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Adoption by Canada of Tariff Nomenclature and Statistical Classification System Developed by Customs Co-operation Council

Discussion Paper

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Department of Finance
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Object

The purpose of this Discussion Paper is to examine the merits of adoption by Canada of the Customs Co-operation Council Nomenclature (CCCN) and the Harmonized Commodity Description and Coding System (HS) for tariff classification and statistical purposes and to outline options with respect to the timing of such a move.

Background

The Customs Co-operation Council (the Council) was established in Brussels in 1950 with its primary objective being the simplification and harmonization of all aspects of customs procedures throughout the world. As one means towards this end the Council developed the CCCN (formerly known as the Brussels Tariff Nomenclature or BTN) as the framework for the classification of goods for customs tariff purposes. The CCCN is currently used by 147 countries. It is not used by Canada or the United States, although Canada does employ a modified CCCN for chemicals and plastics. (Further details on the Council and the CCCN are set out in the attached Annex.)

The CCCN is also used as a basis for the reporting of trade statistics by those countries who use it for tariff classification purposes. A committee of the Council has, however, been working on a new commodity coding system (the HS) which, while based on the CCCN, would provide the additional commodity detail needed for international trade statistics and the preparation of invoices and shipping documents. The work being done on the HS has identified a number of aspects of the CCCN that need updating and, therefore, a revised CCCN (for tariff classification purposes) is being developed at the same time. (More detailed information on the HS is contained in the Annex.)

Although not a signatory to the CCCN Convention, Canada (like the U.S.) is a member of the HS Committee and has been active in the development of the new commodity code, to ensure that account is taken of North American technology and that adequate provision is made for products prevalent in our import and export trade. For many years signatories to the CCCN have been urging Canada to adopt it for tariff classification purposes, to facilitate the international comparison of tariff and trade data and to make it easier for their exporters to determine what tariff rates would apply on shipments to Canada. An interdepartmental group (Finance, External Affairs, Industry, Trade and Commerce, National Revenue and Statistics Canada) was formed in 1972 to study the feasibility of Canada adopting the CCCN as a basis for the Canadian tariff nomenclature. It appeared at that time that universal adoption of the CCCN — and in particular its adoption by the U.S. and Canada — would be negotiated in the Tokyo Round of multilateral trade negotiations (MTN).

A mock-up of the Canadian Tariff in CCCN language was completed in 1975 but the issue was not pursued further because it was evident that there was no disposition on the part of either the U.S. or those countries then applying the CCCN to take up the matter in the MTN. One reason for this was that conversion of the U.S. and Canadian Tariffs would have entailed complex negotiations which could not have been accommodated within the MTN timetable. Moreover, the U.S. took the position that the CCCN was out of date and inadequate as a universal tariff classification system and that a decision regarding its adoption should be reserved pending completion of the modernization exercise being carried out in conjunction with the development of the HS, on which considerable work still had to be done. (It is expected that the HS Committee's work on the basic classification system will be completed by the end of 1981 and that a further year and a half will be needed to produce "explanatory notes" providing technical descriptions of goods, methods of production and uses, and practical

guidance for their identification. It is intended that the completed package be submitted to the Council for approval in June, 1983 with implementation to take effect on January 1, 1985.)

Factors

Once the Council introduces the proposed new HS and updated CCCN, Canada is likely to come under increased pressure, both nationally and internationally, to adopt them. This pressure would be heightened if the U.S. decides to use the CCCN and HS. The U.S. International Trade Commission has been inviting public comment on the development of the HS. It is understood that procedures for consulting U.S. industry regarding conversion of the U.S. Tariff to a CCCN/HS format will be in place by mid-1981 and that the U.S. expects to be in a position by mid-1983 to present a revised tariff schedule based on the CCCN and HS to its trading partners. Any tariff rate changes associated with the adoption of the new nomenclature would be negotiated under the relevant provisions of the General Agreement on Tariffs and Trade (GATT).

Aside from international considerations, there would appear to be a number of valid reasons for reviewing the adequacy of the current Canadian tariff nomenclature. Its wording and structure are outdated. Improvements to make it more easily understood by the business community would be in line with the government's program of regulatory reform. One of the main problems with the current tariff classification system is that it bears no relationship to the import commodity classification system used for statistical purposes. As a consequence, Canadian importers, who are responsible for indicating the import commodity code and tariff item number on their customs entry documents must be acquainted with two classification systems — the tariff nomenclature and the Canadian International Trade Classification (CITC). This leads to errors in the application of the CITC and poor quality statistical data. These errors tend to go unchecked to a greater extent than tariff classification errors since they do not affect the dutiable status of the goods.

Under the Canadian tariff classification system many imported goods are classified not so much by what they are but as to how they will be used. In other situations, tariff classification depends on whether or not the imported goods are of a class or kind made in Canada. This results in goods with the same physical characteristics being classified under a number of different tariff items depending on the circumstances. The scope of certain other tariff items is so broad that they encompass several unrelated kinds of goods. Consequently, the current tariff nomenclature is inadequate for statistical purposes.

The CCCN and the HS, on the other hand, will form a comprehensive classification system designed to ensure simplicity, precision and uniformity in application. As such they will be ideally suited for both tariff classification and import statistical purposes. Their various subdivisions are mutually exclusive; products are classified according to their physical characteristics (or occasionally according to their usual end-use) and not according to actual end-use or whether or not they are of a kind manufactured in the country of importation. The CCCN and HS also utilize internationally agreed definitions for many products (such as steel shapes, metal alloys and textiles) and include rules and notes to facilitate administration and interpretation.

The benefits to be gained by converting the Canadian Tariff to a CCCN/HS format may be summarized as follows:

It would facilitate the electronic processing of trade data.

There would be an opportunity to eliminate anomalies and problems under the existing tariff nomenclature arising from the fact that the same product can have multiple tariff classifications depending on end-use and "made-in-Canada" status.

The tariff system would be simpler to administer and much more readily understood by importers, exporters and manufacturers.

There would be an improvement in the reliability of import statistical data which would enable a more precise identification of import-related problems and import replacement opportunities.

There would be a readily apparent relationship between Canadian tariff and trade data and that of other countries who use the CCCN and HS, thereby improving the ability of Canadian negotiators to bargain effectively at international tariff negotiations and enabling Canada to more effectively monitor tariff changes made by other countries.

In the case of Canadian exporters who also import, expertise developed in relation to the Canadian tariff and statistical systems would facilitate preparing export documents and gathering knowledge about foreign tariffs on their exports.

Canada's foreign relations would be improved by removing what is perceived by our trading partners to be a non-tariff trade barrier. This move would be particularly welcomed by the developing countries who have complained that they cannot determine the value of Canada's general preferential tariff scheme due to the complexity of our tariff classification system.

Some of the problems associated with the fact that Canada has a tariff classification system different from most other countries could be addressed by developing an up-to-date detailed concordance between the CCCN and HS and the Canadian tariff nomenclature. However, such a concordance would at best be a fairly cumbersome statistical tool and would not resolve the statistical coding error problem referred to above. Nor would it permit an accurate comparison on a product-by-product basis of Canadian duty rates with those of other countries. An alternative would be to attempt to incorporate the present tariff rate structure into a CCCN/HS framework. The conversion completed in 1975 indicated, however, that the end result would be so complicated that there would still be complaints from other countries about its complexity and trade-impeding effects. Domestic interests would probably also raise objections. Indeed, any attempt to avoid the tariff rate adjustments which would logically flow from adopting the CCCN and HS, would result in a "Canadian" version of the CCCN and HS which would lose much of its value for tariff classification and statistical classification purposes. For example, it would be necessary to introduce about 1,000 different tariff lines for pumps if the existing tariff treatment were to be superimposed, without change, on a CCCN/HS classification system.

To determine the nature and scope of the tariff rate adjustments and the policy restrictions that might be imposed by adoption of the CCCN and HS, it would first be necessary to prepare an up-to-date draft version of the Canadian Customs Tariff in CCCN/HS language, i.e., a one-to-one fitting of the Tariff to a CCCN/HS format while preserving, to the extent possible, present tariff rates and policies. Much of the previous work undertaken in this regard has been, or will be, superseded by revisions to the CCCN that are being made in conjunction with the development of the HS.

When completed, it is expected that the CCCN and HS together will consist of over 1,000 main headings and up to 5,000 subdivisions. The Canadian Customs Tariff which now contains about 2,800 individual tariff items would have to be adapted to a CCCN/HS format, initially on the basis of maintaining current rates. The fact that many tariff items cut across CCCN/HS headings and subdivisions, and vice versa, would add to the complexity of preparing a draft conversion. Another complicating factor is that adoption of the CCCN and HS, by itself, would not completely satisfy statistical requirements. In a parallel exercise, Statistics Canada would be required to consult with industry and other users of import statistics to develop statistical classes based on the CCCN and HS which would meet the future requirements of government and industry while maintaining continuity with statistical series now in use. This would involve, in some cases, creating subdivisions of HS classes.

After a basic conversion of the Canadian Tariff to a CCCN/HS format was completed, the next step would be to determine what tariff rate changes might be necessary or desirable. The

objective would be to ensure that any changeover to the new nomenclature was as neutral as possible in terms of the tariff rate structure and that tariff decreases affecting any particular industry sector made necessary by the change were offset by tariff increases in the same sector.

The third step would be to refer the draft tariff schedule to Canadian importers and manufacturers for comment as to the "neutrality" of the schedule and alternative ways of achieving this objective. A reference to the Tariff Board, with public hearings, might be desirable for this purpose.

Alternatives

On the assumption that Canada would wish to adopt the CCCN and HS for tariff and statistical classification purposes, and that the work program outlined in the preceding four paragraphs would be put in hand immediately, there are essentially two options with respect to timing. It should be noted, however, that the timing of Canada's adoption of the CCCN and HS may itself become a subject for negotiation with our trading partners if universal adoption becomes a high priority trade policy objective for them.

Plan for Adoption of CCCN and HS on January 1, 1985

January 1, 1985 is the target date set by the Council for adoption of the revised CCCN and acceptance of the new HS by those countries agreeing to do so. It is also the date on which Canada is committed to adopt the new GATT Agreement on Customs Valuation and to make any tariff rate adjustments that may be required to prevent a decline in the level of tariff protection when the new valuation system is implemented. These rate adjustments will need to be negotiated with our trading partners in accordance with GATT procedures and it could be argued that these negotiations would be facilitated if they were broadened to encompass any tariff rate changes that might be required for Canada to adopt the CCCN and HS. Simultaneous implementation of changes in the valuation rules and the tariff nomenclature would also shorten the total period of adjustment to the new system, avoiding some of the uncertainty and confusion that might result from sequential changes.

If, as anticipated, the U.S. negotiates the tariff rate adjustments associated with its adoption of the CCCN and HS to meet a January 1, 1985 target date, it would enhance Canada's bargaining position in relation to U.S. tariff changes affecting our trade if we were in a position to negotiate our rate adjustments related to CCCN/HS adoption during the same time frame.

On the other hand, completion of the work program and negotiations with our trading partners in this time frame would place considerable strain on the resources of the Departments of National Revenue and Finance as well as the Tariff Board. Moreover, to allow adequate time for negotiations, the Tariff Board would have to be asked to review the draft schedules before the CCCN, HS and the "explanatory notes" had been approved by the Council in June, 1983. The results of their work would then have to be re-examined when the approved final versions of the CCCN, HS and accompanying notes became available.

Simultaneous changes of a fundamental nature in both the tariff classification and customs valuation systems might also place considerable strain on the resources of Canadian importers and foreign exporters. There would also be a considerable burden on manufacturers who would wish to comment on the draft tariff schedule and who are already engaged in consultations with the Government on a number of tariff and other trade policy changes that are currently taking place or are under review (i.e. Discussion Paper on Import Policy and Tariff Board References on customs valuation, "made/not made" tariff items and the General Preferential Tariff). Moreover, the staging of the MTN tariff cuts would be more complicated if based on a different nomenclature.

Implementation by Canada sometime after 1985

If it were decided to wait until the CCCN, HS and explanatory notes have been formally accepted by the Council (mid-1983) before directing the Tariff Board to study the matter, it would probably not be possible to implement the new system before January 1, 1986 at the earliest. In this event, there would be much to be said for delaying implementation until January 1, 1987, when the MTN tariff concessions for most products will have been fully implemented. These tariff reductions will remove many of the "peaks" in the Canadian Tariff, making it easier to convert the nomenclature to the CCCN and HS. This would also make the changeover to the new nomenclature simpler by eliminating problems that would be caused by trying to apply our MTN commitments regarding the staging-in of tariff reductions to a tariff nomenclature radically different from that used in the negotiations.

Awaiting completion of the current studies on the Import Policy Paper, customs valuation, "made/not made" tariff items, and the General Preferential Tariff would simplify the CCCN/HS review process, reduce the strain on the manpower resources of National Revenue, Finance, the Tariff Board and other interested parties, and allow time for a better overall study of the problems involved. An extended schedule would be able to make provision for any unforeseen contingencies or delays that could arise.

This option would not necessarily preclude initiating, and possibly substantially concluding, before January 1, 1985, the tariff rate negotiations associated with the change in nomenclature, provided the Tariff Board could complete its study by mid-1984. Thus, it might be possible to combine the advantages of pre-1985 negotiations (outlined above) with the advantages of a later target date for actual implementation of the change.

International Considerations

Adoption of the CCCN and HS by Canada should eliminate a source of criticism by our trading partners, particularly the developing countries. In fact, our trading partners are likely to urge us in the strongest possible terms to support the principle of universal adoption of the new codes. While many of the tariff rates that would be affected by CCCN/HS adoption are bound against increase under the GATT, and while our trading partners would be entitled to compensation for increases in those rates, we would expect that they could be paid for by decreases in tariff rates that would also flow from the conversion exercise.

Recapitulation

The Customs Co-operation Council Nomenclature (CCCN) is currently being reviewed and updated in conjunction with the development of the Harmonized Commodity Description and Coding System (HS). The CCCN and HS together will form an up-to-date comprehensive international system for both tariff classification and statistical purposes.

The feasibility of Canada adopting the CCCN's predecessor (the Brussels Tariff Nomenclature or BTN) was examined during the 1970's but was not pursued mainly because it was not taken up as a negotiable matter in the multilateral trade negotiations. However, once the Customs Co-operation Council introduces the revised CCCN and the new HS on January 1, 1985, Canada is likely to come under strong pressure from both domestic and foreign sources to adopt the two systems. This pressure would be heightened if, as anticipated, the U.S. decides to use the CCCN and HS.

There would be advantages for Canada in adopting the CCCN and HS. Aside from the increased international goodwill that would accrue to Canada, adoption of the CCCN and HS would: provide the opportunity to modernize and restructure the Canadian tariff nomenclature to eliminate anomalies and other problems; result in improved import and export statistical data; facilitate the electronic processing of such data; simplify the administration of the tariff

classification system and make it more understandable; improve Canada's ability to bargain more effectively in international trade negotiations and to monitor the results of such negotiations; and permit more precision in the evaluation of problems and opportunities related to import and export trade.

Adoption of the CCCN and HS would necessitate some adjustments in tariff rates which are bound under the GATT and which would have to be renegotiated. Any attempt to avoid the tariff rate adjustments which would logically flow from adopting the CCCN and HS would result in a "Canadian" version of the CCCN/HS which would lose much of its value for tariff and statistical classification purposes.

The first step in a work program leading to adoption of the CCCN and HS would be for National Revenue to prepare an up-to-date draft version of the Customs Tariff in CCCN/HS language. The next step would be for the Department of Finance to determine what tariff rate adjustments might be necessary or desirable. The draft schedule could then be referred to the Tariff Board for public hearings. Finally, negotiations with our trading partners would be required.

There would be some advantage in trying to meet the Council's January 1, 1985 target date for implementation of the CCCN and HS. The negotiations of tariff rate adjustments flowing from the exercise could then be tied in with those associated with Canada's adoption of a new valuation system and U.S. adoption of the CCCN and HS. However, because of the complexity of the conversion exercise, the advisability of having in hand the final versions of the CCCN and HS as approved by the Council, and the heavy demands placed on the resources of the government, importers, exporters and manufacturers by a number of current tariff and trade policy reviews, a post-1985 target date (e.g. January 1, 1987) for adopting the CCCN and HS may be more realistic. This would not necessarily preclude the initiation of tariff rate negotiations prior to January 1, 1985.

Annex

The Customs Co-operation Council

The Customs Co-operation Council (the Council), under whose auspices the revised Customs Co-operation Council Nomenclature (CCCN) and the Harmonized Commodity Description and Coding System (HS) is being developed, was established by a Convention signed in Brussels on December 15, 1950. This Convention came into force on November 4, 1952. One of its purposes is to assemble the executive machinery required for the interpretation and application of Conventions on Nomenclature and Valuation in a single international organization. Apart from administering the Conventions on Nomenclature and Valuation it has the more general tasks of:

- studying all questions relating to co-operation in Customs matters which the members agree to promote;
- examining the technical aspects of Customs systems with a view to proposing practical means of attaining the highest possible degree of harmony and uniformity;
- preparing for this purpose draft Conventions and Recommendations;
- circulating information regarding Customs procedures;
- furnishing information or advice to members; and
- co-operating with other international organizations.

The Council is a technical body and its studies to resolve Customs problems are based on a purely technical approach. Its purpose is to improve and harmonize Customs operations and thus facilitate the development of international trade, without obliging members to adopt provisions incompatible with their individual economic policies. It is assisted by a Permanent Technical Committee in respect of Customs matters (other than nomenclature and valuation) and by a General Secretariat. The functions of the Council are thus clearly defined; they in no way duplicate the activities of other international organizations, particularly those essentially concerned with economic policy.

Canada became a member of the Council on October 12, 1971. Accession to the Council Convention does not entail accession to either of the Conventions on Nomenclature and Valuation, but is obligatory for any country wishing to accede to either of those Conventions. The Council which had, as of July 25, 1979, 87 signatories to its Convention, normally meets once a year. The delegates are usually the heads of national Customs administrations.

The CCCN and its Committee

The essential aims of the CCCN Convention are:

- to establish a common basis for the classification of goods in national Customs tariffs;
- to facilitate comparison of the Customs duties applicable in the various countries to all goods entering into international commerce;

to help simplify international tariff negotiations;

to provide governments and traders alike with a high degree of uniformity in the classification of goods in national Customs tariffs; and

to facilitate international trade generally and thus contribute to its expansion.

The CCCN is designed to provide a comprehensive framework for the classification of goods in Customs tariffs and to ensure: simplicity, so that it may be readily understood by the public as well as by experts; precision, so that the most appropriate description for a given commodity can be readily identified; and, uniformity in application, so that the same commodity will be classified in the same way in the tariffs of all countries using the CCCN. It is also very useful as a commodity code and as a medium for the international comparison of trade statistics and tariff rates.

The CCCN is a structured system encompassing identification of all commodities in trade. It is divided into 21 sections and contains 99 chapters, each dealing with a specific commodity area. Each chapter can be further broken down into 99 mutually exclusive subchapters or, as they are most commonly called, headings, thereby making the CCCN a four-digit classification system.

It is a complete, closed classification system supported by interpretative rules and explanatory notes. These rules and notes assure maximum uniform application at the international level by setting the basic criteria for classifying goods in the CCCN. Some of the explanatory notes take the form of exclusions referring products to other chapters or headings; some specify the scope of certain headings; some establish priorities; and, some settle general questions, such as the treatment of incomplete articles, mixtures and composite goods, the choice of one heading rather than another when several headings seem to be equally applicable, and so on.

The "mutually exclusive" feature of the CCCN is important from an administrative point of view in that products are classified according to their intrinsic characteristics (or occasionally according to their usual end-use) and not according to their actual end-use or whether or not they are of a kind manufactured in the country of importation.

The CCCN is used by all major trading countries with the exception of Canada and the United States. Currently, 47 countries are signatories to the CCCN Convention and about 100 use it as a basis for their tariffs without having signed the Convention. It is also used by many regional organizations, for example, the European Economic Community, the European Free Trade Association, the Latin American Free Trade Association, and the Common Organization of African States and Madagascar.

On June 11, 1959, the Nomenclature Committee began operating under the authority and directives of the Council to supervise the operation of the CCCN.

The Committee's main tasks are to decide on the more complex classification questions raised by administrations or by international organizations, to resolve differences of opinion between Customs administrations and, in general, to take appropriate steps to ensure international uniformity in the interpretation and application of the CCCN.

To this end, the Committee:

collates and circulates information concerning the application of the CCCN;

studies the procedures and practices of the signatories in relation to the classification of goods for Customs purposes;

makes appropriate recommendations to the signatories to secure uniformity in the interpretation and application of the CCCN;

prepares draft amendments to the CCCN Convention;
drafts and amends the Explanatory Notes, and
issues Classification Opinions.

The Nomenclature Committee normally meets twice a year for a fortnight. Although its membership is composed of delegates representing signatories to the Convention, its meetings are also attended by observers representing international organizations or countries who are not signatories.

Canada is not a signatory to the CCCN Convention and consequently has no voting rights on issues raised at the Nomenclature Committee meetings. As an official observer, however, Canada does exert some influence by presenting its views formally at the meetings or informally to voting delegates. In addition, the Canadian delegation is frequently asked for its views on technical subjects in which it has a particular expertise (for example, National Revenue, Customs and Excise Laboratory's expertise in chemical products).

The HS and its Committee

The 1950 Convention establishing the CCCN provides that it will facilitate the comparison of trade statistics in so far as the data for such statistics are based on the classification of goods in Customs tariffs. However, because the headings in the CCCN generally represent families of products, the statistical data resulting from use of the CCCN relates only to broad categories of goods and lacks detail.

In September, 1970 the Council set up a Commodity Coding Study Group to explore the possibility of developing a detailed international commodity code which could simultaneously meet the needs of Customs, external trade statisticians and carriers. This Study Group reported to the Council in May, 1973 that the development of a harmonized commodity description and coding system was not only feasible but was essential and recommended that the Council undertake to carry the project to completion.

In September, 1973, the HS Committee, established by the Council, began the work of expanding the CCCN headings to form six-digit sub-headings and thereby establish a new more detailed CCCN identifying all goods of significance in world trade. This work is based on about 15 widely used classification systems (including Canada's) developed for Customs, statistical and transportation purposes. While primarily aimed at international trade, the HS could also be applied to national trade. Business associations claim that a major obstacle to trade is the requirement to reclassify commodities according to different systems at each step in the path from manufacture to consumption.

The HS Committee is also reviewing the present headings of the CCCN to ensure that they reflect modern technology and trade patterns. Headings representing families of products may either be expanded to form two or more headings or merged with others, depending on a product's importance in trade at the world level. This is the first wholesale revision of the CCCN undertaken since 1955.

When the HS is implemented there will effectively be two main classes of users. The first consists of the commercial interests — manufacturers, wholesalers and carriers, and the second, Customs authorities and statisticians who are concerned with external trade and industrial statistics. For production and selling purposes, the commercial interests require extremely detailed commodity information. They need to specify, for example, size, shape, colour, weight, and many other physical attributes. The HS would not replace internal commodity information systems but commercial interests engaged significantly in international trade could adopt the HS number and add to it the more specific commodity data on their internal records.

The Council hopes that Customs authorities, statisticians and carriers will eventually base their commodity description and coding systems on the HS. Thus, the new system would not be additional to present requirements; rather, tariff and statistical classifications based on it would replace existing ones wherever possible. This would not in any way alter the authority of national administrations and carriers to apply whatever tariff rates or other policy related provisions that may be desired. Suppliers could quote HS numbers on invoices and shipping instructions to carriers for Customs documentation and for declarations for export trade requirements. Importers would, of course, be able to quote, in addition to the HS, any other descriptor which may be required for the completion of administrative formalities in the course of the delivery of goods.

Canada is a voting member of the HS Committee (with a delegation led by Revenue Canada, Customs and Excise and participates actively in this Committee, offering views on the conceptual and technological problems of producing a commodity code. Canada's experience in commodity classification has been useful in the preparation of position papers for the Canadian delegation to the Committee. Several proposals concerning the revision of the CCCN have been presented by the delegation at Committee meetings and have been accepted.

When preparing comments on various issues, the Canadian delegation confers with companies, industrial associations or organizations and government agencies to obtain expert technical opinions. Consequently, manufacturers in some sectors of Canadian industry have been involved in discussions on the development of the HS, for example, forest products, electrical and electronic products, chemicals and textiles.