



INSIGHT

THE EUROPEAN UNION CUSTOMS ADMINISTRATION AND THE FIGHT AGAINST FRAUD

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ABSTRACT: The EU customs management system is based on uniform legislation that is implemented on a decentralised basis by the Member States. In theory, the Customs Union should operate as if it were one single administration. In practice, the non-harmonised and uncoordinated application of the common customs legislation disrupts the proper functioning of the Customs Union. The objective of this *Insight* is to analyse and assess the current model of customs administration in the European Union, focusing on the shortcomings of the system and its consequences in the form of customs fraud. The *Insight* uses as a case study the undervaluation fraud case concerning textile and shoes imported from China via the United Kingdom between 2011 and 2017, still pending before the Court of Justice of the European Union.

KEYWORDS: Customs Union – European Union – customs fraud – undervaluation fraud – United Kingdom – case C-213/19.

I. INTRODUCTION

In the Agenda for Europe presented on 16 July 2019 by Ursula von der Leyen in her capacity as a candidate for President of the European Commission, she raised the need “to take the Customs Union to the next level, equipping it with a stronger framework that will allow us to better protect our citizens and our single market”.¹ To this end, she proposed “a bold package for an integrated European approach to reinforce customs risk management and support effective controls by the Member States”.

In line with the political guidelines established by Ursula von der Leyen, the three main EU institutions responsible for customs administration – the Directorate-General for Taxation and Customs Union (DG Taxud), the Directorate-General for Budget (DG

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¹ U. VON DER LEYEN, *A Union that strives for more. My agenda for Europe. Political guidelines for the next European Commission 2019-2024*, Luxembourg: Publications Office of the European Union, 2019, op.europa.eu.



Budget) and the European Anti-Fraud Office (OLAF) – have drawn up their respective “Strategic Plan 2020-2024”.² These plans translate the priorities set out in the political agenda of the President into concrete and operational strategies. With regard to the commitment “to take the Customs Union to the next level”, the three institutions agree on a common strategy for modernising customs administration and strengthening control systems with the priority objective of fighting fraud.

Bearing in mind the topicality and relevance of the issue, the goal of the article is to analyse and assess the current state of play regarding the EU customs administration, focusing on the shortcomings of the system and its consequences in the form of customs fraud. The starting hypothesis is that the current EU customs management model, based on a non-harmonised and decentralised implementation of the EU common customs legislation and guidelines, is not efficient in effectively tackling the problem of customs fraud. To answer this hypothesis, in addition to analysing the general operating framework of the EU customs administration, the article focuses on studying one of the most relevant cases of undervaluation fraud in the 2010s as empirical evidence of the shortcoming of the system: the case of undervaluation fraud in textile and shoes imported from China via the United Kingdom, still pending before the CJEU.

The *Insight* is structured in three sections. In the first section, the main features of the EU Customs Union organisation and management model are analysed. The following section examines the undervaluation fraud case of textile and footwear imports from China to the United Kingdom as an empirical example of the shortcomings of the system. Finally, the conclusions provide a summary of the main findings of the investigation, and trace an outline of the improvement margins of the EU customs management system.

II. THE ORGANISATION AND MANAGEMENT OF THE EU CUSTOMS UNIONS

The development of the Customs Union has been one of the pillars on which the European integration project has been based since the elimination of domestic tariffs and the establishment of the common external customs tariff, which came into effect on 1 July 1968 for countries within the European Economic Community (EEC). Over time, the EEC developed into the European Union and the Customs Union has been consolidated. This process of integration makes the EU a unique example in this field not only due to the magnitude and the speed with which Member States handed over part of their sovereignty but also for its political and economic implications.³ As described by the European Commission, “the European Union’s Customs Union is one of the most successful examples of European integration and European policy. It has served as a stable foun-

² Strategic plans 2020-2024 published by DG Budget, DG Taxud and OLAF, ec.europa.eu.

³ H.M. WOLFFGANG, *What makes the EU Customs Union unique?*, in I. MUSCAT (ed.), *The EU customs union @ 50. Concept to Continuum*, Malta: Malta Customs, 2018, p. 18 *et seq.*, available at ec.europa.eu.

dation for economic integration and growth in Europe for over four decades".⁴ Nowadays, the Customs Union is one of the EU's main exclusive competences.⁵

In addition to being one of the core policies of the European Union, it is an essential element for ensuring the free movement of goods and the functioning of the internal market within the borders of the EU.⁶ At the same time, it also has an important security and safety component, protecting EU trade and citizens.

The TFEU establishes the general legal framework for the Customs Union, the internal market and the free movement of goods within the Union.⁷ With regard to the free movement of goods, Art. 28 TFEU provides that "the Union shall comprise a Customs Union which shall cover all trade in goods and which shall involve the prohibition between Member States of customs duties on imports and exports and of all charges having equivalent effect, and the adoption of a common customs tariff in their relations with third countries".

It is therefore necessary to distinguish two dimensions when analysing the EU Customs Union: external and internal. Starting with the external dimension of the Customs Union, Member States apply uniform rules and a common customs tariff in trade relations with third countries. Internally, and in order to ensure the free movement of goods within the Union, no customs duties and controls apply in trade between Member States.⁸ Both levels are directly interconnected as, once the imported goods have crossed the "common customs barrier", they can move freely throughout the territory of the Union. Therefore, the control of the customs borders is essential to ensure the proper functioning of the internal market. Moreover, customs authorities are "the guardians" of issues such as protection against counterfeiting, piracy and other intellectual property rights violations; control of drug precursors; customs controls on safety, health and environment; the management of customs laboratories; the movement and control of cultural goods; baggage controls; cash controls; and the creation of European Land Frontier, Ports and Airports contact groups.⁹

When analysing the EU customs issue it is also essential to consider the fiscal and budgetary side of the question. The collection of customs duties is the principal source of traditional own resources of the EU budget.¹⁰ In the first two decades of the 21st cen-

⁴ Communication COM (2012) 791 final of 12 December 2012 from the Commission on the State of Customs Union.

⁵ Art. 3 TFEU.

⁶ For further information on the legal framework and objectives of the Customs Union, see T. LYONS, *EU Customs Law*, Oxford: Oxford University Press, 2018, pp. 37-64.

⁷ Arts 26-37 TFEU.

⁸ Indeed, some customs procedures (e.g. transit) require the monitoring and control of goods from one customs office to another where the goods are cleared.

⁹ For further information on the scope and goals of customs control, see European Commission, *Customs Controls*, ec.europa.eu.

¹⁰ Council Decision 2014/335 of 26 May 2014 on the system of own resources of the European Union.

tury, revenues from customs duties were around 12-15 per cent of the EU's annual budgets.¹¹ Variations in customs revenues, among others, determine the final amount of contributions based on gross national income (GNI) to be made by the Member States in order to cover the budget. Moreover, import controls have an impact on VAT collection, which mainly affects the budgets of the Member States but also the EU budget that is partly drawn from this source of revenue.

DG Taxud, DG Budget and OLAF are the three main EU institutions involved in the administration of the Customs Union. The legal services of the European Commission also intervene when necessary. In sum, the DG Taxud mission is to study and develop the European Commission's customs policies and strategies.¹² The DG Budget is responsible for ensuring the proper application of the European Commission's customs policies and strategies, monitoring and inspecting their implementation.¹³ The European Anti-Fraud Office (OLAF) is responsible for investigating fraud against the European budget and for drawing up the European Commission's anti-fraud policies.¹⁴

On the one hand, the European institutions propose and legislate on customs matters, laying down rules and establishing a common customs tariff.¹⁵ The application and administrative enforcement of this legislation, on the other hand, is the responsibility of the Member States. The customs authorities of the Member States are responsible for administering the customs procedure and collecting the own resources for customs duties.¹⁶ Member States currently retain 20 per cent of the traditional own resources to cover their collection costs. In the field of customs the European Commission is responsible for several issues that include inspecting, auditing and monitoring the customs

¹¹ In previous years, the proportion of revenues from customs duties was even higher, but several agreements with third countries ended up in a reciprocal 0-duty rate, reducing the proportion of customs revenues. The budget statistics are available at European Commission, *EU expenditure and revenue 2014-2020*, ec.europa.eu.

¹² For further information on the mission statement and strategic goals of DG Taxud, see ec.europa.eu.

¹³ For further information on the mission and responsibilities of DG Budget, see European Commission, *Mission Statement and Strategic Goals – European Commission's Directorate General for Taxation and the Customs Union*, ec.europa.eu.

¹⁴ The OLAF was established by the Commission Decision of 28 April 1999 establishing the European Anti-fraud Office (OLAF) in order to carry out external administrative investigations for the purpose of strengthening the fight against fraud, corruption and any other illegal activity affecting the financial interest of the European Union. For further information on the mission and activities of the OLAF, *What We Do*, ec.europa.eu.

¹⁵ The Union Customs Code is the basic body of legislation governing customs management. See Regulation (EU) 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code.

¹⁶ The procedure for the management and collection of traditional own resources is laid down in, Council Regulation (EU, Euratom) 609/2014 of 26 May 2014 on the methods and procedure for making available the traditional own resources.

administration of the Member States.¹⁷ Through these prerogatives of control and inspection, the Commission assesses the compliance of the Member States with the relevant customs legislation and the capability of their systems to protect the financial interests of the European Union.¹⁸ All the activities put in place by the Commission and the Member States are aimed at ensuring the harmonised, standardised and coordinated implementation of the common customs legislation throughout EU. This eventually ensures the equivalent level playing field of customs control across the EU territory.

The European Commission inspects the customs administrations of each Member State to verify their compliance with the EU legal provisions and the application of a uniform and solid approach to performing customs controls. To this end, it draws up an annual plan, which includes on-the-spot inspections. The Commission analyses the entire administrative process carried out by the customs administrations from the lodging/receipt of the declaration to the clearance and post-clearance checks of the goods, together with accounting procedures and the management of accounts.¹⁹

The imported goods must first pass through the filter of prohibitions and restrictions that the EU has established to protect the internal market, for example in the areas of health, environment or intellectual property rights.²⁰ Having passed this first requirement, customs administrations put in place their risk assessment to detect cases of fraud and/or irregularities filtering the huge amount of imports arriving daily at the European Union's borders and harbours. These warning systems verify the accuracy, integrity and validity of the information provided in the customs declarations, by assessing and comparing factors such as the origin, the customs value and the tariff classification of the imported goods.

At this point, it should be recalled that, currently, there is not a single EU-wide risk assessment, management and control system for all Member States.²¹ Each customs administration applies its own risk assessment and management system. They do not even share the same IT system. This lack of harmonisation of technical means is a

¹⁷ On the distribution of competences and the objectives of the European Commission in the field of customs, see European Commission, *The EU Customs Union: Protecting the citizen and facilitating trade*, Luxembourg: Publications Office of the European Union, 2014, available at op.europa.eu.

¹⁸ The mission of customs authorities is set out in the Art. 3 of the Union Customs Code.

¹⁹ The provisions concerning control and supervision of own resources are provided in Council Regulation (EU, Euratom) 608/2014 of 26 May 2014, which lays down implementing measures for the system of own resources of the European Union.

²⁰ For a full list, see European Commission, *P & R List of EU bans and Restrictions for Customs*, June 2018, ec.europa.eu.

²¹ On the lack of harmonisation in customs management and its consequences for the governance of the Customs Union, see K. LIMBACH, *Uniformity of Customs Administration in the European Union*, Oxford: Hart Publishing, 2015.

weakness and sometimes an obstacle to the exchange of information and the coordination of a common strategy amongst administrations.²²

Although origin and tariff classification are substantial factors in the determination of the customs debt, the most sensitive element of control and verification is the customs value declared at import.²³ Fraudsters tend to under declare the value of the goods when lodging their customs declaration thus affecting severely the collection of customs duties and VAT.²⁴ To avoid this fraudulent practice, Member States put in place several risk criteria to tackle undervalued consignments. However, in the same way as in other policy areas, the criteria and standards of risk assessment on the valuation and effectiveness of control systems differ amongst the various customs administrations. This lack of harmonisation results in dysfunctions and facilitates fraudulent practices aimed at tax avoidance.

Making use of an analogy, the current EU customs control model is as a "shield" made of different materials. Depending on where it is struck, the shield is more or less resistant. This fragmented "shield" provides fraudulent traders with a useful tool for choosing the place of import for unlawful purposes, diverting their consignments to Member States perceived to be less effective in their control strategy.²⁵

The next section analyses the case of undervaluation fraud in textile and shoes imports from China to the United Kingdom between 2011 and 2017, still pending before the CJEU. This case study is an empirical example of a place of importation chosen for circumvention purposes, highlighting the *modus operandi* of "rogue" traders and their impact on the governance of the Customs Union and the EU budget.

III. THE UNDERVALUATION FRAUD CASE OF TEXTILE AND FOOTWEAR IMPORTS FROM CHINA TO THE UNITED KINGDOM

In relation to customs, OLAF produces risk profiles identifying the goods that have the greatest potential for fraud. These fraud warnings are communicated to the customs

²² To improve cooperation and interconnection in the field of customs, the European institutions have introduced the Customs Programme. One of the objectives of the programme is to develop common software for all customs authorities. For more information, see Report from the Commission to the European Parliament and the Council on the IT Strategy for Customs COM (2018) 178 final of 11 April 2018. See also, European Parliament, *Workshop on Strengthening competitiveness of the internal market by developing the EU Customs Union and governance*, May 2019, www.europarl.europa.eu.

²³ The method of customs valuation is set out in Commission Implementing Decision (EU, Euratom) 195/2018 of 8 February 2014 establishing the form for reporting on fraud and irregularities affecting entitlements to traditional own resources and on inspections relating to traditional own resources pursuant to Council Regulation (EU, Euratom) No 608/2014.

²⁴ On the types of customs fraud and the customs tax gap, see Directorate General for Internal Policies of the Union, *Study on Protection of EU financial interest on customs and VAT: cooperation of national tax and customs authorities to prevent fraud* of 27 March 2019, PE 636.470, pp. 28-53.

²⁵ European Court of Auditors, *Special report 19/2017, Import procedures: weaknesses in the legal framework and an ineffective implementation impact the EU's financial interests*, pp. 14-24.

authorities of the Member States in order to implement preventive measures to safeguard the financial interests of the European Union.

Since 2007, OLAF has stressed risks of fraud relating to the imports of textile and footwear originating from China. Beside the warnings, the European Commission monitored and carefully inspected the risk control procedures applied by the Member States customs administrations on this group of products.²⁶

The outcome of investigations carried out by OLAF and those conducted by the Commission within the framework of own resources management, found that fraudsters systematically targeted the United Kingdom because it was not putting in place effective customs controls.²⁷ Among other questions, the United Kingdom was lacking a forceful control strategy to tackle undervalued imports and was not applying all the safeguard measures envisaged in the customs legislation to protect the financial interests of the EU (e.g. requesting a guarantee for the release of goods in order to cover a potential duty loss).²⁸ The European Court of Auditors underlined that this laxity gave rise to a “traffic diversion”: since 2012 the volume of imports of Chinese textiles and footwear in the United Kingdom had been increasing, while it was decreasing in other Member States.²⁹ This increase mainly resulted from imports whose declared values were significantly lower than the risk threshold values applied by OLAF.

In view of the multiple requests received from the European institutions, the United Kingdom launched the so-called Operation Swift Arrow in 2017, which introduced measures to correct deficiencies in the control of these products.³⁰ This new scenario led to a readjustment of traffic at the European level, with a shift from the United Kingdom to other Member States that were considered “more attractive” by fraudsters.³¹

The European Commission calculated that the infringement of EU legislation by the United Kingdom resulted in losses to the EU budget amounting to 2.7 billion euros (minus collection costs) between November 2011 and December 2017, without including losses in VAT collection. The European Commission held the United Kingdom liable for traditional own resources losses, urging it to make that amount available to the EU budget.

²⁶ OLAF, *The OLAF report 2016*, Luxembourg: Publications Office of the European Union, 2017, pp.19-20, ec.europa.eu.

²⁷ OLAF, *Report from the Commission to the European Parliament and the Council 30th Annual Report on the protection of the European Union's financial interests. Fight against fraud 2018*, Luxembourg: Office of the European Union, 2020, p. 34, op.europa.eu.

²⁸ OLAF, *The OLAF report 2017*, Luxembourg: Publications Office of the European Union, 2018, pp. 26-27, ec.europa.eu.

²⁹ ECA Special Report 19/2017, cit., p. 40.

³⁰ European Commission, *Annual Management and Performance Report for the EU Budget. Financial year 2017*, Luxembourg: Publications Office of the European Union, 2018, pp. 92-93, op.europa.eu.

³¹ OLAF, *The OLAF report 2018*, Luxembourg: Publications Office of the European Union, 2019, pp. 31-32, ec.europa.eu.

In the face of the United Kingdom's refusal to repay that amount, on 8 March 2018 the European Commission decided to start a formal infringement procedure by sending the United Kingdom a Letter of Formal Notice under Art. 258 TFEU.³² On 7 March 2019, the Commission referred its infringement case against the United Kingdom to the CJEU.³³ The judicial dispute between the European Commission and the United Kingdom to determine the liabilities and financial consequences of the case is still pending resolution.

In addition to affecting the budget, this kind of fraudulent practices also has other consequences for the governance of the EU. Among others, the following consequences should be highlighted:

a) Loss of EU traditional own resources. Customs fraud directly affects the financial interests of the EU. Firstly, it leads to losses in the collection of customs duties. Secondly, it also has a negative impact on VAT collection, affecting Member States' budgets and, to a lesser extent, the EU Budget. Own resources losses are offset by Member States' GNI-based contributions.

b) A source of friction among Member States. As can be seen in the present case, the current decentralised management model allows for both fair and unfair competition amongst Member States, which compete to attract more commercial traffic to their countries, benefiting from the resulting economic returns.³⁴ This framework of competition is giving rise to concern amongst EU Member States, particularly those which consider themselves to be penalised for carrying out a more efficient customs management.³⁵ It is worth recalling that lower revenues resulting from less efficient customs management by a Member State is compensated by all Member States through their GNI-based contribution.

c) Distortion of the internal market and loss of competitiveness of European industry. The irregular or fraudulent entry of goods affects the proper functioning of the internal market throughout the EU. In fact, after crossing the EU customs barriers, the movement of these goods is free throughout the territory of the Union. In the case of footwear and textiles during the period investigated by OLAF, the goods entered the United Kingdom but the majority of them were sold in other Member States, mainly on the black market.³⁶ Fraudulent imports alter free competition and constitute unfair

³² For further information on the infringement procedure, see EU Budget: Commission takes further action to ensure the United Kingdom makes customs duties fallen due, available to the EU budget, in European Commission Press Corner of 24 September 2018.

³³ Court of Justice, case C-213/19, *Commission v. United Kingdom (Lutte contre la fraude à la sous-évaluation)*, pending.

³⁴ The investigation of OLAF also revealed that the increase in imports favoured United Kingdom VAT revenue to the detriment of other Member States such as Spain, Germany and Italy. OLAF, *The OLAF report 2018*, cit., p. 26.

³⁵ ECA Special Report 19/2017, cit., pp. 21-22.

³⁶ OLAF, *The OLAF report 2016*, cit., p. 13.

trade to the detriment of those operators respecting the legislation and the market rules, thus creating an economic distortion worldwide.

d) Threat to the security of European consumers. The absence of effective controls at European borders to ensure compliance with the quality and safety standards set by the EU is a threat to the protection of European consumers.

IV. CONCLUSIONS

The current EU customs management model is an example of the dysfunctions resulting from the non-harmonised and decentralised implementation of the EU common legislation and guidelines. Although, theoretically, the entire customs territory should operate as a single customs administration, in practice, the degree of stringency of customs controls differs amongst the customs administrations EU-wide. This lack of correlation between legislation, guidelines and implementation results in a “fragmented customs shield” where fraudulent operators exploit the loopholes. This scenario gives fraudsters the possibility of choosing the place of importation in accordance with the perceived weakness of the system targeted, thus diverting their imports accordingly.

The goal is to take steps to enhance the convergence of risk management and controls performed by the customs administrations in order to tackle effectively the fraudsters and facilitate the legitimate trade.³⁷ A more efficient and effective customs control system will reduce fraudulent practices, will contribute to increasing the collection of EU traditional own resources and will decrease the share of GNI-based contributions. Similarly, more refined external customs management would lead to a better functioning of the internal market, strengthening the competitiveness of European industry and enhancing the protection of European consumers.³⁸

The principle of subsidiarity is not an obstacle to further convergence, including the possibility of creating a European Customs Agency.³⁹ Recently, the former Director General of OLAF has moved in that very direction, pointing out that “EU Member States should seriously start considering a move towards a single EU Customs Agency” in order to ensure “uniform checks, risk assessment and harmonized enforcement”.⁴⁰ The Customs Union is one of the areas where EU has exclusive competence. This is the rea-

³⁷ For the analysis of the possible future scenarios of the Customs Union, see A. GHIRAN, A. HAKAMI, L. BONToux, F. SCAPOLo, *The future of customs in the EU 2040. A foresight Project for EU policy*, Luxembourg, Publications Office of the European Union, 2020, ec.europa.eu.

³⁸ European Commission, *Study contributing to an impact assessment concerning possible legislative proposal for an EU action programme for customs for the period after 2020*, Luxembourg: Office of the European Union, 2018, op.europa.eu.

³⁹ The proposal to create a European Customs Agency has been on the table for a long time. As an example, see Directorate General for Internal Policies, *Customs cooperation in the area of freedom, security and justice* of April 2011, pp. 45-46.

⁴⁰ G. KESSLER, *More integration needed to combat transit fraud*, in *WCO News*, 2017, p. 65.

son why it could be feasible to envisage a single common administration to be applied in all Member States. The principle of proportionality would also support this convergence. Further harmonisation and coordination in the management of the “common customs shield” would lead to a better protection of the interests of the Union and the Member States. However, as happens in other EU policy areas, the main obstacle to further progress towards a greater integration remains the consent of all Member States. In fact, some of them are reluctant to give up their risk and control system to a supra-national body that will be able to guarantee a comprehensive and effective EU-wide customs control management.