
Institutional Reform via Hired Integrity

Lessons from a Widespread Approach to Combating Customs Corruption

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Motivation

- Little is known about the effectiveness of specific anti-corruption efforts
 - Becker and Stigler (1974): monitoring, wages
- Key concern is corruptibility of the enforcers/monitors
 - Consider using private firms as monitors

Corruption in customs

- Theft of government revenue
 - Amount turned over to treasury is less than correct amount of duties payable
 - Falsified import documentation masks theft
 - Undervaluation
 - Misreporting of goods classifications
- Extraction of bribes from importers
 - Threats to delay shipment clearance, often under pretext of disagreements over shipment contents/value
 - Potentially discourages trade
- Net result: less import duty revenue
 - In 1990, import duties as share of government revenue averaged 23% across developing countries

Question of interest

- Can governments successfully combat bureaucratic corruption by “hiring integrity” from the private sector?
- Focus: hiring private firms to inspect imported shipments, generating data for fighting corruption in customs agencies
 - Main goals are to:
 - reduce customs corruption
 - facilitate trade
 - improve customs duty collection

Relevant working papers

- Yang (2005), "Integrity for Hire: An Analysis of a Widespread Program for Combating Customs Corruption"
- Yang (2004), "Can Enforcement Backfire? Crime Displacement in the Context of Customs Reform in the Philippines"

Preshipment inspection (PSI)

- PSI firm's agent determines tariff classification and value of shipments before they leave their *origin* countries
 - Information on each shipment then reported to client government
 - Customs duty assessment remains in hands of client country's customs service
- Potential benefits:
 - Reduce theft by revealing falsification of import documentation
 - Reduce extortion of bribes from importers by reducing customs ability to delay shipments

PSI in action



Further details on PSI

- Four largest firms are Bureau Veritas (based in Paris), Cotecna (Geneva), Inchcape Testing Services (London), and Societe Generale de Surveillance (Geneva)
- First PSI program (Indonesia's) started in 1985
 - Total of 50 developing countries have had PSI programs (through end of 2000)
- Fees: ~1% of declared value, with a minimum charge of ~\$250 per shipment
 - Typically paid by client government
 - ~\$0.5 billion per year in mid-1990s

Agenda

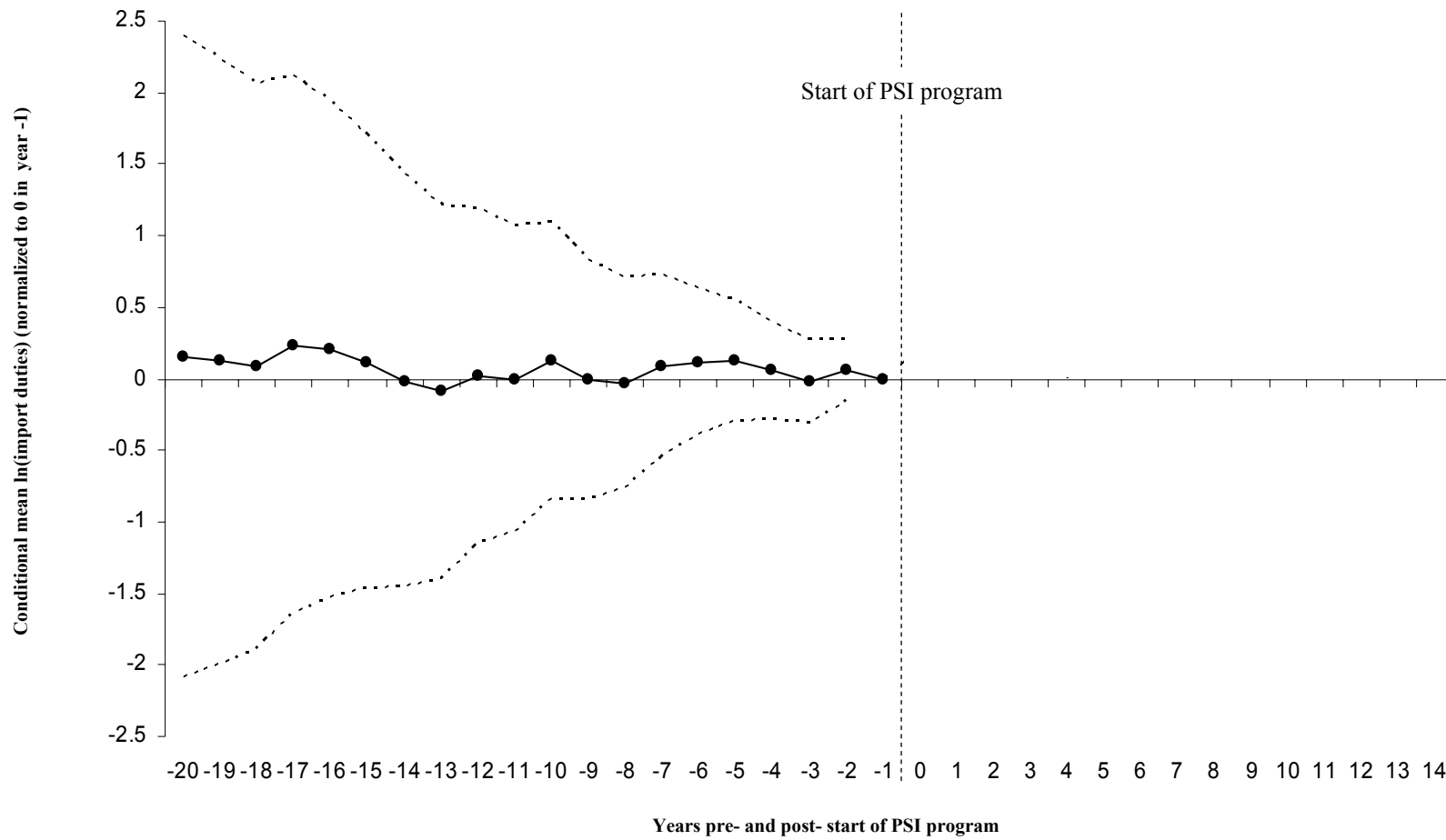
- International evidence on PSI's effectiveness
- A case of failed implementation:
The Philippines, 1989-1992
- Broader implications

Program dates

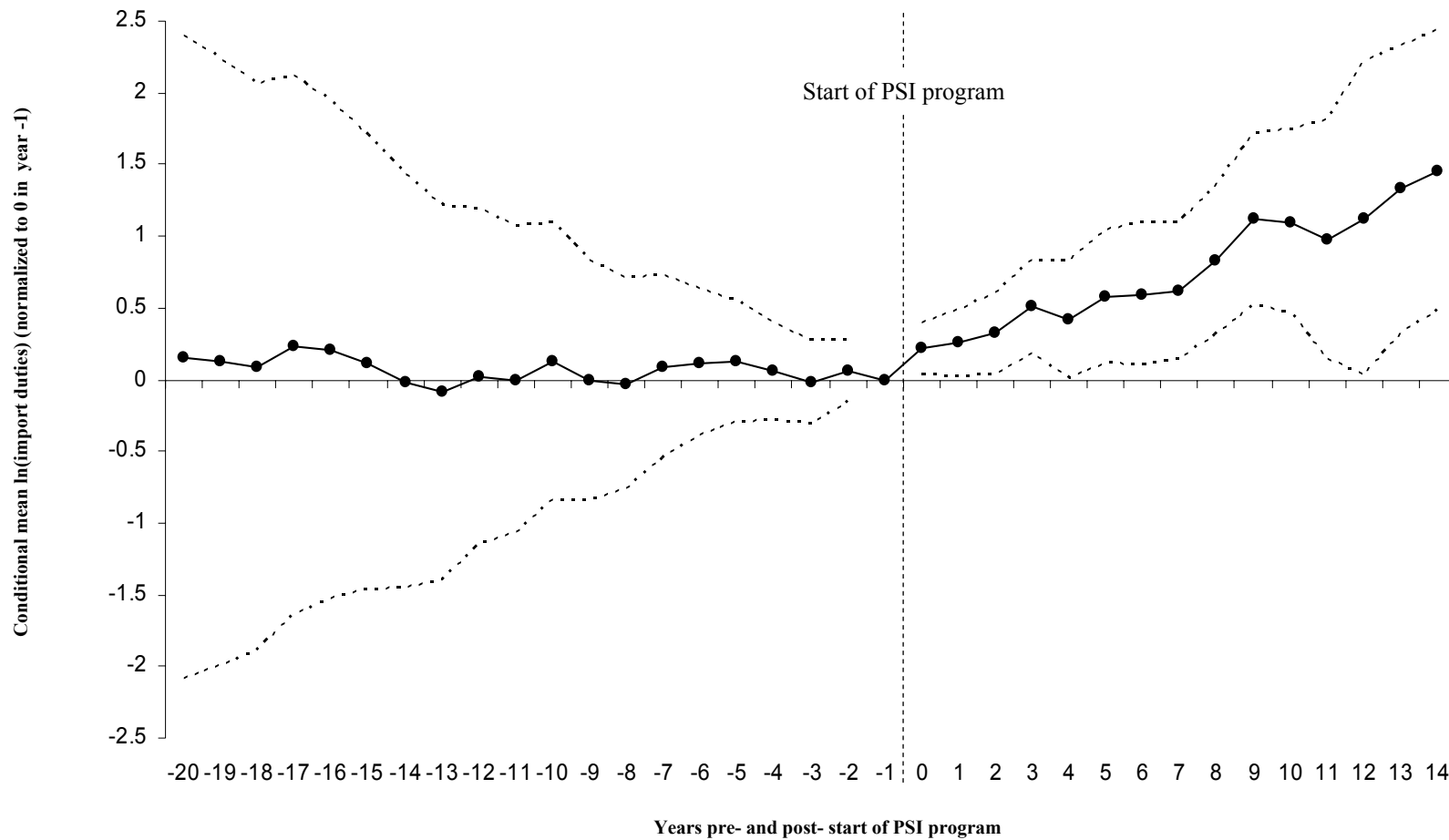
Table 1: Active dates for PSI programs
(as of end of year 2000)

<u>Country</u>	<u>Start date</u>	<u>End date</u>
Indonesia	11-Apr-85	01-Apr-97
Bolivia	21-Apr-86	
Philippines	01-Apr-87	31-Mar-00
Cameroon	01-Dec-88	
Madagascar	01-Jan-89	
Pakistan	18-Apr-90	15-Nov-97
Sierra Leone	15-Nov-90	
Peru	15-Jan-92	
Burkina Faso	23-Sep-92	
Cote d'Ivoire	11-Mar-93	
Congo, Rep.	09-Jun-93	
Uganda	15-Jan-94	
Kenya	31-Jan-94	
Colombia	09-Jun-95	09-Jul-99
Congo, Dem. Rep.	15-Jun-95	
Paraguay	06-May-96	09-Jun-99
Belarus	06-Jan-97	31-Mar-99
Argentina	23-Sep-97	
Georgia	15-Aug-99	

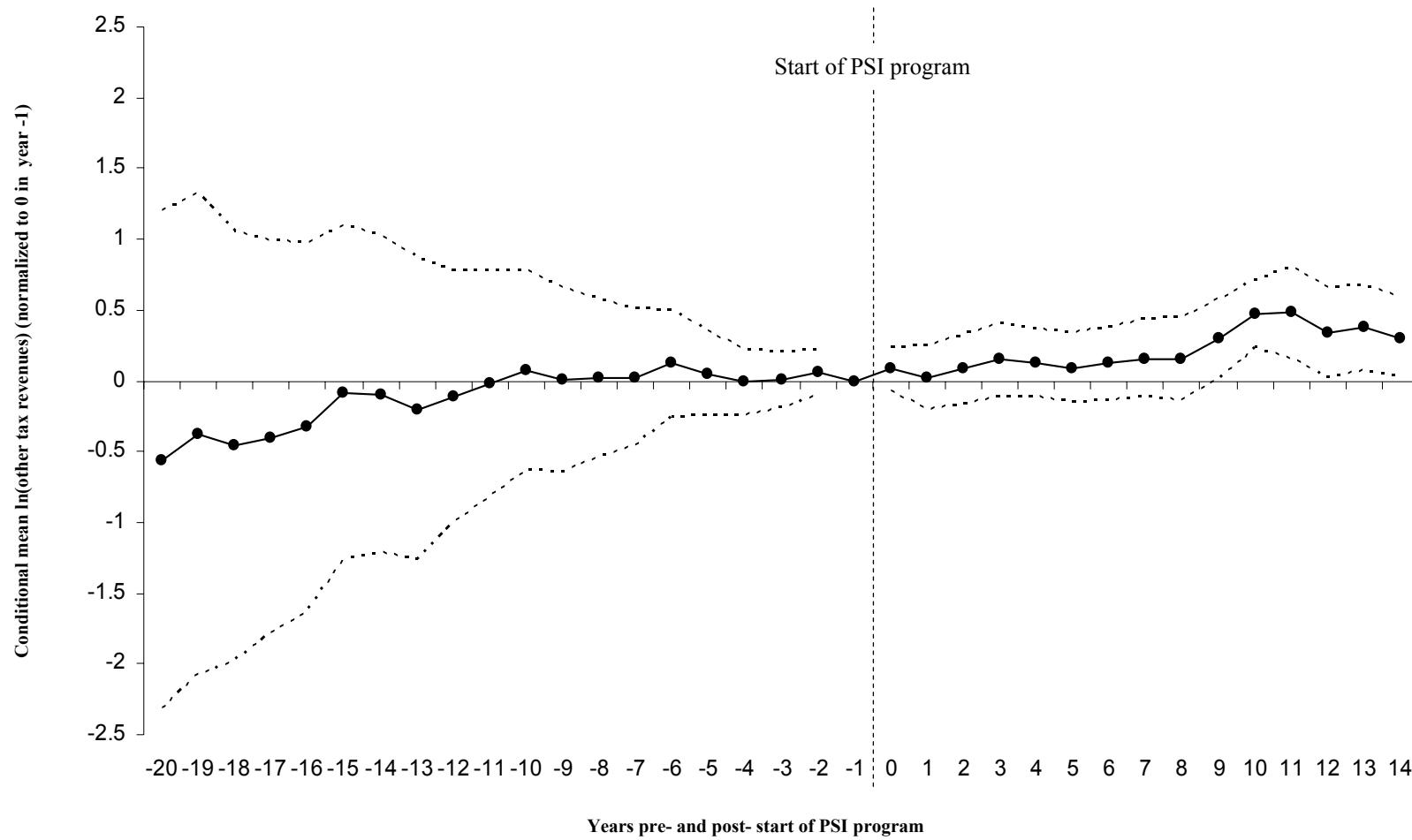
PSI and import duties



PSI and import duties



PSI and other tax revenues



Channels of PSI's effect

- Imports
 - Rise after PSI implementation
- Import capture ratio (index of aggregate *undervaluation*)

$$\theta_{jt} = \frac{\text{Imports recorded by country } j \text{ in year } t}{\text{Exports recorded as destined for country } j \text{ in year } t}$$

- No strong effect of PSI
- Coefficient of variation of product-level import capture ratios (84 ISIC industries, 4-digit level)
 - *Falls* with PSI implementation, suggesting *declines in misreporting* of import product classification

Summary of international evidence

- Implementation of PSI programs is associated with substantial increases in import duty collections
- Likely channels of PSI's effect on import duties include:
 - Increases in imports
 - Declines in mis-reporting in customs
- Cost effectiveness:
 - For the average country implementing PSI, improvements in import duty collections in the fifth year of the program were roughly 5 times larger than program costs

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- International evidence on PSI's effectiveness

- A case of failed implementation:
The Philippines, 1989-1992

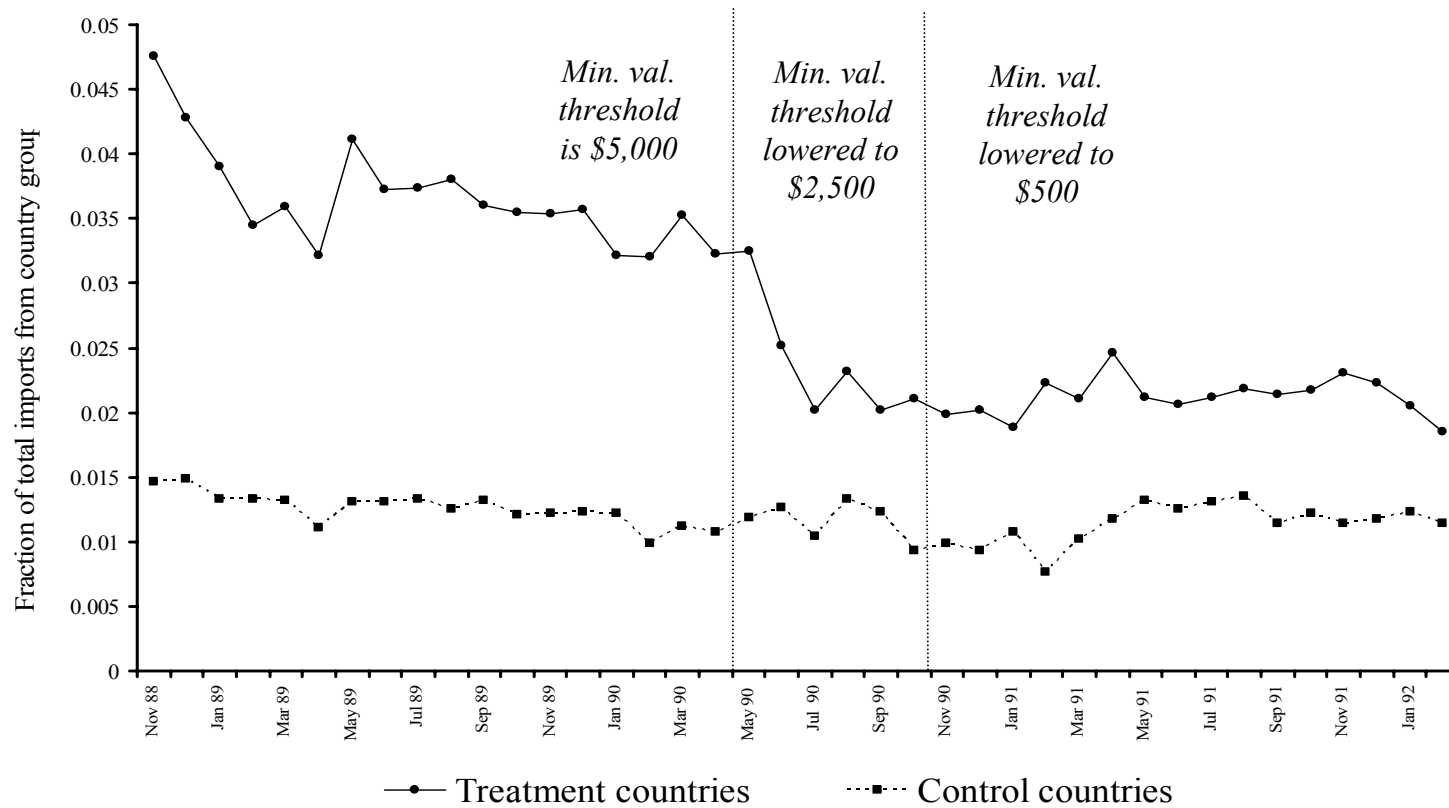
- Broader implications

Philippines natural experiment

- From 1989-1992, PSI only required for imports from a subset of countries
- Prior to 1990, a common method of avoiding PSI: valuation under minimum value threshold (\$5,000)
- In 1990: threshold lowered to \$2,500, then \$500
 - This is an increase in enforcement for imports from the subset of PSI-covered countries
- Results:
 - Reduction in targeted method of duty avoidance
 - But an *increase* in an alternative method: importing via export processing zones
 - Cannot reject that total amount of duty avoidance is unchanged

Reduction in targeted method of duty avoidance

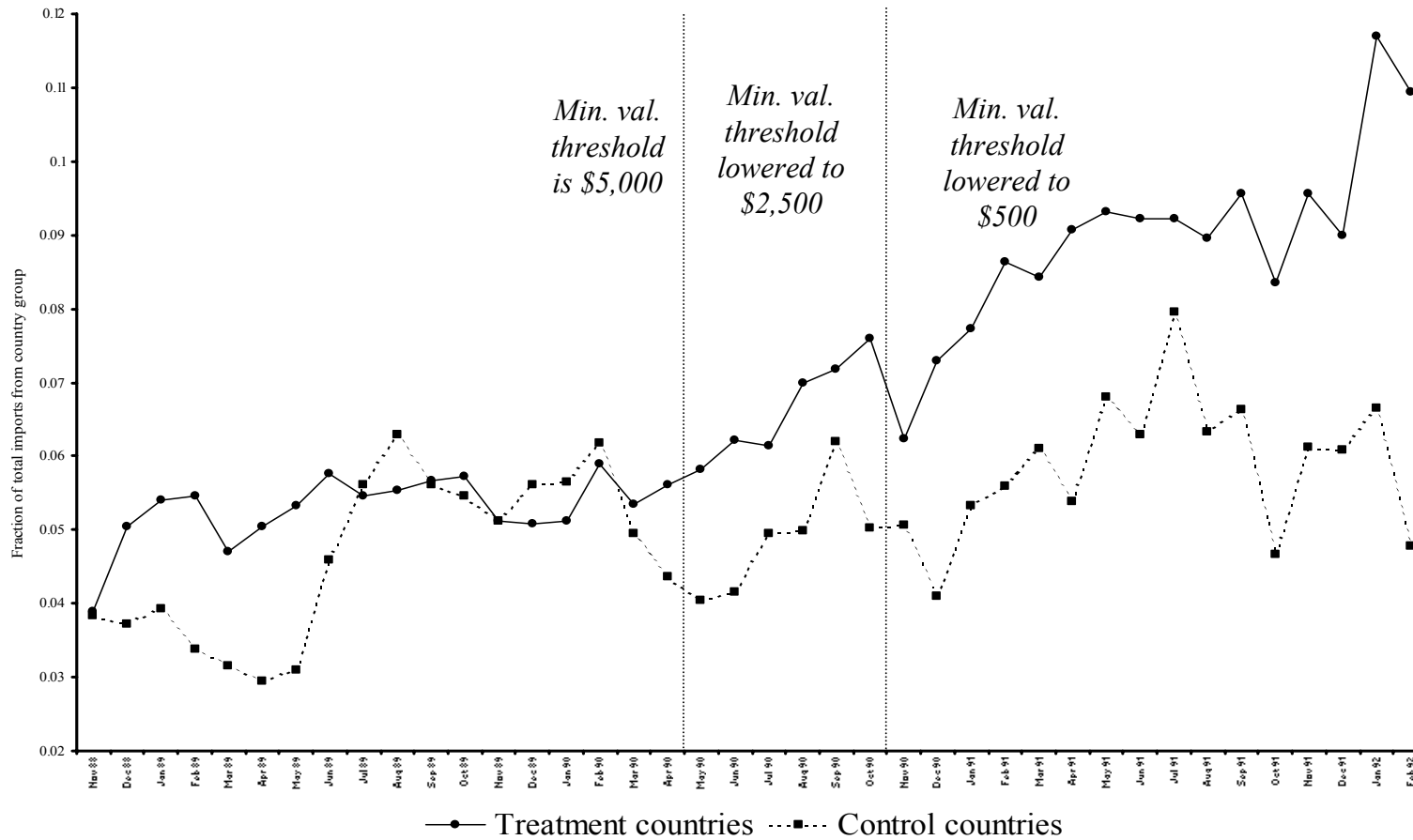
Figure 2: Fraction of total imports entering in shipments valued between \$2,500 and \$5,000 (November 1988 – February 1992)



NOTES-- Chart plots fraction of total imports by value entering in shipments valued between \$2,500 and \$5,000 in the given month, from treatment (PSI) countries and from control (non-PSI) countries. Treatment countries during the period depicted are Hong Kong, Japan, Taiwan, Brunei, Indonesia, Malaysia, Singapore, South Korea, and Thailand. All other countries are control countries. Shipments in overlapping shipment types (e.g., shipment is both "under \$500" and "destined for export processing zone") are allocated to the low-value types (either "between \$5000 and \$500" or "under \$500").¹⁸ Data source: shipment database of the National Statistics Office of the Philippines.

Increase in alternative method

Figure 5: Fraction of total imports destined for export processing zones (November 1988 – February 1992)



NOTES-- Chart plots fraction of total imports destined for export processing zones in the given month, by country group. Data are smoothed to reduce noise (each data point is a three-month centered moving average). For all other notes, see Figure 2.

Agenda

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Broader implications:

(1) The power of information

- PSI simply increases information available to higher-level enforcers
- Increased information had major impact
 - Even in Philippine case, although ultimate outcome was perverse
- So wholesale “outsourcing” of government functions (e.g., customs) may be unnecessary in many cases

Broader implications:

(2) Private firms as monitors

- PSI experience demonstrates that private firms can successfully be used to generate information for anti-corruption efforts
- Existing analogy: auditing of financial statements of public firms, to aid securities regulation
- Approach may be applicable to other contexts
 - Auditing of government procurement
 - “Mystery shoppers” to check service quality in licensing, land titling, etc.

Broader implications:

(3) Pay attention to displacement

- Successful reforms are appropriately “broad”:
 - Cover a wide enough range of alternative methods of committing the illegal activity
- Otherwise, displacement to alternative methods can negate initial gains