Philippine Institute
for Development Studies
*Surian sa mga Pag-aaral
Pangkaunlaran ng Pilipinas*

Policy Notes

ISSN 1656-5266

No. 2012-16 (October 2012)

Should the Philippines tariffy its quantitative restriction on rice?

Roehlano M. Briones

Overview

In June 2012, the special treatment accorded to the Philippines for rice by the World Trade Organization (WTO) expired. This compels the Philippines to place rice under the normal WTO regime, i.e., convert all tariff and nontariff barriers to customs duties—a move known as "tariffication." There is also a need to negotiate tariff ceilings, together with a schedule of reduction in these maximum or "bound" rates, to open up market access.

The Philippines instead has opted to request for yet another extension of special treatment for five more years (up to 2017). It is now timely to revisit the issue of tariffication in terms of its pros and cons, and offer some policy recommendations.

What is tariffication?

For "sensitive" agricultural products, governments may erect various trade barriers in addition to import duties or tariffs. A common practice (at least before the establishment of the WTO) was to impose a quantitative restriction (QR). This is a ceiling on the amount of allowable imports over a given period.

In the Philippines, the most politically sensitive agricultural product is rice. The government-owned National Food Authority (NFA) is given an import monopoly by law. Every year the NFA Council (headed by the Secretary of Agriculture) identifies rice importation targets upon the recommendation of an interagency committee. These targets effectively impose a QR.

PIDS Policy Notes are observations/analyses written by PIDS researchers on certain policy issues. The treatise is holistic in approach and aims to provide useful inputs for decisionmaking.

The author is Senior Research Fellow at PIDS. The paper is presented at the seminar on Philippine Trade Policies and Rice Security: Future Directions organized by the Philippine Rice Research Institute, 26 September 2012, AIM Conference Center. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

Tariffication involves conversion of nontariff trade barriers into an equivalent tariff, i.e., one that confers the same level of protection as the original trade barrier. Conceptually this may be depicted in Figures 1a and 1b. For a country importing rice, let the domestic demand curve be D (Figure 1a); let the domestic supply curve be S, and the world price be given at OPw. The QR is represented by the segment Q0Q1, domestic production is given by OQ0, and domestic consumption by OQ1. The QR allows the domestic price to rise to OPd, which is higher than OPw; otherwise the domestic price would have to fall to the level of the world price.

The tariff equivalent is shown in Figure 1b. An ad valorem tariff of *t* is levied on each unit of rice imports. The rate *t* is calibrated such that $(1+t)*P_w$ equals Pd, making the effective price of imports identical to the domestic price of rice. The same levels of domestic production, consumption, and imports prevail as under the QR. Imports are limited to Q0Q1; under the QR the reason is border control; under tariffication, importers inhibit themselves from importing more as additional stocks cannot be sold at the going price.

Disadvantages of tariffication

Tariffication abolishes the status quo of the NFA import monopoly, with some possible negative repercussions. First, government relinquishes control of imports to the private sector. What is the guarantee that the private sector would bring in the right amount of imports at the right time? Would they be able to balance household food security with domestic industry and farmer interests? The state may feel that these goals are too important to leave to the market. This boils down to an issue of trust in the private sector.

Second, world and domestic prices are unpredictable. In Figures 1a and 1b, these

Figure 1a. Schematic for quantitative restriction

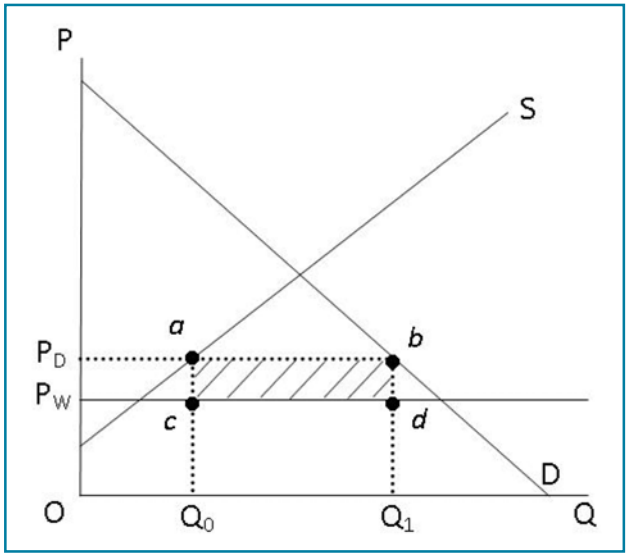
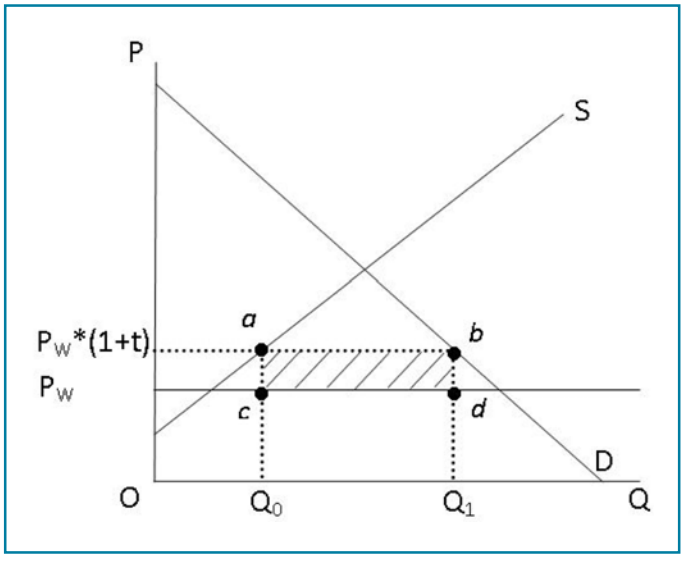


Figure 1b. Schematic for tariff equivalent



Box 1. The Philippines, rice, and trade agreements

The Philippines acceded to the WTO in late 1994. In doing so, it submitted all agricultural products to tariffication, with the exception of rice, for which it was conferred a temporary exception until 2004. In the meantime, rice was subject to a minimum market access (currently at 350,000 t), for which the tariff for imports from most favored nation (MFN) countries is set at 40 percent; beyond this, imports are slapped a 50 percent tariff. Under a separate agreement, rice imported from ASEAN countries enters the country at only 40 percent.

The Philippines obtained an extension of special treatment for rice until 2012. Currently, it is awaiting a decision on its extension request to 2017. In the meantime, it maintains a QR under the NFA import monopoly. Since 2010, it has allocated the bulk of rice importation to the private sector through a bidding procedure. Effectively the tariff on imports has been waived since 2006 through a simultaneous tax subsidy given to the NFA.

prices are implicitly predictable. In reality, these prices fluctuate unpredictably. If say domestic (world) price is lower (higher) than expected, then a proposed equivalent tariff may be too high. Conversely, suppose the domestic (world) price is higher (lower) than expected, then a proposed tariff equivalent may be too low. Hence, calculation of an equivalent tariff is not straightforward.

Advantages of tariffication

Next, we look at the advantages of tariffication. The first obvious advantage, at least from the government's viewpoint, is that government earns revenue under tariffication. Under the QR, the difference between the domestic price and world price amounts to a quota rent. In Figure 1a, this is given by the area abcd. This entire amount goes to the traders given the import privilege. Under tariffication, the same amount goes to government as tariff revenue. In practice (Box 1), government can win back the quota rent (at least in part) by implementing a bidding procedure for allocating the quota.

The second advantage is that government no longer assumes planning function of computing the annual quota. This is the obverse side of not trusting the private sector, as imports are needed, then it falls to government to meet the need. This renders importation—ordinarily a commercial activity—to a government function. Rice importation becomes an enclave for a command-and-control regime within a market economy.

The government would need to compile information and forecasts (mainly from the Bureau of Agricultural Statistics) to arrive at estimates of domestic supply, domestic demand, and the deficit to be filled up by imports. The forecast needs to be updated often, under evolving conditions of demand and supply. However, it may not be able to avoid underimporting, causing domestic price spikes, or overimporting, depressing the domestic price and/or draining the national treasury (Box 2).

Third, tariffication avoids the added uncertainty from discretionary import targeting. This is a

major deterrent to private investment. Ideally, government intervention should stabilize the domestic price and reduce volatility. In practice the private sector is wary of public sector intervention as such interventions can be politically driven; such vagaries are additional to inherent market uncertainty. For instance, a mill owner may have a difficult time investing millions of dollars in modernization if he or she is unsure that the political winds may eventually swing back in favor of cheap NFA rice and overimportation.

Fourth, in case the NFA assigns import privileges to the private sector, tariffication avoids the perennial problem of allocating the import quota to private traders in a fair and transparent manner. The allocation problem poses a severe test to good governance, inasmuch as traders have the incentive of spending up to the amount of quota rent, in rent-seeking activity. Under tariffication, entry into the import business is liberalized, subject only to ordinary licensing, permits, and payment of custom duties.

What are the implications of tariff reduction?

Understandably, farmers and rice millers are concerned about any commitments on reducing tariff ceilings, which would be integral to tariffication. To examine the implications of tariff reduction, I apply a scenario analysis using the Agricultural Multi-Market Model for Policy Evaluation (AMPLE) over the period 2010–2020. At the model baseline, the tariff rate is set at the book MFN rate of 50 percent. I posit two scenarios: i) Reference scenario pertaining to the status quo (no tariff reduction); ii) Tariff reduction scenario: the rate declines from its baseline level to 35 percent, by 3 percentage points per year from 2012 to 2017. In both scenarios we impose the same assumptions about future trends for population, gross domestic product (GDP) growth, agricultural productivity, world prices, and other factors affecting demand and supply. In particular, I incorporate the productivity and area harvested targets of the Food Self-Sufficiency Program (FSSP) of the Department of Agriculture.

Box 2. The NFA's spotty record at importation

It is possible for NFA to underimport; this seems to have happened in 1995 when the optimistic forecast for rice harvest did not materialize, hence the estimated import requirement was too low. By the time government approved additional imports and underwent procurement process, prices had already spiked. Afterwards, government adopted a highly precautionary stance. This served well in avoiding price spikes during the severe drought of 1997–98, but it eventually led to the country having the dubious position of being the largest rice importer in the world. The opposite problem of overimportation became obvious in 2008 when, despite prices rising to thirty-year peaks, the government opted to hike imports to its highest level at over 2 million tons.

See Intal, P. and M. Garcia (2005), Rice and Philippine politics, PIDS DP No. 2005-13, Philippine Institute for Development Studies, Makati City.

Demand projections are shown in Figure 2 for the Reference scenario. Consumption is expected to rise from 11 to 15 million tons per year. Imports hold steady at around 2.2 million tons per year; this implies that the import-to-consumption ratio declines, from 0.2 to 0.145; however, it does not drop to zero contrary to the government target of 100 percent self-sufficiency as early as 2013.

With tariff reduction, imports are expected to rise. This is confirmed by the results of the tariff reduction scenario (Figure 3). Rather than stabilizing at about 2.2 million tons, the reduction in tariffs raises imports to 3.5 million tons. Consumption gets a boost from a cheaper alternative source of rice rising to 15.9 million tons (compared to 15 million t under the Reference scenario). The import-to-consumption ratio rises to 0.22 (compared to 0.145).

We likewise would expect cheaper foreign rice to be reflected in the retail price (Figure 4). From a baseline of PHP 35.7 per kilogram, the retail price declines to PHP 33.0 per kilogram (in fixed base year prices) under the Reference scenario. The decline compared to the baseline is due to the aggressive expansion of rice supply due to the FSSP. Compare this with the Tariff reduction scenario, in which the decrease in the price of rice is faster, hitting PHP 32.6 per kilogram, which is 1.2 percent below the terminal price under the Reference scenario.

On the other hand, reduction in the tariff rate leads to a fall in the producer price owing to availability of cheaper imported rice. The magnitudes involved are shown in Figure 5. The producer price is already falling under the Reference scenario owing to the productivity-enhancing instruments under the FSSP. From PHP 14.4 per kilogram, the producer price falls to PHP 13.5 per kilogram (again in fixed baseline prices). Under Tariff reduction scenario, the fall in the producer price is somewhat faster, falling to PHP 13.25 per

Figure 2. Imports and consumption (in million t) and import-to-consumption ratio, 2009–2020, Reference scenario

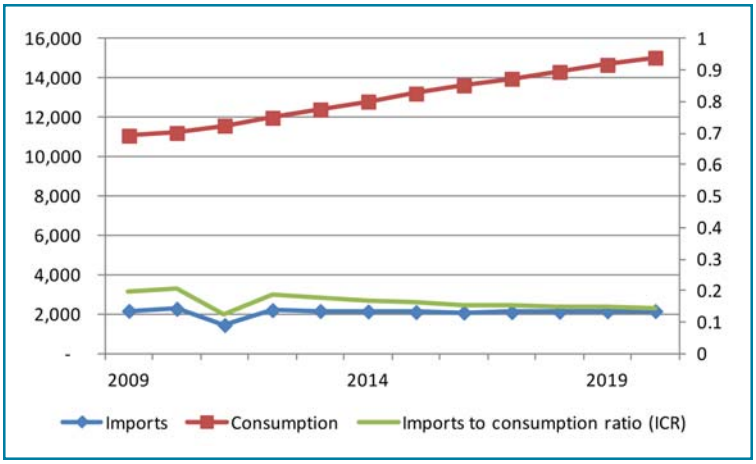


Figure 3. Imports and consumption (in million t) and import-to-consumption ratio, Tariff reduction scenario

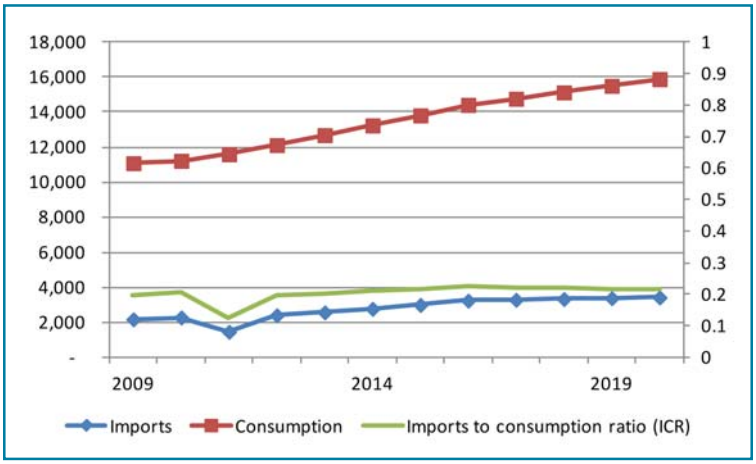


Figure 4. Retail price of rice in pesos/kg, Reference and Tariff reduction scenarios, 2009–2020

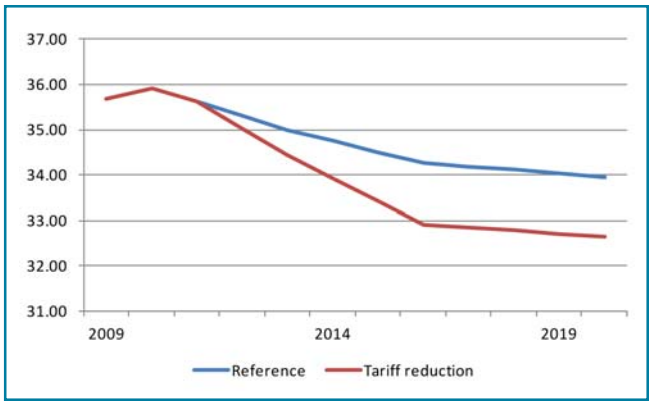
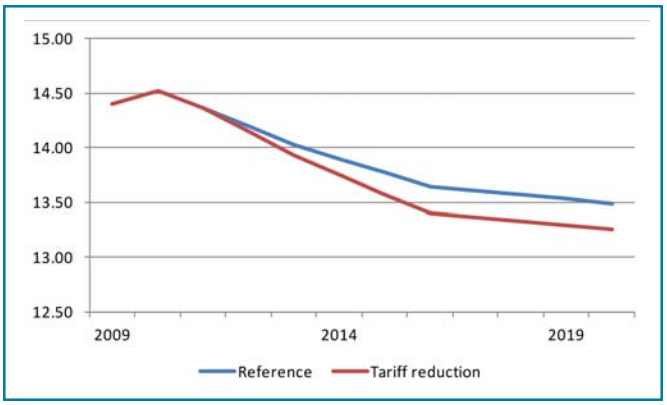


Figure 5. Producer price of rice in pesos/kg, Reference and Tariff reduction scenarios, 2009–2020



kilogram. This is 1.9 percent below the producer price under the Reference scenario. This accounts for political resistance to tariffication.

Note however that losses to producers, together with gains from consumers, are relatively small. A strong warrant for tariffication other than fulfilling treaty obligations should be sought elsewhere. Obversely, there seems to be no strong indication that tariffication would inflict serious losses on farmers. Similarly, there is no warrant for extending special treatment simply on that basis.

For further information, please contact

The Research Information Staff
Philippine Institute for Development Studies
NEDA sa Makati Building, 106 Amorsolo Street, Legaspi Village, 1229 Makati City
Telephone Nos: (63-2) 894-2584 and 893-5705
Fax Nos: (63-2) 893-9589 and 816-1091
E-mail: rbriones@mail.pids.gov.ph; publications@pids.gov.ph

The *Policy Notes* series is available online at http://www.pids.gov.ph. Reentered as second class mail at the Business Mail Service Office under Permit No. PS-570-04 NCR. Valid until December 31, 2012.

Should the Philippines tariffy?

Considering both pros and cons, the Philippines should tariffy its QR on rice. It should no longer seek an extension of special treatment. Rather, the country should negotiate a tariff that offers equivalent protection to its producers as well as a schedule of reduction that would eventually improve rice affordability to consumers.

Our scenario analysis suggests that the gains in terms of affordability to consumers, or losses in terms of reduced prices for producers, are relatively small for plausible adjustments of the tariff rate (e.g., a 15 percentage point reduction). Hence, the best reason to tariffy is improve governance and the investment climate for the rice supply chain. Tariffication eliminates a system that is inherently prone to rent-seeking and co-option of public institutions. In short, the main benefit is derived from enhanced predictability, orientation of private rice trade toward commercial interests, and promotion of rational calculation over political influence.