TARIFF REFORMS IN THE PHILIPPINES [1]

INTRODUCTION

Following the attainment of political independence in 1946, the Philippine government embarked on an industrialization drive aimed at achieving economic self-reliance. Import substitution was adopted as the strategy to bring about self-reliance. Some manufactured goods that were previously imported began to be produced domestically. A few heavy industries such as chemicals and iron and steel, were also established.

At that stage of the country's economic development, the import-substituting industries were not efficient enough to compete against imports. And so the government, prodded by interest group lobbying, put up high tariffs and import restrictions to protect local industries. Thus, begun the regime of high and widely dispersed tariffs, which gave protection to local industries. The revenues that the tariffs delivered to the government provided the extra appeal.

However, under this high and widely dispersed tariff structure, balance of payments problems emerged and persisted. The protected import substituting industries grew, but a bias against exports was structured into the economy. This came about in many ways. For one, the peso exchange rate was fixed and overvalued to enable the protected industries to reduce the cost of their imported raw materials and capital equipment. But the overvalued peso was effectively a tax on exports. And since at that time, the country's top merchandise exports were mainly agricultural, the policies ended up discriminating against the economy's largest sector. Assured of a domestic market, the import substituting industries failed to realize economies of scale, thereby limiting growth of the

[1] Prepared by Ms. Amelia A. Menardo of the Trade, Industry and Utilities Staff, National Economic and Development Authority for the APEC High-level Conference on Structural Reform, 8-9 September 2004, Tokyo, Japan.

industrial manufacturing sector. In consequence, the employment share of manufacturing stagnated at about 10-12 percent over time.

The high and dispersed tariffs brought additional costs. Smuggling was encouraged. A good deal of resources got spent not in creating wealth but in diverting the government's revenue share to private pockets.

Given these undesirable outcomes, policymakers started a reform process towards a low and narrowly dispersed tariff structure with a uniform rate as the final goal. The tariff reforms showed positive results but its implementation was bereft with difficulties. This paper presents a brief review of the progress of tariff reform that started in the early '80s and some issues, which remain.

THE TARIFF REFORM PROGRAM in the 1980s

The Tariff Reform Program (TRP), which was carried out in 1981-1985 consisted of a wide- ranging revision of the Philippine tariff system. It was geared towards reducing or phasing out tariff protection which were deemed excessive, obsolete, or which the burden of protection outweighed the returns. It involved narrowing the range of tariffs from zero to 100 percent to 0-50 percent, and phasing tariff adjustments on fourteen sectors i.e., food processing, textiles and garments, leather and leather products, pulp and paper, cement, iron and steel, automotive, wood and wood products, motorcycles and bicycles, glass and ceramics, furniture, domestic appliances, machineries and other capital equipment and electrical and electronic industries.

As a result of the TRP, the average nominal protection rate (NPR) was reduced from 34.6 percent in 1981 to 27.9 percent in 1985. Some studies indicated that while the TRP of 1981 brought down the levels of protection and dispersal of rates among sectors, the structure of protection remained bias against the exports and the agriculture sector.

Domestic industries derived protection not only from high tariff walls, but also from import restrictions. To complement the TRP, liberalization of quantitative import restrictions and licensing requirements likewise started in January 1981. The implementation of the program, was however, impeded by the economic and financial crisis that gripped the country following the assassination of former Senator Aquino in 1983.

A series of tax reforms from 1983 to 1985 gradually unified the sales taxes on imports and import substitutes, removing the additional protection from the differentiated sales tax rates. By 1985, the mark-up rate[2]was also reduced to a uniform of 25 percent on semi-essential and essential goods and was eventually removed in 1986.

Under the Economic Recovery Program and subsequently the Medium Term Philippine Development Plan of 1987-1992, a policy of further trade liberalization to raise industrial competitiveness was adopted. The trade reform package includes the rationalization of the tariff structure, making it the principal instrument of protection, the elimination of the remaining quantitative restrictions and licensing requirements, and strengthening of safeguard measures against unfair trade practices were among the other components. A more uniform rate of protection rate across sectors was targeted.

The removal of import licensing requirements was resumed in 1986. As of 31 December 1989, 2,427[3] items were liberalized. Among the items where import licensing requirements were removed, included fresh fruits, iron and steel products, canned sardines and mackerel, fabrics an textiles, synthetic resins, pulp and paper and cement.

Apart from the lifting of the quantitative restrictions, the government also undertook tariff adjustments to further rationalize the tariff structure or otherwise

[2] The mark-up rate increases the tax base of imports; this effectively raises the total duties paid.
[3] Based on 1977 Philippine Standard Commodity Classification Code.

cushion the impact on local industries affected the import liberalization program. On the other hand, tariffs on certain critical items such as spare parts and components of motor vehicles and cement were reduced on a temporary basis to abate supply shortages in response to the emergency situation in 1989.

In July 1990, government undertook efforts to achieve a simplified and more unified tariff structure. Tariff levels were to be reduced from seven to four and the tariff band narrowed down from 0-50% to 3-30%. However, it implementation was suspended due to allegations of a number of industries that the changes in tariffs were too drastic and would cause serious dislocation to industries.

TARIFF REFORMS: 1990s

Following consultations with the Senate and House Ways and Means Committee, concerned government agencies and individual industry groups, the tariff structure earlier proposed in 1990 has been modified to incorporate phase-in period and transition rates that would afford reasonable time to make the necessary adjustments and innovation. Under Executive Order 470, which was issued in July 1991, the final rates are to cluster around 3%, 10%, 20% and 30%. However, as interim assistance to some local industries, intermediate rates of 5%, 15%, and 25%, as well as rates below 3% and higher than 50% have also been provided for.

“Tariffication” or conversion of quantitative restrictions to tariff equivalents started in 1992 with the implementation of EO 8. Said EO raised the tariff rates applicable to the relevant liberalized commodities by 100 percent of their pre-EO 8 levels subject to a five-year phase-down schedule. However, the tariffication of certain sensitive agricultural products did not pushed through due to the passage of a law regulating the importation of agricultural products.

Table 1

Average Nominal Tariffs by Sector

(in percent)

Sector	1981	1985	1990	1991	1995	1998	2000	2001	2003
Agriculture	43.23	34.61	34.77	35.95	27.99	18.91	14.40	14.21	11.04
Mining	16.46	15.34	13.97	11.46	6.31	3.58	3.27	3.25	2.84
Manufacturing	33.74	27.09	27.49	24.61	13.96	9.36	6.91	6.68	5.43
OVERALL	**34.60**	**27.60**	**27.84**	**25.94**	**15.87**	**10.69**	**7.95**	**7.70**	**6.19**

Source: Tariff Commission.

Mid-way in the 1990s, the government undertook a comprehensive tariff review, in response to the request of the private sector to look into the possibility of lowering tariffs on capital goods and raw materials to improve their competitiveness. Further, the review became an urgent matter in light of the acceleration of the implementation of the AFTA-CEPT scheme by 2003 and the on-going GATT-Uruguay Round of Negotiations.

By mid-1994, a series of major trade reforms were adopted. EO 189 issued in July 1994 provided for a multi-year tariff reduction program from 1994-2000 for capital equipment and machinery, followed by EO 204 in September 1994, which reduced duties on textiles, garments, and chemical inputs. EO 264 issued in July 1995 reduced tariffs on industrial products while EO 288 in December 1995 lowered tariffs on non-sensitive agricultural products. The restructuring of the tariffs under the latter two EOs aimed at establishing a four-tier tariff schedule: 3%, 10%, 20% and 30%.

A two-tiered tariff by 2003, i.e., 3% for raw materials and intermediate inputs and 10% for finished goods, and a uniform tariff of 5% in 2004 have been envisioned under the tariff reform. There will be no more distinction between raw materials and finished goods. A uniform tariff was seen to be easy to enforce and leaves little room for discretion and corruption. Further, it abolishes cascading tariff structures, which favors finished products over intermediate goods production.

Import licensing requirements on new motor vehicles were removed in October 1995. Import restrictions on certain sensitive agricultural products were lifted and consequently tariffied. Liberalization and deregulation policies in the areas of investments, foreign exchange and services complemented the tariff reforms.

To promote the modernization of agriculture and the fisheries sectors, The Agricultural and Fisheries Modernization Act and the Fisheries Code allowed the duty-free importation of capital equipment and raw material inputs for a period of five-years. In line the Philippine commitment under the Information Technology Agreement, the duties on certain information technology products were reduced to zero.

There was concern, however, over the speed of the tariff reform in the face of mounting trade deficits and inability of local industries to compete vis-à-vis their foreign counterparts following the Asian financial crisis. Thus, a review of the tariff program was undertaken with the view of correcting the remaining tariff distortions and smoothening the pace of the tariff reduction to deserving industries. Twenty-two industries,[4] which were identified to have competitive potential, were initially covered in the review, followed by a review of the remaining items. Despite the slower pace of tariff reduction for certain items, the objective of achieving a uniform tariff by 2004 remained.

[4] The review covered electronics, garments/textiles, metal products, processed food, marine products, furniture, jewelry, holiday decors, seaweeds and carageenan, ceramics, marble products, basketwork, footwear, leathergoods, fresh fruits, oleochemicals, fertilizers, copper products, petrochemical and plastic products, motor vehicle parts and components, iron and steel products, industrial tree plantation products and rubber products.

TARIFF REFORMS: 2001-2003

The Medium-Term Philippine Development Plan 2001-2004 espoused the commitment of government to free enterprise and market reliance and ensuring market friendly regulations. Towards this end, government's role will be to increasingly make markets work by simplifying bureaucratic procedures and promoting market-friendly regulations to reduce cost of doing business and protect the interest of the consumers and sectors vulnerable to global integration.

In line with this policy, a four-year tariff program was implemented in 2001 with the objective of achieving a 0-5 percent tariffs on industrial and non-sensitive agricultural products by 2004. The reform was seen as necessary to attain global competitiveness and simplify tariff structure for ease of customs administration. However, given the fiscal problem and considering the need to encourage the manufacturing sector, it was decided to delay lowering of the tariffs on locally produced agricultural and industrial products.

Despite certain difficulties, the Philippine government in line with her commitment in the ASEAN, reduced duties to zero on 60% of its products in the Inclusion List of the Common Effective Preferential Tariff scheme of the ASEAN Free Trade Area (FTA). The Philippines is also participating in the negotiations for the FTA between ASEAN and China, and is currently negotiating with Japan for an FTA under the Japan Philippines Economic Partnership Agreement.

ISSUES RAISED ON TRADE POLICY REFORMS

A number of papers, which analyzed the impact of the trade policy reforms, showed that these reforms had resulted in changes in the country's output structure and export orientation. In the manufacturing industry, for instance, there has been a shift from consumer goods like food processing and beverages to intermediate goods like chemicals and petroleum refineries. The share of capital goods in production output has risen due to the growing importance of electrical machinery and professional and scientific equipment. In terms of export orientation, meanwhile, the share of manufactured goods to total exports increased from 25 percent in 1981-1985 to 90 percent in 1996-2001. Trade liberalization also contributed to the lowering of domestic prices, which has enabled consumers to buy more out of disposable income and in turn has allowed the economy to grow.

Despite these improvements, some issues still remain. Some of these issues are briefly discussed in the paper.

For developing countries with significant fiscal imbalance like the Philippines, a loss in revenue would be an important consideration. The indications are that failure to boost other sources of revenue and to achieve macro stability compromise trade reform. In the Philippines, the reduced reliance on international trade taxes has at times been constrained by the weakness of domestic tax mobilization.

On the other hand, there was the concern that trade liberalization would increase imports in the short-run and aggravate the trade balance and balance of payments of the liberalizing economy. There were calls to limit imports through use of quotas, quantitative restrictions, particularly those competing with domestic production. The entry of competitively priced imported goods make it difficult for inefficient local firms to unduly increase selling prices affecting profit margins.

Temporary protection to preserve employment has also been raised. However, one must be extra careful in identifying domestic industries where competition from imports has been too fierce to allow the transition process to be socially sustainable. Protection may be awarded as long as import growth is the cause of serious injury to domestic import-competing industries but it must be temporary and strictly related to a restructuring program. Using tariffs in the preservation of jobs as a social policy often results to tremendous costs to consumers, and even affect the competitiveness of the export industries.[5] Certain quarters, however, found the process of pursuing cases on anti-dumping, subsidies, or import surges to be difficult, costly and time consuming.

Doubts about the slow growth of the manufacturing value added vis-à-vis the fast growth in manufactured exports have also been raised. This could be explained by the continued dependence of the country's manufactured exports on imported inputs and the lack of backward linkages with domestic output. Despite the continuous decline of manufacturing value added during the 1980s, there are signs of gradual improvement in the 1990s as the share of manufacturing increased from 21 percent in 1990 to 24 percent in 2000 although further improvement is yet to be seen.

Another source of concern among certain quarters that raises doubts on the benefits of the trade reforms is the lack of growth in total factor productivity. This poor performance has been attributed to both adverse domestic and international shocks that hit the country as well as the adjustment lags that have accompanied the trade reforms. Nonetheless, some small positive contribution in factor productivity has been observed during the 1996-2001 period.

Timing and pacing of trade reforms were also raised. When should liberalization be done - when a country is growing or not?. Economies during episodes of growth slowdowns found it more difficult to open and liberalize their markets in view of need to implement stabilization measures to restore growth. Philippine experience has shown this. On the pacing of the tariff reduction, some concerns have been raised that the Philippines is moving at a faster pace than her ASEAN neighbors.

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[5] Medalla, Erlinda and Aldaba, Rafaelita, "No to Policy Reversal…", PIDS Policy Notes No. 2003-10, September 2003.

On the political front, it has been observed that liberalization at the beginning stage is relatively easier than liberalizing at the latter stage. Sectors left to be liberalized are either politically sensitive (i.e. agriculture) or have been highly protected in the past. There would always be pressures for a delay or for extension or status quo of the protection on said sectors. Protection to sensitive agricultural products for instance sugar, corn, pork and poultry products remained high. In the case of industrial products, proponents of petrochemicals, iron and steel, and automotive industries wanted higher protection. Downstream industries, on the other hand, clamored for reduction in duty to bring down their raw material costs to enable them to compete with imported finished goods.

SUMMING UP

Since 1980s, policymakers have realized that trade policy reforms are a necessary component for successful industrialization. While studies indicate positive results arising from trade policy reforms, its implementation faced certain difficulties. Sectors left to be liberalized are either politically sensitive or have been highly protected in the past. Thus, there would always be pressures for delay or for an extension of the status quo of the protection on said sectors. Moreover, the positive results could not be solely attributed to trade policy reforms alone nor are these reforms sufficient to realize expected benefits.

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