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Working Party on Preshipment Inspection

VIEWS PRESENTED ON THE ISSUES IN THE PROGRAMME OF WORK

Note by the Secretariat

1. At its meeting of 10 December 1997, the General Council adopted the Report of the Working Party on Preshipment Inspection, contained in document G/L/214¹. The Report contained 7 recommendations to enhance implementation of the Agreement on Preshipment Inspection (hereafter, the Agreement), and 2 recommendations for future action of the Working Party. These last two recommendations read as follows:

"8. The life of the Working Party shall be extended for one year to exchange views on a Code of Conduct/Practice for PSI entities; a standard inspection format; selective examination of shipments; auditing of PSI entities; the promotion of competition among PSI entities; fee structures for PSI entities; and the use, to user Members, of building price data bases.

9. An assessment of technical assistance activities should be undertaken, in accordance with Article 3 of the Agreement, and draw upon the assessment of technical assistance activities under consideration in the Committee on Customs Valuation and the integrated framework for trade-related technical assistance endorsed by the WTO High-Level Meeting for Least Developed Countries. Technical assistance activities, which should be administered on a request basis, could include areas such as tariff and customs administration reforms; simplification and modernization of systems and procedures; and the development of an adequate legal, administrative, and physical infrastructure.

2. In accordance with recommendation 8, the Working Party has held two meetings this year, on 19 March and 12 June 1998, to exchange views on the issues contained in that recommendation. This note organizes the views presented in the Working Party on the issues elaborated in recommendation 8 above, at these two meetings. The views are listed under each issue. In addition, as foreseen in recommendation 9, the Working Party engaged in an exchange of views on the issue of technical assistance; these views are also contained in this note.

Issue No. 1: Code of Conduct/Practice for PSI entities

¹ The Working Party on Preshipment Inspection was established by the General Council at its meeting of 7, 8, and 13 November 1996. The terms of reference are "to conduct the review provided for under Article 6 of the Agreement on Preshipment Inspection and to report to the General Council through the Council for Trade in Goods in December 1997".

3. In exchanging views on this issue, several delegations discussed the proposal by the Swiss delegation, contained in G/PSI/WP/W/16, for a draft model contract to be used to establish the agreement and terms of the contract between a PSI company and a user Member. Below are the views presented on this issue:

The United States found that the Swiss proposal could have merit in creating an interface between the obligations of the Agreement and the activities of PSI entities. It posed questions regarding the type of monitoring and enforcement mechanism that might be available to ensure that PSI entities would fully implement the terms of a model agreement, and whether there might be some role for technical assistance in this area. It assumed that there would not be any rights for exporters and importers as a result of such a model agreement forming a part of a contract. If they were to include the model agreement in a contract, what would be user Members' willingness to use their judicial mechanisms to enforce the specific provisions?

The European Communities said that the model contract would need to offer added value. For example, in the Agreement, there was no reference to importers. Some points might be identified and inserted to provide this added value. Also, it would be important to ensure that the model agreement would not raise any incompatibility with the Agreement. Otherwise, serious interpretation and enforcement problems might arise. Serious reflection was needed on the manner of enforcing this model agreement; it was difficult to imagine how it could be binding.

The Philippines was concerned that if it, as a user Member, was bound by this model contract, its freedom would be limited to enter into a type of contract fit for its purposes. As a non-binding instrument, it had more appeal as something that might address the concerns raised by exporters. It should also not be applied retroactively; The Philippine Government had just renewed its contract with a PSI entity so this would not apply to this contract. As a lot of the provisions of the model contract were already in the Agreement, what would be its added value?

Hong Kong, China noted that the model contract had taken into account many of the recommendations in G/L/214. By repeating many of the provisions of the Agreement, the model contract effectively extended, in a contractually binding manner, the obligations of the Agreement to PSI companies which otherwise would not be bound by these obligations. The contractual relation established would be between the user Government and the PSI entity concerned. As such, the enforcement of the model contract would be a matter for these two parties, never for exporters nor their governments. The draft model contract contained separate provisions, namely Articles 9.4 and 9.5, for complaints and appeals to the PSI entities. This two-tier structure, though not necessarily inconsistent, did not seem to be envisaged in Article 2.21 of the Agreement. Discussions and any adoption of such an instrument should not effect the rights and obligations of WTO Members with respect to the Agreement.

Switzerland said its submission (G/PSI/WP/W/16) was based on its communication last year (G/PSI/WP/W/9). Such a model could help increase the efficiency of preshipment inspection activities and meet some concerns of Members. Its model was prepared in close consultation with all the interested groups in the Swiss private sector, and in accordance with the recommendations of the Working Party contained in G/L/214. The model attempted to ensure the respect of contractual freedom. It had stated its view that it should not be binding nor that it could not be modified according to specific circumstances of user Members. It might add value by including provisions that were in the Agreement now and that actually only applied to user Members. Monitoring and enforcement laid with the user Members so a specific mechanism was not needed. It was true that the two-tier approach was not foreseen in the Agreement, and that the model contract should be in conformity with the Agreement. It would always be up to PSI entities and user Members to agree on its specific provisions.

Australia expressed its interest in pursuing the ideas in the model contract. This type of instrument could be seen as a tool to help provide the link that was not in the Agreement between who was actually going to be carrying out the PSI activities and who was responsible under the Agreement. The fact that there were already many items in the draft model contract that were in the Agreement was intentional as it was meant to be an enforcement tool for obligations under the Agreement. The enforcement of the contract was left in the hands of the user Members. Regarding the independent review and appeal procedures under paragraph 9 of the model, while what was in the Agreement was slightly different, the Swiss proposal was a useful way of formalising the PSI companies' existing obligations to entertain complaints and appeals from traders within their existing structures.

The European Communities suggested two specific drafting changes to the Swiss text to allay some of the concerns expressed. The first was to add the sentence, 'in case of conflict between the provisions of the model agreement and the Agreement, the provisions of the Agreement always would prevail'. The second suggestion was to add the sentence, 'the provisions of the model contract in no way affect the sovereignty of Member states and the freedom of contract'.

Issue No. 2: A standard inspection format

4. The following views were presented on this issue:

The European Communities thought such forms could not be standardized completely. Inspections were usually product-related, therefore, to what extent would a fully standardized inspection format be workable?

Australia expressed the need for additional time to reflect on what would be workable and useful for Members. It was open to IFIA and ICC involvement in developing this concept and had a preference for any format to be contractual rather than the other options listed in the US communication.

Colombia thought it would be useful to have a standard inspection format and would look into specifics.

The United States said that standard inspection formats could be a useful idea to the extent that different PSI entities used different formats which created confusion for exporters.

Issue No. 3: Selective examination of shipments

5. The following views were presented on this issue:

The European Communities said that selective examination could speed up the exporting process and contribute towards avoiding excessive delays and bureaucratic burdens. Serious thought would have to be given to the criteria that would be used to avoid any discrimination and to promote full transparency.

Switzerland noted that IFIA had expressed support for selective physical inspections on a controlled basis provided that they complied with the Agreement requiring PSI activities in a transparent manner and on an equal basis for all exporters. Selective examination was already a reality and the Agreement did not prohibit it. It was up to user Members to introduce this concept in their contracts with PSI entities. It would be interesting to hear from user Members what criteria they had used, what were the results and the problems. It seemed that

the criteria used, especially the objectivity, might be the key factor in dealing with any discriminatory nature of selectively inspecting shipments.

The United States said that selective examination of shipments was a priority for his delegation and should be addressed by the Working Party. The trend among customs authorities was to engage in risk assessment and to only examine those shipments that were considered to be high risk. The IFIA representative had noted, however, that it had concerns related to non-discrimination. This was not an issue because it was clear that customs authorities, who had obligations with an even higher rigor than PSI entities in this area were already using this. There was no question as to whether their activities were non-discriminatory and transparent. Therefore, this was not an obstacle to PSI entities using this technique. It would be interesting to hear the experiences of those user Members whose contracts with PSI entities provided for selective examination.

Issue No. 4: Auditing of PSI entities

6. The following views were presented on this issue:

The European Communities said some basic questions would need to be answered such as the independence of auditors, the scope of audits to be undertaken, and the protection of confidentiality which should not be undermined by auditing.

The Philippines had great reservations on auditing. Each time its PSI contract was up for renewal, intense scrutiny of the entity was conducted. There were some parts of the Philippine Government that were in favour of getting rid of PSI and some that were in favor of keeping it. The Philippine Government was against requiring an independent audit; no less than the legislative branch of the Government was auditing the PSI entity and from this it was clear that it was not an easy task.

Hong Kong, China said that the Working Party should consider the cost effect of engaging an auditor and the level of PSI activities to which the audit should be directed. On the latter, exporters might be concerned about whether they would be subject to repeated inspections when the PSI entity was being audited.

Switzerland said that the Agreement did not prevent user Members from using independent auditors. Input from user Members would be useful. The responsibility of the full implementation of the Agreement was with user Members who should monitor PSI entities and the presence of external auditors should not change this legal reality. Auditing activities, mandated by foreign government authorities, would be considered illegal in Switzerland as they were not specifically foreseen in the Agreement. It was also essential that the confidentiality of information be preserved in accordance with the provisions of the Agreement. Given the unclear legal implications of auditing, this idea should not be pursued.

The United States was interested in looking at whether there would be use to user Members in engaging the services of auditors. This issue warranted further discussion.

Issue No. 5: The promotion of competition among PSI entities

7. The following views were presented on this issue:

The European Communities considered that competition among PSI entities should be welcomed by user Members and the Working Party should reflect on practical means of

improving competition. One way would be to enhance information concerning PSI entities available to user Members so that they always would make an informed choice.

The Philippines noted that one user Member was seeking to promote competition by signing multiple contracts. Was this something that exporters would be in favor of, and would it be more efficient to have multiple contracts? It might be more confusing. In the Philippines, although there was no competition, there was a basis on which the fee structure was being set. Exporters should reflect on this point and the Working Party should discuss the experience of those exporter Members where an importer user Member had signed multiple contracts for PSI services to be provided.

Switzerland said that promotion of competition was beneficial and useful, but it could not be imposed neither on user Members nor on PSI entities. It was difficult to accept the view that the absence of competition led to non-transparent, arbitrary, and discriminatory treatment of exporters and importers. It would be useful to hear from user Members who were using such systems what the benefits had been. Had the number of complaints increased or decreased as a result of multiplying PSI entities? For what reasons had these user Members decided to introduce such systems?

The United States said that in an oligopolistic market such as the PSI industry true competition was questionable. There would not be a proliferation of PSI entities and the Working Party's ability to promote competition would be somewhat limited. However, at least one user Member had engaged multiple contracts and it would be interesting to hear about its experience. While it may be confusing, there could be overriding benefits in exporters having the potential choice among PSI entities. User Members were at the same time exporter Members and had interests in the issues as well.

Argentina stated that its experience was very recent, only six months. However, the discussions of the Working Party would be referred to the capital in order to secure information on any results of the experience as soon as possible. The reason behind Argentina's particular PSI programme was basically to promote competition. In the programme, the exporter had the possibility of selecting among six PSI companies that had been qualified through a process of public competition. In this way, it was believed that the exporter would have the chance to select the enterprise with which it felt most comfortable and which it considered was the best. The Government thought that the promotion of competition was positive and saw no obstacles in it. In the initial experience, there was no sign of any resulting confusion. The companies were not divided by any particular product sector, all companies offer services for all products. Enterprises could be better monitored and controlled if there were many in number.

Peru had a PSI programme which utilised several PSI companies and its experience was positive. Users of the programme were importers who also paid the fees for the inspection, which was an *ad valorem* percentage. The fact that there was more than one PSI entity competing stopped the fees from being too high and maintained them closer to reality. If one entity's fees were too high, an importer could go to another entity whose fees were lower.

Korea recalled that his delegation had initially proposed the issue of promotion of competition to the Working Party last year which had come from Korean exporters' opinions. When an exporting company had a problem, such as being asked to provide information or delays, if it had the possibility of choosing another PSI company, the problem could be solved. So, changing PSI entities could be a solution. There was no information on the specific experience, but more information could be sought from capital.

Issue No. 6: Fee structures for PSI entities

8. The following views were presented on this issue:

The European Communities reiterated its strong reservation on practices based on flat fee rates. The fees charged should be proportionate to the services rendered which would help avoid conflicts of interest.

Australia would prefer that fees be charged on the basis of services provided rather than *ad valorem* rates. For example, this could mean a fee negotiated and agreed between the user Member and the PSI entity at the time of the signing of the contract that would reflect an estimate of the value of the resources and time. Flexibility would have to be built in as it would be an estimate. The Working Party could examine the mechanics of this at a later time.

Hong Kong, China agreed that input from user Members would be helpful to better understand this issue, especially from those user Members that were adopting structures involving a linkage between fees and the verified value of the goods. They should be given opportunities to explain how they addressed the question of conflict of interest under such arrangements.

The United States shared the views of the European Communities that fees should be strictly related to the services rendered and that there could be implications with respect to Article VIII of GATT 1994.

Issue No. 7: The use, to user Members, of building price data bases

9. The following views were presented on this issue:

Colombia considered that using price databases to make comparisons with prices declared by importers and to justify doubts that the customs authorities could have about a price expressed by an importer, would be a very useful tool in order to quantify the value which would allow the release of the good to the importer. Price databases could also be extremely useful in determining the customs value in conformity with Article 7 of the Customs Valuation Agreement, that was when the customs value could not be determined on the basis of Article 1 through 6 of the Agreement. Article 7 said that such value would be determined according to reasonable criteria which were compatible with the principles and the general provisions of the Agreement and Article VII of GATT 1994, on the basis of data available in the importing country. As the representative of IFIA had said at the informal meeting, price databases could also be useful as references for the valuation in accordance with Article 2 of the Agreement, the transaction value of identical goods, or with Article 3, the transaction value of similar goods. For Colombian customs authorities, a price database would include reference prices and not minimum prices. So, if it was understood that price databases constituted reference prices and not minimum prices, the Working Party could do away with the concern that such a price database could distort the customs valuation and would therefore be against the principles of the Customs Valuation Agreement. Columbia considered a price database with market prices, not minimum prices, as a source of information to expedite customs valuation work. Nevertheless, the importer always had the right to show that the price declared was the true price paid.

The European Communities had reservations against the building of price databases which would have to be studied very carefully. It entailed the danger of leading to fictitious prices, undermining the market structure and complicating, instead of simplifying, exporting practices. According to Article 7 of the Customs Valuation Agreement, among the means

allowed to identify price for customs purposes were databases available in the country of importation. However, the EC considered that any measures that might be used to allow the identification of the price had to be strictly consistent with the principles and general provisions of the GATT 1994 and the relevant agreements. This was also included in Article 7 of the Agreement. In this regard, a basic principle that would have to be respected was that every effort had to be made to avoid arbitrary or fictitious prices. This was explicitly stated in the Customs Valuation Agreement, in the PSI Agreement, as well as in Article VII of the GATT 1994. To the extent that these price databases might lead to fictitious prices, the EC believed that they should be resisted. Nothing, of course, would prevent the importing country from using price references if they so wished provided that they stuck to the principle of avoiding fictitious prices.

The United States appreciated the views of Colombia and noted the reference to Article 7 of the Customs Valuation Agreement. Nevertheless, the concerns of the EU were shared. Under Article 1 of the Customs Valuation Agreement, it would not appear to be legitimate to reject the transaction value on the basis of price databases, at least solely on this basis.

Japan stated that it had a strong interest in the relationship between price databases and the Customs Valuation Agreement.

Issue No. 8: Technical assistance

10. On this issue, the following views were presented:

The United States said that technical assistance in this area should not be oriented towards encouraging Members to engage the services of PSI entities, but instead should assist them in making the transition away from PSI and taking up these responsibilities themselves. This meant effective customs reform. There was a relationship with the discussions on technical assistance in the Customs Valuation Agreement. Surely there would have to be more focused technical assistance to allow user Members to reform and modernize their customs administrations.

The European Communities was willing to examine this issue in a structured way under certain conditions. The Working Party would need to have an integrated, global assessment of on-going technical assistance problems and shouldn't engage itself in the issue without having a clear picture of who was doing what, bilaterally as well as multilaterally. In addition, specific requests for assistance were needed, as foreseen in Article 3 of the Agreement. Further, specific programs were needed which were aimed at the objectives of the Agreement and eventually of customs reform. Coordination was also needed with other organizations and Members so that duplication of assistance was avoided and that a more focused and targeted effort was made. With these conditions and given the EU priorities and capabilities, the EC was willing to examine this issue.

The Philippines stated that it was receiving technical assistance bilaterally, plurilaterally and even multilaterally. This assistance was geared towards reform of customs practices and there were already tangible results. Among them was the ASYCUDA program of UNCTAD which had contributed towards a great improvement in the release time of goods in customs. Whether this assistance would enable the Philippines to phase out the PSI programme was not something that could be answered at present. However, since by the year 2000 many developing countries were obliged to shift to the transaction value of the WTO Customs Valuation Agreement, that might be the time when PSI activities would have to be phased out.

Switzerland also considered that it would be useful to begin this work with a fact-finding exercise with user Members, exporters and PSI entities to know more about the technical assistance that was already provided and requested. There was a clear relationship between this subject and the exercise going on in the Committee on Customs Valuation in terms of building up of customs infrastructures and capacities. The life of the Working Party was limited in time and, therefore, it might not be possible to launch a process at this time that would go beyond a fact-finding exercise. Such a process could also be duplicative. Members should endeavour to take the PSI dimension into the work of the Customs Valuation Committee.
