Customs Reform in Indonesia

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The Leadership Academy for Development (LAD) trains government officials and business leaders from developing countries to help the private sector be a constructive force for economic growth and development. It teaches carefully selected participants how to be effective reform leaders, promoting sound public policies in complex and contentious settings. LAD is a project of the Center on Democracy, Development and the Rule of Law, part of Stanford University’s Freeman Spogli Institute for International Studies, and is conducted in partnership with the Johns Hopkins School of Advanced International Studies. LAD gratefully acknowledges support from the Omidyar Network.
Customs Reform in Indonesia: A Case Study

Introduction

In 1995, Dr. Saleh Afiff, Indonesia’s Coordinating Minister for Economic Affairs, was confronting a growing crisis in the country’s customs service. As a core member of President Suharto’s economic team, he needed to make a decision: support the continuation of a Swiss-run, private-sector innovation called “pre-shipment inspection” (PSI) or return control of import-processing to civil servants. PSI had been put in place to combat corruption and increase revenue-collection in the country’s customs service, but the results were mixed, and critics said it was too expensive and distracted the government from making more permanent reforms.

A decade earlier, reformers had high hopes that PSI would clean up a notoriously corrupt agency. They thought it could short-circuit the rampant collusion between importers and customs officials that was bankrupting the government and slowing the growth of the manufacturing sector. Indonesia had hired a Swiss company, Société Générale de Surveillance (SGS), to do PSI for the country. SGS had offices around the world, and used a standard approach: The company inspected imports and set their taxable value at the point of departure, before the goods arrived in Indonesia. This third-party verification reduced customs officials’ discretion—reducing their ability to accept bribes in exchange for falsifying the value of the goods and altering tax payments.

The PSI contract, based on a percentage of total import value, was worth millions of dollars annually. Indonesia was one of the first countries to adopt such a system, and it was considered a radical choice. Eventually, countries such as Pakistan, the Philippines, Bangladesh, Peru, Bolivia, Ecuador, and Nigeria would use PSI, but Indonesia was still at the forefront.

After a decade of operation in Indonesia, PSI could be considered successful by many measures. The contribution of customs levies to overall government revenue had risen, and, according to some reports, the bribes importers had to pay had declined, as had the time needed to clear goods. Much of the business community and the PSI champions in government supported its continuation.

But PSI had not eliminated corruption entirely. And some complained that the expensive system ignored the need for training and reform within the civil service. In addition, nationalists in the legislature disliked the idea of foreigners performing what they saw as essential duties of government. They argued that Indonesia should train its customs officials to do proper goods inspections rather than be dependent on a foreign company. Resistance within the customs service, a proud group, also was growing—customs officials saw their roles being marginalized and their integrity questioned in a public manner. Some of these complaints echoed the position...
of international customs experts, who believed that other, more comprehensive approaches to customs reform would be more effective than PSI in curbing corruption.

Finally, some powerful businesses were getting restless. Many of these businesses were owned by President Suharto’s family and cronies, and they had benefitted from the old customs arrangement. In part to appease these well-connected businesses and nationalists, the government had scaled back the role of SGS from primary contractor to sub-contractor a few years before, but the Swiss company continued to conduct the bulk of the physical inspections.

When Afiff faced this final decision on PSI in 1995, Suharto had been president for almost three decades. He was an authoritarian ruler, and Afiff knew Suharto needed to maintain a level of elite consensus to keep power. Suharto also had the final say on the matter of customs; in fact, to make things even trickier, the head of customs was married to Suharto’s daughter. Afiff was a clear-eyed pragmatist, trained at the University of California, Berkeley, and at Stanford, but with enough experience in government to know the power of family loyalties and entrenched interest-groups. In making his decision, he knew he needed to take into account not only the political constraints on Suharto, but the interests of the business community. How should Afiff reconcile these opposing views—and persuade his boss, President Suharto, to make the right decision about the future of customs in Indonesia?

Background

Indonesia is a sprawling archipelago in Southeast Asia. Its islands span more than 3,000 miles from west to east. With 230 million inhabitants, Indonesia is the fourth most populous country in the world, behind only China, India, and the United States. The capital, Jakarta, is located on the island of Java, which is home to half of the population. The country is rich in natural resources, including oil, natural gas, copper, and gold. Indonesia declared independence from the Netherlands in 1945, but was only recognized by the Dutch as independent in 1949. Despite its abundant natural resources, Indonesia was a very poor, agrarian country at independence, and remained severely under-developed for the next two decades under Sukarno, the country’s first president (like many Javanese people, he only had one name).

In 1965, the Indonesian economy was on the brink of collapse, with 500 percent inflation and the government poised to default on its foreign debt. During the same period the country was rocked by political instability, and the president was forced to call in the military to put down an attempted coup by soldiers close to the country’s Communist party. A counteroffensive ensued, but in the aftermath of the turmoil President Sukarno was impeached and replaced by General Suharto, ushering in a period known as the “New Order.”

From the outset, President Suharto focused on promoting economic development. He succeeded in spurring economic growth by reforming the agricultural sector, taking steps such as disseminating new food crop production technologies; strengthening family planning measures; opening the country more to foreign capital; and promoting manufacturing for export. As a result, Indonesia’s real per capita GDP tripled from $190 in the mid-1960s to more than $610 by the early-1990s.

Notwithstanding the economic progress, Indonesia’s authoritarian political system was becoming increasingly corrupt. It was commonly characterized by the acronym KKN, which stands for the Indonesian words for corruption, collusion, and nepotism. President Suharto’s wife, Siti Hartinah (nicknamed “Madame Ten Percent”) and his children grew very rich over the years as they were granted exclusive licenses, permits, and quotas. They also received “founders’
shares” in new companies started by Suharto’s cronies in exchange for special government treatment. Those who benefited included a number of Indonesian businessmen of Chinese descent, who proved a key source of capital—both for the country’s development and for the network of patronage that kept President Suharto in power. As one historian explained, “In the end, the new order elite led by [Suharto], his family, and cronies created a form of government labeled ‘kleptocracy’: government by thieves.”

Under President Suharto, Indonesia’s parliament, known as the DPR, was largely a rubber-stamp institution. Although elections were held regularly, President Suharto’s Golkar party invariably won them by large margins. His campaigns were supported by money funneled illicitly into “tactical” funds of Golkar.

The customs service was one source of such funds. In fact, all three elements of KKN could be seen in Indonesia’s Directorate-General of Customs and Excise. After independence in the 1950s, President Sukarno, a fierce nationalist, disbanded the pro-independence militia and offered the revolutionaries options for employment: They could continue their education, go into the army, or join the civil service. The customs agency, with this policy, experienced an influx of former revolutionaries. President Sukarno fired many of the customs inspectors who had been trained by the Dutch colonial government, despite the fact that these inspectors had much more administrative training than did the former revolutionaries. By the 1980s, many of the revolutionaries had risen to senior positions in the agency, where bribery and collusion between customs officials and importers ran rampant.

Expansion of the manufacturing sector hindered by corruption

Also in the mid-1980s, the slow growth of Indonesia’s manufacturing sector was a national worry. A decline in oil prices from US$35 a barrel in 1981 to US$29.53 in 1984 had translated into a sharp fall in government revenues and foreign exchange receipts. At the time, Indonesia depended on oil and natural gas for about 70 percent of its export earnings.

Elsewhere in Asia, countries including South Korea, Taiwan, Hong Kong, and Singapore were successfully using a “manufacturing-for-export” strategy to develop their economies. As oil prices fell, President Suharto’s advisors argued more forcefully for structural reforms to reduce the country’s dependence on increasingly volatile oil prices, and promoted new streams of government revenue and foreign exchange.

President Suharto’s economic advisors had identified corruption in the customs agency as a key constraint to expansion of the country’s manufacturing sector. Rahmat Saleh, Indonesia’s Minister of Trade from 1983 to 1988, explained that industry—manufacturers in particular—simply could not calculate how much time would be needed to import their spare parts or raw materials because they could not calculate how long it would take to clear their goods through customs. The uncertainty forced these import-dependent manufacturers to maintain exceedingly high inventories, which increased their operating costs and eroded their competitiveness.

Corruption in Indonesia’s customs agency generally took two forms. The first was collusion between customs inspectors and importers that typically resulted in “under-invoicing.” For example, the two sides would agree that the importer pay only 60 percent of the required customs duties and hand an additional 15 percent of the true tariff to the customs agent. Thus, the importer’s total tariff bill would be 25 percent lower than legally mandated, and the customs agent was the beneficiary of a steady, illicit income stream.
The second form of systemic corruption was bribe-taking by customs agents. Bribes would typically be paid by importers to expedite the clearance process, though these payments were actually often made to prevent further delays. A World Bank report describes this problem as a situation where “customs authorities are deliberately delaying and rendering more costly the clearance of goods in order . . . to extract economic rents from traders.”

The government had tried a number of tactics to clean up the customs service. In one effort, it dismissed and arrested customs officials for “irregularities,” and in another, it increased customs officials’ salaries to ten times the amounts earned by civil servants. Neither of these experiments worked. Finally, in 1985 the government took a chance on an untested, private-sector-based intervention designed to shake up customs and deter corruption.

The introduction of PSI

On April 4, 1985, Presidential Instruction No. 4 (Impres 4/1985) replaced Indonesia’s traditional customs inspection system with the new “pre-shipment inspection” (PSI), wherein goods are inspected at their point of origin. All shipments worth more than US$5,000 would be subject to inspection by Société Générale de Surveillance (SGS), a Swiss company founded in 1878 that specialized in providing inspection, testing, certification, and verification services around the world. SGS was the largest of a handful of companies that conducted PSI at the time. This service came at a significant cost, however: SGS would be paid a percentage of the total value of goods it inspected—an amount that was not made public, but is estimated at around $500 million.

Under Indonesia’s PSI system, SGS took over the customs agency’s inspection and valuation duties. The Swiss company physically inspected shipments at their ports of origin, such as Singapore or Hong Kong, and verified that invoiced prices were in line with prices of similar goods exported by the country of origin. After inspection, SGS would seal the shipping containers and affix paperwork stating the goods’ value. They would separately send documentation of that value to the Indonesian government, and the value could later be checked against reports from the customs agency.

Once the goods reached port in Indonesia, government customs officials were prohibited from opening the containers unless they saw evidence that the container had been tampered with. They were required to let the containers pass through customs if the tariff specified in the paperwork was paid.

This system greatly reduced face-to-face interactions between importers and customs officials. Most importantly, it prevented customs officials from fraudulently reducing the assessed value of an imported good, a tactic that had been a great source of bribe-seeking. Under PSI, importers would have face-to-face contact with only two customs officials: one who checked and stamped the certificate of inspection, and another who informed the importer where his or her goods were being held in the customs storage area.

Government officials hoped that by reducing corruption in trade-related transactions, PSI could boost the competitiveness of the manufacturing sector as well as government revenues. As former trade minister Rahmat Saleh explained:

I was looking for a system which would benefit the country. . . . We wanted to see to it that there was a good and reliable system of trade under which importers received the commodities they had contracted to receive. . . . In any case, this (PSI) was a more
efficient system, a more reliable system. There was of course an additional benefit; customs, for whatever reason (this was necessary)—for reasons of honesty or inefficiency or lack of professionalism—would have time to reorganize itself.\textsuperscript{xiv}

About half of Indonesia’s customs officials were given indefinite leave of absence. “They continued to receive their government salary even though they were no longer authorized to continue with their government duties,” according to Radius Prawiro, Minister of Finance at the time. “Some of those employees were ultimately fired, some were given early retirement, and others returned to work at the directorate-general of customs, but usually in different capacities from their previous positions.”\textsuperscript{xv}

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How does PSI work?
The company exporting the goods first sends its shipment to a local PSI office in the exporting country. The PSI company inspects the goods, sets a value for the shipment, and creates a document recording all the appropriate information. This document, a Clean Report of Finding (CRF), is attached to the shipment and sent separately to the importing country's ministry of finance. The PSI-set value, in combination with customs paperwork, serves as a basis for tariffs and other duties. When the importer pays these fees, the government can cross-check the amount with the documentation it received directly from the PSI company. Typically the PSI company charges the importer a 1% surcharge (though the details of the SGS contract with Indonesia are unknown). Theoretically, this system discourages customs officials from charging bribes in exchange for undervaluing goods and thus reducing their tax liability. (Description based on Anson et al., 2003)
What was the role of the government customs agency under PSI?

Customs officials still play an important role in a country’s importing and exporting, even if a private company is inspecting the goods. In Indonesia’s case, the PSI company simply took over one customs function. The government customs officials retained the responsibility of controlling goods crossing the country’s frontiers—as imports, exports, or goods transiting a country. They also conducted inspections for shipments valued under $5,000. In general terms, they implement trade policy, combat smuggling, and protect the public from health risks and other safety threats. As Permana Agung, the director-general of Indonesia’s customs department noted in a 1997 paper, customs has the following responsibilities:

- Protection for society against the importation of dangerous goods;
- Protection for industries against unhealthy competition from similar imported goods;
- Execution and implementation of regulations laid down by other government agencies (health, agriculture, etc.) involving traffic of goods across international border lines;
- Prevention of smuggling; and
- Collecting and securing state revenue to support national development.

Positive impact of reform

By a number of metrics, Indonesia’s PSI regime could be judged a success. The contribution of customs levies to overall government revenue rose from 3.9 percent in the fiscal year 1984 to 5.4 percent by fiscal 1996. At the same time, the bribes importers had to pay declined significantly. According to the Importers Association of Indonesia, there was a 98 percent reduction in “illegal levies payable” after implementation of PSI. In addition, the time needed to clear goods also fell significantly.xvi

In a 1990 survey of 200 members of the American Chamber of Commerce (AMCHAM), 84 percent of respondents said that the clearing time had gotten shorter since the beginning of PSI. When asked how the termination of SGS’s contract would impact their business, 80 percent said a reversion back to customs-run procedures would result in slower and more expensive clearance.xvii

These improvements in the business environment and government finances cannot be attributed only to PSI, however. The private inspections system was part of a package of economic reforms, so its individual impact was hard to disentangle from that of other changes. While subsequent studies have shown that PSI regimes have improved revenue collection and shortened delays in some countries, they have reduced revenue collection in other instances. And studies of PSI’s impacts on fraud in a number of countries have come up with mixed results.xviii

Negative aspects of PSI

By the late 1980s, serious questions had been raised about the impact of PSI. Critics complained that SGS officials were too lax in their inspections, that smuggling was occurring.xix and that fees paid to administer PSI were too high for a developing country.xix More generally, there were few mechanisms to monitor or audit PSI companies.

Most important, perhaps, was the lost opportunity for capacity-building. Outsourcing customs inspections does little to improve the quality of the domestic customs service, an agency that is vital to any nation’s efforts to regulate trade and protect the public against health hazards, crime, and other threats that cross a country’s borders. No matter how efficiently or effectively a foreign company executes PSI, it passes few of those technical skills on to local workers. In fact, the presence of a foreign company may allow the government to put off important changes in its own
workforce. According to the World Bank, “foreign PSI companies may create incentives for postponing institutional change at a local level, removing revenue-based pressure for indigenous reform, negatively affecting morale in customs and possibly slowing any reforms already underway.”\textsuperscript{xxi}

Customs experts at the World Bank and other international organizations emphasize that it is impossible to find a “quick fix” for corruption in customs. They note that the impulse to use PSI often is well-intentioned but comes from a desire to work around the problem, rather than solve it.\textsuperscript{xxii} These experts generally believe that the best long-term solutions include building the strength and integrity of local institutions, as well as the capacity of public servants, through training, oversight and proper incentive structures.

**Dilemma**

In recent years, Saleh Afiff had seen the pressure grow on President Suharto to reinstate the power of Indonesia's customs authority. The good economic times had emboldened the customs officers and nationalist politicians. As the World Bank observed, “While there can be no doubt about the satisfaction of the trading community with Indonesia's [initial] PSI arrangements, it was also clear that the government would find it politically awkward to maintain indefinitely what amounted to a quasi-privatization of customs functions.”\textsuperscript{xxiii}

In 1991 the government decided not to renew SGS's contract. Instead, it came to a compromise with PSI opponents. Customs officials and their allies were unable to push through a complete termination of PSI, but they succeeded at making two major modifications to the system. First, Surveyor International (SI), a newly established private Indonesian company, would progressively take over the PSI contract from SGS.\textsuperscript{xxiv} Second, customs officials were given more leeway to inspect shipments. Specifically, the 1991 reform gave the customs authority permission to re-inspect goods if:

- container seals had been tampered with;
- there was leakage or damage;
- there were any discrepancies in the documentation;
- an external inspection of the packaging indicated that the goods did not fit the description;
- information or intelligence about possible illegality had been received about a particular shipment;
- the customs authority had proof that the value of the shipment was inconsistent with what was reported;
- the PSI company advised re-inspection; or
- an importer requested that a decision made by a PSI company be reviewed.\textsuperscript{xxv}

The customs service and the nationalist faction saw these two amendments as a partial victory.

From 1991 to 1993, just before Afiff became Coordinating Minister for Economic Affairs, the government transferred the PSI contract from SGS to SI, which had been created explicitly to allay concerns about foreign control over the customs process. SI in turn hired SGS to do much of the inspection work as the Indonesian-owned company built up its infrastructure and capabilities abroad. But SI took the lead in the administrative aspects of PSI, such as coordinating communications between the overseas offices and Jakarta.\textsuperscript{xxvi} By 1997, SI had established 17 branches overseas.\textsuperscript{xxvii}

SI’s capabilities expanded over time, but the company was not expected to take over all inspections. The government knew a complete takeover would not have satisfied some of its most important political constituencies. For example, SI would not be as efficient as SGS in its inspections, thereby frustrating the trading community. Meanwhile, customs officials fumed. They
wanted all of their former responsibilities reinstated, and halfway measures would not placate them.

Importers encountered more problems with customs clearance following the changes in 1991, as compared with the period under SGS. For example, an AMCHAM survey taken in 1991 indicated that while 65 percent of respondents were satisfied with the new PSI procedures, 35 percent said the new procedures caused problems or delays. This was a less positive view than that found in a similar AMCHAM survey just a year earlier, when there was “virtually unanimous” agreement that SGS's activities with regards to PSI should either increase or remain the same. At the same time, a movement was afoot in Indonesia's legislature to end PSI outright.

**Customs officials and nationalists**

By 1995, the government faced a choice between continuing with PSI, led by SI, or ending PSI and returning to a traditional inspection system conducted by the national customs service. Those pushing to end PSI argued that PSI had been viewed from the beginning as a temporary measure—a shock to the system in a difficult period. They contended that the goal had been to produce a more functional and efficient customs system, and ultimately to improve government finances and develop the country's manufacturing sector. In their view, the original 1985 reform was meant to address a crisis that had long since been resolved, so it was unnecessary to retain the policy.

PSI's most vocal critics included nationalist politicians and customs officials. The nationalists felt that customs was a function of the state, “not a matter for private firms,” especially foreign ones, said Joseph Stern, a former official at the Harvard Institute for International Development in Indonesia.

The customs officials framed their arguments in terms of national pride, sovereignty, safety, and security, and the importance of capacity building. “We wanted to build our own economy and country,” said a senior customs official. “All of us agreed at the time that sometimes you need a third party, that there had to be a shock. We appreciate it. But after that... it had to be stopped. They should give us time and support to develop ourselves,” the official said. He also said that aspects of government functions that relate to “the people's dignity” should not be outsourced, nor should those related to health and safety of the people.

According to this customs official, “inspectors of the foreign private company who carry out the examination task do not have a sense of belonging and responsibility to the country with which their company agrees to work.”

But others pointed out that this dynamic was not unique, and it was not necessarily aligned with the country's best interests. “The customs officers hated the guts of SGS at this time,” said one former government official. A World Bank survey of PSI regimes showed that this may have been for nefarious reasons:

National customs services are often hostile toward PSI companies, seeing them as usurpers of traditional customs functions. Among some customs officials at least, PSI companies are doubtless seen also as potential spoilers of opportunities for financially profitable collusion with importers, involving understatement of the latter’s tax liabilities to the government. Moreover, the fact of hiring a PSI company amounts to a less than subtle statement of [the government’s] lack of faith in the ability and/or willingness of customs to do its job.

**Technocrats and importers**

Lobbying from the other side were reform-oriented technocrats and the importers association. The technocrats were worried that customs officials would resume their old ways if they regained full inspection powers. SGS did train some customs officials abroad, but the culture of the agency had not fundamentally changed. Indeed, businesses that imported goods in shipments worth less than US$5000, which did not fall under the PSI system, reported that bribe-taking for those
The Importers Association of Indonesia strongly supported retaining PSI, as it meant faster, cheaper customs clearance for its members. In response to the nationalism arguments of opponents, Rahmat Saleh, Minister of Trade at the time, summarized the situation well:

Any government would like to have inspections of its imports done by its own nationals and by its own institutions. That is a valid case. That’s why we have said that PSI should not be forever; it should be temporary, with the understanding that [PSI would be retained] until such time when customs is considered to be efficient enough, honest enough.

Saleh did not believe that time had come. He believed that the creation of SI should have alleviated these concerns, since SI was majority-owned by the Indonesians, principally the government. Moreover, in some ways, PSI was more important than ever in 1995: It could help ensure the continued expansion of Indonesia’s manufacturing sector in the face of competition from China and Vietnam.

In an ideal world
As an economist and well-educated technocrat, Affif knew that PSI systems were typically designed to be temporary. But he also knew that the world was messy. And he was aware that the transition from a PSI system back to a traditional inspections system would work best if the two sides of the debate had good working relations with each other. In fact, the World Bank report on PSI regimes advises that countries planning to transition away from PSI establish “clear performance benchmarks for customs, in terms of service delivery and revenue collection performance.” The World Bank also suggests that if trouble arises, PSI should always be an option to fall back on: “the possibility of reintroducing PSI should be ever-present in the minds of both the government and the customs authorities.”

If Affif chose to abolish PSI, he would still need to address the issue of corruption. One option would be to take different steps to curb corrupt behavior within the national customs service. The World Bank, in a Customs Management Handbook, recommends a number of strategies for this, including changing the punishments and rewards for customs officers’ performance, making administrative processes more transparent by publishing them widely, and appointing to the customs service senior officials known for their honesty in other sectors. A chart from the World Bank’s handbook outlining strategies for addressing corruption is reproduced in the annex.

As Affif faced this decision, there was another politically sensitive issue, where “best practices” diverged from the reality in Indonesia. It is well-known that successful anti-corruption reform depends on a country’s leader’s commitment to that reform. According to the World Bank, “It is generally assumed that the principal [leader] is committed to systemic reform, improvements in tax collection efficiency, and greater integrity in the customs service.” But in Indonesia, as the World Bank pointed out, the commitment of President Suharto to fundamentally reforming the customs agency was unclear. The government had initiated PSI in 1985 more to quell a brewing fiscal crisis than to improve the business climate. Uncertainty about the president’s genuine commitment to customs reform continued to plague those responsible for making a decision.
A choice needs to be made

These were the challenges Saleh Afiff faced in 1995. For many reasons, he was sorely tempted to continue with the PSI system. It had produced some good results and was favored by the business community. PSI also was a way for the president to continue doing something about corruption without launching a deep and risky administrative reform.

But Afiff knew the decision was complex. As a government employee, he was sympathetic to the customs officials’ injured pride and their calls for training and renewed responsibility. Perhaps they were being earnest when they vowed to improve their performance if given the chance, and maybe a few changes to the incentive structure and hiring practices of the agency would do the trick. He knew that a competent national customs service would make the country stronger and more self-reliant.

To complicate things further, there were the political allies of Suharto who needed to be appeased. They were as powerful as the business community, and their motives were less consistent with the country’s economic success. Decades of government service in the Suharto regime had given Afiff a pragmatic eye for this kind of dilemma—he knew that in some contexts, some reforms are not politically feasible.

As he pondered his choices, Afiff knew that any changes would have to retain a certain level of service to keep Indonesia’s business environment stable. His job was to devise a policy that would improve or maintain customs service-level and appease enough constituents to be practical. And finally, he needed to sell it to his boss, President Suharto. What should he do?
References


Economist Intelligence Unit. 1996. “Pre-shipment Inspection and Trade Development in Indonesia”. September.


Senior customs official. Notes, undated.

Tedjosumirat, Didie. Interview, June 24, 2010, Jakarta.


Annex

Strategies for addressing corruption, The World Bank's Customs Management Handbook

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Practical Activities</th>
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| Change administrative systems to remove the corruption-inducing combination of monopoly power combined with officer discretion plus limited accountability | • Reengineer administrative systems or procedures to enhance transparency and predictability  
• Introduce competition or contestability in the provision of key services  
• Contract out selected customs functions  
• Introduce self-assessment to shift the onus of responsibility for compliance to client groups  
• Introduce automation to limit official discretion and face-to-face contact between officials and clients, enhance transparency, and streamline customs procedures  
• Implement job rotation and staff mobility schemes  
• Increase transparency by publishing the criteria upon which officials are entitled to exercise official delegations |
| Select customs officials for incorruptibility as well as job-specific skills and technical competence | • Widen the selection criteria for customs recruitment to include integrity-related factors  
• Introduce merit as the key criteria for recruitment and promotion  
• Carefully screen potential employees, including references from previous employers or educational establishments and background checks of potential criminal record  
• Recruit senior officials who are known for their integrity from other agencies and the private sector |
| Change the rewards and penalties mix facing agents and clients           | • Evaluate the present remuneration levels and conditions of employment to ensure competitive conditions  
• Provide nonsalary benefits that are difficult to obtain elsewhere  
• Restructure bonus or rewards systems to reinforce positive behaviors and, where needed, increase these rewards  
• Introduce performance management and appraisal systems  
• Encourage and reward officials who identify vulnerabilities in administrative systems and procedures  
• Increase penalties to provide a disincentive to engage in corrupt behavior  
• Ensure that penalties are calibrated to correspond to the offense  
• Ensure that all officials, regardless of rank, are subject to the same penalties |
| Increase the likelihood that corruption will be detected                 | • Undertake a thorough analysis of customs’ administrative systems and controls to identify vulnerable points  
• Rely on client and general public for information  
• Assess issues such as internal controls, reporting relationships, staff competence, official delegations, and decisionmaking powers  
• Identify which positions and activities carry an inherent risk of corruption and the adequacy of controls or safeguards in place  
• Establish internal audit and investigation units to thoroughly investigate any information provided or allegations made  
• Encourage officials and clients to report corruption to independent anticorruption agencies, and ensure confidentiality and anonymity for the information provided  
• Ensure that punishments are meted out promptly, and vindicate staff from unjustified accusations; sanctions should be commensurate with the severity of the violation and sanctions should be made public to serve as examples for others |
| Alter attitudes of staff and traders toward corruption                   | • Instill esprit de corps in customs that will raise the moral costs of corruption  
• Implement or improve professional development and training  
• Introduce and promote a code of conduct; make this code widely available to staff and the public; consider making staff sign this code of conduct (upon recruitment or anniversary of appointment)  
• Ensure that managers and supervisors lead by example  
• Introduce a zero tolerance policy for acceptance of gifts  
• Publicize the names of officials found guilty of corruption |
ENDNOTES

\(^{i}\)Economist Intelligence Unit, 20.
\(^{ii}\)Economist Intelligence Unit, 26
\(^{iii}\)Murphy (2005).
\(^{iv}\)Dewi (1998).
\(^{v}\)Ricklefs, 346.
\(^{vi}\)Rahardja interview.
\(^{vii}\)Former government official interview.
\(^{viii}\)Energy Information Agency.
\(^{ix}\)Low, xv.
\(^{x}\)Economist Intelligence Unit, 22.
\(^{xi}\)Economist Intelligence Unit, 23.
\(^{xii}\)The details of SGS’s contract with the Indonesian government were not public. However, companies such as SGS typically charge a fee about 1 percent of the value of goods inspected, according to the World Bank (Low, 39).
\(^{xiii}\)Low, 8.
\(^{xiv}\)Economist Intelligence Unit, 25.
\(^{xv}\)Prawiro, 265.
\(^{xvi}\)Economist Intelligence Unit, 26
\(^{xvii}\)Low, 72.
\(^{xviii}\)For example, a cross-country study by Yang (2008) concludes that pre-shipment inspection programs lead to large increases in import duties. A cross-country study of PSI regimes by Low (1995) concludes that Indonesia’s PSI regime helped facilitate trade by speeding trade transactions. At least one other study suggests that PSI regimes have a more uncertain effect. A World Bank study by Anson et al. (2003) concludes that PSI regimes have an ambiguous effect on the level of fraud in a country, and that in Indonesia’s case, PSI “appears to have had no traceable effect” on the level of fraud.
\(^{xix}\)Economist Intelligence Unit, 3.
\(^{xx}\)Economist Intelligence Unit, 36.
\(^{xxi}\)Dutz.
\(^{xxii}\)McLinden, 68.
\(^{xxiii}\)Low, 71.
\(^{xxiv}\)Economist Intelligence Unit, 19 and Low, 71-73. When SI was founded, the Indonesian government owned 76 percent of the company. SGS owned 20 percent, and Sucofindo, an Indonesian surveying company, owned 4 percent.
\(^{xxv}\)Low, 71.
\(^{xxvi}\)According to Yarso (Yarso interview), there were three types of arrangements in overseas ports: (1) those where SI performed both administration and inspection; (2) those where SI performed administration and SGS performed inspection; and (3) those where SGS performed both administration and inspection. SI conducted at least some inspections in Malaysia, Thailand, Singapore, and the Batam free-trade zone in Indonesia. Munti estimates that even after several years, SGS continued to perform about 80 percent of PSI inspections.
\(^{xxvii}\)Tedjosumirat interview.
\(^{xxviii}\)Low, 71-2.
\(^{xxix}\)Low, 71.
\(^{xxx}\)Low, 71.
\(^{xxi}\)As mentioned earlier, the idea of having SI end its sub-contract with SGS and carry out all inspections was not seen by policymakers as a main option. This is in part due to the perception that SI had insufficient capacity to operate the PSI system on its own, and that such an option would be sub-optimal in terms of both efficiency and the likelihood of satisfying the disgruntled customs service.
\(^{xxii}\)Stern correspondence.
\(^{xxiii}\)Customs official interview.
\(^{xxiv}\)Customs official notes.
\(^{xxv}\)Former government official interview.
xxxviLow, 23.

Stern interview.

Economist Intelligence Unit, 63.

Economist Intelligence Unit, 53.

EIU, 39.

EIU, 39.

A similar point is made in Economist Intelligence Unit, 65.

Low, 120.

Low, 122.

Low, 124.

McLinden, 73

Low, 109.