

# Where Are We in Tariff Reform?<sup>1</sup>

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The tariff policy reform begun in the early 1980s is supposed to culminate in a uniform 5 percent tariff rate by 2004. The essay attempts to answer the following questions: How much distance has been covered toward achieving this goal? How serious are the recent attempts to derail the tariff reform program? Compared with previous liberalization phases, how feasible is the objective of attaining a uniform tariff rate? The paper ends with the proposal of a rule of thumb to follow in the final countdown to 2004.

**T**HE COUNTRY'S MANUFACTURING SECTOR HAS BEEN UNDERGOING substantial trade liberalization since the early 1980s with the end in view of correcting the growth-retarding effects of a protracted policy of import substitution (Medalla et al 1995). To this end, the government has committed itself to a unilateral trade reform policy (TRP) begun in 1981 and designed to culminate in a uniform tariff of 5 percent by 2004. The achievement of this bold policy objective will make the manufacturing sector the economy's most open sector. Traditional industries that can survive only in protected markets will give way to others that can stand the cold winds of world competition. This broad change in industrial configuration is expected to have important implications not only on the basic market orientation of the sector itself, but also on the economy's ability to attract foreign capital flows and to generate new jobs and create requisite skills.

After almost two decades of policy reform and four years before the end-date, the question of whether the stated objective of adopting a uniform tariff rate can be achieved may be posed. How far have we gone into the liberalization program? What else needs to be done? The

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present study reviews the current status of the country's tariff policy reform<sup>2</sup> and presents a simple formula to reach the uniform tariff rate.

#### CURRENT STATUS OF THE TARIFF REFORM PROGRAM

THE tariff reform program is currently in its third phase (TRP III) effected under a series of Executive Orders (EOs) designed to bring down tariffs to just two rates (10 percent for finished goods and 3 percent for intermediate goods and raw materials) in 2003 and eventually to a uniform 5 percent rate by 2004. Even before the end of Phase II in 1995, a number of EOs<sup>3</sup> were approved, which modified tariff rates on a number of imports and refined further the tariff schedule by reducing it to basically four tiers, as follows:

- 3 percent for raw materials and capital equipment not locally available
- 10 percent for raw materials and capital equipment locally available
- 20 percent for intermediate products
- 30 percent for finished goods

By comparing the distribution of tariffs by HS (Harmonized System) lines in 1995 and 1996 with that in 1990, one can observe a simplification of the tariff schedule from the clustering of tariff rates around these four rates (Table 1). Whereas in 1990, 23 percent of tariff lines were found in the 50 percent category and there was none in the 3 percent category, by 1996 they were distributed as follows: 39 percent at 3, 15 percent at 10, 19 percent at 20 and 24 percent at 30 percent tariff rates, with less than 1 percent at 50 percent.

Subsequently, in 1996, in line with the country's commitment to the World Trade Organization (WTO), the government eased restrictions on imports of agricultural products (with the exception of rice) and tariffed them under RA 8178 and EO 313 (July 1996). Moreover, EO 313 set two rates for products with Minimum Access Volume (MAV): a lower duty for imports within the MAV (in-quota rates) and a higher duty for those in excess of the MAV (out-quota rates). The latter could initially be set at a maximum of 100 percent for some products, but had to be phased down over five years. This tariffication explains the result-

**TABLE 1. Percentage Distribution of Tariff Rates by Tariff\* Lines  
1990, 1995, 1996**

Tariff Rates (%)	1990 (%)	1995 (%)	1996 (%)	1999 (%)	2000 (%)
0	0.53	—	—	—	—
3	—	34.99	39.19	51.27	51.20
5	0.68	0.25	0.21	1.14	2.25
7	—	—	0.17	3.98	10.69
10	20.43	16.11	14.54	13.47	17.03
15	—	—	—	10.93	7.31
20	20.56	17.98	19.47	15.99	8.35
25	—	—	0.02	0.04	—
30	19.76	28.19	23.58	0.76	1.10
35	0.11	0.14	0.02	0.04	0.04
40	8.78	0.67	0.56	0.53	0.20
45	0.03	0.04	—	0.53	0.54
50	23.11	1.63	0.82	0.36	0.32
>50	—	—	1.42	0.96	0.98

\*Tariff lines are according to the Harmonized System of tariff classification.

Source: Manasan and Pineda (1999), Annex Table 2, p. 57.

ing dispersion of tariff rates in 1996—albeit inconsequential in relative terms—beyond the maximum 50 percent rate, as seen from Table 1.

A series of EOs<sup>4</sup> issued in 1997 further refined the tariff structure. In 1998, two major changes were effected. EO 465 (13 January 1998) was designed to smoothen the schedule of tariff reduction, correct remaining distortions, as well as adjust the tariff reduction schedule in 23 priority sectors dubbed the 'export winners', and EO 486 (11 June 1998) was issued to modify the rates of residual items.

Furthermore, in line with the country's commitment to the ASEAN CEPT (Common Effective Preferential Tariff), four other EOs (EO 287, 453, 487, 488) were issued between 1996 and 1998 to effect the reductions in tariff.

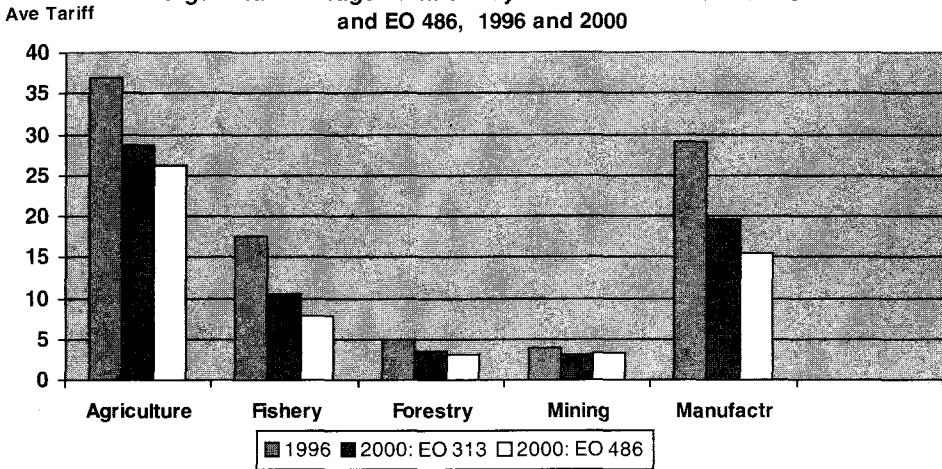
The Manasan-Pineda study examined in detail the changes in the country's tariff schedule resulting from EO 486 in 1998 relative to those

effected under EO 313 in 1996. Their main findings can be summarized as follows:

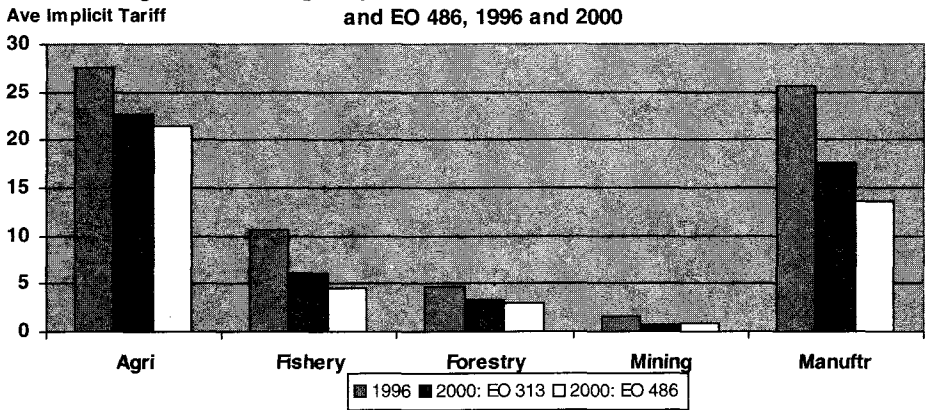
- As a result of EO 486 a greater reduction in overall levels of nominal, implicit and effective protection<sup>5</sup> in all the major input-output sectors has been effected, as compared to those scheduled in 1996 under EO 313. This can be observed from Figures 1a-c, which contrast the protection rates in 2000 under the two EOs .
- Reductions in nominal, implicit and effective protection are larger in the manufacturing sector than in the agricultural sector as a result of EO 486. Thus, the protective bias of the tariff schedule in favor of agriculture as against the manufacturing sector, which became apparent in 1995, is maintained well into 2000. This can be observed from the higher protection rates in agriculture relative to manufacturing in Figures 1a-c.
- However, while simplifying the tariff schedule—given the decline in the number of tariff lines from 5,721 under EO 313 to 5,627 under EO 486—EO 486 has resulted in a more dispersed distribution of tariff lines, with a penta-modal frequency distribution (3-7-10-15-20 percent) in contrast to the tri-modal distribution under EO 313 (3-10-20 percent). Thus, larger coefficients of variation are observed in nominal and implicit tariffs as a result of the introduction of intermediate rates under EO 486 designed to ‘smoothen’ the tariff schedule of EO 313. However, this dispersion continues to be largely limited to the agriculture and food processing sectors, due to the downward stickiness of high tariffs in these two sectors.
- While EO 486 will result in a more drastic reduction in nominal protection in 2000 compared to that scheduled under EO 313, marked exceptions result from EO 486 in the textiles, apparel and footwear sector and, to a certain extent, the furniture/fixtures sector. Figures 2a and c show a rise in these sectors’ nominal and effective protection rates (based on book rates) under EO 486, in contrast to the scheduled decline under EO 313. Similarly, implicit tariffs in 2000, while declining for the rest of the

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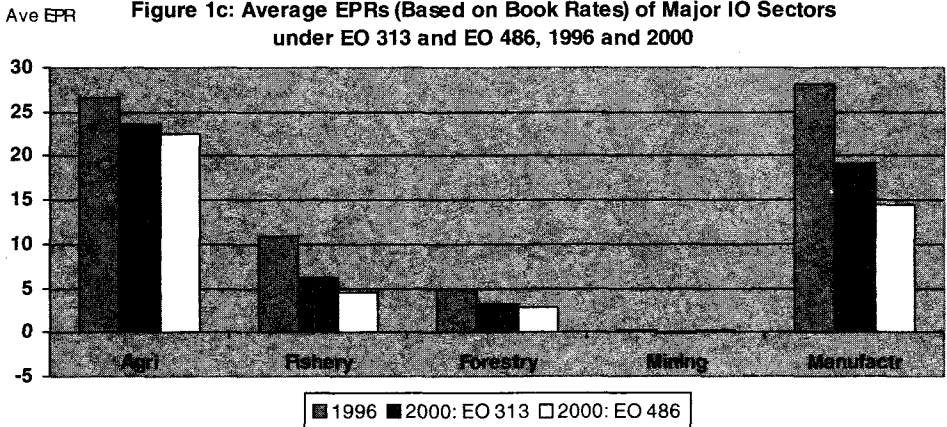
**Figure 1a : Average Tariff of Major IO Sectors under EO 313 and EO 486, 1996 and 2000**



**Figure 1b: Average Implicit Tariffs of Major IO Sectors under EO 313 and EO 486, 1996 and 2000**



**Figure 1c: Average EPRs (Based on Book Rates) of Major IO Sectors under EO 313 and EO 486, 1996 and 2000**



manufacturing industries, will be higher for textiles, apparel and footwear than in 1996 as a result of EO 486 (Figure 2b).

- Food processing remains the most protected sector in the manufacturing sector in 2000, under all measures of protection: nominal, implicit and effective (Figures 2a-c).
- Multilateral trade liberalization undertakings (for example, commitments under WTO or the APEC) are not expected to provide the driving force for further tariff reform in the agricultural and food processing sectors. They have either been less stringent than the country's unilateral tariff reductions or have had only a minimal impact on protection rates (for example, CEPT adjustments).

#### BACKTRACKING ON LIBERALIZATION

THERE has been a lot of legitimate apprehension that the current economic slowdown in the region and the country will be used as a convenient excuse by some sectors to clamor for either a slowing down, a

**A number of initiatives have been undertaken in the recent past, reflecting a dangerous trend toward a possible reversal of, or at least footdragging on, the liberalization program.**

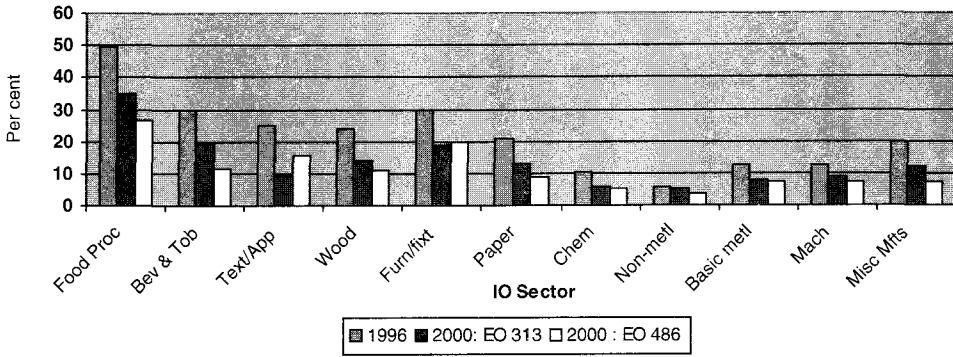
standstill or even a reversal of previous modifications in the tariff schedule, especially those achieved by TRP III. Indeed, while the tariff policy reforms have been believed to be 'irreversible' by a number of observers, recent developments indicate this not to be so. A number of initiatives have been undertaken in the recent past, reflecting a dangerous trend toward a possible reversal, or at least footdragging on, the liberalization program.

This can be seen from the following moves undertaken on behalf of certain interest-groups:

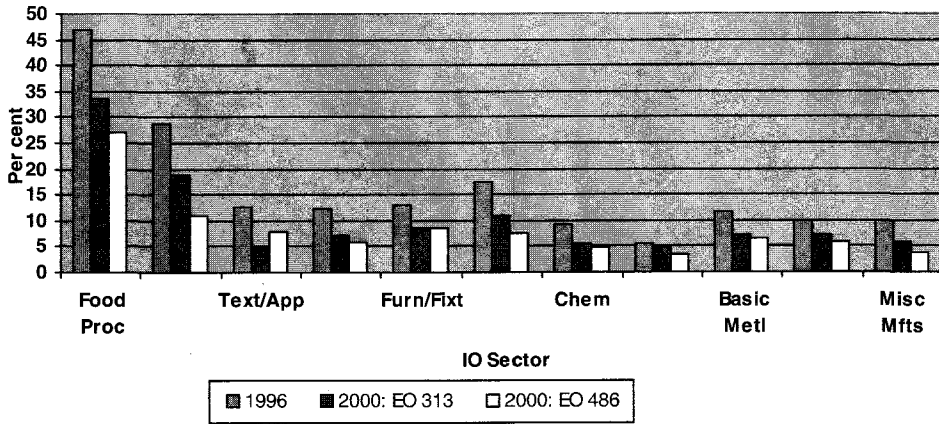
- Issuance of EO 63 in 18 January 1999, adjusting the tariff modifications in six industries: textile and apparel, iron and steel, pulp and paper, petrochemicals, batteries and pocket lighters.
- Administrative Order (AO) 58 asking for the creation of a Philippine Petrochemical Task Force (subsequently renamed Petrochemical Industry Competitiveness Board under AO 58-A)

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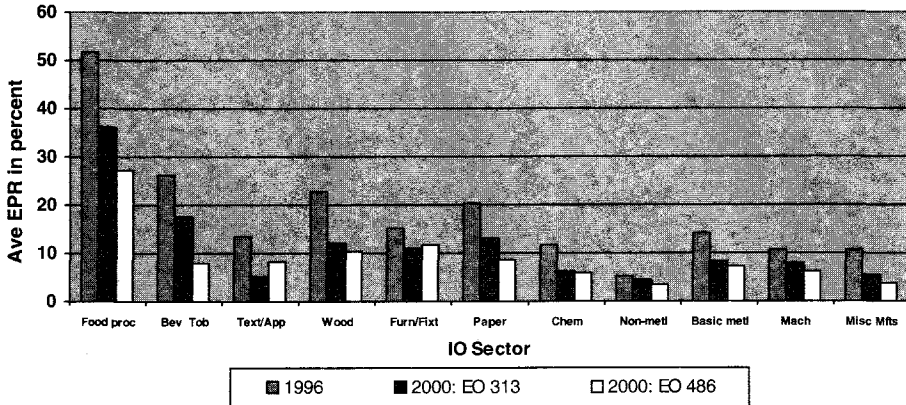
**Figure 2a : Average Tariffs of Manufacturing Industries under EO 313 and EO 486, 1996 and 2000**



**Figure 2b : Implicit Tariffs of Manufacturing Industries under EO 313 and EO 486, 1996 and 2000**



**Figure 2c: Average Tariffs-only EPRs under EO 313 and EO 486 1996 and 2000**



whose task is, among others, to 'effectively monitor and regulate the importation of petrochemical and plastic products'.

- A bill now pending in Congress seeking to mandate the use of coco-fatty alcohol sulfate/soft surfactants in the manufacture of soaps and detergents. The Act invokes the State's policy of encouraging the establishment of industries reliant on the use of raw materials and resources as well as on environmental reasons for the use of 'hard surfactants' or the banning of the sale of detergents containing such substances. While not in itself an attempt to alter previous tariff policy, it nevertheless constitutes yet another initiative—possibly protectionist under a 'green' garb—to ban the importation of chemicals other than coco fatty acids and/or soaps and detergents containing such other chemicals.

Because of the clear deviation of EO 63 from the general trend toward liberalization in the manufacturing sector as well as its preference for specific industries, we dwell at greater length on the implications of this Executive Order.

- EO 63 involves 719 HS lines<sup>6</sup> or 13 percent of a total of 5,627 tariff lines. The relevant sectors are found in 21 two-digit IO sectors in manufacturing, or 16 percent of a total of 132 sectors. Of the 719 HS lines, 684 lines concern goods from the textiles, apparel and footwear industries.
- Table 2 shows two-digit IO sectors in manufacturing affected by tariff adjustments under EO 63 as well as their corresponding rates before (EO 486) and after the change (EO 63). The rates generally went up in 1999, although there are only a few changes in 2000 because EO 63 reverted back to the scheduled tariff schedule under EO 486. The greatest changes in nominal protection (over 30 percent relative to nominal tariff under EO 486) are in textile spinning, weaving, texturizing (IO 69), artificial leather and coated fabrics (IO 76), and knitted fabrics (IO 70). As a result, nominal tariffs on apparel rose by 25 percent, that is, from 20 percent in 1999 under EO 486 to 25 percent under EO 63. Tariff rates on pulp and paper and on synthetic resins



**TABLE 2. Changes in Average Tariff Rates in Affected IO Sectors under EO 63, 1999 and 2000 (in percent)**

IO	Description	Ave. Tariff EO 486 1999	Ave. Tariff EO 63 1999	Percent Change in Ave. Tariff	Ave. Tariff EO 486 2000	Ave. Tariff EO 63 2000	Percent Change in Ave. Tariff
69	Textile spinning, weaving, texturizing	9.53	13.04	36.83	7.97	7.97	0.0
70	Fabric knitting mills	14.03	18.62	32.72	9.44	9.44	0.0
71	Hosiery, underwear, outerwear knitting	20.0	25.0	25.0	20.0	20.0	0.0
72	Made-up textile goods exc. wearing appl	18.89	23.50	24.40	18.62	18.62	0.0
73	Carpets & rugs	14.97	15.01	0.26	13.47	13.47	0.0
74	Cordage, rope, twine, net	10.27	10.36	0.88	10.27	10.27	0.0
76	Artificial leather & coated fabrics	14.29	19.0	32.96	9.59	9.59	0.0
77	Fibre batting, padding, upholstery	4.71	5.3	12.53	4.12	4.12	0.0
78	Custom tailoring & dressmaking	20.0	25.0	20.0	20.0	20.0	0.0
79	Ready-made clothing	20.0	25.0	25.0	20.0	20.0	0.0
80	Embroidery	18.77	23.77	26.64	17.54	17.54	0.0
81	Other wearing apparel exc. footwear	18.13	19.54	7.78	14.98	14.98	0.0
96	Pulp, paper, paperboard	8.03	8.55	6.48	6.71	6.71	0.0
102	Basic industrial chemicals	3.79	3.76	(0.79)	3.47	3.45	(0.58)
104	Synthetic resins, plastics materials, etc.	7.16	7.58	5.87	6.61	6.88	4.08
110	Chemical products	5.65	5.88	4.07	4.96	4.96	0.0
112	Asphalt, lubricants & petr & coal prods.	4.30	4.31	0.23	3.91	3.91	0.0
116	Plastic furniture, footwear, incl. supplies	12.30	12.34	0.33	8.61	8.61	0.0
125	Blast furnace, steelworks and roll	7.45	7.96	6.85	7.21	7.51	4.16
134	Other fabricated wire and coil prods.	15.79	25.82	0.19	13.40	13.42	0.15
148	Parts & supplies for radio, TV, comm.	10.93	10.92	8.89	8.58	8.58	0.0
169	Miscellaneous manufacturing	10.32	10.46	1.36	7,547.46	7.54	1.01

and plastic materials went up by 6 percent; on blast furnace, steelworks and rolling mills by 7 percent; and on parts and supplies for radio, television, communications by 9 percent.

- In terms of the frequency of distribution of tariff rate by HS lines, the effect of EO 63 has been to raise the share of those found in the 20-25 percent category from 16.03 percent to 20.93 percent.
- Average tariff level for the entire manufacturing sector rose by a mere 0.30 percentage points, from 18.24 percent under EO 486

to 18.54 percent for 1999. Average implicit tariffs based on price comparisons declined slightly to 15.43 percent under EO 63 (from 15.73 percent under EO 486) in 1999 and to 13.64 percent (from 14.10 percent) in 2000.

In all, because changes have been concentrated in only a few sectors, EO 63 appears to have had only minor effects on protection levels in the manufacturing sector as a whole. But the same cannot be said of specific sectors. More important, such attempts at changing tariff rates for specific sectors provides a dangerous precedent, because they represent an *ad hoc* approach to policy and render policy making vulnerable to lobbying behind closed doors.

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One goal of the tariff policy reform is precisely that of narrowing down inter-industry differences in protection that past policy regimes have perpetuated without providing any justification based on strict efficiency criteria. EO 63 raises tariffs for a number of imports that compete with domestic production in industries that vary from labor-intensive (for example, textile/apparel/footwear) to capital-intensive (for example, blast furnace and rolling mill products, wires, radio and TV parts) sectors, without any clear justification why they deserve to be allowed to deviate from the general policy stance of liberalization under the TRP. Moreover, attempts at changing the course of policy, such as that represented by EO 63, bypass the long-established and more transparent channels of policy making, which in the case of tariff policy making requires public hearings and the legislative process.

HOW FEASIBLE ARE THE TARGETS?

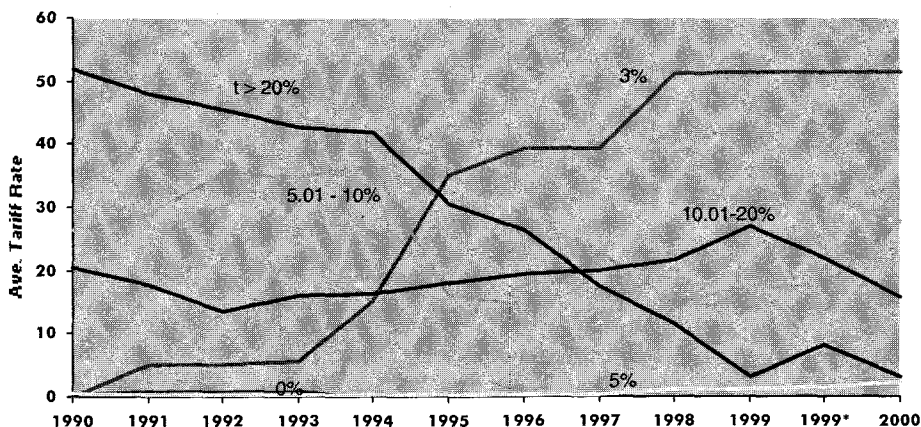
THE end-goal of the present tariff reform program is to arrive at a uniform tariff of 5 percent in 2004, with the intermediate goal of a two-tiered 3 percent and 10 percent tariff schedule by 2003. The question we pose at this point is whether there is a chance that the ultimate goal will be achieved by 2004, given the schedule of nominal tariffs in 2000.

To answer this question, we first examine how HS lines are distributed by tariff rates in 2000. The tariff rate distribution over the 1990s resulting from successive changes under various EOs is summarized in Figure 3. We noted earlier that although EO 63 raises the share of the 20-25 percent category in 1999, it nevertheless maintains the 2000 tariff schedule under EO 486 and thus hardly touches its scheduled frequency distribution in 2000. Figure 3 assumes that the tariff rates scheduled for 2000 prevail.

It can be seen from Figure 3 that by 2000, tariff lines will be concentrated in the 3 percent rate (51.2 percent of all HS lines) and the 5-20 percent rate categories (43.38 percent). Thus, if the 5 percent uniform tariff rate is to finally prevail from 2004 onwards, about 95 percent of all HS lines will have to be either raised from 3 percent or brought down from a maximum of 20 percent. The rest will comprise only about 5 percent of all HS lines: those above 20 percent (3 percent) and those at 5 percent (2 percent). This attests to the relative success of the ongoing tariff reform program in narrowing the tariff bands relative to their levels in 1990 in view of the intermediate goal of a two-tiered tariff schedule (3 percent and 10 percent) by 2003.

Are the tariff adjustments required to achieve a uniform rate of 5 percent in 2004 large and unprecedented? To answer this question, we examine the height of (manufacturing) tariffs in 2000 and then com-

Figure 3 : Distribution of HS Lines by Tariff Rates, 1990 - 2000



pare the magnitude of the tariff changes needed to adjust them to 5 percent with those already undertaken between 1996 and 2000.

From our computations<sup>7</sup> it is clear that the required percentage changes in tariff rates to achieve 5 percent by 2004 will be, without any exception, smaller than those that have already been undertaken under TRP III. This implies that the road to be traveled from 2000 to 2004 will be much shorter than that traveled between 1996 and 2000. However, it cannot be denied that the last downward (upward for those with current tariff rates below 5 percent) adjustments required under the new TRP phase will be the most difficult to undertake as these will involve adjustments in sectors that can be expected to resist it the most, namely, food processing, furniture and fixtures, textile and apparel, and beverages and tobacco, not to mention agriculture. On the other hand, the large peso depreciation has served as across-the-board protection to domestic industries against competition from imports. Also, it provides a boost to industries and firms that have already undertaken the consequent steps toward outward-orientation.

#### TOWARD A UNIFORM TARIFF RATE BY 2004

ASSUMING that the target of achieving a uniform tariff rate of 5 percent by 2004 is kept, policy makers will then have to decide on how best to achieve this. Some industries would prefer a 'sudden death' approach, wherein tariff rates are left unchanged until 31 December 2003 and are suddenly changed to 5 percent on the first day of 2004. A major objection to this approach is that it defeats the purpose of a phasing-in of the tariff reform, which requires that adjustment to the new environment be made as small discrete changes are introduced. With-

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out the adjustment process, industries may be much more tempted to lobby against the drastic tariff changes as the deadline draws near.

But although gradual, the reform process must be resolute and transparent.

A simple method that can be adopted will involve a 50 percent drop of tariff rates that are currently above 5 percent, and a rise in tariffs to 5 percent for those below. Thus, as an intermediate phase before 2004,

current rates of 30 percent, 20 percent and 10 percent rates will drop to 15 percent, 10 percent and 5 percent respectively, while those in the 3 percent category will rise to 5 percent. Then, in a final phase, all tariff rates will converge at 5 percent by 2004.

#### NOTES

1. The author acknowledges the financial assistance from AGILE (Accelerating Growth, Investment and Liberalization with Equity).

2. The paper draws heavily from the results of the Manasan-Pineda study (1999).

3. EO 189 (18 July 1994): capital equipment and machinery; EO 204 (30 September 1994): textiles, garments, and their chemical inputs; EO 227 (4 March 1995): cement; EO 264 (22 July 1995): 4,142 HS lines in the manufacturing sector; EO 288 (1 January 1996): non-sensitive agricultural products; EO 328 (23 April 1996): wheat EO 365 (August 1996): crude and refined petroleum.

4. EO 388 (21 January 1997): for 45 tariff lines, including flavoring materials, popcorn, feed additives, cement, green houses; EO 390 (17 January 1997): reducing duties on 6 HS lines, specifically on aluminum and compact discs media; EO 427 (21 July 1997): for 4 HS lines of tinplates, and tin-free steel; EO 429 (15 September 1997): decreasing tariff rates on 34 HS lines; EO 461 (31 December 1997): fixing tariff duties of 3 percent on imported crude oil and refined petroleum products.

5. Nominal protection is given by the nominal tariff rate, which is the rate of duty levied on imports of specified commodities. Implicit protection, on the other hand, is based on the implicit tariff rate which measures the extent to which the domestic price of a commodity exceeds its world or border price, as a result of quantitative restrictions and other protective instruments. Effective protection measures the extent to which the entire protection system increases a commodity's domestic value added (DVA) above its free trade value (FVA). This is measured for a given I-O sector  $j$  as follows:

$$EPR_j = [ (DVA_j - FVA_j) / FVA_j ] \times 100.$$

6. HS tariff lines with zero tariff in 2000 are not counted in the sum.

7. Results of computations for 130 IO sectors comparing the changes in tariff rates effected between 1996 and 2000 and those required to reach 5 percent by 2004 from the current rates in 2000 are available on request from the author.

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