

Introduction

In 1997-98 Bangladesh imported 12 million metric tons of mostly cement, oil, and wheat worth 308 billion taka. At least that is what has been recorded by the Customs Department. The real story is hidden behind a complex veil of corruption that includes bribery, smuggling, embezzlement, extortion, and intricate collusive arrangements with domestic importers, exporters, and clearing agents. Corrupt transactions are the norm at the Department. Extortive traps make it hard to carry out a non-corrupt transaction.

Tariff on international trade is a significant source of funds for the government of Bangladesh (GOB). In 1998 it accounted for more than half of the total tax revenue of 157 billion taka. Accordingly, the GOB vests a great deal of discretionary power in Customs officials to overcome evasion strategies. These discretionary powers along with fuzzy definitions in the rules that govern Departmental action, supply bribery opportunities to poorly trained and poorly paid officials. The combination of bad procedures and bad staffing has corrupted the Department.

Corruption in Customs reduces tariff revenues flowing to the GOB, undermines trade policies that are implemented with tariff structures, distorts trade data, and produces a sub-optimal regime for international trade. Naive traders and those with a moral aversion to bribery cannot survive in this business environment which tends toward an oligopoly of importers. Reduced competition is injurious to consumers.

Other than that the impact of Customs corruption is not severe and in some ways even beneficial. The amount of the bribe paid by the importer may be thought of as a form of point-of-delivery taxation that reduces the general tax burden. The amount saved by the importer net of the bribe may be thought of as a form of tax relief. Corruption moderates the effectiveness of tariffs and the imperfections caused by restrictions on free trade. What is bad for the government is not necessarily bad for the citizens. Some forms of corruption may be interpreted as an exit strategy from excess and inefficient government. Inefficient government causes corruption.

Corruption in the Department may be curbed with better recruitment, training, and pay scale of customs officials and by a reduction in their discretionary power. A corresponding overhaul and simplification of Customs rules with explicit procedures, timetables for clearance, and cross-check of valuation may be necessary.

Structure and Function of the Customs Department

The Customs Department is a functional entity of the National Board of Revenue or NBR which reports to the Ministry of Finance and collects all revenues for the GOB. The Department itself is organized into three branches which are:

1. Customs Houses
2. Excise and VAT
3. Intelligence

There are four customs houses, one each in Dhaka, Chittagong, Mongla, and Khulna each managed by a Commissioner and charged with collecting customs duty on imports. Value-added-taxes are collected by the Excise and VAT branch which consists of six Commissioner level offices, two in Dhaka and one each in Chittagong, Rajshahi, Jessore, and Khulna. An additional Appeals Commissioner is located in Dhaka. The Intelligence branch investigates fraud, evasion, smuggling, and other cases related to the GOB's control on the inflow of goods into the country. It

controls foreign exchange, arms, and narcotics. The intelligence branch is also responsible for customs valuation, audit, and oddly, for training of customs officials.

The duties of the Customs Department is prescribed in the Customs Act of 1969, the Value Added Tax Act of 1991, and related acts of Parliament dating from British India. They include the assessment and collection of the following revenues.

1. customs duty
2. value added tax
3. supplementary duty
4. advance income tax
5. license fees

Collateral functions of the Department include

1. prevention of smuggling
2. prevention of commercial fraud
3. adjudication of customs offences
4. maintenance of security
5. narcotics and arms control
6. controlling the flow of foreign exchange

In their assessment function customs officials are given monopoly power and a great deal of discretion. There are no enforceable controls and no accountability. In particular, there is no enforceable timetable. Discretion and monopoly powers are also bestowed on higher customs officials who adjudicate disputes and charges against customs officers.

Complexity of Rules and Procedures

The wide range of functions of the customs agent presents a level of complexity made even worse by layers of Byzantine rules and procedures that control and define each of these functions. Complexity works in favor of corrupt officials because it makes it harder for customers to understand the transaction and it provides a cover for non-transparency. For example, advance income tax is collected even from industries still in a tax holiday period but this payment may be avoided by paperwork that even customs officials don't fully understand. And in the assessment of duties on imports a "Harmonized Systems Code" (HSC) classifies all goods into more than 6000 categories grouped into Sections and Chapters in an incomprehensible manual book form. An example HSC description is included in Appendix 1.

The government draws more than 50% of its revenue from import duties, value added tax, and supplementary duties and so tends to set these duties according to their revenue needs rather than rational and consistent policy. The result is that duties tend to be high and haphazard. For example, identical goods may be assigned different HSC codes and different tariff rates. Duties on similar goods are often wildly different without a rationale as in the case of writing paper (25%) and cigarette paper (40%). Duties on raw materials may be higher than those on finished products made with those raw materials. For example, the duty on bicycle parts is 40% while that on bicycles is 30%.

Corrupt customs officials make use of the confused state of affairs to enhance their discretionary power. High tariff rates encourage the supply side of corruption and incomprehensible and irrational rules and procedures strengthen the demand side.

(PSI update June 2000; PSI implementation has standardized and simplified the classification function and has greatly reduced the monopoly powers of the customs official in this function.)

Human Resource Development

Recruitment in the customs department is primarily by a process of "absorption" from unrelated government agencies and by promotion from the Ministry. Many of these transfers are placed in highly specialized positions but they are made without considering the qualifications of the individual and without the necessary training. The transfer itself is considered a form of reward because of the bribery opportunities that the position offers. These transfers are coveted and are obtained through political connections, influence, and bribery. The qualifications of the applicant and requirements of the position are not considered in making the transfer decision.

The customs staff is of generally poor quality. Agents are charged with specialized tasks requiring knowledge, judgment, ethics, and discretion. But they are not selected on the basis of this role and they are not trained in any of these skills. There is no information technology infrastructure and the agents are not trained to use computers.

The salary levels are low and even with government subsidies for housing and commuting expenses it is not possible for customs officials to raise a family without additional income. Bribery is implicit in the compensation package of customs officials. Customs officials who make 6,000 taka (120 USD) per month in official salary come to work in private cars and some even own expensive hillside villas with swimming pools. Anti-corruption measures must necessarily include an overhaul of the compensation plan of customs officials.

Forms of Corruption

The degree of discretion and monopoly power of customs officials, the absence of accountability, and the extent and complexity of restrictions on free trade are directly related to corruption in the Department. Corruption occurs both in the assessment of value and collection of duties by customs officials and in the adjudication of charges against them by higher officials.

Customs officials in charge of assessment and collection of import duties may extort bribes from importers in several ways including delay, misvaluation, misclassification, and the abuse of overseas training programs and powers of adjudication.

Delay

The Customs Act prohibits undue delay in clearing of imports but an insufficient definition of the term "undue delay" provides an opportunity to customs officials to hold the goods indefinitely in order to extort bribes. Goods to be cleared are not placed in a time-priority queue and therefore bribery clients are cleared first. Non-clients are made to wait until they pay. (Regulatory update June 2000; A new law sets the timetable to a maximum of one week. PSI further restricts processing time to 48 hours. These new developments make it hard for officials to use delay tactics with large or sophisticated importers.)

Threat of High Valuation or Adverse Classification

Importers pay a duty based on the value of the goods at a rate that depends on their classification. The amount of duty the importer pays depends on subjective and somewhat arbitrary decisions of the customs official with respect to valuation and classification. Customs officials use this power to extort bribes from importers. Implementation of PSI is expected to reduce the bribery potential of the valuation function.

Favorable Misclassification

A bribe paid to the customs agent facilitates importation of textiles for resale classified as tax-free raw materials for garment manufacture. It is estimated that 25 taka per meter of cloth in tariff is

saved at a cost of 10 taka in bribes and another 5 taka in agency fees. In 1998 the garment industry imported about 2.2 billion meters of cloth but re-exported about 1.8 billion meters as garments leaving 400 million meters unaccounted for. The corresponding bribery amount is 4 billion taka. The back-to-back letters of credit used for these imports are normally forged and the clearing and forwarding agent is complicit or non-existent. Traders are motivated to carry out the corrupt transaction by the high rate of duty on fabric import. In 1999 the rate was 40%.

Similarly, cigarette paper is imported as "writing paper" with a reduction in the duty from 40% to 25%. The dramatic reduction in the import of cigarette paper according to customs department data without any reduction in cigarette manufacture is convincing evidence of this form of corruption.

The sale of raw materials from bonded warehouses by manufacturers continues unabated even in the presence of PSI. It is reported that the BGMEA has taken steps in self-regulation to reduce the abuse of favorable tax treatment of fabric imports by garment manufacturers.

Misdeclaration of Quality or Quantity

Recording the trade items as damaged, defective, or otherwise of lower quality may lower the rate of tariff. Understating the amount of the shipment in the customs declaration may reduce the net amount payable. Either or both of these misdeclarations may be arranged with a corrupt customs agent as the agent's discretionary decisions in the matter are unchecked and unchallenged. (PSI update; As of June 2000 it is reported that PSI implementation has greatly reduced this form of corruption because the PSI agent overseas also assesses quality and quantity.)

Under-Invoicing

When the commercial invoice from the exporter is a source document for valuation purposes, complicity among the importer, exporter, and customs agent makes it possible to set the invoice amount to a suitably low value and thereby evade customs duties. (PSI update June 2000; This form of corruption has been impacted by PSI and it is not known at this writing whether the practice of under-invoicing is prevalent in the presence of PSI.)

Seizure of Gifts

In shipments that do not offer normal bribery opportunities, customs officials are likely to ask for a portion of the shipment as an outright "gift" without any reason. For example bottles of perfume may be pilfered from a crate. The importer's permission is sought in such gift taking but only in a perfunctory manner.

Speed Money

Voluntary payments are made by the importer to obtain preferential treatment or extra-normal services when customs clearance is time sensitive. Time sensitivity may be imposed by the terms of the L/C, by spoilage, or by late fees or fines that may be assessed by the importer's final customer. This form of corruption is supply driven. (PSI update June 2000; With other sources of bribery greatly reduced by PSI, it is believed that the role of speed money in generating income for customs officials has increased in importance.)

Abuse of the Power of Adjudication

When a customs officer imposes a penalty or confiscates goods the trader may appeal to Superintendent, Principal Appraiser, or Commissioner depending on the amount involved. The quasi-legal proceedings are not bound by legal technicalities nor constrained by a time frame and

therefore they afford a great deal of flexibility and discretion to the adjudicator. Discretion in these cases is easily translated into bribery opportunity.

The case may be delayed indefinitely until an appropriate bribe is paid or higher political influence is brought to bear on the adjudicator. Even if an order is passed it may not actually be "issued" or implemented until the necessary corruption transaction takes place. The adjudicator is not accountable to a higher authority and these cases are decided without transparency.

Purchase Of A Bribery Position

Transfer of government officers from other departments or from the Ministry into positions in the customs department that offer bribery opportunities may be arranged by applying political influence or by paying a bribe to officers responsible for transfers.

The PSI System

Pre-shipment inspection or PSI has been used to deal with corrupt customs departments in developing countries particularly for shipments that originate in countries with reliable valuation functions. The system reduces the monopoly power of corrupt customs officials by introducing an alternate source of valuation.

The value, quality, quantity, and classification of PSI shipments are assessed in the shipping country by an approved PSI agent in what is assumed to be a relatively corruption free environment. When the shipment arrives in the corrupt environment it has already been classified and assessed once and that greatly reduces the role and power of custom officials in the corrupt environment.

PSI rules force expedited clearance of goods and generally reduces the bribery opportunities but PSI implementation, even if successful, can only control the demand side of bribery and does not affect the supply side nor the use of influence to obtain privileged treatment from the customs department. The system itself may be corrupted if exporters in the country of origin are able to set up collusive arrangements with PSI agents.

It is reported in June 2000 that the implementation of PSI in Bangladesh has been largely successful and many loopholes initially encountered have been closed. More than 60% of the shipments fall under PSI regulations. The only clear exceptions are for government, project, and diplomatic goods. The PSI system is in place until 2003 and it remains to be seen whether it can be continued in the face of stiff opposition by importers and in the absence of its backers at the top of the NBR. As of this writing, the principal supporter of PSI at NBR is planning to leave the organization.

A Theoretical Framework for Corruption in Customs

The Supply Side of Corruption

A supply and demand analysis leads to several useful insights into corruption in the customs department. Supply side corruption, which may be termed "bribery", is normally initiated by the importer who seeks better than fair treatment in terms of rapid clearance and low duties. The motivation for supply side corruption is generated by restrictions on free trade and the complexity of the rules and procedures. Restrictive import laws create the potential for importers to circumvent the laws. Likewise, the higher the duty the higher will be the bribery amount they are willing to pay to avoid the duty payment.

Liberalizing trade and simplifying the rules and procedures of clearance may reduce supply side corruption. In the words of a former NRB official, "both the assessor and the assessee must be

able to understand the rules". It should also be noted that trade is a powerful engine of economic growth and an attempt by the government to profit from trade excessively may be injurious to the economy. Reduction in bribery may also be achieved by improving the quality of customs officials through better recruitment higher salaries, and better human resource development through various means including training. It is assumed that higher salaries and better working conditions will attract educated, motivated, and ethical individuals and that these individuals will be more likely to refuse a bribe.

The Demand Side of Corruption

Demand side corruption, which may be termed "extortion" is usually initiated by the customs official who threatens the importer with worse than fair treatment. It may even be in the form of "blackmail" when contraband or smuggling is involved. In that case the customs official threatens the criminal with "fair treatment" and offers to sell better than fair treatment.

Extortion and blackmail are the result of monopoly powers vested in the customs agent and the degree of discretion he or she is allowed to exercise without accountability. The customs department fits this model well. Measures that may be used to curb these forms of corruption in the department include organizational changes to reduce the monopoly power of the agent and also to simplify and regularize importation and clearance rules in order to leave fewer discretionary alternatives in the way the goods are cleared.

Implementation of a simplified and uniform tax code designed on a rational basis instead of current revenue needs will make it harder for corrupt customs officials to use complexity and confusion to demand bribes. Changes in organizational policies and procedures to enhance and enforce accountability of the agents are also expected to reduce demand side corruption.

The Contingent Theory of Corruption

The direct effect of corruption in customs is a reduction in revenues collected by the government from import transactions. The loss to the economy from this reduction is contingent on the efficiency of the government in translating revenues to social welfare. Thus, corruption in customs is egregious in an economy where the government is extremely efficient and non-corrupt and makes good use of all revenues to directly benefit the people with little overhead or bureaucratic losses.

On the other hand, if the government is completely corrupt, revenues that are not diverted by the customs officials will likely be diverted elsewhere anyway. In such a scenario corruption in customs is an internal distribution issue among corrupt bureaucrats and not a social welfare issue. The impact on the economy of corruption in customs is therefore contingent on the level of corruption in government. This relationship makes it necessary to view anti-corruption measures in customs in an integrative context and not strictly in terms of loss of revenues as long as the government is less than perfect.

Optimal Tariff Rates in the Presence of Corruption

International trade plays an important role in economic growth. Barriers to trade reduce the wealth of the nation and at the same time create incentives for corrupt means of avoiding the barriers. Bangladesh is unusual in her dependence on tax on trade as a means of financing the government and this dependence at once retards economic growth and causes corruption.

It should be noted that increasing the rate of duty on trade does not necessarily increase tax revenues because the flow of goods decreases and the level of corruption increases with the rate at which duty is levied. If "FLOW" is the volume of international trade and "CORRUPTION" is the net leakage of tax revenues due to corruption in customs at a given level of the tariff RATE we may describe these relationships algebraically as

$$\begin{aligned} \text{REVENUE} &= \text{FLOW} * \text{RATE} - \text{CORRUPTION} \\ \text{CORRUPTION} &= K1 * \text{RATE} \\ \text{FLOW} &= K2 / (\text{RATE} + F0) \end{aligned}$$

“K1” and “K2” are as characteristics of the bribery economy. “K1” is the propensity for corruption and “K2” represents the elasticity of international trade with respect to tariffs. “K2/F0” may be interpreted as the maximum volume of international trade achievable by removing all tariff barriers.

We may infer from these relationships that increasing “RATE” may not increase “REVENUE” and that for the same value of “K2”, tax revenues are maximized at a lower value of “RATE” for higher values of “K1”. We may therefore conclude that the optimal rate of duty at which revenues are maximized is lower in the presence of corruption.

For example, if we set F0=1 and K2=300, we find that revenues are maximized at a tariff rate of 31% when the corruption index is 175 but the optimal rate falls to 22% when the corruption index is raised to 200. Revenues drop from 16 billion taka to 11 billion taka. The difference is a cost of corruption and it cannot be recovered by raising tariff rates. In fact any increase in the tariff rate will result in a further drop in revenue. The development and application of such an economic model in optimizing tariffs may serve as an anti-corruption measure in Bangladesh

Information Technology and Corruption

The customs tax code even if simplified is likely to contain thousands of categories, hundreds of tax rates, and myriads of exceptions and amendments. The implementation of a well-designed database and transaction processing system in the customs department should facilitate the accurate, rational, and consistent application of these rules. Agents will be able to use information technology as an aid in their assessment function and to communicate directly over a network with supervisors and even with clearing agents and with customs officers in the exporting country.

Information technology will enhance consistency, reduce delays, and improve transparency and accountability of customs transactions. An effective transparency measure is the placement of the database screen in a manner in which it is clearly visible to customs officials, supervisors, and customers. Accountability is enhanced by information technology because it allows easy access to information and facilitates auditing of transactions. For example, it would be possible to compare the transactions involving identical goods both as an aid in clearing and as a method for auditing. Just as secrecy and complexity breed corruption so the use of technology to improve access to information serves as an anti-corruption device.

Appendix 1: Harmonized Systems Code

HS heading number 54.07 and 54.08: all HS codes

- (1) Shirting and suiting of 85% or more by weight synthetic or manmade fibres (synthetic, regenerated or blended yarn or both) and similar fabrics in any form, including fence cut pieces except polyester shear of mesh 80-150 required for screen printing machine/table and saree fabrics of 85% or more by width, of synthetic or manmade fibre (synthetic, regenerated or blended yarn or both) in piece of 5.5 yards to 6 yards not in than or roll.