ANTI-CORRUPTION HELPDESK

PROVIDING ON-DEMAND RESEARCH TO HELP FIGHT CORRUPTION

SUPPLY-CHAIN CORRUPTION, CUSTOMS TRANSPARENCY AND CONSUMER PROTECTION

QUERY

What are the links between corruption, lack of transparency and customs? What are the best practices for customs transparency and consumer information? What steps can be taken to improve access to the information in question?

PURPOSE

We are working with other NGOs to prevent corruption-tainted products from passing through customs in order to protect consumers.

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1. Connections between corruption risks and customs transparency
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SUMMARY

Supply chains are susceptible to many different forms of corrupt practices and illicit behaviour, all of which inflict costs and harm to the wider society. Different strategies exist to address these risks, such as legislation, enhancing management procedures and pursuing due diligence. Yet all of these rely on transparency.

Customs is a possible link in the supply chains where transparency can be increased. This brief discusses the connections between customs transparency, corruption in supply chains and consumer protection before identifying best practices to increase the transparency of products passing through customs and best practices for how consumers can access more information. The final section focuses on next steps that the governments, businesses and civil society can make to increase the transparency of products passing through customs.

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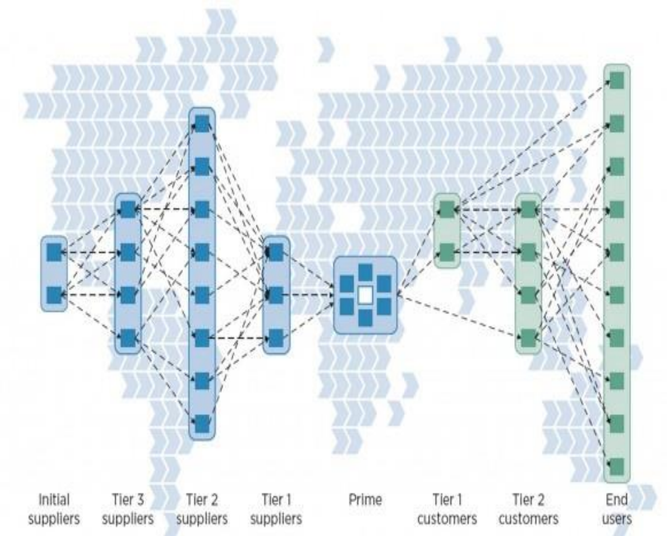
1 THE CONNECTIONS BETWEEN CORRUPTION, LACK OF TRANSPARENCY AND CUSTOMS

Corruption challenges in supply chains

Global business transactions work through intricate supply chains: “the persons, entities and infrastructure that transform materials and human capital into intermediate and finished products and services for customers and consumers” (Global Compact 2010, p. 7). Supply chains can often be vast networks, involving a multitude of actors –suppliers, assemblers, producers, distributors, retailers and, finally, consumers – operating across different jurisdictions (see diagram below).



Source: (IfM 2014)

Supply chains are susceptible to many different forms of corrupt practices and illicit behaviour, all of which inflict costs and harm to the wider society. These corruption risks include:

Human rights abuses and environmental damage

- Modern slavery can persist when businesses are not aware of certain practices within their supply chain (UK Government 2015). Estimates made by the Walk Free Foundation (2014) suggest that there are 35.8 million men, women and children trapped in modern slavery.
- The OECD also reports that corruption in supply chain facilitates human trafficking (OECD 2015).
- More general labour exploitation and mistreatment occurs in global supply chains, where workers have few rights and dire working conditions. Misconduct in the supply chains of some of the world’s major brands, such as the Rana Plaza factory collapse, has been well documented (CCC 2016).
- Opaque supply chains make it difficult to deal with the environmental risks of illicit activities. The United Nations Office on Drugs and Crime (UNODC), for example, suggests that the environmental costs from the production of counterfeit goods are understated (UNODC).

Organised crime and illicit trade

- Organised crime and illicit trade benefit from the vulnerabilities of global supply chains (OECD 2016). For example, the US government report that trade-based money laundering – the process of disguising criminal proceeds through trade to legitimise their illicit origins – is a particular vulnerability for global supply chains (ICE).
- It is estimated that annual trade-based money laundering exceeds billions of dollars and is growing each year (ICE).

Corruption

- Generally, billions of dollars are lost in supply chains due to different kinds of fraud, including physical and information theft, bribery, money laundering, kickbacks, fraudulent billing and various purchasing schemes (Global Compact 2010).
- Most companies suffer from corruption in supply chains. The Kroll Global Fraud report, based on a survey of 768 executives, found that 75 per cent of companies had fallen victim to an incident of fraud in the past year, a rise of 14 per cent in just three years, and that 69 per cent of companies had suffered a financial loss as a result of fraud during 2015 (Kroll 2015).
- PricewaterhouseCoopers’ analysis of 600 companies that had experienced supply chain disruptions shows that the companies’ average shareholder value plummeted when compared to

their peers, their stock prices experienced greater volatility, and they suffered sharp declines in return on sales and return on assets (PwC 2008, p. 5).

What is the potential impact on consumers of these risks?

Health risks

In 2007, for example, the government of Panama unknowingly used diethylene glycol falsely labelled as glycerine to make 260,000 bottle of cough syrup. The origin of the counterfeit chemicals was traced from Panama through trading companies in Spain to a source near the Yangtze Delta in China. As the poisonous substance travelled from China, a certificate attesting to the purity of the shipment was repeatedly altered. One hundred people died in Panama from ingesting the tampered cough syrup (Picard & Alvarenga 2012, p. 58).

Misleading product information

In 2013, DNA tests revealed that some meat products labelled as beef from a well-known supplier contained a considerable proportion of undeclared horsemeat or pork. Blind spots in the supply chain were at fault as, unknown to the end-producers, the meat was suddenly being supplied by different providers than previously. Investigations revealed that the horsemeat sometimes took a complicated route through sub-suppliers across several countries (Zurich Risk Nexus 2015, p. 5).

Lack of information to make choices

Risks to consumers are posed because the level of information that businesses have about their supply chain is not sufficient; often businesses are unable to work out what is going on beyond first-tier suppliers (Picard & Alvarenga 2012, p. 57). Indeed, the majority of companies that do business globally suffer from a lack of supply chain visibility:

- The 2014 edition of the Business Continuity Institute's annual survey of 525 companies based in 71 countries found that roughly 75 per cent of companies lacked full supply chain transparency and only about a quarter coordinated and reported supply chain disruptions across the enterprise (Zurich Risk Nexus 2015).
- A study conduct by Stanford's Graduate School of Business revealed that while most respondent companies have social and environmental systems in place for internal operations, less than a third have similar structures to monitor the practices of their immediate and extended supplier network (Linich 2014).

How does a lack of transparency in customs contribute to these risks?

Different strategies exist to address these risks, such as new legislation, enhancing management procedures, and pursuing due diligence. Yet *all of these rely on transparency.* Increasing transparency is about bringing to light information that can document the behaviour of different actors within each tier of a supply chain in order to allocate responsibility and agency at all levels (CCC 2016, p. 2). Transparency, therefore, provides the foundation for strategic action against corruption and human rights violations

Customs is a possible link in the supply chains where transparency can be increased. In particular, customs can be an important location where critical information can come to light to enable:

- public authorities to protect against misconduct and illicit behaviour
- consumers to know where, who and under what conditions the product was made that they want to buy
- consumer and human rights organisations to verify due diligence of companies and identify malpractice

Transparency in the customs sector can refer to two aspects of a customs regime. Generally, transparency relates to the extent to which information about customs' operations and procedures is available. The WTO Glossary defines transparency in customs as "the degree to which trade policies and practices, and the process by which they are established, are open and predictable" (WCO 2016). It includes a number of interrelated actions, such as[1]:

- Customs laws, regulations, procedures and administrative guidelines should be made public, be easily accessible and applied in a uniform and consistent manner.
- The basis upon which discretionary powers can be exercised should be clearly defined.
- Appeal and administrative review mechanisms should be established to provide a mechanism for clients to challenge or seek review of customs decisions.

Using a similar definition, the World Economic Forum has developed a Customs Transparency Index for which transparency encapsulates the overall transparency of the procedures and regulations related to customs clearance.[2] Transparency refers, therefore, among other things, to: the extent to which the laws and regulations are published in an official journal; changes to regulations can be commented on prior to implementation; and that there is a public and regularly updated website available with a full description of all customs procedures (WEF 2014).

Corrupt actors benefit from a lack of this kind of transparency. Hence, the link between this kind of transparency and corruption is quite clear: the less transparent that customs are, the higher the corruption risks. Accordingly, the World Customs Organization's (WCO) Arusha Declaration on Integrity in Customs (revised 2003) aims at enhancing the efficiency of its member states' administrations to help eliminate the risks and opportunities for corruption.

Less commonly, transparency in customs can also refer to the availability of information about products passing through customs; in other words, the extent of information about products (for example, identity and origin of product) is available via a publicly accessible database. A review of the literature suggests that this kind of transparency is less commonly discussed as a source of corruption. In fact, it is difficult to find an evidenced-based link between this kind of transparency and the risk of corruption. There seems to be little research on the effects of databases and customs and its possible consequence for addressing corruption. There are no legal standards about this kind of transparency and it is not an integrated element of trade agreements or international conventions.

2 BEST PRACTICES IN CUSTOMS TRANSPARENCY

Even though few policy documents discuss transparent databases at customs as a mechanism to reduce corruption in supply chains, some civil society groups advocate for customs databases as part of a general model of transparency for supply chains (see CCC 2016). There are also best practices which do try to increase the transparency of products passing through customs and best practices for how consumers can access more information. This section identifies some of these best practices.

Best customs practices to generate transparency of product information

United States

The US government can be said to lead the way in providing some kind of transparency of products passing customs through setting up the Interactive Tariff and Trade DataWeb, which provides US international trade statistics and US tariff data to the public full-time and free of charge. The available data relates to the customs value, first unit of quantity, second unit of quantity, landed duty-paid value, dutiable value, calculated duties and import charges for all kinds of commodity imports.[3] This data has been made available as part of a broader initiative of transparent government instigated by the president. The information available is limited, however. It is unlikely the data allows for the identification of the

[1] Best practices in terms of the integrity of procedures and operations can be found in the World Custom Organization's Compendium of Best Practices (WCO 2007).

[2] This indicator is based on seven survey questions taken from the GEA Customs Capabilities Reports, evaluating World Economic Forum's calculations based on data from the Global Express Association. http://www3.weforum.org/docs/WEF_GlobalEnablingTrade_Report_2014.pdf

[3] https://dataweb.usitc.gov/scripts/user_set.asp

manufacturer of certain products; rather it is mostly designed to assess trade patterns.

The US government has also developed a specialized computer system called the Data Analysis & Research for Trade Transparency System (DARTTS) that is managed by the Trade Transparency Unit (TTU) within the US Immigration and Customs Enforcement (ICE).[4] Established in 2004, this initiative is "designed to protect the integrity and security of the US economy by targeting and eliminating systemic vulnerabilities in commercial trade and the financial and transportation sectors susceptible to exploitation by criminal and terrorist organizations" (ICE).

The database is based on the idea that the best way to analyse and investigate suspect trade-based activity is to have systems in place that can monitor specific imports and exports to and from given countries. Using automated analysis tools, the TTU examines the voluminous data to seek out anomalous patterns in international trade that could reveal financial irregularities indicative of trade-based money laundering, customs fraud, contraband smuggling and even tax evasion. The raw data, sourced from both US and foreign sources, contain information on the product ID, the vendor and receiver. However, data from the DARTTS is not publicly available (ICE).

European Union

There is a trend to make customs information electronic across the EU, but this is more about customs harmonisation and facilitation rather than transparency and anti-corruption. The Union Customs Code (UCC) is a 2016 update to customs legislation across the EU, and will introduce a number of revisions to existing requirements.

The UCC was enacted to modernise and simplify trade into and within the EU. It also aims for a harmonisation of customs procedures across the member states. In particular, the UCC will make changes to customs procedures and authorisations, modifications to existing electronic procedures and introduce a new digital processes, including the Proof of Union Status.

The key principle of the UCC is that all customs declarations should be electronic. However, there is no mention of public databases within the new code.

Examples of how technology could be used to generate more information for consumers

Technological innovation is providing unprecedented visibility into supply chains. Companies and civil society groups must harness this technology, and fortunately there are some examples of best practice which lead the way.

These practices could be adapted to help customs authorities generate data to increase transparency. For example, on a general level, product-tracking technology means that processes in a supply chain are digitally recorded so that any licit or illicit activity will leave digital footprints that can be made nearly impossible to tamper with or erase (Picard & Alvarenga 2012, p. 60).

Examples include:

- Product labelling has been transformed by microscopic electronic devices, genetic markers for agricultural products and a new generation of bar codes that can be read with standard mobile phones. Radio-frequency identification tags, well established for inventory management and other purposes, are becoming smaller, cheaper and more flexible. A new generation of tags – such as Hitachi's sand-grain-size mu-chip – can be used, for instance, to label jewellery inconspicuously (New 2010).
- Retail giants, such as Tesco and Walmart have used an innovative service from UK supply chain services firm Historic Futures. The system enables textile suppliers to collect and submit information about cotton products, with a focus on ensuring that products are not manufactured from Uzbek cotton that was harvested with child labour. These data are used internally, allowing the retailers to be more confident in making ethical claims about their products (New 2010).

[4] https://www.ice.gov/trade-transparency

- Swiss textile company, Switcher, labels each of its products with a code that consumers can enter at the website Respect-code.org to retrieve information about the firms and factories along the supply chain, as well as from ISO 14000 environmental-performance certificates (New 2010).
- The integrity of the product could be provided not by the supply chain but by the product itself. For example, Coats Textiles in the United Kingdom has developed a "digital thread" with a security code embedded in the thread (Picard & Alvarenga 2012, p. 60).
- New technology means that if a company does not make transparent information available to their customers, others will provide it. GoodGuide provides a mobile phone application to get information on a product's health, environmental and social impacts. If it transpires, for example, a washing powder has a low environmental score, GoodGuide will propose an environmentally friendly alternative (Picard & Alvarenga 2012, p. 60).

3 STEPS TO IMPROVE CONSUMER INFORMATION

This section focuses on the broader public policy angle of the issue and on the best practices of governments, businesses and civil society in generating more information that can be used in the public domain about products passing through customs. To this end it provides best practices in three areas: regulation, civil society advocacy and technology.

Regulation

Regulations on supply chains differ across jurisdictions and vary in the kind of due diligence and reporting obligations they demand from companies. Two acts lead the way in explicitly demanding action against human rights violations:

- The California Transparency in Supply Chains Act means that since 2012 companies in California with business operations worth more than US$100 million annually disclose their efforts, if any, to ensure that their supply chains are free from slavery and human trafficking (CorA 2015).
- In the UK, the government has introduced a provision in the Modern Slavery Act 2015 which requires certain businesses to produce a statement setting out the steps they have taken to ensure there is no modern slavery in their own business and their supply chains. If an organisation has taken no steps to do this, their statement should say so. One key purpose of this measure is to prevent modern slavery in organisations and their supply chains. A means to achieve this is to increase transparency by ensuring the public, consumers, employees and investors know what steps an organisation is taking to tackle modern slavery (UK Government 2015).

Other regulation can be sector-based:

- The Dodd Frank Act (paragraph 1502) in the USA means that since January 2013 all companies listed on a US stock exchange must prove and make publicly accessible the origin of certain conflict minerals, such as tin, tantalum (from coltan ore), tungsten and gold. The corresponding draft of an EU Regulation does not, however, contain any binding regulations concerning due diligence. Furthermore, the proposed regulation is intended to be limited to those companies which market conflict minerals directly (CorA 2015).
- The EU Timber Regulation, which came into force on 3 March 2013, requires all companies importing timber or wood products to the EU for the first time to adhere to particular due diligence obligations and to document that the wood and the traded products originate from legal logging sources. Timber merchants from within the EU must also be able to verify the merchant from whom they bought the timber or wood products, and to whom they have sold these on to, along the entire supply chain. This information must be conserved for five years (CorA 2015).
- In September 2014, the Council of the European Union adopted the directive on disclosure of non-financial and diversity information by certain large companies. This means by 2017, environmental, social and employee-related reporting will be mandatory for all companies based in the EU with more than 500 employees. While detailed regulations will be the responsibility of member states it is clear it will be the organisations'

responsibility to identify risks and deficiencies in their supply chain and to prevent potential violations against the companies own sustainability goals. The EU directive encourages organisations to report against well-established and recognised frameworks such as the Global Reporting Initiative, the UN Global Compact, or ILO Tripartite Declaration.

Increasing transparency in global supply chains is in line with international principles for fair and ethical business practices.

- The UN Global Compact, the UN's corporate sustainability initiative, has enshrined the principles of the UN Convention against Corruption (2005) into an anti-corruption instrument for corporations: the 10th Principle. This principle serves as an inspiration for companies adopting or reviewing internal anti-corruption policies, strategies and measures. The 10th Principle commits UN Global Compact Participants in particular not only to avoid corruption but to develop policies against it and to join government bodies, UN agencies and civil society to realise a more transparent global economy (Global Compact 2010).
- UN Guiding Principles on Business and Human Rights (2011) are a set of guidelines for states and companies to prevent, address and remedy human rights abuses committed in business operations. According to UN Guiding Principles, governments where brands and retailers are registered should encourage and, where appropriate, require business enterprises to communicate how they are addressing their effects on human rights. Governments where clothing is produced have a duty to make sure systems are in place to protect human rights.

Civil society advocacy

Many civil society organisations (CSOs) advocate for greater supply-chain transparency. One of the leading organisations is the Clean Clothes Campaign (CCC), which is dedicated to improving working conditions and supporting the empowerment of workers in the global garment and sportswear industries. CCC's position paper on transparency provides a transparency model for the production of clothes and garments and could be used by other CSOs in their pursuit of transparency in other sectors and industries. To generate greater transparency in supply chains, the CCC calls for (CCC 2016):

governments in consumer countries to:

- require companies to report, on an annual basis, on the effectiveness of their responses to address the adverse effects of their activities on human rights, including in their supply chain
- require companies disclose the names, addresses and contact details of their supplier facilities, subcontracted suppliers (tiers 2 and 3) and labour agents managing home-working facilities, at least on an annual basis
- require products sold within the jurisdiction to be labelled to include a product code linked to a website that will provide information including supply chain traceability, employment statistics at the facility, economic information of the facility, pricing information and product information
- operate a standardised shipping database at an EU level which stores records for all exports and imports of cargo entering European ports, noting the class of cargo, the trading names of the companies involved, the point of origin, the value as an FOB price and quantity, and the ultimate destination and recipient, and make this available by access request

garment brands and retailers to:

- report annually on the effects of their activities throughout the supply chain on human rights, including explicit reporting on due diligence processes, policies, and on the effectiveness of their responses to address the adverse effects of their activities, using measurable indicators
- disclose the names, addresses and contact details of supplier facilities, subcontracted suppliers and labour agents managing home-working facilities, on an annual basis or more frequently
- publish social audit reports
- work alongside key stakeholders to report regularly on the effects to human rights and work towards protection and remedy where appropriate

suppliers and manufacturers to:

- disclose a buyer list, on an annual basis or more frequently
- disclose the names, addresses and contact details of subcontractor facilities and labour agents managing home-working contracts, on an annual basis or more frequently
- publish social audit reports in the public domain, including information on: number of workers in each department and grade, number of migrant and juvenile workers, percentage turnover of workers, number of grievances filed by workers, number of accidents causing injuries in the recent period
- appoint an individual at top level management responsible for social performance and publish the contact information for this individual

governments in producing countries to:

- require suppliers report on an annual basis on effectiveness of their responses to address the adverse effects of their activities on human rights, supply chain traceability, employment statistics, economic information and social audit reports
- publish a database of findings of labour inspectorates showing compliance with labour rights as per local law, naming suppliers that have repeatedly failed to meet standards over periods of six months or more

Businesses

The damage to a company's reputation in particular can dramatically affect the value of the brand, relationships with business partners and share prices (Global Compact 2010). Shareholders, consumers, civil society and government have growing expectations that company executives be knowledgeable and accountable for what is happening in their extended supply chains (Picard & Alvarenga 2012, p. 57).

Evidence suggests supply chain integrity is increasingly at the forefront of supply chain managers' priorities. A 2008 PwC study surveyed 59 global consumer and retail companies and found that large brand-owners were particularly sensitive to both the reputational and operational risk of supply chains (Picard & Alvarenga 2012, p. 58).

Part of the burden for greater transparency in supply chains is carried by companies. There are many practical guides available to help businesses generate more information on their supply chains through implementing certain internal management procedures, such as inventory management, procurement procedures, recordkeeping, reporting practices, inspection and testing protocols. These guides include:

- UN Global Compact's Fighting Corruption in the Supply Chain: A Guide for Customers and Suppliers (2010)
- OECD Guidelines for Multinational Enterprises (2011)
- Deloitte University's The Path to Supply Chain Transparency (Linich 2014)
- Zurich Risk Nexus's Supply Chain Integrity (Zurich Risk Nexus 2015)

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