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ANOTHER PATH TO CUSTOMS REFORM: MEXICO'S SECOND INSPECTION

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ABSTRACT

This paper presents two theses about reforming customs administration in developing countries. First, that modern customs systems increasingly rely on documentary audit rather than physical control and that the private sector can improve the information needed to strengthen audit. Second, that reform of customs administration in developing countries requires building both accountability and efficiency. The widespread use of Pre-Shipmetn Inspection (PSI) services by developing countries and Mexico’s innovative privatized second inspection supports the first thesis and Mexico’s experience with privatizing a key layer of its customs administration supports the second thesis.

This paper examines Mexico’s recently introduced Second Customs Inspection which is a novel approach of using private firms to improve the accountability of a customs system. The Second Inspection is uniquely poised to improve both physical control and documentary audit in Mexico’s customs by clearly defining the
inspection as “rough justice.” “Rough justice” is an approach to physical customs inspection that recognizes the limitations of time and space of customs inspections prior to detailed documentary audit. Rough justice is an approach to customs administration that promotes systematic but selective review of contents and documents in the front end of the customs process (inspection) that can be done within reasonable time limits that do not unduly delay trade.

INTRODUCTION

Customs reform in the 21st century in developing countries will bring into being dramatic changes in the roles of the public and private sectors, which will increasingly work in partnership with each other. The first thesis of this paper is that modern customs systems increasingly rely on documentary audit rather than physical control and that the private sector can perform an important role in improving the information needed to strengthen audit. The widespread use of the Pre-Shipment Inspection services and the innovative use of private firms in Mexico’s customs administration offer proof of this growing trend. The evolution of customs administration will be based on the following assumptions increasingly agreed to by customs specialists: (2)

(i) Customs administration should be based on voluntary compliance because it protects revenue and does not restrain trade. Voluntary compliance is the payment of the legal tax obligation without the active involvement of the tax administration.

(ii) Voluntary compliance requires deterrence.

Deterrence is created by a credible front-end physical inspection that detects and deters blatant fraud and contraband and by an effective back-end audit that
protection of revenue. The key to an effective front and back-end customs system is timely and appropriate information. Timely and appropriate information promotes deterrence.

(iii) Private sector agents can provide information services to customs administration which promote deterrence.

(iv) A change in the focus of customs administration from physical control to documentary audit requires significant organizational change, which often involves structural and social change. The introduction of the private sector into customs administration is one means of providing the required structural and cultural organizational changes.

(vi) The use of private firms for strengthening customs administration can assist cash-strapped governments in developing countries that need to finance ongoing customs operations and to invest in customs infrastructure.

The second thesis of this paper is that reform of customs administration in developing countries requires building both accountability and efficiency. Efficiency alone is not enough.

Prior to the customs reform program which began in 1989 and introduced the second inspection, customs administration in Mexico was cumbersome and involved considerable discretion on the part of inspectors. Customs inspection was performed on 100% of the goods imported, the inspection was not time bound, and the inspectors determined the amount of taxes to be paid in all cases. The official entry form was complicated and prepared manually. The General Customs Administration was part of the Ministry of Finance but operated autonomously. The discretion of the inspectors coupled with their low pay and the lack of individual and institutional supervision of customs administration bred corruption.
Mexico's customs reform introduced efficiency but especially accountability. Efficiency was introduced through several measures: automation of customs processes, reduction of the inspection rate from 100 to 10 percent, simplification of the number of steps in the dispatch process (from 15 to 3), and privatizing the warehousing and handling of goods.

The strategy for improving accountability was drastic and novel. It was drastic because most of the customs officials were either fired or left voluntarily in anticipation of being fired and a new cadre of college-trained officials were employed. It was novel for it introduced a new level of administration that was privately managed (the second inspection). The architect of the second inspection in Mexico believed firmly that the only way to fight corruption in the Government of Mexico was to build overlapping layers of administration that would be pitted against each other. Efficiency alone is not enough.

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The second inspection introduced redundancy into Mexico's customs administration which in one sense made it less efficient because it added a second layer of administration. The second inspection has also made the inspection process carried out by government staff more efficient. Ensuring that bureaucratic procedures are essential and not burdensome traps that delay and promote rents is no easy task. A key feature of the second inspection reform and a feature that continues to evolve is the role of the second inspection as a model for the procedures of the first inspection carried out government staff. It is a model that probes the very definition of an inspection. The second inspection is implementing in practice the concept of a customs inspection as defined by the law. The legal definition is one of "rough justice" that confines the inspection to a reasonable time and inspection. Prior to the second inspection, government officials were inspecting 100% of all shipments with little or no regard to the amount of time involved which resulted in both the delay of trade and promoted corruption (importers would pay to have their goods released quickly).

In brief, the second inspection provides a second opportunity to inspect goods. Ten percent of all goods are selected randomly by the computer for the first inspection performed by government inspectors. Once the goods leave the first inspection they face again a random selection by the same computer system. Again, ten percent of all goods are selected for inspection by inspectors (Dictaminadores Aduanales) employed by the private firms. The Dictaminadores
Aduanal prepares a confidential inspection report which is forwarded to the customs authority officers. The second inspection does not detain goods but can return the shipment to the first inspection if irregularities are found.

Mexico’s unique innovation of introducing an additional layer of customs administration managed by the private sector illustrates our two theses. While the private sector is not a panacea for customs reform, it can, when properly designed, improve information sources to strengthen documentary audit and provide redundancy in customs administration that promotes accountability. It does not stand alone. The audit capacity of the customs administration needs to be strengthened. There are virtues to imperfect systems. The second inspection has dramatically improved the accountability of customs administration in Mexico and is a model of customs reform worthy of study.

This paper is organized in three parts. The first part provides an overview of the evolution, structure and processes of Mexico’s customs system. The weakness of the different levels of customs are also outlined. The second part explains why the second inspection has succeeded. The third part considers the next steps necessary for the evolution of the second inspection.

OVERVIEW OF CUSTOMS ADMINISTRATION IN MEXICO

Mexico’s customs administration can be analyzed in terms of its evolution, structure and processes.

The Evolution of Mexico’s Customs Administration

The evolution of Mexico’s customs profoundly affects the purpose of and strategy for privatizing customs functions. The focus of customs administration of Mexico’s principal trading partners, Canada
and the United States, is changing from physical control to documentary audit. The North American Free Trade Agreement (NAFTA) between these countries places a premium on customs administration that minimizes restraints on trade. Commercial interests have evolved, embracing a “just in time” production strategy which minimizes inventories and promotes the rapid delivery of goods. NAFTA increases the importance of determining the point of origin, requiring effective documentary audit. To facilitate trade while protecting revenue, customs administration needs to promote and enforce self-compliant customs.

Implicit in this evolution of customs is the practice of “rough justice” - a timely physical inspection of goods and a cursory examination of the documentation at hand that allows rapid determination of compliance or the need for further review and audit. The administration of rough justice makes allowances for limitations of time, space and availability of information. In order to implement rough justice, customs must first identify high risk shipments. Rough justice, which is a cursory but systematic approach to customs enforcement, is preferable to the partial and ad hoc approach used in Mexico prior to its reform.

Customs administration can be viewed in terms of three processes: information gathering, enforcement and collection. The evolution of customs from physical control to documentary audit places a premium on information. While information gathering and voluntary collection processes are suitable for privatization, enforcement and enforced collection are not.

There are two complementary initiatives underway that could strengthen customs administration in Mexico. The first initiative is the second inspection, which is meant to strengthen importer/broker compliance to reinforce the discipline of the first inspection. A second initiative under discussion is the reform and strengthening of the government’s audit capacity.
The Structure and Process of Customs Administration

Mexico’s customs import process is administered through a four-tiered system of inspection and documentary audit. This section reviews each tier’s processes and weaknesses and suggests recommendations for improvement. This review and the recommendations are based on a six month study of the second inspection required by the consortium of customs brokers managing the second inspection and the Government of Mexico. (5)

Tier 1: Customs Entry Preparation--Brokers/Importers

The first tier is done by customs brokers, who inspect the importer’s goods and prepare import documentation that accounts for tariff classification, valuation and origin. At this stage, payment of duty is made to private and government banks, which subsequently advise the brokers and customs of the collection. There are several problems with the first tier. There should be a better distribution of responsibility and liability between brokers and importers. Standards in the broker industry need to be improved, and the industry needs to work on disciplining its own members when necessary.

Recommendation #1: To review the responsibility of customs brokers and importers.

The first tier must be substantially strengthened. In order to facilitate trade and protect revenue, the inspection of goods and preparation of import documentation must be done accurately by the brokers. Because they are licensed, brokers serve as agents of the state in performing the initial inspection since they have the training, experience and responsibility to ensure that shipments are accurately documented. Brokers must assume the majority of the responsibility in the initial inspection. This does not absolve the importers of liability. When the importers seek to defraud the government, they should receive severe penalties. Making brokers more responsible for the integrity of the customs systems at the first tier fits with the
strategy of privatizing the customs inspection function at the second inspection. Of the three inspections in customs, two are done by private firms and one is done by the government. The initial and comprehensive inspection is done by brokers at the first tier; the next inspection is done by the government in a random, but targeted manner; and the last inspection is done, at random, by private firms. (6)

**Tier 2: Physical Customs Inspection - First Inspection**

The second tier of customs is the first inspection conducted by the government’s customs service. The role of the first inspection is to both randomly and selectively check for fraud or misrepresentation. Selection of goods for first inspection is done by a computer program that is both weighted and random. As the import documentation is entered at the first inspection stage, the computer generates a red or green signal upon which the goods are either inspected or cleared. Automation of selection reduces discretion and hence corruption. Approximately 10% of all goods are selected by the computer to be checked by the first inspection.

The first inspection is problematic in several respects. First, there are reports that the computer system has been compromised and that selection of goods for the inspection is not random.

Second, although it is clearly stated in the 1982 Customs Law, the role of the first inspection is not clearly understood by government inspectors. The first inspection should be limited to a basic check in order to avoid restraining trade. The objective of the first inspection is to establish rough justice in physical inspection while awaiting refinement of justice at the audit stage. Some customs administrators are looking to second inspection with the unrealistic expectation that it can provide more revenue protection. Revenue protection is properly done at the back end of customs through documentary audit and not at the front end through physical inspection.
A third problem with the first inspection is that some customs administrators routinely exercise their discretion to inspect imports thought to be high risk in a procedure known as an "operational red." An operational red is when a government customs inspector overrides the computer generated "green" which would release the shipment from inspection. Differences in the utilization of operational reds between customs administrators derive from the personal interpretation each gives to the last paragraph of article 29 of the Customs Law. In some cases, there are as many operational red inspections as computer selections. Operational reds are not necessarily bad if utilized under the informed discretion of an experienced customs official, and can be a valuable means of targeting inspection. This discretion, however, must be properly monitored or it can be abused. Operational reds cannot be monitored by the second inspection, because they are still identified by the computer system as greens, and therefore are not part of the selection population for second inspection (the second inspection only review a sample of the first inspection reds). Finally, the first inspection is weak because the monitoring provided by the second inspection is not followed up.

The second tier could be improved if the following three recommendations were implemented.

Recommendation #1: To limit the first inspection to rough justice as defined by this legal definition should be put into practice through the implementation of procedures and training.

To ensure the efficiency of inspections and curb discretion, the actions of inspectors have to be clearly defined in law, procedure, and practice.

Recommendation #2: To require the customs administrator provide the second inspection with information on actions taken to resolve irregularities identified at the first inspection, which should be reinspected by the second inspection or have documented proof of compliance with the administrator's ruling.
The purpose of the second inspection is to check the actions of the first inspection. That check should include follow-up actions.

Recommendation #3: To consider operational reds as system reds for the purposes of second inspection selection.

The second inspection must be able to check the discretionary actions (operational reds) of the first inspection.

Tier 3: Physical Customs Inspection - Second Inspection

The third tier of customs is the second inspection, which is managed through a contract with 11 companies of customs brokers (the Consorcios) and a contract with the Societe Generale de Surveillance (SGS), an international preshipment inspection firm. The 11 companies of the customs brokers manage 45 of the 48 second inspection concessions. The operational management of the customs brokers’ companies has been sub-contracted to the firm Operadora de Gestion Aduanal (OGASA). The remaining three inspection concessions are managed by SGS.

The role of the second inspection is to audit the performance of the first two tiers: importers/brokers and the first inspection. The same computer system that selects 10% of shipments for review by the first inspection selects 10% of those shipments for further review by the second inspection. In theory, the second inspection should review 1% of all shipments.

The second inspection was introduced in 1993 over a brief period of three months, and was effective in challenging a corrupt and moribund customs administration. Virtually all of the customs officials and brokers interviewed during a recent review of the second inspection agreed that it had had a significant and positive effect on the first inspection.

Despite the positive impact of the second inspection to date, several problems remain. First, the second inspection can be ignored.
The information can be sanitized and buried by the first inspection or by the regional customs administration. Second, because the first inspection is not required to communicate the actions taken to resolve inconsistencies, the second inspection has no capability of verifying its performance. Third, as an audit of the first inspection, the second inspection is not complete. Computerized selection of shipments for the first and second inspection can be and have been tampered with. The discretionary practices of the first inspection, such as the use of operational reds, are also not monitored. While recent changes in regulations have made operational reds illegal, the practice continues.

The legal definition of inspection holds that first and second inspections should be rough justice. The inspectors at the second inspection, the Dictaminadores Aduanales, are going beyond rough justice by delving too far into issues of classification and origin because they have time on their hands, want to demonstrate their competence, and in some cases are responding to the expectations of local administrators of customs. The initiative of the Dictaminadores Aduanales poses three problems. Trade can be impeded, the second inspection can be inconsistent, and initiative can be abused. In the past, unscrupulous government customs inspectors (called vistas) have used their authority to extract bribes from importers.

The autonomy of the Dictaminador Aduanal creates a formidable management challenge. Short of firing a Dictaminador Aduanal for fraud or gross negligence, there are limited means of supervising performance and ensuring consistency. The methods for measuring and correcting substandard performance are not adequate. The relationship between the Dictaminador Aduanales and the company managing the (OGASA) is weak for the following reasons: recruitment is done by government; there are no clear criteria for supervision; the mechanisms for reward are unspecified; and the mechanisms for discipline are unreliable (lie detector tests).

The isolation of the first and second inspections is also a problem. Communication between these two tiers is a delicate balance, for the
second inspection is to check on the first inspection, but the two tiers also need to communicate findings and techniques.

A final weakness of the second inspection, at least initially, has been the lack of communication between government and the private firms implementing the second inspection. The contract for the second inspection did not specify exactly how government was to oversee the contract on a routine basis. The contract did provide for a performance audit, but this was not enough. Given that the inspection was new, there was considerable learning that had to be done by both parties. There has been also some lingering suspicion by government staff of the brokers. It is critical to understand that the value of this relationship can be gained only if the partnership is fully developed. Management requires constant consultation, review, and adjustment. Recent changes have brought about closer and more frequent consultation between government and the firms managing the second inspection.

Implementing the following recommendations would improve the second inspection.

Recommendation #1: To clarify and implement the rough justice inspection.

This recommendation is stated explicitly in law. A customs inspection should do the following: first, check the customs documents to determine completeness, and second, provide a detailed description of the goods (nature, number, origin and other characteristics) that will help determine the truth of what is declared. This physical information must then be compared with the entry documents. A rough justice inspection will accord with the law, not restrain trade, and promote the evolution of customs from physical control of goods to documentary audit.

Recommendation #2: To improve the delivery and supervision of the second inspection.
The effectiveness of the second inspection requires that staff be trained and well supervised. Relying on lie detector tests and high salaries is a necessary but not a sufficient means of promoting honest performance. It is essential to build professionalism among the second inspection staff. Professionalism comes from clearly defining tasks, training staff to have competence, and infusing tasks with value.

Recommendation #3: To expand inspection to include approximately 3% of all imports (red and greens). (The current second inspection only samples 10% of the reds of the first inspection. It does not sample the greens).

This recommendation would provide a comprehensive and random inspection of all imports, a check on broker/importer performance, and a check on the performance of the second inspection.

Recommendation #4: To define and implement rough justice analysis role for the Dictaminadores Aduanales.

Currently, the Dictaminadores Aduanales compare the physical goods with the documentation to determine broad tariff classifications. This recommendation expands the role of the Dictaminador Aduanales in analyzing the import documentation from simply matching the category of goods in the documents with the physical goods, to conducting a more detailed classification. Expanding this role is possible because the inspection will be fresh, and the inspector has time to work with the classification reference material. This analysis should be done only after the goods are gone, in order to comply with a rough justice inspection. The results of the analysis would be in the form of a recommendation addressed to the audit agency AICG (Administración de Informática Contrariedad y Glosa, which translates as Data Processing, Accounting, and Documentary Analysis Administration), commonly known as GLOSA.

There are several justifications for this recommendation. Under the present system, classification is fragmented and not done
systematically. The audit agency, GLOSA, is understaffed and recent government hiring restrictions will significantly limit the amount of additional manpower available for classification. GLOSA has welcomed the idea of additional assistance. Customs administrators feel that classification is being performed inadequately and could be done by the second inspection. An expanded role in analysis will reinforce the second inspection's principal objective of providing information, and can potentially provide a model for GLOSA that will shift its attention from minor document errors to more significant revenue losses. This expanded role would fully utilize the costly Dictaminadores Aduanales.

Recommendation #5: To analyze information by the Consorcios for use by customs.

This would assist the fourth tier in improving documentary review and audit.

Broadening the coverage of the second inspection to include both the reds and the greens from the first inspection will make the second inspection comprehensive. This recommendation is currently being adopted.

Tier 4: Review and Audit

The fourth tier of the customs process is the responsibility of the customs administration. The fourth tier does three things: checks the consistency of the pedimento (import declaration), assembles trade data, and audits importers and brokers. The fourth tier includes three institutions: the GLOSA, Administración General de Auditoria Fiscal Federal (AGAFF), and the Legal Department of Customs.

The process of review begins with the assembly by the broker of a packet of import documents which can include the following: the declaration (pedimento), invoice, certificates of origin, permits, and shipping documents (bills of lading). This package accompanies the
goods as they pass through the two stages of inspection. Once the goods have cleared the second inspection, the documentation is sent to the customs administrator, who forwards the package to the local office of GLOSA.

GLOSA conducts a review that involves four steps. First, information contained in the supporting documents (invoice and bills of lading) is compared with the information on the pedimento. Second, documents are checked to determine their compliance with quotas, anti-dumping provisions and anti-dumping certificates. Third, minimum price regulations are applied. Fourth, a determination of non-tariff requirements (permits and safety standards) is made.

In general, the local office of GLOSA will review shipments valued under a specified amount, and the central office will review shipments valued over that amount. This value threshold varies from office to office (for example, NP$ 15,000 in Veracruz and NP $30,000 in Nuevo Laredo). The central office of GLOSA in Mexico City receives all documentation and can review any shipment.

The review by GLOSA can result in four actions. First, no action may be taken. Second, additional revenue may be demanded by the Revenue Collection Department of the Ministry of Finance. Third, GLOSA can recommend that fines be imposed. In such cases, a recommendation is sent to the Legal Department, which sends it to the Revenue Collection Department. Fourth, suspected fraud is forwarded to AGAFF for audit. GLOSA’s review is used to weight the computer system, so that brokers who perform poorly will be targeted for inspection.

The second institution involved is AGAFF, which audits all taxes, including customs. AGAFF’s mandate allows it to cross check compliance between customs, and value added and income tax. The agency’s audit strategy is reactive, not proactive. An audit of a broker or an importer by AGAFF is the result of a formal procedure (fine or seizure). The agency does not systematically review the import
documents. AGAFF also provides input into the targeting of the computer program which selects goods for inspection.

The third institution is the Legal Department of Customs Administration, which performs two roles. First, it reviews the Procedimiento Administrativo en Materia Aduanera (PAMA) - a legal procedure which provides the taxpayer with the opportunity to present evidence to clear the seizure of goods. Second, if requested, it renders an interpretation of tariff classification.

The back end, of the review and audit state, of customs administration is crucial for maintaining the discipline of the customs process and for protecting revenue. The review and audit stage of Mexico’s customs is currently extremely weak. First, the functions of verifying tariff classification, origin, and valuation are fragmented. Second, GLOSA is understaffed and does not have the manpower to effectively review all documents or even a reasonable sample of them. Third, GLOSA headquarters is backlogged by as much as a year in the review of documents, so that targeting arising from review is not timely. Fourth, GLOSA is able to do only a superficial review of the documents. It does not do tariff classification, origin, or valuation. Fifth, GLOSA focuses on minor inconsistencies in documentation which have little or no impact on revenue but use excessive administrative resources. Sixth, review and audit of documents is not systematic, but is done instead by referral and exception, weakening voluntary compliance. Seventh, the results of the second inspection are not directly reviewed by AGAFF, since they are referred to the first inspection for action and can be ignored by this inspection. Finally, there is a lack of communication between the first and second inspections, and GLOSA and AGAFF. Review by GLOSA and audit by AGAFF is made difficult because these agencies lack communication with the people who physically inspect the goods. Communication between GLOSA, AGAFF, and the inspectors is especially important in order to improve future review and audit.

At this stage in the evolution of Mexico’s customs, the fourth tier performs documentary audit and is the weakest tier. The following
recommendations could be helpful:

Recommendation #1: To redirect audit resources.

The current GLOSA review is principally a clerical function, which could be largely computerized. Laborious attention is paid to data-element by data-element comparison of the pedimento to the invoice and permits attached to the accounting. This is not an audit, but merely a check function. Audit personnel should be utilized for tasks involving thought and judgment, such as establishing the accuracy of the tariff classification (in instances where there is no obvious naming of heading reference), the appropriateness of valuation judgments, and the plausibility of the origin declaration.

Recommendation #2: To allocate sufficient resources for timely analysis.

The results of audit review are of little or no use if they are very delayed. The current backlogs of one year or more in the central GLOSA office are not acceptable.

Recommendation #3: To transform AGAFF’s audit strategy from reactive to proactive.

A vigorous and systematic audit strategy is needed.

Recommendation #4: To ensure that the communication of information and results of audit reviews takes place among all tiers.

The key factor in the effectiveness of the audit systems implemented by the Canadian and US Customs administrations is the capacity to share information from the front end to the back end and from the back end forward. In this way, all levels of the customs process are able to refine and focus their targeting and to work together to ensure that inspections are performed only when needed,
that audits are conducted in areas of legitimate risk on the basis of fully adequate information trails, and that timely and appropriate monitoring and corrective action can be taken at all levels. This sharing of information and feedback should be a strong motivating factor for officers at all levels and should confirm for them that the work they are doing has a concrete, positive impact.

Recommendation #5: To focus audit reviews on the use of appropriate databases.

There is a clear limit to which the accuracy of import accounting can be verified solely on the basis of the documents presented to customs. For example, tariff classification may depend to some extent on the use to which the good or goods will be put after importation (particularly in the case of parts and components). Valuation may incorporate the consideration of required adjustments that will not appear on the invoice, such as royalties, contingent payments based on sales, and assists, which should be declared as part of the import value for purposes of customs accounting. Entitlement under the NAFTA rules of origin can ultimately be determined only through a verification that manufacturing processes in the exporting country or countries were sufficiently expensive to meet the tests imposed by the applicable rule. For these reasons, audit reviews must ultimately be focused on the information systems maintained by the importers themselves (and, in the case of NAFTA origin, exporters in Canada and the US). Customs will never find out about an undeclared royalty payment, for example, without looking into receipts and the accounts payable of importers. This is an area where the Mexican government may be incurring a significant revenue loss through inaccurate and incomplete customs declarations.

Recommendation #6: To ensure that full interaction between customs and other agencies is achieved.

Currently, a number of government agencies have an interest in some parts of the customs accounting process: customs; AGAFF (to the extent that customs revenue falls within the purview of a taxpayer
audit); and the Secretaria de Comercio y Fomento Industrial--SECOFI (with respect to anti-dumping/countervail investigations and the operation of preferential import programs, such as the maquiladora zones). For the same reasons noted in recommendation #4, it is imperative that there be a full information flow among all government agencies.

Recommendation #7: To establish a trained unit in the Consorcios for data analysis and reporting that would proactively analyze reports in order to determine importer compliance and domestic industries vulnerable to illegal or misrepresented imports, and thereby assist government and AGAFF to target activities.

This recommendation would improve the information for documentary audit.

Section Summary

Mexico's customs administration differs from customs in the United States and Canada in two ways: discretion is not carefully monitored, and audit capacity is weak. While there is considerable discretion in the Canadian and American inspection process, discretion in both these countries is guided by computer generated targets and is carefully documented. The first inspection in Mexico, in contrast, is a combination of random computerized selection and, until recently, administrative discretion or operational reds - neither of which are adequately monitored.

WHY THE SECOND INSPECTION HAS BEEN EFFECTIVE

Since the second inspection was introduced rapidly, all possible contingencies could not be foreseen and designed in advance. Despite shortcomings, the second inspection demonstrates the virtue of
imperfect systems for curbing corruption and has been effective for the following reasons:

**Shock Treatment**

The reform was introduced in a very short time (three months), providing little time for the rest of the customs to either stop the reform or neutralize it. Many government customs officials retired voluntarily, as the scope of the reform became evident.

**Commitment by Reformers**

The reform was proposed by one of the most influential technocrats in the government. His support and unwillingness to compromise in implementing the reform was critical to the program’s success. This commitment continued, even after the initial phase.

**Complimentary Reforms**

The second inspection was complemented by a wide range of reforms, which included the professionalization of the customs inspectors and the privatization of the warehouses.

**Limited Role**

The second inspection was designed to inspect only 1% of total imports. It was intended to have a comprehensive, but selective, impact. If the computer system were truly random and uncompromised, the 1% selection rate would be wide-ranging enough, while limiting restraints on trade. The architects of reform have always been concerned that the second inspection maintain a delicate balance between deterrence, trade and institutional capacity. One of the principal dangers to the reform is over-expectations. Although the second inspection performs an important and clear role, it is limited and cannot compensate fully for the weaknesses of the other tiers.
The effectiveness of the second inspection depends on the clear definition and implementation of roles.

**Brokers Made Stakeholders**

An unusual feature of the second inspection has been the use of customs brokers to manage the inspection. This decision is unusual, because the industry has a somewhat questionable reputation in Mexico. The customs brokers have been given a clear signal that they are partners with government and that they should share in the task of reforming the industry. Customs brokers understand the business better than others and have been able to introduce the second inspection design rapidly.

**Effective Management**

The rapid introduction of an administrative innovation with no precedent requires skilled management. One advantage of using the private sector is that it has better management experience than the public sector. The Consorcios management firm, OGASA, has been very effective. It has deftly handled a range of issues from personnel to information systems and has consistently devised innovative solutions.

**Consistency**

The second inspection firms were selected through tendering, and 45 of 48 customs ports were won by a group of brokers which formed a group called the Consorcios. Although this coalition of brokers could restrain competition and lead to oligopolistic pricing of services, an extremely important and likely benefit is consistency in performance with the majority of the customs ports managed by the Consorcios and one management company. Consistency is especially important, since if one customs port is weak, trade will automatically gravitate toward that port.
NEXT STEPS

The evolution of Mexico’s Customs is at a critical juncture. The innovation of the second inspection is in place, and improvements in the second inspection are being planned and implemented. The Consorcios, which manages most of the customs inspection points, recently commissioned a review to prepare a strategic plan for the second inspection. The strategic plan recommended that the strategic task at hand is to evolve the second inspection from a means of rapidly introducing improvement in customs administration to a model of physical inspection and preliminary document analysis. The role of the second inspection would then be clearly defined as rough justice in terms of physical control and preliminary documentary audit. If done comprehensively through new reforms, which would allow sampling of all imports and operational reds, the second inspection could provide an objective check on the front end of the customs system. Such a role would be a major achievement. Through its combined task of physical inspection and preliminary documentary audit, the second inspection can provide a real, rather than perceived, deterrent. The deterrent would also ease some of the pressure (but not the responsibility) on the weak back end of customs (the fourth tier) to protect revenue. There is a tendency in customs systems to push compliance to the back end or audit stage, and the second inspection can redress this imbalance.

One question already being asked is whether the success of the second inspection eliminates the need for other tiers of customs, especially the first inspection. While the second inspection can physically inspect, it cannot seize property. Second inspection sends a shipment back to the first inspection for reinspection and detention. There are limits on the legal authority of a private firm to seizure of property. Customs remains a public sector function in Mexico.

Eliminating tiers eliminates redundancy. Until a critical level of accountability exists in Mexico’s customs service, institutional
redundancy is still needed. Until the audit capacity of the fourth tier provides a credible deterrent, deterrence in Mexico’s customs administration will rest principally at the first and second inspections. The deterrence of these inspections rests in large part in their redundancy.

The effectiveness of the second inspection has in large part been due to its clear, but limited, role. The proponents of this reform crafted a delicate design that balances comprehensiveness and selectivity. While the proponents of the reform accept the need for the second inspection to broadly sample all imports, they have raised the concern that only a fraction should be sampled. This concern underscores the belief that the second inspection should have a selective role.

Mexico’s second customs inspection affirms the values of private participation in customs administration and the value of institutional redundancy in promoting accountability. Despite the relative short period of time since its introduction, the reform suggests some design lessons for administrative reform in customs. First, build accountability through redundancy. Second, improve the efficiency of redundancy through process improvement within and between administrative layers (e.g. clarifying the concept of the inspection as rough justice and automating processes), rather than through process re-engineering, or the elimination of layers. Third, introduce continual process change with an initial shock and continuous refinement that keeps pace with or, better yet, stays ahead of corruption. The value of introducing private firms into customs administration is that they provide redundancy and are better able to manage the rapid and continuous changes required. The principles of redundancy and renewal have made this reform a success.

Mexico’s customs reform demonstrates that improving the accountability of corrupt administrative systems requires drastic reform. The reforms must significantly change administrative procedures so that illegal practices are deterred or disrupted. The
maintenance of accountable administrative systems requires continual evolution in the system. Until a critical mass of compliance is established and vigorous oversight mechanisms are established, corruption will continue to defeat administrative reforms. However, even imperfect administrative innovations can have a significant deterrent effect on corruption and on improving the accountability and efficiency of customs administration.

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REFERENCES


2. Ibid.

3. Personal communication, Dr. Francisco Gil Diaz, Vice Governor of the Central Bank of Mexico.

4. The term, rough justice, as applied to tax administration is from Glenn Jenkins.

6. Mexico has three customs inspections, but the first inspection conducted by the broker is not referred to as the “first” inspection since it is not done by government or under government contract like the privatized second inspection.


9. In 1995 the NPS exchange rate was 7.5 peso to one US dollar.