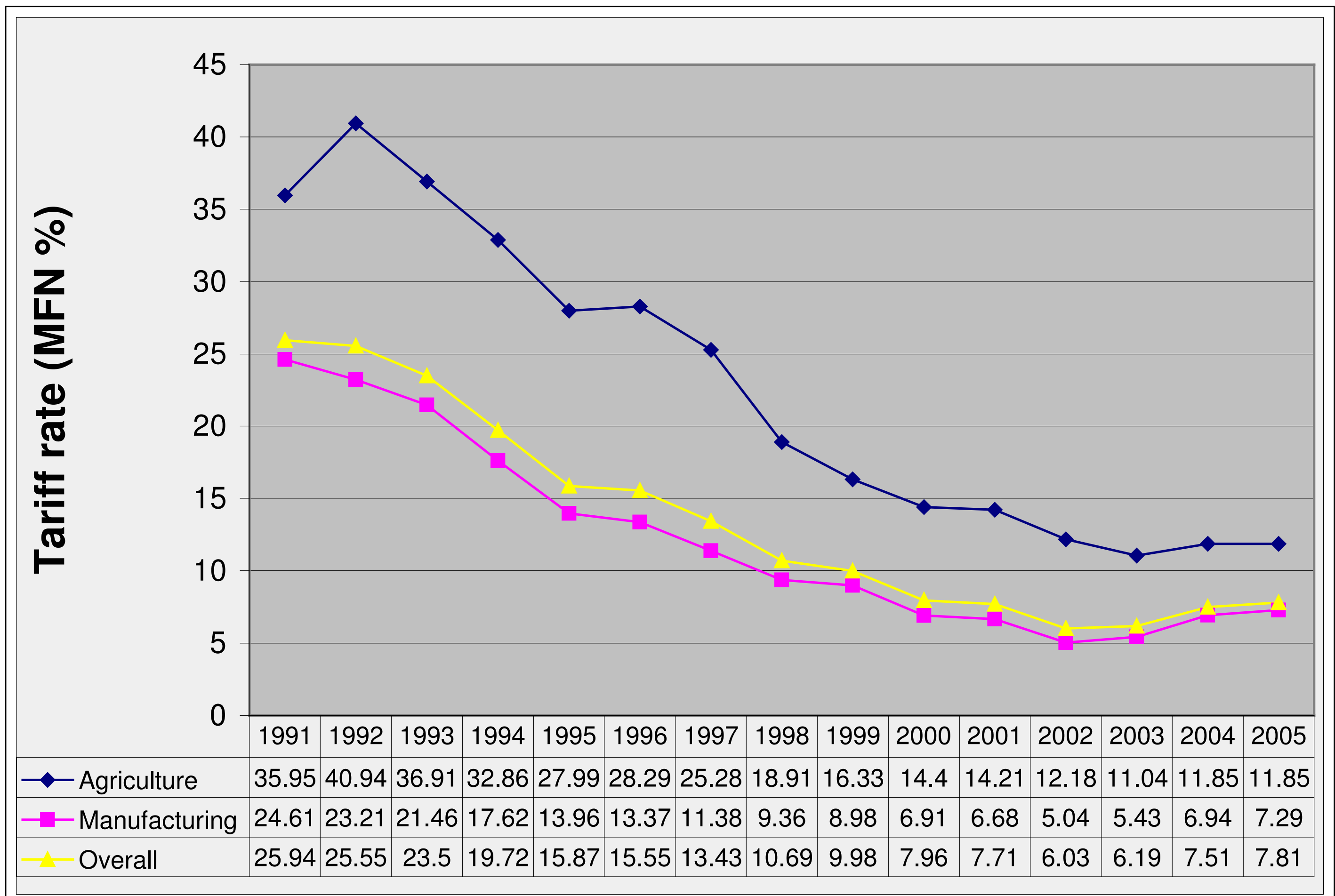
Notes on Philippine Trade Policy

(Final Version)

Philippine MFN tariffs were drastically reduced from the 1980's to the 1990's as shown in the chart below. This unilateral and non-reciprocated lowering of tariffs was largely due to a series of Tariff Reform Programs (TRPs), principally aimed at opening the domestic market to imports and simplifying and reducing the number of duty rates, that accompanied the Structural Adjustment Programs (SAP) imposed on the country by global financial institutions such as the IMF.

Figure 1. Philippine MFN Average Nominal Rates 1991-2005



	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture	35.95	40.94	36.91	32.86	27.99	28.29	25.28	18.91	16.33	14.4	14.21	12.18	11.04	11.85	11.85
Manufacturing	24.61	23.21	21.46	17.62	13.96	13.37	11.38	9.36	8.98	6.91	6.68	5.04	5.43	6.94	7.29
Overall	25.94	25.55	23.5	19.72	15.87	15.55	13.43	10.69	9.98	7.96	7.71	6.03	6.19	7.51	7.81

Source: Philippine Tariff Commission

The objective of tariff simplification however was negated by the complications arising from free trade agreements which further aggravated the tariff reduction trend. The entry into force of free trade agreements (FTAs) in the 2000's such as the AFTA, which later evolved into the ATIGA, the ASEAN-China FTA, ASEAN-Korea FTA, PJEPA, ASEAN-Australia-New Zealand FTA and the soon to be implemented ASEAN-India FTA exponentially expands the number of distinct duty rates. Taking into account the modalities for reciprocal rates for asymmetric sensitive lists further complicates the implementation of the preferential rates

under the FTA system. Unfortunately, these agreements were entered into by the Philippines without a clear program of reaping the benefits of greater market access to trading partners and without establishing the necessary safety nets and structural support for vulnerable sectors. Seemingly the decision to engage some trading partners through FTAs and economic partnership agreements was motivated more by the fear of non-participation or of exclusion from the trading bloc.

The obsession for trade liberalization, without ensuring that the underlying fundamental prerequisites for liberalization were secured, has left the country with battered and distressed sectors in both agriculture and industry. Because of the FTAs, trade liberalization has left the country with little usable policy space and while such space is still present under the WTO framework, there is obvious reluctance or apparent aversion to utilizing such policy space. Consequently, economic development and the strategic objective of nurturing domestic production enterprises seem to be compromised with the unavailability of a key tool for industrial development – effective and time-bound protective tariffs. The comparative tariff profiles in Table 1 below highlights the fact that the Philippine profile for **applied** average tariff rates more closely resembles that of developed countries.

Table 1. Tariff Profiles for Industrial Goods – selected countries

Non-Agricultural Products					
WTO Member	Average Bound Rate (%)	Average Applied Rate (%) in 2010	Average Applied Rate (%) in 2004	Maximum *ad valorem* Applied Rate (%) in 2010	Maximum *ad valorem* Applied Rate (%) in 2004
Japan	2.5	**2.5**	2.7	*304*	30
United States	3.3	**3.3**	3.7	*60*	59
Australia	11.0	**3.8**	4.6	*249*	25
Philippines	23.4	**5.8**	4.3	30	30
Indonesia	35.5	**6.6**	6.7	150	170
Korea	10.2	**6.6**	7.0	*300*	50
Malaysia	14.9	**7.6**	8.1	60	300
Thailand	25.5	**8.0**	14.2	*195*	80
China	9.2	**8.7**	11.3	50	51
Mexico	34.9	**9.9**	17.1	50	35
India	34.4	**10.1**	27.7	*240*	160
Brazil	30.7	**14.1**	14.1	35	35

Source: World Tariff Profiles 2010 and 2004 (a joint publication of the WTO, UNCTAD and ITC)
http://www.wto.org/english/res_e/booksp_e/tariff_profiles10_e.pdf

(*note: maximum applied rate in italics are based on ad valorem equivalent estimates and also applies in cases when the ad valorem is part of a compound or mixed duty as ceiling or floor.*)

The above table shows that the Philippines is more or less aligned with the developing countries in setting binding obligations in the WTO at average bound rates of

from 23% to 35%. However, because of a trade policy framework that anchors itself in the theoretical benefits of free trade, the Philippines underwent a series of accelerated, unilateral and non-reciprocated tariff reduction programs resulting in its average **applied** MFN tariff structure to be closer to that of highly developed countries like the United States (3.3%), Japan (2.5%) and Australia (3.8%). In contrast, major developing countries like Brazil (14.1%), India (10.1%), and China (8.7%) maintain applied tariff rates for industrial goods which are much higher than the Philippine average of 5.8% in 2010.

The above table can also indicate the level of resolve other countries place in utilizing tariffs as a tool for development and the preservation of sensitive sectors. It should be particularly noted that for 2010, the Philippines has the **lowest** maximum applied rate for industrial products among all the countries profiled. This can be considered strange since developed countries like Japan, the US, Australia and Korea impose industrial tariffs as high as 60% to 304% even at the present time. Compared to the maximum rates of more than 100% for Japan (304%), Australia (249%), Indonesia (150%), Korea (300%), Thailand (195%) and India (240%), the Philippine maximum applied rate at 30% for non-agricultural products may not allow for a level playing field in international trade, especially since these other countries have more varied non-tariff barriers aside from their higher tariff rates. At these peak rates, the practical effect could very well be the closure of their borders to products enjoying such high barriers of entry. It may thus be helpful to revisit and identify the stages of economic development of certain industrialized countries at the time when their liberalization process was initiated or re-initiated.

A former chief economist of the UNCTAD, Yilmaz Akyuz, in a 2005 paper entitled "The WTO Negotiations on Industrial Tariffs: What is at Stake for Developing Countries" presented the following table:

Table 2. Historical Ave. Applied Tariffs – Selected Industrialized Countries

Country	*Year*	*Per capita (at 1990$)*	*Ave. applied tariffs (%)*
US	1913	5,301	44.0
Germany	1950	3,881	26.0
France	1950	5,270	18.0
UK	1950	6,907	23.0

*Sour*ce - Yilmaz Akyuz, The WTO Negotiations on Industrial Tariffs: What is at Stake for Developing Countries, TWN, 2005.

The equivalent Philippine indicators for the year 2004 show per capita figures to be more or less US$1,000 with average applied tariffs of 4.3% for industry and 6.15% for agriculture. It is therefore seemingly irrational that the Philippines undertook a general and unilateral tariff reduction decision without taking into account the development needs and the competitive framework of Philippine industries. It can be categorically stated that the Philippines undertook the core measures for trade liberalization prematurely, haphazardly and without setting in place the correct sequence for bringing down legitimate and necessary trade barriers that could have substantially helped in the development of domestic industries. The results of such negligence and the dire consequences of a mismanaged liberalization process is evident in the following table:

Table 3. Sectoral Contribution to GDP – selected ASEAN countries

Country	GDP in $ millions		Agriculture % of GDP		Industry % of GDP		**Manufacturing % of GDP**		Services % of GDP	
	1995	2008	1995	2008	1995	2008	**1995**	**2008**	1995	2008
Philippines	74,120	166,909	22	15	32	32	**23**	**22**	46	53
Malaysia	88,832	221,773	13	10	41	48	**26**	**28**	46	42
Thailand	168,019	272,429	10	12	41	44	**30**	**35**	50	44
Indonesia	202,132	510,730	17	14	42	48	**24**	**28**	41	37
Vietnam	20,736	90,645	27	22	29	40	**15**	**21**	44	38
Cambodia	3,441	10,354	50	35	15	24	**10**	**16**	36	41

Source: 2010 World Development Indicators

The above Table 3 clearly shows that for the Philippines, the contribution of the industrial sector to GDP in 1995 and 2008 remained stagnant at 32% while that of the Manufacturing sector actually declined from 23% to 22%. This performance is in stark contrast to most ASEAN neighbors where we see the contribution of industry and manufacturing significantly increased in the reference years studied. According to PIDS President Josef T. Yap (9/21/03), "Historically, an upward movement in the development ladder has meant a shift from agriculture and other primary producing activities to manufacturing industry." As can be gleaned from Tables 2 and 3 above and the economic history of these selected countries, a well-managed trade policy framework that consists of strategic tariff support plays a significant role in the economic development of any nation.

A relevant insight from former Department of Agriculture Secretary Luisito Lorenzo is worth recalling at this point:

> "Unbridled trade liberalization that has singularly and mistakenly focused only on tariff elimination and blind to our development needs, and the sophisticated protectionism of the developed in the form of trade- and production-distorting subsidies, has no human face and is fast dismantling, rather than helping us build, our launching pads to economic and social development — the true intent of the multilateral trading system."

The above statement closely fits the Philippine experience in the last two decades. Industrial sectors such as textile milling, petrochemicals and plastics, shoe manufacturing, iron and steel, etc. experienced contractions in operations as well as displacement of market share from imports. Trading on their own products by some manufacturers became a strong alternative to continuing domestic production. The accelerated tariff reduction process also caused deep dysfunctions among Philippine segments of the production chain. At the sectoral level, the failure to consider and to rationally preserve tariff support within the value-chain caused severe conflicts in upstream-midstream-downstream operations. Because of deliberate tariff distortions created within the same trading arrangement, these conflicts weakened the domestic linkages in the chain and thus hampered vertical integration programs that could have enhanced industrial competitiveness earlier.

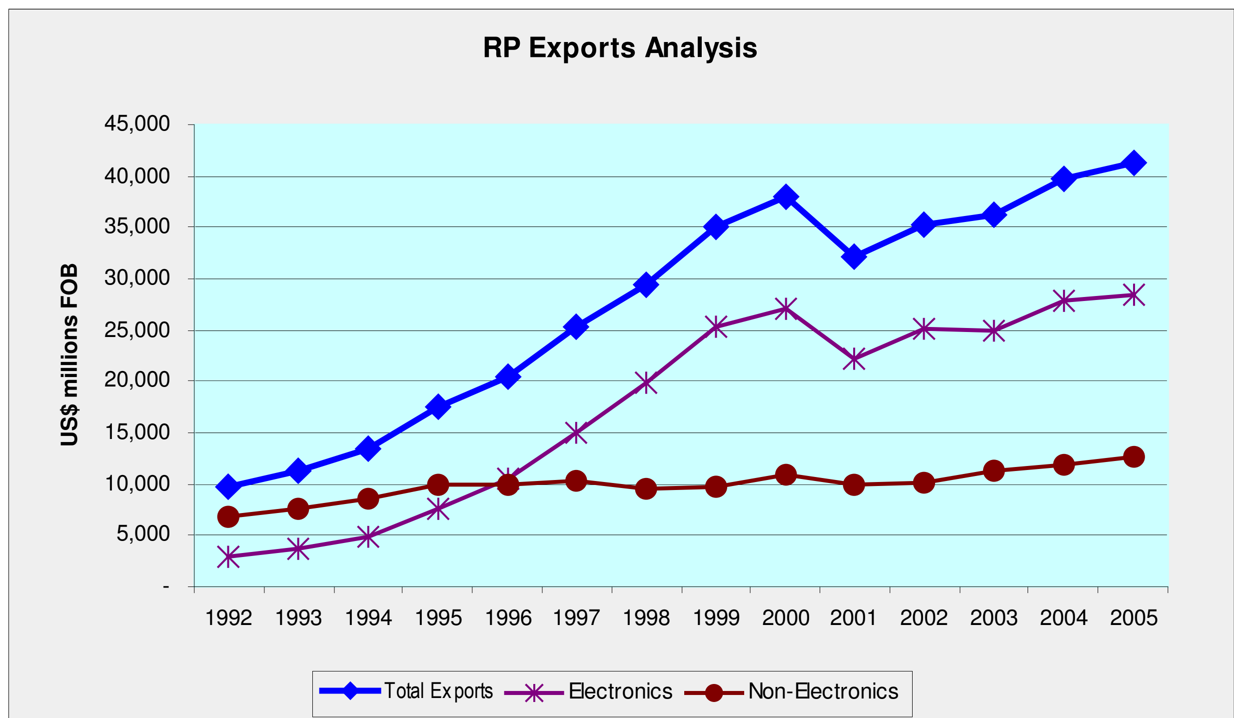
The Export Performance Dimension

Proponents of unilateral and accelerated trade liberalization often trumpet the benefits of the tariff reduction program by citing the substantial growth in Philippine exports during the last ten or so years. Figure 2 below shows that total exports grew from about US$ 9.8 billion in 1992 to US$ 41.2 billion in 2005 representing a 13-year growth of over 300%!

One sector largely contributed to this growth in exports – ELECTRONICS. In an industry report, the Semiconductor and Electronics Industries in the Philippines, Inc. (SEIPI) traced the growth of electronics exports from 1992 to 2000, tabulating an enviable growth from just US$ 2.97 billion in 1992 to US$ 27.17 billion in 2000.

Because of the tremendous contribution of this single sector alone to total Philippine exports, one will have to wonder how **non-electronics** exports performed during the same 13-year period which was characterized by massive reductions in tariff rates. By relating export growth as a major benefit of tariff reduction, neo-liberal economists seem to point to an open domestic market as a pre-condition to export competitiveness. Because the share of electronics exports to total exports grew from 30% in 1992 to 70% in recent years, there is a need to factor out this single sector to determine the export performance of our non-electronics products.

Figure 2. RP Export Performance 1992-2005



Source: NSO, SEIPI

Figure 2 above clearly shows how anemic non-electronics export performance had been for the 13 years under review. It can be generally stated that <u>outside of electronics, Philippine exports from 1995-2005 were practically FLAT!</u> This reflects a lack of genuine development for the other non-electronic exporting sectors and shows

that tariff reduction alone does not lead to sustained and deep development. The persistent high unemployment and underemployment figures also show that any growth have not been inclusive growth.

This analysis highlights the mismanaged globalization process the Philippines undertook **unilaterally**. While allowing wide access for foreign goods into the domestic market to compete with locally manufactured products, handicapped as they were and even now with high power costs and deficient infrastructure, the trade liberalization policy of government has generally left Philippine exports with the challenge of facing formidable barriers in accessing foreign markets because no reciprocity for our rapid tariff reduction was ever negotiated. The argument that our export products became more competitive with lower cost of inputs due to lower tariffs on raw materials fails to be supported since the above statistics show dismal performance of non-electronics exports.

More importantly, it should be noted that electronics are basically tariff-neutral products because most of these are re-exports of duty-free imported components. A typical semiconductor company is located in a PEZA zone and is usually BOI registered, thus allowing for the zero-duty importation of raw materials and components for assembly. This sector is therefore unaffected by tariff reduction programs because it already operates in a duty-free environment. In summary, the growth in exports cannot be attributed as a resulting benefit for the lowering of tariffs.

Lessons from other countries on trade liberalization – some excerpts

- WB (East Asian Miracle, 1993) wrote on Japan:
  "protection (ERPs) in Japan were quite high and exhibited the cascaded pattern from raw materials (low) to consumer products(high)…there was surprisingly high protection of machinery (final producer goods) …[which was] reduced during the l970s only after it was evident from export performance that the sector had become internationally competitive. Quite high levels of protection were afforded sectors such as iron, steel and non-ferrous metals as late as l970. Protection in capital-intensive industries such as pulp, paper and chemicals also remained high, to say nothing of the remarkably high levels in textiles." (p. 295)
- With trade protection and 'learning' from abroad, early industrializers build industrial base, first by replacing light imports, followed by capital goods and exports. Later, industrializers ease trade protection by focusing on technology upgrading and raising productivity
- Liberalization when industries have 'matured' or developed, not before
  (China now doing this, earlier the Asian NICs)

From these lessons, we need to seriously re-assess the current paradigm, seemingly still held by most economic planners, that free trade automatically results in economic development and poverty alleviation. The hollowing out, during the last two decades, of the industrial landscape should compel policy makers to proceed with caution before entering further into trade arrangements that could very well have greater adverse effects than their claimed benefits. It is lamentable that up to this time, and despite repeated requests for a thorough and comprehensive assessment of the benefits and

adverse effects of existing trading arrangements, no study has been made comparing the actual effects of these agreements against the projected benefits claimed before these agreements were implemented. A detailed feasibility study and a scorecard for each FTA should have been maintained to evaluate whether the expected contributions to development were actually achieved. Even the process of objectively determining expected benefits and identifying vulnerable sectors had not been efficiently established. For this reason, the Federation of Philippine Industries is advocating for the return of the Department of Industry instead of the current setup where the Department of Trade and Industry (DTI) handles both trade promotion and industry development programs but seemingly puts greater emphasis on market liberalization over domestic industrial development. For a long time now, no serious industrial development plan had been formulated to provide a strategic anchor for industry and a key guidepost for trade policy. The discredited Washington Consensus policy characterized by the idea of "let the market decide" seems to still prevail in the minds of the bureaucracy. This may have something to do or could be the motivation behind the failure to rectify a martial law aberration on the tariff-setting powers of the President which continues to persist up to this time. This issue is more thoroughly discussed by retired Supreme Court Justice Florentino P. Feliciano in his essay entitled "Deconstruction of Constitutional Limitations and the Tariff Regime of the Philippines: The Strange Persistence of a Martial Law Syndrome."

Following a re-configuration of economic governance structures, there is also a need to establish the Philippine Trade Representative Office in order that the formulation of trade policy and negotiating strategies also undergoes a process that is constitutionally compliant and accompanied by meaningful and genuine consultations. The passage of the Freedom of Access to Information Bill is a key component of this re-configuration.

In conclusion, the MFN tariff structure of the Philippines urgently needs to be re-calibrated. This re-calibration should create negotiating room in the multilateral trading system and provide policy space that will preserve industries and jobs, allow further investments now and in the future, deepen industrial development and assist in the much-needed revenue-raising activities of government. Trade policy should be coherent and closely aligned with a robust industrial development policy. The leeway for MFN rate adjustments available to us under the WTO must be optimized not only to help solve the current fiscal deficit problem but also to rectify imbalances in the comparative international tariff structures that put the country at a competitive disadvantage vis-à-vis both developing and developed countries exporting products to the Philippines. Otherwise, the country could be locked-in with an inflexible low tariff regime – depriving future economic managers of a basic tool for industrial development

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