



# Policy Advisory

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## **STRENGTHENING ANTI-SMUGGLING STRATEGIES TOWARDS IMPROVED FISCAL PERFORMANCE**

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**Congressional Planning and Budget Department  
House of Representatives**

# STRENGTHENING ANTI SMUGGLING STRATEGIES TOWARDS IMPROVED FISCAL PERFORMANCE

*By PRINCE CAL I. MAMHOT*

## BACKGROUND

Almost one-fifth of national tax collection is generated by the Bureau of Customs (BOC); the remainder is provided by the Bureau of Internal Revenue (78%), Land Transportation Office (1%) and other tax collecting agencies (2%). For 2008, the Customs bureau is tasked to generate P254.5 billion worth of tariff duties - or 14% higher than last year's revised programmed receipts of P223.2 billion. Over the medium-term, BOC's annual collection is targetted to grow by 16%<sup>1</sup>.

Treasury data shows that from January to November last year, the BOC collected P192.1 billion<sup>2</sup>, which is P14.9 billion or 7.2% lower than period target of P207.0 billion. According to BOC, more than 60% of the shortfall is due to the lower-than-expected volume of imports, and the appreciation of the peso against the dollar that brought down import values. Another reason cited is the high composition of non-dutiable, non-oil importation that yields lesser tax revenues for BOC. A major factor, however, for the dismal performance of the Customs bureau is the high incidence of unabated smuggling<sup>3</sup>.

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<sup>1</sup> Updated Medium Term Philippine Development Plan 2004-2010

<sup>2</sup> Cash Operations Report, January-November 2007, Bureau of the Treasury

<sup>3</sup> Tess B. Bacalla, 25-28 October 2004, available at [www.pcij.org/stories/2004/smuggling](http://www.pcij.org/stories/2004/smuggling) and Victor Abola, et.al. "Source of Leakages in Customs Collections: An Update for 2002-2005" UA&P, 2006

Smuggling – or the entry of goods in a customs territory without payment of legal dues or in violation of law - may be classified into physical and technical smuggling. Physical smuggling refers to importation of goods that evades inspection of Customs personnel and payment of tariff duties. Technical smuggling, on the other hand, involves fraud through the use of incorrect information in bringing the goods through legal points of entry. The most common types of technical smuggling are: (a) under-valuation or under-statement of import values; (b) misdeclaration or the use of fake identities/addresses and product description outside the appropriate tariff heading, *e.g. car parts declared as electric fans*; and (c) misclassification or the use of another tariff line within the same heading, *i.e. leather shoes declared as slippers*.

Except for intermittent activities in our southern backdoor and some reported cases of motorcycle unloading in the high seas off Northern Luzon, physical smuggling is no longer as widespread as it used to be. However, various sectors<sup>4</sup> have reported that cases of technical smuggling have become very pervasive.

## **SOCIO-ECONOMIC IMPLICATIONS OF SMUGGLING**

Smuggling affects the financial and resource management of both the government and business sectors.

- ***It robs the government of much needed revenues.*** The Fair Trade Alliance (FTA) and the Federation of Philippine Industries (FPI) estimate that no less than P174 billion is lost annually through smuggling. A four-part documentary by the Philippine

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<sup>4</sup> Sectors include the Federation of Philippine Industries for industry, Fair Trade Alliance for trade and Alyansa Agrikultura for agriculture

Center for Investigative Journalism (PCIJ) presented in detail how the government lost potential revenues due to technical smuggling<sup>5</sup>. In 2003, for instance, the United Nations Conference on Trade and Development (UNCTAD) registered a total of \$44.4 billion worth of exports to the Philippines but official records of the national government registered only \$34.5 billion worth of imports, or a difference of \$10 billion. In peso terms, this translates to P86 billion foregone revenues<sup>6</sup> - enough to wipe out more than 40% of the P199.9 billion budget deficit during the same year.

The PCIJ study also reported that about 60% of imported goods are classified as non-dutiable items, consisting mainly of commodities intended for re-export. However, actual re-exporting often does not happen as the imported goods end up in the local market. Assuming that a quarter of items sold locally are illegal, total revenue loss could even be much more than the \$10 billion as reported by PCIJ.

- ***Smuggling distorts fiscal planning and resource allocation.*** Annual estimates of tax leakages consistently surpass NG budget deficit for 2000-2005<sup>7</sup>. In 2000, the estimated foregone revenue of P679.9 billion is five times higher than the budget deficit for that year (see *Table 1*). While tax leakage significantly went down in 2005, its peso equivalent (P149.09) is still higher than the NG deficit by P2.3 billion.

The foregone revenues could have been used to build more infrastructure, hire additional teachers or purchase more

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<sup>5</sup> [www.pcij.org/stories/2004/smuggling](http://www.pcij.org/stories/2004/smuggling)

<sup>6</sup> Using average duty of 6.19% (Tariff Commission), 10% VAT and exchange rate of P54.20:US\$1.

<sup>7</sup> Source of Leakages in Customs Collections: An Update for 2002-2005, UA&P 2006.

medicines, among other things. Also, the government could have been spared from contracting new loans to fill in the yearly budget deficit. From 2000 to 2005, total net borrowings (i.e. gross borrowing less principal payments) amounted to P1.4 trillion whereas “unrealized” surpluses during the same period totaled P1.64 trillion. Aside from laying claim on the budget in the terms of interest payments, issuance of government debt instruments competes with private sector demand for loanable funds, thus, raising the private sector cost of borrowing.

More importantly, imposition of new taxes (e.g. increase of VAT rate from 10% to 12%) that impacts on the purse of every Filipino consumer could have been avoided had BOC been vigilant in running after smugglers.

**TABLE 1**  
**TAX LEAKAGES DUE TO SMUGGLING**  
**Vis-À-Vis NG BUDGET DEFICIT**

Year	Tax Leakages (a)	Average Forex (b)	Tax Leakages (c= a x b)	Budget Deficit (d)	“Unrealized” surplus (c-d)
	(in billion \$)		(in billion pesos)		
2000	16.39	41.48	679.86	134.21	545.65
2001	11.97	51.62	617.89	147.02	470.87
2002	5.69	52.12	296.56	210.74	85.82
2003	8.49	54.73	464.66	199.87	264.79
2004	8.03	56.81	456.18	187.06	269.12
2005	2.68	55.63	149.09	146.79	2.30
<b>Total</b>					<b>1,638.55</b>

Sources: Tax Leakages in Dollars (UA&P Study), Ave. Forex (NSO), Budget Deficit (BTr)

- **Smuggling pushes industries to close shop.** Because of this illegal activity, hundreds of local industries have either downsized or totally stopped operations. The Fair Trade Alliance reported that the shoe industry lost P8 billion from 1997 to 2002, the ceramics

industry lost P450 million in 2002 while the petrochemical industry loses P2 billion a year.

The local textile industry is barely alive.<sup>8</sup> Only seven out of the 33 member-mills of the Textile Mills Association are left because others could not compete with the traders of illegitimate imported textile goods that do not pay the right duties and value added tax .

- ***It kills livelihood and trims down job opportunities.*** Closures in the textile industry resulted to reduction in employment by as much as 50% (i.e. this sector now employs one million individuals from previous workforce of two million). Moreover, entry of very cheap products has caused the displacement of 300,000 vegetable farmers in Mt. Province, 60,000 shoe workers in Marikina and 7,000 workers in the auto and auto parts industries<sup>9</sup>. Massive lay-offs have also been reported in other industries (e.g., match, resin, tire, ceramics, cement, steel) due to cut back in production.
  
- ***It pollutes the psyche of Filipino consumers.*** Surprisingly, consumers are not complaining. Since they benefit from low-priced (but not necessarily better quality) goods, they tend to overlook the billions of pesos bilked out of government as well as the massive lay-offs, down-sizing and even closure of industries that cannot compete with dirt-cheap smuggled goods.

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<sup>8</sup> [www.pcij.org/stories/2004/smuggling](http://www.pcij.org/stories/2004/smuggling)

<sup>9</sup> Trade Fair Alliance documents submitted to the House Ways and Means Committee. Out of 7,000 displaced workers in the automotive industry, 1,500 were occupying good-paying (supervisory/managerial) jobs.

## FORMS OF CORRUPTION<sup>10</sup>

Smuggling is made possible by the connivance of corrupt elements among customs people and traders. Almost all stages of Customs operation (i.e. assessment, valuation, classification, warehousing, transshipment) are prone to fraudulent activities.

- ***Use of spurious documents/fictitious identities.*** These nefarious activities commonly occur at the initial stage of Customs operation. BOC insiders and industry organizations say that detection of fraud should have been easy – one would just have to examine import documents thoroughly. It would be a different story, however, if Customs examiners are in cahoots with corrupt importers.

At present, only BOC personnel have access to inward foreign manifests (IFMs). Such import records should also be made available for scrutiny to other stakeholders like the Departments of Agriculture, Trade and Industry, and the Philippine Chamber of Commerce and Industry (PCCI).

- ***Under-valuation.*** Imported goods are currently taxed at invoice cost (i.e. transaction value method)<sup>11</sup>. This system is prone to manipulation as dishonest importers may ask foreign suppliers to undervalue their shipment. In connivance with corrupt business people, some customs personnel simply accept invoices without validating. Restricted access to reference values exacerbates

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<sup>10</sup> Unless stated, discussions under this section are mostly based on personal observations and experiences of the author.

<sup>11</sup> In compliance with WTO commitments, the Philippines adopted the transaction value method (RA 8181). Transaction value pertains to the price declared in the consular, commercial, trade or sales invoice. It replaced the "home consumption value" method of import valuation.

under-valuation. With only the importer and BOC personnel having knowledge of importation, appropriate values may not be reported. Several such cases have been fully documented by PCIJ.

- **Misclassification.** To avoid payment of higher duties and taxes, importers declare high-tariff products as low-tariff goods. For instance, the FPI reported that in 2001 and early 2002, about 91% to 95% of imported garments were declared as sacks, resulting in estimated losses of \$3.575 million <sup>12</sup>. The FPI further noted that these spurious transactions are sometimes cleared at the local ports - despite the presence of industry commodity experts (ICEs) fielded by the PCCI. While ICEs are authorized to verify import entries and recommend appropriate duty if they find under-valuation/ misclassification, it is still the BOC that decides the final assessment. Moreover, ICEs have no way of knowing how much has been actually paid.
- **Use of duty-free ports.** Instead of going through regular ports of entries (e.g. Port of Manila), importers ship their cargoes to duty-free ports like Subic and Clark in order to evade taxation. Customs territories where “accommodating” district collectors are posted are also favorite shipment destination for unscrupulous importers. For instance, the smuggling issue at the Subic Freeport has refused to die down during the past 15 years despite changes in leadership (i.e. Presidents and SBMA Administrators).
- **Leakages in custom bonded warehouses and transshipment.** Imported raw materials that are intended for re-export are required to be stocked temporarily in customs bonded warehouses (CBWs). Importers are entitled to tax and duty exemptions as long as 70%

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<sup>12</sup> [www.pcij.org/stories/2004/smuggling](http://www.pcij.org/stories/2004/smuggling)

of these raw materials are transformed into exportable items. However, many of the CBW goods end up in the local market and compete with locally manufactured products - as evidenced by the rise in consumption and warehousing entries without corresponding increase in export figures<sup>13</sup>. Another indication of leakages in CBWs is the accumulation of uncollected customs bonds posted by importers. These bonds are intended to guarantee payment of taxes and duties as well as other charges in case goods placed in CBW are not re-exported.

Goods transported to and from CBWs are sometimes lost along the way. This happens because of the absence of proper auditing and inventory by Customs personnel<sup>14</sup>. The PCIJ reports that some importers even practice "paper exporting" i.e., declaring shipment to a foreign port but sending an empty container instead.

## INITIATIVES TO CURB SMUGGLING

Efforts to address the problem are not lacking. Both Congress and the Executive Branch have carried out reforms to help curb, if not eliminate, smuggling.

***Executive Action.*** The Presidential Anti-Smuggling Group (PASG) was created on 23 May 2007 (EO 624) to investigate and prosecute violations of the Tariff and Customs Code and the Revised Penal Code. The anti-smuggling group is assisted by a team of special prosecutors from the Justice Department to expedite prosecutions.

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<sup>13</sup> [www.pcij.org/stories/2004/smuggling](http://www.pcij.org/stories/2004/smuggling) and CR No. 37 of the Committees on Trade and Commerce and Economic Affairs, 13<sup>th</sup> Congress, Philippine Senate.

<sup>14</sup> Transshipment issue was taken up during the COCCTRP meeting held at the Board Room of Landbank Plaza, last January 22, 2007

Their recent accomplishments include the raid of 30 warehouses in Tondo, Manila on 01 September for alleged storage of about P400 million worth of smuggled goods. It was reported later that a warehouse contain sacks of dicumyl peroxide mixed with sulfur and acetone, a raw material used in shabu production. Two simultaneous operations were also conducted on 05 September 2007 in Cebu that resulted in the seizure of P50 million worth of untaxed vehicles, used clothing and rice<sup>15</sup>. Another raid at Metrowalk Car Fair showroom along Ortigas Avenue was also undertaken on 11 September 2007, due to alleged sale of undervalued luxury vehicles<sup>16</sup>.

However, anti-smuggling groups (e.g., COSAC/NASTF and PAGC) can be easily dissolved/called off due to the ad hoc nature of their creation. Such was the case of the National Anti Smuggling Task Force (NASTF) – the unit that was created through E.O. 297 issued on March 2004 and disbanded six months later despite objections from FPI and the Trade Union Congress of the Philippines (TUCP). Incidentally, Resolution No. 97 (13<sup>th</sup> Congress) was approved by the Senate urging the Office of the President to reconstitute the NASTF.

Meanwhile, the Revenue Integrity Protection Service (RIPS) in the Department of Finance conducts a lifestyle check among BIR and BOC personnel (i.e. whether their acquisitions and spending are justified by their declared sources of income). A former deputy commissioner has been dismissed from office because of RIPS. The Ombudsman has also placed under six-month preventive suspension a Customs operations officer and a DOF intelligence officer for alleged ill-gotten wealth.

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<sup>15</sup> PASG Accomplishment Report submitted to the House Committee on Ways and Means, October 2, 2007

<sup>16</sup> ABS-CBN Interactive News, September 12, 2007

For its part, the BOC is implementing a "Run After the Smugglers" (RATS) program. Under this program, suspected big-time smugglers are investigated and prosecuted. As of 28 December 2007, 60 criminal cases involving more than 300 respondents have already been filed in the Department of Justice, of which 21 cases have been elevated in proper courts<sup>17</sup>. Thirty-two RATS lawyers who have underwent training at the Asian Institute of Management<sup>18</sup> have been deputized by the Justice Department and the Office of the Solicitor General to handle and prosecute these cases.

Risk management strategies (i.e. profiling and selectivity) are also employed to intensify the campaign against smuggling. Profiling primarily involves the collection of import-export records of persons/corporations that transact business with the Bureau of Customs.

Selectivity or selection of shipments for inspection based on profiled data and import entries is necessary because hundreds of containerized cargoes are up for inspection daily. Based on risk assessment outcome, corresponding shipments are subjected either to thorough inspection (red lane), random inspection and documentary review (yellow lane) or speedy clearance and release (green lane).

The BOC database also includes which commodity from what country are the common sources of leakages. Table 2 shows the results of a study done by the UA&P, upon the initiative of DOF.

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<sup>17</sup> Philippine Information Agency News Release, 28 December 2007, [www.PIA.gov.ph](http://www.PIA.gov.ph)

<sup>18</sup> Funded by the United States Agency for International Development (USAID) through its Millennium Challenge Account Philippine Threshold Program

**TABLE 2**  
**TOP SOURCES OF TRADE LEAKAGES, 2002-2005 AVERAGE**  
**(IN MILLION US DOLLARS)**

By Country Source	Value	By Commodity Group	Value
Japan	1,504	Electrical, electric equipment	1,575
China (Mainland)	1,084	Commodities not elsewhere specified	685
China (Hongkong)	628	Nuclear reactors, boilers, machinery	485
Singapore	581	Optical, photo, technical, med. apparatus	358
South Korea	581	Vehicles other than railway, tramway	289
Taiwan	566	Ores, slag and ash	248
Thailand	259	Plastics and articles thereof	231
Indonesia	250	Mineral fuels, oils, distillation products	177
Germany	134	Iron and steel	154
United Kingdom	117	Ceramic products	90

*Reference: Source of Leakages in Customs Collection: An Update for 2002-2005*  
*Abola, Bedano and Tan*

Current agency practice on risk management needs further improvement. Instead of merely relying on documents presented by importers upon arrival of goods in the Philippines, BOC should seriously look at the advance copy of inward forward manifest and other electronically-transmitted information. This will enable customs people to make better risk analysis and focus on high-risk cargo due to the availability of risk-related information at an early stage. It will also allow quicker processing of documents and release of goods. A USAID funded study by the Center for Economic Policy Research Team has observed that the risk management system in the Customs bureau does not have the capability to learn from its own experience in processing transactions<sup>19</sup>. There is no feedback system or comparative assessment between the appraiser's findings and the

<sup>19</sup> Risk Management Diagnostic Report: the Bureau of Customs, Center for Economic Research Team, December 13, 2005

selectivity system. Information acquired by Customs intelligence personnel is also hardly shared with other operating units, particularly the enforcement group.

### **Box 1. BOC COMPUTERIZATION PROJECT**

In the late 1990s, the Bureau of Customs adopted the Automated System for Customs Data (ASYCUDA), a core software developed by UNCTAD through the funding assistance of the World Bank. Since then, the agency has consistently credited its collection performance to its computerization program. The creation of web-based applications system using portal/gateway enabled the agency to enhance interface, streamline processes and promote transparency in the system. BOC has also drastically reduced the number of signatures required for the release of goods, from 70 to less than ten.

The application of x-ray technology has fast-tracked processing of commodities, minimized human intervention in the examination of shipments and helped in the agency's fight against smuggling. This technology has already been used in other ASEAN countries like Malaysia and Indonesia several years back. In the Philippines, only five out of 11 customs districts (and more than 30 points of entry) have x-ray facilities i.e. Ports of Manila, Davao, Cebu and Cagayan de Oro and the Manila International Container Port.

***Legislative Measures.*** In 1993, Congress enacted RA 7650 that provides, among others, the creation of a Congressional Oversight Committee for Customs (COCC). The primary mandate of the joint

oversight group is to monitor the enforcement of the Tariff and Customs Code, specifically on the physical examination of cargoes. Membership includes the chair of the Ways and Means Committees of both Houses plus four members each from both Houses.

During the 13<sup>th</sup> Congress, there had been attempts to amend the Tariff and Customs Code of the Philippines, primarily to minimize the incidence of smuggling. In particular, the proposals provide for more transparent rules for importation, strengthen the role of the private sector, lessen the discretion of Customs personnel, provide for heavier penalties on smuggling and create a permanent inter-agency anti-smuggling body<sup>20</sup>.

## **STRENGTHENING THE CAMPAIGN AGAINST SMUGGLING**

Several studies have analyzed that the present smuggling activities in the Customs office are not really complicated as what the agency pictures it to be. As identified earlier, major contributory factors to the proliferation of smuggling activities in ports of entries involve systems and procedures, and human factors. Thus, administrative remedies and legislative actions should focus on these areas.

### ***Administrative Strategies***

1. ***Seriously Pursue the Charges Filed under the RATS and RIPS Program.*** The government must send strong signals about its seriousness to curb smuggling by putting a “big fish” behind bars.

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<sup>20</sup> HB No. 4069 (transmitted to the Senate on August 3, 2005), and SB Nos. 1969, 1979 and 2154.

2. **Review Compensation/Incentive Package.** Salary adjustments must take into consideration the examiners' overall responsibility in generating resources for the government. There is also a need to review the implementation of the Lateral Attrition Law (RA 9335), specifically the grant of performance bonus/incentives. Until now, BOC personnel have yet to receive their rewards for last year's collection surplus due to funding problem. The release of incentives should be made automatic from the DBM.
3. **Require Information Sharing and Develop Feedback Mechanisms.** This is especially true among members of the Risk Management Group and the Office of the Commissioner, and between the selectivity system personnel and appraisers, respectively. Reports should be made more frequently and publicized for transparency purposes.
4. **Fast-track Computerization Program.** Full automation facilitates the review of documents and hastens release of shipments. Consequently, opportunities for smuggling and other forms of corruption are minimized. The Bureau also needs to align its system with international best practices.
5. **Install Additional Container X-ray Machines.** More container x – ray machines should be installed in the five major ports as well as other minor points of entries i.e. Legazpi and Zamboanga, to minimize human intervention and hasten processing of shipments.
6. **Liquidate Infow - Outflow of CBWs / SEZs entries.** BOC's warehouse operating units (i.e. Warehouse Inspection Division, Bonded Warehouse Committee) should closely keep tract of the entry, processing and eventual withdrawal / re-export of goods from CBWs/SEZs. These offices should ensure that all entries are

properly liquidated and that liquidation reports are made available on demand by the Customs collector and/or the accredited private sector groups.

### ***Legislative Action***

#### ***1. Amend Anti-Smuggling Provisions of the Tariff and Customs Code of the Philippines (TCCP).***

- ***Impose Stiffer Penalties.*** Penalties are currently set at very low levels thus, encouraging some traders to bring in million peso-worth of goods through illegal means in connivance with BOC personnel. Heavier penalties, whether fines or imprisonment, must be imposed. For instance, incarceration may be prolonged from 1-10 years to 10-15 years. Penalties must also be set as a percentage of the appraised value of confiscated items rather than on fixed amounts. It is further recommended that smuggling of goods in an amount exceeding P50 million be declared as an act of economic sabotage.
- ***Provide Advance Copies of IFMs to DA, DTI and Accredited Private Sector Associations for Early Detection of Irregularities.***
- ***Publish the Reference Values on the BOC Website to Check Undervaluation and Require Regular Updating of Postings.***
- ***Mandate the Conduct of Spot Inspections and Periodic Audits of CBWs and Ecozone Locators.*** This function which is presently being undertaken by a task force headed by

a deputy commissioner should be specifically provided for in the TCCP to be more effective.

- ***Authorize Private Sector Participation in the Deliberation of Valuation Issues.*** Private sector representatives must be allowed to sit in the Valuation and Classification Review Committee to minimize the discretionary authority of BOC personnel.
2. ***Convene the Congressional Oversight Committee on Customs (COCC) as Mandated by RA 7650 (1993).*** COCC meetings may be conducted in the BOC premises to facilitate access to records and ensure the availability of accountable officers.

## CONCLUSION

The Bureau of Customs plays a very vital role in helping the national government achieve its goal of containing government deficit and attaining a balanced budget. Being a major source of tax revenue - next to BIR - the Customs bureau has to employ every available strategy to improve its collections. Customs officials have pointed to lowering tariffs, stronger peso and low volume of dutiable goods as the reasons for missing its revenue goal. However, estimates on the magnitude of lost revenue due to smuggling (i.e. more than the size of BOC's annual collection) merits attention. While efforts have been exerted by the different offices of the Executive Department, CPBD believes that much has still to be done to address the smuggling problem.

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