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Recasting the Bureau of Customs as a Developmental Agency

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Recasting the Bureau of Customs as a Developmental Agency

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Introduction

Some months back, we met with a young agent working in the Intelligence Group of the Bureau of Customs (BOC), and she shared that an importer offered her PHP 5 million to let a shipment pass through the enhanced inspections regime that's already being implemented at the BOC. She proudly shared with us that she did not accept the bribe and instead chose to help push the good governance reforms being pursued under Commissioner Sunny Sevilla.

The annual income of the highest salary grade in the Intelligence Group is roughly 11 percent of what was plainly offered to the young agent, a relative newcomer in the agency and part of the reform group that recently took over. Put simply, that one bribe was equivalent to about ten years worth of salaries for this customs agent.[1]

Indeed, for someone who's earning modestly in an agency where many do not even share the same zeal for "*matuwid na daan*", the temptation would have seemed unbearable, yet it was the young agent's sense of morality and idealism that managed to prevail in the end. It is rumored, however, that corrupt officials put in the "freezer" (an industry term for those assigned to positions where they can do the least harm, and only because it would be difficult to fire them under our civil service rules) are already licking their chops as the Aquino administration winds down.

Reformists in the BOC are fighting against time. It is well known that highly entrenched interest groups in the agency attempt to simply wait out the tenure of the reformists (a common practice at the end of every attempt to reform the BOC), expecting to bring back the old status

[1] Perhaps one can get a clearer perspective from Appendix Table 1, which shows indicative annual and monthly compensation data for BOC Intelligence Group positions.

* The views expressed in this paper are those of the authors' and do not necessarily reflect the views and policies of the Asian Institute of Management. Questions and comments should be directed to the AIM Policy Center at policycenter@aim.edu.

quo of corruption and rent-seeking that has plagued the agency for decades now. This is the "boom-bust" cycle of reform and regression that has characterized the agency (and perhaps even the entire country).

Someone asked us frankly, "Why should we even bother to reform the Bureau of Customs? With increased trade liberalization (i.e., the reduction in tariffs to zero for many products), won't it become irrelevant anyway?" After discussions with stakeholders and an ongoing analysis of the data, we believe that indeed, we should try to reform this critically important agency, because by facilitating international trade and boosting economic development, the BOC could even be an integral part of our industrialization strategy—a "developmental agency" as our colleague Dr. Cielito Habito puts it.[2] Thus, if we are to succeed, more stakeholders—academics, NGOs, and the private sector—should also take up the challenge to support the reformists.

Trends on the Surface

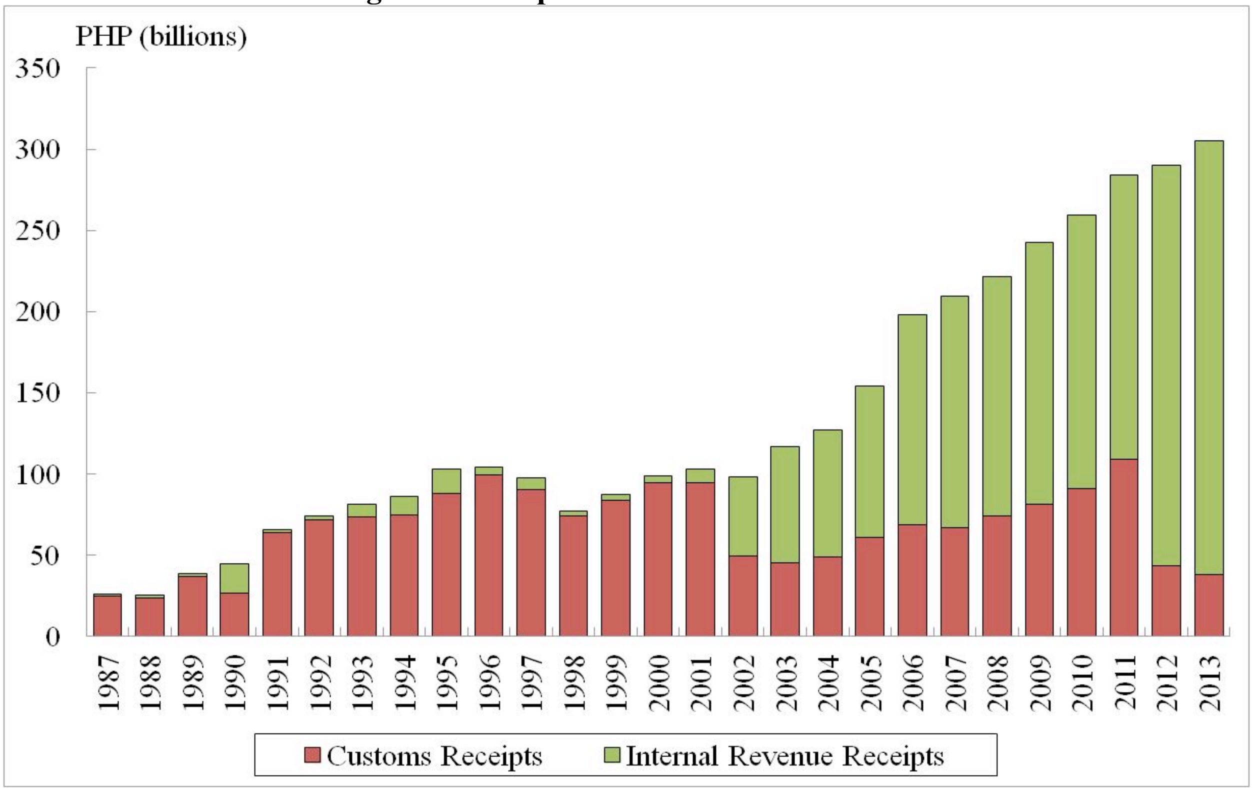
Historically, BOC collections rose from about PHP 26.2 billion in 1987 to about PHP 304.9 billion in 2013, mostly on the back of higher value-added tax collections (and even as tariff revenues declined). As we have noted before, in ECO-101, we learned that diminishing taxes or tariffs could actually boost demand for the products in question (just as increasing taxes or tariffs can dampen demand).[3] So, with tariff reduction and trade liberalization, we may end up with increased trade, which could actually boost revenues even on very marginal tariffs left behind, or more likely, with the value-added tax which still applies to most imports.

However, BOC revenues expressed as a share of total government revenues are somewhere in the range of roughly 20 percent in the past decade, compared to a previous high of about 30 percent in the 1990s. On first blush, this might suggest that the importance of the BOC as a revenue agency has been declining over the years.

Nevertheless, a deeper analysis of potential revenue performance across time paints a slightly different picture.

[2] http://opinion.inquirer.net/64697/customs-as-developmental-agency
[3] http://business.inquirer.net/176327/eco-101-of-customs-reform

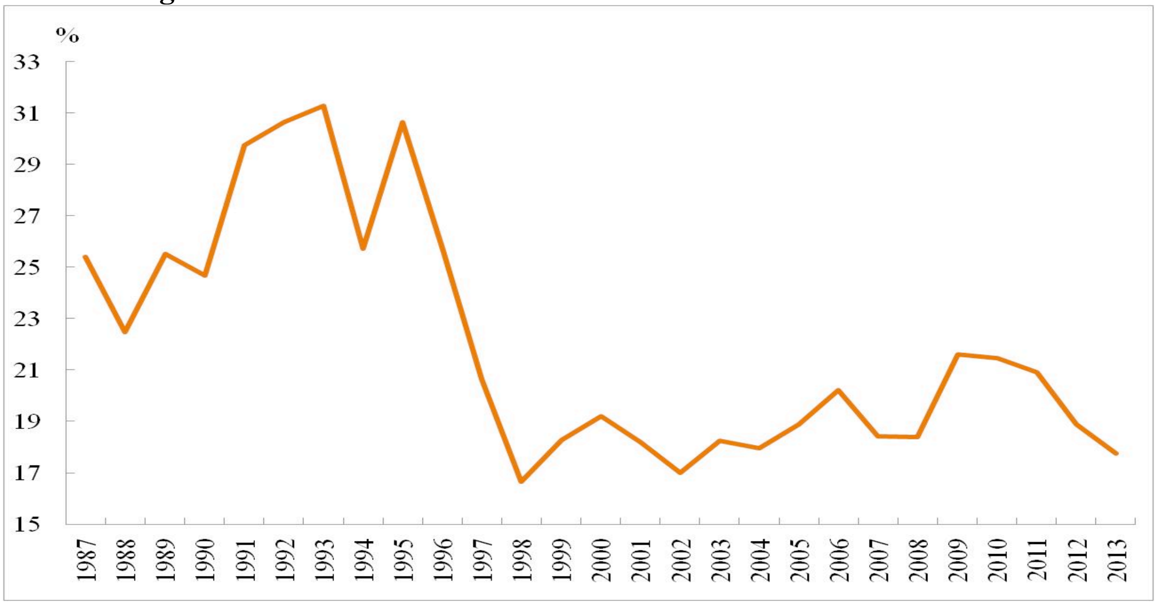
Figure 1: Composition of BOC Collections



Source: Asian Institute of Management (AIM) Policy Center calculations using data from the Bureau of Treasury (BTr) and the Department of Budget and Management (DBM).

Note: PHP = Philippine peso. Customs receipts include import duties, export duties, customs documentary stamps, and other income. Internal revenue receipts include excise tax, advance sales tax, compensating tax, and other taxes (including VAT).

Figure 2: Share of BOC Revenues in Total Government Revenues



Source: AIM Policy Center calculations using data from BTr and DBM.

Potential Revenues and Leakages

Sound estimates of potential revenue are critical in order to assess the performance of an agency with respect to its revenue targets and potential. Revenue targets are typically set by the Department of Finance, and these may or may not reflect the true revenue potential of the BOC. Examining actual trade misinvoicing—the discrepancy between the trade reported by a country and its trading partners—could provide a more useful benchmark of potential revenue performance.[4]

The logic of tracking leakages through misinvoicing is simple. Our trading partners report the amount of goods that they export to us, and our authorities also report the amount of goods that we import. Since there is typically no collusion in these two activities, we could use one to validate the other.

Typically, "technical smuggling" results in undervalued import declarations (resulting in import data that are much lower than what the export data from other countries would suggest). Hence, we can use the amount of misinvoiced trade—the difference between what our trading

[4] Nevertheless, we acknowledge that an analysis of trade misinvoicing is only one of several approaches possible to estimate leakages in customs revenues. This approach also has limitations. It works as a guesstimate of technical smuggling, because it draws on misreported trade data. Hence, any trade that is no longer reported at all—due more likely to direct smuggling—is not captured in the estimate.

partners say they exported to us and what our authorities say we imported from them—as a rough benchmark of what we could have taxed. The result is the estimated "leakage" due to technical smuggling.

We build on the analysis and data in Kar and LeBlanc (2014). These authors examine the illicit flow of money into and out of the Philippines over a 52-year period from 1960 to 2011. Their work finds that between 1960 and 2011, illicit financial inflows amounted to about USD 277.6 billion, while illicit outflows amounted to about USD 132.9 billion. Thus, over the 52-year time span, cumulative illicit financial flows into and out of the Philippines amounted to about USD 410.5 billion.

Part of their analysis generates useful estimates of trade misinvoicing and the resulting revenue leakages during the past 50 years. They note that the vast majority of money flowing illicitly into and out of the Philippines was accomplished through the misinvoicing of trade, rather than hot money flows (e.g., unrecorded wire transfers). Of the USD 132.9 billion that flowed illicitly out of the nation, USD 95.2 billion (or roughly 72 percent) was associated with trade misinvoicing.

The dominance of trade misinvoicing as a conduit for illicit flows is even more apparent when examining illicit inflows. Of the USD 277.6 billion in illicit financial inflows over the years, USD 267.8 billion (or roughly 96 percent) is attributable to trade misinvoicing.

Moreover, Kar and LeBlanc (2014) conclusively find that both illicit outflows and inflows are harmful to the Philippines. Illicit outflows drain money from the domestic Philippine economy. They facilitate income tax and customs duty evasion, and are found to deplete domestic savings. As such, it is concluded that illicit outflows hamper sustainable economic growth in the long run.

Interestingly, illicit financial inflows are found to be an even bigger drain on the Philippine economy. Most of the USD 267.8 billion in illicit inflows due to trade misinvoicing is the result of under-invoicing imports. It is so widespread in the Philippines that over the past decade, 25 percent of the value of all goods imported into the Philippines (i.e., 1 out of every 4 dollars worth of imports) goes unreported to customs officials.

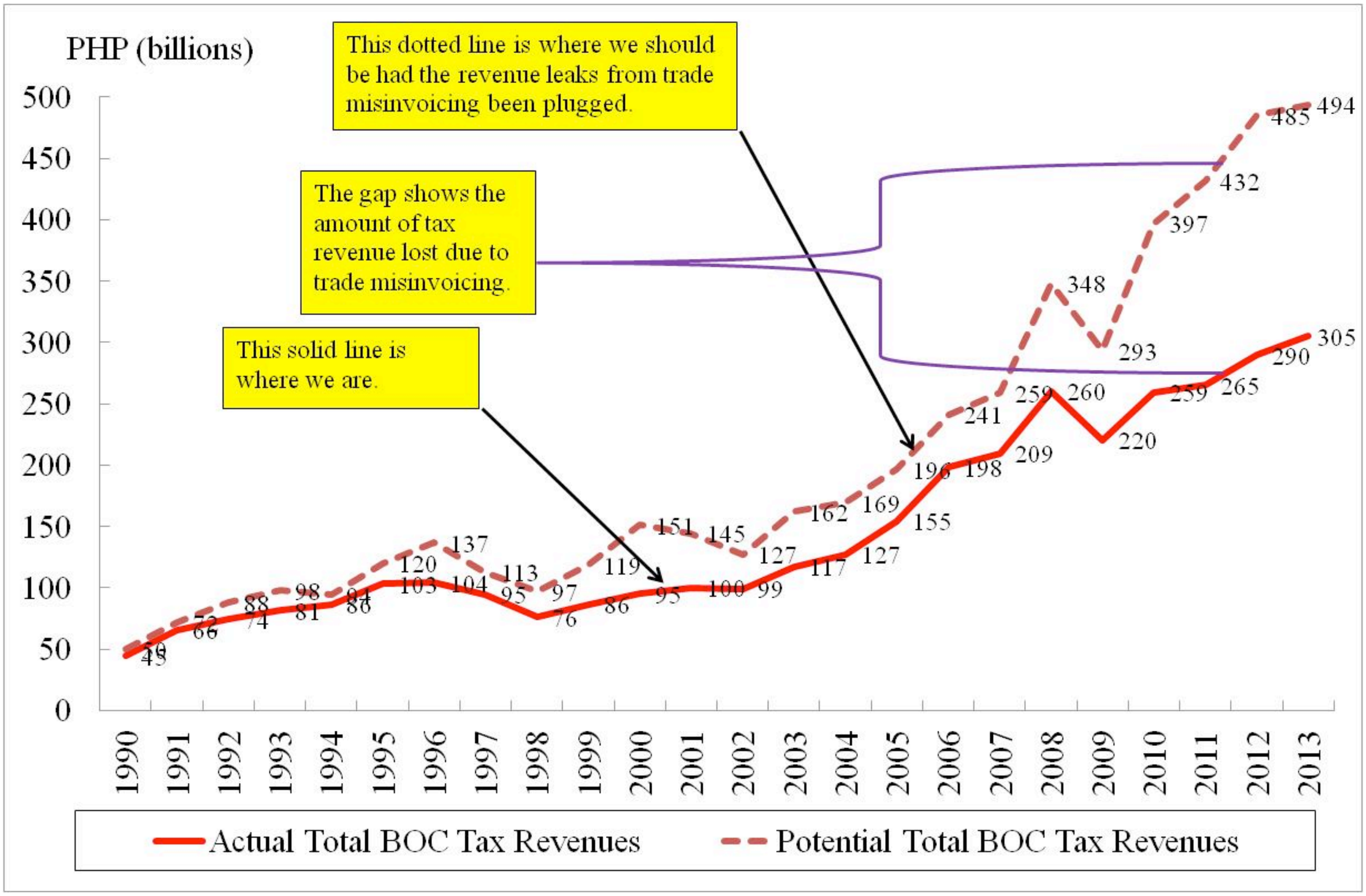
Import under-invoicing is seen to be driven by a desire to reduce or eliminate the costs of customs duties and tariffs. As taxes on international trade constitute about 22 percent of total taxes in the Philippines, such widespread under-invoicing could have a severely damaging effect on government revenues.

These figures suggest that BOC revenues could have been much higher, if only leakages were plugged. Even as tax revenues collected by the BOC have increased over the past decades, leakages due to corruption appear to have risen as well. In 1990, the revenue gap due to misinvoicing was about PHP 5 billion, as shown in Figure 3. By 2011, the revenue gap due to misinvoicing ratcheted upwards to PHP 167 billion. When we apply the method used in Kar and LeBlanc (2014) in order to estimate the revenue gap due to misinvoicing in 2012 and 2013, our calculations are in the order of about PHP 195 billion in 2012 and about PHP 189 billion in 2013.[5]

Looking at Figure 4, one should also realize that had the leakages been plugged, the share of BOC revenues in total government revenues would have been much larger. In fact, had there been no leakages from 2010 to 2012, the share of the BOC in total government revenues would have easily matched the 30 percent peak achieved during the 1990s. Thus, the BOC should have continued to play a huge role as a revenue agency. Its decline in importance, however, was not simply a natural consequence of trade liberalization. Rather, its steep decline was more likely due to systemic corruption.

[5] Lost revenues due to misinvoicing are calculated using the definitions and formulas found in Kar and Le Blanc (2014), pages 13-14. First, the amount of import under-invoicing is multiplied by the effective tariff rate on imports (i.e., the effective tariff rate on imports = total tax revenues from international trade divided by imports). Second, the amount of export under-invoicing is multiplied by the effective tax rate on incomes, profits, and capital gains (i.e., the effective tax rate on incomes, profits, and capital gains = taxes on incomes, profits, and capital gains divided by gross domestic product (GDP). Estimates of misinvoicing are calculated using data from the Direction of Trade Statistics (DOTS). The effective tariff rate on imports and the effective tax rate on incomes, profits, and capital gains are calculated using data from the Philippine Department of Finance, the Department of Budget and Management, Bangko Sentral ng Pilipinas, and World Bank Economic Indicators Database.

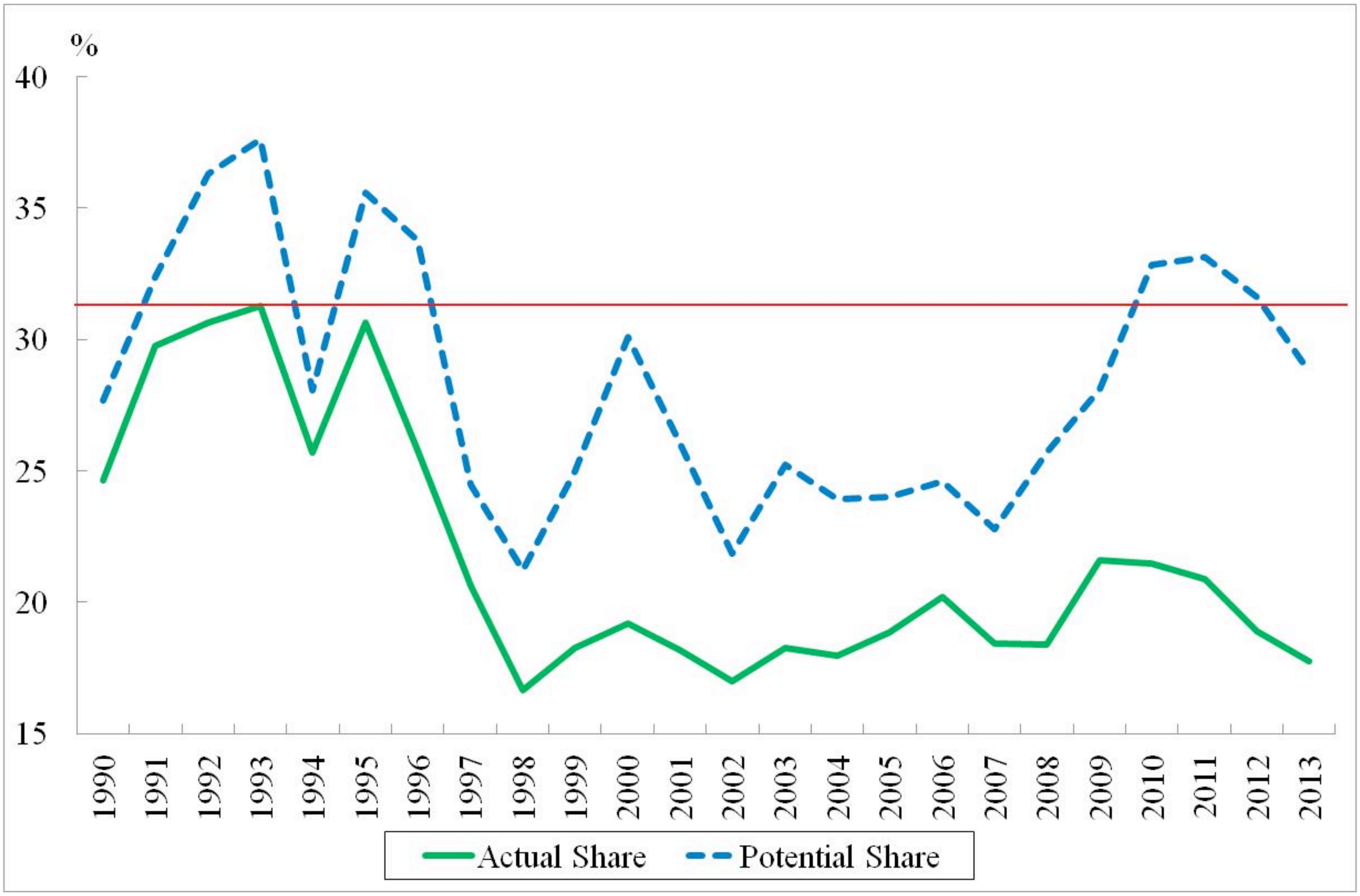
Figure 3: An Illustration of the Growing Gap Between Actual Total Revenue and Potential Total Revenue



Source: AIM Policy Center calculations using data from Kar and LeBlanc (2014), BTr, DBM, and BSP.

Note: PHP = Philippine peso. Tax revenue losses from trade misinvoicing were originally quoted in United States dollars, so average annual exchange rates were obtained from the Bangko Sentral ng Pilipinas (BSP). Total tax revenue loss + actual total tax revenues = potential total tax revenues.

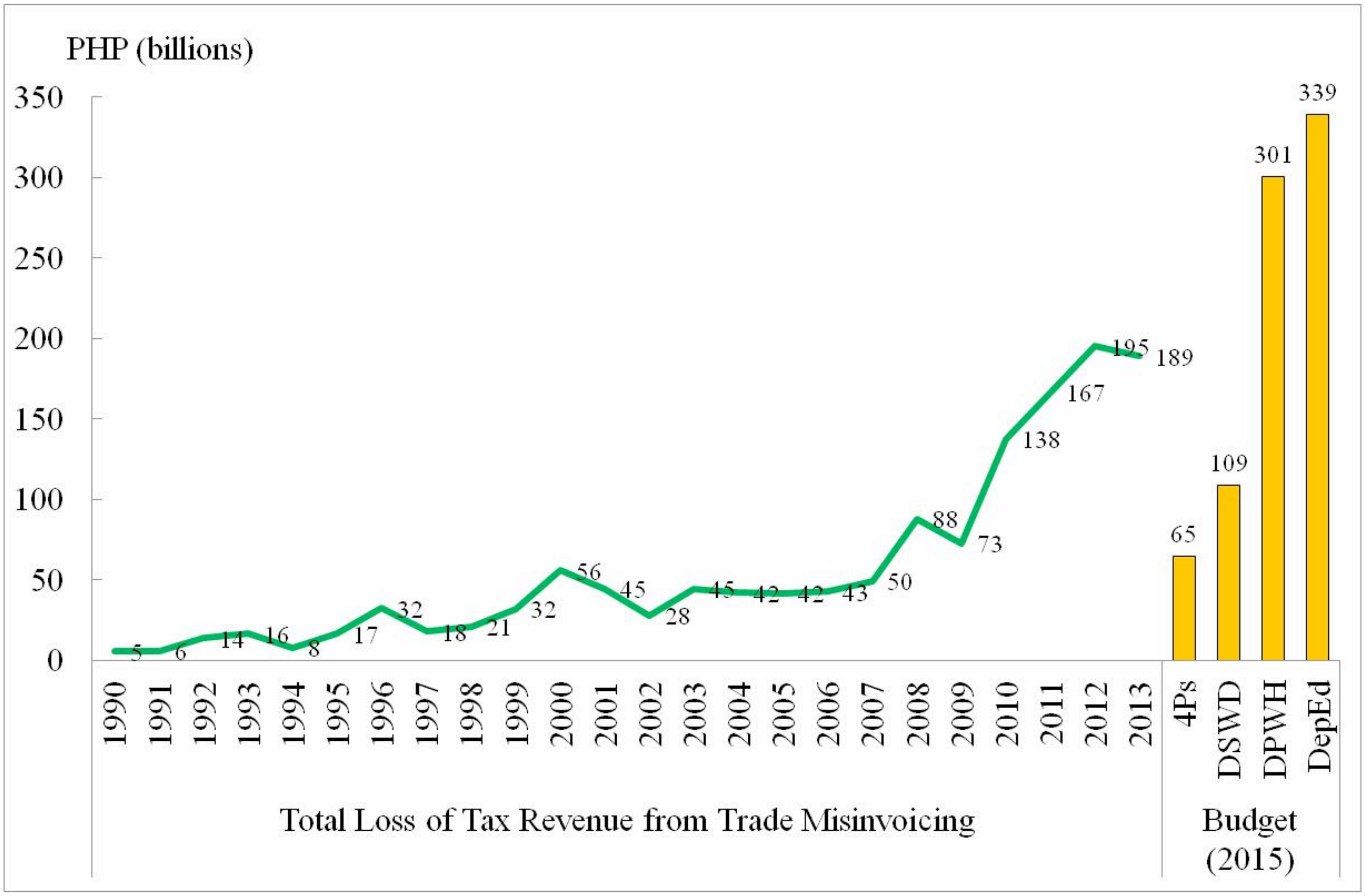
Figure 4: Actual and Potential Shares of BOC Revenues in Total Government Revenues



Source: AIM Policy Center calculations using data from Kar and LeBlanc (2014), BTr, DBM, and BSP.

Just to put things in perspective, these estimates of tax leakages from trade misinvoicing are roughly equivalent to half of the Department of Education budget, and well over twice the size of the budget for *Pantawid Pamilyang Pilipino* Program or 4Ps (i.e., the government's anti-poverty program), as shown in Figure 5.

Figure 5: Revenue Loss from Trade Misinvoicing Juxtaposed Against 2015 Public Spending



Source: AIM Policy Center calculations using data from Kar and LeBlanc (2014), BTr, DBM, and BSP.

Note: PHP = Philippine peso. Tax revenue losses from trade misinvoicing were originally quoted in United States dollars, so average annual exchange rates were obtained from the BSP.

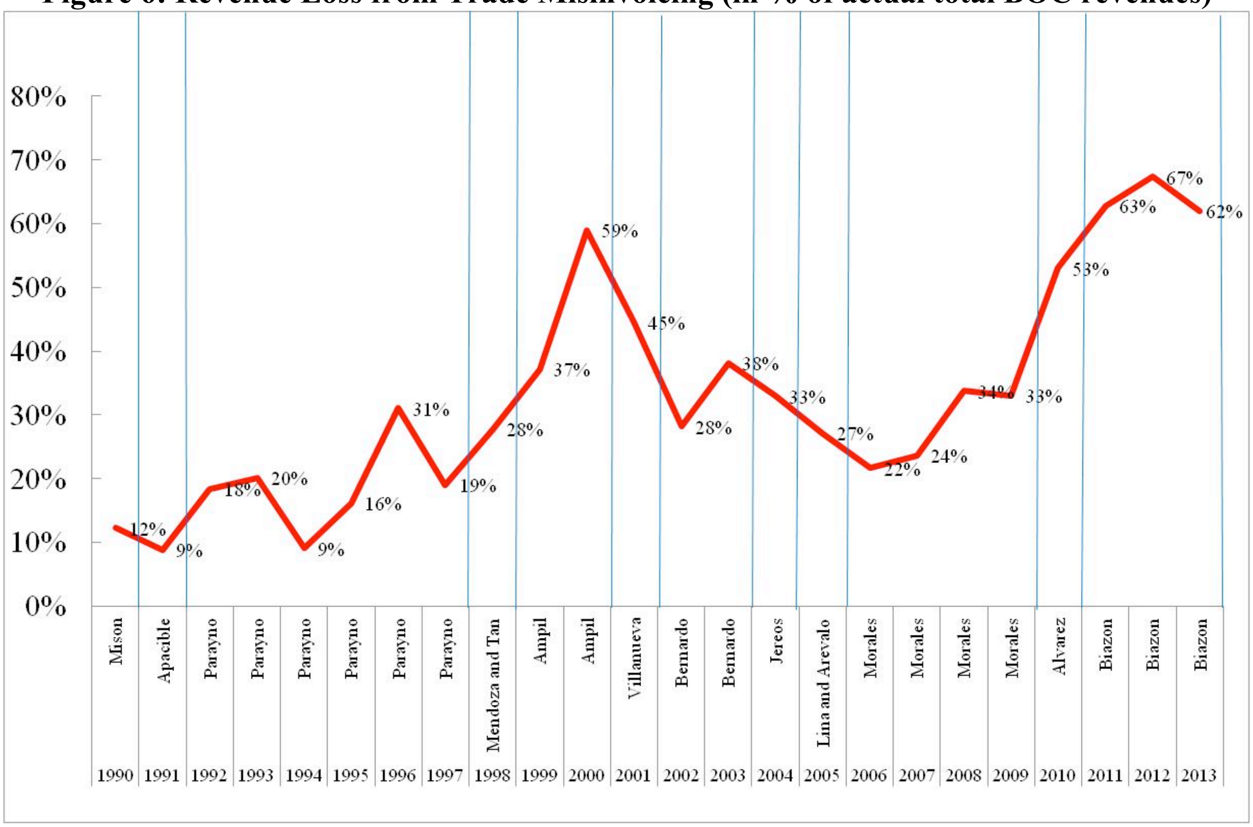
Instead of strengthening the provision of public goods and services, this money has been siphoned and is likely part of "corruption finance" (for lack of a better term)—that is, the money that could be used to further propagate corruption and rent-seeking opportunities. Analyses and anecdotal evidence on the BOC are replete with examples of how customs officials are coddled by politicians, who then take a share of the regularly harvested tax leakages. Anecdotal reports point to numerous cases of corruption at the port level which spill over to the political sphere. With "corruption finance", corrupt individuals can continue to perpetuate themselves in power and weaken our institutions (and ultimately the overall economy).

We can consider PHP 167 billion (and growing) as an upper bound estimate of resources that end up as “corruption finance”. Because these are resources at the disposal of the corrupt, we can only guess at how much more corruption this begets.

Indeed, these revenue loss figures can help us define clear benchmarks of whether and to what extent the BOC is progressing (or not) in combating corruption—and in this case, specifically in the effort to limit trade misinvoicing and increase the actual tax revenues to approximate the potential total revenues. Figure 6 and Table 1 provide a brief illustration of the amount of lost tax revenues (expressed as a share of total BOC revenues) under each BOC Commissioner.

Of course, we cannot simply attribute these figures directly to these leaders, but they could still serve as a rough barometer of whether we are winning or losing this battle to end corruption in the BOC under different reform regimes.

Figure 6: Revenue Loss from Trade Misinvoicing (in % of actual total BOC revenues)



Source: AIM Policy Center calculations using data from Kar and LeBlanc (2014), BTr, DBM, and BSP.

Note: Tax revenue losses from trade misinvoicing were originally quoted in United States dollars, so average annual exchange rates were obtained from the BSP.

Table 1: Tax Revenue Losses by BOC Commissioner

Commissioner	Number of Years in Service	Total Tax Revenue Loss (in billions of PHP)	Average Tax Revenue Loss (in billions of PHP)
Mison	1	5	5
Apacible	1	6	6
Parayno	6	105	18
Mendoza and Tan	1	21	21
Bernardo	2	73	36
Lina and Arevalo	1	42	42
Jereos	1	42	42
Ampil	2	88	44
Villanueva	1	45	45
Morales	4	253	63
Alvarez	1	138	138
Biazon	3	551	184

Source: AIM Policy Center calculations using data from Kar and LeBlanc (2014), BTr, DBM, and BSP.

Note: PHP = Philippine peso. Tax revenue losses from trade misinvoicing were originally quoted in United States dollars, so average annual exchange rates were obtained from the BSP.

A Paradigm Shift Towards a Modern and Developmental Customs

Ending the "corruption finance" propagated through tax leakages in the BOC could be good in and of itself for the country, but international evidence and experience suggest that our customs agency has the potential to become much more relevant to the broader economic development agenda.[6] It could very well be the vanguard of trade facilitation for the country, by simplifying and harmonizing international trade procedures, and thus also lowering the costs and the "friction" of moving goods across our borders.

In the ASEAN Economic Community Blueprint, an outstanding commitment made by the member-countries is the establishment of trade facilitation measures, which fall largely in the hands of their customs authorities.[7] Indeed, there is an international trend of diminishing dependence on trade taxes as a contributor to government revenues. For instance, World Bank data on the share of customs and other import duties in total tax revenue show that in a sample of

[6] For interested readers, international papers that more thoroughly discuss the topic of trade facilitation are cited in the list of references.

[7] ASEAN stands for the Association of Southeast Asian Nations, which is composed of the following: Brunei, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. The blueprint is found on: http://www.asean.org/archive/5187-10.pdf.

83 countries, the shares in 52 have actually declined between 2008 and 2012. (See Appendix Tables 2 to 5.)

In light of such trend, the World Customs Organization (WCO) has placed greater emphasis on the economic development function of customs agencies via trade facilitation. The WCO links trade facilitation to overall policy objectives, such as improving well-being, reducing poverty, protecting consumers, and promoting economic development. Customs plays a role in expedited—but still highly robust—clearing and regulatory processes that continue to protect the public and promote general consumer welfare. Hence, highly efficient customs agencies could help underpin economic competitiveness and also facilitate the robust growth of international trade.[8]

Indeed, the literature on trade facilitation emphasizes the potential welfare gains from investments in customs agencies that expedite processing while still ensuring that national laws and regulations are upheld. A recent study estimates that up to 75 percent of the transaction costs in international trade are due to administrative obstacles—including customs procedures, tax procedures, and cargo inspections—thus emphasizing the importance of streamlining these procedures without necessarily sacrificing the effort to implement the laws and regulations of the country (notably those that protect the public).

Often-quoted studies point to a possible increase in global income in the order of about USD 40 billion from even a 1-percent reduction in trade transaction costs (Walkenhorst and Yasui, 2003:21), as well as a boon for small-scale and medium-scale enterprises (SMEs) that normally face much higher trade transaction costs (compared to large firms). Thus, countries like the Philippines, and those in ASEAN more broadly, which possess much larger numbers of SMEs as a share of total enterprises, stand to gain even more, as more enterprises are able to break into international export markets. Another study suggests that enhanced trade facilitation could boost global trade in manufactures by roughly USD 377 billion. Roughly half of these gains are expected to come from improved port efficiency and customs environment alone (Wilson et al, 2004:16).

Thus, customs can play a much larger role in the country's development efforts. And reformists in the BOC are working on a highly compacted timeline to push key reforms, which include: 1) pre-arrival clearance to expedite the release of cargo; 2) full implementation of the

[8] See http://www.wcoomd.org/en/topics/facilitation/overview/customs-procedures-and-facilitation.aspx.

National Single Window (an online platform facilitating all clearances for importation); 3) investments in the computerization and IT system underpinning customs administration, in order to facilitate information capture, data collection, and reporting platforms to underpin "open government" reforms (e.g., the "Customs ng Bayan" website). Finally, a related reform is focused on the passage of the proposed Customs Modernization and Tariff Act (CMTA) (already filed in 2008 under the 15th Congress and being pursued for finalization by the 16th Congress).[9]

Clearly, the main gains from a well-functioning and modernized BOC are no longer just revenues. Rather, the main benefit would largely be its contribution to good governance (by shutting down one major source of "corruption finance"), while also promoting expanded trade and commerce, which ultimately redound to stronger and more inclusive growth and development.

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[9] Regarding the CMTA, since the 1978 Tariff and Customs Code is no longer responsive to the present demands of trade and commerce, the bill is expected to align the country with global customs administration standards and update our tariff laws. It makes the BOC consistent with the provisions of the Revised Kyoto Convention of the World Customs Organization, which the 14th Philippine Congress ratified. CMTA is expected to further rationalize tariffs, reduce the costs of doing business, making it much easier for small and medium enterprises to access essential imported inputs.

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Appendix

Appendix Table 1: Indicative Annual Compensation Data for BOC Intelligence Group Positions (Salaries in Philippine Pesos)

Position	Division	Government Salary Grade	Indicative Annual Salary	Indicative Monthly Salary
Attorney IV	Investigation Division	23	552,768	46,064
Attorney IV	Investigation Division	23	552,768	46,064
Attorney III	Investigation Division	21	473,916	39,493
Intelligence Agent II	Intelligence Division	19	406,308	33,859
Intelligence Agent I	Intelligence Division	19	406,308	33,859
Intelligence Officer III	Intelligence Division	18	383,412	31,951
Customs Operations Officer III	Intelligence Division	16	322,536	26,878
Intelligence Officer II	Intelligence Division	15	298,644	24,887
Special Investigator II	Investigation Division	11	222,588	18,549
Special Investigator I	Investigation Division	11	222,588	18,549
Special Investigator I	Investigation Division	11	222,588	18,549
Special Investigator I	Intelligence Division	11	222,588	18,549
Intelligence Officer I	Intelligence Division	11	222,588	18,549
Special Agent II (IG)	Intelligence Division	11	222,588	18,549
Administrative Officer I	Intelligence Division	10	207,060	17,255
Special Agent I (IG)	Intelligence Division	8	179,172	14,931

Source: BOC bulletin of vacant positions for hiring and promotion and salary grade data from the Commission on Elections.

Appendix Table 2: International Comparison of Customs and Other Import Duties as % of Total Tax Revenue (first of four tables)

Country Name	2008	2012	Change (Increase, Decrease, No Change)
Sierra Leone	50.90	13.21	Decrease
Sao Tome and Principe	38.35	24.52	Decrease
Bahamas, The	41.52	28.63	Decrease
Liberia	46.48	35.17	Decrease
Afghanistan	45.68	36.42	Decrease
Oman	40.06	32.60	Decrease
Cambodia	24.03	17.72	Decrease
Serbia	10.53	5.06	Decrease
Nepal	24.09	19.32	Decrease
Colombia	8.88	5.02	Decrease
Philippines	24.80	21.30	Decrease
Suriname	13.19	9.85	Decrease
Macedonia, FYR	8.16	5.31	Decrease
Morocco	7.22	4.44	Decrease
St. Kitts and Nevis	21.68	19.15	Decrease
Grenada	23.08	20.76	Decrease
Lao PDR	11.70	9.42	Decrease
Jordan	10.31	8.15	Decrease
Ukraine	7.15	5.05	Decrease
Uganda	11.47	9.54	Decrease

Source: World Bank Economic Indicators Database.

Appendix Table 3: International Comparison of Customs and Other Import Duties as % of Total Tax Revenue (second of four tables)

Country Name	2008	2012	Change (Increase, Decrease, No Change)
Guatemala	7.28	5.40	Decrease
San Marino	3.17	1.38	Decrease
Burkina Faso	18.31	16.57	Decrease
Lebanon	9.51	7.90	Decrease
Honduras	7.03	5.50	Decrease
Costa Rica	6.56	5.08	Decrease
Peru	3.28	1.81	Decrease
Dominica	16.98	15.53	Decrease
St. Lucia	22.45	21.05	Decrease
Bulgaria	1.37	0.19	Decrease
Moldova	8.59	7.58	Decrease
Jamaica	7.66	6.80	Decrease
Malaysia	2.33	1.50	Decrease
Kenya	8.43	7.64	Decrease
Antigua and Barbuda	14.08	13.41	Decrease
El Salvador	5.83	5.19	Decrease
Nicaragua	5.44	4.88	Decrease
Cyprus	1.10	0.57	Decrease
Paraguay	12.21	11.79	Decrease
Azerbaijan	3.60	3.28	Decrease

Source: World Bank Economic Indicators Database.

Appendix Table 4: International Comparison of Customs and Other Import Duties as % of Total Tax Revenue (third of four tables)

Country Name	2008	2012	Change (Increase, Decrease, No Change)
Thailand	6.43	6.15	Decrease
Armenia	6.03	5.77	Decrease
Uruguay	6.12	5.95	Decrease
Israel	1.29	1.16	Decrease
Slovenia	0.40	0.28	Decrease
Russian Federation	9.80	9.72	Decrease
Japan	1.90	1.87	Decrease
Latvia	1.07	1.05	Decrease
Croatia	2.73	2.71	Decrease
France	-0.03	-0.03	Decrease
Czech Republic	0.00	0.00	Decrease
Portugal	0.00	0.00	Decrease
Slovak Republic	0.00	0.00	Increase
Togo	23.48	23.49	Increase
Poland	0.75	0.75	Increase
Cabo Verde	20.54	20.56	Increase
Austria	-0.04	0.00	Increase
United States	1.98	2.02	Increase
Ireland	0.05	0.10	Increase
Norway	0.30	0.37	Increase

Source: World Bank Economic Indicators Database.

Appendix Table 5: International Comparison of Customs and Other Import Duties as % of Total Tax Revenue (last of four tables)

Country Name	2008	2012	Change (Increase, Decrease, No Change)
Malta	-0.11	0.00	Increase
Australia	2.12	2.24	Increase
New Zealand	3.13	3.29	Increase
Turkey	1.63	1.86	Increase
Georgia	1.14	1.43	Increase
Iceland	1.63	1.95	Increase
Romania	0.25	0.64	Increase
Tunisia	8.30	8.83	Increase
South Africa	3.48	4.13	Increase
Benin	26.44	27.19	Increase
St. Vincent and the Grenadines	10.18	11.05	Increase
Brazil	3.56	4.59	Increase
India	16.21	17.32	Increase
Kyrgyz Republic	14.92	16.76	Increase
Angola	5.42	7.29	Increase
Mongolia	10.01	12.80	Increase
Cote d'Ivoire	30.54	34.07	Increase
Seychelles	19.21	25.66	Increase
Belarus	7.49	16.59	Increase
Botswana	37.89	47.32	Increase
Kuwait	61.96	74.21	Increase
Sri Lanka	10.90	23.84	Increase
Central African Republic	16.70	39.05	Increase

Source: World Bank Economic Indicators Database.

+AMDG

The Asian Institute of Management (AIM) is a pioneer in international management education in Asia. It is committed towards making a difference in the sustainable growth of Asian societies by developing professional, entrepreneurial, and socially responsible leaders and managers. Its programs and research focus on the nexus between business and development in Asia.

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