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Valuation of Imports into Fiji Islands, Kiribati, and Papua New Guinea and Avoidance of Customs Duty

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Preface

This report was prepared for the Pacific Islands Forum Secretariat (PFIS) in Suva, Fiji Islands. The report is one output of an Asian Development Bank (ADB) technical assistance project (TA 6226 REG): "Developing and Implementing the Pacific Plan for Strengthening Regional Cooperation and Integration." The Commonwealth Secretariat provided funding to the project.

The lead author of the report was Dr. Roman Grynberg, Deputy Director of Trade and Regional Cooperation at the Commonwealth Secretariat. He was assisted by Michael Hyndman, a cost-benefit analyst contracted by ADB, and Sacha Silva, an economist contracted by the Commonwealth Secretariat. Consultants from PIFS and the Pacific region provided valuable inputs for the report. Bill Costello was the ADB task manager.

The report is published in three volumes. Volume 1 is the Executive Summary. Volume 2 is the main report. Volume 3 contains the working papers commissioned for the report—a series of independent studies assessing potential benefits and costs of implementing a variety of possible regional initiatives. Volume 3 has been printed in hard copy in only limited numbers. However, it is available on the websites of ADB (www.adb.org) and at www.pacificplan.org.

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I. INTRODUCTION

There are two ways in which customs duty on imports may be avoided or reduced. The first is by an import being classified to a lower duty rate than the correct rate. The second is by declaring a value for the import that is less than its true value (under invoicing). However, as with all corrupt practices, measurement of their incidence is extremely difficult if not impossible, as such activities are carried out in secret. Avoidance through misclassification of the duty rate applied to imports can only be detected by inspection of the imports and the documents declaring its duty rate classification. Hence, this form of detection can only take place by means of on-the-spot inspection. Detection of avoidance of customs duty through under-invoicing also requires on-the-spot inspection of the goods and of the invoices, and knowledge of the internationally traded prices of the goods.

This paper addresses the question of the cost and value to Forum Island countries (FICs) of a regional body that in some way complements the work of the customs authorities in the FICs and assists in the full collection of the customs duties levied. After the event, it is very difficult to detect corrupt practices in the collection of customs duties. Therefore, there is no attempt here to estimate the possible loss of customs revenue in the FICs. Nor is there any presumption that customs authorities in the FICs are corrupt. The paper reports the results of a review of trade data in three countries that, at best, can raise suspicions about corrupt behaviour on the part of importers through false declaration of the value of imports. The paper then goes on to discuss the form and cost of a regional mechanism for ensuring improved compliance on the part of importers.

To some extent, detection of duty avoidance through declaration of false values of imports is possible. The values of countries' imports and exports are reported to the United Nations. Therefore, from the United Nations (UN) Trade Database it is possible to compare the value of imports reported by a country with the value of exports to that country as reported by other countries. The two figures will usually not agree since they are not provided on the same basis—imports are valued on a cif (costs including freight) basis while exports are valued on a fob (free on board) basis. Also, the data are reported in terms of United States (US) dollars and the exchange rates used for the conversion of the import and export values may not be consistent with the timing of the imports. Further, in the case of developing countries, the recording of export data by their major trading partners—usually the high-income countries—is likely to be more accurate than the recording of import data by the developing countries. Still, where the discrepancies are overly large, questions may be raised as to their propriety. The International Monetary Fund (IMF) uses a figure of 15% as the average of the difference between the cif value and the fob value. Of course, the amount of "costs including freight" will vary from country to country, depending on the size of insurance premiums, transport charges, port charges, etc. However, for our purposes we use the estimate of 15% as a benchmark.

An analysis of the valuation of imports into Fiji Islands, Kiribati, and Papua New Guinea (PNG) was undertaken to see whether there is any suspicion that imports are not being declared at their true value, which may indicate avoidance of customs duty. Available data were drawn from the UN Trade Database for imports reported by these countries at the one-digit SITC (Standard International Trade Classification) level. Exports by all other countries (Rest of the World, ROW) to these countries at the one-digit SITC level were also extracted. The aggregate values of imports and exports and the percentage differences between them are reported in Tables 1-3.

II. FIJI ISLANDS

The available data for Fiji Islands (Table 1) is for the years 1980 to 1994 and 2000 to 2003. During this period there is only one highly suspicious observation, that for 1993. For this year the value of exports from the rest of the world to Fiji Islands exceeded the value of imports reported by Fiji Islands by 9.2%. At the one-digit SITC level, exports exceeded imports in the case of SITC 1 (Beverages and tobacco), SITC 2 (Crude materials), SITC 5 (Chemicals), SITC 6 (Manufacturing), SITC 7 (Machinery and transport), SITC 8 (Miscellaneous manufacturing) and SITC 9 (Commodities not elsewhere classified). The largest disparity is in SITC 9 where the export value exceeds the import value by 220%. The next largest disparity is in SITC 2 (Beverages and tobacco), where the export value exceeds the import value by 31.5%.

On average, over the 19 years of data in Table 1 the excess of import values over export values is 14.7%, which is very close to the average difference between the cif and fob values used by the IMF. Using this benchmark, it cannot be claimed that there is significant undervaluing of imports taking place. However, over the three-year period 2000-2002, the differences between the import values and the export values are only around 8%, which is substantially below the difference in most of the other years. Inspection of the data in these years at the one-digit SITC level shows that export values consistently exceed import values for SITC 3 (Mineral fuels, lubricants) and SITC 9 (Commodities n.e.c.), and import values consistently exceeded export values by a considerable amount in the case of SITC 0 (Food). The export values are up to three times the import values in the case of SITC 3, and up to 14 times in the case of SITC 9. The export value reported for SITC 9 in 2003 was also 14 times greater than the import value reported.

Inspection of import data reported by the Reserve Bank of Fiji Islands for the 2000-2002 period shows values of imports of SITC 3 that are closer to the reported values of exports by the rest of the world but still well below these fob values. Also, there is an even larger gap between the value of SITC 0 imports reported by the Reserve Bank of Fiji and SITC 0 exports to Fiji Islands reported by the rest of the world. One suggestion is that the high level of SITC 3 exports to Fiji Islands from other countries includes re-exports, as Fiji Islands is a transhipment port for other FICs. However, the data over the period 1980-94 do not have these features. If re-exports are not being netted out, it is a recent phenomenon. It is quite likely that there are differences in SITC classification between the exporting countries and Fiji Islands. However, it is difficult to believe that this could account for the excess of reported export values over reported import values in the case of SITC 3 and for the reverse situation in the case of SITC 0. Differences in classification could account for the large differences between the two series in the case of SITC 9. This could be for the purpose of reducing the import duty paid by changing the duty classification but such a conclusion cannot be tested.

The total values of imports reported by the Reserve Bank of Fiji for the 2000-02 period are more consistent with the aggregate fob values of exports reported by the rest of the world than are the import values reported by Fiji Islands to the UN. Therefore, the differences in values at the one-digit SITC level between the import data reported to the UN and the import data reported by the Reserve Bank and the export data reported by the rest of the world suggest that at least there is room for improvement in the classification and reporting of the Fiji Islands trade data to the UN.

Table 1: Comparison of Import Values Reported by Fiji Islands with the Value of Exports to Fiji Islands Reported by the Rest of the World, 1980-2003
(US$ million)

	Total Imports Reported by Fiji Islands (cif basis)	Total Exports to Fiji Islands Reported by the Rest of the World (fob basis)	Percentage Difference
1980	500.8	455.3	10.0
1981	604.8	506.2	19.5
1982	493.7	456.3	8.2
1983	464.1	427.3	8.6
1984	427.4	369.4	15.7
1985	417.3	356.1	17.2
1986	409.8	331.8	23.5
1987	352.2	277.4	27.0
1988	423.7	350.7	20.8
1989	536.4	461.7	16.2
1990	701.2	566.3	23.8
1991	615.3	507.8	21.2
1992	602.6	539.7	11.7
1993	504.7	551.1	9.2+
1994	802.0	673.3	19.1
2000	701.2	647.8	8.2
2001	698.5	646.0	8.1
2002	756.7	702.8	7.7
2003	1,025.5	845.9	21.2

cif = cost, insurance and freight, fob = freight on board.
Source: International Economics Data Base, The Australian National University, Canberra.

III. KIRIBATI

Table 2 shows import and export values reported for Kiribati for the years 1990 to 1999. It is important to note that in the case of Kiribati imports are reported at fob values, not cif values. Therefore, it would be expected that the import and export values would be the same. Export values are substantially in excess of import values over the 1990-1994 period, but import values are in excess of export values over the 1997-1999 period. This pattern could suggest that there was substantial undervaluation of imports in Kiribati in the earlier period but that the problem was corrected over the 1997-99 period. The lack of recent data does not allow any conclusions to be drawn about recent behaviour.

Table 2: Comparison of Import Values Reported by Kiribati with the Value of Exports to Kiribati Reported by the Rest of the World, 1990-99
(US$ million)

	Total Imports Reported by Kiribati (fob basis)	Total Exports to Kiribati Reported by the Rest of the World (fob basis)	Percentage Difference
1990	26.9	40.1	49.1+
1991	25.9	48.9	88.8+
1992	36.7	66.3	80.7+
1993	27.8	49.5	78.1+
1994	26.5	50.8	91.7+
1995	34.1	24.8	37.5
1996	38.0	42.7	12.4+
1997	38.9	30.6	42.0
1998	32.6	27.4	19.0
1999	41.0	31.9	28.5

cif = cost, insurance and freight, fob = freight on board.
Source: International Economics Data Base, The Australian National University, Canberra.

IV. PAPUA NEW GUINEA

Table 3 presents the import and export values for Papua New Guinea for the years 1981 to 1990, 1998, and 2000 to 2003. Over the 15 years, import values reported by Papua New Guinea average 11.6% higher than the reported export values, which is below the IMF benchmark of 15%. The most suspicious looking figures are in the early years, from 1981 to 1984. In 1983, reported export values were in fact 3.5% higher than reported import values. The figures for the period 2000 to 2003 are unusual in that in 2000 exports are only 1.8% lower than imports, while in 2001 exports are 41.8% less. This unusual behaviour in these two years could be the result of a timing difference in the year the exports were reported by the exporting countries and the year the imports were reported by Papua New Guinea. The average difference between the import values and the export values over the period 2000-03 is 20%, which suggests no undervaluation of imports and that there has been an improvement in performance from the earlier period.

However, inspection of the data at the one-digit SITC level shows a consistent pattern over the period 2000-03, with the value of imports of SITC 0 (Food and live animals) reported by Papua New Guinea being much larger than the export values reported by PNG's trading partners and the export values of SITC 9 (Commodities n.e.c.) being much larger than the import values reported by Papua New Guinea. Again, this outcome could be the result of innocent differences in the classification of merchandise. Or it could be due to due to differences in classification for the purpose of reducing the duty paid.

Table 3: Comparison of Import Values Reported by Papua New Guinea with the Value of Exports to Papua New Guinea Reported by the Rest of the World, 1990-99
(US$ million)

	Total Imports Reported by PNG (cif basis)	Total Exports to PNG Reported by the Rest of the World (fob basis)	Percentage Difference
1981	1,074.4	1,040.0	3.3
1982	1,001.9	916.8	9.3
1983	917.5	949.3	3.5+
1984	932.0	862.9	8.0
1985	861.5	772.9	11.5
1986	890.7	809.4	10.0
1987	1,126.4	995.3	13.2
1988	1,297.5	1,195.2	8.6
1989	1,527.9	1,337.6	14.2
1990	1,177.1	1,131.7	4.0
1998	1,290.4	1,108.1	16.5
2000	998.5	980.7	1.8
2001	1,272.1	897.1	41.8
2002	1,156.1	937.0	23.4
2003	1,268.0	1,133.8	11.8

Source: International Economics Data Base, The Australian National University, Canberra.

V. RECOMMENDATIONS

This evaluation suggests it is less likely that import undervaluation has taken place in Papua New Guinea in recent years than in earlier years. The same can be said for the period studied for Kiribati. However, in Fiji Island's case, the opposite appears to hold. In the case of both Fiji Islands and Papua New Guinea, there are substantial and persistent patterns of differences in classification of merchandise at the one-digit level that merit further inquiry. These patterns could be innocent differences in classification between exporting countries and the two importers, or they could point to duty avoidance.

Even though more disaggregated data on imports are available in Fiji Islands and Papua New Guinea, it would be difficult even from this data to confirm the suspicions. As noted previously, on-the-spot inspections are necessary to say whether there is misclassification or undervaluation of imports (under invoicing) being carried out in order to avoid the payment of duty.

Globally, the most frequently used means of reducing corruption in customs operations is the use of independent surveillance teams to check the valuation of the merchandise imported and to check the classifications of goods for purposes of charging customs duty. These independent inspections may be comprehensive or they may be random. An alternative adopted in the case of Indonesia, where the customs service was seen as particularly corrupt, was to have an independent inspection agency take over the role of customs. The result in terms of the increase in the customs duty collected was dramatic.

The services of these inspection agencies are quite expensive and to have such an agency take over the role of customs services throughout the Pacific Island countries seems extreme. Corruption in customs services is more likely where the average rate of duty is high and there is significant variation in rates. Therefore, if an independent inspection agency were to be used, it would likely have its largest payoff in those countries where customs duty regimes have these features and in the larger countries such as Fiji Islands and Papua New Guinea where a significant amount of customs duty is collected (around Fiji dollars [F$]150 million a year in Fiji Island's case).

An alternative means of checking corruption in customs services within the region would be to have an independent inspection team stationed in one of the FICs and for it to undertake random checks on customs practices in those countries that have tariff regimes. Such an exercise would not be as effective as having a continuous inspection service stationed in each country but should not be nearly as expensive. Random audits, together with severe sanctions for actions taken to evade customs duties, could be quite effective in reducing corruption and increasing duty collection.

The cost of a customs surveillance team that would undertake random checks of custom authority practices in the FICs, as well as carrying out training programs for personnel in the customs services, should be no more than F$1 million per year. This estimate is based on a budget for the surveillance team of four staff at an average salary plus on-costs of F$200,000 each (including administrative support costs). The total cost of an average of five country visits by each staff member for purposes of inspections and training of F$5,000 per visit would amount to around F$100,000 annually. Office rental, equipment and supplies should take the total amount to around F$1 million annually.

According to the Central Bank of Solomon Islands, revenue collection problems in the form of evasion of duties on log exports appear to be continuing in Solomon Islands. The surveillance team could help to reduce such evasion through in-the-spot inspections and maintenance of global timber prices. However, to undertake this task in Solomon Islands and Papua New Guinea, the two major timber-exporting countries, could add considerably to the cost, while the benefits from the surveillance would be highly dependent upon severe penalties being levied for corrupt practices.