CHAPTER 4

Preshipment inspection

Summary

The Agreement on Preshipment Inspection (PSI), negotiated in the Uruguay Round, provides developing countries with a means for dealing with the problem of under- or over-valuation of imported goods. Over 30 developing countries currently use the services of PSI companies for mandatory and independent verification in the exporting country of the prices of goods to be imported. The Agreement recognizes that the use of such services by developing countries may be necessary to prevent ***over- and under-invoicing and fraud****. It states that these countries may use the services of such companies "for as long as and in so far as it is necessary to verify the quality, quantity or price of imported goods".*

In order to ensure that PSI companies do not arbitrarily reject the price agreed voluntarily between importers and exporters, the Agreement lays down the principles and rules which these companies must follow in verifying prices in exporting countries. In particular, it states that in verifying export prices, PSI companies should use for comparison purposes the prices of identical or similar goods offered for exportation:

- *To the country of importation, or*
- *To other markets.*

Where prices charged for goods exported to countries other than the country of importation are used, the economic and other factors that influence the different export prices charged to different markets should be taken into account.

The Agreement also establishes a mechanism for reviewing exporters' complaints when they consider that decisions to revise prices have been taken by PSI companies arbitrarily and without following its rules.

In countries using PSI services, Customs administrations cannot automatically determine the transaction value on the basis of the price recommended by PSI companies in their reports of findings. The Agreement on Customs Valuation clarifies that Customs in using PSI-recommended prices must take into account its obligations under that Agreement. This implies that Customs will have to treat PSI-recommended prices as advisory opinions. When, on scrutinizing the prices declared by the importer and that recommended by the PSI company, Customs finds that the latter price does reflect the true value of the goods, it can determine the transaction value on the basis of that price if the importer does not contest it. Where, however, the importer challenges the PSI-recommended price, Customs will have to determine value by using the methods prescribed in the Agreement on Customs Valuation.

1. General

Since about the second half of the last century importers have used the services of independent inspection companies to certify the quality and quantity of products they want to import. These inspections, which are conducted in most cases prior to shipment and in the country of exportation, assure the importer that the goods conform to the technical specifications and the quality standards laid down in the contract and that the quantities exported are correct. The services of such inspection companies are utilized not only by private business firms, but also by State-owned enterprises and government departments. In fact, the regulations in many countries require goods procured by government departments to be inspected and certified for quality and quantity by independent and competent inspection companies.

Since the mid-1960s, the governments of some developing countries have also been using the services of PSI companies to inspect goods to be imported and to verify their prices, prior to shipment and in the exporting countries. Their basic purpose in doing so is to bring under control the under- or over-invoicing of imported goods and other unfair or improper practices. Today, over 30 countries in Asia, Africa and Latin America use the services of PSI companies:

- For the physical inspection of the goods to be imported in order to ensure that they conform to the terms of the contract;
- To verify their prices; and

- To ensure that they are classified by the exporter under the correct tariff classification of the importing country.

The physical inspection of goods is an integral part of the procedures adopted by PSI companies to ensure that the prices indicated by the exporter in the invoice reflect the true value of the goods and that there is no under- or over-invoicing. Such inspections also help importers as they are assured that the goods they have ordered meet contractual specifications and quality standards, thereby reducing possibilities for dispute after the goods arrive at destination. These inspections also prevent the import of products that are considered harmful to health and therefore cannot be sold (e.g. banned chemicals and pharmaceutical products, substandard food products) in the exporting countries.

PSI companies carry out a physical inspection and price verification of almost all goods imported by the countries using their services. Most contracts, however, exempt goods with values below the specified threshold for preshipment inspections.

There are currently five PSI companies providing preshipment inspection services on a worldwide or a regional basis.[9] They are all members of the Preshipment Inspection Committee of the International Federation of Inspection Agencies (IFIA). The main objective of the Federation is to establish a basis for common rules governing their operations.

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9 The largest among them is the Société générale de surveillance (SGS) of Geneva. It has over 130 affiliated companies, with a presence in more than 140 countries and a staff of over 30,000. The other four companies are BIVAC International of Paris, COTECNA of Geneva, Inchape Testing Services International (ITSI) of London, and Inspectorate of the United States. There are indications that a number of other companies may enter the market in the future.

2. Objectives for using PSI services

Contracts for mandatory preshipment inspections can be grouped into two broad categories according to the purpose for which the services of PSI companies are employed. In the terminology used by PSI companies, these are *foreign exchange contracts (Forex)* and *customs contracts*. The first is usually employed to designate contracts whose basic objective (and that of the government requiring them) is to prevent the flight of capital through over-invoicing. The second is used for contracts undertaken when the governments' main aim is to prevent slippage of customs revenue as a result of undervaluation or deliberate misclassification by traders of goods to be imported under low-duty headings.

Until about a few years ago, the predominant government objective was to prevent the overvaluation of imports. Traders tend to overvalue imports when the import trade and foreign exchange transactions are subject to restrictions. As most developing countries are now liberalizing their trade regimes and are removing restrictions on foreign exchange, they are relying increasingly on PSI services to detect the undervaluation of imported goods and thus to prevent slippage of customs revenue. The result has been that, as box 8 shows, a large majority of the countries using PSI services rely on them to prevent both the loss of revenue from under-invoicing and the loss of foreign exchange from over-invoicing.

While PSI services are mainly used for the preshipment inspection of imports, a few governments also utilize them to control the flight of capital through the undervaluation of exports.

Box 8

COUNTRIES/AREAS USING PSI SERVICES

Country/area	**Nature of contract**
Angola	Forex
Benin	Customs/Forex
Bolivia	Customs
Burkina Faso	Customs/Forex
Burundi	Forex
Cameroon	Customs/Forex
Central African Rep.	Customs/Forex
Chad	Customs
Congo	Customs
Côte d'Ivoire	Customs
Ecuador	Customs
Ethiopia	Forex
Ghana	Customs/Forex
Guinea	Customs/Forex
HaitiCustoms/Forex	
Indonesia	Customs
Kenya	Customs
Mali Customs	
Madagascar	Customs/Forex
Malawi	Customs/Forex
Mauritania	Customs/Forex
Mexico	Forex
Mozambique	Customs/Forex
Nigeria	Customs/Forex
Pakistan	Customs
Peru	Customs
Philippines	Customs
Rwanda	Customs/Forex
Senegal	Customs/Forex
Sierra Leone	Customs/Forex
Tanzania, United Rep. of	Customs/Forex
Togo	Customs
Uganda	Customs
Zaire	Forex
Zambia	Customs/Forex
Zanzibar	Forex

3. Background to the negotiations

3.1 Concerns of exporters from developed countries

This expansion of PSI services to the mandatory verification of the prices agreed between importer and exporter was viewed with concern by business and industry, especially in some developed countries. They were particularly worried by the fact that they were asked to revise their prices downward when the PSI companies found contractual prices to be overvalued. They argued that the criteria used by PSI companies for price comparison was not always known to the exporters. The lack of transparency not only created uncertainty about the acceptability of prices negotiated with buyers but also put exporters in a disadvantageous position, as there were no procedures for appealing to independent bodies against the decisions of PSI companies. The delays in carrying out physical inspections and price verifications also delayed shipment, adding to the exporters' costs.

3.2 Response of countries using PSI services

In the initial phase of the discussions in the Uruguay Round the developed countries therefore argued that the use of PSI services for mandatory physical inspection and verification of prices constituted a non-tariff barrier. This view was challenged by developing countries. They maintained that far from constituting non-tariff measures, the prices re commended by PSI companies in their reports of findings facilitated clearance of goods at the importing end. In their view, it was not appropriate to look at the impact the use of these services had on trade without taking into account the broader policy objectives for which they were being utilized. Their experience had shown that the PSI service was the most effective means of preventing capital flight through over-invoicing and the loss of customs revenue through under-invoicing by traders.

4. Main provisions of the Agreement on Preshipment Inspection

4.1 Objectives and scope

The Agreement on Preshipment Inspection, negotiated in the Uruguay Round, attempts to strike a balance between the concerns expressed by exporting enterprises in developed countries and the need to safeguard the essential interests of developing countries that consider PSI services useful. It clarifies that its provisions apply only to preshipment activities carried out in exporting countries that are "contracted or mandated by the government". The term "preshipment inspection" is defined as "all activities relating to the verification of the quality, the quantity, the price, including currency exchange rate and financial terms and/or the customs classification of goods to be exported".

Agreement on Preshipment Inspection (PSI), Article 1

PSI, Preamble

The Agreement further recognizes that a number of developing countries use PSI services, and allows their use "for as long as and in so far as" they are "necessary to verify the quality, quantity or price of imported goods." The basic aim of the Agreement is to lay down a set of principles and rules for countries using PSI services and for exporting countries to ensure that their activities do not cause barriers to trade. Its substantive provisions ensure that the practical problems encountered by exporters as a result of delays in carrying out physical inspections and price verifications by PSI companies, the lack of transparency in the procedures they follow, and the treatment of confidential information are reduced or eliminated. Box 9 summarizes these and other provisions.

4.2 Price verification provisions

PSI, Article 2.20

The Agreement further lays down guidelines and rules which PSI companies must follow when verifying prices in exporting countries of the products to be imported. In particular it states that, in order to determine whether the export price reflects the correct value of the goods, it should be compared with the prices of identical or similar goods offered for export from the same country of exportation to the country of importation, or to other markets.

However, where for price comparison purposes the prices charged for export to countries other than the country of importation are used, the economic and other factors that influence the prices charged to different countries should be taken into account. In other words, the rules recognize that firms often charge varying prices in different markets, taking into account demand and growth potential as well as such factors as per capita income and standards of living in these markets. An exporting firm may thus charge higher prices for its exports of, say, shirts to Europe than it does for exports to Africa. The Agreement stipulates that when third-country prices are used for price-comparison purposes, the factors responsible for variations in the prices charged to importers in different countries should be taken into account and PSI companies should not "arbitrarily impose the lowest price upon the shipment". In addition, it states that PSI companies should make appropriate allowances for certain "applicable adjusting factors" in regard to the export

Box 9

COUNTRIES USING PSI SERVICES AND EXPORTING COUNTRIES: MAIN OBLIGATIONS

Obligations of importing countries using PSI services

Non-discrimination. Procedures and criteria should be applied on an equal basis to all exporters. There should be uniform performance of inspection by all inspectors. [PSI, Article 2.1]

National treatment. Countries using PSI services should not apply national regulations in a manner that will result in less favourable treatment of the goods being inspected in comparison to the like domestic product. [PSI, Article 2.2]

Site of inspections. Physical inspection should be carried out in the exporting country and, only if this is not feasible, in the country of manufacture. [PSI, Article 2.3]

Standards. Quality and quantity inspections should be conducted according to the standards agreed between buyer and seller or, in their absence, international standards. [PSI, Article 2.4]

Transparency. Transparency should be ensured by providing exporters with information, *inter alia,* on the laws and regulations of user countries on PSI activities, and the procedures and criteria used for inspection. [PSI, Article 2.5 to 2.8]

Protection of confidential information. Confidential information should not be divulged to third parties. [PSI, Article 2.5 to 2.13]

Delays. Unreasonable delays should be avoided. [PSI, Article 2.15 to 19]

Price verification. See box 10.

Appeals procedures. See box 11.

Obligations of exporting countries in relation to PSI activities

Non-discrimination. Laws and regulations should be applied on a non-discriminatory basis. [PSI, Article 3.1]

Transparency. All laws and regulations should be published. [PSI, Article 3.2]

Technical assistance. Technical assistance should be provided to user countries with a view to gradually reducing their reliance on PSI services for the verification of prices. [PSI, Article 3.3] price of the goods being inspected and the prices of identical or similar goods being used for price comparison. (See box 10.)

Since one of the main aims of governments in using PSI services is to prevent the loss of customs revenue from undervaluation of goods, the question arises of how Customs should use the prices recommended by PSI companies in determining value for customs purposes. The Agreement on Customs Valuation clarifies the role of Customs in such situations by stating that the obligations of user member countries "with respect to the services of preshipment inspection entities (in connection with customs valuation) shall be the obligations which they have accepted" under the Agreement (on Customs Valuation). The aim of the complex legal language is to ensure that Customs administrations in countries using PSI services do not automatically determine dutiable value on the basis of prices recommended by the PSI company in its report of findings. Customs have to examine each case. If on the basis of the examination and a comparison of price declared by the importer and that recommended by the PSI company, it finds that the latter reflects the correct price and the importer does not contest it, the value can be determined on the basis of that price. In all cases, it will be necessary to ensure that, in arriving at the recommended price, the PSI company has followed the rules relating to adjustments for various elements (e.g. buying commissions and sole agency commissions) laid down by the Agreement on Customs Valuation.

There will always be a few importers who will contest the PSI-recommended prices that are acceptable to Customs, and maintain that the prices declared by them reflect the true value of goods. In

Box 10

AGREEMENT ON PRESHIPMENT INSPECTION: PROVISIONS ON PRICE VERIFICATION (the text of Article 2.20)

User Members shall ensure that, in order to prevent over- and under-invoicing and fraud, preshipment inspection entities conduct price verification according to the following guidelines:

(a) preshipment inspection entities shall only reject a contract price agreed between an exporter and an importer if they can demonstrate that their findings of an unsatisfactory price are based on a verification process which is in conformity with the criteria set out in subparagraphs (b) through (e) below;

(b) The preshipment inspection entity shall base its price comparison for the verification of the export price on the price(s) of identical or similar goods offered for export from the same country of exportation at or about the same time, under competitive and comparable conditions of sale, in conformity with customary commercial practices and net of any applicable standard discounts. Such comparison shall be based on the following:

(i) only prices providing a valid basis of comparison shall be used, taking into account the relevant economic factors pertaining to the country of importation and a country or countries used for price comparison;

(ii) the preshipment inspection entity shall not rely upon the price of goods offered for export to different countries of importation to arbitrarily impose the lowest price upon the shipment;

(c) When conducting price verification, preshipment inspection entities shall make appropriate allowances for the terms of the sales contract and generally applicable adjusting factors pertaining to the transaction; these factors shall include but not be limited to the commercial level and quantity of the sale, delivery periods and conditions, price escalation clauses, quality specifications, special design features, special shipping or packing specifications, order size, spot sales, seasonal influences, licence or other intellectual property fees, and services rendered as part of the contract if these are not customarily invoiced separately; they shall also include certain elements relating to the exporter's price, such as the contractual relationship between the exporter and importer;

(d) The verification of transportation charges shall relate only to the agreed price of the mode of transport in the country of exportation as indicated in the sales contract;

Box 10 (cont'd)

(e) The following shall not be used for price verification purposes:

(i) the selling price in the country of importation of goods produced in such country;

(ii) the price of goods for export from a country other than the country of exportation;

(iii) the cost of production;

(iv) arbitrary or fictitious prices or values.

such cases, importers have a right to expect Customs to give them the opportunity to produce documentary and other evidence to justify their declared price. If, after examining the evidence, Customs still maintains that the price declared by the importer involves either under- or over-valuation, it cannot under the provisions of the Agreement on Customs Valuation determine value on the basis of the PSI-recommended price.[10] It will have to determine it by using the methods laid down in the Agreement for the determination of value when the transaction value declared by the importer is not acceptable.

PSI, Article 2:21, Article 4

4.3 Appeal, revision and dispute settlement provisions

One of the other major criticisms made by exporters of PSI activities was the absence of an institutional mechanism for considering complaints. When they regarded a decision to revise prices as arbitrary or wrong, and the PSI company concerned refused to review its decision, the exporters found it

10 This applies even when the PSI company has arrived at the price by adhering to the rules of the Agreement on Customs Valuation.

difficult to obtain a hearing for their grievances. To facilitate consideration of such complaints, the Agreement establishes a three-tier mechanism (see box 11). First, it calls on PSI entities to designate officials to whom exporters can appeal against the decisions of PSI inspectors. Second, it establishes an Independent Review Entity (IRE) to which both exporters and PSI entities can submit grievances. Complaints made to the IRE are to be examined by a panel consisting of three experts — one member to be nominated by the International Chamber of Commerce (ICC), the second by the International Federation of Inspection Agencies (IFIA), and the third, who should be a trade expert and who will act as chairman, to be nominated by the IRE itself. Third, it recognizes that governments of countries using PSI services and exporting countries could bring disputes on any matter related to the operation of the Agreement to WTO for settlement.

PSI, Article 2:21

PSI, Article 4

PSI, Article 8

5. Business implications

By laying down rules on PSI activities, the PSI Agreement seeks to reduce, if not completely eliminate, the difficulties exporting enterprises experience in regard to transactions with countries using PSI services. In addition, the Agreement has created a mechanism for the consideration of complaints. This will enable exporters who believe that their prices have been revised arbitrarily by the verifying inspector to complain to a designated senior official of the inspecting company, and, if they are not satisfied, to bring the matter up for consideration by the Independent Review Entity, which has been established under the Agreement.

Governments of PSI-using countries benefit from the increased customs revenue resulting from

Box 11

AGREEMENT ON PRESHIPMENT INSPECTION: PROVISIONS ON APPEALS, REVIEWS AND DISPUTE SETTLEMENT

(PSI, Article 4)

Appeals procedures

The Agreement imposes an obligation on user member countries to require PSI entities whose services they employ to designate one or more officials "who shall be available during normal business hours in each city or port in which they maintain preshipment inspection administrative office, to receive, consider and render decisions on exporter's appeals or grievances". The designated officials are expected to take decisions on such complaints promptly.

Independent review mechanism

Where a dispute cannot be settled through mutual consultations between exporters and PSI entities, either party can, within two days after its submission under the appeals procedures, refer it to the Independent Review Entity established under the Agreement and administered jointly by IFIA and the ICC. This entity is required to establish a list of experts who can serve as members of panels considering the complaints brought to it.

A panel shall consist of three experts. One member is to be nominated by the exporter; the second by the PSI entity. The experts so nominated should not, however, be affiliated to these two nominating parties. The third expert, who is to be nominated by the Independent Review Entity, shall be a trade expert and is to act as chairman.

The decisions of the panel shall be taken by majority vote and in eight working days of the request for independent review. The panel decisions are binding on the parties to the dispute.

Settlement of disputes between governments

However, where either the user or the exporting country considers that its right under the PSI Agreement or under the General Agreement is infringed, it may request consultations. If the consultations do not succeed in reaching a mutually satisfactory solution, it may invoke the GATT dispute settlement procedures.

the detection of undervaluation and from the decline in the flight of capital through overvaluation. The employment of PSI services also brings indirect benefits to business enterprises. First, by speeding up the clearance of goods, it greatly reduces the inventories which manufacturers have to maintain and thus enables them to cut costs. Second, the use of PSI services lowers the level of customs-related corruption, thereby reducing demands for under-the-table payments for imported goods to be cleared. As has been said, one of the objectives of governments using PSI services is to bring customs-related corruption under control. Third, when verifying prices, PSI companies carry out physical inspections of all goods to be imported in order to ensure that they conform to the conditions stipulated in contracts between importers and exporters in regard to quality and quantity. Except therefore in cases of low-value imports, which are not inspected, importers obtain an assurance that the goods they will receive will be in conformity with the terms of their contracts. However, as PSI companies enter into contracts with governments, importers have no right of recourse to these companies if they (the importers) ultimately find that the imported goods do not, in fact, meet the terms of their contracts.