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The Effects of Shifting to Transaction Value and Other Issues

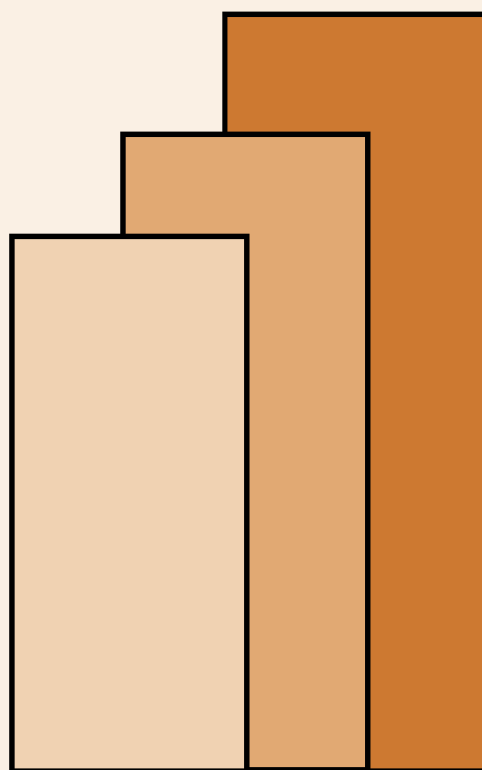
Erlinda M. Medalla and Leah Panganiban-Castro

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THE EFFECTS OF SHIFTING TO TRANSACTION VALUE AND OTHER ISSUES

*Erlinda M. Medalla
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Final Report

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ABSTRACT

This study takes off from an earlier inquiry on the effects of HCV (Home Consumption Value) Valuation (Medalla, De Dios, Aldaba, PITO-P, 1993). This study is intended to assist policymakers as well as the private sector in their task of deciding whether to implement or postpone the adoption of the GATT Valuation Code (GVC) by January 1, 2000. Under the GVC, the dutiable base for imports is defined as the “transaction value” – i.e., “the price actually paid or payable for imported goods”.

The major objectives of the study are as follows:

1. To determine the impact of the change in duty base (i.e., Home Consumption Value (HCV) to Export Value (EV)) on the incidence of underinvoicing. The indicator used for underinvoicing are the ratios of HCV and EV to the declared invoice value (IV).
2. To estimate the government revenue impact of the shift from Export Value (EV) to Transaction Value (TV) as the basis of import duties.

The raw data for this study was generated from the SGS-MLO (Societe Generale de Surveillance Manila Liaison Office) data warehouse. The data are contained in the Clean Report of Findings (CRFs) being issued by SGS to importers. It covers a five (5)-year period from July 1994 to May 1999. The period covers the shift in July 1996 from HCV (home consumption value) as the dutiable base to EV (export value). The raw data include the following information on imports on a monthly basis: CRF number, commodity classification using a two (2)- digit Harmonised System (HS) Code, HCV, EV, declared invoice value (IV) and country of origin.

The findings of the study support the argument that trade liberalization in the form of lower tariffs will reduce the incidence of underinvoicing. These findings are summarized below:

- There is an improvement, albeit small, in the number of CRFEs (CRF line entries or particular commodities being imported identifiable by its HS code) with $R=1.0$ (no underinvoicing) from 33.5% in July 1994-June 1995 to 38.8% in July 1998-May 1999;
- The number of CRFEs with $R>1.0$ (underinvoicing) dropped from 52.6% in July 1995-June 1996 to 43.0% in July 1997-June 1998; and,
- Overall weighted average ratios showed a tendency for importers to underinvoice - i.e., $R>1.0$. However, a declining trend was observed over the period July 1994-June 1998. The overall weighted average ratio fell from 1.10 in July 1994-June 1995 to 1.03 in July 1997-June 1998. The decline is less dramatic than expected inasmuch as certain sectors (e.g. “Agriculture”) still enjoy a significant amount of tariff protection.

Over the period being studied, underinvoiced commodities are mostly imported from the following countries: Hongkong (1.25), ASEAN excluding Singapore (1.17) and China (1.12).

The decline in government revenues due to the shift to a transaction value (TV) system is much less than feared. The study estimates of the decline in government revenues in 2000 (the first TV year) range from –3.3% assuming high import elasticity and –5.2% with low import elasticity. Assuming a uniform tariff level of 5.0% in 2000 instead of using weighted average tariffs, the study estimates of the decline in government revenues range from –3.3% to –4.6%.

In terms of peso value, the estimated decline in government revenues resulting from the shift to transaction value range from PhP 3.2 billion to PhP 5.2 billion. Assuming a uniform tariff of 5%, the estimated drop in government revenues range from PhP 2.7 billion to PhP 3.7 billion.

The study identified the following advantages under the GVC regime:

- a.) Trade facilitation;
- b.) Relative clarity in the determination of dutiable base;
- c.) Increased government revenues in the long-run;
- d.) Increased self-compliance of both the Bureau of Customs (BOC) and importers;
- e.) Greater possibility of synergistic cooperation between the BOC and the Bureau of Internal Revenue (BIR); and,
- f.) Provides the BOC with the opportunity to reinvent itself into a new, clean and efficient agency.

Implementing GVC is without potential losses. The potential losses identified by this study are as follows:

- a.) gross underinvoicing at the onset to establish the transaction value of an imported commodity;
- b.) overinvoicing when duty drawbacks exist; and,
- c.) rent-seeking inasmuch as the discretion of Customs is resorted to in some cases.

Based on the findings of this study and as long as the legal framework and institutions for WTO compliance are in place the gains from implementing GVC outweighs the potential losses.

THE EFFECTS OF SHIFTING TO TRANSACTION VALUE & OTHER ISSUES

1.0 BACKGROUND

In 1947 the General Agreement on Tariffs and Trade (GATT) was signed and put in place. GATT Article VII defines the dutiable basis of imports as the transaction value - i.e., “the price actually paid or payable for imported goods”. This standard valuation was established for the purpose of creating a sense of fairness among exporters and importers. Unfortunately, no multilateral organization was established to implement GATT much more the standard customs valuation defined by Article VII. Unlike the International Monetary Fund (IMF) and International Bank for Reconstruction and Development (IBRD now the World Bank), the proposed International Trade Organization (ITO) was never set up.

An effort was made to set a standard customs valuation during the 1953 Convention on the Valuation of Goods for Customs Purposes. The said convention established the Brussels Definition of Value (BDV) system. The BDV system is based on a notional value of the prices of goods on sale in the open market under specified conditions. In practice, BDV can raise the price of an imported good for purposes of customs valuation and may substantially differ from what was paid or payable. BDV favoured protectionist regimes and countries with huge fiscal deficits whose major source of financing is tariffs. The BDV system goes against the free trade spirit of GATT.

In the Philippines, customs valuation for seven decades was based on Home Consumption Value (HCV). The HCV system was found to further distort the country’s protection structure (Medalla, De Dios, Aldaba, 1993). All this, however, changed in 1994 with the signing of the Agreement on the Implementation of Article VII of GATT and in 1995 with the creation of the World Trade Organization (WTO). Article VII of

GATT is also referred to as the GATT Valuation Code (GVC). The WTO is the ITO that never was - a multilateral institution empowered to enforce GATT principles.

The GVC is an attachment to the WTO agreement. It was in place in 1979 and until 1994 was enforced in mostly industrial countries. GVC assumes that its members engage in “bonafide trade” or to put it simply “honest trade”. Critics find this difficult to accept because in the real world some may not be as honest as others.

The Philippines being a founding member had to align its legal framework for international trade with that of the WTO. On March 28, 1996, Congress approved Republic Act (RA) No. 8181 changing the dutiable base of imported goods from HCV to transaction value (TV) effective on or before January 1, 2000. RA 8181 also amends Section 201 of Title II, Part I of Presidential Decree (P.D.) 1464 or the Tariff and Customs Code of the Philippines. However, Section 2 of the said RA provided for a transition period before Congress authorizes the shift on January 1, 2000. During the transition period, the Export Value (EV) will be used as basis of import duties. The EV is defined as the price “at the time of exportation, the same or identical, like, or similar article is freely offered for sale in the principal export markets of the exporting country for exportation to the Philippines, in the usual wholesale quantities and in the ordinary course of trade...”. Both the HCV and EV are variants of BDV.

The objectives of the study are as follows:

1. To determine the impact of the change in duty base (i.e., Home Consumption Value (HCV) to Export Value (EV)) on the incidence of underinvoicing;
2. To estimate the government revenue impact of the shift from Export Value (EV) to Transaction Value (TV) as the basis of import duties;
3. To discuss the potential impact on so-called “suspense regimes” (i.e., customs bonded manufacturers’ warehouse, duty-drawbacks etc.);

4. To be able to assist policymakers as well as the private sector in their task of deciding whether to implement or postpone the adoption of GVC by January 1, 2000.

2.0 CONCEPTUAL FRAMEWORK

The rationale behind GATT Article VII (GVC) as mentioned earlier is to establish a standard of valuation to ensure fair treatment of exporters and importers. WTO members will adhere to the same valuation system and valuation will not be used as a tool to create trade barriers. Also, that trade is undertaken by most if not all WTO countries with a relatively high degree of honesty.

Apart from curbing protectionist tendencies, the shift to TV is expected to greatly facilitate trade transactions and thereby reduce the cost of doing business here in the Philippines. One problem that is always pointed out with the shift to TV is the possibility of massive underinvoicing that could result. The incidence of underinvoicing is influenced by the following: level of tariffs and other taxes and the dutiable base. Reductions in tariff, other taxes and the dutiable base is expected to result in lower incidence of underinvoicing - i.e., a more honest declaration of import values.

The 1993 Medalla et al study concluded that the government revenue losses with the shift from HCV to TV will be less than expected and even less so with an intermediate shift to EV. In the long-run, it is expected that increased import volumes resulting from lower importation costs (i.e., tariffs, other taxes, non-tariff barriers, dutiable base) and improved tax administration will compensate for the reduction in tariffs and dutiable value. More than six years have passed since the estimate was made. Will more recent evidence support such findings? Or will the shift from the present transition valuation, EV, to the ultimate, TV, result in more significant revenue losses than expected?

The shift to TV as dutiable base would have been less of an issue if the 1997 Asian financial crisis did not occur. The recent financial crisis (despite signs that it has bottomed out) is being used as an excuse to delay further trade reforms - i.e., further tariff reductions, removal of remaining non-tariff barriers (NTBs), shift to TV. Issues, among others, that could make the decision to shift to TV by January 1, 2000 a bit difficult are as follows:

- Rising protectionism.

Since TV is expected to be less than EV, using TV as dutiable base will allow goods to be “dumped” in the country to the detriment of local industries. Particularly industries still “reeling from the impact of the recent financial crisis”.

- Reduced government revenues.

The shift to TV will result in lower government revenues since TV is expected to be a lower dutiable base compared to EV. This is bad news considering the country’s rather large current fiscal deficit.

- Underinvoicing.

Will the shift to TV substantially increase the incidence of underinvoicing? Importers will be encouraged to declare at the onset an invoice value much lower than TV. This is to ensure that future shipments will be evaluated on the basis of this initial invoice value. At worst, all declared import prices is expected to fall substantially. Underinvoicing might be difficult to establish.

3.0 METHODOLOGY

3.1 HCV/IV and EV/IV Ratios

To assess the impact of the shift in customs valuation from the current BDV-like system (export value) to the GATT valuation code (transaction value), the basic approach of the study is to measure the gap between the SGS-CRF (Clear Report of Finding) value with that of the declared invoice value. Such a gap could be interpreted in two ways. One, it could indicate the relative "honesty" of importers in declaring import value (the lower the gap, the more "honest"). Two, if indeed the importer was honest in his declaration but was still subjected to an uplift in the valuation, then the gap represents an additional (implicit) tax. Whether it is one or the other would vary from case to case and without any hard data, it is difficult to make a definite judgement.

The 1993 Medalla et al HCV study measured the ratio of HCV to IV to assess the impact of the HCV valuation system on protection. The study argued that a valuation base different from the "true transaction value" (TV) implies a different tax rate. Since the HCV was not merely a pre-audit tool but one meant to uplift import valuation, importers in general pay relatively higher taxes than they should. The effective tax rate was defined by the 1993 Medalla et al HCV study as:

$$te = t(HCV)/TV = t(HCV/TV) = t(1+h)$$

$$\text{where } HCV/TV = 1 + h$$

Tariff protection is thus increased by $(1 + h)$.

It could very well be that the declared IV is also nowhere near its "true transaction" value. However, there is some difficulty in documenting the true transaction of an imported commodity. Furthermore, as earlier pointed out, whether or not the declared IV is the "true transaction" value, the shift in valuation would definitely change

(in most cases, lower) the customs valuation base from EV to IV. Thus, as in the 1993 Medalla et al HCV study, this study will use the observed HCV/IV (for earlier period as effective) and EV/IV (for the latter period) to measure the impact on customs valuation and the attendant impact on government revenues.

In July 1996, RA 8181 mandated the use of the Export Value (EV) as the dutiable base in the transition period before the shift to the transaction value system in January 1, 2000. The EV is defined by RA 8181 as the wholesale price, at the time of exportation to the Philippines, of the same or identical, like, or similar commodity that is being freely offered for sale by the exporting country to its principal export markets and in the ordinary course of trade. This is different from HCV, which was defined as the wholesale price of the commodity in the exporting country.

We expect that EV is closer to the true transaction value (TV) of the imported commodity than HCV - i.e., $IV < EV < HCV$, although some variation could actually result since, in practice, the assessed values could feasibly come from similar sources. HCV, EV and IV are expressed in FOB terms.

The HCV/IV ratio will be estimated for the periods July 1994-June 1995 and July 1995-June 1996. The EV/IV ratio will be estimated for the periods July 1996-June 1997, July 1997-June 1998 and July 1998-May 1999. Both ratios will be used to assess the impact of the change in dutiable base on the incidence of underinvoicing.

The ratios will be expressed in terms of simple averages and weighted averages for each commodity grouping. The weights used will be each commodity's share of the total import value. Commodities are classified using the Harmonized System (HS) code and matched with its corresponding Philippine Standard Commodity Classification Code (PSCC) and UN Standard International Trade Classification (SITC).

3.2 Estimating Government Revenue Impact

A major issue raised with regards to the shift to a transaction valuation system is the potential drop in government revenues. This is based on the expectation that using transaction value under the GVC would result in a generally lower customs valuation base. This is primarily due to fears (whether real or imagined) that all importers - having a simplistic interpretation of “transaction value” as whatever is declared on the invoice will be accepted - will undervalue at the onset.

As in the 1993 Medalla et al HCV study, this TV study will estimate revenue changes using trade elasticities. Trade elasticity estimates of GATT, R. Bautista will be used. These are given in the Table 1 below:

TABLE 1: ELASTICITY ESTIMATES - GATT (1985) AND R.M. BAUTISTA (1977)

SITC	GATT, 1985			R.M. BAUTISTA, 1977
	Low	High	Median	
0	- 0.9	- 1.59	- 0.78	- 1.236
1				- 0.462
2	- 0.17	- 1.15	- 0.50	
3	- 0.10	- 2.78	- 0.96	- 1.206
4	(Included in SITC 2)			- 0.015
5				- 0.383
6				- 4.260
7	- 0.74	- 2.64	- 1.34	- 0.703
8				- 0.422
9				
All	- 0.42	- 1.37	- 1.06	

The study will look at the case where the shift in dutiable base is from EV to IV. As earlier suggested, it is assumed that IV closely approximates the true transaction value of the commodity. Regardless of whether the gap between the SGS-CRF value and the declared invoice value indicate relative “honesty” of importers or an additional (implicit) tax, the shift in valuation would definitely change (in most cases, lower) the dutiable base from EV to IV. Thus, in determining the impact of the shift in revenues, it would be appropriate to use the computed EV/IV ratio.

The formulas for estimating the impact on government revenues of the shift to transaction value is shown below:

a.) Change in revenue from import of commodity i

$$\Delta R_i/R_i = h_i/(1 + h_i) \{ e_{mi} t_i / [1 + (1 + h_i) t_i] - 1 \}$$

where R refers to government revenue
h refers to the EV/IV ratio-1
i refers to sector i
e refers to import elasticity, and
t refers to the applicable tariff rate.

b.) Total percentage change in revenue is estimated by the weighted average percentage change for all commodities using their respective share in revenues as weights ($w_i = t_i m_i / \sum t_i m_i$). This gives:

$$\Delta R/R = \sum (\Delta R_i / R_i) w_i$$

Annex B gives the derivation of the above formulas.

Average tariffs used in the revenue change estimation are derived by taking the average tariff per HS Chapter. The case whereby a 5.0% uniform tariff level is assumed will also be looked into.

3.3 Raw Data Source

3.3.1 Raw Data Description

The raw data for this study was generated from the SGS-MLO (Societe Generale de Surveillance Manila Liaison Office) data warehouse. The data are contained in the Clean Report of Findings (CRFs) being issued by SGS to importers. About half of total imports pass through the SGS system of selected pre-shipment inspection, clearance on goods classification, description and valuation. This system is officially referred to as

SPACS or Selected Pre-Shipment Inspection and Advance Clearance System. SPACS is a contract with the Philippine government through the Department of Finance (DOF), Department of Trade and Industry (DTI) and Bangko Sentral ng Pilipinas (BSP). SGS involvement with the Philippine government began in 1986 with a contract then known as CISS or Comprehensive Import Supervision Service. Imports that do not pass through the SGS system as per amended Joint Order 1-91 dated March 16, 1998 are as follows, among others:

- a.) Crude oil and petroleum products in bulk excluding petrochemicals and their products, petroleum additives and lubricating oils;
- b.) Fresh, frozen or chilled foodstuff and fruits;
- c.) Live animals;
- d.) Goods with FOB value of less than US\$ 500.00 (does not apply to goods declared as off-quality, off-grade, reconditioned, substandard, not of prime quality);
- e.) Goods directly imported by the government or any of its corporation, agencies and instrumentalities;
- f.) Goods imported through export processing zones (EPZAs); and,
- g.) All duty and tax exempt shipments including those that go through CBMWs (Customs Bonded Manufacturing Warehouse).

A complete list is given in Annex A. Most of the items in the said list are commodities that enjoy import duty exemption or duty drawback privileges.

The raw data provided by SGS covers a five (5)- year period from July 1994 to May 1999. The period covers the shift in July 1996 from HCV (home consumption value) as the dutiable base to EV (export value). The period covered is broken down as follows: July 1994-June 1995, July 1995-June 1996, July 1996-June 1997, July 1997-June 1998 and July 1998 to May 1999.

The SGS raw data include the following information on imports on a monthly basis: CRF number, commodity classification using a two (2)- digit Harmonized System (HS) Code, HCV, EV, declared invoice value (IV) and country of origin. All import values are expressed as “free on board” (FOB).

The SGS opinion on valuation in the CRF (whether HCV or EV) is nothing more than a reference value for the use of the Bureau of Customs (BOC) in its attempt to arrive at a correct import valuation. BOC is not obligated to automatically adopt the SGS-CRF value. As a result, the SGS-CRF indicates “duties payable” which may not be equal to actual duties paid. According to SGS, however, of total imports covered by CISS/SPACS about 98.5% of SGS-CRF opinion on valuation are accepted by BOC. The remaining 1.5% goes through the appeals process.

The SGS raw data generated included only CRF line entries (CRFEs) with data on HCV, EV and IV for each period for each CRF printed and issued by SGS. The data excludes cancelled CRFs. The number of CRFs generated with data on HCV, EV and IV total 215,078 accounting for 14.6% of total CRFs processed by SGS (1,470,491) over the period July 1994-May 1999. A CRF line entry (CRFE) refers to a particular commodity being imported identifiable by its HS Code. Each CRF document may contain several line entries if for instance different types of goods are imported by a single importer in a single shipment. The SGS generated raw data include 786,300 CRFEs for the period July 1994 to May 1999. The breakdown per period is shown in Table 2.

TABLE 2: TOTAL NUMBER OF CRFEs BY PERIOD,
JULY 1994 TO MAY 1999

Period	Total CRFEs
July 1994-June 1995	194,538
July 1995-June 1996	293,884
July 1996-June 1997	154,817
July 1997-June 1998	69,384
July 1998-May 1999	73,677
Total CRFEs	786,300

The total number of CRFEs declined substantially (55.2%) in July 1997-June 1998 from the previous period. The decline is due to:

- a.) the financial crisis that began with the peso devaluation in July 1997;
- b.) deviation of imports to Customs Bonded Manufacturers' Warehouses (CBMWs) and Export Processing Zones/Special Economic Zones; in 1998, the volume of import entries going through warehousing increased by 31.4% (BOC Annual Report 1998); and,
- c.) lumping of shipments in the first half of 1997 (January-June 1997).

3.3.2 Raw Data Limitations

The SGS MLO database sources its information on HCV and EV from affiliates worldwide. One of the SGS affiliates' main tasks is to provide SGS opinion on the value of specific types of imported commodities. Thus, there are no zero HCV or EV in the raw data field generated. Also, valuation data sourced from affiliates are available up to the 8-digit HS code level of disaggregation. However, they are not mandated to input data on declared invoice value (IV) on a per commodity basis (i.e., 8-digit HS Code). Thus, the occurrence of significant IV=0 in the data field generated on a per commodity basis – 64% as a proportion of total CRFEs.

Total IV, on the other hand, is available on a per CRF document basis. Note, however, that IV on CRF documents represent total import value of a particular shipment by an importer and may include values of different types of commodities (i.e., different HS codes). Total IV per CRF was arrived at by sorting the raw data by CRF document number. The results are shown in Table 3. The table shows occurrence of zero IV values resulting from the fact that (as mentioned earlier) SGS affiliates are not mandated to input IV values. The number of CRFs without total IV value is negligible at 1.26% of the total number. CRFs with total IV values account for 98.74% of the total number.

TABLE 3: CRF DOCUMENTS WITH AND WITHOUT DECLARED
TOTAL INVOICE VALUES, JULY 1994 TO MAY 1999

Period	CRFs , IV = 0	% Share in Total	CRFs , IV > 0	% Share in Total	Total CRFs
July 94-June 95	346	0.61%	56,613	99.39%	56,959
July 95-June 96	805	1.03%	77,727	98.97%	78532
July 96-June 97	15	0.05%	32,963	99.95%	32,978
July 97-June 98	692	1.97%	34,514	98.03%	35,206
July 98-May 99	856	7.51%	10,547	92.49%	11,403
Total CRFs	2,714	1.26%	212,364	98.74%	215,078

The next step was to allocate computed IV values for each commodity item defined by its HS Code within each CRF covering more than one HS classification. This was done by computing the share of each commodity's HCV or EV in the total value for each CRF. The percentage (%) share was then used as weights to pro-rate total IV to each commodity item in each CRF. After having done so, the raw data was sorted by HS code and the results are shown in Table 4. The number of CRFEs without IV values is negligible at 1.7% of the total number. CRFEs with IV values account for 98.3% of the total number.

TABLE 4: CRF LINE ENTRIES WITH AND WITHOUT DECLARED
INVOICE VALUES, JULY 1994 TO MAY 1999

Period	CRFEs , IV=0	% Share in Total	CRFEs , IV>0	% Share in Total	Total CRFEs
July 94-June 95	1,533	0.79%	193,005	99.21%	194,538
July 95-June 96	1,339	0.46%	292,545	99.54%	293,884
July 96-June 97	137	0.09%	154,680	99.91%	154,817
July 97-June 98	5,652	8.15%	63,732	91.85%	69,384
July 98-May 99	4,739	6.43%	68,938	93.57%	73,677
Total CRFs	13,400	1.70%	772,900	98.30%	786,300

4.0 STUDY FINDINGS AND ANALYSIS

4.1 HCV/IV and EV/IV Ratios: Incidence of Underinvoicing

HCV/IV and EV/IV ratios (R) were computed on a per CRF basis. $R < 1.0$ indicates overinvoicing while $R > 1.0$ indicates underinvoicing. $R = 1.0$ indicates "honesty" on the part of importers. Cases with extreme ratios were observed – i.e., insignificant

ratios ($R < 0.01$) or very large ones ($R > 10$). A subset was created to be used in the study for analysis. This subset is selected by excluding CRFs with $IV = 0$ (i.e., where the invoice values were not properly recorded) and CRFs with "inexplicable" ratios. The latter includes those with ratios less than 0.5 and ratios greater than 5. After such deletion, the number of remaining observations in the subset used is reduced to 165,503 or 77% of total CRFs. Acceptable CRFs cover 77.5% of total CRFEs (i.e., 609,120).

The distribution of CRFEs by ratios for the period July 1994 to May 1999 is shown in Table 5. The share of CRFEs with $R > 1.0$ declined albeit slowly beginning July 1996 only to rise to 47.4% during the period July 1998-May 1999 – the same share in July 1994-June 1995. Taken by regimes, the share of CRFEs with $R > 1.0$ was more or less constant - ranging from 47.5% to 52.6% during the HCV regime and 43.0% to 49.2% during the EV regime. But the degree of honesty improved with the share of CRFEs with $R = 1.0$ increasing to 38.8% in July 1998-May 1999 from 33.5% in July 1994-June 1995. The period July 1996-June 1997 is rather an exception since there were more instances of overinvoicing than underinvoicing. The share of CRFEs with $R < 1.0$ increased substantially to 40.9% from 15.4% during the previous period!

TABLE 5: CRFEs WITH RATIOS $<$, $=$ OR > 1.0 , JULY 1994 TO MAY 1999

Period	CRFEs, $R < 1$	% Share in Total	CRFEs, $R = 1$	% Share in Total	CRFEs, $R > 1$	% Share in Total	TOTAL
HCV Regime							
July 94-June 95	27,390	19.01%	48,215	33.47%	68,456	47.52%	144,061
July 95-June 96	35,184	15.40%	73,058	31.98%	120,188	52.61%	228,430
EV Regime							
July 96-June 97	50,636	40.90%	12,279	9.92%	60,896	49.18%	123,811
July 97-June 98	10,573	22.02%	16,782	34.95%	20,665	43.03%	48,020
July 98-May 99	8,904	13.74%	25,152	38.82%	30,742	47.44%	64,798
TOTAL	132,687		175,486		300,947		609,120

The phenomena observed during the period July 1996-June 1997 can be explained in terms of the impact of the exchange rate on import valuation. July 1996-June 1997 is the period immediately preceding the onset of the Asian financial crisis and the fall of the peso-dollar exchange rate in July 1997. Pressure on the overvalued peso may have been already mounting during this period. If the premium on the exchange rate is higher than

the tariff on a particular commodity, a tendency to overinvoice ($R < 1$) is expected. As the Philippine peso stabilized, the incidence of overinvoicing dropped substantially to 13.7% in July 1998-May 1999 from 40.9% in July 1996-June 1997.

Acceptable CRFEs were classified by SITC commodity group. The distribution is shown in Table 6. For all periods, “machinery & transport equipment” account for the largest average share at 44.6% followed by “manufactured goods classified chiefly by material” (23.2%) and “chemicals & related products, nes” (12.7%).

TABLE 6: DISTRIBUTION OF ACCEPTABLE CRFEs BY SITC COMMODITY GROUP

SITC	DESCRIPTION	NUMBER OF CRFE's				
		July 1994- June 1995	July 1995- June 1996	July 1996- June 1997	July 1997- June 1998	July 1998- May 1999
		<i>HCV Regime</i>		<i>EV Regime</i>		
0	Food and Live Animals	2,976	4,269	1,281	1,891	2,932
1	Beverages & Tobacco	148	238	74	140	770
2	Crude Materials, Inedible, except Fuels	15,606	16,689	2,199	1,505	946
3	Minrl Fuels, Lubricants & Related Mat'l	191	454	246	231	150
4	Animal & Veg Oils, Fats & Waxes	124	290	81	94	99
5	Chemicals & Related Products, Nes	17,528	27,910	8,498	8,276	9,660
6	Manuf Goods Classified Chiefly by Mat'l	40,129	58,170	18,834	10,954	16,072
7	Machinery & Transport Equipment	51,484	95,013	84,230	19,131	24,360
8	Miscellaneous Manufactured Articles	15,875	25,397	8,368	5,798	9,809
ALL COMMODITIES		144,061	228,430	123,811	48,020	64,798
SITC	DESCRIPTION	PERCENT SHARE (%)				
		July 1994- June 1995	July 1995- June 1996	July 1996- June 1997	July 1997- June 1998	July 1998- May 1999
		<i>HCV Regime</i>		<i>EV Regime</i>		
0	Food and Live Animals	2.07	1.87	1.03	3.94	4.52
1	Beverages & Tobacco	0.10	0.10	0.06	0.29	1.19
2	Crude Materials, Inedible, except Fuels	10.83	7.31	1.78	3.13	1.46
3	Minrl Fuels, Lubricants & Related Mat'l	0.13	0.20	0.20	0.48	0.23
4	Animal & Veg Oils, Fats & Waxes	0.09	0.13	0.07	0.20	0.15
5	Chemicals & Related Products, Nes	12.17	12.22	6.86	17.23	14.91
6	Manuf Goods Classified Chiefly by Mat'l	27.86	25.47	15.21	22.81	24.80
7	Machinery & Transport Equipment	35.74	41.59	68.03	39.84	37.59
8	Miscellaneous Manufactured Articles	11.02	11.12	6.76	12.07	15.14
ALL COMMODITIES		100.00	100.00	100.00	100.00	100.00

The simple and weighted averages of HCV/IV and EV/IV ratios by SITC commodity group for the period July 1994-May 1999 is shown in Table 7. Note that the ratios were weighted by the share of commodities in total imports for each commodity group. It is assumed that particular types of commodities are likely to be over- or under-invoiced compared to others. Overall simple average ratios (i.e., for all commodity groups) are higher than the overall weighted average ratios. This implies that larger shipments have relatively lower ratios. This is not surprising since large global as well as domestic firms are less likely to commit fraud. There is a general tendency to underinvoice (based on the overall weighted average ratios), the extent of which for the five (5)-year period under study ranges from 2.9% to 10.1%.

A declining trend is observed with regards to the overall weighted average ratios (i.e., for all commodities) for the five- (5) year period under study (see Table 7). The overall weighted ratio dropped from 1.10 in July 1994-June 1995 to 1.03 in July 1997-June 1998. The decline in the said ratios indicates that by reducing tariffs importers' incentive to underinvoice was dampened. The government's trade reform program (TRP) has reduced the incidence of underinvoicing although not as dramatic as expected. The less than dramatic decline in the overall weighted average ratios can be explained by the fact that certain sectors (e.g. "Agriculture") still enjoy a significant amount of tariff protection.

In July 1998-May 1999, the overall weighted ratio increased to 1.06 from 1.03 in the previous period probably as protectionist sentiments surfaced and as people gets used to the new system. The resurgence of protectionism is evidenced by increases in tariff on selected commodities albeit temporary. This will be discussed further in Section 4.2.

Overall weighted average HCV/IV ratios for the period July 1994-June 1996 (i.e., the HCV regime) are higher than the overall weighted average EV/IV ratios for July 1996-June 1999 (i.e., the EV regime). The overall weighted ratio dropped as the dutiable basis changed from HCV to EV in July 1996 - from 1.09 to 1.06 (see Table 7). This implies that EV is much closer to the true transaction value (TV) than HCV. The said

ratio is expected to drop further as the Bureau of Customs implements the necessary supplementary measures and a learning process takes place.

TABLE 7: SIMPLE AND WEIGHTED HCV/IV AND EV/IV RATIOS BY COMMODITY GROUP,
JULY 1994 TO MAY 1999

SITC	DESCRIPTION	Simple Average				
		July 1994- June 1995	July 1995- June 1996	July 1996- June 1997	July 1997- June 1998	July 1998- May 1999
		HCV/IV		EV/IV		
0	Food and Live Animals	1.218	1.164	1.212	1.086	1.116
1	Beverages & Tobacco	1.157	1.032	1.096	1.235	1.055
2	Crude Materials, Inedible, except Fuels	1.099	1.115	1.149	1.013	1.063
3	Minrl Fuels, Lubricants & Related Mat'l	1.048	1.085	1.117	1.043	1.009
4	Animal & Veg Oils, Fats & Waxes	1.141	1.106	1.134	0.994	1.019
5	Chemicals & Related Products, Nes	1.056	1.115	1.061	1.049	1.090
6	Manuf Goods Classified Chiefly by Mat'l	1.125	1.083	1.062	1.016	1.156
7	Machinery & Transport Equipment	1.009	0.964	1.074	1.102	1.042
8	Miscellaneous Manufactured Articles	1.159	1.198	1.188	1.050	1.293
ALL COMMODITIES		1.127	1.119	1.126	1.048	1.142
SITC	DESCRIPTION	Weighted Average				
		July 1994- June 1995	July 1995- June 1996	July 1996- June 1997	July 1997- June 1998	July 1998- May 1999
		HCV/IV		EV/IV		
0	Food and Live Animals	1.105	1.071	1.037	1.026	1.050
1	Beverages & Tobacco	1.117	0.993	1.032	1.078	1.025
2	Crude Materials, Inedible, except Fuels	1.095	1.127	1.087	1.019	1.076
3	Minrl Fuels, Lubricants & Related Mat'l	1.048	1.085	1.117	1.043	1.009
4	Animal & Veg Oils, Fats & Waxes	1.141	1.106	1.134	0.994	1.019
5	Chemicals & Related Products, Nes	1.105	1.159	1.018	1.053	1.081
6	Manuf Goods Classified Chiefly by Mat'l	1.078	1.105	1.011	1.012	1.065
7	Machinery & Transport Equipment	1.057	1.052	1.002	1.014	1.050
8	Miscellaneous Manufactured Articles	1.164	1.161	1.151	1.027	1.183
ALL COMMODITIES		1.101	1.095	1.065	1.029	1.062

The 1993 Medalla et al HCV study used a different database such that comparing results with this study should be done with caution. However, it is worth noting the results of the said earlier HCV study. The 1993 HCV study covered the period September 1991 to February 1993. The period coverage was divided into two, as follows: September 1991-March 16, 1992 or the so-called CISS period and March 17, 1992-February 1993 or

the so-called Global CISS (GCISS) period. The period breakdown was meant to capture the expansion in the country coverage of the SGS CISS contract. Overall weighted average HCV/IV ratios computed were as follows: 1.07 for CISS and 1.11 for GCISS. These ratios are close to the current study's estimates.

The commodity group with the highest ratio for the five (5)-year period is "miscellaneous manufactured articles" at an average weighted average of 1.14 (see Table 7) followed by "chemicals & related products" (1.08) and "crude materials, inedible, except fuels" (1.08). During both the HCV and EV regimes, the commodity group with the highest ratio is "miscellaneous manufactured articles" at 1.16 and 1.12, respectively.

The ratios derived by the 1993 HCV study and the current study, are crude measures of improvement in "relative honesty" among importers. Comparing the results, it seems that an improvement in importers' "relative honesty" is observed.

Over the period being studied, underinvoiced commodities are mostly imported from Hongkong with an average ratio of 1.25 (see Table 8). It is followed by the following countries: ASEAN (minus Singapore) (1.17) and China (1.22).

TABLE 8: RATIOS BY COUNTRY OF ORIGIN OF IMPORTS,
JULY 1994- MAY 1999

COUNTRY	July 1994- June 1995	July 1995- June 1996	July 1996- June 1997	July 1997- June 1998	July 1998- May 1999	AVERAGE
	HCV/IV		EV/IV			
HKG	1.153	1.202	1.526	1.125	1.261	1.253
ASEAN-SGP	1.140	1.173	1.078	1.296	1.182	1.174
CHN	1.133	1.132	1.123	1.081	1.142	1.122
USA	1.125	1.104	1.065	1.045	1.091	1.086
TWN	1.089	1.121	0.998	1.125	1.092	1.085
ROW	1.071	1.103	0.956	1.099	1.050	1.056
EU	1.072	1.107	0.981	1.038	1.061	1.052
KOR	1.035	1.060	1.000	1.030	1.081	1.042
JPN	1.054	1.049	0.970	0.969	1.016	1.012
SGP	0.937	0.997	0.928	1.004	1.083	0.990

4.2 Trade Reforms, Underinvoicing and the Shift to Transaction Value

Trade policy reform was accelerated during the 1990s beginning with E.O. 470 issued in July 1991. Trade liberalization in this study refers mostly to tariff reductions. The study's results indicate that trade liberalization policies do indeed reduce the incidence of underinvoicing. To summarize:

- a.) There is an improvement, albeit small, in the number of CRFEs with $R=1.0$ from 33.5% in July 1994-June 1995 to 38.8% in July 1998-May 1999;
- b.) The number of CRFEs with $R>1.0$ dropped from 52.6% in July 1995-June 1996 to 43.0% in July 1997-June 1998; and,
- c.) Overall weighted average ratios showed a tendency for importers to underinvoice - i.e., $R>1.0$. However, a declining trend was observed over the period July 1994-June 1998.

The Asian financial crisis in mid-1997 awakened protectionist sentiments in most countries including the Philippines. In January 1998 two Executive Orders (E.O.s)– nos. 465 and 486 – increased tariffs for 870 lines as against a reduction in 512 lines. Most of the tariff increases (86%) were in the following commodity groups: agriculture and food; chemical and chemical products; textile, paper, wood and leather; base metals and non-base metals; and machineries and equipment. Effective tariff protection enjoyed by the agricultural sector to date still remains in place. In January 15, 1999, E.O. 63 was issued raising tariffs albeit temporarily on the following commodity groups: iron and steel; garments and textiles; pulp and paper; automotive battery; disposable lighter; and, petrochemicals. The justification behind the said temporary tariff increases was to cushion the impact of the Asian financial crisis on these supposedly “hard hit” industries. To quote from E.O. 63: “currency depreciation spawned by the crisis requires some action to cushion industries against surges of low priced imports”. The government claims that these industries are or have potentials of becoming globally competitive but whose very existence is threatened by unfair trade practices.

Was there a temporary reversal of the government's efforts to liberalize trade? No, according to the Tariff Commission in its 1998 Annual Report, since despite E.O.s 465 and 486 overall nominal tariff remained almost unchanged at 10.69% in 1998. However, on a sectoral level, the average nominal tariff for manufacturing increased to 9.42% from 9.05% in 1998. Regarding E.O. 63, it can be argued that the tariff increases embodied in it are temporary with a shelf life of one year. But what does real trade (i.e., international trade in practice) tell us. Increased protection by way of higher tariffs will encourage underinvoicing. The trend in the incidence of underinvoicing was reversed in July 1998-May 1999 as the overall weighted average ratio increased to 1.06 – the same level as in the period just before the peso devaluation (1.06 in July 1996-June 1997). Indeed looking at Table 7, underinvoicing in the following commodity groups increased significantly from July 1997-June 1998 to July 1998-May 1999 and somehow matches those groups with tariff increases in 1998 and 1999:

- a.) Crude materials, inedible, except fuels – from 1.019 to 1.076;
- b.) Chemicals & related products, nes – from 1.053 to 1.081;
- c.) Manufactured goods classified chiefly by material – from 1.012 to 1.065;
- d.) Machinery & transport equipment – from 1.014 to 1.050; and,
- e.) Miscellaneous manufactured articles – from 1.027 to 1.183.

4.3 Estimating the Impact on Government Revenues of the Shift to Transaction Value

The 1993 HCV study estimated the impact on government revenues of shifting from HCV to EV and HCV to transaction value (TV). IV is assumed to closely approximate TV. Again, caution should be exercised with respect to comparing the results of the said study with the current one since different databases were used. The results of the said study, however, are worth noting. The estimates of the potential losses in government revenues resulting from a shift to IV from HCV were lower than expected – i.e., -3.95% assuming high import elasticity and -6.15% with low import elasticity.

The current estimates show that shifting from EV to TV (where TV=IV) will indeed result in a decline in government revenues but much lower than feared. The estimates are shown in Table 9. The study estimates of the decline in government revenues in 2000 (the first TV year) range from –3.3% assuming high import elasticity and –5.2% with low import elasticity. Assuming a uniform tariff level of 5.0% instead of using weighted average tariffs, the study estimates of the decline in government revenues will range from –3.3% to –4.6%. These figures arrived at are lower than the estimates in the 1993 HCV study. This implies that EV is much closer to TV than HCV ever was.

TABLE 9: ESTIMATES OF IMPACT ON GOVERNMENT REVENUES OF
A SHIFT TO A TRANSACTION VALUE (TV) SYSTEM

Case 1: Average EV/IV for two periods, July 1997-June 1998 & July 1998-May 1999					
SITC	DESCRIPTION	EV/IV	Year 2000		Uniform
			low e	high e	5% Tariff high e
0	Food and Live Animals	1.038	-0.0332	-0.0292	-0.0330
1	Beverages & Tobacco	1.051	-0.0464	-0.0428	-0.0471
2	Crude Materials, Inedible, except Fuels	1.047	-0.0449	-0.0430	-0.0425
3	Minrl Fuels, Lubricants & Related Mat'l	1.026	-0.0250	-0.0221	-0.0215
4	Animal & Veg Oils, Fats & Waxes	1.007	-0.0065	-0.0061	-0.0062
5	Chemicals & Related Products, Nes	1.067	-0.0613	-0.0574	-0.0582
6	Manuf Goods Classified Chiefly by Mat'l	1.039	-0.0344	-0.0265	-0.0300
7	Machinery & Transport Equipment	1.032	-0.0295	-0.0262	-0.0262
8	Miscellaneous Manufactured Articles	1.105	-0.0883	-0.0684	-0.0769
ALL COMMODITIES		1.046	-0.0376	-0.0326	-0.0334
Case 2: Using EV/IV for July 1998-May 1999					
SITC	DESCRIPTION	EV/IV	Year 2000		Uniform
			low e	high e	5% Tariff high e
0	Food and Live Animals	1.050	-0.0430	-0.0378	-0.0428
1	Beverages & Tobacco	1.025	-0.0229	-0.0211	-0.0232
2	Crude Materials, Inedible, except Fuels	1.076	-0.0700	-0.0671	-0.0662
3	Minrl Fuels, Lubricants & Related Mat'l	1.009	-0.0088	-0.0077	-0.0075
4	Animal & Veg Oils, Fats & Waxes	1.019	-0.0189	-0.0176	-0.0180
5	Chemicals & Related Products, Nes	1.081	-0.0730	-0.0683	-0.0692
6	Manuf Goods Classified Chiefly by Mat'l	1.065	-0.0564	-0.0434	-0.0492
7	Machinery & Transport Equipment	1.050	-0.0456	-0.0404	-0.0405
8	Miscellaneous Manufactured Articles	1.183	-0.1438	-0.1116	-0.1254
ALL COMMODITIES		1.062	-0.0520	-0.0447	-0.0460

In estimating the impact of a shift to a TV system on government revenues in 2000, two (2) cases were looked into, as follows:

Case 1: Using the average of the EV/IV overall weighted average ratio for the last two (2) periods (i.e., July 1997-June 1998 and July 1998-May 1999).

Case 2: Using the EV/IV overall weighted average ratio for the period July 1998-May 1999.

Case 2 shows higher government revenue declines relative to Case 1 at -5.2% assuming low import elasticity and -4.5% assuming high import elasticity.

In terms of peso value, the estimated decline in government revenues resulting from the shift to transaction value range from PhP 3.2 billion to PhP 5.2 billion (see Table 9A). Assuming a uniform tariff of 5%, the estimated drop in government revenues range from PhP 2.7 billion to PhP 3.7 billion. Under Case 1, the estimated drop in government revenues is relatively small ranging from PhP 3.2 billion (low import growth assumption; high import elasticity) to PhP 3.7 billion (high import growth assumption; low import elasticity). Under Case 2, the estimated drop is relatively larger ranging from PhP 4.4 billion (low import growth assumption; high import elasticity) to PhP 5.2 billion (high import growth assumption; low import elasticity). It is very difficult to say when government revenues will return to its 1999 level since numerous economic variables influence the direction of imports. For instance, if the current economic recovery is solid, imports may surpass their projected levels such that government revenues from them may not even fall at all. But if the current economic recovery is fragile, imports may remain the same or at worst drop and along with it government revenues.

TABLE 9A: E ESTIMATES OF IMPACT ON GOVERNMENT REVENUES
In Million Pesos

	Year 2000		Uniform 5% Tariff
	low e	high e	
<u>Projected level of imports*</u>			
low growth assumption	1,603,704.7	1,603,704.7	1,603,704.7
high growth assumption	1,618,753.4	1,618,753.4	1,618,753.4
<u>Projected revenues from imports</u>			
low growth assumption	98,263.4	98,263.4	80,186.4
high growth assumption	99,185.5	99,185.5	80,938.8
Case 1: Average EV/IV of July 1997-May 1999			
<u>projected change in revenues</u>			
low growth assumption	(3,696.7)	(3,203.1)	(2,679.8)
high growth assumption	(3,731.4)	(3,233.1)	(2,704.9)
Case 2: Using EV/IV of July 1998-May 1999			
<u>projected change in revenues</u>			
low growth assumption	(5,109.1)	(4,391.6)	(3,690.8)
high growth assumption	(5,157.0)	(4,432.8)	(3,725.5)

Source of Import Projection: MTPDP 1999-2004

4.4 Potential Gains and Losses Under the GVC Regime

The main difference between the current valuation scheme and the GVC is where fraud is determined. The former is upon entry while the latter focuses primarily on post-audit in conjunction with efforts at risk assessment. RA 8181, while providing for the final shift to TV by January 1, 2000, does not have a post-audit provision and thus falls short of WTO compliance. While the objectives are presumably the same -- that is, to arrive at "true" valuation-- the procedures for the two systems are very different. What are the advantages of one system over the other?

Do the potential gains outweigh the potential losses when the GVC (GATT Valuation Code) regime is in place? The study identified the following advantages of implementing the GVC:

- a.) Trade facilitation;
- b.) Relative clarity in the determination of dutiable base;
- c.) Increased government revenues in the long-run;
- d.) Increased self-compliance of both the Bureau of Customs (BOC) and importers;
- e.) Greater possibility of synergistic cooperation between the BOC and the Bureau of Internal Revenue (BIR); and,
- f.) Provides the BOC with the opportunity to reinvent itself into a new, clean and efficient agency.

From the point of view of the importer, goods are held hostage at the port under the present system. In contrast, if selected for audit under the GVC regime (using presumably some risk assessment), they will have to open their books at some later date and after their goods have been allowed to go through. At the outset, there is definite trade facilitation under the GVC.

The pre-shipment audit of goods under the present system is but a form of non-tariff barrier delaying the flow of imports. Pre-shipment inspection (PSI) should be liberalized in the sense that it should be market determined. Importers should decide whether they want PSI on their goods and thus, pay for the cost of such a service. Trade is greatly facilitated under the GVC whereby importers are considered “innocent” of any fraudulent act unless proven guilty under a post-audit system. (Again, note that although RA 8181 provides for the shift to transaction value by January 1, 2000, it does not provide for the establishment of a post audit system.)

A rather obvious advantage is the change from a notional method of valuation to a relatively more definitive method of assessing dutiable value. A notional method of valuation is subjective and open to manipulation. Guidelines in determining dutiable value reduce the opportunity for arbitrary valuation. The use of transaction value (TV) to determine dutiable base is only one method indicated in the GVC. If TV is difficult to ascertain, the other methods of assessing dutiable value are as follows:

- a.) transaction value of identical goods;
- b.) transaction value of similar goods;
- c.) deductive method – based on domestic sales revenue of the imported good or similar or identical goods less import costs and selling expenses;
- d.) computed method – based on the sum of production costs, general and selling expenses and gross profit margin; and,
- e.) fallback method – allows Customs to use any of the above methods that it thinks will closely approximate transaction value.

In practice, Customs will probably accept the invoice value (IV) as the TV or resort to the fallback method. Under the GVC, Customs cannot determine dutiable value based on:

- a.) selling price of locally produced goods;
- b.) a system whereby the higher of two alternative values should be used;
- c.) domestic price of goods in the exporting country;
- d.) export price of the goods to a country other than the importing country;
- e.) production costs different from that computed for identical or similar goods;
- f.) minimum customs values; and,
- g.) arbitrary or fictitious values.

The increase in government revenues from import duties could also result from the inclusion of certain items in determining dutiable value which the present system cannot effectively deal with. These items are, among others, “assists”, “royalties” and “license fees”. Under the BDV, these items may or may not have been included in the price of imported commodities. In the GVC regime, these items should be added back to the invoice value in determining dutiable value if they have not been included in the price of the imported commodities. Adding back these items potentially increases the valuation base. However, it is difficult to determine at this point whether the potential increase will be large enough to offset the extent of expected underinvoicing during the first transaction value year (i.e., 2000) such that estimated government revenue losses will be

reduced. Again, the importance of post audit system in checking expenses associated with such items as “assists” cannot be overemphasized. In the long-run, however, the improvement in the degree of honesty among importers in declaring the correct transaction value will raise government revenues.

The new system under the GVC regime will improve self-compliance of both the Bureau of Customs (BOC) and importers. It will also remove dependence on outside pre-shipment audit that may not be cost effective in the long-run.

The BOC has long since “suffered” a credibility crisis in the sense that it has always been considered one of the major centers of rent-seeking activities. The GVC regime provides the BOC with the opportunity to reinvent itself into a new, clean and efficient agency. It will also pave the way for the possibility of synergistic cooperation between the BOC and the Bureau of Internal Revenue (BIR).

Implementing GVC is not without potential losses. The potential losses identified by this study are as follows:

- a.) gross underinvoicing at the onset to establish the transaction value of an imported commodity;
- b.) overinvoicing when duty drawbacks exist; and,
- c.) rent-seeking inasmuch as the discretion of Customs is resorted to in some cases.

There is a lack of information on historical prices of commodities which are not traded in the open-market. For such commodities, there is an incentive for importers to underinvoice to be able to set a transaction value at the onset. Underinvoicing will also be resorted to by importers of commodities that involve “assists”, “royalties” and “license fees” since adding back these items increases their dutiable value. On the other hand, importers with duty drawback privileges are encouraged to overinvoice particularly if they perceived that TV is lower than the current EV. Overinvoicing allows them to

maximize the tax credits they can claim. Both a.) and b.) above will result to lower than expected government revenues.

Cases that allow for Customs' discretion will increase rent-seeking activities. This is particularly true in instances where Customs have to decide whether indeed "assists", "royalties" or "license fees" are included in the invoice price. Rent-seeking activities diverts funds from the government to private individuals. Again, this reduces government revenues.

As long as the legal framework and institutions for WTO compliance are in place the gains will outweigh the potential losses. The use of TV as the basis for assessing dutiable value combined with lower tariffs will improve "relative honesty" among importers in the long-run. However, it is wishful thinking to assume that under- and over-invoicing can be completely eliminated. There will always be your "compulsive" under- and over- invoicers who will risk committing fraud despite reduced tariffs and a flexible exchange rate regime. The important thing is to be able to profile these so-called "compulsive" under- and over-invoicers and put in place a viable risk management system.

In sum, what the above discussion implies is that, in time, there is no reason why the GATT valuation system should not result in a more accurate valuation than the present system. This bolsters somewhat our basis for using the EV/IV ratio in estimating the revenue impact of the switch to TV. That is, there is no strong argument for assuming that the declared IV would fall once we abandon the present BDV-like EV system.

5.0 CONCLUSIONS AND RECOMMENDATIONS

Based on the study's findings, the following conclusions and recommendations were arrived at:

a.) Need for improved trade database.

The SGS database has been very useful for the study. However, it was not originally designed to be used for statistical and economic research (not yet anyway). Therefore, it has its shortcomings. Furthermore, it does not include all importation into the Philippines. The subset used for this study accounts for only 7% of total imports value for the same period. The “relative honesty” of importers with duty-free and duty-drawback privileges cannot be compared to those who are duty-paying. The need for a reliable and timely trade database cannot be over emphasized.

b.) Trade liberalization cum exchange rate flexibility.

The success of trade reforms is somehow limited with a less than flexible exchange rate. This is evidenced by a sharp increase in the incidence of overinvoicing during the period prior to the peso devaluation in July 1997. During the period July 1996–June 1997, the number of CRFEs (Clean Report of Findings Entry) with $R < 1$ rose to 40.9% of total as against 15.4% in the previous period (July 1995-June 1996). As the Philippine peso stabilized, the incidence of overinvoicing dropped substantially to 13.7% in July 1998-May 1999.

c.) Reduced underinvoicing with trade liberalization .

The findings of the study support the argument that trade liberalization in the form of lower tariffs will reduce the incidence of underinvoicing. These findings are summarized below:

- There is an improvement, albeit small, in the number of CRFEs with $R = 1.0$ from 33.5% in July 1994-June 1995 to 38.8% in July 1998-May 1999;
- The number of CRFEs with $R > 1.0$ dropped from 52.6% in July 1995-June 1996 to 43.0% in July 1997-June 1998; and,
- Overall weighted average ratios showed a tendency for importers to underinvoice - i.e., $R > 1.0$. However, a declining trend was observed over the period July 1994-June 1998. The overall weighted average ratio fell

from 1.10 in July 1994-June 1995 to 1.03 in July 1997-June 1998. The decline is less dramatic than expected inasmuch as certain sectors (e.g. “Agriculture”) still enjoy a significant amount of tariff protection.

Over the period being studied, underinvoiced commodities are mostly imported from the following countries: Hongkong (1.25), ASEAN excluding Singapore (1.17) and China (1.12).

d.) Minimal decline in government revenues due to the shift to a transaction value (TV) system.

The decline in government revenues due to the shift to a transaction value (TV) system is much less than feared. The study estimates of the decline in government revenues in 2000 (the first TV year) range from –3.3% assuming high import elasticity and –5.2% with low import elasticity. Assuming a uniform tariff level of 5.0% in 2000 instead of using weighted average tariffs, the study estimates of the decline in government revenues range from –3.3% to –4.6%.

In terms of peso value, the estimated decline in government revenues resulting from the shift to transaction value range from PhP 3.2 billion to PhP 5.2 billion. Assuming a uniform tariff of 5%, the estimated drop in government revenues range from PhP 2.7 billion to PhP 3.7 billion.

e.) GVC system is potentially superior to the BDV system.

There is no reason why valuation under the GVC regime will be less accurate than the present system. Note the study’s observation of reduced incidence of underinvoicing with the shift to EV from HCV in July 1996. The advantages of the GVC system identified by the study are as follows:

- Trade facilitation;
- Relative clarity in the determination of dutiable base;
- Increased government revenues in the long-run;

- Increased self-compliance of both the Bureau of Customs (BOC) and importers;
- Greater possibility of synergistic cooperation between the BOC and the Bureau of Internal Revenue (BIR); and,
- Provides the BOC with the opportunity to reinvent itself into a new, clean and efficient agency.

f.) Changes in the legal framework and institutions.

Implementing the GATT Valuation Code (GVC) is but one aspect of the WTO agreement. A wholistic approach to WTO compliance should be taken. The sooner the legal framework is amended for WTO compliance the less confusion and arbitrariness there will be when and if the Philippines implement the shift to a TV system in January 1, 2000. There is also the issue of how prepared government institutions and local industries are for WTO compliance.

g.) Exports and WTO compliance

International trade is a two-way affair. One country's imports are another country's exports. There is a need to look into the implications on exports of WTO compliance.

h.) The folly of postponement.

Per R.A. 8181, a transition period of more than three (3) years was set before implementing the shift to a transaction value system. Policymakers at that time believed that this was sufficient to prepare the Philippines for the eventual shift. There are those who claim that the country is not as prepared as it should be. But WTO compliance is like marriage – how prepared can one be? As long as one is convinced that the benefits outweigh the costs, one takes the plunge and go through the learning experience.

REFERENCES:

Agreement to Implement Article VII of the General Agreement on Tariffs and Trade, 1994.

Medalla, E.M., De Dios, L.C. and Aldaba, R. “Effects of HCV Valuation: A Policy Paper”; PhilExport/USAID PITO-P, July 2, 1993.

**LIST OF COMMODITIES EXEMPTED FROM SGS CISS
PER JOINT ORDER 1-91, MARCH 16 1998 (a.)**

1. Goods imported pursuant to Sec. 105 of the Tariff & Customs Code of the Philippines excluding commercial imports under consignment basis.
2. Crude oil & petroleum products in bulk such as but not limited to crude oil, LPG, naphtha, gasoline, reformates, kerosene, aviation fuel, gas oil, base oil for lubricants, fuel oils, asphalt; excluding chemicals & their products, petroleum additives & lubricating oils.
3. Shipments of explosives, ammunition, arms & equipment & other strategic materials certified as such by the Department of National Defense; excluding raw materials such as chemicals for the manufacture of explosive & firearms & ammunition for commercial use.
4. Precious stones, artifacts & precious metals.
5. Fresh, frozen or chilled foodstuff & fruits.
6. Live animals.
7. Works of art.
8. Current newspapers & periodicals.
9. Parcel post.
10. Individually-owned motor vehicles qualifying under the provisions of Executive Order No. 248, Vehicle Development Program, series of 1987, specifically relating to the no-dollar importation of second hand motor vehicles of returning residents or immigrants.
11. Goods whose FOB value is less than US\$500.00 as declared in the Letter of Credit (L/C) or its equivalent in other currencies at the time of L/C opening or as declared in the total invoice covering the shipment in cases where importation is not financed by an L/C; excluding partial shipments invoiced as less than US\$500.00 FOB against an L/C whose amount exceeds US\$500.00.

The exemption does extend to goods invoiced or declared in the shipping documents as off-quality under such descriptive terms as “stock lots”, “side runs”, “cull rolls”, “seconds”, “mill lots”, “scraps”, “off-grade”, “reconditioned”, “used”, “junk”, or similar terms conveying or purporting to convey the condition of the article as sub-standard or not of prime quality.

12. Goods whose consignee is either the Government of the Philippines or any of its corporations, agencies, & instrumentalities but excluding those imported in behalf of these entities by the private sector.
13. Importation of semi-conductor & allied firms subject to the qualification requirements of the Board of Investments.
14. Importation by export processing zone (EPZA) firms duly registered as such with the Philippine Export Zone Authority.

15. Importation of equipment, machinery, spare parts & other materials for oil, coal mining & geothermal operations imported by petroleum, geothermal & coal service contractors pursuant to P.D. Nos. 529, 972 & 1442 as certified by the Office of Energy Affairs.
16. Importation by member firms of the automotive wiring harness industry.
17. Importation of pre-cut fabrics & accessories for processing into finished garment & textile products for export by firms which have been engaged in the business of exporting said products for the last five (5) years. The following conditions, however, must be met:
 - a.) the firm and/or any of its officers have not violated any rules & regulations of the Garments Textile Export Board (GTEB) & Bureau of Customs (BOC) governing import/export operations during the last five (5) years nor have any pending case whether administrative or judicial regarding the conduct of importation of its raw materials;
 - b.) the firm must not be delinquent in the liquidation of imported raw materials;
 - c.) the said pre-cut fabrics & accessories are directly used in the manufacture of the products to be exported; and,
 - d.) the firm must present an exemption certificate issued by the Ad Hoc Committee on the CISS through the GTEB.
18. Importation by firms registered with the Subic Bay Metropolitan Authority (SBMA) & Clark Special Economic Zone (CSEZ), subject to the implementing rules & regulations jointly promulgated by the SBMA, CSEZ & BOC; excluding shipments bound for duty free shops, outlets or trading warehouses catering to duty free shops & outlets.
19. All duty & tax exempt shipments including those entered under the Customs Bonded Manufacturing Warehouse (CBMW).

Notes:

a.) CISS refers to Comprehensive Import Supervision Service. A contract that has been entered into by Societe Generale de Surveillance (SGS) with the Philippine government through the Department of Finance (DOF), Department of Trade & Industry (DTI) & Bangko Sentral ng Pilipinas (BSP).

ESTIMATING THE IMPACT OF THE SHIFT TO TRANSACTION VALUE ON GOVERNMENT REVENUE

The formula for estimating the impact of the shift to transaction value on government revenue is discussed below. The assumption here is that the true transaction value is very close to the IV. The formula is taken from the Medalla et al 1993 HCV study.

Let $R(0)$ = revenue level when the IV is used
 $R(h)$ = revenue level when the EV is used
 h = ratio of EV and IV less one (1) from
 $(1 + h) = EV/IV$
 m = level of imports
 P_b = import price given by the IV
 t = tariff

$$1.) R(h) = t P_b (1 + h) * m$$

Shifting from EV to IV, will result in a decline in the valuation base from $P_b(1+h)$ to P_b . The decline in the import price will result in an increase in the demand for the commodity. Import levels will change depending upon the import demand elasticity of the commodity denoted by e_m expressed in absolute values. Thus $R(0)$ is expressed as:

$$2.) R(0) = t P_b * (m + \Delta m)$$

$$\text{where } \Delta m = -e_m * m * \Delta P/P$$

$$\text{or } \Delta m/m = -e_m \Delta P/P$$

The change in the import price ($\Delta P/P$) is derived as follows:

Let $P(h)$ = the domestic price of the import commodity when the EV is used
 $P(0)$ = the domestic price of the import when the IV is used

$P(h)$ is expressed as,

$$3.) P(h) = P_b (1+h)t + P_b = P_b [1 + (1 + h)t]$$

$P(0)$ is expressed as,

$$4.) P(0) = P_b t + P_b = P_b (1 + t)$$

The change in import price, $\Delta P/P$ is expressed as,

$$5.) \Delta P/P = \frac{P(0) - P(h)}{P(h)}$$

Substituting equations 3.) and 4.) into 5.)

$$6.) \Delta P/P = \frac{P_b(1+t) - P_b[1 + (1+h)t]}{P_b[1 + (1+h)t]}$$

$$= \frac{1+t - 1 - (1+h)t}{1 + (1+h)t}$$

$$\Delta P/P = \frac{-ht}{1 + (1+h)t}$$

Substituting $\Delta P/P$ in equation 6.) into 2.) gives $\Delta m/m$ as

$$7.) \Delta m/m = \frac{e_m h t}{1 + (1+h)t}$$

For $t \neq 0$, the change in the government revenue is derived as,

$$8.) \Delta R/R = \frac{R(0) - R(h)}{R(h)}$$

$$= \frac{t P_b (m + \Delta m) - t P_b (1+h) m}{t P_b (1+h) m}$$

$$= \frac{m + \Delta m - m - mh}{(1+h) m}$$

$$= \frac{\Delta m/m - h}{1+h}$$

Substituting equation 7.) into 8.), the change in government revenue is expressed as,

$$9.) \frac{\Delta R}{R} = \frac{\frac{e_m h t}{1 + (1+h)t} - h}{1+h} = \frac{h}{1+h} \left[\frac{e_m t}{1 + (1+h)t} - 1 \right]$$

Revenue change brought about by each commodity group is computed. For commodity i, the above formula is expressed as,

$$10.) \frac{\Delta R_i}{R_i} = \frac{h_i}{1 + h_i} \left[\frac{e_{mi} t_i}{1 + (1 + h_i) t_i} - 1 \right]$$

If $e_{mi} = 0$, the above equation is reduced to,

$$\frac{\Delta R_i}{R_i} = - \frac{h_i}{1 + h_i}$$

The sum of revenue changes due to each commodity group is shown in equation 11.) weighted by the share of each commodity group in tariff revenues expressed as

$$\frac{t_i m_i}{\sum t_i m_i}$$

$$11.) \sum_1^9 \left(\frac{\Delta R_i}{R_i} \right) \frac{t_i m_i}{\sum t_i m_i}$$