Business Climate Legal & Institutional Reform

Best Practices for the Business Environment

May 2006

Issue 2

New Leadership Leads Customs Reform
Lessons from Egypt

This Best Practice was adapted from "*Doing Business 2007:* How to Reform Case Study: Egypt—Trading Across Borders—From New Leadership, a Record of Reform," prepared by Booz Allen Hamilton in cooperation with USAID for the World Bank Group's 2007 Doing Business Reformers Club Conference.

Executive Summary:

Responding to increasing public discontent, the president of Egypt appointed a young cabinet to revisit the need for reform. Relying on surveys and strategic plans prepared for the prior administration, the newly appointed economic team was able to implement both "quick wins" and longer-term initiatives. While additional reforms are warranted, the country's cross-border trade processes have improved substantially. Additionally, while the rate of annual GDP growth hovered around 2.5 percent between 2002 and 2003, the rate in 2005 was around 5.7 percent.

Introduction

In July 2004, in response to increasing criticism from the media and public discontent over the country's dreary economic performance, Egypt's President Hosni Mubarak appointed a new economic team signaling a fresh interest in economic reform. The trade reforms implemented by the new economic team ranged from "quick wins" to longer-term initiatives. They included the elimination of surcharges and processing fees charged by the Customs Administration (a division of the Ministry of Finance); simplification of tariff bands; reduction of signatures required for clearance; consolidation and clarification of regulations; and increased implementation of risk management, a common method of managing imports.

Although the need for additional reform is recognized, this first wave has had some success: While the rate of annual GDP growth hovered around 2.5 percent between 2000 and 2003, the rate in 2005 was around 5.7 percent.

Context

The process of moving goods across Egypt's borders was surely ripe for reform. At the time, problems faced by importers were notorious. By virtue of an exceedingly complex and antiquated system of customs and other controls, goods would typically sit at Egypt's ports for weeks, suffering through innumerable paperwork requirements and unnecessary inspections prior to release. How long goods actually stayed could only be roughly quantified, given the lack of meaningful or consistent data maintained by Customs and other border agencies.

Prior to the cabinet shake-up in 2004, cross-border trade facilitation, particularly within Customs, had long been a subject of study and lament. In July 2002, the International Monetary Fund (IMF) issued a lengthy report that characterized the state of Egypt's tariff structure and customs as "distortionary," "restrictive," "non-transparent," "outdated," and "ineffective." The IMF specifically cited as problematic the country's 29 official tariff rates ranging from 0 percent to 3,000 percent—along with surcharges, import fees, quality control procedures, total or partial exemptions, overstaffing, and an absence of information technology. Though disregarded in most substantive respects by the government's prior economic team, the IMF's report would ultimately serve as a critical benchmark for reform initiatives.

USAID FROM THE AMERICAN PEOPLE

Approach

To its partial credit, in October 2002 the Ministry of Finance responded to the IMF's report by establishing a Customs Reform Unit (CRU) within the Customs Administration. Consisting at first of about 15 people, the CRU was formed for the purpose of managing reform in nine core areas: law; procedures; tariffs; exemptions; special regimes; valuation; human resources; training; and information dissemination. Although in its first 14 months the CRU took some limited steps forward, among them the creation of various new informational tools and training programs, its effectiveness was stymied by a number of factors. These included not only risk aversion at the top, but also a trust-inhibiting organizational structure in which the head of CRU reported not to the Customs Commissioner, but directly to the Minister of Finance.

By April 2004, at least three donor-sponsored datasets had been created and shared with the interested ministries for the purpose of analyzing port clearance times. Each painted a relatively consistent picture of the time it took for goods to pass through Egypt's largest port, Alexandria – about 16 days, but with an unusually large standard deviation.

In addition, using a sample drawn from one week in January 2004, USAID's Assistance for Trade Reform project launched another study aimed at benchmarking clearance times and, for the first time, associating delays with particular groups of commodities and identifying specific steps or procedures causing delays. The study centered on a set of shipments that had been inspected at four ports by Egypt's General Organization on Export and Import Control (GOEIC), the office within the Ministry of Foreign Trade and Industry. The study concluded that, on average, it takes 22.3 days to clear goods from ship arrival to final release. On average a shipment completes port procedures in 6.6 days; customs procedures in 12.5 days; and GOEIC's quality inspection procedures in 9.1 days.

Drawing for the first time from the private sector—rather than from Egypt's more traditional sources of ministerial leadership such as academia or the military—the president placed new heads at the Ministry of Finance and the Ministry of Foreign Trade and Industry, among others. In rapid pace, the new team immediately identified three priority areas for reform: taxes, the banking sector, and customs (or, more broadly, cross-border trade).

Implementation

The poor numbers found by the various donor studies resulted in some measured steps forward. On April 4, 2004, the Ministry of Finance committed to an implementation plan that had been developed by the CRU in conjunction with USAID's Initial Implementation Task for Customs (IITC), a technical assistance project established in 2003. The implementation plan was created as a blueprint for reform. The plan specifically examined short-term and long-term implementation activities pertaining to legislation, human resources, organization, staffing, management and training, procedures, information technology, tariff policy, valuation, exemptions, and other issues. The IITC itself was a $3.3 million project that dedicated its resources to strategic vision and planning, measuring customs performance, organizational realignment, improvement of procedures, and stakeholder engagement. Thus, rather than channeling outside funds into new equipment, planners within the Customs Administration began to focus on the underlying conditions that could and should be changed without an influx of new money.

New Tariff Structure

On September 8, 2004, fewer than eight weeks after installing a new economic team, the government announced a new tariff structure. Finally enacting a set of changes that had languished for months in the hands of the previous Minister of Finance, the government reduced the number of tariff rates from at least 27 to 6, pegging them to the degree of processing of the goods, and ranging from 0 percent and 2 percent on certain raw materials, spare parts, and primary feeding products and up to 40 percent on durable consumer goods. The changes in tariffs reduced the officially announced weighted average tariff rate from 14.6 percent to 9.1 percent.

In addition, the government replaced its 13,000-line, 10-digit tariff structure with a 6-digit structure with fewer than 6,000 tariff lines. It also eliminated service fees and import surcharges ranging from 1 percent to 4 percent. (Meanwhile, a number of high tariffs were not changed, including duties on poultry, alcoholic beverages, tobacco and cigarettes, and passenger vehicles with a cylinder capacity (cc) above 2,000. In general, Egypt's tariffs are still considered too high.)

New Customs Commissioner

In November 2004, the Minister of Finance appointed a new Customs Commissioner, who had previously worked as the manager of customs in Damietta, where he established a strong reputation as an effective leader who understands Egypt's customs environment. With the new commissioner came a new and improved accountability structure for the CRU: rather than having the head of CRU report directly to the Minister of Finance, the commissioner himself leads the CRU, with a deputy responsible for managing CRU's day-to-day business.

Legislative and Regulatory Framework

Both Customs and GOEIC have endeavored to clarify, consolidate, and in many instances change their respective legislative and regulatory frameworks. Prior to July 2004, hundreds of decrees and at least 22 manuals contained guidance pertaining to Egypt's customs regime. In 2005, donors worked with the Ministry of Finance and various stakeholders in the trade—brokers, shippers, small importers, freight forwarders, passengers, business associations, and others—to review the authority for compliance with international standards and practical implications in the trade and to consolidate them into a single set of executive regulations. Enacted in 2006, these regulations are now accessible in Arabic as well as in English, the latter thanks to a USAID-funded translation. Similarly, the Ministry of Foreign Trade and Industry revamped Egypt's import and export regulations through consolidation, simplification, and removal of many restrictions that were found to undermine the goal of facilitating trade. This exercise also took place with considerable USAID support.

Customs has committed to organizational changes, among them reducing the number of reporting levels in the organization, drafting of job descriptions, development of office standards, creation of a code of conduct, and rewards for meritorious service.

Trade-related agencies have strived to transform the "mentalities" of their respective workforces, changing from an essentially ministerial sense of purpose to acceptance of such core values as responsiveness, efficiency, and pro-trade. Within GOEIC and the Ministry of Foreign Trade and Industry generally, there have been similar efforts to redefine their mission from "control" over exports and imports and protection of the country from purportedly shoddy merchandise to facilitating and encouraging international trade. To that end, through training and mentoring initiatives, USAID's Assistance for Trade Facilitation project has engaged in building capacity among government personnel to act decisively, to work with the business community to generate a consensus over the importance of trade, and to reach out to their colleagues in other agencies whose interests they share.

Among Customs' key priorities is bringing its bloated workforce into a state more compatible with efficiency, practicality, and international best practice. In November 2005, CRU examined the number, functions, work history, and accountability channels of all persons employed by Customs. It found that the agency employed 16,099 people to handle a volume of trade equivalent to the port of New York/New Jersey, where fewer than 400 people work. Although layoffs within Egypt's notorious bureaucracy remain unheard of – they are not "culturally acceptable," one Egyptian involved in the reform process explained—CRU determined the appropriate number of Customs staff to be well under 10,000. Measures such as early retirement, attrition, and reassignment are now on the table.

In addition, with continuous USAID support, Customs has built new bridges into the trade communities in Alexandria and Port Said, where advisory committees consisting of brokers, importers, exporters, and border agents now meet twice monthly to discuss issues of common concern. These committees have been very effective in securing quick responses from the government.

Customs has embarked on the long-term process of integrating risk management into its clearance procedures. The goal of risk management is for Customs to develop a sufficiently strong understanding of its import community—which includes as many as 28,000 importers over the course of a year—so that it can base decisions to inspect on a series of risk factors and, where those factors are not present, allow the release of goods without inspection. At this time, according to one donor, Egyptian decision makers are strongly "interested in the concept, but they are grappling with the reality." Effective risk management demands solid information technology that is capable of holding, sharing, and tracking data on importers and their shipments. Although Egypt is a long way from implementing and using an IT system that facilitates these key aspects of risk management, reforms have taken place to the degree that Customs inspection rates have diminished from 100 percent in the recent past to around 60 percent currently, with the commissioner eyeing inspection rates closer to 20 percent in the future. A major portion of donor aid—up to $10 million—will be devoted to helping procure, purchase, and support new Customs software and some hardware.

Account Management System

Customs has created a new account management system (AMS) for its largest importers to streamline the clearance process applicable to around 500 companies that represent more than 60 percent of the value of the nation's imports. Through the establishment of close working relationships between designated Customs officials and importing companies, AMS aims to transfer risk analysis from "transaction by transaction" to "company by company." In the six months following the inception of AMS, 150 companies applied for and, following careful scrutiny of a broad array of risk-related data, were accepted to the program. The rate of inspections for these companies diminished from around 90 percent in October 2005 to 36 percent in April 2005.

Several other reforms, some showing greater impact than others, have been initiated. These include the creation of modern customs centers, or "one-stop shops" for border functions, in Alexandria and Suez, with more envisioned for the future. They also include increased performance monitoring, staff training, and international accreditation of GOEIC labs. Finally, Egypt expects to join the World Customs Organization's Kyoto Convention, through which it commits to further simplification and harmonization of procedures, in September 2006.

Donor Involvement

Although donors recognized the enormous need for trade-related reform, obvious ambivalence on the part of the government discouraged USAID, the European Union (EU), and others from investing large amounts of money into initiatives that lacked champions from within. Instead, donors focused on the need to quantify and understand the problem—in particular, to provide a "game plan" for the specific processes, activities, charges, times elapsed, and other details involved with import, export, and transit of goods. Technical assistance projects sponsored by USAID and the EU's Middle East assistance program also stressed the importance of long-range planning, legislative reform, and capacity building within Customs and other trade-related offices.

Since the changes in government leadership, CRU has grown to about 25 people. Among other functions, CRU is the focal point for a number of large, donor-funded projects that took shape in 2005. These include up to $30 million devoted to Customs modernization by USAID through its Technical Assistance for Policy Reform II program; six million Euros committed by the EU to help develop, among other reforms, risk management in Customs; and possibly a few other initiatives, such as training and capacity building proposed by Switzerland.

Results

Although parties involved in trade continue to perceive conditions at Egypt's 21 ports as far from ideal, feedback regarding changes at the border has been remarkably positive from a wide array of stakeholders. Some proof of success is reflected in the country's macroeconomic numbers: While the rate of annual GDP growth hovered around 2.5 percent between 2000 and 2003, the rate in 2005 was around 5.7 percent.

Implementation of the government's short-term changes, though generally welcome, did not prove seamless. For example, one businessman contended that, in its haste, the government did a "slip-shod job" of classifying goods in the new regime. On the other hand, the fact that the government was finally attempting to tackle the private sector's concerns has resulted in greater business confidence in the economy.

Challenges to Reform

There is not yet sufficient trust among those ministries charged with implementing long-range, trade-related reform. More effective consultation, cooperation, and coordination between Customs and GOEIC have long been on donor wish lists. There is also no consensus in Egypt concerning the wisdom or necessity of free trade in general. Manufacturers in particular feel threatened by the expectation of cheaper goods from all over the world flowing into Egypt. Finally, a pronounced difference remains between the relative enthusiasm for trade-related reforms held by larger, well-integrated companies and the clear cynicism held among the smallest participants in international trade.

About BizCLIR:

BizCLIR, or the Business Climate Legal & Institutional Reform Project, is a multi-year initiative of the United States Agency for International Development with the goal of improving the efficiency and impact of assistance programs intended to help developing countries improve their business enabling environments. This series, Best Practices for the Business Environment, represents one of many knowledge management components of the BizCLIR project. The goal of the series is to highlight the known best practices, case studies, lessons learned, and in some cases worst practices, so that the lessons can benefit other practitioners in the field. All issues are available at www.bizclir.com.