

# Curbing Illicit Financial Flows: Combating Corruption in Customs

Bob Rijkers – World Bank



# OVERVIEW

## **Motivation**

- Tariff evasion is costly, and a major source of illicit flows

## **How costly is tariff evasion?**

- Detecting corruption: Mirror statistics
- Tax revenue losses are large – up to 50% of tariff revenue

## **Who benefits?**

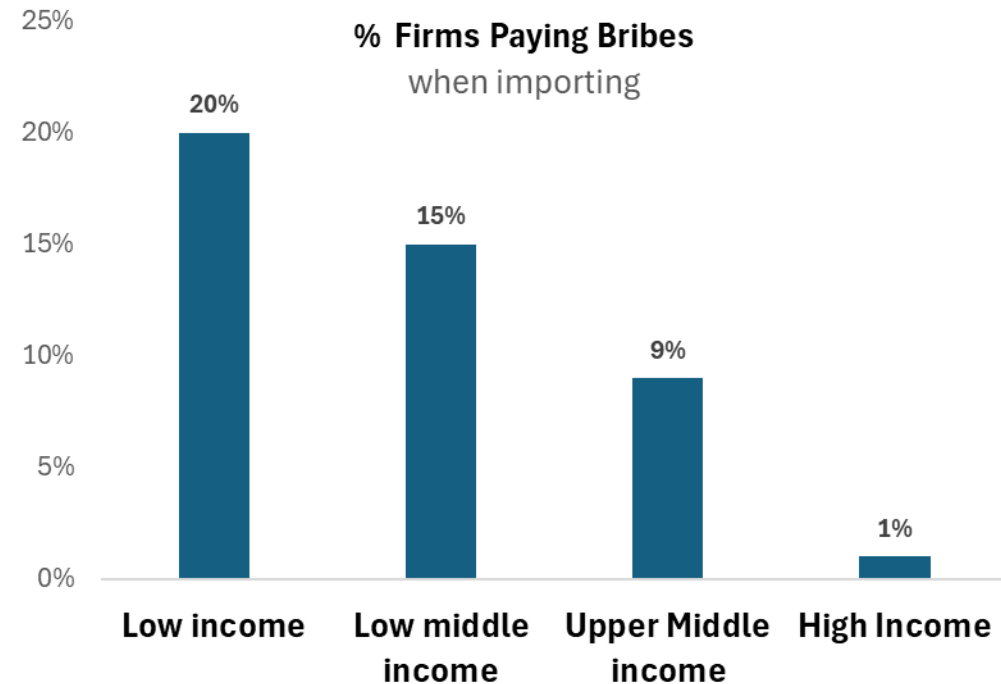
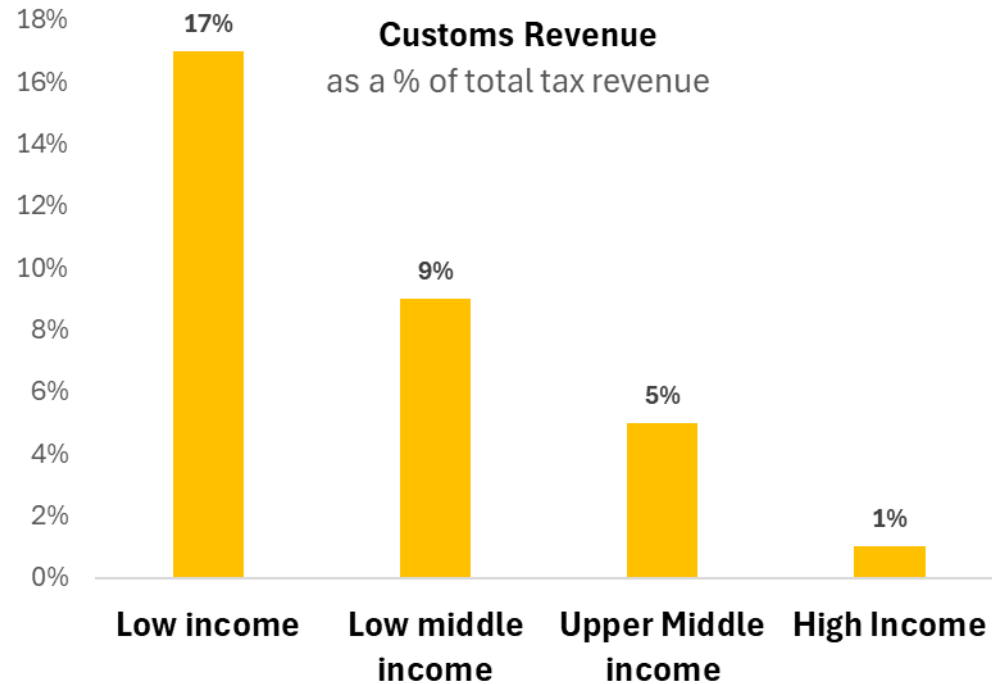
- Gains are concentrated – typically a few bad apples
- Consumers may gain

## **How can corruption be remedied? A Case Study**

- IT vs Incentives?
- Evidence from Madagascar

## **Conclusion**

# CORRUPTION IN CUSTOMS IS COSTLY ESPECIALLY IN LOW INCOME COUNTRIES

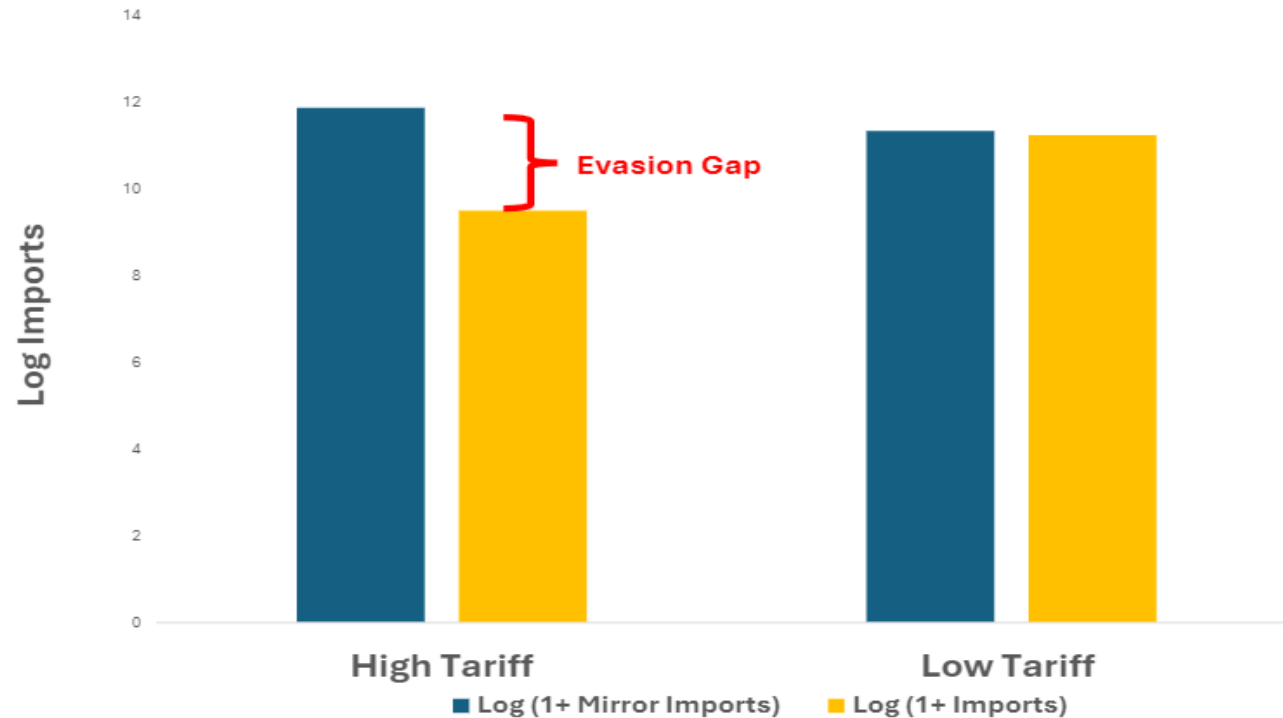


- Low-Income Countries are Highly Reliant on Customs Revenue
- But also face greater challenges enforcing trade policy
- **Tariff evasion is a major contributor to Illicit Financial Flows**

# DETECTING CORRUPTION

**Mirror analysis:** use discrepancies in trade statistics to identify cases of potential **underreporting** of goods at import.

$$\text{Evasion Gap} = \text{Exports (X)} - \text{Imports (M)}$$



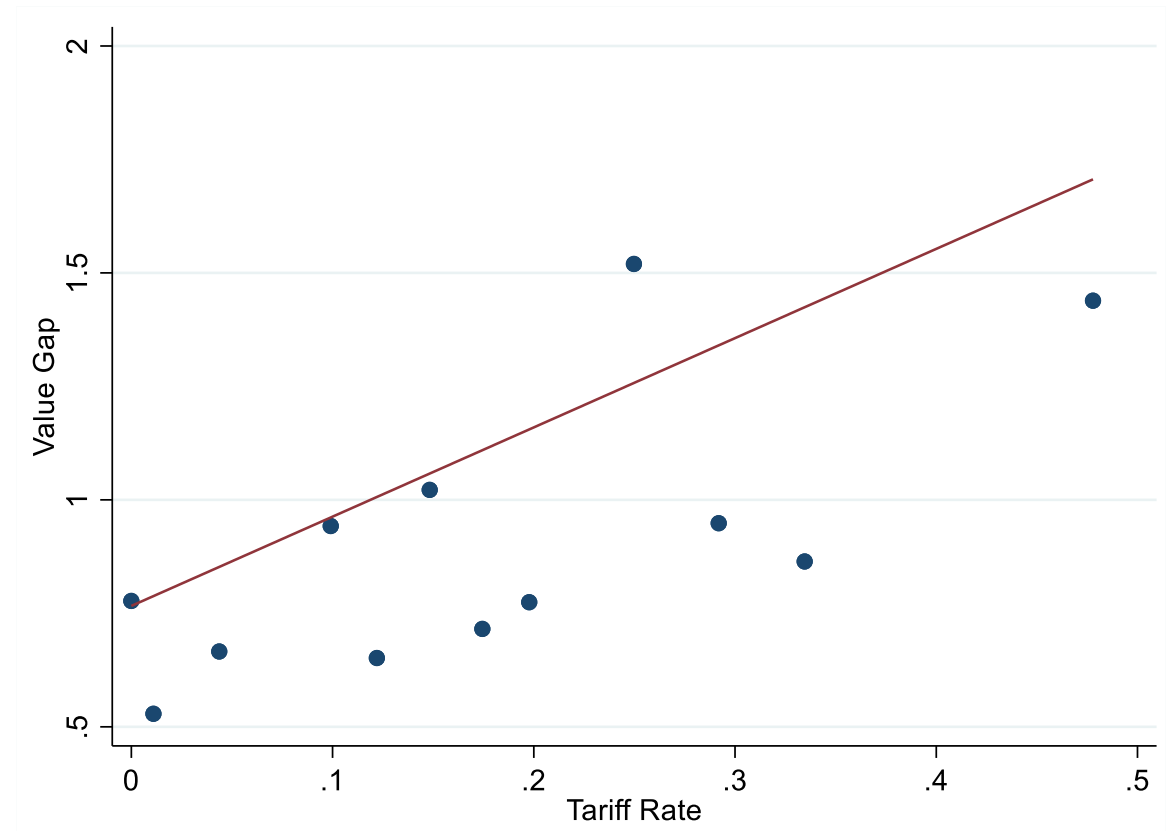
# REVENUE LOSSES ARE SIZABLE

## UP TO 50% OF TARIFF REVENUE IS LOST DUE TO EVASION

**Trade discrepancies correlate with tariffs**

**Revenue losses are large**

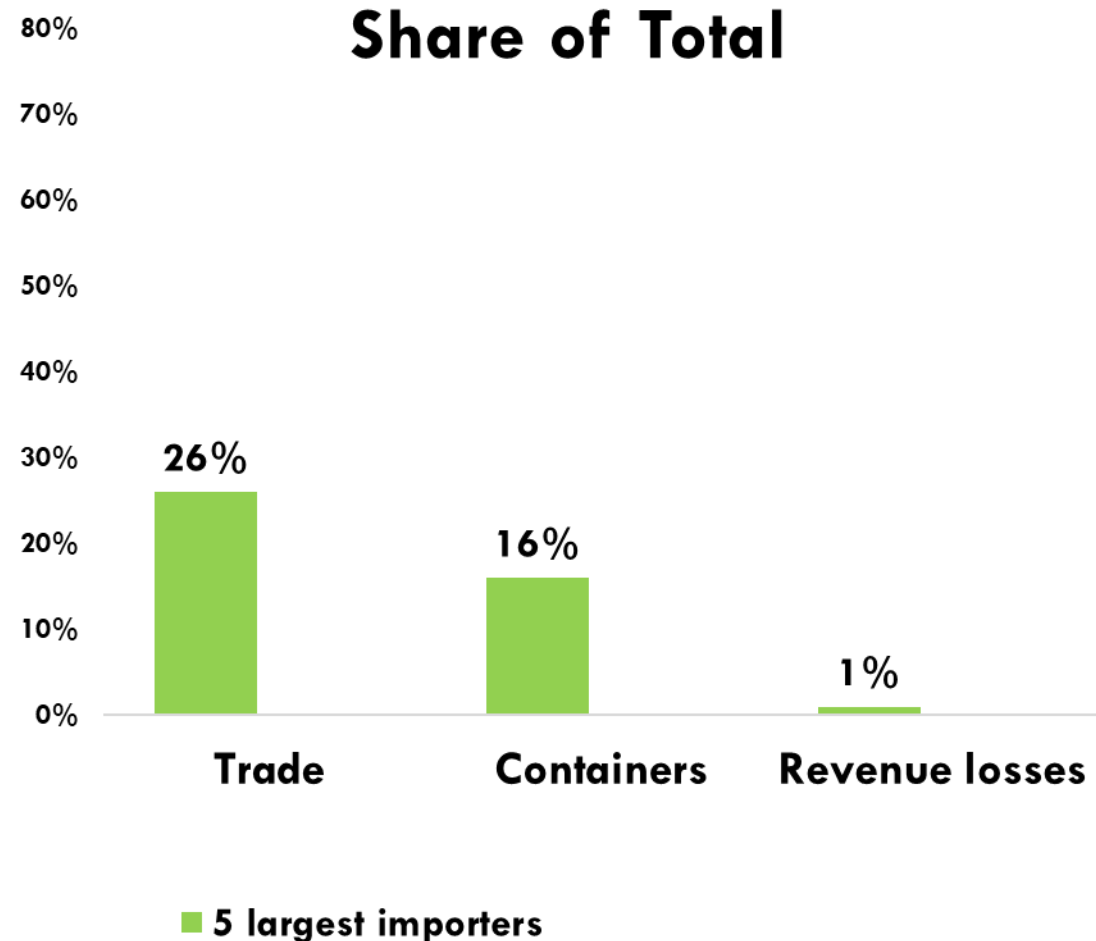
- Uganda: 20-33% of revenue
- Madagascar & Nigeria >30%



# EVASION IS HIGHLY CONCENTRATED

## How do we measure evasion?

We match import transaction data from Madagascar with export transaction data from France using **container identifiers**



Source: Anne et al. (2023) "Containing Tariff Evasion"  
Policy Research Working Paper 10606.

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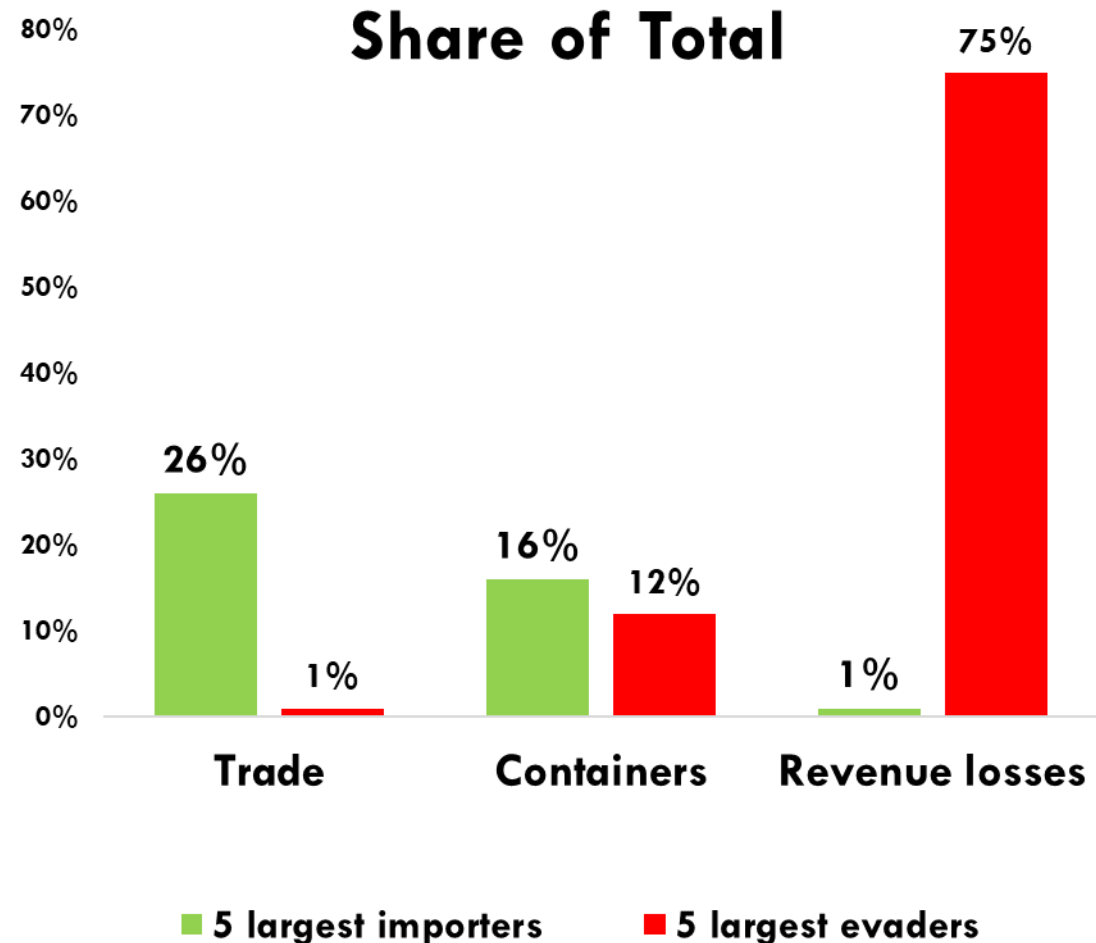
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## Key findings:

- Evasion is more concentrated than trade
- A handful of firms account for the bulk of all losses

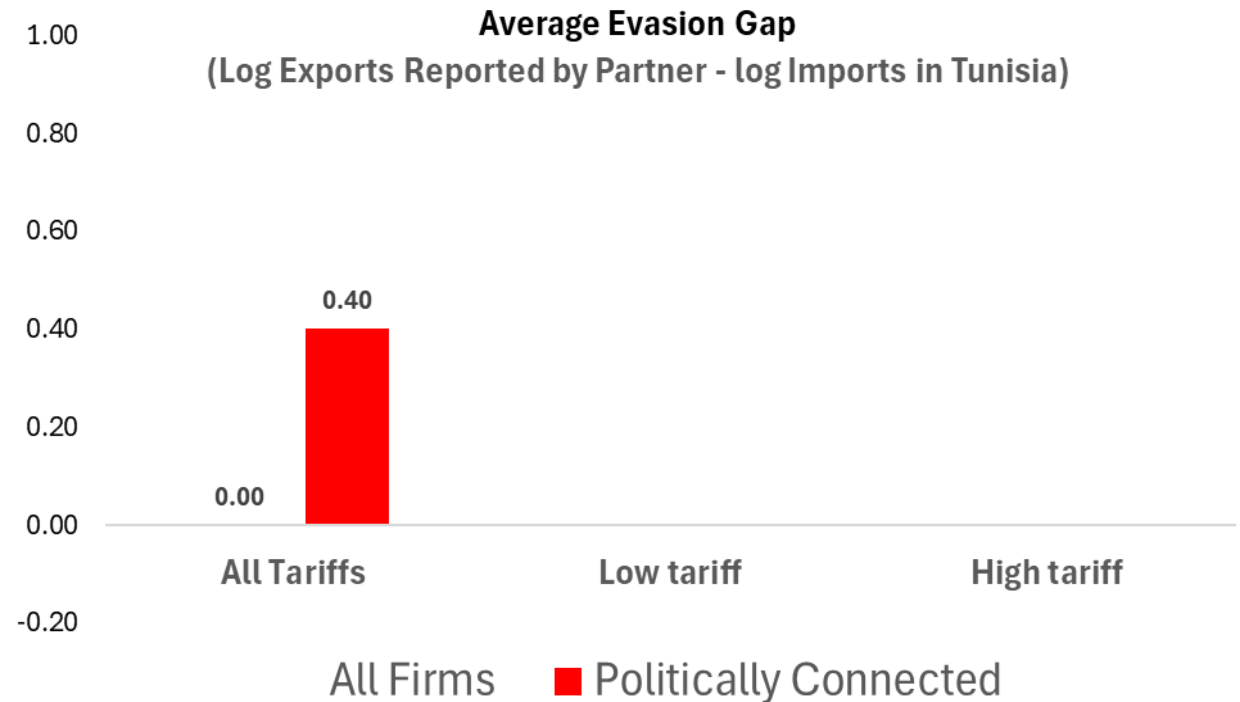
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# POLITICALLY CONNECTED FIRMS ARE MORE LIKELY TO EVADE TARIFFS

## How do we measure political connections?

- Firms owned by former Tunisian president Ben Ali and his family – **confiscated** – after the Arab Spring
- Identified in customs transaction data



# POLITICALLY CONNECTED FIRMS ARE MORE LIKELY TO EVADE TARIFFS

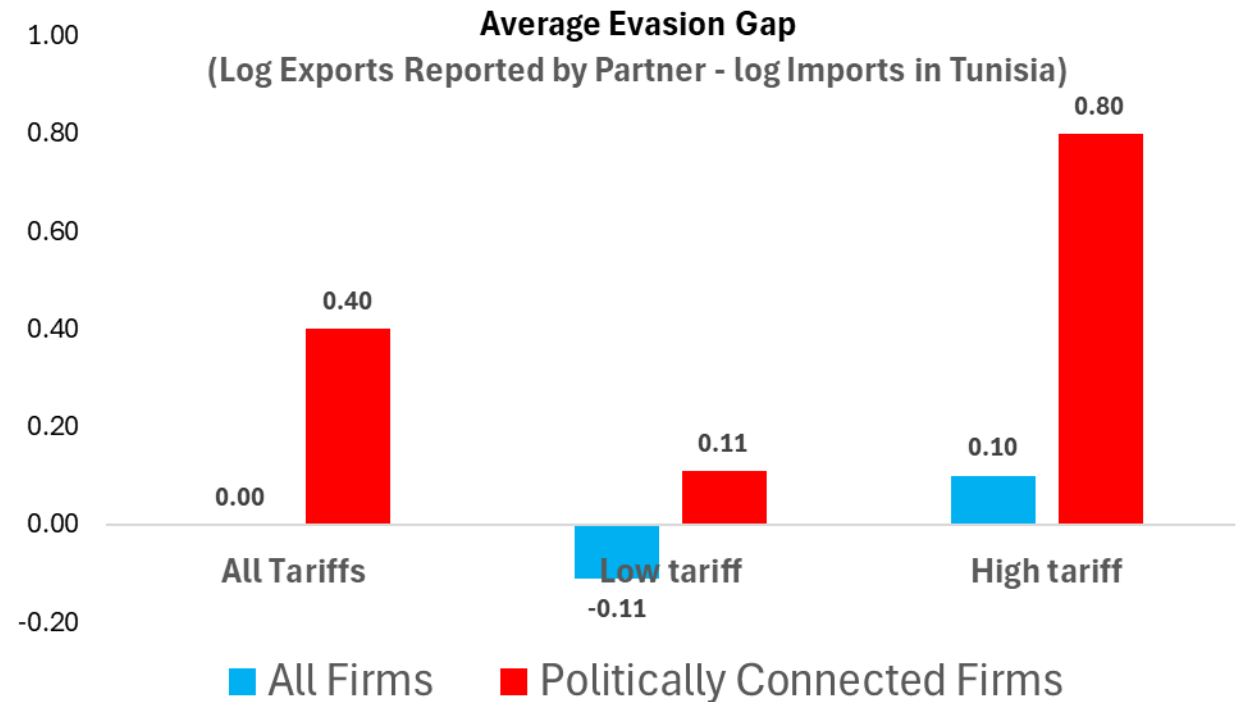
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## Key findings:

1. Connected firms are more likely to evade tariffs
2. Evaded >200 million USD of tariffs between 2000-2010

Source: Rijkers, Bob, Leila Baghdadi, and Gael Raballand. "Political connections and tariff evasion evidence from Tunisia." *The World Bank Economic Review* 31.2 (2017): 459-482.



# WHY IS THERE SO MUCH (MORE) CORRUPTION IN LOW-INCOME COUNTRIES?

## High(er) Returns to Bribery

- Tariff liability on a single declaration sometimes  $>20$  times an annual salary of customs officer

## Limited incentives for proper conduct

- Limited rewards: Hiring and promotions are not meritocratic
- Lack of punishment of opportunistic behavior
- Political interventions

**Lack of “capacity” – e.g. asymmetric information – is not the main issue**

*These conditions facilitate **collusive** corruption*

# REDUCING CORRUPTION IS FEASIBLE.. ..AND CAN PAY HUGE RETURNS

**Small improvements of a few key actors can pay big dividends**

**Ingredients for effective engagement:**

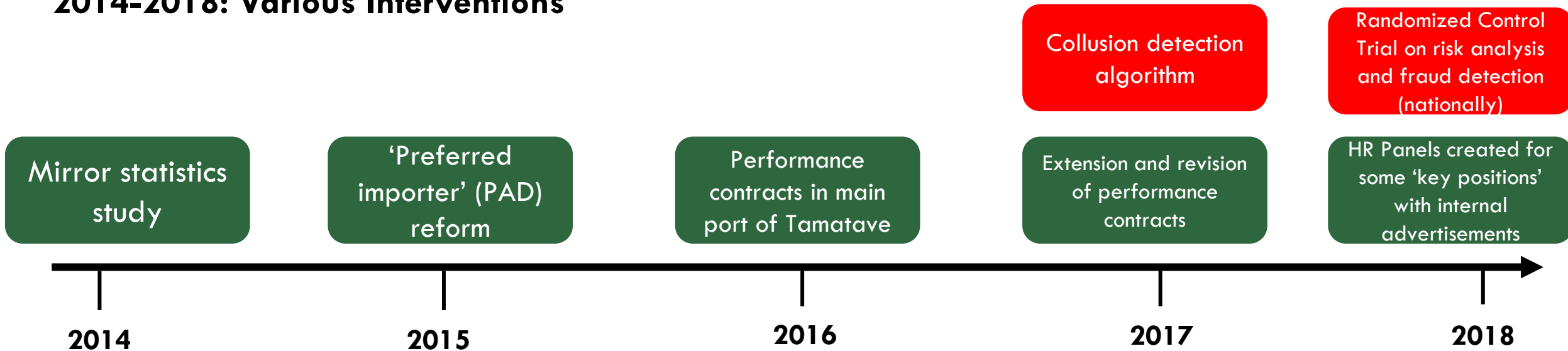
- **Quick wins:** help build momentum for deeper structural reforms
- **Be realistic:** start small and implement reforms gradually to limit resistance
- **Evidence-Based Decisions:** Use **data and research** to guide reforms and evaluate impact
- **Stakeholder engagement:** Maintain dialogue with staff, brokers, and importers to ensure collaboration

# EXAMPLE: MADAGASCAR CASE STUDY

## In 2014: inefficiency & widespread corruption

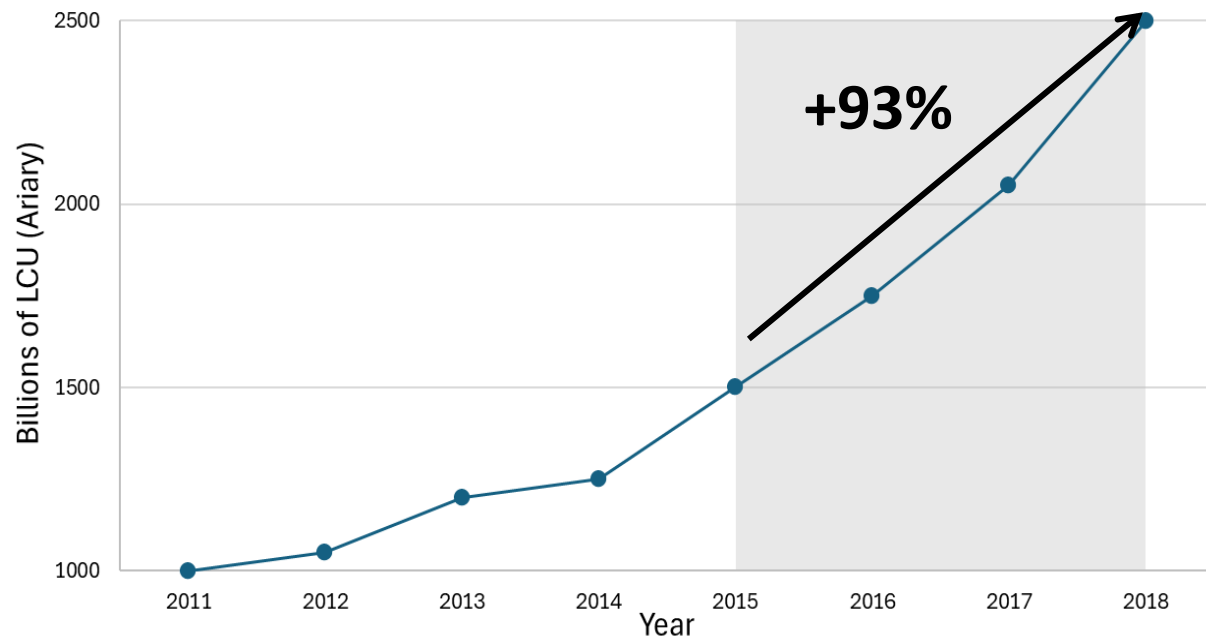
- Sizable revenue losses - at least 30% of customs revenues (mirror statistics)
- Numerous and inefficient controls
- Lack of meritocracy

## 2014-2018: Various Interventions



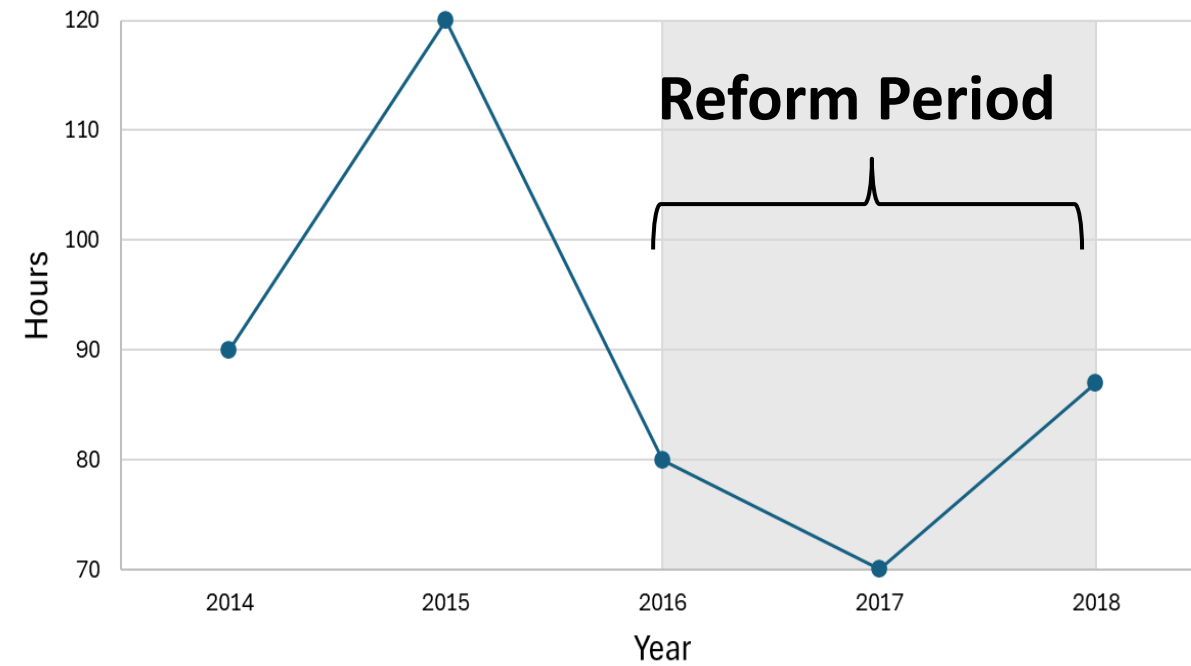
# CUSTOMS PERFORMANCE IMPROVED

Evolution of Revenues Collected at the Border



Source: Madagascar Customs

Evolution of Assessment Time at Toamasina Port



Source: Madagascar Customs. Sample restricted to frontline/documentary controls

# DETECTING COLLUSION

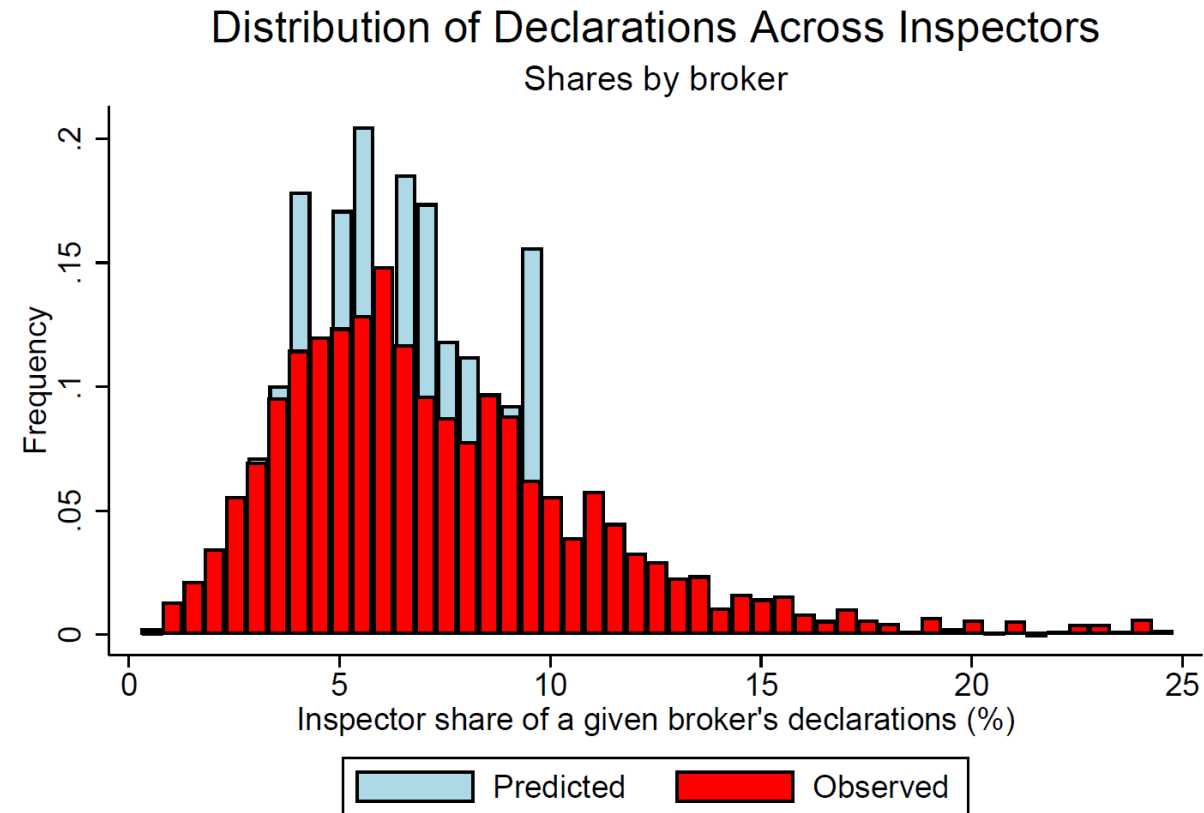
## DO ALLOCATIONS OF DECLARATIONS FOLLOW OFFICIAL RULES?

**Formal rules:** minimum workload principle (random assignment)

- Probability of a broker matching with a given inspector is equal to her “productivity”

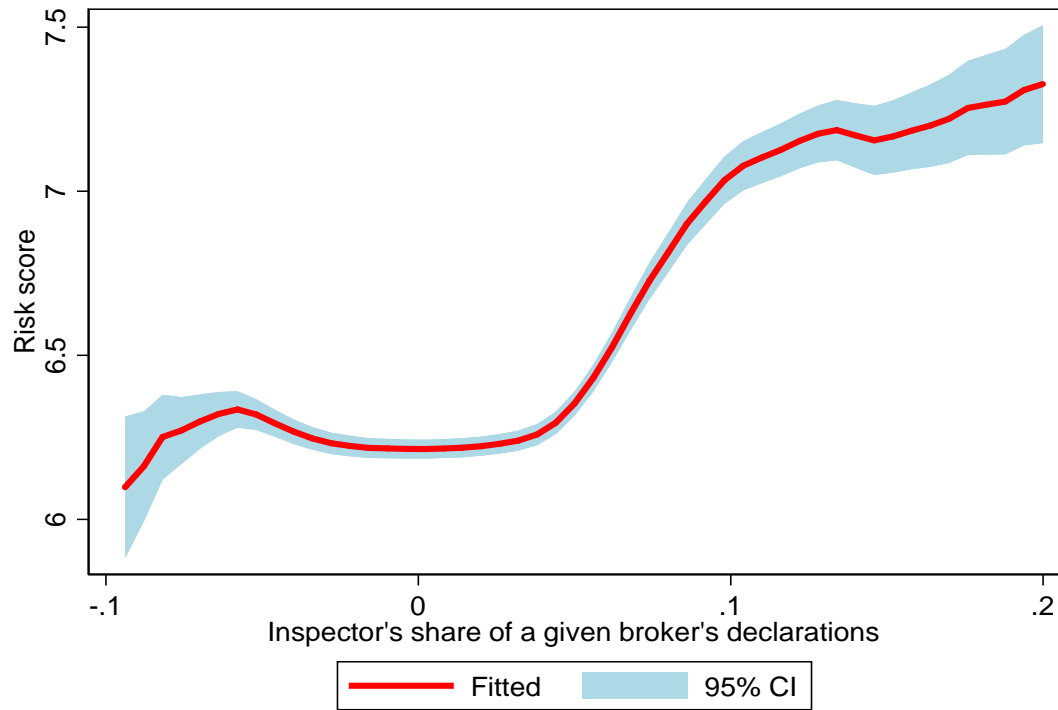
**Reality:** excess interaction (manipulation)

- Certain inspectors and brokers interact excessively frequently
- Allocation of 10% of declarations is manipulated

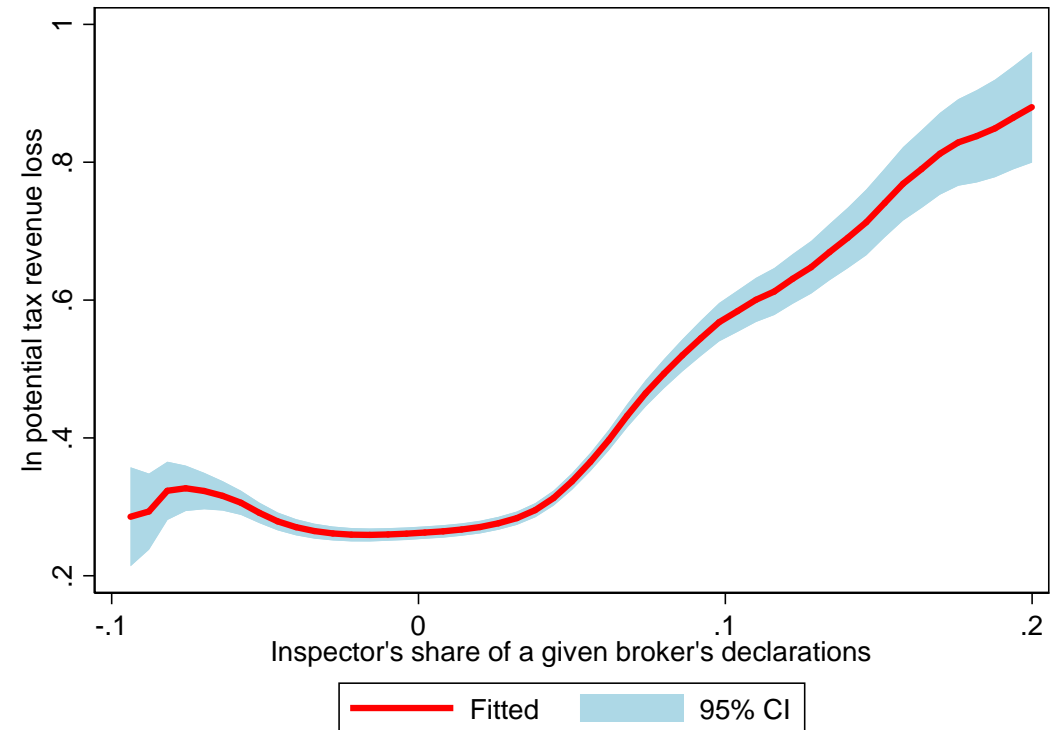


# DEVIANT DECLARATIONS ARE RISKY

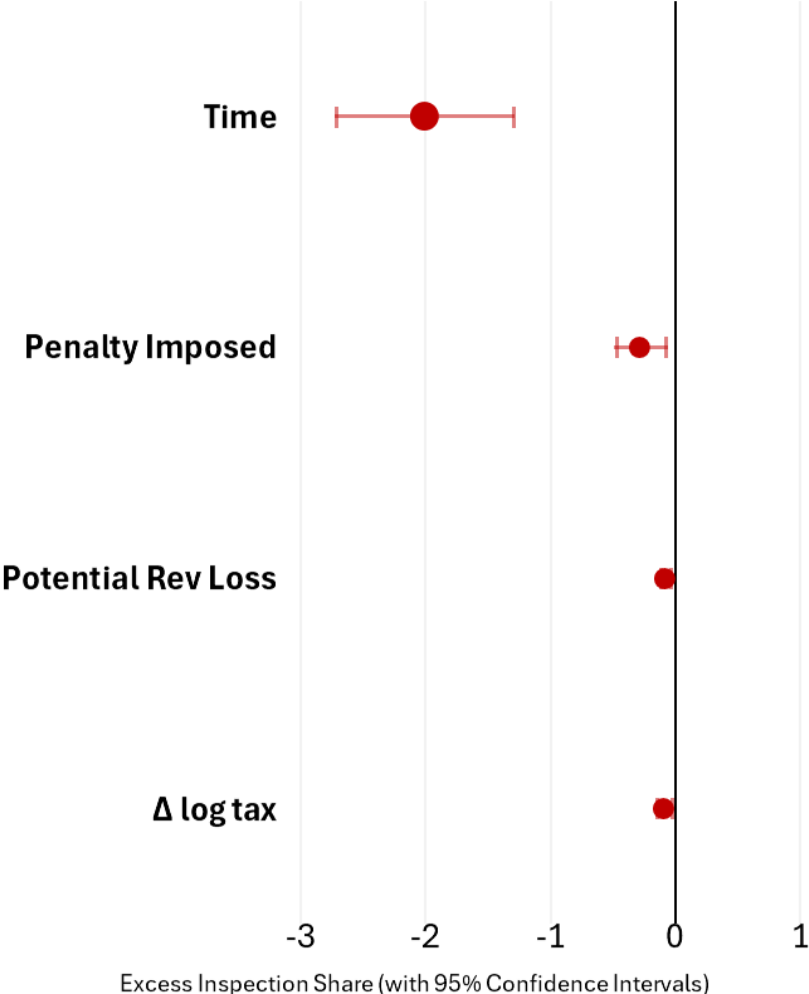
Higher risk scores



Higher potential revenue losses  
(=tax rate\*unit price gap\*initial weight)



# DEVIANT DECLARATIONS ARE TREATED PREFERENTIALLY BY INSPECTORS



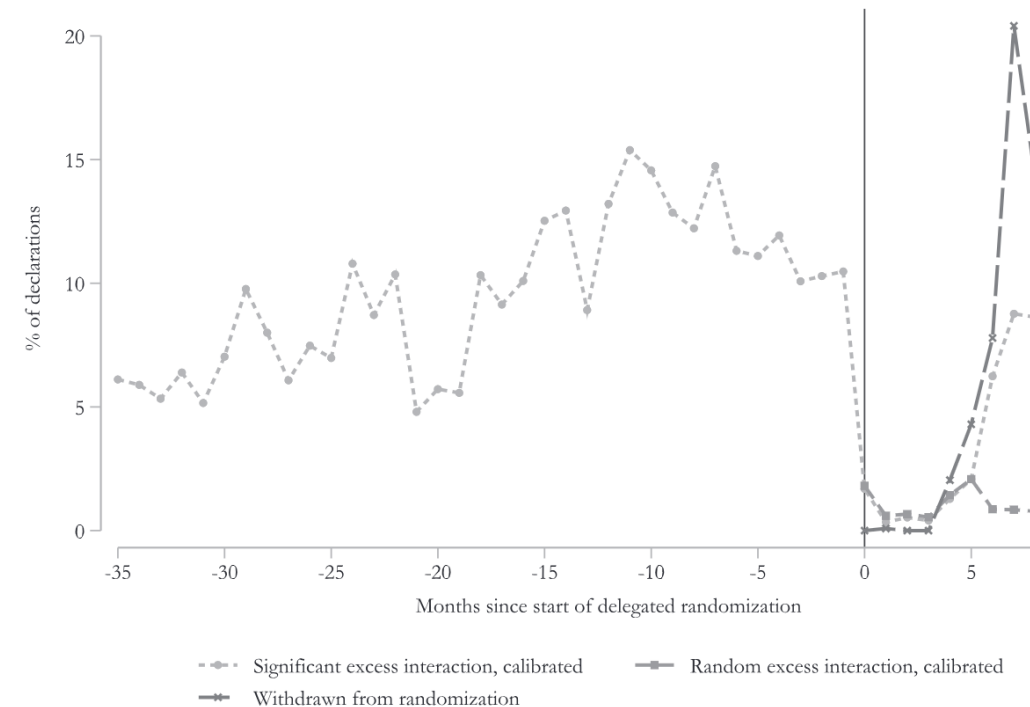
Source: Chalendar, C., Fernandes, A. M., Raballand, G., & Rijkers, B. (2023). Corruption in customs. *The Quarterly Journal of Economics*, 138(1), 575-636.

# HOW WAS COLLUSION CURBED?

5 inspectors were sanctioned (or volunteered to retire)

Allocation of declarations was divested to a public private partnership

- This temporarily eliminated non-random assignment
- Yet, IT manipulation resurfaced as IT staff enabled “bypassing” of the re-randomization procedure



Source: Chalendar, C., Fernandes, A. M., Raballand, G., & Rijkers, B. (2023). Corruption in customs. *The Quarterly Journal of Economics*, 138(1), 575-636.

# SUMMING UP

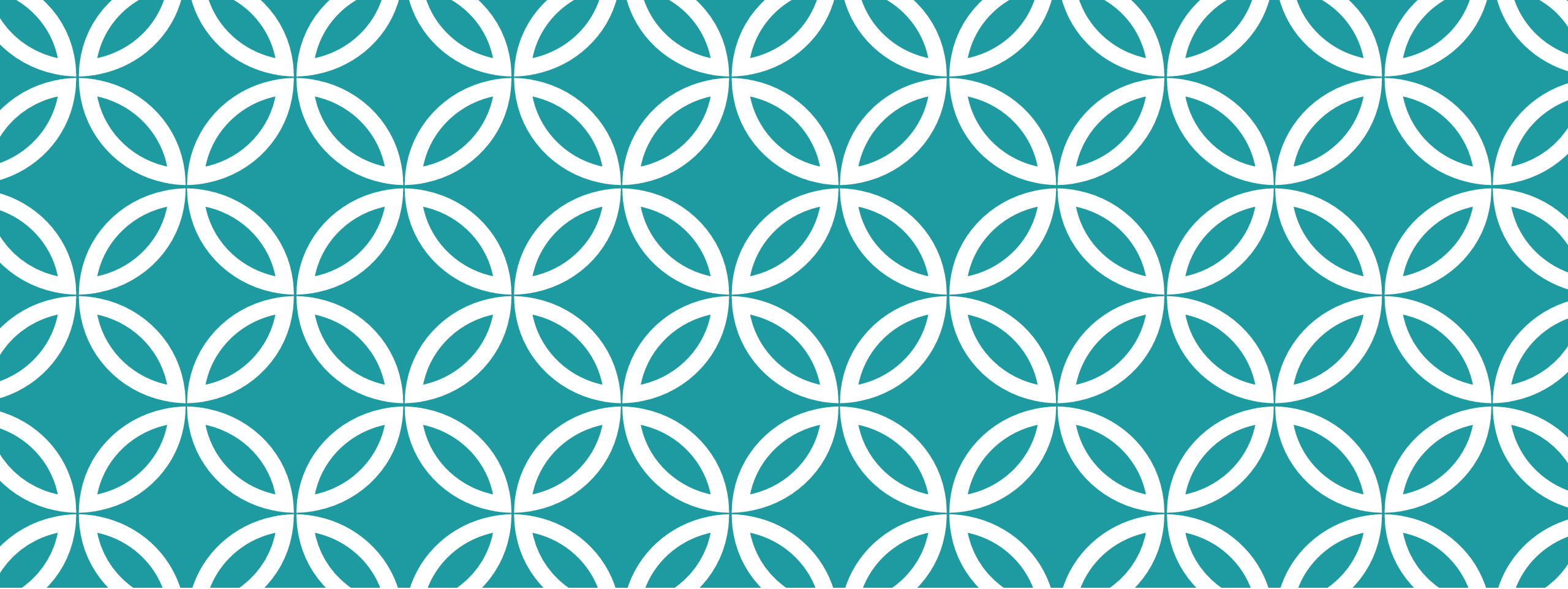
## **Corruption in customs is prevalent and costly and important source of IFFs**

- Often systemic – enabled by officials
- Gains are concentrated

## **But can be remedied**

## **Small interventions can yield big payoffs**

- Focusing on IT alone is unlikely to yield good results
- Incentives are key: Political economy needs to be taken seriously
- Research can help



**EXTRA SLIDES** |

# CAVEATS

The value gap “X-M” may be caused by factors other than customs fraud

## Reporting discrepancies

- Exports are expressed free on board (f.o.b)
- imports are expressed cost insurance freight (c.i.f)
- the “X-M” discrepancy is often negative. The difference represents the cost of transport, insurance, and freight.

## Other explanations:

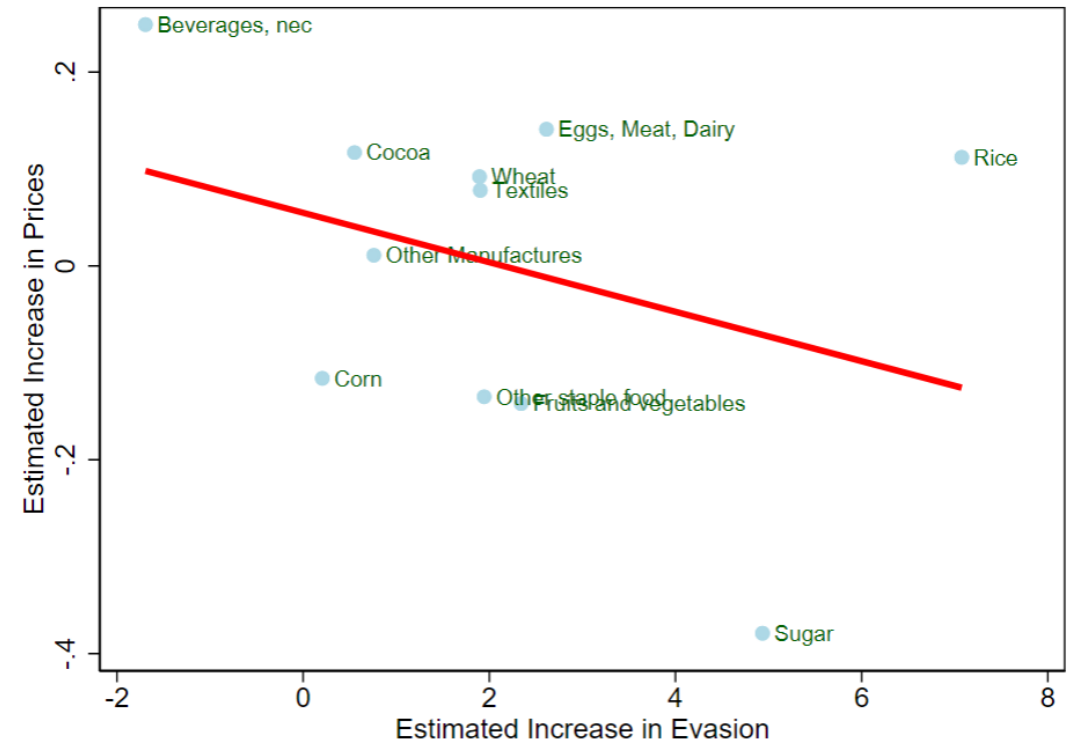
- **transit of goods** (transit through a third country),
- **differences in classification** between the exporting and importing countries (Nitsch (2012))
- **exchange rate fluctuations** (Carrère and Grigoriou (2014))
- **Inaccurate export records** (Stoyanov (2012))
- **Inflated export records**

# EVASION CAN BENEFIT CONSUMERS BY REDUCING TRADE COSTS

**Evasion reduces trade costs** which benefits consumers

## **Example: import bans in Nigeria**

- Increase consumer prices by 9.9% on average
- Inflationary impacts are dampened by evasion
  - Hard-to-evade goods: 12.4% price increase
  - Easy-to-evade goods: insignificant price increase



# LACK OF INFORMATION IS NOT THE PROBLEM

## USE OF INFORMATION IS

### Example: Valuation advice in Madagascar

- Valuation advice: reliable information on what the true value of the import declaration is (provided by 3<sup>rd</sup> party)

### Customs adjustment is suboptimal

### Especially when opportunities for bribery are high

- Less adjustment when there is more revenue at stake

