

**Factors Affecting the Effectiveness of Border Management
Strategies for Contraband Trade Prevention; “The Case
in Sri Lanka Customs”**

By

**N. K. G. K. NEMMAWATTA
GS/MC/1271/2000**

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To-whom it may concern

Declaration

The research study and the works described in this theses which has been carried out by me under the supervision of the Dr. Nevilee Warnakulasooriya, professor, Head of the Marketing Department of University of Sri Jayawardanapura has neither been submitted previously for any other university no any other Institution as a research study other than fulfillment of Msc degree program of this university.

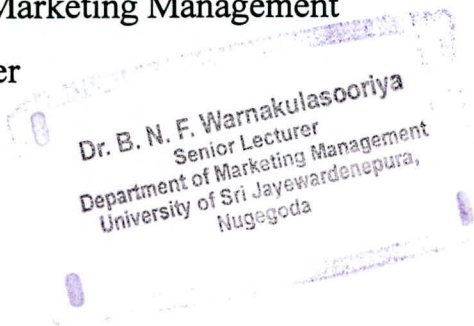


N.K.G.K Nemmawatta
Msc Student
GS/MC/1271/2000

I hereby recommend that the thesis prepared under my supervision by Nemmawatta Kankanamalage Gamini Kithsiri Nemmawatta entitle to be accepted in partial fulfillment of the requirements for the degree of **Master of Science in Management**.



Dr. Neville Warnakulasooriya
Professor in Marketing Management
Thesis Adviser



MSc (Management) Degree Programme
Faculty of Graduate Studies
University of Sri Jayewardenepura
Sri Lanka

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Dedication

To my parents, and Teachers

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ABSTRACT

The purpose of this study is to find out the factors affecting the effectiveness of the border management strategies for contraband trade prevention in Sri Lanka. Border management is significantly important in building up its image of a country. This image building is important not among the traders involved in international trade but also among the passengers who travel across the country's borders. Though the different agencies of international trade have defined border management in different ways, this study defines Border management as the supervision of border activities of a country to meet the challenges of facilitating cross border movements of legitimate people and goods while maintaining secure borders and meeting national legal requirements such as ensuring due revenues are collected (United Nations Trade Facilitation Net Work, 2005).

Generally, border management agencies perform a vital role in community protection in terms of preventing international terrorism, a fiscal role in terms of tax collection, and an environmental and social role in terms of protecting public health and cultural heritage. Border management strategies of Sri Lanka have been formulated to realize the following objectives: (1) Facilitating flow of legitimate people and goods across the border and, (2) taking adequate measures to meet national legal requirements to secure borders of the country. Therefore, when formulating strategies on border management, it is the need to ensure trade off between these two objectives.

Therefore, this study has been designed to address the problem as to why the border management strategies adopted by respective government bodies have not been successful to materialize the objectives of the border management. On this ferment the following research questions are raised. What are the *characteristics* of contraband trading? What is the degree to which border management strategies have been able to minimize the contraband trade? What factors have affected the effectiveness/ineffectiveness of the border management strategies in preventing contraband trade? What is the role of Sri Lanka Customs in implementing the border management strategies and preventing contraband trade?

To address the above research questions four objectives are formulated. First, to assess the characteristics of contraband trading, second to investigate the degree to which border management strategies have been able to minimize the contraband trade, third, to identify and analyze the factors influencing the effectiveness of the border management strategies in

preventing contraband trade, and, finally to identify and describe the role of Sri Lanka Customs in implementing the border management strategies and preventing contraband trade. Since, this study, which attempts to explore the characteristics of contraband trading, the border management strategies, the factors influencing the effectiveness of the border management strategies, and the role of Sri Lanka Customs in implementing the border management strategies and preventing contraband trade, is an exploratory in nature.

Characteristics of contraband trade have been identified through exploring literature available in the government publications, non government publications and previous research studies. The degree to which border management strategies have been able to minimize the contraband trade has been evaluated through reviewing literature plus Focus Group interviews.

The factors influencing on the effectiveness of the border management strategies in preventing contraband trade has been investigated through Focus Group Interviews.

The role of the Sri Lanka Customs in prevention of contraband trade was evaluated exploring existing literature available in published research and documents.

The characteristics of contraband trade have been identified as false invoicing, non declarations, and undervaluation, Mis-use of duty free facilities and Mis-description.

Border management strategies pointed out by the Focus Groups can be categorized into Policy and Regulatory requirements, Risk Management adopted, Systems, Process and Procedures, Systems Automation, One Stop Border Agency as collective efforts for Clearance of cargo, and Human Resources development.

The major factors affecting the effectiveness of Border Management Strategies identified by the Focus Groups were the following lapses in strategy formulations of areas such as policy formulations on taxes, system development, and automation of systems, risk management, and human resources development.

The findings of the focus groups on what strategies were able to minimize contraband trade and the factors influencing the strategies of border management drawn from primary data were confirmed and triangulated in term of respective Customs Cases obtained from Automated Data Processing (ADP) Unit. Furthermore, the characteristics of contraband trade and the role of the Customs, which were delineated through literature review, were also triangulated and confirmed using selected Customs Cases from Automated Data Processing (ADP) Unit.

The study discusses that the fulfillment of national legal requirements of a country is an indicator to determine the successful achievement of revenue targets and minimizing the

illegal trade during the period concerned. If all requirements of border management were met, there should not be any space to persistence illegal trade. Further, developments of process, procedures and systems, and introduction of systems automation that would address the issues of complexity of trade, multiplicity stakeholders' involvement at border, and trade volume, enable to make environment conducive to facilitate legitimate trade across the border providing 'One Stop' services. The Presidential tax commission revealed present border tax structure and methods/basis of computation for collection were exceedingly complex. Therefore, it is the time to re-visit the strategies adopted, amendments for legal systems, and revisions for tariff structures.

Finally, this study elaborates on how recent contraband trade practices have adversely affected the government revenue. In additions, the selected ADP Customs cases clearly indicated the magnitude of contraband trade during the period concerned in this study.

Based on the analysis of the study, the following recommendations were made to improve the border management strategies. Border tariff adopted by Sri Lanka needs to be simplified in order to prevent contraband trade. The existing tariff structure is not convenient for all stakeholders because of the complexity and ambiguity of tariff system in Sri Lanka.

As explained in appendixes of this study, the findings of another researcher revealed that, processes of international trade have several institutional link and number of documents to be filled to clear consignment of cargo at the border. This indicates that the indirect cost involved in international trade was higher than the direct cost. In the same vein, unnecessary documents and involvement leading to time consumption of the border clearance discourages the smooth flow of border transaction. To minimize these problems, an integration and automation of systems should be established. Moreover, a good Performance Evaluation system should be introduced to overcome problems associated with factors of human resources development which the focus group highlighted as the most influential factor affecting the effectiveness of the strategies. Furthermore, adopting a good Performance Evaluation system would contribute to build image as well as enhance dedication of members to provide the best service to the country. The World Customs Organization emphasized the collective efforts in prevention of contraband trade. Integration and automation of systems would also be important as per the literature of The World Customs Organization (WCO).

Key words; Border Management, Contraband Trade, Sri Lanka Customs, Automated Data Processing, Customs Cases.

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ABBREVIATIONS

ADP	– Automated Data Processing
ASC	– Assistant Superintendent of Customs
BOI	– Board of Investment
CCED	– Central Cargo Examination Directorate
CIB	– Customs Investigation Bureau
CIF	– Cost Insurance & Freight
CUSDEC	– Customs Declaration
CIU	– Central Intelligence Unit
CDDA	– Cosmetic Drugs Devices Authority
CKD	– Complete Knock Down
DC	– Director of Customs
DDC	– Deputy Director of Customs
FCL	– Full Container Load
FOB	– Free on Boat
LCL	– Loose Container Load
PAL	– Port and Aviation Development Levy
PCT	– Physical Contraband Trade
RTF	– Revenue Task Force
SC	– Superintendent of Customs
TCT	– Technical Contraband Trade
VDF	– Value Declaration Form
VAT	– Value Added Tax

CHAPTER 1

1 BACKGROUND OF THE STUDY

1.1 Introduction

Border management is the supervision of border activities of a country to meet the challenges of facilitating the movement of legitimate people and goods while maintaining secure borders and meeting national legal requirements such as ensuring due revenues are collected (United Nations Trade Facilitation Net Work, 2005).

Hence, border management agencies perform a vital role in community protection in terms of preventing international terrorism, a fiscal role in terms of tax collection, and an environmental and social role in terms of protecting public health and cultural heritage (World Customs Journal, 2010). At present, progress has made towards liberalizing the international trade through reduction and removal of tariff and non-tariff barriers with the view of facilitating legitimate global trade (Kieck, 2010). At the same time, border management has been becoming more complex and this has been compounded by multiplicity of state agencies involved. To overcome this problem the World Customs Organization (WCO), the World Bank and other agencies have championed coordinated border management. However, one stop border posts have been introduced or are being considered as a mechanism to improve the movement of goods across borders.

These arrangements have both economic and enforcement benefits (Kieck, 2010). Economic benefits considered in the study were minimization of transaction cost at the border and protection of government revenue. Customs as border authorities has to prevent and detect smuggling of goods and combat commercial fraud where traders endeavor to evade or minimize payment of duties and taxes. Accomplishment of these objectives with different regulatory requirements on international trade has been mandatory issues that have to be resolved. Designing process and procedures to be fulfilled with numerous requirements and

number of agencies to be attended when clearing goods create involvedness to trade communities at the border. Further, imposition of additional costs on goods which move across borders, rather than existing cost on goods trading, makes situation worse in the sense of economic cost of border transaction. Additionally, these makes delays, cumbersome procedures and much of requirements to be fulfilled, leads for corruption and weak administrative capacity affect on cost effectiveness of trade. If collective border controls could be implemented, then malpractices of traders could be eliminated as collective border controls. Hence, economic benefits are immense that country could be gained as results of these implementations. Enforcement benefits considered in this study are, time saving by completion of a job, working with all agencies together in collective manner. Facilitating and controlling of cross border movements at frontier, by themselves or performs duties on behalf of other agencies, could be considered as example for enforcement benefits. Those include services that assist to maintain speedy process of cross border movements, such as agriculture quarantine, food inspections, licensing requirements needed for medical items, immigration, and standards requirements needed for certain goods. These controls are executed either by the agencies themselves or by other agencies on their behalf them at the border, such as Customs department.

However, literature from secondary sources maintained by respective Sri Lankan government bodies as well as other literature pertaining to this shows, that economic and enforcement benefits expected from border management strategies have not been achieved in Sri Lankan context. For example, document published by Asia-Pacific Research and Training Network "Improving Imports/ Exports Process and Procedure in Sri Lanka" explains delays of processing cargo at borders between India and Sri Lanka. Further, major constraints confronted by traders of India and Sri Lanka were delays in acquiring necessary

documents(Mel, Jayaratne, Premaratne 2011)¹, and licensing requirement which consumes time in processes²of border clearance. If border agencies could develop a mechanism, where all these parties could work together, would be the enforcement benefits of international trade for these two countries. Therefore, present study has been designed to find out degree of the effectiveness of border management strategies in facilitating smooth movement of legitimate trade in Sri Lanka.

1.2 Problem Statement

Border management strategies of Sri Lanka have been formulated to realize the following objectives: (1) Facilitating flow of legitimate people and goods across the border and, (2) taking adequate measures to meet national legal requirements to secure borders of the country. Therefore, when formulating strategies on border management, it is the need to ensure tradeoff between these two objectives. Hence, the objectives of border management should ensure that smooth and legitimate flow of people and goods across the border, protection of State revenues, and Cooperation among the respective implementing agencies. However, observation of the respective records discloses border management strategies adopted by respective government bodies have not been successful to materialize the objectives of border management. Specially, strategies have been unable to reduce or minimize contraband trade in Sri Lanka .For example, contraband trade which has characteristics of informal trade, under invoicing of formal trade, and violations of laws of international trade has gradually been increased. Among illegal activities of international trade, recoveries of additional revenue by uplifting invoice value declared to Customs by

¹ The Certificate of Origin (COO) is issued only after the shipment has been effected, and shipments usually arrive in India/Sri Lanka within a period of 48 hours, which means the goods arrive prior to the documents. Without the essential Certificate of Origin the goods cannot be cleared, resulting in delays. Due to these delays there have been instances where demurrages have to be paid and additional costs have to be incurred.

² The Study finds out that there are 24, 19, 18 and 19 documents involved in trading tea, rubber tyres, cars and textiles respectively; the number of agencies involved range from 5 to 9. The number of days taken to export is 17.06 and 16.9 for tea and rubber; for car and textile imports, it takes 6.4 and 6.05 days, respectively. The costs range from US\$ 79 (for a car import) to US\$ 677 (for import of a 20-foot container of textile). Some numbers differ significantly to the benchmark estimates published by agencies such as the World Bank.