Behavioral Economics in Customs Policy: Enhancing Compliance through Nudge

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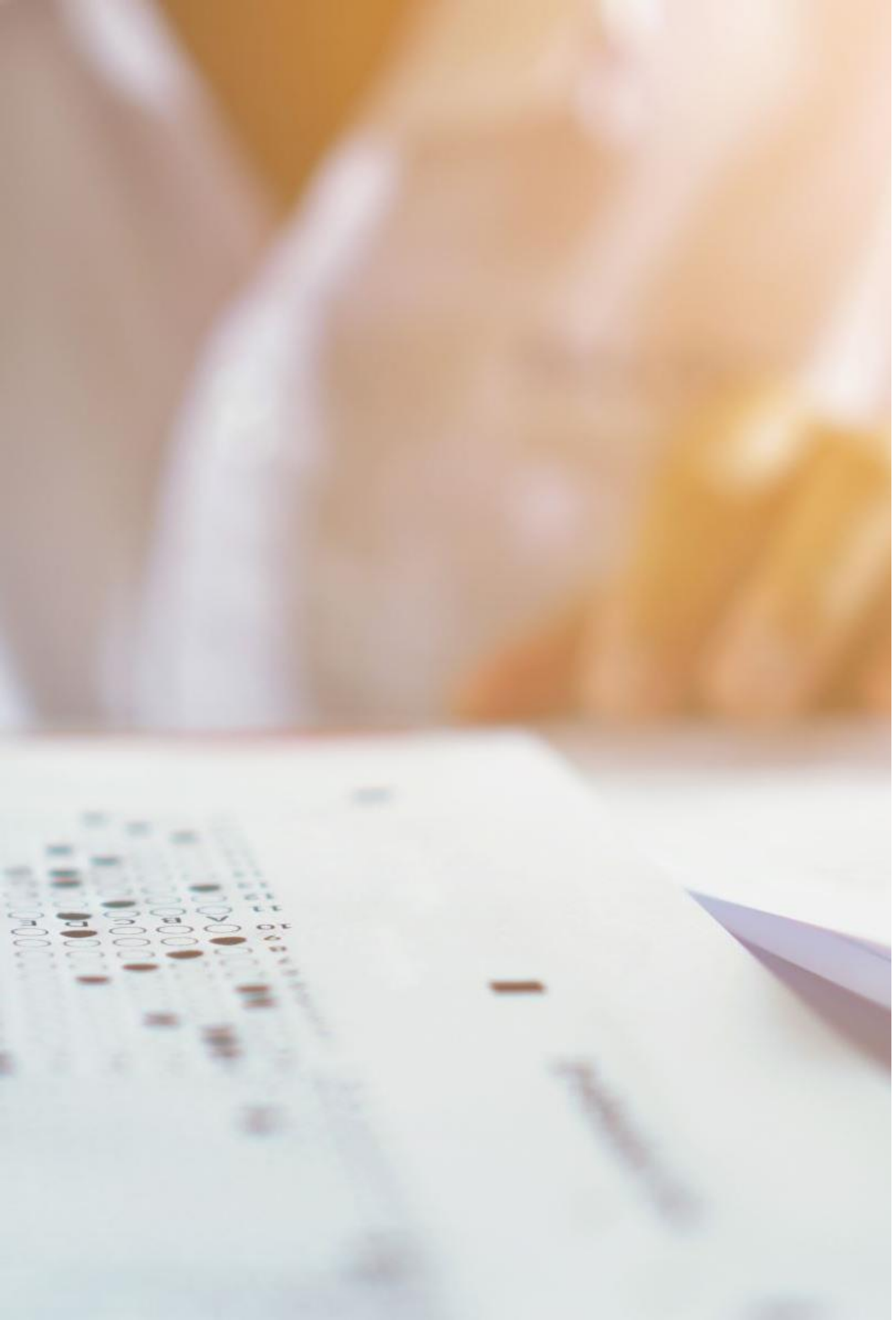
1. Introduction

- Tax non-compliance signifies a failure to comply with tax responsibility, either intentionally or unintentionally.
- The main form of non-compliance with customs regulations:
  - Tariff/tax evasion i.e., declaring less goods values, misclassifying, false invoices, falsifying country of origin, avoiding deferred duty after the release of goods, etc.
  - Smuggling



II. Understanding Compliance Behaviors

- ❖Compliance can happen by either
  - voluntarily results from taxpayers' willingness to follow the tax obligations, arising from their moral views and commitments to society
  - enforcedly resulted from concerns over getting detected and fined
- ❖Economic drives e.g., financial incentives
- ❖Psychological drives e.g., social norms, tax fairness, morality, and so on.

Conventional Compliance Model

- Based on the neoclassical economic model
- Try to understand why people do not comply?
  - relies on expected utility function, assuming that individual will maximize their expected utility gained from tax evasion against the risk of being detected and fined.
  - tariff and non-tariff barriers are incentives to evade (compliance cost).
- Lead to deterrence theory, indicating that the higher probability of detection and penalty will deter non-compliance (deterrence effect).

➢ Encouraging compliance approach is the reduction of compliance cost and the increase on probability of detected/fined.

Behavioral Compliance Model

- Based on behavioral economic model
- Try to understand why people comply?
  - relies on non-expected utility functions, the probability an individual perceives is not accurate (subjective probability)
  - people's decisions tend to be biased (individual framing effects)
  - people's decisions are influenced by social interactions, not just driven by self-interests

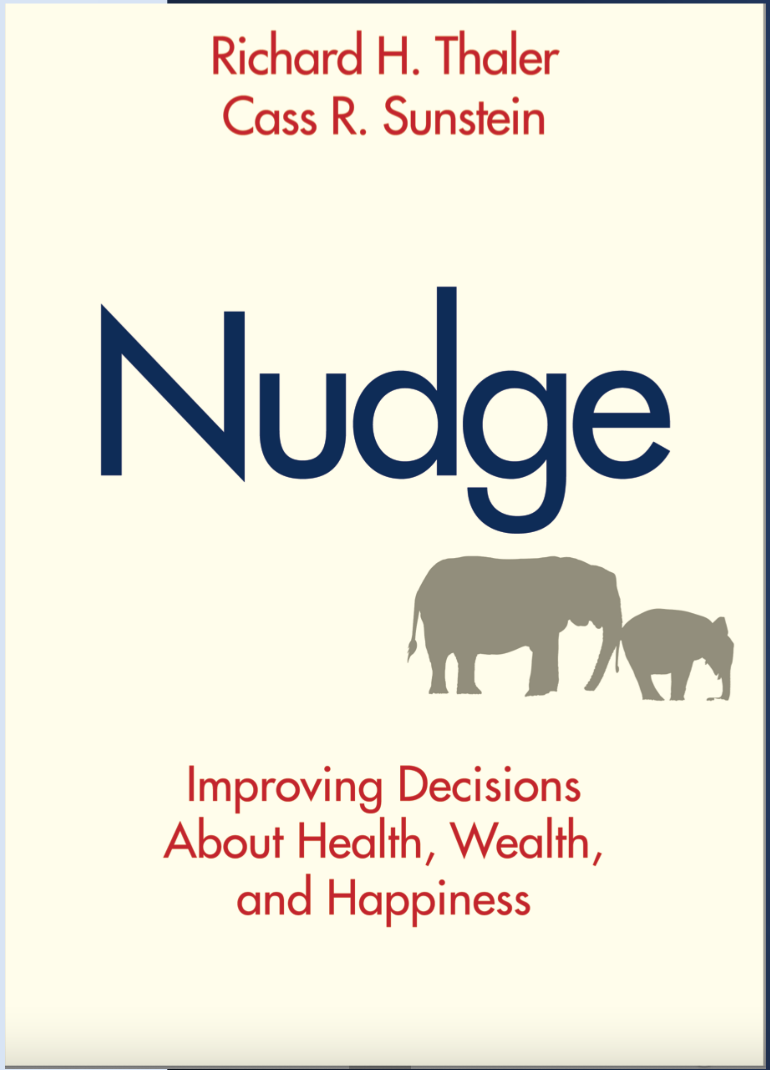
➢ Encouraging compliance should aim on the enhancement compliance norm/tax morality.

III. WCO Compliance Framework

- "Carrots and Sticks" are deployed to encourage voluntary compliance and hinder intentional violations.
- VCF has divided clients' compliance levels into 4 categories:
  - Type (1) are voluntarily compliant, provided with incentives
  - Type (2) try to be compliant but do not always succeed, provided with assisted compliance
  - Type (3) avoid complying, given with directed compliance
  - And Type (4) deliberately do not comply, given with enforced compliance

What is Nudge?

- Nudge is defined as "*any aspect of choice architecture that alters people's behaviour in a predictable way without forbidding any options or significantly changing their economic incentives*" (p.6).
- Nudge instruments # carrots and sticks approach
- Nudges are employed as a complementary tool rather than a substitution for the conventional approach like the legal enforcement for violations.
  - **Loss and Gain Framing**
  - **Norm Nudge**
  - **Deterrence Message**



Loss and Gain Framing

- Loss and gain framing refer to the way that information could be framed before conveying to the client.
- Negative framing focuses potential loss outcomes, while positive framing highlights gain outcomes.
  - if companies are concerned about positive gains like simplification of procedures, then the information should be conveyed the potential gain of that
  - if taxpayers want to avoid negative outcomes like losing the reduced regulatory scrutiny, then the framing should include the potential loss of that

- Loss and gain framing could apply to type 1 client to remain complying as well as type 2 and 3 to pay more attention to their compliance behavior.

Norm Nudge

- Norm nudge targets social norms (inform of what others are doing or what should be done) and moral suasion (make consequences of moral decisions visible)
  - Information campaign, focusing on tax's benefits to society and tax fairness
  - Include tax morality and compliance norm in reminding messages, focusing on the need for compliance cooperation
  - Peer effects in reminding message, i.e., informing that majority of other taxpayers are complying.
- Norm nudge could apply to all types of clients to increase their perceived compliance norm; however, type 3 should be specifically targeted, presumed that their compliance avoidance may be caused by the lack of social norms and intrinsic motivation.

Deterrence Message

- To raise concerns over detection capability and penalty degree by including threat and warning sentences in reminding letters to pay tax.

  - Threating of being audited/fined

  - Threating of being “named and shamed”

- The deterrence letter can induce the type 3 client to revise their beliefs about the detection probability and pull back their non-compliance intention.

Limitation

- Nudge approach is still a new integration with the policy domain.
- Most of the behavioral evidence are from experimental studies, which are still concerned over its validity in a real intervention application
- Its reliability and tenacity in another situation or overtime is still a question.
- Evidences are found in taxation administration rather than the applicability in customs administration

Conclusion

- Nudge interventions can help tackle willingness to comply subconsciously and remind taxpayers to be more conscious of compliance choice, especially to clients with unintentional mistakes (Type 2) and low-key intentional avoidance (Type 3).

- More explorations of behavioral economics and nudges are required to ensure its efficiency and applicability in one respective social infrastructure and customs context.

THANK YOU!!