

CASE STUDY 10

CUSTOMS ADMINISTRATION

Customs Reforms in Madagascar

Using customs reforms and performance contracts in Madagascar to curb tax evasion, facilitate trade and enhance revenue

Overview

While the Malagasy customs collected half of the country's overall tax revenues, it was at the same time an institution permeated with corruption, with large revenue losses due to tariff evasion. Collusion between inspectors, importers and brokers was widespread, while customs management was crippled by information asymmetries on practices on the ground. As a response, Malagasy customs, in close collaboration with the World Bank, introduced individual performance contracts for customs inspectors in Madagascar's main port of Toamasina, incentivizing them to curb tax evasion and illicit financial flows, and expedite customs clearance. This was accompanied by continual data mining and monitoring, which helped to detect corrupt individuals and practices, such as the manipulation of the customs' IT system, and enabled the design and implementation of an evidence-based and locally-tailored reform program. As a result, the intervention reduced some corrupt practices of inspectors, facilitated trade, and doubled customs' revenues within four years. The success of this type of performance contract may serve as an important mechanism toward modernizing customs and revenue administration (when complemented with other measures).

Introduction

With a tax to GDP ratio of 10 percent, Madagascar's revenue mobilization is among the lowest in Africa. Like in many developing and least-developed countries, revenue mobilization is highly dependent on customs, which alone accounts for 48 percent of Madagascar's overall tax revenues. With a customs officer collecting on average 1.5 percent of total annual tax revenues each year (about USD1.4 million per inspector per month), inspectors play a key role in mobilizing revenues. However, tariff evasion by colluding customs inspectors and brokers has led to an estimated revenue loss equivalent to at least 30 percent of non-oil revenues for the government.⁸¹ Information asymmetry about fraudulent practices on the ground constrained customs management in its ability to adequately address these issues. Limited information also entailed the risk that top-down reforms would not cascade to the level of frontline officers. Consequently, an approach was needed that would strengthen the hierarchical link, provide the head of customs with sufficient information on practices on the ground, and finally remedy corrupt practices.

In 2016, under a newly appointed Director General, the Malagasy customs introduced individual performance contracts for customs inspectors in Madagascar's main port of Toamasina, incentivizing them to curb tax evasion and illicit financial flows, and expedite customs clearance. This was undertaken in close collaboration with the World Bank, which provided financial incentives for customs reforms through investment project financing⁸² and supported the reform efforts by providing training, analytic and advisory support, including on-site visits to countries with similar systems.

The implementation process

The reform approach to address tariff evasion and improve customs performance can be divided into four principal steps:

Generation of operationally relevant knowledge

The initial step (January 2016) was to generate the operationally relevant knowledge for designing an effective and context-specific program. The World Bank supported the Malagasy customs by studying tariff evasion channels using mirror trade statistics,⁸³ which made it possible to identify higher risk importers and customs brokers as well as the dominant corrupt mechanisms, such as misclassification⁸⁴ and undervaluation⁸⁵ of imported goods.⁸⁶ Estimates suggested that, in 2014, customs fraud reduced non-oil customs revenues (duties and import value-added tax) by at least 30 percent.

The presentation of these study results to the private sector and to customs inspectors helped the Malagasy authorities to identify two priorities: reforming the accelerated clearance program and improving human resource management.

Design and implementation of individual performance contracts for customs inspectors in Madagascar's main port of Toamasina

As a next step, contracts were designed rewarding good performance with (i) bonuses, such as merit awards, where the best performer in a quarter receives a bonus

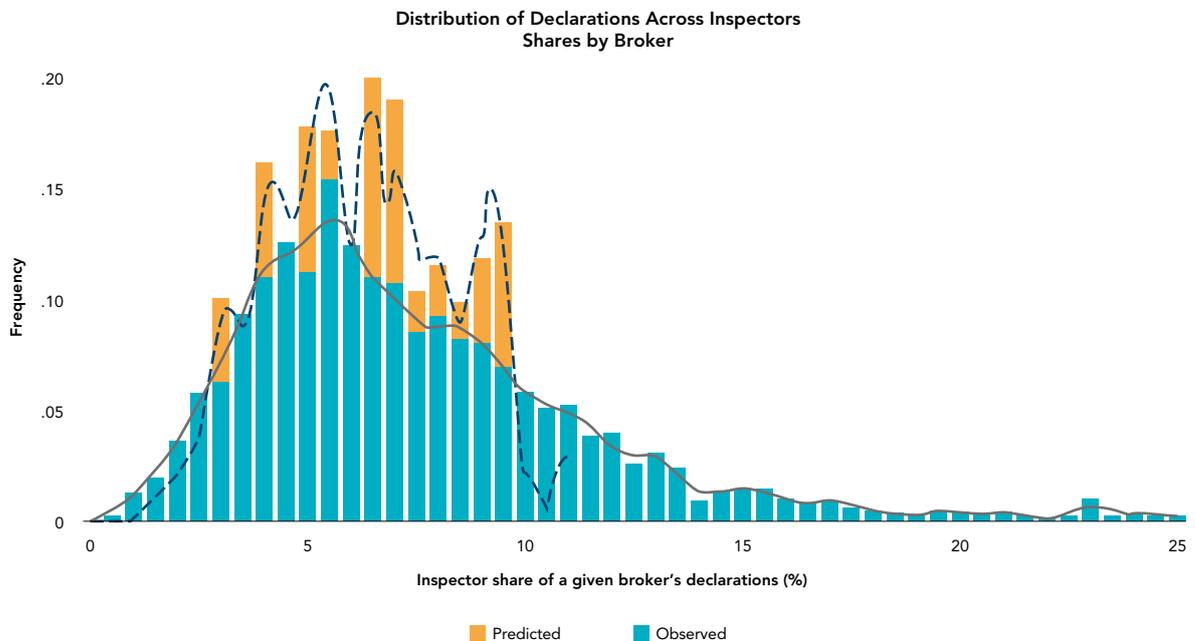
of USD1,000, representing 2.5 times the GDP per capita of Madagascar; (ii) training opportunities at home and abroad; and (iii) accelerated career progression. More importantly, the negative incentive was to sanction poor performance by reassigning inspectors to less desirable positions where corruption opportunities were much smaller. The focus of the individual performance contracts for customs inspectors has been on non-financial incentives, since the extent of corruption was so high for some officers that financial incentives could not offset illegal payments. In customs, the threat of reassignment is, in general, a strong deterrent because the role of an inspector is also prestigious, especially a position at the main port of Toamasina. In 2017, for example, 15,000 candidates applied for a 300-position recruitment program launched by Madagascar customs.⁸⁷

The contracts contained seven objective indicators (at the beginning) covering trade facilitation with an expedited clearance process, but also the fight against fraud and maximizing revenue collection. Setting explicit performance targets required a structured stakeholder dialogue, particularly through consultations and negotiations with inspectors, to overcome resistance to measures that would reduce opportunities for corruption.⁸⁸ A project implementation unit was established to lead this dialogue and to monitor each inspector's performance by using data on import declarations collected from the Automated System for Customs Data (ASYCUDA).

The performance contracts were signed in September 2016 and came into force the following month for 15 inspectors at the main port of Toamasina. Launched as a six-month pilot, it has been gradually expanded to several other offices.

Evaluation and adjustment

Data mining and monitoring of individual performance almost on a real-time basis revealed sophisticated IT manipulation and collusion between some IT staff, inspectors and some brokers and importers. A randomized control trial, conducted in 2018-2019, showed that import declarations suspected of involving collusion are significantly riskier, as measured by risk scores from a service provider,⁸⁹ with a greater likelihood of being recommended for physical inspection and of being subject to reference value advice. Moreover, declarations suspected of involving collusion were

FIGURE 4.1 Excessive Interaction between Inspectors and Brokers

Source: Chalendar et al. (2018)

found to have significantly higher ex-ante declared values, taxation rates and undervaluation, and hence embody higher potential tax revenue losses.⁹⁰ Analysis of customs data also demonstrated clear-cut evidence of a differential treatment provided by inspectors to the declarations of brokers they may be colluding with. For example, inspectors give priority to such declarations and assess them significantly faster; they also scan them less frequently and change less frequently the inspection channel (Figure 4.1).

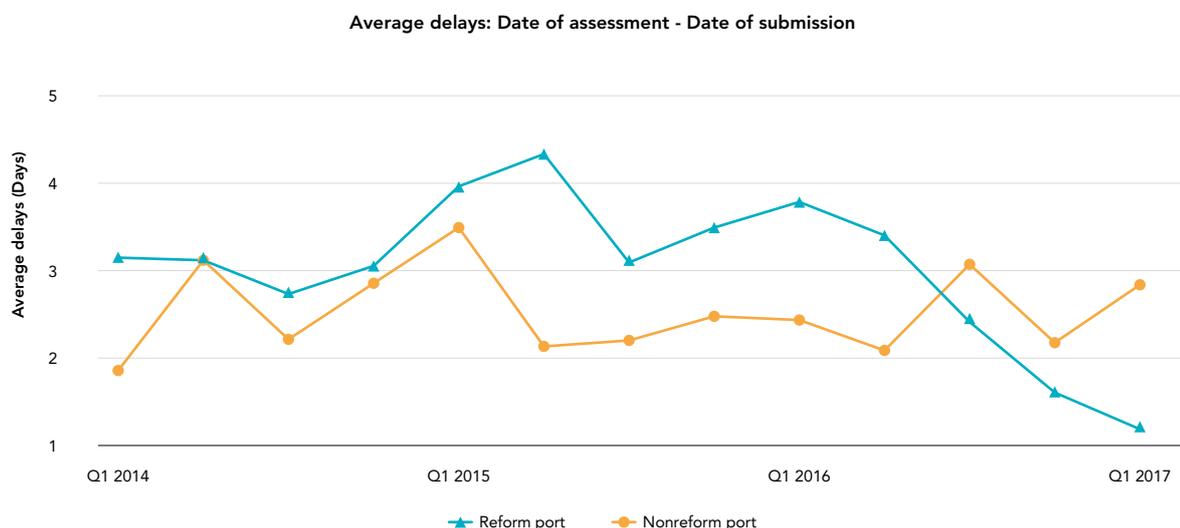
The detection of the fraudulent practices of individual inspectors enabled the transfer of 6 out of the 15 customs agents.⁹¹ As a result, the most common practice from inspectors, which was to stop cargo until a bribe payment was received, was reduced. The likelihood of being sanctioned became higher, which started to act as a deterrent for some non-compliant importers.⁹² This triggered a virtuous circle, which has been increasingly put in place.

However, some non-compliant practices continue. In this regard, several indicators in the performance contracts were adjusted during the process due to some 'gaming' and evolving collusion practices.

Transparency

Transparency through publicizing performance metrics and rewarding good performance contributed to more merit-based promotion and recruitment. This was important, since, according to a survey conducted during contract implementation, only one out of every ten inspectors in Madagascar believed promotions were fair. To enhance transparency, a vacancy announcement to replace the transferred inspectors in Toamasina was published internally to all of the country's inspectors (more than 120), and a panel selected the best candidates.⁹³ This type of recruitment was the first of its kind to fill positions in Toamasina and a critical step.

From a trade facilitation perspective, customs reforms have shown a strong positive impact on aggregate customs outcomes, such as expedited customs clearance times (Figure 4.2)—which have increased in other ports—and reduced frequency of physical inspections (red channel) from 60% in 2014 to 20% in 2018. At the same time, inspection targeting and the detection and recording of fraud improved.⁹⁴ Among general improvements in customs administration, these performance enhancements have contributed to the

FIGURE 4.2 Evolution of Average Delays

Source: Raballand et al. (2017)

TABLE 4.1 Revenues Doubled in 4 Years

	2014	2015	2016	2017	2018
Collected Revenues by the Customs DG (in bn Ariary)	1255	1459.2	1682.7	2047.1	2427.9
Evolution of Revenues (in %)	7.1%	16.3%	15.3%	21.7%	18.6%
Revenues of Customs DG as % of GDP	4.9%	5.1%	5.3%	5.7%	Nd

Source: World Bank data

rapid growth of collected revenues since 2015 (Table 4.1), which doubled within four years. Average revenue per container increased from USD3,435 in 2016 to USD5,020 in 2018.

Reflections

An important finding is that customs inspectors in Toamasina have the required capacity and information to detect fraud, but they usually have strong financial incentives not to do so. Consequently, since the working

environment enabled inspectors to deliberately not detect fraud, tax evasion and the associated corruption of most customs inspectors were a logical corollary.

This highlights the importance of incentives in institutions, especially customs. Yet, the key to the behavioral change of inspectors was to combine targeted incentives with improved monitoring. Data mining and analysis on a regular basis—not just a one-time exercise at the beginning of the project—have proven to be extremely helpful in documenting and demonstrating evidence of collusion in customs. This, in turn, has enabled the design of context-specific reforms



and the making of evidence-based adjustments during the implementation process. Positive reform outcomes were achieved without any expensive infrastructure investments, such as information technology or equipment, or lengthy legal changes. Instead, applied research has paid considerable dividends.

The relatively low-cost of this approach facilitates upscaling and replication in other contexts.⁹⁵ In this regard, having a good understanding of political economy aspects and customs practices, including corruption patterns, is paramount, especially when setting financial and non-financial incentives. Since strong internal vested interests make reforms relatively difficult in Madagascar, performance contracts were implemented with the aim of gradual improvement, but with important gains in terms of revenues already in the short term.

Government reform leadership, particularly the support from the Director General and the Minister of Finance and Budget, has been central to the success of the intervention.⁹⁶ However, with a new President elected in 2019, the Director General and a number of key officers were replaced in customs. The performance

contracts have been modified with much less teeth (but expanded to several offices with less monitoring and a hardly credible sanction mechanism), which could undermine the previous successes, as observed at the end of 2019. Moreover, key personnel in the IT department have been kept, which, without strong monitoring, may have important consequences on the integrity of the IT system.

While individual performance contracts have shown to generate positive outcomes in the social sectors, this case study provides a novel example that this approach can positively impact multiple outcomes also in customs, at a relatively rapid pace and low cost for the administration.

However, it requires a strong investment from international financial institutions in terms of personnel, policy dialogue, and advice almost on a weekly basis over many years. The higher pace of support to Madagascar customs began in 2016 but was built on an engagement that started several years before. A mutual trust relationship between the customs administration and donors like the World Bank is essential to fight corruption in customs.