

Minimizing Smuggling and Restoring Public Trust in the Philippine Bureau of Customs

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Why is customs in a crisis of public trust?

The Philippine Bureau of Customs has been consistently ranked the least sincere in fighting corruption since 2005. There are at least five reasons for this erosion of public trust:

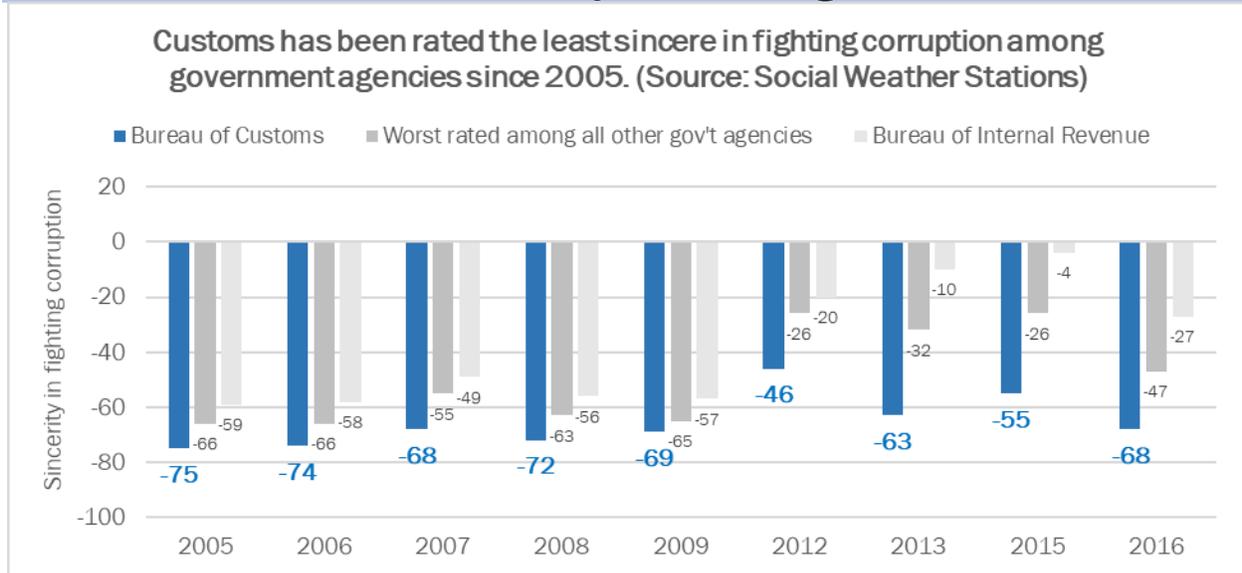


1. Customs inspects one in every four transactions, but only one percent yields derogatory findings. There is too much discretion with very little yield. Importers complain that this process is too unpredictable.
2. Importers would rather pay bribes than incur the massive costs of being held at port by customs officials. This environment encourages collusion, tax evasion, and smuggling.
3. Dishonest officials live impossibly lavish lifestyles and are seldom prosecuted, while honest officials are seldom rewarded for good behavior. A rank-and-file customs clerk can flaunt a Porsche. The culture of bribery is so ingrained that there are a dictionary of words and a classic action film about it.
4. Around P12 billion in illegal drugs and contraband has slipped past porous customs border control in the past two years. This has endangered public safety.
5. Top leadership changes too fast to build long-term systemic reforms. Since World War II, the median tenure of customs commissioners has been just one year.

Key Recommendations

Addressing the first two factors that erode public trust, this policy brief recommends three proposals: (1) lowering the rate of physical inspections, (2) focusing inspections on the riskiest products, and (3) creating a central assessment office that monitors and implements this program. If phased and implemented well, these reforms can cut average clearance time by half and still increase revenues by around P10 billion over six years. By reducing discretion and minimizing smuggling, these reforms can help improve the public's experience with customs and restore public trust. However, a larger reform of the organization is required to sustain these reforms, which will be detailed in a future project.

What is our key motivating fact?



What is the extent of smuggling in the Philippines?

I studied around 10 million import transactions from 2012-2017 and found that:

- 1 Fully closing the smuggling gap due to underinvoicing would have yielded additional taxes worth P16 to P38 billion¹. This represents a one to two percent increase in revenues over this six-year period.
- 2 Cheating on prices may have been a dominant means of smuggling: I found significant evidence of evasion in values², but found no strong evidence of evasion in quantities.
- 3 The Valuation Reforms of 2014-2015 were effective at stamping out undervaluation in meat, plastic, and steel products. If it were implemented two years earlier, it would have yielded P18 billion, a 3 percent increase in revenues.
- 4 The current estimates of the customs tax gap may be too high and “misleading.” Kar and LeBlanc’s current estimates, which now dominate public discourse in Congress, range from 1 to 2.8 percent of GDP, 20 to 50 times higher than my estimate.
- 5 Attempts to increase customs revenue targets based on the Kar and LeBlanc study should be tempered. While customs is important to the country’s tax base, an obsession over revenues as a policy goal may incentivize officials to increase discretion and further erode public trust.

¹ This estimate is limited to homogenous and reference-priced goods that represent a third of total Philippine import value.

² On average, a one-percentage point increase in the tax rate is associated with a 0.9 to 2.0 percent increase in evasion in values from 2012 to 2017. This is significant at the one percent level.

How do we minimize smuggling and restore public trust?

Proposal 1: Lower discretion by reducing physical inspections

Policy	Outcome
1.1. Decrease the rate of physical inspections from 27 percent to a much lower number.	Cuts the average clearance time by half, from 4.9 days to 2.7 days, for entries no longer physically inspected. Reduces discretion and opportunities for bribery and corruption, which improves public trust.
1.2. Increase the percentage of green lane shipments from 25 percent to a much higher number.	
1.3. Stagger changes to prevent abuse.	

Proposal 2: Focus inspections on the riskiest products

Policy	Outcome
2.1. Require importers of the top 20 riskiest products (like tobacco, alcohol, and copper) to submit additional documents if the price they declare goes below a set threshold level.	Focuses limited staff capacity on only the riskiest transactions. Would have yielded P10 billion if implemented over 2012 to 2017, a 0.5 percent increase in revenues.
2.2. Apply lessons from the successful implementation of the Valuation Reforms of 2014-2015	

Proposal 3: Create a central assessment office to manage these reforms

Policy	Outcome
3.1. Hire 18 to 32 new staff to compute fair inspection thresholds. Hire based on product, valuation, and statistics skills. Get help from Philippine Tax Academy and the Tariff Commission on training.	Maintains independence from operations, as opposed to the current system where the port's formal entry division reviews values. Working with trade transparency units of major trading partners can help detect smuggling on quantities. Using non-price features for predicting fraud helps policymakers know if the channels of cheating have changed.
3.2. Use machine learning techniques to detect fraud using non-price features.	

Lessons from the Valuation Reforms of 2014-2015

The Valuation Reforms of 2014-2015 covered 15 product categories of meat, iron and steel, and plastic³. To illustrate: if a shipment of meat were declared below the set threshold price of \$3 per kilogram, then importers would need to send additional documents to a central assessment team before the shipment could be released. The reform was largely successful: Time-sensitive importers opted not to cheat on prices than have their shipments delayed at port by an additional review process. Weighted average prices of meat, for example, increased six-fold when the thresholds were introduced.

We can learn three lessons from this successful reform: First, reference prices should be simple, reasonable, and responsive to world prices and stakeholder feedback. Second, the office in charge of reviewing prices must be independent of operations to maintain the objectivity of the valuation reviews. Third, implementation must be focused and phased.

What is the attitude needed for reform to succeed?

1. This brief aims to temper sweeping statements that customs is hopeless, that all customs officials are corrupt, and that everyone should be fired. All these characterizations are reductionist. They evade the hard but necessary questions of reform. Through this policy analysis, I hope that Filipino policymakers and citizens can understand not only why smuggling persists, but also why customs officers are vulnerable to engaging in corrupt practices under this current environment. This does not absolve individuals from engaging in dishonest practices, but I hope this policy analysis gives readers more empathy into their condition.
2. Our hope lies in the possibility of changing these sets of identified institutions. This reform program is difficult and ambitious. It requires massive political commitment from policymakers and citizens. Citizens must remain vigilant and continue to put their leaders to task. Political leaders need to balance both discipline and tolerance in this learning process. Every reform team needs time to learn. There will be inevitable mistakes in the process. But these are risks worth taking for the public whose trust we want to regain.
3. The problem of public trust in customs is as at least as old as the Christian Bible. Before Matthew was called to be Jesus's apostle, he was first the tax collector Levi, who sat at the customs post of Capernaum. Among policymakers, it is this belief that must prevail: that any person, no matter how spotted the history, can be called to reform and with proper guidance succeed. This policy analysis calls neither for cynicism nor despair at the size of the task, but for faith and reimagination of what is possible.

³ meat (1601 1602), iron and steel (7207 7208 7209 7210 7216 7225 7227 7228), and plastic resins (3901 3902 3903 3904 3907).