenue loss to the government due to underinvoicing of imports by the traders since controlling mechanisms such as PCA are not adequately developed. In Ethiopia PCA is in infant stage and other customs valuation facilities in terms of importers' voluntary compliance, data base, infrastructures and skilled manpower are still inadequate. Although customs operating situations have been now improved, there are still many irregularities that need to get remedial actions.

The survey analysis revealed that a high concentration of underinvoicing had been detected in imports from selected countries (China and UAE) while other countries were thinly reported on with regard to occurrences of such economic offences. High customs-risk products such as textile products, electronics, shoes, and vehicle spare parts were also identified. As per the in-depth interview with customs valuation and tariff

classification director and valuation officers, the extent of under-invoicing is so high that customs revenue is likely to rise significantly when evaded customs values are properly assessed and taxed. The main factors that may exacerbate underinvoicing by importers are the higher duty and tax rates, various cost items (such as insurance and freight charges) included in the taxable base, and the existence of relationship between importers and their supplies.

The Government of Ethiopia ought to recognize that the present customs assessment chaos is connected with the existence of ineffective and arbitrary customs valuation system. It can probably bring about some improvement in foreign trade activities by implementing appropriate valuation system. Therefore, the government should strengthen the controlling mechanisms within the customs valuation system since duties and taxes on foreign trade contribute the significant portion of tax revenue.

## **5.2 Recommendations**

The problems and irregularities prevailing in the customs valuation operation impair the revenue produced by the Ethiopian Government and the import trade activities in the country. In the previous chapter, the study tried to identify the pitfalls within the customs valuation system applied in Ethiopia. In this section, a number of suggestions aiming at addressing the various problems discussed in the previous chapter are presented.

### **Controlling underinvoicing**

Under-invoicing of imported goods is an extremely serious and complex problem that has a negative impact on the Ethiopian economy in several ways. Duties and taxes escape the net and this would result in gross economic distortions. This leads to an uneven playing field and unfair competition, and is disadvantageous to goods manufactured in Ethiopia. Despite the general increase in customs duties and import tax collections, there has been frequent occurrence of underinvoicing, which demands more attention from the Government of Ethiopia. The increased vigilance and deployment of modern systems in Ethiopia such as the introduction of an AYCUDA<sup>++</sup> which may enable to reshuffle some staffs to functions involving controlling underinvoicing, as well as price database of indicative values for imported goods, may help in minimizing this loss. In addition, ERCA needs to strengthen the capacity of its customs valuation and tariff classification functions in order to control the underinvoicing of import values.

### **Formulating and implementing comprehensible procedures**

According to Finger and Schuler (2000), the customs processes in poorer countries exhibit many interacting weaknesses of procedures that are not codified along with poorly trained officials, who often receive side-payments for performing their functions. In many such poorer countries, smuggling is rampant. Thus, customs valuation function is another challenging task of customs authorities that need improvement through extensive reform. Customs valuation procedures must be based on transparency, objectivity, and accountability and In view of the inherent problems in customs administration of Ethiopia, there is a need

for comprehensive customs procedures so that implementations of the newly stipulated customs valuation rules are practical and beneficial to the country.

### **Promoting voluntary compliance culture**

Customs valuation should not always be a subject of dispute between the government and the business community. Hence, a congenial environment should be created so that importers declare the price actually paid or payable for the goods imported. Transparency, fairness and competency in valuation process will develop a voluntary compliance culture in the business community. On the part of custom officials, attitude and behaviors toward traders and technical competency are also equally important. The private sector, together with the agencies concerned, would have to be encouraged to promote a culture of voluntary compliance. The voluntary compliance by the private sector may help in the realignment of resources including arranging appropriate customs manpower needed for improving the valuation process rather than wasting more time and resources for fraud investigation.

### **Frequent updating of the database**

The commencement of price database and ASYCUDA<sup>++</sup> has helped ERCA in terms of facilitating assessment activities. However, it is equally important to maintain and update the facilities created by the Authority so that the full benefits in terms of enhancing trade facilitation potential may be realized. As emphasized by the survey result, there is a huge time lag in updates, which creates various problems among different sets of importers. Therefore, ERCA needs to increase its capacity and update the database as timely as possible. Furthermore, the ASYCUDA<sup>++</sup> and the price database should be integrated to

avoid the need for switching from one computer program to another. This simplifies customs valuation officers' work and reduces the time needed for customs clearance.

### **Training and development of customs valuation officers**

Only skilled manpower can take advantage of modern technology of information. At the same time adequate knowledge on customs valuation among custom officers is required to effectively implement the customs valuation rules and procedures. Timely updating the database and adopting automated systems such as ASYCUDA<sup>++</sup> will be successful only after customs official have received adequate training and qualification in customs valuation matters. Therefore, sufficient training in valuation methods and information technology application must be given to assessors of customs clearing agents as well as valuation officers of ERCA.

### **Information sharing**

Electronic transmission of information among custom branch offices, head office and other related agencies is also equally important. Hence, efforts should be made to develop electronic communication network adequately. Wide area network should be established among custom branch offices and the head office in order to update the price database centrally and perform customs valuation operations uniformly. This enables to eliminate customs valuation inconsistencies among the branch office occurring due to information gap. An integrated computer system that encompass all customs regimes, operations, control functions, audits, administration, exchange of information with foreign trade operators,

statistics and management should be developed and centrally maintained to be accessed by all branch offices and customs stations.

### **Harmonized approaches in customs valuation and transfer pricing**

During the interview held with the director and valuation officer, it was pointed out that some of the import transactions involve related parties. The authority should explore such transactions and devise suitable methods of determining value for customs purpose. Related parties transactions usually allow the parties to manipulate the product's price in order to reduce duties and taxes on it. In the context of related party transactions, customs valuation poses a huge challenge. The issue becomes more pronounced in situations where the importer is sole agent or subsidiary of the foreign supplier. In the currently used customs valuation system there is no clear way of treatment for the related parties. Therefore, related parties transactions matters need to be properly observed and appropriate policies are suggested to be formulated.

### **Combating corruption**

An effective customs control system is required to plug revenue leakage through malpractice of customs officials. A strong enforcement mechanism is required also to protect the honest traders. Ethiopian customs valuation law has ratified the PCA of selected firms to verify whether the customs values have been properly determined by the valuation officers. However, the practice of PCA is in very initial stage in Ethiopia. In order to ensure an effective custom control, PCA should be extended as well as strengthened. However, it is not an easy task in Ethiopia where traders do not keep

accounting records properly. Traders even may feel PCA causes an additional burden and resist against it. Therefore, special programs should be launched in this regard. Effort should be made to convince traders that it would give them long run benefit.

Finally, this study did not consider the whole customs assessment operations of ERCA, but merely its customs valuation systems. Furthermore, the study did not cover some aspects of the customs valuation systems including the significance of revenues lost due to underinvoicing of import values and operating efficiencies of the system. The investigator suggests further investigations to be conducted pertaining to the undiscovered matters of customs valuation. Although, this is the case, it is believed that the findings of the study are expected to fill the knowledge gap concerning the operational issues of customs valuation and the problems of customs operation.

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## Appendices

### *Appendix 1: Questionnaires for importers*

**Addis Ababa University**

**Faculty of Business and Economics**

**Department of Accounting and Finance**

#### **Questionnaire Filled by Finance Managers and Accountants of Importing Firms**

This project is entitled “**Customs valuation Systems in Ethiopia**”. The investigator is Tenkir Seifu who is currently an MSc (in accounting and finance) student at Addis Ababa University.

The aim of this project is to assess the customs valuation systems applied in Ethiopia and to pinpoint the pitfalls of the system. To supplement the data obtained from in-depth interview with customs valuation officers and documentary analysis, the investigator seeks to gather relevant information from a sample of importing firms by means of questionnaires.

Participation in this project is completely voluntary. The questionnaire results will be recorded anonymously and strict confidentiality will be maintained. Individual responses will not be identified in the investigator’s MSc thesis.

For further information, please contact Tenkir Seifu by the following address:

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E-mail: [tenkirs22@yahoo.com](mailto:tenkirs22@yahoo.com)

**Part one: Background information**

1. Your educational qualification

12 Completed <sup>1</sup>  College diploma <sup>2</sup>  BA degree <sup>3</sup>

Masters Degree and above <sup>4</sup>  Others <sup>5</sup>  please specify\_\_\_\_\_

2. Your year of experience in the organization

Less than 2 years <sup>1</sup>  2 - 4 years <sup>2</sup>  5 - 7 years <sup>3</sup>

8 – 10 years<sup>4</sup>  More than 10 years <sup>5</sup>

3. Form of the organization you work in:

Sole proprietorship <sup>1</sup>  Partnership <sup>2</sup>  Corporation <sup>3</sup>

Others <sup>4</sup>  please specify\_\_\_\_\_

4. How does your firm do international trade?

As an agent of foreign Company <sup>1</sup>

As sole distributor of Multinational firm <sup>2</sup>

Subsidiary of multinational firm<sup>3</sup>

Independent importer <sup>4</sup>

Others <sup>5</sup>  Please specify\_\_\_\_\_

5. From which of the following continents does your firm get majority of the imported items?

Africa <sup>1</sup>  Europe <sup>2</sup>  South America <sup>3</sup>

North America <sup>4</sup>  Asia <sup>5</sup>  Australia <sup>6</sup>

6. What are the types of products imported by your company?

Electronics <sup>1</sup>  Automobile <sup>2</sup>  Agricultural inputs <sup>3</sup>  Building material <sup>4</sup>

Chemicals <sup>5</sup>  Machinery consumer goods <sup>6</sup>  Pharmaceutical and medical equipments<sup>7</sup>  Textile and apparel<sup>8</sup>  General import<sup>9</sup>

Others <sup>10</sup>  Please specify\_\_\_\_\_

7. For how long has your firm been engaged in international trade (import transactions)?

Less than 2 years <sup>1</sup> 2 - 4 years <sup>2</sup> 5 - 7 years <sup>3</sup>

8 - 10 years <sup>4</sup> More than 10 years <sup>5</sup>

8. How does your organization deal with customs issues on imports?

Firm's accountants deal with all the matters pertaining to customs <sup>1</sup>

Firm's finance manager deals with all the matters pertaining to customs <sup>2</sup>

Transistors deal with all the matters pertaining to customs <sup>3</sup>

Others <sup>4</sup> please specify \_\_\_\_\_

**Part two: General product information**

	Yes <sup>(1)</sup>	No <sup>(2)</sup>	I do not know <sup>(3)</sup>
9. Products imported by your firm are imported by other firms from the same country			
10. There are products imported by other firms which have similarity with the product imported by your firm			
11. The products imported by your company have different grades			
12. your firm appraises its foreign suppliers regarding their reliability in providing correct certificate of product's origin			
13. your company can get the same products if it wants to import from different countries			
14. your firm can provide the certificate of origin for products on customs entry documents			

**Part three: Customs valuation matters**

15. On average, how many days does it take for an importer in Ethiopia to complete the customs clearance process?

Less than 5 days  6 – 15 days <sup>2</sup>  16 – 30 days <sup>3</sup>  More than 30 days <sup>4</sup>

	Yes <sup>(1)</sup>	No <sup>(2)</sup>	I do not know <sup>(3)</sup>
16. Import transactions are the major economic events in your firm			
17. Your company considers payment for customs duties as its major expenditure			
18. In your firm, change in import value is the main factor affecting the expenditure for customs duties			
19. Your firm pays transportation cost for items imported			
20. Your firm pays insurance for items while they are in transit			
21. In your firm, costs of transportation and insurances are significant portion of import value for customs purpose			
22. There is responsible and knowledgeable individual within your organization who review customs documentations to assure that they are reliable, complete and accurate			
23. Your firm consults an expert to assist it comply with customs clearance requirements of ERCuA			
24. When your firm purchases merchandise from a "related" supplier in foreign country, it reports the fact upon entry			
25. Your firm can always provide complete and adequate documents for its import transactions			

**Part four: Opinion on customs valuation system applied by Ethiopian Revenues and Customs Authority (ERCuA)**

	Strongly agree <sup>(1)</sup>	Agree <sup>(2)</sup>	Neutral <sup>(3)</sup>	Disagree <sup>(4)</sup>	Strongly disagree <sup>(5)</sup>	I do not Know <sup>(6)</sup>
26. Customs valuation system in Ethiopia is based on objectively stated procedures and criteria						
27. Customs valuation officers in Ethiopia are qualified enough to handle their duties						
28. customs valuation officers have adequate expertise on import transaction						
29. The time taken for customs clearing process is fair and reasonable						
30. Customs valuation system applied in Ethiopia has appropriate control mechanism						
31. The documentation system used by ERCuA is effective in capturing import transactions						
32. Customs valuation system applied in Ethiopia creates fair play ground among importers						
33. Most importers in Ethiopia provide ERCuA with the correct import value of merchandise						
34. Overall, customs valuation system employed by ERCuA is effective						

35. If you have any comment, please mention it below.

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***Thank you very much***

*Appendix 2: questionnaires for transiters*

**Addis Ababa University**

**Faculty of Business and Economics**

**Department of Accounting and Finance**

Questionnaire to be Filled by assessors of Customs Clearing Firms

This project is entitled “**Customs valuation Systems in Ethiopia**”. The investigator is Tenkir Seifu who is currently an MSc (in accounting and finance) student at Addis Ababa University.

The aim of this project is to assess the customs valuation systems applied in Ethiopia and to pinpoint the pitfalls of the system. To supplement the data obtained from in-depth interview with customs valuation officers of ERCA and documentary analysis, the investigator seeks to gather relevant information from a sample of customs clearing firms by means of questionnaires.

Participation in this project is completely voluntary. The questionnaire results will be recorded anonymously and strict confidentiality will be maintained. Individual responses will not be identified in the investigator’s MSc thesis.

For further information, please contact Tenkir Seifu by the following address:

Tel.: 0911 54 10 65

E-mail: tenkirs22@yahoo.com

**Part one: Background information**

36. Your educational qualification

12 Completed <sup>1</sup>  College diploma <sup>2</sup>  BA degree <sup>3</sup>   
Masters degree and above <sup>4</sup>  Others <sup>5</sup>  please  
specify\_\_\_\_\_

37. Your year of experience in the organization

Less than 2 years <sup>1</sup>  2 - 4 years <sup>2</sup>  5 - 7 years <sup>3</sup>   
8 - 10 years <sup>4</sup>  More than 10 years <sup>5</sup>

38. Form of the organization you work in:

Sole proprietorship <sup>1</sup>  Partnership <sup>2</sup>  Corporation <sup>3</sup>   
Others <sup>4</sup>  please specify\_\_\_\_\_

39. For how long has your firm been engaged in customs clearing services?

Less than 2 years <sup>1</sup>  2 - 4 years <sup>2</sup>  5 - 7 years <sup>3</sup>   
8 - 10 years <sup>4</sup>  More than 10 years <sup>5</sup>

40. Who is directly responsible for customs valuation duties in your firm?

Accountants <sup>1</sup>   
Operational managers <sup>2</sup>   
Customs valuation officers <sup>3</sup>   
Others <sup>4</sup>  please specify\_\_\_\_\_

**Part two: Customs valuation matters**

41. On average, how many days does it take to complete the customs clearance process for an importer?

Less than 5 days <sup>1</sup>  6 – 15 days <sup>2</sup>  16 – 30 days <sup>3</sup>  More than 30 days <sup>4</sup>

42. Which method of customs valuation is mostly applicable in practical situation for customs valuation?

Transaction value method <sup>1</sup>  Transaction value of identical merchandise <sup>2</sup>

Transaction value of similar merchandise <sup>3</sup>  Deductive value <sup>4</sup>  Computed value <sup>5</sup>

43. When customs officers in Ethiopia doubt the declared value of imported goods, which method of valuation do they commonly apply?

Transaction value of identical merchandise <sup>1</sup>  Deductive value <sup>2</sup>

Transaction value of similar merchandise <sup>3</sup>  Computed value <sup>4</sup>

Others <sup>5</sup>  please specify \_\_\_\_\_

44. In your opinion, imports from which continent are more susceptible for underinvoicing of import values?

Africa <sup>1</sup>  Europe <sup>2</sup>  South America <sup>3</sup>

North America <sup>4</sup>  Asia <sup>5</sup>  Australia <sup>6</sup>

45. In your opinion, the most common way of underinvoicing import value in Ethiopia is:

Using third country invoice <sup>1</sup>  Adjusting invoice value <sup>2</sup>  misrepresenting grades <sup>3</sup>

Others <sup>4</sup>  please specify \_\_\_\_\_

**Part three: Opinion on Importers Compliance**

	Strongly agree <sup>(1)</sup>	Agree <sup>(2)</sup>	Neutral <sup>(3)</sup>	Disagree <sup>(4)</sup>	Strongly disagree <sup>(5)</sup>	I do not Know <sup>(6)</sup>
46. Most importers provide reliable and complete invoice value for customs valuation						
47. Items imported by most firms can be obtained from different countries at different price						
48. Most importers in Ethiopia report the correct country of origin for products on customs entry documents						
49. Means of transportation used by most importers are creditable and effective in keeping adequate document						
50. Most importers in Ethiopia provide all legally required costs or payments associated with the imported merchandise for customs valuation						
51. Most importing firms in Ethiopia purchase items from affiliated (related) supplier in foreign country						
52. When importers purchase merchandise from an affiliated supplier in foreign country, they report the fact in most cases						
53. Importing firms have knowledgeable individuals who review customs documentations to assure their reliability, completeness and accuracy						
54. Undervaluation of import values is generally the rule of the game for only few importers in Ethiopia						
55. Overall, most importers comply with the customs valuation systems' requirements						

**Part four: Opinion on customs valuation systems applied by Ethiopian Revenues and Customs Authority (ERCA)**

	Strongly agree <sup>(1)</sup>	Agree <sup>(2)</sup>	Neutral <sup>(3)</sup>	Disagree <sup>(4)</sup>	Strongly disagree <sup>(5)</sup>	I do not Know <sup>(6)</sup>
56. Customs valuation system in Ethiopia is based on objectively stated procedures and criteria						
57. Customs valuation officers in Ethiopia are qualified enough to handle their duties						
58. customs valuation officers have adequate expertise on import transaction						
59. The time taken for customs clearing process is fair and reasonable						
60. Customs valuation system applied in Ethiopia has appropriate control mechanism						
61. The documentation system used by ERCA is effective in capturing import transactions						
62. Customs valuation system applied in Ethiopia creates fair play ground among importers						
63. Customs valuation system applied in Ethiopia is less susceptible of undervaluation						
64. Customs valuation system applied in Ethiopia is based on built-in incentives for compliance by importers						
65. Overall, customs valuation system applied by ERCA is effective						

**Part five: Other Issues**

66. Can you mention some of the main problems related to customs valuation system in Ethiopia?

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67. What possible solutions do you recommend to resolve the above mentioned problems?

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68. If you have any comment, please mention it here.

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Thank you very much