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*Trade Liberalization in the Philippines:
Assessment of Progress and Agenda
for Future Reform*

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Preface

This paper gives an overview of the results of a trade liberalization study which was undertaken jointly by the Philippine Institute of Development Studies and the Philippine Tariff Commission. The study received support from the East Asia Programs Department as part of its program of country economic work. The overview paper was written by John Power and Erlinda Medalla. A set of 11 Background Papers is available through the JOLIS library system in the AEAPH library. The studies are listed in the Annex of this paper. The whole study was supervised and edited by Isabel Guerrero.

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PHILIPPINES

I. AN OVERVIEW OF PROTECTIONIST HISTORY IN THE PHILIPPINES AND ITS ECONOMIC RATIONALE

Introduction

1. After three decades of protectionist policies, designed to promote industrialization for the domestic market, the Philippines at the beginning of the 1980's embarked on a program of gradual liberalization of the trade policy regime. The principal elements in the liberalization program are the elimination of quantitative import restrictions and the reduction and rationalization of tariff protection. A first phase of tariff reform was carried out during 1981-85, resulting in a significant decline of average effective protection, as well as a reduction in its dispersion. Initial steps in the program for removal of quantitative restrictions were undertaken in 1981 and 1982. The onset of the balance of payments crisis in the latter half of 1983 interrupted this process, however, and for about a year imports were tightly constrained by a foreign exchange rationing system. The rationing of foreign exchange has since been relaxed, but in the meantime the continuation of the process of removing quantitative restrictions has been delayed.

2. The balance of payments and debt crisis led the government to adopt austere monetary and budget policies, as well as to restrict imports. At the same time, world prices for the Philippines' major exports have remained generally depressed. Political uncertainties added to the adverse economic climate to discourage investment, both foreign and domestic. The result has been a deeply depressed economy after two years of declining GNP, with widespread unemployment and underutilization of capacity.

3. Recovery is the first priority. But beyond that is a goal of achieving sustained growth at the full potential of the Philippine economy. It is now recognized that realization of this potential has been frustrated in the past by overly protectionist policies. These, together with other interventions on the part of the government, have often distorted investment and resource allocation away from an efficient pattern that freer markets would have produced. Thus, despite a comparatively high proportion of national income saved, the Philippines has had one of the worst records among developing countries in achieving real output gains from the investment of that saving.

4. This study, undertaken jointly by the Tariff Commission and the Philippine Institute for Development Studies, is designed to provide support and guidance to the continuation of this important policy reform. In addition to this paper which serves as a general report, background papers on the special topics have also been produced (see Annex I). These cover theoretical rationale for tariff reform, an assessment of progress so far, the role of import restrictions, the impact of liberalization on income, employment, the trade balance and government revenue, the prospects for integrating tariff reform with multinational trade negotiations, timing and phasing in the implementation of trade liberalization, and complementary indirect tax

measures. In addition, four industries were selected for special study of the effects of tariffs and import restrictions and their prospects under liberalization. The industries are textiles, pulp and paper, home appliances, and flour and bakery products. Finally, there are two technical papers on methodology.

5. This general report draws on all of these individual studies. It is divided into three parts. The first includes a brief survey and critique of three decades of Philippine protection, 1950-80, a summary of the rationale for reform of protection, and an assessment of trade liberalization since 1980. The second part summarizes findings from the four industry studies. The third deals with aspects of the implementation of future trade liberalization, its likely consequences, and various complementary measures.

Survey and Critique of Philippine Protection, 1950-80

6. Protection of the domestic market for Philippine industry began in 1950 in response to the balance of payments crisis that followed a sharp reduction in U.S. economic assistance. If foreign exchange rationing had been limited to a brief period as an emergency measure to save foreign exchange, while fundamental corrective measures were undertaken, it would have had little protective effect. Instead, however, the system remained throughout the decade, masking the need for an adjustment of the exchange rate. Furthermore, it generated a distorted system of protection that fostered the production of finishing stages, and import substitution in manufacturing. The high cost of saving foreign exchange and the increased dependence on primary exports for foreign exchange earnings made the country more vulnerable to balance of payments pressures. By 1960, the scope for further tightening of import controls had disappeared and foreign exchange reserves severely depleted. Given the underlying weakness in the balance of payments and pressures from export lobbies the government then opted for liberalization of import controls and devaluation.

7. When liberalization was completed in 1962, the existing tariff structure emerged as the dominant protective instrument. Tariff escalation largely preserved the general bias of the 1950s' controls system toward the finishing stages of consumption goods and against backward linkages and exports. Again, the inability of manufacturing to earn or efficiently use foreign exchange increased the country's dependence on primary exports and its vulnerability to balance of payments deficits. While import controls were resumed in the late 1960's, eventually the government in 1970 was forced to float the peso and allow it to depreciate.

8. There was some simplification of the tariff structure in the early 1970's, but its general character and protective effect remained the same. In the meantime, quantitative import controls became steadily more pervasive in the 1970's. By the end of the decade, about one-third of the total number of items at the seven-digit level of PSCC classification were either "banned"--i.e., required prior Central Bank (CB) approval--or regulated by various government agencies (notably the Board of Investments). Generally, imports of non-essential consumer goods and other consumer goods that were locally available ("of acceptable quality and competitively priced") were subject to

CB approval. Other imports were regulated to protect domestic suppliers (as in the case of the progressive manufacturing programs) and to insure a supply of inputs to favored sectors.

9. The reason for import licensing was clearly protective in the cases of textiles, paper and paper products, iron and steel, tires, sheet glass, some chemicals and plastic products. Safeguarding public health and national security was indicated as the motive for import restriction in the cases of meat and fish products, pesticides and fertilizer, antibiotics, coal and petroleum products, feedgrains and various chemicals. In some cases, these restrictions also had a protective effect on domestic producers. In the cases of autos, trucks, motorcycles and home electric appliances, protection was accorded to promote domestic production with gradually increased domestic content.

10. In general, the quantitative restrictions on imports reinforced the effect of the tariff structure. Consumer goods, especially non-essentials, generally had the highest tariffs and were also "banned". Producer goods generally had lower tariffs and were more liberally imported. Escalation in the structure of protection was therefore even greater than that implied by the tariff system alone. While it is difficult to measure the protective force of import restrictions, comparisons of domestic with border prices indicate that, for a number of items, the implicit tariff was greater than the legal tariff. Moreover, the response of some imports that were subsequently liberalized in 1981-82 again indicate some force of restriction.

11. By the 1960s it had become recognized that industrial growth was being frustrated by the strong bias against exports inherent in the protective system. New policies aimed at promoting non-traditional exports through various subsidies were implemented without attempting to reform the protective system. At the same time the bias against agriculture from the industrial promotion system was recognized and greater government support was directed to agricultural growth. By the end of the 1970s, however, the inadequacy of this offset approach became increasingly clear. While non-traditional exports had substantially increased their share, this growth was mainly in electronic parts and garments, both of which are heavily import dependent. The country remained excessively dependent on primary exports, with disastrous consequences for the terms of trade in the early 1980's.

12. The legacy of three decades of excessive protection of the domestic market can be summarized briefly. The bias of the system against exports and efficient import substitution severely limited the efficient growth of the industrial sector. Moreover, the system created a strong bias toward capital intensity, large scale and concentration around Manila. These combined to retard industrial labor absorption so that agriculture, petty trade and services were obliged to absorb more than their share of the rapidly growing labor force, with severe adverse consequences for real wages and income distribution.

13. The inability of manufacturing to earn foreign exchange or to save it efficiently increased dependence, as noted above, on primary exports. At the same time the system, by penalizing exports, created disincentives to primary production. The result has been recurrent balance of payments crisis.

14. The protective system has worsened income distribution by turning the terms of trade against agriculture, and by the bias for producing in and near Manila. Incentives for small-scale regionally dispersed manufacturing have not been put in place.

15. All of these biases have contributed to the inadequate growth of output, and especially employment, in the industrial sector, to the persistence of poverty in agriculture and most likely to the worsening income distribution throughout the economy. By the end of the 1970's it had become clear that it was financially impractical to offset all of these biases of the protection system with fiscal incentives. Moreover, subsidies to exports became increasingly subject to international retaliation. As a result, the government finally directed its attention at the beginning of the 1980's to the heart of the problem--the protection system.

Protection and Development

16. To address the question of reform of the protection system, we must be clear as to the effects of the protection on the long-term development objectives of the country. This will, then, provide a basis for setting some guidelines for reform.

17. To simplify the discussion we can concentrate on tariff reform. The justification for this is twofold. First, tariffs give a more clear-cut and certain quantitative indication of the level of protection than do import restrictions. Moreover, the latter more easily involves discriminatory treatment in its administration. Thus, tariffs give small and medium enterprises a more even chance in competition with large firms. Second, the implicit tariff under quantitative restrictions accrues as a gain to the licensee, while tariff revenue goes to the government. Accordingly, we will assume that the optimum system is virtually free of import licensing.

18. Under the small country assumption--that the country's trade is too small to affect the world prices of its imports and exports--there are well-known welfare loss from the imposition of a tariff. There is a consumer welfare losses from not permitting consumers to trade at the relative prices the world offers. On the production side, the reallocation of resources to the protected industry means raising the real cost of balancing the foreign exchange budget. It costs more at the margin to save a unit of foreign exchange in the protected industry than to earn or save it in other industries. Since these welfare losses are widely understood, any defense of tariff protection must rely on some compensating advantages or on the denial of the small country assumption.

19. Taking the latter possibility first, we have the basis for the classic optimum tariff argument. If a country has any degree of monopoly power in world trade, it can increase national welfare by some degree of restriction of trade. Tariffs will reduce imports and the demand for foreign exchange which, in turn, will reduce the price of foreign exchange, penalizing exports. If the (average) tariff has been set at the optimal level, the improvement in the terms of trade will have more than offset the efficiency loss from restricting trade. This optimum tariff argument is the only first-best defense of tariffs that is widely accepted by economists.

20. The first question is whether, indeed, the Philippines has any monopoly power in world trade. If it does exist, it would be on the export side and would pertain only to one or a few major exports. The optimum tariff on imports, however, taxes all exports at a uniform rate by means of the undervaluation of foreign exchange that it defends. This would mean an unwarranted penalty on all minor exports. Clearly, a superior solution would be specific export taxes on the major exports where some monopoly advantage exists.

21. The only possible justification for an optimum tariff on imports, then, would be the existence of less than infinitely elastic world demand elasticities even for minor exports. The fact that the world market is fragmented and trade is concentrated may mean that the small country assumption is too extreme. This, of course is an empirical question, as is the question of monopoly power with respect to major exports.

22. For the Philippines it seems likely that it would be difficult to justify any but the slightest departure from the small country assumption. This means that, at most, the optimum tariff argument would call for a very low, uniform tariff, supplemented by a few modest export taxes.

23. Tariffs, of course, raise revenue. It is sometimes argued that, despite the distortions created, there is a case for revenue tariffs. This argument can be easily dismissed, however, as it is possible to tax imports via a non-discriminatory sales tax (or value added tax) without the distorting effects of customs duties.

24. Finally and most important, of course, tariffs are commonly designed to protect domestic industries. They can be defended for that purpose, however, only if it can be shown that this is the best, or only practical, way of protecting domestic industries. Moreover, there must be a prior determination that some industries deserve protection, since the latter will always be at the expense of other domestic interests (industries, consumers, taxpayers).

25. Various arguments have been set forth in favor of protection of selected industries. The best-known is the infant industry argument and we will focus on that case in evaluating tariffs as the appropriate instrument. Much of the analysis will apply to other arguments, as well.^{1/}

26. Protection of domestic industries should mean giving them a competitive advantage over foreign rivals. Tariff protection does this, but only in the limited domestic market. In all other markets, tariff protection puts domestic industries at a disadvantage vis-a-vis foreign rivals, as compared to

^{1/} This case and others are discussed more fully in the study, "Tariffs and Economic Development: The Rationale for Philippine Tariff Reform".

free trade. This disadvantage comes from the undervaluation of foreign exchange that a system of tariffs defends as noted above, acting as a uniform tax on all exports.^{2/}

27. The fact that a system of tariffs accords domestic industries an advantage in the home market, but handicaps them in all other markets, means that it is not unambiguously according protection at all. It is simply creating market discrimination. Moreover, the bias against the larger world market imposes a severe handicap on the growth of infant industries.

28. There is yet another handicap on the growth of infant industries that tariff protection imposes, in the form of impeding forward linkages. By raising the cost of the product to using industries, tariffs impede their growth which, in turn, limits the growth of the market for the protected industry.

29. Economists have long been in agreement that a direct subsidy is preferable to a tariff for protecting or promoting an industry. It will give the domestic industry an advantage over foreign rivals equally in all market--domestic and foreign alike. And it will encourage rather than impede forward linkages.

30. Subsidies must be financed, of course, and tariffs are sometimes defended as no more distorting than alternative means of taxation. It has already been noted above, however, that imports can be taxed via a sales or value added tax that applies equally to the domestic product, thus avoiding the distortion that accompanies tariffs on imports.

31. What remains of the role of tariffs is the very limited one of securing some terms of trade advantage through a low uniform tariff, complemented by a few selective export taxes. Because of anomalies in the international rules for trading behavior (as evidenced in GATT), however, there is greater scope for the use of tariffs in promoting development, as is noted in the immediately following section.

Guidelines for Tariff Reform

32. Ideally a tariff system should be combined with selective export taxes to provide a near first-best solution to the terms of trade disadvantage of free trade, while simultaneously serving the revenue needs of the government. With respect to protection of domestic industries, for whatever market failures are deemed to exist, tariffs are inferior to direct subsidies if the latter can be financed in a relatively neutral way.

^{2/} If the optimum tariff argument, described above, is valid, we are here referring to tariff rates above the optimum uniform level.

33. The major feature of an ideal tariff system includes the following:^{3/}

First, "major" exports (i.e., those where there might be an important influence on world prices) should be taxed in accordance with their estimated world demand elasticities. How many would fall in this category is a difficult empirical question; but the number would be small and might approach zero when a long-run view is taken. The short run cannot be ignored, however, since early effects should be discounted by less than later effects; and an estimate of the discounted value of net gains from tariff reform must take all effects into account.

Minor exports would fall more nearly under the "small country" assumption. But in a world of concentrated and restricted trade in heterogeneous products, finding new markets, even for small exporters, would involve some selling costs, including price reductions. Hence the assumption of infinite demand elasticity is not realistic though we would expect elasticities to be very high. Here it would not pay, however, to estimate an optimal export tax for each of hundreds of minor exports. Accordingly, a uniform low tax for all would be a practical approximation to a first-best solution; and this could be accomplished by a uniform low duty on imports.

34. The appropriate rate of uniform tariff (t) would equal $1/(m-1)$, where m is the estimated average elasticity of demand for all minor exports. The appropriate tax on major exports, then, would equal $(1+t)/M - t$, where M_j is the estimated elasticity of demand for major export j .

35. In principle this would meet the terms of trade problem. The difficulty lies in estimating the elasticities. It would be very surprising, however, if this were deemed to justify a uniform tariff level higher than 10%. The implication of a uniform tariff at this low level is that government revenues might suffer. This problem is further addressed below.

36. Protection of domestic industries for whatever market failures are deemed to inhibit their development would come from subsidies. The exact nature of the subsidy would vary from case to case and is left aside here since the focus is on tariff reform.

37. What is important here, however, is the problem of financing the subsidies. The elements of tariff reform set out above might imply, as already noted some loss in government revenues. The key to solving this problem is to avoid a reduction in revenues from taxing imports--or even to increase them--while removing the protective effect (beyond the degree justified by terms of trade considerations). The means is a sales or value added tax which would apply equally to imports and domestic sales (but not to exports). So long as imports and domestic sales are taxed equally there is no additional protective effect, so that the rate of the value added tax could be

^{3/} An approach to an ideal system is set out in Power (1979).

set solely on revenue considerations. For income distribution reasons, however, it might be desirable to levy a rate higher than the normal rate on "luxuries" and lower on certain basic necessities. Again, so long as import and domestic sales are treated equally, there is no additional protective effect.

38. In this ideal system, then, tariffs would play no role whatsoever in protecting infant industries or in overcoming other market failures (except for the terms of trade) to promote industrial development. The preferred instrument is subsidies. Since these subsidies would apply equally to production and sale for domestic and export markets, there might seem to be no legitimate complaint that this represents an export subsidy in the usual sense. Nevertheless, the U.S. and others are not likely to make this distinction when there is a complaint from one of their domestic industries. And some of the subsidized industries may be predominantly exporting so that the appearance would be that of export subsidy.

39. Unfortunately for a country that would like to follow an ideal policy of industrial promotion, international rules and attitudes are irrationally biased against it. GATT, for example, sanctions import duties, but proscribes export subsidies, despite the lack of any economic rationale for such discrimination. And the U.S. and other major trading nations follow the GATT example. This means that as a practical matter it is necessary to consider a role for tariff protection beyond that indicated above. Accordingly, a means of using tariff protection for promoting industries that minimizes the bias against exports and other import substitutes is suggested in the following paragraphs.

40. Since the infant industry case may be the most popular and, perhaps, most important of the market failures justifying industrial promotion, the suggested second-best tariff policy is set out in that context.

41. First, recall that while a particular tariff protects a particular industry with minimal general equilibrium repercussions, a set of tariffs on many industries penalizes non-protected industries and dilutes the protection of those enjoying tariff protection via the induced fall in the real exchange rate. Obviously the relative importance of the real exchange rate effect depends on how many industries fall under the tariff umbrella. If only a few, the effect is minor and the argument against tariffs as a promotion device is weakened.

42. If then, tariff protection in the form of a surcharge over the uniform tariff rate were selectively administered to a very few infant industries at any one time, the general bias against exports and non-protected import substitutes would be minimal and the practical considerations in favor of tariffs as a protective instrument would prevail.

43. There is still the disadvantage vis-a-vis the subsidy instrument that the "protection" of tariffs extends only to the domestic market. But if the surcharge of limited duration--say five years--the bias would be temporary and would not inhibit long-range plans to prepare for the export market.

44. Moreover, even though the protection would be accorded only to a select few at any time, the limit of its duration would mean that over a long period a much greater number would be reached.

45. In sum, because of irrational international attitudes toward trading rules, there is a second-best case for tariff protection beyond that justified by terms of trade considerations. Infant industry tariffs should, however, be restricted to a few at a time, and should be of limited duration.

46. The principal weaknesses of this second-best approach to tariff protection are the failure to protect infants in the world market as already noted, and the penalty on users of "infant products" if they are intermediate goods. The latter could be overcome by granting a tax credit equal to the protection surcharge (over the uniform tariff rate) for purchases of protected products. This would not represent a serious administrative problem since there would be few such products at any one time. Moreover, the tax system already incorporates credits for taxes paid on intermediate products. This would represent then only a minor addition to the existing system.

Assessment of Tariff Reform and Import Liberalization, 1981-1985

47. Past studies have consistently pointed out the adverse effects on resource allocation of the distortions in market incentives created by the highly uneven protection structure. Such a structure of protection, which the Philippines has had for the past three decades, has rewarded inefficient import substitutes and generally penalized exports and import substitutes possessing comparative advantage. As a result, further import substitution became more and more costly and difficult to achieve, while much of the potential for export growth remained unrealized. (See Background Paper No. 2 for more detailed discussion).

48. In the 1970's, attempts were made to offset these biases, particularly through BOI incentives to exports. Undoubtedly, these incentives have had some favorable effects as a few nontraditional exports grew dramatically during the period. Necessarily, however, due to budget limitations, the export incentives package could cover only a small portion of potential export industries. A large part of the potential for new export growth was still untapped. Furthermore, since these incentives are interpreted as subsidies to exports by trading partners, the possibility of retaliation has become a growing threat to these exports. Finally, neglected but efficient import substitutes have remained neglected.

49. In 1981, the government initiated the first major reform towards the rationalization of the protection structure. First, the tariff reform program (TRP) was launched; second, a schedule of import licensing liberalization was formulated. Except for a temporary uniform additional import surcharge, the TRP proceeded as scheduled. In view of the 1983-84 BOP crisis, however, import liberalization plans have been delayed.

50. The purpose of the remainder of this section is to assess how much has been achieved so far in these two areas of reform. Where are we in terms of moving toward more uniform nominal tariff rates and, more importantly, more

uniform effective protection rates? How much import liberalization has really been achieved and how has this complemented the TRP? In general, how far has the rationalization program reached?

The Tariff Reform Program

51. Under the TRP, tariff rate changes were implemented over a five year period in three general areas. First, peak rates imposed on nonessential consumer (NEC) and unclassified consumer (UC) goods (as classified by the CB) were reduced from a ceiling of 100% to a ceiling of 50%. This affected 177 tariff lines. Second, tariff rates were revised to conform to a more uniform structure within 14 selected key industries, namely food processing, textile and garments, leather and footwear, pulp and paper, cement, iron and steel, automotive, wood and wood products, cycles, glass and ceramics, furniture, domestic appliances, machineries and capital equipment, and electrical goods. The changes within these industry sectors reduced rates of 295 tariff lines and increased the low duties of 100 tariff lines. Finally, rates within some ten residual sectors were modified. Within these sectors, rates of 128 tariff lines were reduced and 13 tariff lines were increased.

52. Tables 1 to 3 summarize the changes made under the TRP. Before TRP, 27% of tariff lines had tariff rates of 70 and 100%, 16% with 40-50% tariff, 57% with 10-30% tariffs, and only 3 tariffs with free or 5% tariff duties. After TRP, no tariff rates were above 50%, 31% were imposed 40-50% tariffs, 68% between 10 and 30% tariff (see Table 1). Seventeen tariff lines now have free or 5% tariff duties.

53. Table 2 gives a picture of changes by selected industries and by type of commodity--raw materials, intermediate or finished goods. Raw materials were taxed mostly at 10%. Except for food processing, textile and garments, leather and footwear, pulp and paper and furniture, the rates were not more than 25%. After TRP, most of the 10% rates remained the same. One notable exception is raw materials for iron and steel, whose rate was even lowered to 5%. The higher rates were in general, reduced. For intermediate goods, tariff rates fell mostly within 20 to 30% after TRP compared to 10 to 50% before. Much of the tariff reduction occurred in the finished good category where tariff rates, which were mostly 70 to 100%, fell to a range of 30 to 50%.

54. In terms of nominal tariff rate, the Tariff Commission computed the simple unweighted average statutory tariff rates of all tariff codal lines by I - 0 sector. Table 3 presents the results for 1979 and 1985. The largest change occurred in the agricultural sector--from 56% in 1979 down to 33% in 1985. The average statutory rate in manufacturing went down from 42% in 1979 to 28% in 1985. Minimal changes occurred in the mining and quarrying sector which was, in general, imposed lower duties even before TRP. It should be noted that the high average for agriculture is misleading, since the statutory rates on the major crops are not operative. This is particularly true for rice, corn and various exportables.

55. Thus, there has been not only a fall in the average tariff rate but an apparent movement towards greater uniformity in nominal tariff rates.

Table 1: DISTRIBUTION OF TARIFF LINES BY NOMINAL RATE

Tariff levels	P.D. 1464 before TRP as amended by E.O. 521, P.D. 1500 and P.D. 1620	Up to and including E.O. 609, 632-A and 706	
		As of 1981	1985
Specific	2	2	2
Free	1	3	3
5%	2	14	14
10%	319	380	334
20%	204	282	335
30%	218	194	284
40%	5	87	100
50%	203	151	331
60%	-	59	-
70%	119	139	-
75%	-	2	-
80%	-	58	-
90%	-	29	-
100%	228	2	-
<u>Total Tariff Lines</u>	<u>1,301</u>	<u>1,403</u>	<u>1,403</u>
<u>Total Tariff Levels</u>	<u>10</u>	<u>14</u>	<u>8</u>

**Table 2: COMPARATIVE TARIFF STRUCTURE ON 14 INDUSTRY SECTORS
BEFORE AND AFTER ISSUANCE OF E.O.s 609 AND 632-A
(%)**

Sectors	Raw materials		Intermediate goods		Finished goods	
	Before	After	Before	After	Before	After
Food processing	5-100	5-50	Free 100	Free 50	10-100	10-50
Textile & garments	10-50	10-30	50-70	40	30-100	10/50
Leather & footwear	10/50	5/10	50/70	30	100	40
Pulp & paper	10/20/50	10/20	30/50/100	20/30	30-100	20/50
Cement	10	10	100	40	50	50
Iron & steel	10	5	30	30	50	30
Automotive	-	-	10-100	25	30/70/100	40
Wood & wood products	10	10	35	20	70	35
Motorcycles & bicycles	-	-	35	30	70	45
Glass & ceramics	10	10	30	25	55	35
Furniture	40	30	50	30	100	50
Domestic appliances	25	20	50	30	70	50
Machineries, other capital equipment	-	-	25	20	20	30
Electrical, electronics	-	-	35	25	35	30

Table 3: AVERAGE STATUTORY TARIFF RATES
(%)

I/O sector	Industry/industry group	1979	1985
01-14	Agriculture, fishery and forestry	56.38	33.08
01-02	Palay	70.00	50.00
03	Corn	70.00	50.00
04	Coconut including copra	85.00	35.00
05	Sugarcane	70.00	50.00
06	Banana	100.00	50.00
07	Other crops	27.18	13.05
08-09	Livestock	53.57	26.47
10-11	Poultry	74.28	47.78
12-13	Fishery	93.75	33.08
14	Forestry	46.00	27.22
15-21	Mining and quarrying	16.38	13.09
15	Copper mining	10.00	10.00
16	Gold and silver ore mining	10.00	10.00
17	Chromium ore mining	10.00	10.00
18	Nickel mining	10.00	10.00
19	Other metal mining	10.00	10.00
20	Salt mining	30.00	15.00
21	Other nonmetallic mining/quarrying	18.12	14.70
22-58	Manufacturing	42.38	28.06
22-30	Food manufactures	60.00	33.68
31	Beverage industries	78.46	50.00
32	Tobacco manufactures	65.00	42.30
33	Textile manufactures	53.53	35.44
34	Footwear and wearing apparel	85.62	48.86
35-36	Wood and cork products	53.42	32.32
37	Furniture and fixtures	82.00	45.00
38	Paper and paper products	55.71	30.70
39	Publishing and printing	56.25	24.16
40	Leather and leather products	69.00	30.00
41	Rubber and plastic products	37.43	26.35
42-45	Chemicals and chemical products	23.39	17.53
46-50	Products of petroleum and coal	20.55	17.50
51-52	Nonmetallic mineral products	47.30	34.54
53	Basic metal products	21.20	16.13
54	Metal industries	44.75	35.24
55	Machinery except electrical	24.32	22.15
56	Electrical machinery	38.05	27.55
57	Transport equipment	26.00	23.66
58	Miscellaneous manufactures	46.66	30.85

However, while the cascading nature of the tariff structure has diminished, there still remains even after TRP a progression of rates according to the degree of processing--i.e., raw materials, intermediate goods and finished goods. This could have a significant bearing on how the effective rates of protection are affected by the changes brought about by the TRP.

56. Effective protection rates for 1979 and 1985 were calculated for all of the tradable sectors of the input-output table. (Details of methodology and results are found in the paper, "Assessment of the Tariff Reform Program and Trade Liberalization".) The overall results are shown in Table 4. Three weighting systems were used, the preferred one being indicated by the letter C.

57. Average EPR for all sectors declined from 24% to 12%. This was due wholly to the decline in the average for importables from 44 to 25%, as the average for exportables remained at minus 3%. The average for primary and agricultural remained at about zero because of the preponderance of exportables. Manufacturing importables had the highest average, of course, but this declined significantly from 58 to 33%.

58. The major part of the decline came from the reduction in peak rates. On the other hand, the TRP failed to raise the low EPR's of penalized sectors and even lowered them in some cases. Thus while escalation was reduced it remains substantial. Indeed, the principle of escalation was used by the Tariff Commission as a guideline in restructuring rates.

59. Among importables, three sectors are still estimated to have negative free trade value added. For the rest, the range of EPR's has been reduced from 22 to 299% to a narrower one of 18 to 144%. The latter, however, indicates that extreme disparities remain. Thus, a further stage of reform is indicated as clearly desirable so as to move toward the goal of uniformity.

Import Liberalization

60. As already noted, the import restriction system tended to reinforce the biases of the distorted tariff structure, as well as to create some additional biases of its own. To reform the tariff structure without removing import restrictions would leave the Philippines with the same kind of trade policy regime that has handicapped development in the past. Moreover, protection by import restriction is especially biased against small enterprises. Accordingly, the elimination of quantitative restrictions on imports (with minor exceptions for security and health reasons) is a key element in the trade liberalization program.

61. Liberalization of imports began in 1981 with 263 items removed from the "banned" list. 610 additional items were removed in 1982, followed by 48 more in 1983. These were mainly non-essential and unclassified consumer goods that were protected by high tariffs. At the same time, however, additional items were added during this period to the regulated list.

62. In the Fall of 1983, in response to the balance of payments crisis all foreign exchange receipts were pooled and allocations were limited to

Table 4: AVERAGE EPRs
(%)

	A		B		C	
	1979	1985	1979	1985	1979	1985
All sectors	19	9	26	14	24	12
Exportables	-3	-3	-4	-4	-3	-3
Importables	37	20	46	27	44	25
Primary and agriculture	0	-2	2	-1	1	-1
Manufacturing	35	20	43	25	40	23
Exportables	1	1	1	1	1	1
Importables	51	29	60	35	58	33

Weights used:

A. FTVA ($Q/1 + T_j$) where FTVA = free trade value-added ratio
 Q = value of production
 T = implicit tariff

B. 1. Mixed sector - FTVA ($\frac{Q}{1 + T_j} + M - X$)

2. Exportables - FTVA ($\frac{Q}{1 + T_j} - X$)

3. Importables - FTVA ($\frac{Q}{1 + T_j} + M$)

C. 1. Mixed sector - FTVA ($\frac{1.5Q}{1 + T_j} + M - X$)

2. Exportables - FTVA ($\frac{1.5Q}{1 + T_j} - X$)

3. Importables - FTVA ($\frac{1.5Q}{1 + T_j} + M$)

payments for crude oil, essential grain imports, raw materials for export products and certain other imports considered vital. Lesser priority items were allowed through a scheme of "no-dollar" imports and pre-paid letters of credit. A year later the foreign exchange rationing system began gradually to be relaxed, though import restrictions remained more severe than prior to the onset of the crisis. Finally, in May 1986, the government resumed the long-delayed process of removal of import restrictions. As of September 30, 1986, 929 items have been liberalized including 202 NEC/VC "banned" items, and 727 items of raw materials and intermediate goods.

63. Despite the debt and balance of payments difficulties, the government remains committed to eventual full removal of quantitative restrictions on imports. The time table will depend, in part, on the pace of recovery of the economy, as remaining items to be liberalized will increasingly be competitive with domestic industries.

64. In sum, the Philippines has made some headway in trade liberalization, despite the severest economic difficulties since World War II. This, of course, was long overdue and much remains to be done. Nevertheless, the direction is clear and the commitment is firm.

II. LESSONS FROM INDUSTRY STUDIES

65. Long-run and dynamic gains resulting from a more efficient allocation of resources are expected from the tariff reform and trade liberalization. In the short run, however, there are real apprehensions regarding their implementation. It is often feared that many firms would not survive the new foreign competition. Aside from the invested capital that would be lost in the process, massive unemployment may follow if new investments do not respond as quickly as needed. Fiscal, monetary, and exchange rate policies may alleviate some of the immediate adjustment costs, but much still depends on the speed of adjustment.

66. Four industry studies were thus undertaken in the project to examine the impact of the TRP at a micro level. These include flour and bakery products, home appliances, paper products and textile. The more detailed studies are contained in Background Papers Nos. 6, 7, 8, and 9. Tariffs on competing imports of these industries' outputs were historically among the highest and have been reduced since 1981. Examining the adjustment to lower tariffs at the firm level provides us with further insights about the impact of TRP and trade liberalization on industries and firms in the short-run.

67. Tables at the end of this chapter summarize the results of these industry studies. In general, the firms sampled represent the majority of the industry, in terms of size and output.

Flour and Bakery Products

68. Firms A to H belong to the flour industry while the rest are industry users of flour such as producers of bakery and macaroni/noodles products.

69. The flour industry was one of the few beneficiaries of the TRP between 1980 and 1982. The Effective Protection Rate (EPR) of all firms, except firm B, increased in the period. Correspondingly, real output also rose for all firms except firm B which only managed to maintain output level between the two periods. In 1984, EPRs of all firms, except D and G, fell. Real output for all firms also fell but this is probably due more to the economic recession in 1984. In spite of the drop in output, employment suffered only slightly. The flour industry, despite problems with NFA state trading and price ceilings, did fairly well in general.

70. The EPRs of the flour industry are not as high as indicated by statutory tariff rates. EPR's could even be largely negative using computations based on price comparisons where the quality of the products has not been standardized. The fact that the flour industry was able to cope adequately could be explained by the efficiency of both the industry as a whole and firms

in general as indicated by low DRC/SER ratios.^{4/} The results of the EPR and DRC computations show that the flour industry would be able to survive quite well or even benefit from further tariff reform and trade liberalization.

71. Firms I and J represent a product group whose major input is flour. Both firms receive high protection, but have diametrically opposite estimates of the DRC/SER ratios of the two firms. Firm I has a DRC/SER ratio which is less than one, while firm J, the smaller firm, has a very high DRC/SER ratio. The real output of firm J went down drastically between 1980 and 1984. Firm I, which is the efficient firm, on the other hand, was able to maintain real output in 1982, before falling by a lesser degree in 1984.

72. Firms K to M represent another product group using flour as a major input. Real output rose from 1980 to 1984, despite falling EPRs. DRCs for these firms are probably higher than the SER as could be indicated by the result for one year for firm M where DRC was 46% higher than SER. Based on price comparisons, however, EPRs increased sharply in the 1980-84 period, especially for firm L. Actual protection probably increased due to the increasing importance of NTBs. Real output rose in response.

73. The output of the firms of the flour industry are relatively homogeneous. The differences in the firms' EPRs do not vary greatly. Still, some differences in efficiency could be noted although these are not very substantial.

74. With the more heterogeneous bakery/macaroni/noodles products, however, much greater difference are observed. Differences in EPRs across firms indicate a greater room for product and intermediate input switching in response to tariff changes. Differences in efficiency, however, seem to be able to explain the ability of firms to adjust to changes in the tariff protection. These conclusions become more apparent in the industries to be discussed below.

Home Appliance Industry

75. The home appliance industry is adequately represented by firms A to K, covering a range of heterogeneous products--from electric fans and stoves to refrigerators and air conditioning.

76. Although consistently high, there is considerable variation in EPRs across firms, whether based on tariffs or price comparisons. The variation across firms could be explained by different product lines with different applicable tariff rates. EPRs based on tariffs went down from 1980 to 1984 due to TRP, greatly reducing the variation across firms. Based on price comparisons, however, which shows the effect of non-tariff measures, EPRs

^{4/} The domestic resource cost over the shadow exchange rate ratio indicates comparative advantage if less than one and comparative disadvantage otherwise.

generally went up in 1982 before finally going down in 1984.^{5/} Firms were in fact able to seek product lines and input combinations which would allow them to maximize incentives from the protective structure. This seems to be their first option when responding to changes in the structure of protection.

77. In general, real output went up in 1982 and capacity utilization remained high. Indeed, EPRs based on price comparisons rose in this period and output responded favorably. All the firms sampled which yielded DRC/SER substantially greater than one in 1980, improved in 1982.

78. In 1984 total output and employment went down although still higher than the 1980 level. As noted above, whether based on tariffs or price comparisons, EPRs went down for all firms in 1984. However, a large part of the decline in output is probably due to the overall drop in economic activity. The largest firm in the group managed to maintain real output and become more efficient. Its DRC/SER fell to 0.56 in 1984. This is another indication of the fact that not all firms are smothered by increased foreign competition. Some survive quite well and are forced to achieve greater efficiency. In the case of both the home appliance sector and bakery/noodles products the biggest firm was the one able to survive. This suggests the existence of economies of scale for the sector.

Paper Products

79. This industry suffered a downward trend in output, employment and capacity utilization from 1980 to 1984. Firms A and B were able to increase real output and employment in 1982. Firm B continued to expand in 1984, while firm E seemed to be able to recover remarkably also in 1984.

80. For firm A and B, the expansion in output is consistent with the higher EPRs they received for the period. For firm E, however, the estimate of EPR is not only the lowest but the EPR even went down, from 1980 to 1982. Still it was able to recover and increase real output in 1984 in spite of the overall recession. Its relatively low EPR probably indicates it has been the relatively more efficient firm and was able to increase efficiency, as indicated by the drop in its DRC/SER ratio to less than one.

81. DRCs for the rest of the firms in the industry are generally very high and in many cases they show negative net foreign exchange saving. The findings show an extremely inefficient industry with the exception of firm E which reveals some potential. The other firms will not be able to compete with trade liberalization, given their present structure.

^{5/} Except for Firm H where the EPR continued to go up.

Textile Industry

82. The firms sampled included different stages of processing (fabric, yarn, fibers) and levels of integration. Firms A to G produce textile fabrics, while the rest produce yarns and fibers.

83. For the textile producers EPRs went down from 1980 to 1984. Using price comparisons, estimates of EPRs were even negative, except for firm A. Real output, however, went up for three firms even in the face of falling EPRs and the recession in 1984. One of these firms was able to reduce the DRC/SER rates down to 1.5 in 1984, i.e., it was able to become more efficient as output expanded. Another firm had a low EPR and had been operating at a DRC/SER less than one. The third firm had a negative EPR which shows it is probably also very efficient. Thus, once more, we see efficient firms being able to cope well with less protection, probably also able to survive complete trade liberalization.

84. Although relatively less efficient than producers of textile fabrics, the rest of the industry shows similar patterns. Except for the two firms with the lowest EPRs, real output went down from 1980 to 1984--consistent with falling EPRs. Firm J appears to be the most efficient firm, with a DRC/SER less than one in 1982 and close to one in other years. Although the DRC/SER for firm L remained greater than one, it also dropped consistently, showing that it became more efficient. The negative product EPR also indicates that the firm is probably competitive.

85. Given that most firms have high DRCs, at actual capacity utilization, the next question to ask is if they will be able to become socially profitable (a) with full capacity utilization and (b) when capital is considered sunk cost. Calculating the relevant ratios at full capacity gives information as to whether there is some potential for the firm/industry as their markets expand, through exports for example. Assuming sunk capital cost determines whether it is still socially profitable to continue operation until capital is exhausted. Resulting estimates of DRC/SER less than one under the two assumptions could justify some form of continuing protection for the industry for a specified period of time.

86. Simulation results assuming full capacity utilization made only two firms in home appliances and paper products industries socially profitable--firm A of home appliances, and firm F of paper. The textile industry on the whole became socially profitable. The DRC simulation under the two assumption were not done for the flour industry as it already exhibited favorable results.

87. DRC simulations assuming sunk capital cost still show a few firms in home appliances and paper products with DRC/SER ratio less than one. The same firms which become socially profitable under the assumption of full capacity utilization, also showed favorable outcomes assuming sunk capital costs. Simulations for textiles were not carried out since the industry already passed simulation results under the assumption of full capacity utilization.

Summary and Conclusions

88. First, even within industries, different firms are affected differently by tariff reforms. Usually, in response to tariff changes firms tend to seek product and input combinations which would yield higher protection. Second, some firms, generally already the more efficient ones, are able to maintain production levels or even increase their market shares. It seems that these more efficient firms are able to take over part of the market share of less efficient firms which are forced either to contract or shut down. They are able to operate at greater capacity utilization and become more efficient, enough to compete with less protection from imports made possible by tariff reform or trade liberalization.

89. Still, there are a number of firms, probably the majority, which suffered as a result of the tariff reform, without much possibility of acquiring greater efficiency. Simulating DRCs assuming (a) full capacity utilization and (b) sunk capital cost could help settle the question regarding what to do with these firms. Results for home appliances and paper products were not very encouraging, except for a few cases.

90. Adjustment policies are discussed more fully in the third part of this study.

Table 5: OUTPUT, EMPLOYMENT AND CAPACITY UTILIZATION BY FIRM AND INDUSTRY
(Constant 1980 prices)

Industry	Firm	Output (constant 1982 price)			Employment			Capacity utilization		
		1980	1982	1984	1980	1982	1984	1980	1982	1984
Flour	A	249,393,800	263,115,480	236,903,690	159	160	175	46.49	47.68	48.45
	B	126,217,910	123,389,990	124,347,870	219	220	222	40.19	39.28	39.86
	C	295,219,190	406,207,950	342,460,670	458	471	515	29.50	40.69	33.98
	D	263,469,580	305,416,020	244,237,140	328	358	227	48.31	54.84	44.55
	E	145,682,900	173,744,070	148,898,690	220	206	241	47.72	53.66	48.78
	F	267,935,330	285,582,860	231,363,020	261	256	265	51.19	54.56	44.20
	G	234,995,010	298,852,050	244,456,340	309	331	279	41.68	53.68	43.93
	H	211,183,990	256,858,170	194,324,580	443	478	479	45.26	55.06	41.71
	Subtotal		<u>1,794,097,700</u>	<u>2,113,166,600</u>	<u>1,767,192,000</u>	<u>2,397</u>	<u>2,480</u>	<u>2,403</u>	<u>41.87</u>	<u>49.04</u>
	I	183,464,800	181,624,430	136,236,550	324	320	302	70.00	80.00	80.00
	J	8,552,764	6,236,766	3,082,547	126	121	94	-	-	-
	Subtotal		<u>192,017,560</u>	<u>187,861,200</u>	<u>139,319,100</u>	<u>450</u>	<u>441</u>	<u>396</u>	<u>70.00</u>	<u>80.00</u>
	K	2,710,668	3,532,489	6,377,125	-	-	-	-	-	-
	L	3,949,600	11,114,575	12,019,971	-	346	495	45.00	65.00	75.00
	M	-	6,854,819	-	471	445	411	60.00	80.00	40.00
Subtotal		<u>6,660,268</u>	<u>21,501,883</u>	<u>18,397,096</u>	<u>471</u>	<u>791</u>	<u>906</u>	<u>105.00</u>	<u>145.00</u>	<u>115.00</u>
Total Flour		<u>1,992,775,528</u>	<u>2,322,529,683</u>	<u>1,924,908,196</u>	<u>3,318</u>	<u>3,712</u>	<u>3,705</u>	<u>216.87</u>	<u>274.04</u>	<u>2,389</u>
Home appliance	A	413,576,603	466,852,130	464,067,510	2,183	2,076	2,135	95.00	97.00	96.00
	B	36,111,600	42,782,400	55,501,200	124	141	143	60.00	60.00	75.00
	C	7,107,211	6,571,405	2,862,740	141	122	112	110.00	100.00	66.00
	D	29,389,844	33,091,677	19,467,427	490	298	236	80.00	90.00	55.00
	E	97,934,683	89,166,025	29,698,900	-	-	-	80.00	85.00	30.00
	F	-	29,612,285	22,216,955	-	-	-	-	-	-
	G	-	157,990,397	118,554,757	511	630	213	-	-	-
	H	89,109,945	155,289,520	78,625,231	476	532	398	100.00	100.00	70.00
	I	-	-	-	1,247	1,286	669	90.00	90.00	92.00
	J	-	-	-	795	778	524	-	-	-
	K	89,109,831	29,063,171	16,103,092	417	384	222	-	-	-
Total Home Appliance		<u>716,441,717</u>	<u>1,010,419,010</u>	<u>807,097,812</u>	<u>6,384</u>	<u>6,247</u>	<u>4,652</u>	<u>87.00</u>	<u>87.00</u>	<u>68.00</u>
Paper /a	A	30,209,800	50,441,990	30,003,384	113	143	123	99.00	81.00	48.00
	B	168,027,939	178,845,255	198,942,515	739	841	829	100.00	56.00	66.00
	C	163,727,907	107,659,550	75,678,768	392	377	318	60.00	37.00	20.00
	D	134,192,543	107,362,411	105,898,604	329	329	299	72.00	58.00	59.00
	E	931,143,718	649,535,342	802,254,682	7,948	5,820	6,283	82.00	57.00	71.00
	F	-	-	10,851,515	-	-	213	-	-	20.00
	Total Paper		<u>1,427,301,907</u>	<u>1,093,844,548</u>	<u>1,223,629,468</u>	<u>9,521</u>	<u>7,510</u>	<u>8,065</u>	<u>413.00</u>	<u>289.00</u>
Textile	A	331,420,036	374,515,830	562,194,635	767	953	909	70.00	65.00	72.00
	B	145,472,152	158,986,152	166,449,797	1,530	1,666	1,447	-	-	-
	C	107,902,122	94,620,897	54,778,206	718	737	669	79.00	69.00	40.00
	D	95,066,231	113,371,163	56,427,065	584	769	689	71.00	111.00	71.00
	E	134,424,285	116,902,866	56,427,065	1,217	791	931	70.00	90.00	87.00
	F	146,423,847	122,551,424	110,015,244	841	822	897	92.00	77.00	70.00
	G	-	-	-	-	-	260	-	-	50.00
	H	-	-	-	381	369	264	80.00	70.00	40.00
	I	20,216,980	12,516,170	4,256,943	59	51	65	-	-	-
	J	252,582,015	381,972,272	321,193,977	3,472	2,493	2,571	47.00	51.00	31.00
	K	291,245,469	224,374,572	159,049,749	3,948	2,995	2,104	75.00	-	40.00
	L	118,865,485	118,578,261	140,350,876	2,296	1,857	2,000	64.00	57.00	76.00
	M	-	-	-	1,665	2,140	-	-	-	-
Total Textiles		<u>1,754,340,980</u>	<u>1,792,564,615</u>	<u>1,702,374,161</u>	<u>17,478</u>	<u>15,643</u>	<u>14,682</u>	<u>72.00</u>	<u>74.00</u>	<u>58.00</u>

/a Output at constant 1982 prices.

Table 6: EPR (BASED ON TARIFFS) AND DRC/SER /a BY FIRM AND INDUSTRY

Industry	Firm	EPR			DRC/SER /a		
		1980	1982	1984	1980	1982	1984
Flour	Firm A	55.86	113.07	100.56	0.44	3.11	0.90
	Main Product	145.72	482.19	63.22			
	Firm B	144.72	112.98	98.75	1.99	1.23	0.78
	Main Product	126.62	111.10	67.41			
	Firm C	97.10	108.55	71.73	4.25	2.96	0.60
	Main Product	149.93	176.25	85.65			
	Firm D	69.10	77.53	90.44	0.98	0.85	1.16
	Main Product	163.12	154.19	397.83			
	Firm E	183.01	234.37	82.42	NA	NA	NA
	Main Product	66.78	82.19	72.14			
	Firm F	82.00	102.01	102.67	0.62	0.96	0.79
	Main Product	NA	NA	159.20			
	Firm G	77.92	99.24	106.16	0.38	0.50	0.49
	Main Product	120.37	191.30	181.26			
	Firm H	130.74	164.22	116.65	1.47	1.48	0.77
Main Product	802.75	*	242.25				
	90.07	110.61	91.92	0.86	1.19	0.74	
Firm I	250.04	166.61	156.91	0.325	0.327	0.480	
Main Product	383.46	187.57	94.61				
Firm J	585.56	220.26	186.79	**	5.208	12.958	
Main Product	552.34	186.57	102.07				
Firm K	10,349.87	630.41	218.88	NA	NA	NA /b	
Main Product							
Firm L	259.46	273.87	171.18	NA	NA	NA /b	
Firm M	NA	111.47	NA	NA	1.466	NA /b	
Main Product	225.93	127.98	73.91				

Industry	Firm	EPR			DRC/SER /a		
		1980	1982	1984	1980	1982	1984
Home appliance	Firm A	350.00	254.00	108.00	2.36	1.28	0.55
	Product	922.00	361.00	145.00			
	Firm B	2,900.00	528.00	-	**	**	-
	Firm C	315.00	127.00	107.00	2.27	0.59	1.32
	Product	347.00	540.00	190.00			
	Firm D	*	155.00	158.00	-	-	-
	Firm E	*	*	108.00	-	-	-
	Product	*	*	*			
	Firm F	-	637.00	-	-	-	-
	Firm G	-	534.00	224.00	-	**	1.17
	Product	-	264.00	179.00			
	Firm H	2,919.00	733.00	277.00	-	-	-
	Product	834.00	388.00	269.00			
Product	848.00	226.00	*				
Product	*	*	-				
Product	1,820.00	311.00	174.00				
Firm I	-	-	-	-	-	-	
Firm J	1,017.00	-	-	-	-	-	
Firm K	26.00	26.00	19.00	1.50	5.63	25.21	
	458.00	350.00	119.00	2.53	2.16	0.78	
Paper	Firm A	57.30	115.80	85.80	2.07	**	**
	Product	56.03	118.60	97.30			
	Firm B	192.66	98.77	101.60	**	**	**
	Product	262.13	109.83	81.03			
	Firm C	187.35	960.83	101.60	4.20	**	24.2
	Product	427.90	128.20	49.70			
Firm D	343.90	94.30	62.40	**	**	**	
Product	338.90	108.83	74.80				
Firm E	96.00	55.40	49.90	**	**	0.9	
Product	138.40	72.80	54.10				
Firm F			23.60			*	
Product			28.00				

Industry	Firm	EPR			DRC/SER /a		
		1980	1982	1984	1980	1982	1984
Textile	Firm A	108.40	77.20	41.80	**	**	1.55
	Product	141.70	93.80	77.40			
	Firm B	26.58	8.55	5.54	0.59	0.18	0.34
	Firm C	43.68	10.21	8.05	1.25	1.05	
	Product	43.70	10.20	6.20			
	Firm D	56.80	23.29	21.29	3.42	2.40	-
	Product	38.80	5.76	3.32			
	Firm E	44.50	22.00	3.58	1.15	-	-
	Product	18.58	10.25	0.90			
	Firm F	(2.20)	(3.64)	(0.50)			
	Product	(2.15)	(3.50)	(0.25)			
	Firm G /c	-	-	14.73	-	-	-
	Product	-	-	11.16			
	Firm H	458.07	1,252.5	531.80	**	**	-
	Firm I	190.00	271.00	154.00	-	-	-
Product	*	267.00	163.20				
Firm J	111.40	62.90	58.40	1.35	0.42	1.10	
Product	116.60	108.00	61.00				
Firm K	281.00	147.00	55.00	**	**	1.84	
Product	211.00	108.00	61.00				
Firm L	95.96	47.15	30.30	19.63	6.09	1.47	
Product	(5.93)	(6.82)	(5.56)				
Firm M	109.20	90.76	63.00	1.75	0.93	1.42	
Product	79.56	44.21	32.28	5.27	1.88	1.23	

/a DRC/SER - actual capacity.

/b Firm did not give enough information in the survey.

/c Firm G (textile) started commercial operation in 1983 product.

* EPR - negative free trade value added.

** DRC/SER - negative foreign exchange earnings

() Negative EPR resulting from the rates of domestic value added to free trade that is less than one.

Product: Refers to particular representative product the particular firm produces.

III. THE IMPLEMENTATION OF TRADE LIBERALIZATION

91. The rationale for trade liberalization has been set forth above. In this section of the paper we assume that the goal of liberalization has been set and that it encompasses removal of import restrictions and a transition to low uniform tariffs. We are concerned here with the timing and sequencing of the reform. We will first assess possible effects on income, employment, the trade balance and government revenue. Then, we will discuss complementary measures taking into account the proposed sequencing.

Timing and Sequencing

92. The key questions here are when to start, how rapidly to proceed, and in what order to introduce the principal components of liberalization.

93. With respect to the first question, when to start, we must first take into account the fact that the economy is in a very depressed condition after two years of declining GNP. There is widespread excess capital capacity, together with unemployment and underemployment of labor that goes beyond that which could be accounted for by labor surplus. Because of the debt and foreign exchange crisis aggregate demand has been constrained below output potential. Recovery of the economy will provide jobs from fuller use of existing capacity as well as from new capital formation. So long as this condition prevails the social cost of using existing capital to save foreign exchange is far below the long-run cost of using replacement capital for that purpose; hence, there is a case for interfering with the free market mechanism to facilitate the fuller use of existing capacity.

94. It might be useful to put this in the context of the relations among import restrictions (including tariff protection), the exchange rate, and exports. It is true, of course, that import restrictions penalize exports by defending an undervaluation of foreign exchange. One possible sequence would be to start liberalizing imports, allowing the exchange rate to rise with the increased demand for foreign exchange, and eventually encouraging more exports to match the increase in imports. An alternative sequence, however, would be an initial rise in the exchange rate which would encourage more exports, followed then by permitting the liberalization of imports.

95. In static equilibrium analysis, where time plays no essential role, we could treat the three adjustments as simultaneous. In the real world, however, lags will occur whichever sequence is followed, the key lag being that between the rise in the exchange rate and the expansion of exports. Uncertainty about the length of this lag points to an advantage of the second sequences in assuring the expansion of exports before imports are liberalized.

96. It is important also to consider the monetary and income implications of the two alternative sequences. The first would be deflationary in its monetary effect (from the initial worsening of the balance of payments) and depressing in its income effect (from the increase in imports at the expense of demand for domestic goods). The second sequence, in contrast, would be inflationary (in the sense of money creation) and would stimulate aggregate demand. Clearly the first would be more appropriate in conditions

of excess demand and inflation, while the second would be more appropriate in conditions of depressed demand and idle capacity, the conditions prevailing presently in the Philippines.

97. There are, however, two obvious disadvantages from delaying import liberalization and tariff reform. First, continuance of protection of favored industries in the domestic market would preserve the present disincentive to greater efficiency and cost-saving. Second, it would also mean continuing to give the wrong signals for resource allocation. Therefore the key is to make now a strong and wholly credible commitment to import liberalization. This means clearly stating the goal, explaining the rationale and setting a time table. If this is done now, and made credible by a clear commitment from the top it will be possible in the short run to save foreign exchange relatively efficiently, by using existing sunk capital to fuller capacity, while avoiding a long-run inefficient allocation of new investment. The temporary delay in the implementation of liberalization, together with a clear commitment to a program of phased liberalization following recovery would also serve to give some time to the business community to prepare for a more competitive environment.

98. Finally, there is yet another reason for considering some delay in tariff reform. While unilateral liberalization is clearly in the national interest, far greater gains could be achieved if it were carried out in the context of multi-national trade negotiations (MTN). It is likely that such negotiations will occur in the near future, quite possibly at a time that would be consonant with the other criteria for the timing of import liberalization.

99. This consideration need not be binding, however. If for some reason MTN are delayed, the Philippines could move ahead on its own time table and claim credit for its unilateral liberalization in the eventual negotiations. Indeed, it should claim credit for the tariff reform already accomplished during 1981-85. All of this will require, of course, some negotiations and some commitments as to the binding character of the unilateral reforms.

100. There are some important qualifications to the above argument for temporary delay in import liberalization. With respect to quantitative import restrictions, these should not apply to inputs used by export producers nor to basic raw materials. The latter should have restriction-free, as well as duty-free access to imported inputs. Indeed, the procedures for ensuring this access should be further streamlined, with delay and red tape kept to a minimum. The recovery, if it is to be rapid and not choked off by foreign exchange scarcity, must be led by a surge of export growth.

101. As the recovery proceeds, some industries producing for the domestic market may begin to face shortages of essential inputs where domestic supply is inadequate. Therefore, it will be necessary to relax the force of restrictions on imports for these industries. Thus, in the recovery period, before the complete dismantling of import controls begins, there should be a judicious relaxation of controls. Note that since these imports would supplement domestic supply to provide essential inputs, they would enhance rather than impede the recovery.

102. Finally, while the argument here is to delay further reduction of high tariffs until recovery is attained, there may be a case for immediately raising tariffs that are far out of line on the low side. These would be represented by those with rates of zero or 5%. Two considerations are relevant here. First, these cases represent deviations from the original guidelines for the 1981-85 tariff reform program, which set the target range of duties as 10 to 50%. Hence, raising them to 10% would simply be a correction of a departure from the original intentions. Moreover, these rates pertain to industries that, like exports, have been penalized by negative net effective rates of protection. The presumption is that some at least might represent comparatively advantageous areas of expansion.

103. After the question of timing comes that of sequencing import liberalization and tariff reduction. By this we mean both the speed of the process and the order of the various steps. These can be considered together if we simply set out a scenario for the implementation of the elimination of quantitative import restrictions and low uniform tariffs.

104. During the recovery, our suggested scenario calls for an exchange rate policy that undervalues the peso aiming in advance at a rate closer to that which is appropriate to the projected liberalization of imports following the recovery. This is in line with the preferred sequence appropriate to a depressed economy, as described above. Exports are given additional encouragement via improved access to imported inputs free of restrictions and duties. The strength of import restriction is gradually relaxed where needed in order to provide an adequate supply of inputs. All of this should help to speed the recovery to the point where full trade liberalization and tariff reform can begin.

105. Removal of import restrictions, then, should be the first priority, with a gradual scheduled adjustment of tariff rates to follow.^{6/} The reason for starting with the removal of quantitative restrictions is two-fold. First, if done together with the announcement of the scheduled tariff changes, it will give the private sector clear signals about expected relative prices of internationally traded goods. Second, it will provide small and medium enterprises more equal treatment in access to imports. Tariffs apply equally to large and small but import licensing inevitably favors the larger firms.^{7/}

106. The tariff reform then could proceed on a gradual scheduled pattern as in 1981-85. Five years, again, might be an appropriate duration for the process. At the end of the period rates would be uniform at, say, 10 or 20% mainly based on revenue considerations. Needless to say, this is a purely hypothetical scenario, designed to illustrate the principles involved.

6/ The advent of MTN may, of course, affect the timing of tariff reform.

7/ Evidence from the Philippines' experience in the early 1960's when tariffs replaced licensing supports this view.

Some Likely Consequences of Trade Liberalization

107. One of the special studies attempted to estimate the effects of TRP on income, employment, the trade balance and, ultimately, the exchange rate.^{8/} The estimation was carried out in the framework of a model that combined partial equilibrium assumptions for the supply and demand functions for tradables with general equilibrium effects through inter-industry relationships and the exchange rate. The methodology is described in detail in Background Paper, number 13. Estimations were done first for the 1981-85 TRP and, then, for a simulated further reform to a 20 to 30% tariff range.

108. The most important input into the computations is the set of EPR's for 1979 and 1985. The methodology for the EPR calculations is described in Background Paper, number 12.

109. Export taxes and agricultural price interventions through state trading were held constant to isolate the effects of the TRP. Thus, supply of exportables remains unchanged at a given exchange rate so that changes in exports reflect changes in demand.

110. The supply elasticities with respect to effective price (value added) are assumed to be 0.1 for a low estimate and 0.5 for a high estimate. Demand elasticities, on the other hand are taken to depend on the type of commodity. Income elasticity of demand is assumed to take on three values-- 0.5, 1.0 and 1.5--depending upon whether it is an agricultural product, a mining product, or essential and non-essential manufacturing product. Price elasticity of demand, on the other hand is assigned a value based upon previous studies on elasticities.

111. Finally, due to lack of data on possible growth of output by sector without TRP, it is assumed that all sectors grow at the same (average) rate. Hence, sector S, for example is simply taken as the 1979 level of output. Although the upward bias in some sectors could compensate to some extent the downward bias in other sectors, the net effect could still be significant.

112. Following the model described above, estimates are made of the potential effects of the TRP on variables such as output, income, employment, and exports and imports. These effects are only potential and may not actually be realized for several reasons. First, we are isolating the effects of TRP and, hence do not consider other policy variables. Second, the model is handicapped by its partial equilibrium nature. Although general equilibrium effects of changes in tariffs on effective prices and change in income are considered, the cross price effects are neglected. These may not be important within tradables but the cross effects between tradables and non-tradables may be significant between these two sectors. The implicit assumption is that nontradables are not affected by TRP and would grow at the same rate. And third, following the small country assumption, the model treats the

^{8/} "Impact Effects of Tariff Reform Program", Background Paper, Number 13, PIDS.

trade effects on exports and imports symmetrically, i.e., increases in excess supply for exportables are readily exported just as increases in demand for importables are readily imported. In this regard, increases in exports are thus to be treated only as potential increases.

113. As a result of the tariff changes undertaken during 1981-85, total real output falls by a value between 0.6% to 2.8% depending upon the value of the supply elasticity. Correspondingly, real income falls by around 0.4% to 1.9%, less than the decline in output. This indicates a shift from low value-added activity to higher value added activity, or at least, a larger contraction in low-value added activities, especially in the case of the higher elasticity of supply (0.5).

114. Total demand does not change significantly. At most, it declines by only as much as 0.6%. Total demand even rises if the supply elasticity is assumed to be the lower value of 0.1.

115. The overall effect is a worsening of the trade balance by as much as P 2.7 B. Imports grow by as much as 5.0 to 1.8% due to TRP while exports grow by 0.7 to 1.8%. The former is due mainly a shift from domestic production to imports. On the other hand, the growth in export is mainly due to the fall in demand as in most cases, supply of output declines.

116. Employment, following the decline in output, also goes down, although by a smaller amount from 0.3 to 1.6% even less than the fall in real income. Although only slight, the difference could indicate that, simultaneous with the shift from low to high value added sectors, there also occurs a shift towards more labor-using sectors.

117. Looking at individual input-output sectors, the decline in output is borne by import substituting industries. Furthermore, sectors with low value-added ratios in general suffer the larger reduction. Conversely, the higher the value-added ratio of the sector, the less the decline in output that takes place. This is indicated, as noted above, by a lower decline in income compared to that of output. This is even more evident in the case of the higher supply elasticity (0.5). These results can perhaps be expected since the low value-added activities in general received the higher EPRs and were also the most affected by the TRP. Thus the direction towards better allocation of resources can already be discerned.

118. The supply for exportables remains unchanged, i.e., with or without TRP, since the effective price of exporters is fixed. Export taxes are fixed and all nontraditional exporters are assumed to be able to get duty drawbacks.

Effects of TRP with Exchange Rate Adjustment and Compensating Fiscal and Monetary Policies

119. The purpose of the tariff reform is to change the structure but not the level of output. The decline in both output level and income shows the need to combine lower tariffs with demand management policies which will assist in the transition to a more open system by preventing output and income from falling sharply.

120. Without these adjustments, the trade balance worsens from P2.4B to P2.7B (1979 prices) due to TRP. This increased BOP deficit requires either an increase in net capital inflow (e.g., higher foreign borrowing), real exchange rate adjustment or both. Unless the increase in net capital inflow is autonomous, higher foreign borrowing would only postpone the need for real exchange rate adjustment. The worsening of the trade balance, would eventually require a real exchange rate adjustment.

121. To get back to the original trade balance ^{9/} an exchange rate adjustment from 5.0 to 21.4% will be required, depending upon the supply response to new price signals. Potential exports grow by 4.4 to 7.8% while imports grow by 3.4 to 6.0%. Customs revenue falls by 12.4 to 18.3% but this is in 1979 prices, unadjusted for the change in exchange rate. In fact, adjusting for devaluation total revenues could increase by 3.1% assuming 0.1 supply elasticity.^{10/}

122. If fiscal and monetary policies are implemented to prevent a sharp decline in income following lower tariffs, real output still falls in the range of 0.6 to 2.8%. Total demand, however, increases by around 0.9%, assuming 0.1 supply elasticity, or at worst declines by only 0.2%, assuming 0.5 supply elasticity. Correspondingly, imports grow in the range of 5.2 to 9.2% while exports grow around 0.5 to 2.3%. As a result, the over all trade balance worsens by as much as P 2.6 B to P 3.95 B in 1979 prices.

123. Again, we try to find out how much exchange rate adjustment is needed to get back to original trade balance. The required exchange rate adjustment ranges from 5.8% to 18.8%. As a result exports grow from 4.3% to 8.0% while imports grow by 3.3% to 6.2%.

124. Looking at individual sectors, we see the export sectors as direct gainers from the combination of policies outlined above. Furthermore, the output of import substitution sectors does not decline by as much as the increase in exports. Output of drugs and pharmaceuticals and industrial chemicals even rise.

125. All the above discussion assumes that we can export any excess supply since world demand for our exports is infinitely elastic. Let us now assume a less than infinitely elastic demand, say, equal to -10 in the longer run. For simplicity this average could be taken as uniform for all export. Hence

$$\frac{\Delta x}{x} \bigg| \frac{\Delta P_x}{P_x} = -10$$

where: P_x is the price of exports

^{9/} This analysis assumes initially an equilibrium, or otherwise more adjustment is needed.

^{10/} The higher the supply elasticity, the lower the magnitude of the exchange rate adjustment.

Given the supply of exportables and the domestic price, $\Delta P/P$ equals $(\Delta r/r)$, the change in exchange rate. We can see in Table 3 that $\Delta x/x$ ranges from 4% to 8%. Therefore, there is additional exchange rate adjustment, arising from the fact that the Philippines has a less than infinitely elastic world demand for export, of around 0.4% to 0.8%. In the short-run, the export demand elasticity could be lower, around -5. This implies a greater additional adjustment of around 1% to 2%.

126. The adjustment required is on the real exchange rate, RER. If the nominal exchange rate is NER, world trade price index is WTP and primary factor price index is PFP, then,

$$RER = NER \times \frac{WTP}{PFP}.$$

127. The real exchange rate is equal to the nominal rate multiplied by the ratio of world trade price index and primary factor price index. Thus, the required real exchange rate adjustment could come from a rise in the nominal exchange rate or a fall in primary factor prices relative to world trade prices or to a combination of both.

Simulated Impact Effects of Further Tariff Reductions to a Range of 10% to 30%

128. We also examine what happens if additional tariff reform is implemented to further narrow down the range from 1985 level to a tariff range of 10% to 30%.

129. Imposing a ceiling of 30% and a floor of 10% on tariff duties reduces EPR variation to a range of 17% to 97% (excluding sectors with negative free-trade value-added) for importables. Importable machinery (non-electrical) receives lowest EPR whereas importable electrical machinery which includes household appliances, receives the highest. The projected range is very close to the initial goal of 20% to 80% EPR, although exports will get zero EPR.

130. In general, the results of the simulation show minimal further impact effects. Without complementary demand management policies, supply declines further by only around 0.3 to 0.5 supply elasticities, respectively. Correspondingly, income is diminished further by only 0.2% to 1.1%. The trade balance worsens by P 6 B to P 2.2 B.

131. Again, suppose that we find the right combination of compensatory fiscal and monetary measures to be implemented so that income is unaffected by the further reform. Real exchange rate adjustment required ranges from 4% to 12%, for 0.5 to 0.1 supply elasticity, respectively.

Complementary Measures

132. The most important of the complementary measures is, of course, exchange rate policy. This has been discussed above in the context of the trade liberalization program. There it was suggested that the peso be

deliberately undervalued to encourage an export surge that would hasten and sustain the recovery. Such a policy would also anticipate the adjustment required by the subsequent liberalization of imports and tariff reform.

133. It is impossible to predict in advance the actual exchange rate movements that might be required. On the one hand, the whole process should result in a higher volume of trade--both imports and exports--in relation to GNP. Exchange rate policy must accommodate the need for exports to grow faster than the rest of the economy, the whole process should result in a more efficiently organized and operated economy. This, in itself, would strengthen the peso. What is needed is a flexible exchange rate policy that maintains a favorable climate for export expansion and efficient import substitution in the face of whatever changes an uncertain future brings.

134. A second important complementary measure would be some changes in sales and excise tax rates. Removal of import restrictions and lowering of tariffs to a 20% level will, in themselves, permit and encourage a greater import of non-essential consumer goods. Moreover, the tariff changes may result in some revenue loss though this is not certain. An increase in sales tax rates on non-essential consumer goods would help, in both respects and, perhaps, should be a part of a general tax reform.^{11/}

135. Along with exchange rate policy, export growth would be supported with the removal of export taxes. These applied to a number of agricultural and natural resource based products and have recently been eliminated with the exception of those in place for conservation purposes. Export taxes were rationalized as a substitute for direct taxes on natural resource (including land) rents, as a device for promoting processing, and as a means of improving the terms of trade. None of these represent a very persuasive argument for export taxes. In any case, all exports are already implicitly taxed at a rate of 15% to 20% through the undervaluation of foreign exchange resulting from the industrial protection system. Even with the full implementation of the trade liberalization program, the regime of 20% uniform tariffs will imply an implicit tax on exports of about 10%. It would be difficult to justify for any reason adding an additional explicit tax. This is particularly true for copra, coconut oil and other raw and processed agricultural products where the incidence will be on the poorest segment of Philippine society. The only exception is logs where a high export tax (or a ban) also serves a conservation purpose.

136. Liberalization of capital markets is a natural complement to liberalization of the trade policy regime. In general, each will provide benefits independent of progress in the other; hence, the two need not be tied together. Exceptions occur, however, where financial market distortions are designed to offset or compensate for adverse effects from other policies. The obvious case is special credit facilities or terms for exports. Until trade liberalization is completed a case could be made for such financial market

^{11/} This is discussed in detail in the Background Paper No. 3 by Manasan on indirect tax policy.

intervention. Availability of credit is more important. Any cost preference should be modest to avoid factor bias and to preclude charges of export subsidy.

137. Finally, there is the question of adjustment assistance to both capital and labor that may be adversely affected by the liberalization program. This often occupies a prominent place in discussions of complementary measures, particularly in more developed countries. For the Philippines, however, unemployment compensation and financial assistance to distressed firms may be luxuries beyond the reach of a constrained budget.

138. There is widespread unemployment in the country, owing to a number of causes, that swamps the volume that might be expected from trade liberalization. Moreover, liberalization might even create new and more jobs productive activities. Ideally the expansion of employment in new sectors should not lag greatly behind the contraction that occurs in some old overprotected sectors. Indeed, if the sequence of exchange rate--export expansion--import liberalization is followed there might be little or no lag at all. In any case, the main task is to provide a policy environment that is conducive to employment growth over the whole economy, not just in sectors affected by trade liberalization. And there is no more reason for granting unemployment compensation to those displaced by the liberalization measures than to those displaced by the recent austerity measures, stemming from abusive policies of the past and enforced by the external environment. Clearly at this stage the Philippines is not in a position to provide general compensation to the unemployed.

139. What about re-training of workers displaced by import liberalization? The government, itself, is not in a position to provide this. Training is best accomplished on the job. Where the government might help is in allowing such training to be expensed for tax purposes. However, this is difficult to monitor, and is subject to abuse. Again, the number one priority is an economic policy climate that encourages job creation. Employers would then find it in their own interest to provide the necessary training.

140. With respect to capital, there would generally be no reason to compensate for the quasi-rents lost as a result of trade liberalization. In most cases the likely affected industries would have been long over-protected anyway. If the rationale for their protection was some version of the infant industry argument, they would have an obligation to repay society for the years of infant protection, rather than a claim for compensation because of its termination.

141. Physical capital, however, is scarce; and this scarcity is an important cause of unemployed resources. It would not be socially economical simply to shut down plants and leave them in idle because they could not cover all of their costs, including capital costs. If marginal costs could be covered they should be operated, providing employment, as well as output that would save foreign exchange. The market might serve to accomplish this unaided by government policy in the absence of protection distorted prices, and undervaluation of foreign exchange.

142. Any government assistance should be of limited duration so that there would be no incentive to replace the capital or to encourage new investment. Finally, assistance in the form of credit availability would be desirable where the more efficient firms can demonstrate their competitive ability and wish to buy the physical assets of withdrawing firms. Similar assistance should be available for viable modernization programs that allow the firms to adjust to compete in the new environment. However, assistance should be limited to credit availability on market terms so as to guard against subsidizing socially wasteful investment.

143. This limited role for adjustment assistance is in keeping with the limited resources of the government. It is also consistent with the overriding need for recovery and the resumption of economic growth. As already noted, there is widespread unemployment and underutilized production capacity, far beyond any additional amount that might be temporarily associated with the adjustment to trade liberalization. This provides a potential for a few years of more rapid growth than the long-run natural rate would allow. Success in achieving this would create the ideal setting within which trade liberalization could proceed.

144. What is important now is to get this program under way. Once started there is good reason to believe that the return of confidence in the Philippine's economic future will help to sustain it. As noted earlier in this paper, it must be led by resurgent exports and should not be choked off by a premature flood of imports at the expense of domestic production. What is needed immediately is a clear commitment to a policy of trade liberalization, the elimination of export taxes and all bureaucratic impediments to export expansion and an aggressive exchange rate policy that aims at a rate now that is appropriate to an already recovered and liberalized vigorously growing economy.

IV. MULTILATERAL TRADE NEGOTIATIONS

145. The Philippines unilaterally implemented a substantial reduction of tariff protection in 1981-85. This provided a direct benefit to trading partners without requiring any commitments or concessions on their part. The Philippines would like to continue the reform of its protective tariff structure in the context of multilateral trade negotiations in order to achieve the maximum possible liberalization of its trade with the world. Moreover, it would expect to receive recognition for the tariff reductions already implemented in 1981-85.

146. On the export side, tariff and non-tariff barriers confronting Philippine exports to the United States, Japan and the EEC have been identified and corresponding Philippine requests proposed. On the import side, the extent by which the three countries benefitted from the TRP and Import Liberalization Programs has been assessed; and a proposed offer list has been formulated, consisting of products with high tariff rates which are principally sourced from these countries.

147. In view of data constraints, particularly on non-tariff measures affecting Philippine exports, the positions indicated in the study are indicative and are intended to provide the Philippine delegation with a working basis for the formulation of specific requests to be addressed to the target markets on a country by country level.

148. The details of the study, with extensive back-up data, are found in Background Paper No. 11. We present here only a summary of the key points for negotiations. The tables referred to are found in the Background Paper.

149. A GATT report on the developments in the trading system from April to September 1985 revealed that protectionist measures showed a further increase from already-high levels during this period. While new trade restrictions were comparatively few, there were few trade liberalization actions taken and there was ample evidence of increased bilateralism, managed trade and competitive subsidization of exports.

150. Another study undertaken by UNCTAD revealed that the share of exports subject to non-tariff restrictive measures is far greater for developing countries. This situation is attributed partly to the discriminatory applications of such measures. It also results from the fact that exports of developing countries fall into sectors experiencing structural problems. These are precisely the sectors where there has been an increase in the use of protective measures.

151. In the face of all these setbacks, the GATT new round of MTN provides an avenue for developing countries to work for the liberalization of their trade with the rest of the world through improved market access for their major exports. For its part, the Philippines will seek to achieve liberalization of its trade on agriculture and tropical products, natural resource products and textiles. This will be done first through the implementation of standstill and rollback commitments of developed countries during the negotiation process. This will be followed by the elimination/reduction

of tariff and non-tariff measures facing its exports as a direct result of the new round of negotiations itself.

152. Background Paper No. 11 reports on a study by the Tariff Commission of the possibilities of the Philippines' obtaining concessions during the new round of MTN from major trading partners in exchange for the tariff reduction and liberalization of import licensing already unilaterally undertaken, together with further progress in this direction to be pursued within the context of negotiation.

153. The GATT New Round of Multilateral Negotiations (MTN) will be launched at a Ministerial Meeting to be held in September 1986. A Preparatory Committee (PREPCOM) is now established in GATT to determine the objectives, subject matter, modalities for and participation in the multilateral trade negotiations.

154. While the PREPCOM is still meeting to determine the objectives and agenda of the new round, there has been general agreement among the contracting parties that the negotiations will seek to strengthen the multilateral trading system and to restore confidence in the determination of governments to work for further liberalization and expansion of world trade.

155. What has remained as a contentious issue is the question of the scope of the agenda. The United States has unequivocally stated that it will not participate in any new round of trade negotiations that does not include services. On the other hand, the so-called "hard liner countries" led by India and Brazil have consistently maintained that the new round of MTN should be confined to negotiations over trade in goods on the ground that trade in services does not fall under the jurisdictional competence of GATT. Moreover, these countries have set certain prerequisites to be fulfilled and certain priorities to be agreed upon prior to the launching of the new round. On the side of ASEAN, its member countries have expressed full support for the launching of the new round on all items in the agenda of the negotiations.

156. In pursuance of these objectives, the following guidelines may be adopted:

A. Products On Which Concessions May Be Requested

1. As a first position, a standstill should be requested on all non-tariff measures imposed by the target markets on the products identified as of export interest to the United States, Japan and EEC.^{12/} During the negotiations, no new non-tariff barriers should be imposed on these products.

^{12/} See Tables I-III, Background Paper No. 11.

2. Elimination/liberalization of tariff and non-tariff barriers should be requested on identified products which are of major/substantial Philippine export interest in the target markets. The criteria for selection of products are:
 - (i) the Philippines is either a major supplier of the product in the target market or has substantial supplying interest in the product;
 - (ii) the country enjoys comparative advantage in production over other major suppliers, or additional advantages in terms of distance and transport costs;
 - (iii) substantial demand (and trade potential) exists for the product in a given target market;
 - (iv) the product is subject to relatively high tariff and non-tariff barriers, thus requiring more liberal conditions for access;

B. Products On Which Concession May Be Offered

1. As a first position, the unilateral tariff reductions adopted under the Tariff Reform Program (TRP) and the removal of import licensing restrictions under the Import Liberalization Program (ILP) should be utilized by the Philippines as negotiating leverage to secure reciprocal concessions from its negotiating partners. A commitment to bind the reduced tariffs (1985 rates) under the TRP may be offered in exchange for concessions to be obtained on Philippine exports.
2. To maximize benefits to be derived from the negotiations, a Philippine global offer list of products on which further tariff cuts may be granted could be formulated using the following criteria:
 - (i) the product is subject to tariff rates of 50% and 40%;
 - (ii) the product is classified by the Central Bank as EP, SEP, NEP, UP, EC, or SEC, and is therefore freely importable;
 - (iii) the product is not locally produced, or if locally produced, production is inadequate to meet local demand;
 - (iv) importation in any of the years 1982 and 1983 reached \$1 million and above;
 - (v) the product is principally sourced from any of the three target markets.

C. Indicative Philippine Request Lists

157. Applying the criteria for selection of products on which concessions may be requested, indicative request lists addressed to the U.S., Japan and the EEC have been drawn up with corresponding proposed Philippine requests.^{13/}

158. The products selected are those wherein the Philippines is either the major supplier (accounting for 50% and above of total imports of target market) or substantial supplier (accounting for at least 10% of the market), the tariff and non-tariff barriers on which are considered restrictive. As a negotiating strategy, on products wherein the Philippines is the major supplier, the suggested Philippine positions are first, to request for the elimination/reduction of MFN rates (since concessions on MFN are more permanent) together with the relaxation/elimination of NTB's and, as a fallback position, inclusion in the GSP.

159. On products for which the Philippines is not the major supplier, the suggested position is to request for inclusion in the GSP since it is expected that the principal suppliers will be the ones to seek for an MFN concession, in which case the country stands to benefit as well in view of the multilateralization of concessions.

160. In certain cases, even if the Philippine share is less than 10%, the product is included as it is a major Philippine export product or the country has defined comparative advantage on it.

D. Indicative Philippine Global Offer List

161. To the extent possible, the Philippines should adopt the posture that the unilateral tariff reductions under the Tariff Reform Program and the liberalization of import restrictions under the Import Liberalization Program should be considered by the negotiating partners of the Philippines as its overall contribution to the new round of MTN. The country should therefore utilize these autonomous measures which are of direct benefit to the country's major trading partners to secure reciprocal concessions on its exports from these countries.

162. Under the TRP, the average tariff rate was lowered from 43% in 1981 to 28% in 1985 and the overall tariff rate range brought down from 10%-100% during the pre-TRP period to 10%-50% in 1985. The ILP, on the other hand, resulted in the liberalization of a total of 967 previously banned NEC/UC imports and six groups of regulated commodities prior to 1983. The remaining 202 NEC/UC items and 15 regulated commodity groups are in the process of being liberalized; of the 1,232 items in this group, 929 have been liberalized as of September 1986.

^{13/} See Tables IV-VI, Background Paper No. 11.

163. Table 7 shows data for products which are presently levied 50% and 40% rates of duty, importation of which reached \$1 million and above in any of the years 1982 and 1983. TA study of the data shows that the U.S., Japan and the EEC were the major beneficiaries of both trade liberalization programs, with the lion share going to the U.S.

Table 7: MAJOR BENEFICIARIES OF TARIFF AND TRADE LIBERALIZATION

	1983		1982	
	Value	% Share	Value	% Share
RP Imports of 84 Tariff Lines				
Total	<u>\$518,904</u>		<u>\$435,481</u>	
U.S.	165,440	31.88	120,320	27.63
Japan	103,272	19.90	129,291	29.69
EEC	88,107	16.98	46,677	10.72
Products Already Liberalized Under the ILP				
Total	<u>\$ 27,334</u>		<u>\$ 45,830</u>	
U.S.	7,741	28.32	10,767	23.49
Japan	4,691	17.16	13,593	29.66
EEC	3,208	11.74	3,311	7.22
Products to be Liberalized Under the ILP				
Total	<u>\$236,554</u>		<u>\$225,170</u>	
U.S.	60,161	25.43	63,350	28.13
Japan	31,878	13.48	55,187	24.51
EEC	24,705	10.44	23,403	10.39

164. It is clear from the above that the comprehensive trade liberalization measures adopted during the last five years directly benefitted the country's major trading partners. These measures were undertaken unilaterally and no corresponding concessions have been received as payment for them. During the negotiations, the Philippines should use these liberalization measures as a means to secure reciprocal concessions from its negotiating partners.

165. However, facing the realities of the situation and in view of the announced stand of certain developed countries, notably, the U.S., EEC, Japan and Canada, that the negotiations should be conducted on a reciprocal basis, an indicative Philippine global offer list of products on which further tariff cuts may be considered could be drawn up.

166. In accordance with the criteria set for the selection of products on which further cuts may be considered, the proposed offer list is shown in Annex B of Background Paper 11. The level of tariff cuts is left to the negotiating authority.

PIDS/TC Trade Liberalization Study Background Papers

1. **Tariffs and Economic Development: The Rationale for Philippine Tariff Reform** by Dr. John H. Power.
2. **Assessment of the Tariff Reform Program and Trade Liberalization** by Dr. Erlinda Medalia.
3. **Indirect Tax Reform: A Complementary Measure to the Tariff Reform Program** by Dr. Rosario Manasan.
4. **Non-Tariff Measures Affecting Philippine Imports** by Loreli de Dios.
5. **Impact Effects of Tariff Reform Program** by Dr. Erlinda Medalla.
6. **A Study of the Effects of Tariff Reform and Import Liberalization on the Flour and Flour-based Products Industry** by Cecilia A. Mirabueno.
7. **A Comparative Study of the Home Appliance Industry** by Elizabeth Tan.
8. **A Study of the Effects of Tariff Reform and Import Liberalization on the Paper Industry** by Virgie Pineda.
9. **A Study of the Effects of Tariff Reform and Import Liberalization on the Textile Industry** by Fita Mercado.
10. **The Implementation of Import Liberalization and Tariff Reform in the Philippines: Phasing and Complementary Measures** by Dr. John H. Power.
11. **Possibilities of Securing Trade Concessions from the GATT New Round of Multilateral Trade Negotiations** by Remy Nazaret.
12. **Effective Protection Rate - Methodology** by Maite Quintos.
13. **Impact Effects of the Tariff Reform Program - Methodology** by Noli Mabida.