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'Nudging' Voluntary Compliance in Border Customs

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Legal and regulatory compliance can be voluntarily motivated or enforced by authorities. The World Customs Organization Voluntary Compliance Frameworks (WCO VCF) is adopting a reward and punishment system, responsive to economic constraints of compliance. However, psychological elements do not appear to be incorporated. The WCO VCF could employ 'norm nudge' and 'deterrence nudge' as supplementary tools in responding to different client risk types, analogous to the effective application of nudge incentivization in taxation compliance. Similarly, it could help improve voluntary self-declaration of goods at the border crossing.

Executive Summary

In practice, compliance levels are usually assessed and placed on a compliance continuum, ranging from voluntary compliance to criminal behavior. In particular, the WCO VCF has categorized client compliance levels into four groups. Type 1 clients are highly and voluntarily compliant, and their compliance is often supported and rewarded with incentives. Type 2 are willing to comply but sometimes make unintentional mistakes, so their compliance is assisted through education or training. Type 3 clients avoid complying and require direction, for example, formal warnings. Type 4 clients' compliance must be enforced through administrative penalties or criminal prosecution in more serious cases. These responses embed a reward and punishment system, which is employed to promote voluntary compliance and prevent intentional non-compliance by providing more incentives for good compliance performance in addition to administrative penalty or criminal prosecution following the seriousness of

non-compliance acts. The approach is responsive to economic incentives, namely tariff and non-tariff barriers, by altering the cost-benefits of such a non-compliance act.

Meanwhile, there is a growing literature on behavioral economics, suggesting social and psychological elements are also key determinants of compliance behaviors. Compliance drivers are not only concerned with economic incentives, but also other non-economic factors including cognitive biases, intrinsic motivation, social norms, and so on. Consequently, 'nudge' is adopted as one of the behavioral interventions to promote compliance in taxation, energy saving, and many other sectors. 'Norm nudge' and 'deterrence nudge' can potentially improve voluntary and enforced compliance and should be integrated into the WCO VCF's current responses to various client risk types. It could especially assist WCO VCF's Type 2 (unintentional mistakes) and

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Type 3 (low-key intentional avoidance) clients as nudges help bring compliance norms and the consequences of non-compliance to their attention. Overall, the nudge approach has the potential to increase the incidence of self-declaration at the border crossing.

1. Introduction

Non-compliance behaviors most often take form as unintentional mistake-making or the intentional seeking of economic incentives. “Carrots and Sticks”, or ‘reward and punishment’ systems are consequently deployed as the central strategy of a contemporary compliance approach with the aim of encouraging voluntary compliance and hindering intentional violations. In the customs community, compliance levels are typically evaluated and assigned on a compliance continuum that ranges from voluntary compliance to criminal activity (Widdowson 2020, 66). The approach recognizes different compliance levels and provides a variety of treatments in response. The appropriate regulatory response is therefore to be applied based on a client’s compliance position. In other words, the more compliance demonstrated by traders, the less likely they are to be on the receiving end of punitive regulatory responses.

To examine a particular case, the WCO Risk Management Compendium, which is recommended in the WCO VCF, has divided client compliance levels into four categories including those who (1) are voluntarily compliant, (2) try to be compliant but do not always succeed, (3) avoid complying, and (4) deliberately do not comply (WCO 2014, 2). This model classifies clients along a sliding scale from lowest risk to highest risk—as linked with compliance—which in turn suggests different levels of responses. The WCO VCF has developed sufficient and varied responses to economic drivers of non-compliance behaviors, particularly targeting tariff and non-tariff barriers as constraints to compliance. To illustrate, the WCO VCF’s main strategies of acquiring voluntary compliance include reducing compliance costs, increasing compliance incentives, and increasing the likelihood of non-compliance exposure.

As compared to economic drivers, psychological elements appear to have been given little attention and seem to not be integrated into the WCO VCF. Aside from economic drivers, there is a growing acceptance that social and psychological factors—namely cognitive biases, social effects, tax morality, etc.—can come to affect individuals’ compliance decisions. Therefore, to work with these psychosocial aspects, compliance efforts should engage positive behavioral intervention to harness intrinsic motivations, encourage compliance as a social norm, and influence individuals’ perceived possibility of detection and sanction. Over the past several decades, nudge has been introduced in a wide range of sectors including taxation, environment, healthcare, education,

and pensions in order to encourage compliance and cooperative decision-making.

Most of the literature on the effectiveness of nudging tax compliance is based on direct taxes—such as personal or corporate income tax—rather than indirect taxes like customs and excise duties. Nonetheless, approaches to tax compliance are generally similar, regardless of whether the context is that of direct or indirect taxes (Mohamed 2006, 55–56). The common requirement for the taxpayers of both types of taxes is to comply with each respective regulation. For instance, the obligation of income-tax taxpayers is to report their income or pay their tax debt correctly, and taxpayers of customs duties are to lodge a customs declaration or pay a deferred payment appropriately. In this way, the lessons learned from nudge implications in tax administrations can also be useful when adapted to customs administration contexts.

2. Previous Implications of Nudge on Compliance

Nudge is defined as “any aspect of choice architecture that alters people’s behavior in a predictable way without forbidding any options or significantly changing their economic incentives” (Thaler & Sunstein 2008, 6). Choice architecture refers to the design of choices as presented to decision-makers, a presentation which may come to affect their verdict. Nudge instruments are fundamentally different from the carrots and sticks strategy, which opts to alter the costs or benefits of a person’s actions as a means of encouraging or discouraging a particular choice (Kantorowicz-Reznichenko & Wells 2021, 552). To clarify, a person must choose between the expected costs (punishment) of not complying and the expected benefits (reward) of complying. On the other hand, nudges utilize various psychological mechanisms to influence a person’s behavior—for example, using social norm statements to promote tax compliance or setting the default payment of a flight to offset carbon emissions.

2.1. Norm Nudge

To enhance tax compliance, some tax agencies have tried to alter taxpayer attitudes by using behavioral nudges to establish tax compliance as a social norm (Alm *et al.* 2019, 2). Adding moral suasion and descriptive norms in reminder messages has previously been found to encourage taxpayers’ acts of voluntary compliance in many experimental studies. For instance, a large field experiment was conducted on the effect of a moral persuasion letter that included the statement “your tax payment contributes to the funding of publicly financed services in education, health and other important sectors of society”, directed towards more than 15,000 Norwegian taxpayers who were deemed likely to underreport their foreign income (Bott

et al. 2019, 2801). The result was that in this instance, moral suasion and social norm construction were found to have a positive influence on compliance; it is to be noted, however, that the long-term effect is not proven.

Several experimental results also suggest that if one is aware of their peer’s action or the majority action, one’s behavior might be strongly influenced by that action (Alm et al. 2017, 588; Kettle et al. 2016, 27). Similarly, an experimental study examined effects of the social comparison by sending letters to taxpayers informing them about compliance rates, stating that “9 out of 10 people in Britain pay their tax on time”, with some groups’ letters containing extra data on compliance rates in the recipient’s neighborhood (Cabinet 2012, 22-23). The results of this study show that the compliance rate in contexts where participants had received information with a specific local area comparison had increased tax debt payment, more so than participants who received information about the national compliance rate.

2.2. Deterrence Nudge

Tax agencies also occasionally attempt to nudge compliance through communication about enforcement practices in order to alter taxpayers’ perceptions of the probability of detection and sanction. When taxpayers have limited attention, warnings that emphasize the probability of penalties and legal action can enhance compliance. Per the results of a controlled experiment on the effectiveness of an increased threat of examination—wherein letters were sent to 1,724 Minnesota taxpayers who were informed that their tax returns would be “closely examined”—this strategy was further found to significantly influence compliance choice (Slemrod et al. 2001, 455). Another field experiment that aimed to increase tax compliance among Argentine property tax taxpayers indicated that taxpayers who received the deterrence message were more likely to comply than taxpayers in the control group (no message), indicating a compliance rate of 10% higher if extended to the whole population (Castro & Scartascini 2015, 65). Similarly, evidence from a randomized field experiment in an Argentine municipality suggests that the threat message on the declaration that highlights fines and enforcement for the property tax has a spillover effect on the gross sales tax (Lopez-Luzuriaga & Scartascini 2019, 518). The deterrence letter effect on Norwegian taxpayers has been found to provide more certainty of a long-term effect on compliance than moral suasion (Bott et al. 2019, 2801).

3. Challenges and Applicability of Compliance Nudge

To what extent a nudge can be used to achieve compliance remains open to discussion. To summarize briefly, a compliance nudge targets behavioral factors

to encourage an individual’s motivation to comply, or, alternatively, triggers fears of being punished to stop or discourage their violation intention. Even if a nudge is proven to be successful in one context, its reliability over time and its ability to be applied across circumstances are uncertain. The findings of previous studies are mainly conducted in Western and developed countries, so the implications of the compliance nudge in developing countries and in cross-cultural contexts require further investigation. Notably, other elements deemed equally important and relevant to comprehending compliance decisions were previously expressed in the Forum on Tax Administration’s remark on the factors that influence Taxpayers’ Compliance Behavior, including deterrence, norms, opportunities, fairness and trust, economic reasons, and finally interactions between these factors (OECD 2010, 5-7). If one is to follow this guidance, enhancing voluntary compliance requires enhancing these above factors, hand in hand. In other words, norm and deterrence nudges may not be fully or even partially effective in a setting with a high opportunity to violate and a low level of perceived trust and fairness in the government system.

As an example, a study has examined the possible determinants of tariff evasion in Sub-Saharan Africa and has proposed that evasion happens when there involves incentive, opportunity, and intention of tariff evasion (Bezabih 2018, 8). The economic gain from shirking levied tariff rates is the incentive, but opportunity, intention, and the level of corruption within customs administrations and trading partners will only make evasion more possible. Corruption is contagious and reinforced: if bribery practice is made by a member of the business association or a trade partner, it is likely to influence other partners to behave similarly. In this way, tax evasion can be reduced in part through the mitigation of corrupt practices in both exporting and importing countries. Following this logic, a nudge has a better likelihood of working in a context which already demonstrates a high level of trust in government, or, similarly, a high level of governmental transparency. A jurisdiction with a weak—i.e., not in possession of the above characteristics—customs administration system will likely require (further) effort to reform many aspects, including mitigating corrupt practices, reducing tariff as well as non-tariff barriers, and achieving perceived trust in authority and fairness in the taxation system. Additionally, the need to maintain effective collaboration and cooperation between trade partners to work on these matters in a unified manner is crucial.

4. Conclusion

The contemporary compliance approach tends to deploy a reward and punishment system, which aims to alter the costs and benefits of compliance behaviors. The nudge implication, on the other hand, is a behavioral

intervention used to steer people’s behavior positively and does not attempt to alter client incentives. Instead, it positions compliance as a moral obligation or social norm and non-compliance as a subject to be detected and collectively discouraged, which overall makes compliance more salient to taxpayers. Nevertheless, the compliance nudge is still a relatively new concept and requires more exploration to ensure its efficiency and applicability in any respective social infrastructure. Though enhancing compliance through nudge does not guarantee it, the application is frequently an inexpensive intervention to direct people’s behavior in a positive manner rather than a punitive one, which can be used as a supplementary tool to the contemporary conventional reward and punishment approach. Further incorporating behavioral elements into compliance appears to be a promising avenue, as it helps to expand upon the understanding of peoples’ thoughts and judgments, which are necessary inputs for compliance policymaking.

5. Policy Recommendations

In reflecting upon the findings, nudge interventions could potentially help subconsciously encourage the willingness to comply by raising awareness of social norms, as well as remind taxpayers to be more conscious of compliance choices by increasing perceived penalties for not complying. Norm nudge could be utilized to foster compliance in the customs administration context through an emphasis on the sense of morality, situating compliance as a social norm by informing taxpayers of what should be done and what others are doing. Likewise, a deterrence nudge could raise concerns over detection and sanction by warning of non-compliance consequences, which can induce actors to revise their beliefs about the detection probability and pull back on their non-compliance intentions. Nudges could possibly be made through any means of communication, including customs-business dialogues, business communities, reminder messages, and so on.

5.1. As supplementary tools to WCO VCF

Nudge can be applied, albeit not uniformly, to all types of clients of WCO VCF to increase their compliance morality and reduce intended and unintended non-compliance behaviors, though it could be more feasible on Type 2 and Type 3. Nudge communications can assist and remind Type 2 clients in complying rightly, as they intend to comply but fail to do so due to complicated procedures or neglect. Similarly, a norm nudge could foster intrinsic motivation and the following of social norms in Type 3 clients, while the deterrence nudge could increase their fear of being detected and decrease their intention to avoid complying. On the other hand, Type 1 clients are already highly compliant, so a further compliance nudge is not

necessary for them. Meanwhile, detrimental, intentional non-compliance acts like goods smuggling or illicit trade (Type 4) are unlikely to be deterred by nudge interventions, as their violations in a certain situation are to pursue purely economic incentives without considering the consequences. This type of risk can be treated with legal enforcement, while behavioral intervention will need to be further explored.

5.2. Improving Self-declaration at the Border Crossing

The above experimental evidence from a study of nudge messages that contains audits, penalties, or social norms highlights that a positive effect does indeed occur among self-declared taxpayers in the context of taxation administration; the same approach is likely to be beneficial in encouraging compliance among individuals declaring their goods at the border crossing, too. Then, in addition to the conventional declaration form on goods, highlighting nudge messages on the self-declaration form upon arrival/departure and putting signs at the borders or airport could potentially bring individuals to comply. The customs administration could possibly work with travel agencies to arrange so that declaration forms are sent along with the travel tickets.

The norm nudge could also include how clients can contribute to safe border security and national development in other sectors. However, the mixture of national and international travelers or tourists is a bit different in nature to the context of self-declared individuals in a customs administration, as the commonly deployed moral suasion of a national contribution is likely not to be practical in most cases. Thus, an additional incentive policy for being compliant travelers should be initiated to encourage voluntary compliance. Meanwhile, the deterrence nudge should include the possibility of being detected and punished as well as the difficulty that may be incurred during their anticipated border crossings in the future. This combination would plausibly make the individuals more careful of their declaration submission. Nevertheless, the effectiveness of the nudge initiative also depends upon the capability of customs enforcement between border crossings.

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