



Asia-Pacific Research and Training Network on Trade  
Working Paper Series, No. 18, August 2006

# Implementation of the WTO Customs Valuation Agreement in Nepal: An Ex-ante Impact Assessment

By

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**UPDATE:** A revised and edited version of this paper has now been published as:

Rajkarnikar, P., 2007 “Implementation of the WTO customs valuation agreement in Nepal: An ex-ante impact assessment”, pp. 195-220, Chapter VI in ESCAP, *Trade facilitation beyond the multilateral trade negotiations: Regional practices, customs valuation and other emerging issues – A study by the Asia-Pacific Research and Training Network on Trade*, (United Nations, New York).

Available online at: <http://www.unescap.org/tid/artnet/pub/tipub2466.pdf>

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\* Pushpa Raj Rajkarnikar is the Executive Director Institute for Policy Research and Development (IPRAD), Nepal. D.P. Ghimire, D.R. Upreti and D.L. Kishi provided excellent research assistance for this study. The views presented in this paper are those of the author and do not necessarily reflect the views of ARTNeT members, partners and the United Nations. This study was conducted as part of the UNESCAP/ARTNeT and UNDP Joint Research Programme on Trade Facilitation and Regional Integration and carried out with the aid of a grant from UNDP Asia-Pacific and Investment Initiative (APTII), Regional Centre in Colombo. The technical support of the United Nations Economic and Social Commission for Asia and the Pacific is gratefully acknowledged. The authors are very grateful to Yann Duval and an anonymous reviewer for their valuable comments. Any remaining errors are the responsibility of the author. The author may be contacted at [iprad@ntc.net.np](mailto:iprad@ntc.net.np)

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## *Abbreviation*

**ACV = Agreement on Customs Valuation**

**ASYCUDA = Automated System of Custom Data**

**BDV = Brussels Definition of Value**

**CIF = Cost Insurance and Freight**

**CVM = Computed Value Method**

**DoC = Departemnt of Customs**

**DRP = Duty Clearance Audit**

**DVM = Deducted Value Method**

**EU = European Union**

**FNCCI = Federation of Nepal Chamber of Commerce and Industry**

**GATT = General Agreement on Tariff and Trade**

**GON = Government of Nepal**

**ICT = Information Communication Technology**

**IMF = International Monetary Fund**

**LDCs = Least Developed Countries**

**MUs = Memorandum of Understanding**

**NRB = Nepal Rastra Bank**

**PCA = Post Clearance Audit**

**PSI = Preshipment Inspection**

**TV = Transaction Value**

**TIA = Tribhuvan International Airport**

**UNCTAD = United Nations Conference on Trade and Development**

**UNDP = United Nations Development Programme**

**WCO = World Customs Organization**

**WTO = World Trade Organization**

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## *Executive Summary*

Customs Valuation of goods is an important aspect of trade facilitation. In Nepal, the process of customs valuation for the customs tariff was systematized only after the introduction of Customs Act, 1962. In 1997, the Customs Act was amended and basic valuation provisions based on transaction price were included in the Act. However, ACV is yet not fully implemented. At present Nepal's customs valuation system is hybrid of BDN and ACV.

Nepal became a member of WTO on April 23, 2004. The country enjoyed a grace period of three years to fully implement WTO Valuation Agreement and is bound to introduce all provisions of the valuation agreement from 1st January, 2007. However, the country still has to make acts and regulations compatible with the provisions of the WTO valuation Agreement

There are few studies related to customs valuation. Some of them deal with different aspects and issues of customs valuation in Nepal. But none of these studies make assessment of Likely impact of implementation of the WTO Valuation Agreement on trade, price and revenue. This study aimed to address the above said impact assessment and to examine the difficulties associated with customs valuation in Nepal so as to make recommendation on how to make the WTO customs valuation agreement implementable.

The study is based on both secondary and primary data. Discussion and consultation with selected customs officials, and a brief opinion survey among customs agents were conducted to obtain their view on impact of implementation of WTO Valuation on trade, price and revenue. In this connection qualitative analysis together with some quantitative exercises were done. An attempt was also made to estimate the average level of undervaluation under existing valuation practices through review of appeal cases and deductive exercises.

The study team identified the different problems being faced on existing valuation systems and problems expected to be encountered while adopting WTO Valuation system. Weak customs administration, using transaction value method without proper preparation, lack of mutual cooperation between traders and customs administration, lack of adequate data base and trained manpower, inadequate legal provisions, and initial stage of post clearance audit have been identified as major problems. Various issues like legal issues, issue of database, issue of necessary preparation, issue of post clearance audit, issue of informal trade, issue of dispute and issue of revenue were also found out to be addressed properly, before implementing ACV.

While assessing the impact, it was found that the impact of change in customs valuation system from existing one to ACV on Volume of trade and price is not significant. Regarding the volume of import, the changes in valuation practices with slight increase (2.1 percent) in value of cost of imported goods is likely to exert a negative effect on the demand for imports by 1.9 percent only. On the other hand, the new valuation system help reduce under-invoicing and informal trade, exerting positive impact on customs revenue. Impact of valuation change in the general price level of the country is also as minimum as 0.6 percent.

To conclude, in view of the inherent problems in customs administration of Nepal, there is need for comprehensive customs reform in various spheres like legislation, organization and

management, personnel recruitment and development, computerization and other information and communication technology (ICT) applications. The reform program should be constructed on around three basic themes: moralization, professionalization, and modernization. Moreover, transparency, fairness and competency in valuation procedures and effective customs control system are also equally important. In order to build up necessary capacity to adopt WTO valuation, an arrangement should be made for necessary technical and financial assistance in a broadened way. As the implementation of WTO customs valuation system has insignificant adverse effect on volume of trade and general price level and also has positive impact on revenue, it will be beneficial to the country to implement fully the WTO Valuation System. However, there is also high probability of revenue leakage if ACV is implemented without adequate legislation and strong PCA. As legal provisions are still inadequate, PCA is still in very early stage and these problems can not be resolved by December 2006 in given political situation of the country, the study suggests that Nepal ask for a grace period of two years to fully implement the ACV.

# *Introduction*

## **Research Problem**

The basic purposes of the customs valuation agreement are to require countries to adopt a valuation system that is fair, neutral and uniform and to prevent the use of arbitrary or fictitious values (Rege/2002). GATT Articles VII provides that the value for customs purposes of imported merchandise should be based on actual value.

Nepal became 147<sup>th</sup> member of WTO as its first LDC member to enter through regular accession process in April, 2004. As its commitment, Nepal has to implement the WTO Customs Valuation as per the action plan by 1<sup>st</sup> January 2007. It has to make acts and regulations compatible with the provision of WTO Valuation Agreement. However, its likely impact on trade, price and revenue is yet to be assessed.

A transaction based valuation system was introduced by Nepal in 1997. However, Nepalese customs administration continuously faces the difficulties in determining transaction value, based on the commercial invoices (Ghimire et al, 2005). Custom officials feel uncomfortable with the process of appraisal and verification of transaction values. Similarly, traders are not satisfied with the provisional valuation made by the customs on the basis of reference values. Traders complain that there is lack of transparency, fairness and competency in this area. Therefore, identification of likely problems to be encountered in the course of implementing the WTO Valuation Agreement, and finding out the most suitable solution is very urgent and important.

## **Research Questions**

This study made effort to seek answer to following questions.

- i. Will the implementation of the WTO valuation agreement exert positive impact on imports?
- ii. What will be the effect of implementation of the WTO valuation agreement on price level?
- iii. Will the implementation of the WTO valuation agreement contribute to enhance revenue?
- iv. What are the difficulties to successfully implement the WTO valuation agreement?
- v. Are the human and other resources available with custom administration adequate and compatible to implement the WTO Valuation Agreement?

## **Scope of Study**

Despite WTO valuation agreement having impact on various spheres of business activities, the study will examine the following aspects.

1. The effect of new valuation method on the import price of goods as well as on the total import volume.
2. The extent of price impact of possible change in valuation method.
3. The extent of revenue impact of possible change in valuation prices.

4. Proper identification of factors that determine successful implementation of the agreement.
5. An assessment of the benefits of proper valuation to the government sectors, trading community and the economy as a whole.
6. To make policy recommendation for the establishment of fair valuation system.

## **Literature Review**

Customs valuation of goods is an important aspect of trade facilitation. Walsh (2003) defines it as an important element in a variety of other aspects of international trade including statistics, quota and licensing arrangement, taxes and other charges levied on imports, and the application of preference systems. Custom duties are levied mostly on an advalorem 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.

In view of such an importance of valuation of goods, procedures for determining the dutiable value of imported goods have been the subject of international negotiations since the early 1920s. Rege (2002) has presented a brief account of historical development of valuation agreement. The formal history of customs valuation started from the establishment of League of Nations but the agreement between nations on customs valuation was not finalized until general conference of United Nations held on Trade and Employment in 1947. The conclusions of this conference were incorporated in Article VII of General Agreement on Tariff and Trade (GATT).

GATT Article VII provides that "the value for customs purposes of imported merchandise be based on actual value". However, it also allows countries substantial flexibility in defining the "actual value" of imports, thus permitting GATT contracting parties to use widely differing valuation practices. In 1950, in an effort to achieve greater harmonization of valuation practices, 13 European governments developed the Brussels Definition of Value (BDV), under which the price of imported merchandise is to be determined on the basis of the price of the merchandise or the price that the "merchandise would fetch" if sold on the open market under fully competitive conditions for export to the country of importation. The basic elements of BDV are price, time, place, quantity and commercial level. This concept implies that there is a "notional price" which can be determined by customs on the basis of the available information taking into account the conditions and the other circumstances relating to the specific transaction being valued. Against the notional concept of BDV, on the other hand, big countries viz Australia, New Zealand, Canada and United States used a "positive" concept of valuation laying down the standards based on the price actually agreed on in sale. Since the preparatory phase of the Tokyo Round, the European Union (EU) had been seeking for improvements in the GATT rules on valuation reflecting their desire to restrict customs authorities discretion and in November 1977 meeting, it agreed to make a fundamental change in its valuation systems by opting for a positive approach instead of the notional approach of the BDV. The draft agreement provided that in all cases customs value should be determined on the basis of "price paid or payable" for the imported goods in the particular transaction. This meant that customs should, as a rule, accept the "invoice price". However, most developing countries did not join the new valuation agreement for the fear of under-valuation of goods which leads to significant loss of revenue. The situation changed with the Marrakesh Agreement that established the WTO. Now the agreement on customs valuation has become binding on all member countries. However, the

Uruguay Round also offered least developed countries extra flexibility in implementing WTO agreements.

The multilateral trade negotiation effort known as Uruguay round was commenced in 1986 and concluded in December 1993. The Agreement was amended during the Uruguay round of trade negotiation in 1994 and recognized as "WTO Agreement on Implementation of Article VII of GATT 1994". The outcomes of this round for customs valuation were to reinforce article VII of GATT.

Walsh (2003) has explained various provisions of the WTO valuation agreement and their implementation procedure. The Agreement on Implementation of Article VII of GATT, which is now referred as WTO Agreement on Customs Valuation was one of the results of the Tokyo round of GATT trade negotiations. It officially came into force on January 1, 1981 and was adopted by various signatories from the mid 1980s onward. This agreement establishes rules for the valuation of imported goods that must be applied by all member countries. It provides, as its basis, the use of transaction value (selling price) between buyer and seller. It also specifies alternative methods to be used in sequential order for determining value when the transaction value cannot be determined under Article 1 that is read with Article 8. Article 8 provides certain adjustments to the value. These methods are summarized as follows

- Transaction value of identical goods (Article 2); this method provides for the determination of value based on the transaction value of identical goods exported at or about the same time, in the same quantities, and at the same level of trade (retail, wholesale, and so on) as the goods being valued.
- Transaction value of similar goods (Article 3); the transaction value of similar goods produced by the same producer is used. The conditions in respect of quality, level of trade etc. are the same as in the above method.
- Deductive method (Article 5); value may be determined based on the sale price in the country of importation, less applicable deductions for costs (e.g. expenses and profits)
- Computed method (Article 6); this method provides for the determination of value based on the costs of material and production in the country of export plus certain other costs (e.g. packing, engineering and development work). In addition, amounts for profit, general expenses, and insurance are also included in the value.
- Fall-back method (Article 7); value can be determined based on any of the previous methods as adjusted in a flexible manner to account for special circumstances.

The Agreement on custom valuation allows developing member countries to delay application of the agreement for a transition period of five years after their entry into the WTO. The agreement provides that the committee on Customs Valuation may, on request, agree to grant an extension of the transition period. Moreover, the Part II of the Valuation Agreement provides for Administration, consultation, and Dispute settlement, including creation of a GATT Committee on Customs Valuation and a Technical Committee of Customs Valuation, whose operation has been delegated to the World Customs Organization (WCO). The main rules of customs valuation as laid down in the "Agreement on Implementation of Article VII of GATT 1994 are explained in Annex 1.

In Nepal, the process of customs valuation for the purpose of customs tariff was systematized only after the introduction of Customs Act, 1962. Accordingly preparation of a brief valuation manual in traditional form was prepared and a system of record keeping of product prices which was not included in the manual was also started. In 1997 the Customs Act was amended and set value system of official reference price was in principle, replaced by a transaction based valuation system (GoN, 2004). Following an amendment the new basic valuation provisions were included in the customs act and implementation rules were included in tariff act. However, the customs was not applying the provisions of Articles 5, 6 and also 7 of the Agreement of Implementation of Article VII of GATT, 1994 regarding deductive, computed and fallback method of valuation respectively. Even after the 7th amendment of 1997 there were no provisions in the Custom Act 1962 regarding the case where the buyer and the seller were related to each other and how the customs should act in those cases. Although, even before the accession to the WTO, Nepal was examining the modification that would have to be introduced in current legislation and practices to fully implement the WTO customs valuation Agreement, the legal system has yet not been fully compatible to the ACV.

In the course of joining WTO, Nepal intended to adopt the valuation methods of Articles 2, 3, 5, 6 and 7 of the Agreement and to improve Nepalese legal provisions to implement a WTO consistent regime. For this, Nepal committed to incorporate the remaining provisions of the WTO agreement on customs valuation into Customs Act, 1962 and the Customs Regulations, 1969. A timetable for the enactment of legislation that implements the WTO agreement on customs valuation in Nepal's legal regime was provided in the legislative Action Plan circulated in document WT/ACC/NPL/10/REV I and in the action plan circulated in document WT/ACC/NPL/15.

Department of Customs of Nepal has launched a Three Years Customs Reform Action Plan which is being implemented since the FY 2003/04. The plan accords high priority, among others, towards institutionalizing scientific custom valuation procedures. Accordingly, ASYCUDA system is being introduced for the computerization of valuation treatment, a comprehensive valuation manual is being prepared, post entry verification and post clearance audit are also being introduced on trial basis. Article 20.3 of WTO Customs Valuation Agreement has provision for technical assistance to ensure member country's capacity to fully implement the Agreement.

In accordance with section 37 of the Customs Act 1962, the importer has the right to appeal to the Revenue Tribunal against the decisions of customs official in respect of the determination of customs value. Establishment of an independent administrative tribunal for right to appeal against administrative decision of the customs authority regarding customs valuation is underway. Training of customs officials in the areas of clearance, verification, audit and the method to combat valuation fraud is also being conducted.

Evasion of duty through undervaluation or misdescription of imports is an acute problem for custom administration in developing countries. King et al (2003) estimates a widespread under invoicing in Nepal and also indicates 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 et al, 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) report 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 CVA. A perception survey conducted by Rajkarnikar et al (2005) has also identified custom valuation as one of the major issues of trade facilitation in Nepal.

The Trade and Competitiveness Study (2003) gives a brief account of existing valuation procedure and problems inherent on it. According to the study report the Department of Customs has difficulty in determining the transaction value based on the invoice provided because procedures for determining the value are not fully developed or understood. All these studies indicate the need to implement WTO valuation agreement as it provides a fair, uniform, and neutral system for the valuation of goods for customs purposes, which conforms to commercial realities and prohibits the use of arbitrary or fictitious customs values.

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). Most of the implementation requirements for valuation on the basis of the WTO Agreement on customs valuation are lacking in developing countries. Such various requirements include the establishment of a legislative and regulatory framework; a mechanism for judicial review; administrative procedure; organizational structure; and training. It is incumbent upon the customs administrations to develop the system and procedures necessary to effectively control undervaluation.

Finger and Schuler (2000), argue that the agreement was imposed on developing countries in imperial way with little concern for what it will cost them to change over from BDV to new system, how it will be done or if it will support their development efforts. Finger and Schuler also observe that the customs valuation agreement provides neither appropriate diagnosis nor appropriate remedy for least developed countries problems with customs administration. Because of the differences in trading environments and absence of adequate computer system and databases, custom officials of developing countries are apprehensive that the application of the WTO standards may create practical problems.

Lack of feeling of ownership toward the agreement by the member countries together with lack of prospect of immediate advantages and an inadequate and broader technical and financial assistance responsive to the needs of developing countries hinders rapid application of the WTO standards. Nepal is of no exception in this case.

A study conducted as a part of the Integrated Framework for Trade Related Technical Assistance – Nepal (2004) argues that adopting WTO Valuation methods will be beneficial only after customs inspectors have received training in valuation methods and have access to data base with pricing information. Otherwise, using transaction values simply opens the door to fraudulent invoicing. Finger and Schuler (2000) concludes that not only does the Uruguay Round Customs Valuation agreement address a part of the customs prices, the valuation process itself presumes an administrative environment that does not exist in many of the least developed countries.

Thus, there are few studies related to customs valuation. Some of them deal with different aspects and issues of custom valuation in Nepal. But none of these studies make assessment of likely impact of implementation of the WTO valuation agreement.

## **Study Outline**

As a member of the WTO, Nepal has to implement WTO Valuation Agreement by 2007. This study aimed to examine the difficulties associated with customs valuation in Nepal so as to make recommendations on how to make the WTO customs valuation agreement more useful and practical. Moreover, the study also aimed at determining on how to facilitate the implementation of the WTO ACV in Nepal and LDCs in general. The study also made an assessment of likely impact of change in valuation system on trade, price and revenue. The study is divided into four chapters. The first chapter is a introductory chapter including literature review. Second chapter contains a comparative analytical review of existing valuation system and WTO valuation system. The third chapter makes an assessment of likely impact of change in valuation system on trade, price and revenue. The fourth or last chapter contains concluding remarks and policy recommendations to make implementation of the WTO valuation system successful.

## **Methodology**

The study is based on both secondary and primary data. Secondary source of information has been used for comparative analysis of existing system of valuation and the WTO system of valuation. Related acts, regulations and agreements were thoroughly reviewed. Problems of implementation of WTO valuation agreement have been identified through discussion with selected custom officials. For this, officials of three main custom offices and department of customs were consulted. The study is mainly based on qualitative analysis. However some simple quantitative exercises were done to assess impact of change in valuation practice on trade, price and revenue. Moreover, a brief opinion survey among custom agents was also conducted to obtain their view on impact of implementation of WTO valuation on trade, price and revenue.

## *Customs Valuation in Nepal*

### **Past Practices**

Nepal was almost isolated from rest of the world until the political change of 1950. Traditionally, Nepal's trade was limited with India and Tibet. Tariff on goods imported from

Tibet used to be fixed at specific rate. However, in the case of trade with India both specific and advalorem duties used to be levied. There was no system of customs declaration by the importers before 1945. Instead, Custom Officials themselves used to inspect and value the goods. Thus, the valuation system was in practice even before 1950. However, there was no integrated and uniform system of customs valuation. The process of customs valuation used to be different in different parts of the country. Also, there was no integrated comprehensive customs legislation. In Rana regime (i.e. before 1950) there were only government directives, known as Sanads, istihars to regulate customs. In the year 1945 all old Sanads and Istihars were repealed and single Sawal (also a set of government directives) was introduced for customs purposes and for the first time the declaration of goods in customs points by the importer was started.

A trade treaty with India was signed in 1950, which made a provision that Nepal would get refund of Indian excise levied on goods imported into Nepal directly from Indian manufactures. Accordingly, the importers had to declare the value of goods and also submit the invoices of the goods. The customs used to verify the invoice prices with the border prices of similar goods between India and Nepal. Thus, the practice of levying advalorem duty expanded after the signing of trade treaty with India. Also new era of rule of law was started after the establishment of democratic system in the country in the year 1950. As a result, tariff board was formed and customs commission office was established in 1957.

In Nepal, the process of customs valuation for the purpose of customs tariff was systematized only after the introduction of Customs Act, 1962. Accordingly, the valuation of imported and dutiable goods began to be started as per the said Act and the preparation of valuation booklet (a list of reference prices) and the system of record keeping of product prices was also started. Valuation booklet with regards to import from third countries other than India used to be updated and published based on the consultation with various organizations/ stakeholders like Federation of Nepal Chamber of Commerce and Industry (FNCCI), Nepal Chamber of Commerce, Nepal Overseas Export Import Association. For this, records of the customs department, information received from sellers, contract between the buyer and the seller, documentary evidence submitted by the importer, international market price of the product and the agency price lists were to be used. Generally, the invoice price used to be taken for granted if the value mentioned in it was more than the value fixed in the booklet. Valuation of goods used to be done based on the CIF Price Kolkatta (GON, DoC 2004). In case importer did not declare the value and also at the same time was a new case for the government, the valuation used to be done on the basis of customs reference record. If there was no reference record and the importer also could not submit satisfactory documents the customs officer should determine the value up to the estimated amount of Rs 125,000/-. For value determination exceeding this amount an approval of Director General was required. There was also a provision to purchase of goods by the government if the declared value was lower than 50 percent of the actual price.

With regard to import from India, there are three types of trading arrangements namely, the Duty Refund Procedure (DRP), In-bond import and the Local Purchase System. Under the Duty Refund Procedure (DRP), and In-bond imports valuation is done adding freight and insurance on the ex-factory price. Regarding Local Purchase System, valuation is done based on booklet prepared on the basis of suggestions received from regional meeting of the border customs chiefs. While valuing goods, an amount equivalent to 5 percent used to be added on the price mentioned on the said booklet on account of freight and insurance. This system known as

the Set Value System was practiced to maintain uniformity in the value of imported goods in all custom offices through the reference of the valuation booklet.

With the development of science and technology, various new products began to emerge to suit the demand of the consumers. As the booklet could not capture the new items, valuation of new products used to be done based on catalogue and other documentary evidences submitted by the importer. Price record of new products was maintained and such record used to be the basis for valuation of similar goods. In case there was submission of invoice with the value higher than the recorded price, the pre recorded price used to be revised accordingly.

## **Current Valuation Policy and Practices**

Customs Act, 1962 was amended in 1997. It was a landmark as regards to customs valuation. The amendment, for the first time, recognized the transaction value as a basis for customs valuation. Following the amendment of the Customs Act, 1962, customs Regulation, 1969 was also amended. According to the amended provisions of the said Acts and Regulation, the customs value of the imported goods began to be assessed on the basis of the invoice price. This amendment conceptually and legally recognized the WTO/GATT Valuation system based on transaction value. However, in order to justify the transaction price of the imported goods, the importers have to submit the invoice and other documents as asked by the customs officials. It is the duty of the importer to prove the authenticity of the bills, invoices or documents submitted by them. According to the amended section 13 of the customs Act, 1962, if the transaction price as quoted by the importer does not correspond to the procedure of fixing the actual transaction value or in case where the importer can not submit the transaction price of goods, the customs shall refer to the value of similar or identical goods imported into Nepal. If necessary, the customs shall fix the price of goods on the basis of the recorded prices, previous prices of identical or similar goods, reference prices, suggested price lists of manufacturers, local market price, international market prices and other available information. Implementation rules were also formulated in this regard. In order to check the commercial fraud and valuation discrepancies, the system of Post Clearance Audit (PCA) together with provision of fine and penalties for the offenders was also introduced. Besides, a provision was also made for surety bond and fixation of provisional value for immediate clearance in the cases where the transaction value of the goods could not be ascertained and the importer wishes to clear up the goods beforehand.

Nepal became a member of the WTO, on April 23, 2004. In the course of joining WTO, Nepal committed to improve Nepalese legal provisions to implement a WTO consistent regime, including customs valuation. An action plan to implement WTO Agreement on Customs Valuation in Nepal was provided in Legislative Action Plan circulated in document WT/ACC/NPL/10/RVI and in document WT/ACC/NPL/15.

The main items contained in the Action Plan for Implementation of the Agreement on Customs valuation submitted to WTO by the working party on the accession of Nepal include the following:

- Further amendments to the Customs Act and Customs Regulations, enacting the legislative framework for the gradual implementation of valuation hierarchy with regard to transaction valuation.

- Amendments to current legislation to establish an independent administrative tribunal for right to appeal against administrative decisions.
- Training of custom officials in the areas of clearance, verification, audit, and the method to combat valuation fraud.
- Preparation of customs valuation manual
- Provisions in law and regulations of the interpretative notes
- Gradual implementation of valuation hierarchy: further amendments to legislation to complete implementation of imputed value, computed value and enforcement of prohibited forms of valuation.

As a developing country Nepal, enjoyed a grace period of three years to fully implement WTO Valuation Agreement. This means Nepal is not required to implement all provisions of the valuation agreement immediately and at once. However, it is bound to introduce all provisions of the valuation agreement from 1st January 2007. Hence, Nepal has adopted a policy of implementing WTO Valuation provisions gradually and progressively.

As mentioned above a three- year's Customs Reform Action Plan is being implemented since FY 2003/04 with various objectives including institutionalization of scientific customs valuation procedures and making customs valuation systems more scientific and transparent. Accordingly, ASYCUDA system is being introduced for the computerization of valuation treatment. Post entry verification and post clearance audit are also being carried out on a trial basis. Nepal is seeking out all available external technical assistance, including under Article 20:3 of the WTO Customs Valuation Agreement, to ensure that its capacity to fully implement the agreement upon the expiration of the transition period is assured. Legal and infrastructural development for implementation of the agreement are also in process. Preparation of Manual on Customs Valuation and Post-clearance Audit in WTO compatible manner is underway under Nepal Window II Trade Related Capacity Building Program, UNDP in coordination with Government of Nepal. Customs administration has also started updating valuation data of major commodities. Trade Promotion Centre is also supplying the international market price of major commodities to the Department of Customs. The Department of Customs has started to settle valuation issues within the specified period.

After being member of the WTO, Government of Nepal, in the process of fulfilling its commitment, drafted amendment to Customs Act 1962. But it could not be finalized due to the dissolution of parliament. However, the subsequent Finance Ordinances have made several provisions toward making the legal system compatible to WTO Valuation Agreement. Remarkable features of Financial Ordinance, 2005 and 2006 are given below.

### **Financial Ordinance 2005**

- It has defined transaction price
- It has a provision that whether the buyer and seller are related to each other or not, the customs has to follow the main principles of WTO customs valuation system while determining the transaction price.
- It also includes the provision that if the transaction price declared by the importer is less than identical or similar goods, the customs can ask for further clarification and other documentary evidence

- There is provision that if the transaction price could not be determined as above, the customs will verify and determine the transaction price based on unit or computed value by deducting or adding necessary expenses as per clarification and documents submitted by the importers.
- It has specified that if the transaction price could not be determined even as above, the customs itself may determine the price without violating the principle of WTO valuation system.
- If the importer is not satisfied with the valuation decision of the customs officer, he may appeal within 15 days to the Director General directly or through the customs office concerned.
- In case the transaction value could not be determined in time the importer may request for provisional value decision. There is a provision of post clearance audit as the control measure.
- With regard to the valuation of imports under Duty Refund Procedure (DRP) from India, the customs value will be determined based on the higher value between the value determined by the government of India for excise purpose and ex-factory or ex-depot price. Freight, insurance and other expenses if any will also be added in such determined value.

### **Financial Ordinance, 2006**

- It has tried to make the legal system compatible to WTO Valuation Agreement.
- It further elaborates the valuation method that if there is inclusion of freight and other expenses in the commercial invoices, the transaction price will be fixed based on these invoices. If there is no inclusion of these expenses in the commercial invoices, the valuation authority will fix the transaction price by adding pre-estimated expenses in this price. While fixing transaction price, the Director General can fix the basis of expenses incurred or to be incurred in these goods.
- It has clearly stated sequence and process of valuation in case the importer could not submit the necessary documents and evidence as demanded by customs or transaction price could not be determined based on submitted documents and evidence. In such case the customs will determine the value in following sequence: (a) based on transaction price of previously imported identical goods (b) based on the transaction prices of previously imported similar goods (c) deductive value method or computed value method as chosen by the importer (d) fall back method without violating the principle of WTO valuation system.
- It has also provision that if the price declared by the importer is less than the price determined by the custom official, the customs may clear the goods by charging 50 percent of additional duties on such differences or the customs, with the prior permission of Director General, may purchase or make purchases from the importer at declared price by adding insurance, freight and 5 percent of the declared price as profit in such declared prices
- It has authorized customs to fix value and clear goods in case the importer could not submit the documents regarding the freight and insurance and other expenses and apply for the fixation of provisional value for clearance

## **Finance Bill 2006**

The newly installed government presented Finance Bill 2006 recently. However, the bill does not include any new provision regarding customs valuation. This has been so perhaps because of government focus on political issues. As the government is interim in nature it is more concerned with political matters. This has indicated that it would take some more time to make adequate legislation for effective implementation of ACV.

Thus, from the review of customs legislations, current system of customs valuations in Nepal can be termed as hybrid of WTO valuation system and BDV. It does not follow the GATT Valuation Structure strictly. It permits to use the transaction value of imported goods and other valuation methods such as identical, similar, deducted, computed and fallback either in explicit terms or in implicit. But failure to incorporate all the provisions of GATT Valuation Code in the Act, Rules Ordinances or Finance Bill resulted in a blending of old valuation system and GATT valuation system. While it recognizes transaction value the current valuation system still permits using minimum value. Main features of current practice are as follows:

- Valuation is done on the basis of transaction price
- In case transaction value can not be determined, (a) transaction prices of previously imported identical goods (b) transaction prices of previously imported similar goods (c) deductive value method or computed value method as chosen by the importer (d) fall back method without violating the principle of WTO valuation system are followed sequentially to determine the value of imported goods
- Importer has right to appeal, in case the importer is not satisfied with the valuation done by the customs. Director General of Department of Customs is the final authority to make decision in this regard.
- There is provision of provisional clearance of goods with surety/deposit.
- Customs has to follow fundamental principles of the WTO while fixing value of imported goods for the purpose of tariff.

Although Nepal has committed to follow WTO Valuation Agreement, the valuation system in Nepal does not follow the GATT valuation structure in entirety. The Customs Act 1962 and the various Financial Ordinances/Bill enforced form time to time have not made clear provisions of each method and explanatory notes. There is a lack of detailed provisions of value adjustments. Moreover, the Acts have not defined different terms in accordance with the agreement on Customs Valuation. The Customs Law is also not complete and lacks valuation factors with regard to the use of WTO principles of Customs Valuation. There is no illustration and guidance in the specific application of Valuation methods.

## **Current Problems, Issues**

The study team used both secondary and primary information to identify problems and issues related with Customs Valuation in Nepal. The secondary information for this purpose included laws related with customs valuation and different reports, agreements and other publications published by international organizations like the World Bank, IMF, WTO, WCO etc. The study team also discussed with Customs Officials of Tribhuvan International Airport, Birgung and Bhairahawa Custom Offices and DoC. Information was also collected from

customs agents of Tribhuvan International Airport, Biratnagar, Birgunj, Bhairahawa, Mechi and Tatopani Custom Offices. The study team identified two sets of problems. They are a) problems being faced in existing valuation system and b) problems expected to be encountered while adopting WTO valuation system.

## Current Problems on Customs Valuations

Some basic current problems of Customs Valuation in Nepal are presented below.

**Table 1**  
**Problems Identification and Methods Used**

<b>Current Problems of Valuation</b>	<b>Methods Used to Identify Them</b>
Progressive implementation of WTO valuation system is difficult due to weak customs administration	Literature review (Nepal Next Steps in Tax Reform, IMF, APRIL, 2003)
Customs valuation using transaction method was introduced without proper preparation, and procedural and organizational framework, taking WTO system very lightly	"
Customs Valuation problems are subject of dispute between traders and Customs Administration since long time.	Discussion with custom officials and custom agents and literature review
Lack of value information database	Literature review and discussion with customs officials
Lack of trained manpower on customs valuation	Discussion with custom officials and custom agents and study of IMF report.
Problem of legislations – Custom Act 1962 (with amendment) and finance ordinance/bill, both have no detail provision compatible to WTO systems	Literature review (Nepal Next Steps in Tax Reform, IMF, APRIL, 2003)
Problems of Post – Clearance Audit – Customs control is integral part of customs valuation system. The legal provision and practices of post clearance audit is in very initial stage in Nepal	Discussion with custom officials and Literature review (Nepal Next Steps in Tax Reform, IMF, APRIL, 2003)

## Problems Associated with the Implementation of WTO Agreement on Customs Valuation in Present Situation

Government of Nepal is committed to implement the WTO Customs Valuation Agreement from January 2007 onward. As mentioned in above paragraphs, there are different problems related with human resource, automation, data base, information system as regards to customs valuation. ASYCUDA program has been started in 9 Customs houses. But the personnel directly involved in the operation of this program are very limited. The present situation of skillful man power for ASYCUDA operation is given below:-

**Table 2**  
**Skillful Manpower**

S,N.	Name of major offices	Total Staffs excluding attendants and drivers	Skillful operators	Ratio
1	Department of Customs	67	8	1: .11
2	T.I.A. Customs	112	7	1:.06
3.	ICD Customs Birgunj	30	5	1:.17
4.	Birgunj	62	8	1:.13
5	Mechi	48	3	1:.06
6	Biratnagar	48	7	1:.15
7	Bhairahawa	61	7.	1:.11
8	Tatopani	28	3	1:.11
9	Krishna nagar	35	3	1:.09
10	Nepal Gunj	28	No separate post	
	Total			

*Source: Department of Customs*

Wide Area Network of Computer System to transmit information electronically among custom offices and DoC to support post clearance audit and Customs Valuations is still lacking.

The customs procedures are still non transparent and unpredictable. There is less ground for self compliance especially in valuation practices. These are serious hurdles to implement WTO valuation system fully and effectively. Moreover there is no sufficient legal provision to cover all WTO provisions. In following table, existing legal provisions are compared with WTO provisions and identified problems associated.

**Table 3**  
**Current Problems in Implementation of ACV**

Existing Provisions and Practices	Provisions of ACV	Problems Associated
No detail definitions of valuation terms in Customs Act 1962 and Finance Act 2006	There is detail definition in Article 15 of ACV	In absence of definition in law there will be misleading interpretation of valuation terms. It leaves ground for discretionary power to customs officials.
Customs Act 1962 and Finance Act 2006 are silent in the issues of price adjustment of Article 8 of the agreement	The provision of Article 1 i.e. Value determination using transaction value method is always read with Article 8 (related with price adjustment)	Lack of transparent provision of price adjustment may hamper uniformity in Customs Valuation
Recently Department of Customs has designed the value declaration form but the	The hand book of customs valuation designed by WCO is detailed and compatible to	Absence of details in valuation declaration form will make the task of valuation

procedures are still ambiguous and are not fully compatible with ACV	ACV	difficult to customs officials
There are no provisions of conditions for use of Transaction Value Method in Customs Act and recent Finance Act.	There are six conditions for the use of Transaction Value Method – (1) There must be evidence of a sale for export. (2) There must be no restriction on disposition of goods by buyer other than specified. (3) Price must not be subject to conditions. (4) No part of resale goes to seller. (5) The parties are not related or relation does not influence the price. (6) Sufficient information is available for adjustment.	Partial provisions in legislation lead confusions to the decisions makers.
The Customs Act 1962 and Finance Act both have made partial provisions of ACV. There is no detail rule.	There are 24 Articles followed by interpretive notes, explanatory notes in ACV	Partial implementation of ACV cannot safeguard revenue loss.
The Acts do not state the conditions for the application of TV of Identical goods.	There are certain conditions for application of Article 2 of ACV	"
In the above said Acts there is no specific basis of Valuation control	In ACV there is specific purpose of Valuation control	It leaves gray areas to revenue loss
The Customs Act 1962 and Finance Act 2006 do not state conditions for the application of TV of similar goods	ACV states some basic consideration for the application of Article 2 and 3 which examines the questions of identical and similar goods	Lack of considerations leaves ground for the use of discretionary power
Finance Act 2006 does not state the basic principles of Articles 5 of ACV (Deductive Value Method)	ACV has detail provisions with interpretive notes of DVM	The lack of detail provisions make the use of the DVM complicated
Finance Act 2006 has made provision of Computed Method. However it does not quote basic principles of the application of CVM	ACV has made detail provisions of computed Value Method under Article 6 with interpretive notes to it	Article 6 is not actually in practice in Customs administration because the producers do not expose their production details
Finance Act 2006 has tried to mention basic principles of the application of fallback methods. But it is in brief.	ACV has made details provisions of basic principles of fallback methods with interpretive notes to Articles 7	Fallback method is last instrument of value determination. Lack of detail provisions in legislation may encourage discretionary power

		to customs officials for value determination.
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## **Issues to Address**

WTO Agreement on Customs Valuations is an outcome of long negotiations of the contracting parties in several Rounds. It is a remarkable development in the sector of customs valuation. The positive aspect of WTO valuation is that it is traders friendly. In this system customs administration cannot challenge the declared value without documentary evidences and cannot increase value without giving importers an opportunity to be heard. This system provides several benefits. However, to implement it successfully in a developing country like Nepal, there are many problems associated with it. Nepal is committed to and in the process of fully implementing this agreement by the beginning of 2007. However, there are many issues to be addressed. Some major issues are discussed below.

### **Legal Issues**

The provisions of Customs Valuation Act of Nepal are not fully compatible with WTO valuation system. Section 13 (1) of Customs Act 1962 has stated that the customs duty on imported goods, shall be assessed on the basis of their transaction value while the subsection 4 and 5 of the same section has given the right to customs officer to fix the price of concerned goods on the basis of recorded price and price list obtained from international market. However, the Finance Acts and Ordinances since 1998 have tried to make illustrative provisions in line with Agreement on Customs Valuations. A mere provision of six methods of Customs valuation does not serve the purpose of actual transaction value. There is the need for comprehensive Customs Rules that can carry all provisions of Agreement on Customs Valuations. The Finance Ordinance/Bill has made provision of value determination for customs purpose using six methods prescribed by WTO Agreement on Customs Valuation. But still there is the need of detailing it. There are many terms to be defined according to the provisions. The Custom Act 1962 and Finance Ordinance/Bill do not represent the full body of the Agreement on Customs Valuations (ACV). There are inconsistencies between the provisions of Customs Act and Finance Ordinance/Bill.

### **Issues of Database**

Nepal has implemented ASYCUDA++ developed by UNCTAD for Customs automation. However, local customs offices are not connected with wide area network. At present, the Customs Valuation database cannot be disseminated horizontally and vertically. Although transaction value is the price yardstick for custom valuation, value information and database are the key factors to test its accuracy.. Data can be generated within the Customs and also from outside sources such as international price ledgers, magazines etc. But in absence of adequate computerizations support, they can not be used.

### **Issues of Necessary Preparation**

WTO Agreement on Customs Valuation is free from arbitrariness and it is conducive to trade and commerce. The Customs Administration cannot use the discretionary power to

determine the customs value. The system relies on post clearance audit system for customs control. There is no doubt that the provisions of WTO Agreement on Customs Valuation are based on best valuation practices, but there is need for necessary preparations because the valuation procedures are highly technical and demand high skills. In Nepalese Customs Administration there is no sufficient knowledge of WTO Valuations procedures. The Department of Customs has difficulty in determining transaction value based on the invoice provided because procedures for determining the value are not fully developed or understood (Chapman et. al., 2003). The infrastructures are not developed to cope up with the provisions of Agreement on Customs Valuation.

### **Issues of Post Clearance Audit**

The WCO Manual on Measures to Combat Fraud (Doc 38.080/Rev.2 February 1998) has defined Post Clearance Audit as a process which enables customs officers to verify the accuracy of declarations through examination of the books, records, business system and all relevant commercial data held by persons/companies directly and indirectly involved in international trade. It is one of the customs control measures. It is conducted to verify the accuracy of the declared customs value. Thus, the effective implementation of PCA is necessary to secure the customs revenue and other taxes while facilitating the customs clearance at border. It is conducted, after customs clearance, to conform the accuracy of declared value and all provisions stipulated in the Customs Act. The PCA system in Nepal has been started since last three years. However, it still has a long way to go. There is no trained manpower for audit purpose. The Audit Manual is necessary to implement the post clearance audit. The result of post clearance audit is not significant in Nepalese situation. The Customs Valuation Agreement is positive to valuations control measures and PCA is the most effective one. Customs Administration is aware of Valuation fraud and PCA, if developed properly, can combat the risk of revenue leakages. Currently there is a Post Clearance Cell under the Valuation Section of Department of Customs. Three officers and four subordinate staffs are performing the task of post clearance audit. The Cell selects the particular transaction based on revenue risk and deposes the officer for post clearance audit. In local level there is Valuation and Post Clearance Unit that carries the post clearance audit and value assessment job.

### **Issues of Informal Trade**

Nepal has long land border with India, which is widespread and extremely porous and fertile to informal trade. It is realized fact that higher the customs valuation more the risk of smuggling and informal trade. Studies show that the customs valuation procedures are the driving force of informal trade of Nepal especially with India. The Trade Competitiveness Study (2003) stated that the total volume of informal imports from India accounts for 34 percent of formal trade. Unauthorized trade is being increased even from china. It is extremely difficult to control unauthorized trade in the context of open border with India and difficult terrain bordering with China. When informal trade is in large scale, even genuine traders tend to under invoice in order to make their imports competitive with informal imports. An improvement in customs valuation is critical to reduce such a high magnitude of informal trade.

### **Issues of Dispute**

Customs valuation has remained always a subject of dispute between the government and trading community. The trading community complains that Customs Valuation is discretionary and not fair. The Customs official charge that the traders always try to undervalue the goods they import. The application of WTO Agreement on Customs Valuation can address the issue, provided the importers declare the price actually paid or payable for the goods imported.

### **Issue of Revenue Loss**

While full implementation of WTO valuation system with adequate legal, human and technical support will exert positive impact on trade and revenue, it requires effective PCA in order to control under invoicing in absence of which under invoicing may be enhanced resulting in revenue loss. The very infant stage of PCA in Nepal is a serious issue to be considered before implementing ACV.

## *Impact of change in Customs Valuation Practice*

Nepal has to fully implement WTO valuation practices from January 2007. This section attempts to assess the likely impact of change in custom valuation practice on trade volume, prices and revenue.

### **Methodology**

In order to assess the impact of changes in customs valuation on trade and prices, first of all, an attempt was made to estimate average level of undervaluation under the existing valuation practices through review of appeal cases and deductive exercises. Total 325 appeal cases were registered during the first three quarters of FY 2005/06. Out of 38 appeal cases registered during the last two months of the third quarter of FY 2005/06, 12 cases were selected for both review and deductive exercise. Cases of later months were selected for the reason that market prices are available only for the recent months. Secondly, change in price level of imported goods was estimated considering the likely changes in value of imported goods due to elimination of under-declaration and average rate of tariff burden currently (2005) being imposed. Thirdly, an attempt was made to estimate price elasticity of imports of selected commodities with the help of regression analysis. This was done using value of selected imports and constructed average price index of same imported goods. Impact of change in custom valuation practice on volume of imports was estimated using the remit of regression analysis. Fourthly, impact on general price level was estimated considering the change in price of imported goods resulting from change in valuation practice and share of such a price, as component, in general price index. Available secondary information were also used in this process.

Impact on revenue was assessed applying average rate of tariff on change in value of imports induced due to change in valuation practice.

It is difficult to ensure that the declared value will reflect real transaction value even after implementation of WTO valuation system. It all depends on behaviour of traders. Therefore, a small and brief opinion survey was held among 25 custom agents who better know about

behaviour of custom officials as well as traders, to know their view on likely trend as regards to declaration of value, change in imports and revenue. However, four of them did not respond. Moreover discussions were held with officials of two Land Customs Houses, one International Airport Cargo office and Department of Customs in this regard. Market information was collected from traders.

### Impact on Trade

The following table shows magnitude of under declaration, which ranges from 1.8 percent in TV part to 126.2 percent in multimedia projector. Out of twelve cases, only in two cases there is no under declaration. The table reveals under declaration of 21 percent on an average.

**Table 5**  
**Declared and Reviewed value of Imported Goods**

S.N.	Goods	Declared value	Assessed value	Reviewed value	Under Valuation	
					Amount	Percentage
1.	Celeron Del computer Gx 280 small desktop	US\$650/-	US\$750/-set	US\$ 734/-set	84	12.9
2.	Samsung color monitor15''	US\$71/-pc	US\$73/-pc	US\$71/-pc	-	-
3.	Color Plasma TV42d4S	US\$ 1800/set	US\$ 2280/-Set	US\$ 2280/-Set	480	26.7
4.	Dawoo 14''CTV Parts Kits	US \$16.70/Kits	US\$ 17/-Kits	US\$ 17/-Kits	0.3	1.8
5.	LCD Multimedia Projector	US \$420/-Pcs	US\$950/-pcs	US\$950/-pcs	530	126.2
6.	L.G. Refrigerator sets 413 Ltrs	US\$ 283.49/pcs	US\$336/-pcs	US\$315/pcs	31.5	11.1
7.	Copy Paper	US \$740/Mt	US\$ 790/-Mt	US\$ 790/-Mt	50	6.8
8.	HDPC Injection Grade	US\$ 870/Mt	US\$ 900/Mt	US\$ 900/Mt	30	3.4
9.	Green Peas ( whole )	US\$ 247/Mt	US \$263/Mt	US \$263/Mt	16	6.5
10.	Small Cardamom (Mix green)	US\$ 2600/Mt	US \$3250/Mt	US \$3250/Mt	650	25.0
11.	Clorotetracycline Feed grade	US\$ 1340/Mt	US\$ 2150/Mt	US\$ 2150/Mt	810	60.4
12.	WeildingElectrode 3.2X350mm	US \$555/Mt	US\$590/Mt	US\$ 555/Mt	-	-
Total		9593.2	12349.0	12275.0	2682.0	21.0

Following table shows deductive exercise of selected imported goods. The table reveals an undervaluation of 17 percent. Based on review of appeal cases and deductive exercise, it can be concluded that undervaluation ranges from 17 to 21 percent or 19 percent on an average.

**Table 6**  
**Declared and Deducted Value of Imported Goods**

S. No.	Name of Goods	Aggregate Market Price <sup>1</sup>	Profit	Transport Cost	Customs		Deducted Value	Declared Value	Undervaluation	
					Rate in %	Duty			Amount	Percentage
1	Celeron Del Computer Desktop	812	40.6	1	1	8	763	650	113	14.8
2	Samsung Color Monitor	100	5.00	1	1	1	93.00	71.00	22	23.7
3	Color Plazma TV	2920	146	2	35	721	2053	1800	253	12.3
4	Dawoo CTV Part	21.00	1.5	1	15	1.07	16.08	16.70	(0.62)	(3.9)
5	LCD Multimedia	600	30.00	2	10	52	516	420	96	18.6
6	LG Refrigerator (413 Lt)	907	35.00	5	15	88	582	283	299	51.4
7	Copy Paper	1050	45	55	15	100	707	420	287	40.6
8	MDPE Injection Grade	350	52	55	10	86	857	870	(23)	(2.7)
9	Green Peas	3400	18	55	10	20	252	247	5	2.0
10	Small Cardamom	2500	170	55	10	289	2886	2600	286	9.9
11	Chorerotetracy Link	610	31125	55	5	200	1945	1340	605	31.1
12	Welding Road		31	55		25	499	555	(56)	(11.2)
	Total						11169.08	9272.7	1886.38	17

Note: Figures in parenthesis indicate overvaluation.

The average rate of tariff is currently 10.5 percent. This means that if we use average of the rate of undervaluation shown by review of appeal cases and deductive exercises the traders will have to bear extra financial burden of 2.0 percent (19x10.5) on account of increase in cost of imports. If this is shifted to customers, the price level of imported goods will increase by about 2.1 percent (0.1 percentage point is allowed for profit , as custom office provide a profit of 5 percent on cost of imported goods, when such goods are acquired by it).

For the regression analysis six major products comprising raw materials as well as final product were selected. The commodities selected are pesticide, medicinal chemicals, polyester acrelc yarn, polyester fibers, plastic granules and jute. Based on the availability of both value and quantity data with similar unit of measurement these products were chosen.

A regression analysis of price index of selected imported commodities and volume of imports expressed in real terms shows negative relationship between prices and commodity imports. As the result indicates, one percent increase in the price level of imported commodities under consideration will lead to decrease imports by around 0.90 percent. The t-statistics is significant at 10 percent level. The R<sup>2</sup> is also fairly high at 0.52 which indicates that the explanatory power of the model is relatively good. This means that demand for import is sensitive to price changes. In other words, the change in valuation practice with slight increase

(2.1 percent) in value or cost of imported goods is likely to exert negative effect on the demand for imports<sup>2</sup> by 1.9 percent.

### **Impact on Price**

There is a weight of 30.04 percent of imported goods in the National Wholesale Price Index of Nepal. As change in Customs Valuation practice induces an increase of 2.1 percent in Wholesale Price Index of Imported Goods, its impact on general price level will be only 0.6 percent. Thus, it can be concluded that change in custom valuation practice will not exert a significant pressure on the general price level of the country. Fifty-seven percent of the custom agents also corroborated this view.

### **Impact on Revenue**

As mentioned above, it was estimated that customs valuation will be increased by 19 percent after implementation of WTO valuation practice. Although it is directly related with the value of imported goods, custom revenue will not increase correspondingly because of decrease in the demand for imports due to rise in the price level. However, it is expected that an appropriate valuation system will bring a part of informal import from India into the formal channel. On the whole, control of unauthorized imports together with curtailment in under invoicing practices with the full implementation of the WTO Agreement on customs valuation will exert some positive impact on customs revenue. Forty three percent of customs agents participated in the discussion also viewed that custom revenue will increase due to implementation of ACV.

#### Endnotes

1 Aggregate Market Price: It refers to the price at which largest unit of goods are sold during the review period.

$$2 \text{ LOG(IMVA)} = 24.76022947 - 0.9064538019 * \text{LOG(PI)}$$

(-0.90)                      (-2.31)

R<sup>2</sup> 0.52          N= 5                  DW = 1.36

Where,

IMVA = Imports Value of Selected Commodities

PI = Price Index

## ***Policy Recommendation and Conclusions***

### **Policy Recommendation**

1. 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 addition, there are not enough provisions for appeal. In many such poorer countries, smuggling is rampant. Thus, customs valuation is

only an inch in the whole yard of customs operations that need improvement through reforms. These reforms are to be based on transparency, objectivity, accountability and balance (Finger and Schuler, 2000). In view of the inherent problems in customs administration of Nepal, there is need for comprehensive customs reform so that implementations of WTO customs valuation requirements are practical and beneficial to Nepal. The reform program should be constructed on around three basic themes: moralization, professionalization and modernization. The key reform measures should involve legislation, organization and management, personnel requirement and development, and computerization and other information and communication technology (ICT) applications.

2. Closer inspection of current practices reveals that WTO valuation methods are not being applied fully at present, and they cannot be applied effectively until necessary legislations are prepared. An amendment to make Customs Act 1962 fully compatible with WTO valuation has been drafted but it could not be enforced due to political situation in the country. There was no parliament for the last few years. Now political situation has been improved to some extent and parliament has been restored. However, the Finance Bill 2006, which was brought into effect by the new government does not include any new provisions related to customs valuation. Thus, legal inadequacy still remains. What is needed is a comprehensive Customs Act with detailed definition of valuation terms, transparent provision of price adjustment, clear guidance to valuation etc. First of all the legislation should cover the valuation principles and methods in the form of a set of valuation rules as mentioned in WTO Valuation Agreement. Secondly, there should be provisions in appropriate article of Customs Act regarding the obligation of importers. Following provisions are also recommended to be included corresponding to the different Articles of ACV or ministerial decision, in the Act.
  - Options in respect of Article 8.2\*.
  - Conversion of currency as mentioned in Article 9\*\*.
  - Confidentiality of information as per Article 10\*\*\*.
  - Right of appeal as per Article 11\*\*\*\*.
  - Duration of final value determination under Article 13\*\*\*\*\*.
  - Customs power to ask for supporting documents and additional information's (as per ministerial decision 6).
  - Customs power to carry out all actions involved in verification, including investigation.
  - Customs power to suspect.
  - Customs power to persecute the offender.
3. Adequate data-base, particularly of price information is prerequisite for successful implementation of ACV. Therefore, Nepalese customs need to maintain a rich data bank and also identify and acquire access to regional and international databases. As per ACV, customs officers can question the declared value whenever they have reasonable doubts about the accuracy of the declared value and the documents presented in its support. Reasonable doubt may arise only on the basis of the valuation data bank and the indicators from the risk assessment system. In order to protect the right of the customs to ask importers (in case of suspicion) to justify its transaction value, the customs should be equipped with required information. Adequate data base of imported goods is necessary for also PCA. It is also used to make comparisons while using alternate valuation methods (i.e. other than transaction value methods as mentioned in Article 1). The data about quantity, quality and

time are required to conduct Post Clearance Audit. Electronic data are required to verify the authenticity of the information provided by the importer about the value of identical or similar goods. So, for these purposes adequate data base is required to be maintained. However, these data are not used as a reference price for initial valuation.

4. Electronic transmission of information among custom offices, DoC and other related agencies is also equally important. Hence efforts should be made to develop electronic communication network adequately. At least wide area network must be established among custom offices and DoC. An integrated computer system should be developed at DoC that should encompass all customs regimes, operations, control functions, audits, administration, exchange of information with foreign trade operators, statistics and management.
5. Only skilled manpower can take advantage of modern technology of information. At the same time wide knowledge on WTO valuation among custom staffs is required to make implementation of ACV successful. An extensive training in valuation methods and ICT application are required for adopting WTO valuation methods. Adopting WTO method will be effective only after customs official have received training in valuation methods and have access to databases with price information. There is no training function or customs training strategy within DoC, and the Revenue Training Institute, although it has staff of 44, there is no customs specialist on the faculty (GoN, 2004). Various measures should be taken in areas of personnel recruitment and development including fiscal incentives and evaluation to promote integrity in the customs.
6. 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. Attitude and behaviours toward traders and technical competency on the part of custom officials are also equally important. Computerization and ICT applications that leave little or no room for negotiation, influence, or discretion in customs processes, strict staff evaluation and selection procedures, professional training, good incentives, internal control, a code of conduct, enhance fairness, competency integrity in customs administration. Therefore, it is recommended to extend and upgrade the computerization in all custom offices and Doc. The three year Customs Reform Plan has initiated different actions related to the different aspects of good governance. What is needed is continuous and effective monitoring of the good governance with a strong intelligence audit and investigation mechanism ensuring that the offenders are prosecuted and penalized and the traders who voluntarily comply with the law are facilitated and more benefited. The public private sector consultation mechanism enhances transparency. In Nepal, Government has established institutional mechanism of consulting private sector at different stages of determination of value of imported goods. This should be continued and established as importer right. These reforms will enhance mutual trust, confidence and cooperation between the government and the business community.
7. An effective customs control system is required to plug revenue leakage through under invoicing under ACV. A strong enforcement mechanism is required also to protect the honest traders. Nepal Government's Budget for the fiscal year 2006/07 has made provision for

effective purchase of the under invoiced goods and also to complete the PCA of selected firms and goods within sixty days. However, the practices of PCA is in very initial stage in Nepal. In order to ensure an effective custom control PCA should be extended as well as strengthened. However it is not an easy task in Nepal where traders do not keep accounting records properly. Traders even may feel PCA 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 will give them long run benefit. According to Vinod Rege (2000) lack of filling of ownership is one of reasons for the difficulties that developing countries confront in implementing the customs valuation agreement. Currently, there is a post clearance cell under the valuation section of DoC. Three officers and four subordinate staffs are performing the task of post clearance audit. The cell selects the particular transaction based on revenue risk and deputs the officer for post clearance audit. In local level there is valuation and post clearance unit that carries the post clearance audit and value assessment job. It is recommended that the post clearance audit should be under taken in full-fledged form. There should be separate section of PCA comprising of adequate number of auditors and subordinate staffs in department level as well as in local level.

8. In order to build up necessary capacity to adopt WTO valuation, an arrangement should be made for necessary technical assistance in a broadened way. In addition to assistance to be received under WTO-focused programs, technical assistance for Nepal is needed to support computerization, modernization, and reform of customs procedures. The government also should investment in capacity building of domestic institutions to take advantages of WTO rules. External support and financing are necessary to upgrade physical infrastructure, implement training programs and improve organizational structure.
9. Many WTO member countries have introduced import verification program under which importers are required to obtain certificates of inspection issued by authorized PSI companies before goods are shipped from the country of exportation. In the certificates, the PSI Company certifies the nature, quantity, value, and tariff classification of goods. This would help prevent undervaluation and fraud, and facilitate the customs administration to determine the value for customs purposes. This is an alternative device to detect undervaluation or overvaluation. However, it is costly and integrity of PSI companies is often questioned. Nepal, being a small buyer may not be able to demand PSI certificate from exporting companies and it will be difficult for importing companies to bear the burden of PSI cost. Therefore, PSI may not be an appropriate option for Nepal in general. Nevertheless it should make an attempt to recognize PSI system if big importers want to obtain this service. Particularly in the context of inadequate PCA, information received through PSI may be helpful.
10. As legal provisions are still inadequate and PCA is still in learning stage the probability of revenue leakages seems to be high if ACV is implemented without addressing these problems. In view of political situation now it can not be expected that these problems will be resolved by December 2006. So, it is recommended that government should ask grace period of two years to fully implement ACV.

## **Conclusions**

- WTO Customs Valuation System provides fair, neutral and uniform valuation and protects traders from risk of arbitrary valuation by the customs. But there is also risk of revenue loss to the government due to under invoicing of imports by the traders if controlling mechanism such as PCA is not adequately developed.
- In Nepal PCA is in infant stage and other requisites in terms of legislation, data base, infrastructures and skilled manpower etc are still inadequate. A draft of amendment to Customs Act 1962 to make it WTO Valuation compatible is ready but it is being delayed to enforce due to political situation in Nepal. Although situation has been now improved, its enforcement in near future can not be expected, as the government and whole political forces are more involved in political agendas giving less priority to economic agendas.
- The impact of change in custom valuation system from existing one to ACV on volume of imports is not significant. According to the study, it will exert a decreasing effect of only 1.9 percent on imports. On the other hand it reduces under invoicing and informal trade, exerting positive impact on customs revenue. As estimated by the study team impact of valuation change in the general price level of the country is as minimum as 0.6 percent. As its adverse effect on volume of trade and general price level is insignificant and there is positive impact on revenue, it will be beneficial to the country to implement fully the WTO Valuation System. However, necessary prerequisites and controlling mechanism must also be fulfilled.
- As necessary prerequisites are yet to be fulfilled and controlling mechanism is yet to be strengthened the government of Nepal should ask grace period of two years for fully implementing ACV.

#### Endnotes

- \* According to Article 8.2 in framing the legislation each member shall provide for the inclusion or exclusion from customs values, in whole or in partial of following :
  - i) cost of transport to the port or place of import
  - ii) handling charges
  - iii) costs of insurance
- \*\* According to Article 9 conversion rate should be published by competent authority. The rate to be used should be that in effect at the time of exportations or importations.
- \*\*\* According to Article 10 confidential information provided for valuation shall be treated as strictly confidential.
- \*\*\*\* According to Article 11 the legislation should make provisions of Appeal against the decision of valuation or penalty unit.
- \*\*\*\*\* The ministerial decision six provides rights of customs to ask for supporting documents or evidence or to be satisfied with evidences supporting value declaration.

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# *Appendices*

## **Appendix 1**

### **Method of WTO Customs Valuation**

#### **Methods:**

There are six methods of Customs valuation to be applied in a hierarchic order. These methods are given below:-

- Transaction value of the imported goods.
- Transaction value of identical goods.
- Transaction value of similar goods.
- Deductive value method based on subsequent sale price in the importing country.
- Computed value method based on cost of materials, fabrications cost and profit in the country of production.
- Fall back method or "reasonable means" method.

#### **(a) Transaction Value Method**

Transaction value method is known as the primary method of value determination for Customs purposes. Article 1 of Agreement states that the value is determined on the basis of the price actually paid or payable to the seller by buyer after adjustment in accordance with article 8.

#### **(b)The transaction value of identical goods method**

The second valuation method in the series is known as transaction value of identical goods method. If the provisions are not met to establish the transaction value of imported goods, a consultation will take place between the importer and authority to find out the transaction value of identical goods.

#### **( c) Transaction value of similar goods methods**

Where Customs value cannot be determined using Article 2, the next step is to search the transaction value previously accepted for similar goods sold to the same country of importation at or about the same time, at the same commercial level and at or about the same quantity as the goods being valued.

#### **(d) Deductive value method**

This valuation method is based on the unit price of the imported goods or identical or similar imported goods sold in the greatest aggregate quantity to person not related to the seller in the country of importation. From this unit price, Customs will deduct actual expenses incurred and reaches to the actual CIF price of the commodities in question.

**(e) Computed value method**

The computed value is determined by adding to the cost of producing the goods being valued an amount for profit and general expenses equal to that usually reflected in sales of goods of the same class or kind as the goods being valued which are made by producers in the country of exportation for export to the country of importation.

**(f) Fall-back Method**

Customs value is determined by using any of the previous methods in a flexible manner, provided that the criteria employed are consistent with Article VII of the General Agreement. The value so fixed should not, however, be based on the following factors, among others:

- the price of goods for export to a third country market;
- minimum customs values; and
- arbitrary or fictitious values.

## Appendix 2

### List of Custom Agents

S. No.	Name	Custom Office
1	Mohan Niraula	Mechi Customs Office
2	Bharat Raj Koirala	Mechi Customs Office
3	Ashok Kumar Shrestha	Mechi Customs Office
4	Bimal Acharya	Mechi Customs Office
5	Keshav Pandey	Mechi Customs Office
6	Krishankanta Khaniya	Mechi Customs Office
7	Udaya Karki	Mechi Customs Office
8	Narayan Regmi	Biratnagar Customs Office
9	Kedar Man Karmacharya	Birgunj Customs Office
10	Kashi Raj Upadhaya	Birgunj Customs Office
11	Jaya Prasad Siwakoti	Tribhuvan International Airport Customs Office
12	Prem Kumar Adhikari	Tribhuvan International Airport Customs Office
13	Bhoj Raj Bhattarai	Tribhuvan International Airport Customs Office
14	K. P. Neupane	Tribhuvan International Airport Customs Office
15	Khadga Bd. Karki	Tribhuvan International Airport Customs Office
16	Shyam Khadka	Tribhuvan International Airport Customs Office
17	Ram Hari Adhikari	Tribhuvan International Airport Customs Office
18	Til Pd. Neupane	Tribhuvan International Airport Customs Office
19	Arjun Jamarkatel	Tribhuvan International Airport Customs Office
20	Shambhu Pd. Bhattarai	Tribhuvan International Airport Customs Office
21	Shiva Pd. Sharma	Bhairahawa Customs Office
22	Bishnu Sharma	Bhairahawa Customs Office
23	Prachin Thaiba	Bhairahawa Customs Office
24	Sharad Sharma	Bhairahawa Customs Office
25	Shiva Narayan Joshi	Tatopani Customs Office

### Appendix 3

#### List of Custom Official

S. No	Name	Designation	Office
1.	Mr. Bal Govinda Bista	Director General	Department of Customs
2	Rajan Khanal	Deputy Director General	Department of Customs
3	Madhusudan Bhattarai	Chief Custom Administrator	Tribhuvan International Airport Customs Office
4	Rajendra Dahal	Director Valuation	Department of Customs
5	Surya Sedai	Officer Valuation Branch	Department of Customs
6	Achut Sing Basnet	Officer Valuation Branch	Department of Customs
7	Chetnath Bhattarai	Chief Customs Officer	Tribhuvan International Airport Customs Office
8	Lal Bahadur Chhetri	Chief Custom Officer	Bhairahawa Customs Office
9	Dhurba Pr. Pant	Chief Custom Officer	Birgunj Customs Office