

PRACTICE OF GRAY CUSTOMS SYSTEM BETWEEN RUSSIA AND CHINA

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ABSTRACT

“Gray customs system” is an illegal practice of getting goods across the border without official customs approval. Such practice makes a negative impact on Russia-China economic relations and is, therefore, considered as a barrier for bilateral economic relations between Russia and China. In this context, the paper examines the problems occurred due to the gray customs system and the action taken to mitigate this problem. The research method used for this article is the case study method referring to secondary data, scholarly literature and reports.

KEYWORDS: *bilateral agreement, customs, illegal, practice.*

JEL CODES: F0, F1, F5.

Introduction

The aspect of foreign direct investment and international trade has been of importance together with new approaches and progressive economic policy as it constructs a strong foundation for economic relations between nations. However, the “gray customs system” acts completely in opposite direction in case of building economic relationship between nations. Russia and China both nations confront the problem of gray customs system in their border region. Main scientific problem understanding foreign direct investment and international trade using gray custom system. Main aim of this research- to show negative aspects of this gray customs system for both countries. Used methods: analysis, synthesis.

Gray Customs System

“Gray Customs System” refers to an illegal practice of getting items across the border without official customs approval (Ding Qingfen, 2009). In the early 1990s, Russia was suffering from a serious shortage of consumer goods. Chinese businessmen saw this as an opportunity to make a base for non-governmental trade in Russian territory. But Russian customs clearance procedures created an obstacle in the way of Chinese businessmen in developing such trade ground. In order to simplify the customs procedures, the Russian Customs Committee allowed entire consignment of goods delivered by plane cleared with single customs clearance form. Later, this procedure was extended to customs clearance for shipping and rail transport. In order to get gray customs clearance, Chinese businessmen were simply paying customs duties in China and getting receipt of their goods without giving customs declaration. An intermediate agent company had responsibilities of all the intermediate links including transportation, customs clearance and commodity

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inspection (Huasheng, 2010). “Grey Customs Clearance” refers to the practice by some government connected ‘clearance’ companies in Russia pushing imported goods into the Russian market at a tax rate lower than the official level. These companies pay customs duties on a small portion of the imported commodities bribing the customs officers to let the rest pass (China Daily, 2004). Typical violation at the border in case of declaration include under-declaring and misdeclaring goods. Under-declaring involves the statement of quantity or value of goods imported as less than the true value. Misdeclaring goods involves the falsifying the nature of the imported goods in order to pay less customs duty. For example, high-value mobile phones may be declared as outdated technology in order to avoid the payment of higher rates of customs duty. Such violation at the border happens due to the payment of bribes, ensuring a favourable relationship with certain customs officers (Owen, Hawas, Hecker, 2010). Whereas customs duty is paid on the basis of types of goods imported in Russia (Neil, 2008). According to the report of Russian B2C e-commerce opportunities for Chinese players published by East-West Digital News (EWDN), there are two main ‘gray schemes’ in order to get Chinese goods into Russia: (i) Postal Exchange at Two Borders. Under this option, an exchange up to 60 kg of goods for personal use from China to Russia and vice versa is allowed officially. The customs clearance in Suifenhe (China) – Pogranichny (Russia) set up an example of such exchange option; (ii) Container Shipments. These are bulk shipments which go through without customs inspection of every item of the container (East-West Digital News, 2015). The procedure of customs clearance of goods in Russia includes entry of goods to the customs’ territory, unloading of goods, submission of customs declaration, submission of other documents like certificates and licenses, paying customs duties, taxes and other fees (Economic Aspect, 2008–2009).

Some old Chinese entrepreneurs in order to earn high profits, as they were doing in 1990s, try get all their goods through “gray customs clearance” companies. During such process, when Russian law enforcement agencies do inspection, such Chinese entrepreneurs are in trouble. Such traders do not get any help even from the Chinese embassy because they do not have necessary customs declaration documents and goods are considered as smuggled goods (Ma, 2012).

Foreign Market Access Report of Ministry of Commerce People’s Republic of China (2006) reveals Resolution No. 863 issued by Russian government in December 2004 for the collection of new formalities charges for customs clearance procedures mentioned below:

(i) Clearance formalities payment ranging from 500 roubles to 10,000 roubles by eight grades in accordance with the customs value would be levied on foreign exports-in transit, including the transport tools, within Russian customs territories.

(ii) With regard to the goods being transported by rail within Russian customs territories, 500 roubles of clearance formalities charge would be levied on every batch of goods under the same bill of loading (B/L) and loaded on the same train.

(iii) 500 roubles of clearance formalities charge were levied on every batch of negotiable securities and equivalent foreign exchanges being delivered under the same B/L via Russian customs territories (Foreign Market Access Report, 2006).

Besides these tariffs, Russia imposed an 18% value added tax (VAT) on imports, 10 percent VAT on foodstuffs and articles for children use and 25% to 90% consumption taxes on luxuries such as alcohols, alcoholic beverages and beers, cigarettes, jewellery, automobiles and gasoline. China, in such kind of tax imposition by Russia, perceives the ground of discriminatory measures adopted by Russia against Chinese goods (Foreign Market Access Report, 2006). In view of A. Mikhailitchenko and S. Varshney (2016), after entry into the World Trade Organization (WTO) as a member nation, the Russian government’s regulation of its foreign trade is subject to tariff commitments and other international obligations. They point out that the existing import tariffs were revised through a set of new policies and were implemented as a result of newly imposed internal customs rules and practices during the period between the middle of 2014 and the beginning of 2016. They further state that there is formally no violation of any international import tax agreements, nevertheless these customs rules and practices lead to additional barriers for imports.

Lu Nanquan (an expert on Sino-Russian trade at the government-backed Chinese Academy of Social Sciences) estimates that around \$8 billion in gray market goods flow from China into Russia each year. The normal rate for customs duty is somewhere between 15% and 20% but gray customs clearance charge comes around 5 percent to 6 percent (Asia News, 2009). The Russian Government takes such gray customs clearance as an act of smuggling (Portyakov, 2010).

The local Russian customs brokers are also active in the promotion of prohibited customs related practices. Since, complex documentation and excessive bureaucracy frequently drive foreign importers into the clutch of local Russian customs brokers who work on their clients' behalf in this regard. The local such third party company practices are targeted under the Foreign Corrupt Practices Act (FCPA) or similar legislation (Owen, Hawas, Hecker, 2010). International companies need to observe their local 'fixer' to ensure that illegal act is not being committed in their name or they are not being swindled. Since local fixer's service that promises a smooth and quick transition of goods across the border will often be based on gray practices, greased by a bribe. The FCPA does not make any distinction between a company paying a bribe directly and the intermediary channel paying bribe (Owen, Hawas, Hecker, 2010). At the border, dishonest customs brokers, usually working in collusion with customs officials, distort the true value of contracts and move the hidden, unreported value into their own pockets or offshore. Customs evasion schemes rest on falsified or forged customs declarations with an objective of paying less duty. For example, high-value mobile can be declared as an outdated technology for such purpose of avoiding payment of higher rates of duty (Owen, Hawas, Hecker, 2010).

If we take a case of forest resource exploitation illegally in Russian Far East (RFE) region, roughly half of China's demand for timber is met from the RFE region. China has imposed strict restriction on logging in 1998 due to flooding and forest degradation in the country. China's economic growth has caused an excess demand for timber in its domestic economy. Therefore, in order to meet this excess demand for timber, China has moved to other sources for getting timber such as RFE regions. In the RFE region, illegal harvesting operations include logging without permits, logging outside of parcels approved for cutting, misclassification of species, smuggling, false documents in practice, bribing officials and purchasing illegal permits. The direct impact of illegal logging has made a loss of US \$1 billion to US \$3 billion annually for Russian government. Even the 'Cooperation Treaty' between Russia and China has failed to build a base for investment in the RFE region. When Chinese firms do investment in the RFE region, they are often suspected by Russians. Besides this, the 'Cooperative Treaty' does not appear supportive to resolve the problem of illegal logging (Crowley, 2005).

On the issue of the closure of sprawling the Cherkizovsky market by Russian authorities in Moscow at the end of June, 2009, which affected 100,000 merchants including 60,000 Chinese businessmen, China's Commerce Ministry spokesman, Yao Jian pointed out that it would take time to resolve the practice of "gray customs clearance" that traders have adopted this process to facilitate goods into Russian market. Qin Gang, Chinese Foreign Ministry spokesman, urged Russians to "protect Chinese businessmen's interest in Russia". He also signalled all the Chinese entrepreneurs to abide by the local laws and regulations. In order to curb such practice, the Russian government attempted three times to close Cherkizovsky market since 2001 but failed. In September 2008, the Moscow Auditing Office closed eight large storage facilities in Moscow where Chinese traders were holding US \$2.1 billion worth of goods. The final closure of Cherkizovsky market on June 29 uprooted the operations of tens of thousands of Chinese merchants. In June 2009, with the objective of promoting healthy development of Russia-China economic relations, both nations established a subcommittee on customs operation in order to standardise cooperation by stepping up the crackdown on "gray customs clearance" (Bin, 2009).

Sun Yongfu, director of the department of European Affairs under the Ministry of Commerce People's Republic of China (MOFCOM) says that the practice of gray customs system has negatively affected bilateral trade between Russia and China. He further says that the closure of the Cherkizovsky market in 2009 is an example of Russian Government action against practice of Chinese business via the gray customs system (Ding Qingfen, 2009).

In view of Sun Yao (Vice Governor of northeast China's Heilongjiang Province), highways and railway border ports between the countries have made the clearance process faster. He further says that large amount of Chinese goods have entered Russian market through the normal customs procedure since late 2009, for example, in the "China-Russia Ussuriysk Trade and Economic Cooperation Zone", 18 Chinese shoe producers entered through the normal customs clearance have occupied one tenth of Russia's shoe market in the year 2009 (English.news.cn, 2010).

If Chinese traders pay the requisite customs duties for getting their low quality Chinese merchandise in the Russian market, these goods would be too expensive for their Russian customers. A certain amount of goods transported by Russian citizen in Russia returning from abroad is not subject to customs duties. Therefore, Chinese businessmen hire Russian citizens (possessing passport for travel abroad) to supply Chinese goods to Russia without any payment of customs duties to Russian customs official. On an average, each Russian citizen who is engaged in such trade called "suitcase trade" carries five items of same goods per trip. It is difficult for the customs officials to monitor such small shipment carried out by a network of teams consisting of five to ten members in each team between Heihe in China and Blagoveshchensk in Russia (Ryzhova, Ioffe, 2009).

In view of R. Lotspeich (2005), Russia and China despite being major trade partners, are not the main source of imports or main destination of exports to each other.

G. Dyer (2009) points out that due to the dumping of Russian steel products in Chinese market in 2009, China in response to such dumping imposed duties on imports of the Russian steel products and for the first time, the role of subsidies in lowering prices for imported goods was investigated by China.

Russia enacted new customs code in 2004 to simplify the procedure of customs declaration and collection, and amended its customs valuation practice in line with the provisions of the "WTO Agreement on Customs Valuation" (Foreign Market Access Report, 2010). In view of V. Voitenko (2005), informal trade activities make a case of tension between Russia and China despite some measures adopted by these two nations to mitigate this in 2004. This came in light in 2005, when several Chinese companies were caught by Russian law enforcement agencies in case of smuggling large stock of Chinese footwear into Russia. The Russian side holds that there will be heavy losses of tax revenue due to 'gray customs clearance'. In order to mitigate the problem of "gray customs clearance" Russian authorities have adopted some measures. The Russian Premier Mikhail Fradkov inked the "Pre-Shipment Inspections" on April 15, 2005. According to this regulation, all imports, if considered as "risky", would be inspected twice namely 'frontier clearance inspection' and 'pre-shipment inspection'. On June 3, 2005, Russian government decided to postpone the implementation of pre-shipment inspection. On September 16, 2005, the State Customs Committee of the Russian Federation announced that Russian customs would routinely supervise the import of daily necessities and strictly supervise the identities of importers. Apart from this, importers have to mention the types of goods to be imported in the customs declaration. On December 12, 2005, the Russian government authorized the Ministry of Economic Development and Trade to conduct reasonable additional inspection on "Suspicious Imports" (Foreign Market Access Report, 2006).

Since 1999, Russian citizens do not require Chinese visa to travel to Heihe in China, whereas Chinese citizen requires Russian visa to travel to Blagovshchensk in Russia. In 2006, for Russian citizens, Russia's customs authority limited the commercial trips to Heihe in China to one per month and carry-on luggage (up to 35 kg. per trip and with declared value up to 65,000 rubles) to Russian federation in order to curb gray customs practice in the border region (Ryzhova, Ioffe, 2009).

Customs risk management system taken as a measure under which there is a direct increase in the amount of duties paid by importers leads to increase in the cost of imported goods. The sign of such system in the internal rules and regulations in the form of letters, orders, and instructions of the Federal Customs Service (FCS) is found in the local customs offices in case of clearance of customs declarations. These regulations are critical in case of payment of duties and import VAT (Value Added Tax) which is calculated as a percentage of the declared value of the imported goods (product value and the freight and insurance costs). In these cases Customs can either agree with the declared value of imported goods or let it pass after the payment of regular

duties or disagree and initiate the investigation procedure in the matter of declared value of imported goods (Mikhailitchenko, Varshney, 2016).

In order to combat under-declaration of customs value, the Russian customs authority applies one of the two methods. These are (1) Internal assessment of import without releasing a public announcement, and (2) Issuing a notification to its trading partners. The internal import valuations are applied as reference prices for customs valuation or substituted for the invoice value of the imports (Foreign Market Access Report 2010). A. Mikhailitchenko and S. Varshney (2016) (Teaching at Faculty of California State University, Sacramento, USA) reveal that in the report of Russia Federal Customs Service (2016) “in 2015, customs control departments made 4,782 customs investigations among which 3,972 resulted in fines and penalties. The total amount of additionally charged and collected duties, penalties, and fines during that period was 12.7 billion roubles (US \$187 million), 24.5% higher than in 2014”. On June 10, 2006, Russia promulgated the notice on “Strengthening Control over Customs Values of the Commodities Listed under Chapters 42 and 43 of the Russian Federal Catalogue for Foreign Economic Activities”. According to the provisions of Chapters 42 and 43 of Harmonized Code (HS Code), the Russian customs shall exercise controls over the customs values of imported products of Chinese origin and shall charge specific duties ranging from US \$5 to US \$90 per kilogram on such imports from China. In 2007, customs valuation of Chinese goods was raised from US \$.2 to US \$4 per kilogram to no less than US \$3.5 per kilogram in Russia. The report reveals that such discriminatory measures were adopted without the publication of any official document and without prior notification to the Chinese side. These measures made a considerable negative effect on Russia-China trade volume (Foreign Market Access Report, 2010).

Recommendations

In order to improve understanding of businesspeople about the customs clearance system and its legal framework, Russia and China need to provide in this regard updated facts through education campaign with the help of media and trade related training institutions. In order to mitigate the problem of “Gray Customs System”, dumping and other unfair trade practices, Russia and China both should co-operate with each other through a joint operation by setting up committee on customs operations (Kumar, 2013).

Conclusion

“Gray customs system” is an illegal practice of making wrong customs declaration at the border in order to pay less customs duty than the official level of customs duty for under-declaring or misdeclaring goods. Due to this, there is a loss of revenue to the government coffer. Russia takes the gray customs system as a case of smuggling. Both nations, Russia and China, confront this problem experiencing a negative impact on their trade volume. Proper legislative regulations can make no space for intermediate agent involvement in customs declaration activities.

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KORUPCINĖS RUSIJOS FEDERACIJOS IR KINIJOS MUITINIŲ SISTEMOS PRAKTIKA

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Santrauka

Korupcinė muitinių sistema yra nelegali praktika, kai vežamos prekės kerta valstybių sienas be oficialios muitų sistemos pritarimo ir patikrinimo. Tokia praktika neigiamai veikia Rusijos Federacijos ir Kinijos ekonominius santykius, dėl to traktuojama kaip dvišalių ekonominių Rusijos Federacijos ir Kinijos santykių trukdis. Šiame kontekste šis straipsnis nagrinėja problemas, kurios kyla dėl korupcinės muitinių sistemos, nesiimant veiksmų jas spręsti.

Straipsnio tyrimo metodas – atvejo nagrinėjimas remiantis antriniais duomenimis, moksline literatūra ir ataskaitomis. Norint pakeisti verslininkų požiūrį į muitinių sistemą ir legalią tvarką, Rusijos Federacija ir Kinija turi verslininkus informuoti, įgyvendinti edukacinę programą, pasitelkusi medijas ir su prekyba susijusias valstybines institucijas, kad parodytų mokamų mokesčių naudą, lyginant su korumpuotu elgesiu. Siekdamas pakeisti korupcinę muitinių sistemą ir atsisakyti neteisingų prekybos įpročių, Rusijos Federacija ir Kinija turėtų kooperuotis ir bendromis pastangomis sukurti komitetą, kuris rūpintųsi muitinių atliekamu darbu. Korupcinė muitinių sistema yra nelegali praktika, kai pasienyje pasirašomos neteisingos muitų deklaracijos, siekiant mokėti mažiau mokesčių, negu oficialiai privaloma. Dėl to abiejų valstybių biudžetai praranda pinigų. Rusija į šią praktiką žvelgia kaip į kontrabandą. Abi valstybės – Rusija ir Kinija – susiduria su šia problema ir praranda lėšas, kurias galėtų gauti už įvežamas ir išvežamas prekes. Tinkamas teisinis reguliavimas gali sukurti aplinką, kurioje korumpuotų tarpininkų nebereikėtų.

PAGRINDINIAI ŽODŽIAI: *dvišalė sutartis, muitai, nelegali veikla, praktika.*

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