

**AN EVALUATION
OF THE HOME CONSUMPTION VALUE SYSTEM***

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**I
BACKGROUND AND OBJECTIVES**

There have been intense debates on the merits of the home consumption value (HCV), the country's present valuation system. Since the Tariff Act of 1909, the HCV has been the government's basis in assessing the value of imports for tariff collection, except during 1958-1972 when RA 1937 was in effect and the invoice value was the general basis for valuation.

The Philippines is among the few, if not the only country, that still adheres to the HCV system. Many importers complain that the use of HCV results in the overvaluation of their imports. Others complain that it is arbitrary and increases the cost of doing business in the Philippines substantially more than the increase in import duties does.

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With growing pressure from importers, the government announced a plan to shift away from the HCV system. However, it has yet to decide on the transition period due to its fear of enormous revenue losses as a result of that shift. This concern is valid. However, the HCV system has outlined its usefulness in countering technical smuggling through undervaluation. Tariff rates have declined over the years. What we have instead is a valuation method that serves intentionally or not, as a non-tariff barrier and a deterrent to foreign investment.

With mounting complaints about HCV system, the United States Agency for International Development (USAID) commissioned in December 1992 a study which reviewed the issues surrounding HCV, gave a theoretical discussion of the different basis of valuation, and described the assessment procedures and guidelines of the Bureau of Customs (BOC) and the role of Societe Generale de Surveillance (SGS) in import supervision. It also evaluated the impact of HCV on import valuation and determined the extent and sources of the increase in customs valuation after SGS globalized its pre-inspection scheme, the Comprehensive Import Supervision Service (CISS).

The study concluded that after the SGS globalization, customs valuation increased for countries both covered and not covered by pre-inspection before and after the globalized CISS. However, the results were based on a sample of only 216 import entries, and revenue implications of a shift in valuation system were not estimated.

It is within this context that this study was undertaken. First, a future shift to work the transaction value system is inevitable due to the adverse impact of the HCV system on the protection structure and on direct foreign investments. Maintaining the HCV system runs counter to the present government policy of simplifying the country's tariff structure into a more uniform one.

Second, although a fall in revenue is expected during transition, this may be true only in the short run. In the medium to long term, when import elasticities and the impact of trade facilitation on growth are accounted for,

the increase in imports will most likely compensate for the decreases in assessed values.

This study aims to: (1) assess the impact of the HCV system on the level and structure of protection, and (2) estimate the effects on revenue of a change in valuation basis.

This paper has six sections. Section 1 sets the background and objectives of the study. Section 2 addresses some theoretical considerations in customs valuation. Section 3 presents the evolution of laws on customs valuation, beginning with the Tariff Act of 1909. Section 4 describes the Bureau of Customs' procedures in assessing and collecting taxes. The methodology for analysis is contained in the Appendix. Section 5 discusses the study's results and other areas of concern. Finally, Section 6 provides the summary and conclusions.

II

THEORETICAL CONSIDERATIONS IN CUSTOMS VALUATION

Ideally, import valuation should be equal to the transactions value, i.e., the actual market value paid by the importer. There is a question whether or not to include insurance and freight in the valuation so that it is either in CIF or FOB terms. Japan and Europe use CIF, while the US, Canada, and Australia use FOB.

Although CIF discriminates across countries according to distance, insurance and freight are real transaction costs and part of the value of the good. The Philippines has chosen to use CIF in import valuation, but this issue is secondary (although how such cost of freight and insurance is assessed can be a very important consideration). The main issue is the use of HCV as the basis for customs valuation.

The problem with using transaction value is the possibility of importers securing false invoices either to undervalue their importation (underinvoice) to avoid paying duties or to overvalue importation (overinvoice) for transfer pricing purposes among others. The former practice is more prevalent and a more pressing problem.

The HCV was designed mainly to correct undervaluation and also as an anti-dumping measure. It was later supplemented with the hiring of SGS for pre-shipment inspection and valuation. SGS initially covered three Asian countries (Hongkong, Japan, and Taiwan), then eight more, until it was globalized.

As an administrative procedure to counter undervaluation and determine the true market value of the imported product, the HCV is an ideal base for valuation. The question is, does it promote a more accurate valuation of imports? Is it more effective and efficient in correcting undervaluation? In the first place, how prevalent is the tendency to undervalue imports?

The motive for undervaluation is to reduce tax payments. When an import is used as an intermediate input to production, there should be no incentive to undervalue since this will be reflected as a lower cost of goods sold and will only be captured as a tax (especially since the corporate income tax is higher at 35 percent) by the Bureau of Internal Revenue (BIR); this makes the reverse actions even more plausible. This implies that the importer/producer pays income taxes and uses the same documents. There is a current program to computerize the BOC and the BIR, and counter-checking can be built in to ensure that the same documents are used. Hence, for importations of intermediate, raw materials, and capital goods, which comprise around 90 percent of total Philippine imports, there should be no tendency to undervalue. On the other hand, for importation of final (consumption) goods, the importer may find undervaluation logical and profitable.

In using transactions value to reduce undervaluation, built-in safeguards, as practiced by developing countries like the Philippines or as prescribed under the General Agreement on Tariffs and Trade (GATT), have been devised. GATT rules on valuation, for example, prescribe clear alternative measurements for transactions values when the declared value is in doubt.

Further, SGS derives "exports values" for other client countries. The use of the export price is not necessarily less effective in curbing undervalu-

ation. It may be easier to obtain a more correct HCV, since this has nothing to do with the import transaction and, therefore, is less subject to manipulation. If the energies spent in verifying declared values were instead used in collecting and updating export price data, the tendency to undervalue would be minimized.

The latest executive order on customs base valuation (EO 156, series of 1987), which uses *fair market value* as the base valuation, is still basically an HCV concept. However, it allows the use of a third country market and the transactions value, and whichever is higher is chosen as the base. This is contrary to GATT valuation rules which: (1) allows only price information on the commodity from the same market of origin, whether for identical or similar goods imported at the same period of time, or computed value from cost of manufacture (each allowing for adjustments within specified guidelines); (2) forbids the use of third country market for valuation; and (3) chooses the *minimum* valuation should there be more than one value found in applying the rules. (However, the Philippines is not a signatory to the GATT Valuation Code.)

In contrast, the valuation procedure of the Philippines as mandated by the EO, if implemented efficiently and accurately, will tend to overvalue imports since the highest estimate will be chosen. Consequently, using HCV will tend to impose an additional implicit tax on imports. On the other hand, if the HCV is not efficiently and accurately implemented, its effectiveness in reducing undervaluation is not necessarily superior to other means of valuation. Further, if it is only selectively efficient and accurate, it contributes to the unevenness of the protection structure since it is used as the valuation base, not merely as a basis for checking undervaluation.

III EVOLUTION OF PHILIPPINE LAWS IN THE CUSTOMS VALUATION PROCESS

A number of presidential decrees and executive orders pertaining to the country's valuation system have been passed since 1909. Despite the

modifications and changes in terminology embodied by these laws, no substantial change was made in the overall valuation system. The Philippines has continued to rely on the HCV as the basis for assessing the value of imported goods, except during 1958-1972 when RA 1937 was in effect and the invoice value was used as the general basis for levying duties and taxes.

HCV refers to the wholesale selling price (excluding internal taxes) at which a good is offered in the principal markets of the exporting country. Between 1902 and 1957, reference prices used in the Philippines were based on US published values. From 1957 to 1972, invoice values were used in assessing imported goods due to insufficient resources for verifying the HCV. Since 1972, the BOC has relied on its List of Published Values as the basis for levying duties on imported goods.

Philippine Tariff Act of 1909

Actual Market Value Or Wholesale Price

This Act established the *actual market value or wholesale price* of a merchandise as the valuation base to which tariffs were applied. Actual market value or wholesale price was the value or price of the merchandise bought and sold in the principal markets of the exporting country, in the usual wholesale quantities at the time of exportation to the Philippines, and in the condition in which the merchandise was bought and sold for exportation to the Philippines, or consigned to the Philippines for sale.

The dutiable value of the imported merchandise was based on the actual market value or wholesale price, including packing (value of all cartons, cases, crates, boxes, sacks and coverings of any kind) and all other costs, charges and expenses incidental to placing the merchandise in a condition ready for shipment to the Philippines.

RA 1937 (June 22, 1958)

Market Value Or Price

Under RA 1937, *market value or price* became the basis for customs valuation. The market value or price was defined as the value or price at

which, at the time of exportation to the Philippines, the same or similar good was freely offered for sale in the principal markets of the exporting country, in the usual wholesale quantities and in the ordinary course of trade (excluding internal excise taxes to be remitted or rebated).

The dutiable value was based on the market value or price, plus ordinary expenses prior and incidental to the lading of such article on board the vessel or aircraft at the port of export (including duties and taxes), freight paid, and insurance premium on the transport of the article to the Philippine port of entry.

In the absence of market value, the domestic wholesale market value or selling price of the same or similar imported article in the principal markets of the Philippines on the date of its exportation was used, minus the import duty and taxes, commission not exceeding 6 percent if any was paid or contracted to be paid on goods secured other than by purchase, and profits not exceeding 8 percent and an allowance for general expenses not exceeding 8 percent, and all other expenses incidental to the delivery of the goods from the port of importation to the Philippine principal market.

In practice, the import invoice was used as basis for levying tariffs, since the government did not have enough resources to ascertain market value or price.

PD 34 (October 27, 1972)

Rationale

PD 34 aimed to simplify the complicated tariff structure, improve the administration of customs, raise additional revenues, and prevent technical smuggling. Through PD 34, the country's customs valuation base shifted from actual market value or wholesale price to *home consumption value*.

The use of HCV was meant to prevent technical smuggling through undervaluation of imports and dumping of foreign goods (i.e., selling at a price lower than the price in the country of origin or below the cost of production, or both) in Philippine markets. Further, it was also meant to check imports that have received subsidies from the government of the exporting country. With correct information on the HCV of said imports,

their subsidies could be offset or canceled out through higher dutiable values.

Home Consumption Value

The HCV was the value or price (excluding internal excise taxes) of the same or similar articles as bought and sold or offered for sale in the usual wholesale quantities in the ordinary course of trade in the principal markets of the exporting country on or nearest the date of exportation to the Philippines.

HCV was the value or price declared in consular, commercial, trade or sales invoice. Where there was reasonable doubt about the value or price of the imported article declared in the entry, the correct dutiable value of the article was verified from reports of the Revenue Attache, Commercial Attache, or other Philippine diplomatic officers, and from data available at the BOC. From these data, the Customs Commissioner ascertained and established the HCVs of articles exported to the Philippines and published the values from time to time.

In practice, the BOC relied primarily on this *List of Published Values* in determining the value of an imported article. The dutiable value of an imported article was based on the HCV, including the value of all containers, coverings and packaging of any kind, and all other costs and charges incident to placing the article in a condition ready for shipment to the Philippines, plus 10 percent of the HCV. This across-the-board tax was meant to cover the cost of insurance and freight. It was fixed to reduce the requirements and procedures in processing imports and in assessing their dutiable values, and to correct the arbitrary way of determining the cost of insurance and freight under RA 1937.

When the dutiable value could not be ascertained, or when there was reasonable doubt on the dutiable value of the imported article declared in the entry, the domestic wholesale selling price was used. This was the price of such or similar articles in Manila or other principal markets in the Philippines on the date the duty became payable on the article, in the usual

wholesale quantities and in the ordinary course of trade, minus 25 percent of the expenses and profits, and the duties and taxes paid on the article.

PD 1464 of 1978

PD 1464 was enacted to consolidate and codify all tariff and customs laws of the Philippines and to strengthen the law against smuggling and other forms of customs fraud. Like PD 34, PD 1464 adopted the HCV as customs valuation base.

EO 71 (November 25, 1986)

Transaction Value

EO 71 changed the customs valuation base from *HCV* to *transactions value* or price. However, the transactions value referred to in this EO was very different from the transactions value concept defined in the GATT Code on Customs Valuation. The latter referred to the price actually paid or was payable by the buyer to the seller of the imported good.

EO 71 defined the transaction value as the price of the same or similar articles as bought and sold or offered for sale freely in the usual wholesale quantities in the ordinary course of trade in the principal markets of the exporting country on or nearest the date of exportation to the Philippines (excluding internal excise taxes to be remitted or rebated).

In assessing the dutiable value of an imported article, EO 71 eliminated the 10 percent across-the-board tax on HCV and replaced it with the cost of freight and insurance premium. Except for this provision and the change in terminology, EO 71 adopted the exact definitions and procedures under PD 34 and PD 1464.

EO 156 (March 30, 1987)

EO 71 was never implemented. Four months after it was passed, EO 156 was enacted. This changed the customs valuation base to *fair market value*. Like EO 71, it eliminated the across-the-board 10 percent tax due to objections of nearby exporting countries, which criticized the tax imposition

as arbitrary and discriminatory. The tax was replaced by *actual freight and actual insurance premium*.

To update the BOC's obsolete List of Published Values, the government engaged the services of SGS. It was envisioned that SGS would facilitate an accurate determination of the values of imported articles. On March 31, 1987, all imports from Hongkong, Japan, and Taiwan were subjected to SGS pre-shipment inspection. This was expanded to include imports from South Korea, Singapore, Indonesia, Thailand, Malaysia, Brunei, and Macau. On March 16, 1992, the SGS's comprehensive import supervision scheme was globalized.

Fair Market Value

EO 156 defined fair market value or domestic wholesale value as the price or value of same, like or similar articles, as bought and sold or offered for sale freely in the usual wholesale quantities in the ordinary course of trade in the principal markets of the exporting country on or nearest the date of exportation to the Philippines (excluding internal excise taxes to be remitted or rebated).

The dutiable value of an imported article was defined as the sum of the following: (1) the fair market value, (2) freight and other charges and fees, and (3) insurance.

Fair market value. In the absence of a fair market value for an article from an originating country, the domestic wholesale value or fair market value in the principal market of a third country at the same stage of economic development as the exporting country is used. This value is ascertained by the Customs Commissioner from the reports of the Revenue or Commercial Attaches and from other such information available to the BOC. If the domestic wholesale value cannot be derived from the above, the BOC uses the domestic wholesale selling price of such or similar articles in the principal markets of the Philippines, minus not more than 25 percent for expenses and profits, and duties and taxes paid on the article.

Freight and other charges. Sea freight charges are the amount specified in the Bill of Lading or in other related shipping documents. In no case are

they to be lower than 70 percent of the gross conference rates. Air freight charges are the amount specified in the airway bill or, in its absence, the International Air Transport Association rate.

Other charges and fees cover the value of all containers, coverings and packings of any kind as specified in the invoice. If there is none, an amount equivalent to 3 percent of the fair market value is added, except in the following cases:

- (1) articles imported in bulk, i.e., without external packing, like wheat and crude oil;
- (2) articles in original packing, as when sold for domestic consumption in the country of manufacture, like wheat flour in bags, canned milk or fish or meat in standard cartons.

All other costs, charges and expenses incident to placing the articles in a condition ready for shipment to the Philippines include: labor for export packing; export marketing; selling commission; buying commission when the shipper and the seller, or the buyer and the seller, are the same person in the covering invoice; cartage and drayage to rail, decks, airport or post office; customhouse and brokerage expenses, forwarders fee; export documentation and legalization fees and stamps; inspection and certification fees and stamps; clearance fee; internal insurance; export duties and taxes; inland freight and pier handling charges (except when the articles are exported from a landlocked country passing through another country to a seaport for shipment to the Philippines); airport and handling charges; and such other charges incident to placing the articles ready for shipment to the Philippines.

Insurance. Insurance premium covers the transportation of a good to the Philippine port of entry as quoted in the covering invoice. If there is none, insurance is computed at 2 percent of the invoice value (FOB) for general cargo and 4 percent for inflammables, chemicals and other "high risk" cargoes.

IV CUSTOMS PROCEDURES AND SGS

The HCV, first used in 1909 as the basis for import duties and taxes, was changed to transaction value in 1957. It was revived in 1972 for two reasons: to enable the importer to determine the landed cost of products in accordance with the Brussels accord, and to eliminate corruption or the opportunity to collusion between the importer and Customs officials. However, this did not work because of difficulty in collecting and updating HCV data and the large volume of shipments which the personnel could not handle (e.g., an average of 160 shipments a day passed through Japan, to which only one commercial attache was assigned). At the same time, the HCV was also considered to counter dumping.

The use of a third party to discharge these problematic functions was carried out in April 1987, when the government entered into an agreement with the SGS to implement the CISS. At first, it covered three countries (Japan, Hongkong and Taiwan) instead of the original nine allegedly because of opposition by some BOC officials. Importers used this limited coverage to their advantage, transshipping their goods to evade pre-inspection. Thus, coverage was widened to include South Korea, Singapore, Thailand, Indonesia, Brunei, Malaysia, and Macau. An SGS survey of import entries in 1987 revealed that 80 percent did not have published values, 10 percent had published values equal to the export price, and only 10 percent had true HCVs. The case for CISS was bolstered by Japan's experience: because of pre-inspection, its HCVs were shown to be higher than those of the US. This turned out to be advantageous to importers since they found it easier to import from Japan with its updated values, rendering it more competitive.

The SGS follows the valuation concepts defined in Section 201 of the Tariff and Customs Code and in EO 156. These concepts are spelled out in detail in various Customs Memorandum Orders (mainly CMOs 4-87, 32-87, and 20-88).

Globalization of SGS import supervision was formalized in September 1991 when the Department of Finance, Department of Trade and Industry, and the Central Bank issued Joint Order 1-91 which superseded Joint Order 1-87 and outlined the procedures for implementing the global CISS. Central Bank set the effectivity of the scheme on 16 March 1992. The implementing rules are contained in CMOs 39-93, 51-92, and 96-92.

Globalization took time to fully implement. It was only in June 1993 that the CISS can be said to have become completely global. At present, goods from about 60 countries are covered, although 95 percent comes from only 10 countries. There are about 850 shipments per day, of which half are dutiable.

Commodity Coverage

All imports with a letter of credit (L/C) value of \$500 FOB and over, and non-L/C shipments with the same invoice value, are covered by CISS. Other goods covered regardless of value include partial shipments of L/C transactions with invoice value lower than \$500 FOB but with total L/C value exceeding \$500 FOB, and goods described in the proforma invoice as "used," "second grade," or any other term which implies that they are not of prime quality. Certain goods are exempt, but commodities under consignment basis for reexport are not.

Country Coverage

Goods imported against L/Cs opened on or after 16 March 1992 are subject to pre-inspection regardless of country of supply. Those opened prior to this date undergo pre-inspection only if they originate from one of the ten countries enumerated earlier. Where an L/C has been changed to on or after 16 March, the goods are also subject to pre-inspection. Goods financed by non-L/Cs are covered regardless of origin if the Bill of Lading date is on or after 16 March 1992.

Procedures

1. The importer opens an L/C with an authorized agent bank, stating the type, quality, quantity, unit price and total value, freight charges, country of supply and Philippine Standard Commodity Classification (PSCC) code of the goods. The L/C should be opened not later than ten days prior to the scheduled date of shipment and should include the following conditions:
 - the goods are subject to SGS inspection,
 - the importer shall inform the seller that this is so,
 - the seller shall facilitate the inspection, and
 - the bank shall pay only when the seller submits a final settlement invoice and SGS confirms the number and date of the Clean Report of Findings (CRF). The CRF is the inspection report of the SGS.
2. Upon issuance of the L/C, the importer completes the Import Entry Declaration (IED) and pays the estimated advance customs duties to the bank.
3. The bank issues the Customs official receipt, prepares copies of the L/C, seller's proforma invoice, and the IED for collection by the SGS Manila Liaison Office (MLO).
4. The MLO registers the L/C and the IED and issues an Import Advice Note (IAN) with an assigned number, a copy of which goes to the importer and another to the SGS inspection office in the country of supply.
5. The inspection office sends an advice of inspection requirement to the shipper/consignor/seller of the goods.
6. The seller advises the inspection office of the date and place of the inspection and sends the documents to that office, giving at least seven days advanced notice.
7. The inspection office performs the physical inspection, verifies the declared tariff heading and rate, checks whether or not the invoice value and other elements of the total charged by the supplier correspond reasonably to the export market price level generally

prevailing in the country of supply, determines the dutiable value, and issues the CRF.

The CRF indicates the acceptable dutiable value. It is not issued if uncorrected discrepancies in quality or quantity of supply are not accepted by the importer. An appropriate amendment must be made to the L/C.

8. The seller presents its final settlement invoice bearing the adhesive security label affixed by SGS and the confirmation by SGS of the number and date of the CRF to the corresponding bank in the country of supply. The bank will then send these documents and the invoice to the opening bank.

On the day it is issued, the CRF data is transmitted electronically to the SGS-MLO, where it is printed out and authenticated. The SGS-MLO sends a copy to the importer for customs clearance while another is sent to the Customs Collector at the port where the goods are cleared.

9. The opening bank informs the importer of the arrival of the documents, which the latter collects together with the authenticated customs copy of the CRF supplied by the SGS-MLO to the bank.
10. The importer or broker prepares the IED from the authenticated customs copy of the CRF, with additional duties and taxes due, and the proforma Order of Payment. The importer or broker then presents to the BOC the authenticated CRF and other normal documents for clearance.
11. The BOC verifies the documents and calculates the difference between the deposit paid and the duties due, then issues the Order of Payment to the importer or broker, who presents it to the bank and pays the balance of duties and taxes due.
12. The bank issues the CB Release Certificate and Customs official receipt and sends a copy of the Order of Payment to the SGS-MLO.
13. The importer or broker presents to the BOC the original customs copy of the CRF authenticated by the SGS-MLO and the other documents required for clearance. The BOC issues the delivery

permit for the release of goods and retains the authenticated copy of the CRF.

14. The SGS-MLO transmits to the BOC details of the CRF for verification not later than the day after it receives the CRF from the SGS issuing office abroad.

No customs entry can be filed or accepted or any shipment released for those goods covered by the CISS if the importer is unable to produce the authenticated customs copy of the CRF. If a shipment subject to pre-inspection arrives without having been inspected, whether or not due to the fault of the importer or seller, such shipment will be automatically seized by the BOC. Furthermore, except where the invoice value or published value is higher, the dutiable value reported in the CRF is the basis for the assessment of duties and taxes.

For non-L/C transactions, the importer goes to the Central Bank and completes a Report of a Proposed Importation, which will be endorsed to SGS by the CB and collected by SGS-MLO for transmission to the SGS inspecting office in the country of supply. Importers registered with the Garments Textile Export Board (GTEB), whose imports are on consignment basis, file a report with the GTEB.

In inspecting the goods, SGS first verifies if the total shipment matches the documents. Then a random sample of the goods based on established sampling methods is taken for detailed examination, and weighed, counted, or measured depending on the type of good. All inspected goods are photographed at various stages of the inspection process. After inspection, the selected goods are resealed.

For goods shipped on a "full container load" basis (i.e., the container is destined to one importer only, filled with goods inspected and loaded under SGS supervision, and affixed with the SGS seal at the sealing bracket of the container doors), the SGS

must be present to witness the stuffing of the container and to take photographs.

Valuation

The fair market value (FMV), which is the HCV, is determined on the date of exportation to the Philippines, not when the sale was contracted. As a domestic price, the FMV is determined in the currency of the country of supply and converted into US dollars at the exchange rate published by the Philippine Central Bank on the date of exportation to the Philippines. The additional objectives are to solve the problem of dumping and protect the country from highly subsidized but inefficient producers abroad.

There is only one FMV for a particular product from a particular country, and this does not change with the size of shipment. It is determined for the usual wholesale quantity sold in the supplier's country, to which the standard domestic volume discount is applied. No export volume discount is granted even if the goods are exported in larger quantities.

Data sources for FMV include the following:

- declarations of the product by the exporter,
- prices of similar shipments previously inspected by SGS in the same country,
- price lists submitted by the supplier or obtained from third party sources,
- direct canvassing, and
- published price lists, commodity reports, and specialized commercial publications.

FMV is said to be easier to collect relative to export prices. Export prices are subject to greater variations, such as shipment size, supplier-importer relationship, discounts, and others. On the other hand, according to the Horsley memo, “[PCI President Pastor Lim] noted what SGS has separately confirmed, that distributors are normally the only ones who can buy goods in wholesale quantities but [they] often refuse to divulge their costs to SGS. Accordingly, SGS says it has no choice but to use the only available cost information.”

Where goods are imported on a CIF basis, SGS includes marine insurance, but where the terms of sale are C&F or FOB, the importer must produce the certificate of marine insurance to the BOC. Otherwise, the BOC computes the value of insurance at 2 percent of FOB for general cargo and 4 percent for high risk cargo.

Prior to 1987, the system of valuing freight was arbitrary, i.e., at a 10 percent flat rate. This was deemed unfair because of differences in distance between countries. The BOC switched to the use of the Bill of Lading, but this encouraged fraudulent Bills of Lading, with consequent revenue losses up to 2 percent of the value of goods. The BOC discussed the problem with the Shipper's Council. As a solution, they agreed to use Conference rates, with the rule that a maximum 30 percent of such rates will be used as guide. The SGS compares these rates with the Bill of Lading and gets the higher of the two. For non-members such as Taiwan and Hongkong, the Bill of Lading is compared with published shipping rates.

Since FMV is a domestic and not an export price, all costs prior to FOB are included as dutiable charges. These consist of export packing and other costs. Additional cost of export packing should be shown separately in the final commercial invoice; where this is not done and the cargoes are not in bulk but packed, a 3 percent charge on FMV is added. Other costs (inland freight, pier handling, commissions, cartage and drayage, brokerage, etc.) are supposedly obtained by the SGS from the different offices charging these. Inspection fees are excluded, although the seller is obliged to provide all necessary facilities to the SGS inspector and make the arrangements for handling, presenting, sampling, and testing of the goods for purposes of inspection. The seller shoulders the expenses incurred.

Other Implementation Details

All CRF reports of FMVs are transmitted to the BOC to form part of their Revision Orders or published values. These are compiled and issued every month, but they contain only those goods for which new HCVs have been obtained. In the case of goods valued at less than \$500 which have no

published values, the appraiser adds from 10 to 30 percent to the invoice value.

About 10,000 import entries are filed every month. More likely, some importers split their imports into several smaller batches valued at less than \$500 to escape pre-inspection. To counter this tendency, the Central Bank ruled that all L/Cs opened within a month by a single importer shall be considered just one L/C.

The globalization of CISS has prompted some importers to complain about the use of HCV. The venue for appeals and protests is the BOC-SGS Import Valuation and Classification Committee (IVCC), which has been meeting more often since June 1993, when the effects of global CISS were realized. According to SGS, about 0.5 percent of all cases are appealed, the majority (60 percent) of which uphold CRF values. Some are resolved in favor of the importer, while others are compromise solutions.

V

DISCUSSION

The distribution of import entries sampled by port of entry, commodity group, and pre-GCISS country coverage is given in Table 1 by time period. A mixed section (M) was added to take into account those import entries which consist of more than one Standard International Trade Classification (SITC). Only those directly comparable were included in the calculation, e.g., in FOB terms or with the same currency. This yielded about two-thirds computable entries out of the targeted total. However, the distribution between periods roughly conforms to targets. The following discussion excludes SITC 9 since this is a duty-free section.

A. HCV/IV

Table 2 gives the basic estimates of the ratio between the HCV-based BOC assessment and the IV by broad SITC groups: simple and IV-weighted averages, and standard deviations for each commodity class, before and after the GCISS. The simple averages are always higher than the weighted

Table 1
 SAMPLE SIZE BY COMMODITY GROUP, PRE-GCISS COUNTRY
 COVERAGE, PORT OF ENTRY, TIME PERIOD

BEFORE GLOBALIZATION

SITC	Description	Sample Size	
		MICP	POM
0	Food	38	29
1	Beverages and tobacco	13	9
2	Crude materials, inedible	111	51
3	Mineral fuels	122	121
4	Animal and vegetable oils and fats	55	44
5	Chemicals and products	14	8
6	Manufactured goods by materials	22	1
7	Machinery and transport equipment	58	74
8	Miscellaneous manufactures	186	155
9	Commodities, n.e.c.	26	13
Mixed	All commodities	80	39
	Total	725	544
	Not previously covered	388	214
	Covered	314	337

averages, with the overall simple averages of 1.23 (before GCISS) and 1.29 (after GCISS, close to the SGS estimates of 15-20 percent undervaluation. (For more direct comparisons with the latter, CRF/IV ratios were also averaged over all SITCs, although these are not shown in the table: 1.18

Table 1 *continued*

AFTER GLOBALIZATION		Sample Size	
SITC	Description	MICP	POM
0	Food	40	5
1	Beverages and tobacco	25	15
2	Crude materials, inedible	101	40
3	Mineral fuels	106	135
4	Animal and vegetable oils and fats	166	81
5	Chemicals and products	20	12
6	Manufactured goods by materials	14	12
7	Machinery and transport equipment	51	49
8	Miscellaneous manufactures	187	224
9	Commodities, n.e.c.	31	43
Mixed	All commodities	93	87
	Total	834	703
	Not previously covered	366	181
	Covered	365	521
	Not previously covered	754	395
	Covered	679	858
	Grand Total*	1,433	1,253

*About 698 entries from the sample could not be used because of incomplete information.

Table 2
AVERAGE BOC/IV, BEFORE AND AFTER GCISS BY COMMODITY GROUP

BEFORE GLOBALIZATION					
SITC	Description	Simple Average BOC/IV	Standard Deviation	Weighted Average BOC/IV	Standard Deviation
0	Food	1.165	0.854	0.870	0.026
1	Beverages and tobacco	1.184	0.243	1.101	0.145
2	Crude materials, inedible	1.163	0.394	1.081	0.018
3	Mineral fuels	1.186	0.453	1.094	0.008
4	Animal and vegetable oils and fats	1.538	0.978	1.194	0.018
5	Chemicals and products	1.120	0.350	0.930	0.120
6	Manufactured goods by materials	1.198	0.439	1.067	0.086
7	Machinery and transport equipment	1.158	0.330	1.072	0.018
8	Miscellaneous manufactures	1.234	0.592	1.058	0.011
9	Commodities, n.e.c.	1.297	0.760	1.202	0.043
Mixed		1.366	0.699	1.187	0.016
	All commodities, except SITC 9	1.231	0.588	1.070	0.034

[simple] or 1.11 [weighted] before the GCISS and 1.32 [simple] or 1.17 [weighted] after the GCISS are consistent with SGS results). Standard deviations show large variations between the commodity groups, implying a non-uniform gap between the HCV and the IV, depending on the good being assessed.

Table 2 *continued***AFTER GLOBALIZATION**

SITC	Description	Simple Average	Standard Deviation	Weighted	
				Average BOC/IV	Standard Deviation
0	Food	1.095	0.328	0.947	0.042
1	Beverages and tobacco	1.208	0.394	1.054	0.044
2	Crude materials, inedible	1.292	0.685	1.130	0.013
3	Mineral fuels	1.186	0.426	1.120	0.008
4	Animal and vegetable oils and fats	1.341	0.841	1.118	0.012
5	Chemicals and products	1.381	0.755	1.063	0.062
6	Manufactured goods by materials	1.609	0.925	1.044	0.122
7	Machinery and transport equipment	1.191	0.440	1.183	0.031
8	Miscellaneous manufactures	1.361	0.873	1.076	0.004
9	Commodities, n.e.c.	1.355	0.661	1.126	0.033
Mixed		1.348	0.712	1.166	0.006
	All commodities, except SITC 9	1.291	0.713	1.110	0.033

However, the overall weighted average BOC/IV was much lower and increased slightly between the two periods, from 1.07 to 1.11. More than half of the commodity groups showed higher ratios after globalization; the rest, i.e., SITCs 1, 4, 6 and 9, showed lower ratios. Nevertheless, the ratios varied widely between SITC groups. For imports before the GCISS, the ratios ranged from a low of 0.87 for food to a high of 1.194 for animal and vegetable oils and fats. For imports after the GCISS, the ratios were from a

low of 0.947 again for food to a high of 1.183 for machinery and transport equipment. Dispersion from the averages also varied widely, notably for SITCs 1 and 5 (before) and SITC 6 (after).

The presence of ratios below unity is somewhat unexpected since this means that the BOC assessment is lower than what the importer claims to have paid, and also that the rule of thumb of picking the highest among all values (IV, PV, HCV) is not always followed. This tendency seems especially strong for food, which shows that many large imports in that category had a ratio below one, or there were enough import entries with such a ratio to yield a low weighted average.

In any case, these lower than unity ratios can be explained in several ways. *One*, there are no actual HCV data, so that the invoice value declared by the importer is used. *Two*, there is the "learning effect" by the importer (further explained below) where he simply uses the published values (where available) as the IV. *Three*, the HCV and the IV are really the same.

The invoice values of import entries with ratios below or equal to one were separated from those whose ratios were above one. It is interesting to note that the distribution is roughly equal (Table 3), that is, 51.1-48.9 before the GCISS and 48.0-52.0 after the GCISS. The simple and weighted averages were recomputed for the above-unity group, and these are shown in Table 4. This time, the gaps between the HCV and the IV are substantial, the simple average being 43.2 percent before and 50.2 percent after, and the weighted average being 17.3 percent before and 26.3 percent after. (These are obviously close to the SGS estimates, and with good reason since SGS bases its calculations on its CRFs, while our estimates in Table 2 are from liquidated import entries which include the pull-down effect of below-unity ratios.)

The corresponding standard deviations were a little larger. All SITC groups registered higher ratios after globalization, except for SITC 4 and the mixed section. The lowest ratios were found in machinery and transport equipment (before) and again in food (after), while the highest were found again in animal and vegetable oils and fats (before) and manufactured goods classified by material (after). Again this implies a distortive effect of the

Table 3
PROPORTION OF IMPORT ENTRIES WHOSE HCV/IV < 1 OR > UNITY

	Total Invoice Value	Invoice Value of Imports whose HCV/IV ≤ 1	% of Total	Invoice Value of Imports whose HCV/IV > 1	% of Total
Before GCISS					
Covered	12,849,031	4,667,723	36.3	8,181,308	63.7
Not previously covered	14,070,512	9,078,167	64.5	4,992,345	35.5
ALL	26,919,543	13,745,890	51.1	13,173,653	48.9
After GCISS					
Covered	15,435,652	6,765,00	43.8	8,670,651	56.2
Not previously covered	17,459,043	9,026,081	51.7	8,432,962	48.3
ALL	32,894,695	15,791,082	48.0	17,103,613	52.0

HCV because of its uneven application across commodity groups, even if this happens effectively only half of the time.

The HCV (or fair market value in the CRF) is expected to be greater than the IV for most imports because it is a domestic price and, therefore,

Table 4
AVERAGE BOC/IV EXCLUDING THOSE BELOW OR EQUAL TO UNITY

BEFORE GLOBALIZATION					
SITC	Description	Simple Average BOC/IV	Standard Deviation	Weighted Average BOC/IV	Standard Deviation
0	Food	1.567	1.330	1.114	0.056
1	Beverages and tobacco	1.338	0.211	1.147	0.247
2	Crude materials, inedible	1.286	0.440	1.157	0.020
3	Mineral fuels	1.337	0.532	1.153	0.014
4	Animal and vegetable oils and fats	1.808	1.076	1.367	0.027
5	Chemicals and products	1.241	0.316	1.116	0.096
6	Manufactured goods by materials	1.369	0.530	1.209	0.152
7	Machinery and transport equipment	1.280	0.384	1.115	0.035
8	Miscellaneous Manufactures	1.429	0.721	1.231	0.019
Mixed		1.541	0.771	1.326	0.025
	All commodities, except SITC 9	1.432	0.698	1.173	0.054

includes all costs prior to FOB. In determining the first level of distribution, the question asked by the SGS is, at which point is the good available to the public? Discounts claimed by the importer are excluded in the HCV if the importer can prove that such discounts are available in the domestic market and given freely to all.

Table 4 *continued***AFTER GLOBALIZATION**

SITC	Description	Simple		Weighted	
		Average BOC/IV	Standard Deviation	Average BOC/IV	Standard Deviation
0	Food	1.245	0.347	1.138	0.059
1	Beverages and tobacco	1.419	0.400	1.329	0.087
2	Crude materials, inedible	1.453	0.763	1.183	0.029
3	Mineral fuels	1.302	0.483	1.207	0.015
4	Animal and vegetable oils and fats	1.551	1.965	1.327	0.022
5	Chemicals and products	1.450	0.768	1.186	0.070
6	Manufactured goods by materials	2.006	0.997	1.613	0.089
7	Machinery and transport equipment	1.381	0.533	1.309	0.061
8	Miscellaneous Manufactures	1.668	1.069	1.295	0.008
Mixed		1.571	0.818	1.314	0.009
	All commodities, except SITC 9	1.502	0.837	1.263	0.044

The prime data source of the SGS in determining the FMV for the majority of its CRFs is the supplier of the good. The legal basis for this is Section 1308 of the Tariff and Customs Code, which stipulates that the contents of the commercial invoice should include both (1) the purchase price of each article in the currency of purchase and in the unit of the quantity in which it was bought and sold in the country of exportation, and (2) the value of each article in the unit of quantity and currency in which it is usually bought and sold. If this value is unavailable, the invoice should include the

price which would have been received for such an article if sold in the ordinary course of trade and in the usual wholesale quantities. Many commercial invoices, however, do not conform to this. It is interesting to pursue the question why exporters still give two different values even if they know that the SGS will eventually seek out information on the FMV. At this point, the only likely explanation is that it is costless for the exporter to undervalue, especially since monitoring is not always efficient.

The sources of FMV information vary between countries. For instance, it is easier to gather price data from Hongkong, where suppliers will even give it over the telephone, than from Japan, where one needs to know the suppliers personally before one can obtain information. In Taiwan, price lists are not reliable, and there are no brand names for many goods. The SGS, therefore, also relies on prices of similar shipments previously inspected in the same country, price lists of third party sources, direct canvassing, or published price lists, commodity reports, and specialized commercial publications.

This difference in valuation basis becomes an additional tax on the importer. The HCV contributes to uneven protection where the difference is also uneven between commodities because it is not used merely to check undervaluation but is the basis for payment of duties. In addition, it is common for the BOC assessor to use FMV not as it appears in the CRF but as the total dutiable value. This accounts for the greater ratios of BOC/IV compared to those of CRF/IV. The dutiable value that the SGS determines in the CRF is the sum of the FMV, insurance, freight and dutiable charges which, for certain types of goods, can be substantial. These charges are not a component of HCV, but since dutiable value is based on domestic price, expenses on export packing, inland freight, pier handling, commissions, cartage and drayage, brokerage, and others, become part of it.

The higher the tariffs, the greater the tendency to undervalue, misdeclare, or smuggle. These activities probably even out the dispersion of tariff protection especially if accompanied by a less than efficient administrative machinery. Thus, full efficiency ironically contributes to uneven protection due to an uneven tariff structure. However, this efficiency only pertains to

monitoring; a more uniform tariff structure does not guarantee the removal of the uncertainty associated with the use of HCV as valuation base. Instead, it instills such uncertainty, which becomes an additional burden on the importer.

From interviews with Customs officials, it seems that experienced importers, before opening their L/Cs, check the Published Value of the goods they intend to import and use this in their import declaration. To be sure, the practice of giving out PVs is useful since it makes customs administration transparent and less susceptible to manipulation. It also enables importers to avoid additional transaction costs of having to upgrade or revalue their importations. However, this also leads to cases where the IV is the same as the HCV.

The reverse could also be true. Many PVs could be based on the declared transactions value of importers instead of on reports from commercial attaches, given the difficulty of obtaining data from the latter. For instance, when the IV of a product is higher than its PV, the IV automatically becomes the basis for valuation of future imports of that product. Thus, the convergence between the HCV and IV is not surprising in this case.

The tendency of importers to translate their "learning experience" about HCVs (i.e., using price data available from the current PV, updated by CRF data, as their IV) may be true only for certain goods. In our data set, we removed those imports which entered the country from October to December 1992 and recalculated the weighted averages for each commodity group (Table 5). Only two of the commodity groups (machinery and transport equipment and miscellaneous manufactures) support the above contention since the figures excluding the late 1992 entries are higher on the average than those which include them. However, this could explain why the ratio could fall over time. It is logical and easier for importers to simply copy the HCVs in previous CRFs for future import transactions. The SGS describes this phenomenon as the "repetitive effect," which incidentally makes difficult the quantification of their success in increasing dutiable values. Thus, the BOC/IV ratios before and after globalization are more convergent for these commodity groups.

Table 5
 AVERAGE BOC/IV AFTER GCISS OF ENTRIES EXCLUDING OCT - DEC 1992
 BY COMMODITY GROUP

SITC	Description	Simple		Weighted	
		Average BOC/IV	Standard Deviation	Average BOC/IV	Standard Deviation
0	Food	1.074	0.264	0.906	0.072
1	Beverages and tobacco	1.215	0.047	1.054	0.052
2	Crude materials, inedible	1.329	0.765	1.132	0.025
3	Mineral fuels	1.195	0.461	1.109	0.011
4	Animal and vegetable oils and fats	1.306	0.813	1.127	0.014
5	Chemicals and products	1.404	0.796	1.051	0.076
6	Manufactured goods by materials	1.504	0.481	1.041	0.212
7	Machinery and transport equipment	1.207	0.436	1.217	0.053
8	Miscellaneous manufactures	1.397	0.928	1.084	0.011
9	Commodities, n.e.c.	1.337	0.65	1.102	0.050
Mixed		1.377	0.773	1.188	0.017
	All commodities, except SITC 9	1.294	0.739	1.078	0.042

The sample was also differentiated between those imports from the nine countries previously covered by the CISS before it was globalized, and those that were not. The weighted averages, given in Table 6, are higher after globalization for both groups of countries, although the rise in the average of the covered group is only about 2.7 percent. Looking into the situation

Table 6
SIMPLE AND WEIGHTED AVERAGE BOC/IV, BEFORE AND AFTER GCISS
AND EXCLUDING OCT-DEC 1992 BY COUNTRY COVERAGE

	Simple BOC/IV	Standard Deviation	Weighted BOC/IV	Standard Deviation
Before GCISS				
Covered	1.248	0.507	1.107	0.005
Not previously covered	1.210	0.005	1.004	0.005
After GCISS				
Covered	1.347	0.781	1.134	0.004
Not previously covered	1.200	0.540	1.055	0.006
After GCISS excluding entries from October-December 1992				
Covered	1.383	0.848	1.061	0.005
Not previously covered	1.160	0.388	1.058	0.008

Table 7
AVERAGE BOC/IV EXCLUDING THOSE BELOW OR EQUAL TO UNITY
BY GCISS COVERAGE

	Simple BOC/IV	Standard Deviation	Wigh- ted BOC/IV	Standard Deviation
Before GCISS				
Covered	1.37	0.57	1.19	0.01
Not previously covered	1.50	0.89	1.12	0.01
After GCISS				
Covered	1.56	0.91	1.29	0.01
Not previously covered	1.39	0.64	1.24	0.01

of this group after globalization, excluding late 1992 entries, the lower ratio indicates a reversal in the order of "learning," although the change is really small (4.5 percent). In the case of countries not previously covered, the rise in the weighted average BOC/IV, although smaller than that of the other group, is as expected, whether or not the late 1992 entries are included. The ratios themselves are much lower than the previous study's estimates and the current SGS figures.

This table was recomputed after removing those entries with less than or equal to unity ratios. They yielded essentially the same story (Table 7). The covered countries showed a higher weighted average (1.19 before and 1.28 after), while the countries not previously covered showed lower weighted averages (1.11 before and 1.24 after). However, the ratios for both groups of countries substantially increased. Looking back at Table 3, it can be seen that the covered countries always had a bigger share of the total invoice value (63.7 percent before and 56.2 percent after) for those ratios above unity. This means that before or after globalization, most imports from these countries registered ratios above unity. The opposite was true for previously uncovered countries.

B. Revenue Losses

Estimates of revenue changes due to a shift from HCV to IV are shown in Table 8. The losses are moderate, from -3.95 (high *e*) to -6.15 percent (low *e*). Assuming that the elasticity estimates are still applicable, the losses are essentially lower than previously thought. It must be noted, however, that these revenue changes are merely a comparison of the revenue impact of HCV with that of a shift from HCV to IV or EP. They do not mean absolute revenue reduction after the shift is implemented.

It is possible that import response to the use of IV is more elastic than thought, not in terms of price but in terms of less uncertainty. If imports do not have to undergo inspection, there is less uncertainty and fewer transactions, making import response more elastic. This may even be true in the short run. Revenue losses will, therefore, be smaller (even possibly positive). In reality, revenue-reducing measures, such as the removal of the

Table 8
REVENUE CHANGE WITH A SHIFT FROM HCV TO IV

SITC	HCV/IV Before GCISS	HCV/IV After GCISS	Low elas- ticity	High elas- ticity	Zero elas- ticity
0 Food	0.870	0.947	0.0075	0.0070	0.0094
1 Beverages and tobacco	1.101	1.054	-0.0015	-0.0007	-0.0016
2 Crude materials, inedible	1.081	1.130	-0.0200	-0.0166	-0.0206
3 Mineral fuels	1.094	1.120	-0.0068	-0.0054	-0.0073
4 Animal and vegetable oils and fats	1.194	1.118	-0.0024	-0.0027	-0.0028
5 Chemicals and products	0.930	1.063	0.0002	0.0002	0.0002
6 Manufactured goods by materials	1.067	1.044	-0.0100	-0.0014	-0.0119
7 Machinery and transport	1.072	1.183	-0.0225	-0.0175	-0.0244
8 Miscellaneous manufactures	1.058	1.076	-0.0055	-0.0025	-0.0060
9 Commodities, n.e.c.	1.202	1.126	0.0000	0.0000	0.0000
All Commodities, except SITC 9	1.07	1.11	-0.0615	-0.0395	-0.0650

import levy and the reduction of tariffs, have not led to large changes in imports in the past. To be sure, imports are more dependent on the state of the economy rather than on these measures alone.

We also estimated revenue change assuming zero demand elasticity, representing a worst-case scenario. This is comparable to the revenue impact estimation usually done, for example, by the SGS. This can happen in the very short run, i.e., two to three months, when import plans are already implemented by firms. Estimation results are presented in the last columns

of Table 8, and 1 and 2 of Appendix B. Possible revenue losses ranging from 2.6 to 6.5 percent are shown. Again, the losses are smaller than feared.

C. A Case Study of Valuation Problems

According to Customs Deputy Commissioner Titus B. Villanueva, at least 68 percent of the 3,950 cases filed from June 1992 to June 1993 with the SGS-BOC Import Valuation and Classification Committee directly involved valuation problems (*Manila Bulletin*, 28 August 1993). The following cases give us an idea of the difficulties the HCV system presents to the importer, although how representative these cases are cannot be ascertained given the difficulty of obtaining information from the agencies concerned and the preference for anonymity by most private businesses. (Preference for anonymity stems partly from a desire to avoid the greater cost of pursuing such cases, in terms of time lost from delayed release of shipments, time and energy that must be devoted to numerous correspondences and to following up the processing of papers, not to mention the uncertainty about the resolution of the case. In one particular case, the importer spent about \$1500 for communications, notarization, and others, but the costliest part was the lost business opportunities.) Nevertheless, the facts of these cases indicate how the use of HCV may lead to unexpected results and protect substitutes of inferior quality, with consequent welfare losses to the consumer.

Details of each case are given in Table 9. The first indicated an HCV or FMV which was 3.11 times the IV. Unit prices were also reflected in the invoice.

The importer immediately wrote SGS-Manila requesting a revaluation of their assessment (questions are supposed to be addressed to the local office of the SGS, which in turn submits these to the proper foreign offices). In reply, SGS-Manila said that "the FMVs were assessed based on confirmation from exporter and manufacturer of similar and like products." Therefore, they could not amend them. The importer pointed out that its supplier is not a manufacturer but a first-level wholesaler, since it procures goods from manufacturers and sells them to clients.

Table 9
HCVs AND INVOICE VALUES OF PRODUCTS IN CASE STUDIES

Case A	IV (\$)	HCV ₁ (\$)	$\frac{\text{HCV}_1}{\text{IV}}$	HCV ₂ (\$)	$\frac{\text{HCV}_2}{\text{IV}}$	1991 Prices of Another Distributor of Major Brands
Total			3.11			
Product X - Price per unit:						
Type A	10.25	25.29	2.46	31.88	3.11	13.80
Type B	27.80	91.64	3.30	86.46	3.11	41.00
Type C	99.75	339.30	3.40	310.22	3.11	151.00
Type D	51.45			160.01	3.11	75.00

Table 9 continued...

Case B	IV (\$)	HCV ₁ (\$)	$\frac{\text{HCV}_1}{\text{IV}}$	HCV ₂ (\$)	$\frac{\text{HCV}_2}{\text{IV}}$	Retail Price (\$)	Other Distributors Prices of Known Brands				
							Brand W	Brand X	Brand Y	Brand Z	
Total			3.76								
Per unit price:											
<i>Product X</i>											
Type A to C	2.25	8.47	3.76	8.46	3.76	3.73	2.70	2.95	2.50	2.70	
Type D	4.99	8.47	2.12	18.76	3.76						
<i>Product Y</i>											
Type A	3.78			14.21	3.76						
Type B	8.89			33.43	3.76						
Type C	8.05			30.27	3.76						
<i>Product Z</i>											
Type A	72.28			271.77	3.76						
Type B	53.61			201.57	3.76						

Table 9 continued...

Case C				Invoice Prices of Distributors		HCV/IV of Similar Products Shipped at Different Dates			
	IV (\$)	HCV ₁ (\$)	$\frac{\text{HCV}_1}{\text{IV}}$			A	B	C	D
				A	B	(six months before)	(one month before)	(same month)	(four months after)
Total			1.68						
<i>Product X</i>									
Type A	126.14	211.28	1.68	121.25					
Type B	191.80	321.27	1.68					1.67	
Type C	1,988.64	3,330.97	1.68	1,826.66				1.67	
Type D						1.00			
Type E						1.00			
<i>Product Y</i>									
Type A	24.30	40.70	1.68		21.62				
Type B	31.35	52.51	1.68		27.90				1.08
Type C	66.54	111.45	1.68		59.22		1.25	1.36	
Type D	118.68	198.79	1.68		105.62				
Type E	218.68	366.29	1.68		194.62		1.25	1.36	
Type F	309.35	518.16	1.68		275.32		1.25	1.36	

The importer requested a breakdown of the assessed value. SGS-Manila supplied figures, shown in the HCV1 column, but did not give their source or basis. The discrepancies between these figures and the invoice values were 146 percent, 230 percent, and 240 percent, respectively. No figure was given for Type D, nor was there any indication whether the invoice price was acceptable or not. Several attempts to communicate and obtain an answer to this query were unsuccessful.

The importer submitted a price list of another US distributor of major brands for reference, noting the 1991 prices. SGS provided a revised breakdown of the FMV three months after the first itemization (listed as HCV2), finally including the previously unanswered item. Remarkably, the discrepancies between these and the invoice prices were a uniform 211 percent.

The importer wanted to claim trade discounts usually given to clients, ranging from 20 to 40 percent, depending on the magnitude of purchase. The claim seems legitimate since Customs Tariff Decision Circular 5-73 allows cash discounts of 10 percent and regular trade discounts of 30 percent, or a total of 40 percent.

Case B involved a shipment of three types of products (see Table 9) from the US. The CRF indicated an HCV or FMV 3.76 times the IV. Unit invoice prices did not have the corresponding unit HCVs for products Y and Z.

Upon the importer's request for a revaluation of the goods, SGS-Manila answered that "the FMV was established per price information from a major manufacturer" of like products, and they could not amend the assessment.

The importer then requested for an itemized breakdown of the FMV. In reply, SGS gave the unit FMV only of all four types of product X above as \$8.47. The exact source of this information was not mentioned. The importer questioned the similarity in prices of the D-type with the rest, when in fact it should be more expensive because of its higher quality, as is obvious from its specifications. Further, the importer requested SGS to confirm if the disputed items consisted only of those for which it could supply unit prices, but no reply ever came.

The importer next presented a sales invoice for types A to C of product X, purchased from a retail outlet in the US for only \$3.73 each. The SGS valuation, which is supposedly the prevailing wholesale domestic price, was more than double the retail price.

The importer also submitted four other price lists of some US distributors of known brands of product X for reference. With exactly the same specifications, the prices ranged only from \$2.50 to \$2.95 each (see Table 9).

The SGS provided a revised breakdown of the FMV three months after the importer requested a revaluation. This time, there was a uniform 3.76 ratio between the FMV and the invoice value of each item, which the SGS seems to have merely applied. (There was a slight difference, but a difference nonetheless, between the sums in the original CRF and in the new one, which is likely a result of the uniform application of the percentage uplift in value.) It is difficult to accept that the supposed source of information for the SGS—the major manufacturer of products X to Z—has prices which are uniformly greater than the importer's prices for three different products.

The importer asked for an explanation of the long time it took SGS to finally state its basis for valuation, especially since SGS has announced that communicating between its offices is the easiest thing to do. The above price lists were submitted by the supplier to SGS two months after the importer questioned the valuation basis, yet no answer was given. A related issue is SGS's inability to provide a price breakdown for all products even when manufacturers usually produce the whole range X to Z, yet SGS was able to provide itemized prices only for product X. SGS's selectivity in furnishing information on unit prices leads one to believe that the information is not available for all items, but the apparent inability to obtain information is odd for a highly computerized organization.

Case C consisted of two products of many different specifications. The CRF indicated an HCV or FMV 1.68 times the IV. The supplier tried to establish that he is a first-level wholesaler since he buys products from manufacturers and resells them, although in general he acts as a distributor or broker.

The importer requested a revaluation of the goods, to which SGS-Manila replied that "the FMVs were assessed based on confirmation from exporter and manufacturer of similar and like products," hence, the valuation could be changed.

Upon the importer's request for a breakdown of the FMV, SGS-Manila reiterated its original position after discussing the matter with its inspecting office abroad and after obtaining the supplier's information. Without stating the basis for its valuation, SGS came out with unit prices again uniformly greater than the supplier's prices by 68 percent for each of the product types listed. Two points are noteworthy in this case. First, for similar products, it is difficult to explain why prices are uniformly different across goods between two manufacturers. Second, which is even more telling, the supplier purchased the goods from three separate manufacturers, so that a uniform ratio should be more unlikely.

The importer obtained two documents to support his contention that his invoice values reflected the current domestic wholesale prices. One was his supplier's invoice to another client in the same country, in which two items of the same description had comparable prices (see Table 9). The other was the invoice of the manufacturer from which this same supplier purchased the goods, confirming his status as a first-level distributor. The unit prices of that manufacturer were only 12 percent lower than the supplier's unit prices, which may account for the latter's profit margins. Both documents were certified by the supplier, notarized by a law firm in the country of origin, and authenticated by the Philippine consul there. Still, SGS found these unacceptable and insufficient for verifying FMV.

The importer obtained six other CRFs for similar products imported from nine months earlier to about the same time as the shipment in question. The ratios of the total FMV in each CRF to its respective total invoice value were computed, yielding different figures. However, for the goods that arrived at about the same time, the ratio to the invoice was also 1.67. This strongly suggests that, to get the HCV or FMV, SGS merely applies the same factor to the invoice values of products inspected within the same period. SGS has to explain how it obtained these factors or multipliers.

The above cases raise several issues:

First is the transparency in computing FMV. For SGS to cite merely a general source of information does not seem to place an equal weight of responsibility for accuracy compared that of the importer who is required to submit documents. The burden of proof and the right to contest it must be balanced by equal access to information. SGS cites the need for confidentiality whenever it uses third party sources for price data, but published price lists should present no cause for worry. However, printed net price sheets are said to be uncommon in the source country in question, and most lists are meant for single-unit sales. Nevertheless, even if the price lists are not published, the need for confidentiality escapes us since the third party source should give information that correctly reflects his costs: quoting uncompetitive prices would lead to losses. Why would other manufacturers or exporters be afraid to reveal their prices if they are competitive?

Second is the determination of the first-level distributor, which is crucial in defining the HCV. In the above cases the suppliers tried to establish that they are export/wholesale distributors, i.e., they buy from other manufacturers and sell principally to other wholesale buyers, contractors, large industrial and commercial users, and retailers. SGS considers the first-level wholesale price as that at which the distributor sells the product, not the price at which he purchased it; the above cases would qualify under this definition, considering the documents presented.

Third is the acceptance of the discount levels which the supplier claims is available to all its clients, both domestic and export. Given the magnitude of purchases at the wholesale level, discounts are not unrealistic because they reflect economies of larger orders. This is standard practice in most industries, hence, discounts are competitive. Even prices at the retail level are subject to discounts. Moreover, the importance of volume in the wholesale business is such that profits are based on volume rather than on price differences. In ascertaining FMV, price information should include discount schedules, especially since the Customs Tariff Decision Circular No. 5-73 of May 1973, which grants up to 40 percent discounts, is supposedly

still in effect. Why SGS assumes that discounts are not available to all customers is a big puzzle.

The above difficulties suggest some arbitrariness in the system of valuing goods. It becomes more unfortunate when it penalizes correctly valued imports, yet fails to catch the truly undervalued goods. (Aside from this, the importer has to shoulder other costs, such as demurrage fees for the delays in releasing the shipment, inspection delays which result in their inability to consolidate shipments, and additional inland freight and handling costs.) It is interesting to find out how often this occurs and compare this with the amount of real undervaluation or technical smuggling that was caught using the HCV method. A more detailed tabulation of the import entries by source and type of goods will be most helpful.

The above cases tend to undermine the entire rationale for contracting a third party like SGS (which supposedly has superior and detailed knowledge of border prices and technical expertise in the different trades) to determine the value of imports.

D. Reaction of Importers and Investors to HCV and the CISS

The CISS was recommended by the Philippine Chamber of Commerce and Industry (PCCI) in 1985 because of the threat of increased imports due to import liberalization, and of the very likely high incidence of misdeclaration and undervaluation which would undermine local business. The possibility of rampant undervaluation was very real considering the rush in the opening of L/Cs to beat the 16 March 1992 deadline. This indicated that importers would rather pay duties in advance than go through the pre-inspection scheme.

Complaints about the HCV and the CISS were expected because they were said to have upset the "usual" comparative advantage among importers. Most of the cases referred to the BOC-SGS Committee at present involve misclassification, although this does not mean that the importers have stopped lobbying for a change in the valuation basis. Most of the requests addressed by importers to SGS refer to faster release of documents and the abolition of the bond for shipments in question.

Delays in inspection and in the processing of documents are denied by SGS. It maintains that Inspection Advice Notices are issued 1.5 days from receipt of the L/C, and Taiwan is the only country where advance inspections cannot be done. On the average, it takes three days to release the CRF after the inspection, and less than one day to transmit it to Manila. The speed varies between countries. For example, in Hongkong and Taiwan, the CRF is delivered after the arrival of the vessel; in other countries, it is delivered before the arrival. At year end, shipment volumes are bigger, and this lengthens the inspection duration. The mode of transport is another factor. After the GCISS, 37 percent of US exports were by air; this requires special handling since the documents must be completed before the departure of the aircraft.

Every month, SGS tabulates for each country the delay caused by waiting for the CRF after the arrival of the vessel in the Philippines. In general, about five days is the maximum waiting time for the CRF after the vessel has docked, and this occurs mostly for the countries near us. From January to February 1993, CRFs from China, Indonesia, Taiwan, Macau, Hongkong, Singapore, and a few distant countries (e.g., Ghana and Tanzania) were delayed by one to five days. Such a picture hardly changes from month to month, making the yearly chart predictable. SGS maintains that these are not due to inspection lags but to documentation delays by the exporters themselves. The most hit are garments producers (making them the most vocal), because most of their imports come from Taiwan and Hongkong.

SGS further cites that the delays are not real, since procedures are accomplished so efficiently that the BOC now only has to move 85 to 170 containers a day, which is a considerable drop from the average 500 to 1000 containers before.

SGS also points out that the use of HCV can result in the unexpected, as in the case of Japan, where the HCVs had the highest effect on landed cost, but no effect on its exports to the Philippines. The effects of the use of HCV are negligible, says SGS, which estimates a mere 4 percent increase in landed cost.

As for the possible deterring effect of pre-inspection on investment, SGS argues that in Indonesia (which has the same scheme as that of the Philippines, although with less exemptions and a different valuation base), there has been an increased throughput of goods. Indonesia, however, does not use HCV as valuation base. The problem, therefore, is not so much the additional cost of pre-inspection (and/or increased valuation base by HCV), but the uncertainty as to what value will be assessed, a reflection of the arbitrariness in the HCV-based scheme. To be sure, this is a negative influence on investment.

It is recognized that other factors may cause importers or investors to decrease their activity, e.g., the general economic climate and political stability. The high cost of money is a real deterrent, and this could also explain why the average shipment size is small, about half, compared to that of Indonesia. But even those not normally considered part of the economic environment affects investment decisions more directly. For instance, the move of the Philippine Ports Authority to reduce the number of free port storage days from 8 to 6 was opposed by the affected parties. PPA considers such an opposition unjustified since importers do not make full use of the 24-hour day in which to take out their cargo. Importers, however, have their reason: they close their warehouses at night due to high risk of robberies.

E. Imports Valued At Less Than \$500

These are exempted from the CISS and are inspected by the BOC instead. Most are classified as Informal Entry. L/Cs are not required anymore since other modes of payment have been allowed starting August 1992. However, this provides an opportunity for importers to avoid the CISS. Through this mode, technical smuggling in the form of severe undervaluation can take place. The negative impact of this tendency on revenue can be great, since imports through regular channels would mean higher revenue but data are not readily available to determine how much goods are being classified in this manner to avoid HCV and pre-inspection.

F. Other Valuation Bases

The transaction value is the ideal base for dutiable value. It is simply the price actually paid by the importer for the good. The question is, on what should it be based? If invoice values are used, it is prone to underdeclaration, and the burden of proof falls on the government. However, there is less uncertainty with the TV, which is advantageous to the importer. Using the export price is a more objective method since there is lesser possibility of a special relationship, or collusion with respect to the price, between the importer and the seller. The difficulty in obtaining an average export price, as pointed out by SGS, is due to marketing decisions that differ depending on the type of good. This contributes to large variations between, say, the export price and the FMV. However, this criticism also applies to the FMV or HCV itself. The only justification for the latter is its lower susceptibility to manipulation (because it has nothing to do with the import transaction), thereby providing a benchmark by which to measure whether a good is grossly undervalued or not.

The GATT, however, has prescribed built-in safeguards in the use of TV to reduce undervaluation. For example, it has clear alternative measurements for TVs where the declared value is in doubt. Although the Philippines is not a signatory to the GATT Valuation Code, it may be beneficial to aim for this in the long run.

Other countries have adapted the Brussels Definition of Value (BDV), which takes the value of goods imported for home use to be the normal price, i.e., the price the goods would fetch at the time duty becomes payable in the open market sale between a buyer and a seller independent of each other. The normal price is determined using the following assumptions: that the goods are delivered to the buyer at port or place of importation; that the seller bears all cost charges and expenses incidental to the sale and to the delivery of the goods to the port or place of importation, and these costs are included in the normal price; and, that the buyer bears all duties and taxes levied in the country of importation, and these are not included in the normal price.

An open market sale between independent parties presupposes that the price is the sole consideration, that it is not influenced by any relationship between the buyer and the seller other than that created by the sale itself, and that no part of the proceeds of any subsequent resale, other disposal or use of the goods, will accrue directly or indirectly to the seller or any business associates.

Based on this definition, the BDV may be viewed as a compromise between the IV and the EP since it consists of a normal price and would, therefore, include a range of acceptable export prices, yet it is considered at the time duty becomes payable. In terms of administrative costs, however, this would probably be more expensive to implement because of the need to constantly update prices from several exporters every time the specific product is imported into the country.

The use of EP has the advantage of lower revenue loss and of being more manageable or easier to administer than HCV, not to mention the presence of safeguards that minimize undervaluation. At the same time, distortions and uncertainty are lessened, and statutory rates would correctly reflect taxes and protection rates. However, this requires some retraining for the administrative machinery.

Two bills have been filed in Congress, one in the House of Representatives sponsored by Rep. Emil Javier and another in the Senate sponsored by Sen. Gloria Macapagal-Arroyo, seeking to replace HCV with TV or IV. Senate Bill No. 782, which defines TV as the ex-factory price, argues that HCV includes marketing costs which should not be borne by the importer, that it raises domestic prices, reduces imports and sales, and encourages smuggling. Thus, the dutiable value should be "based on its cost (fair market value) as determined in the value or price declared in the consular, commercial, trade or sales invoice," including packaging, freight, and insurance. Otherwise, the cost or FMV of the article as bought and sold freely in the usual wholesale export quantities should be used. This bill is pending in the Committee on Ways and Means, and no immediate action is foreseen because the priorities are currently focused on tax-enhancement measures.

G. Published Values

This is the official BOC price list of imports. It is updated from time to time by Revision Orders (ROs), which include those goods commonly imported and those not in the CISS route. About half of the goods have a PV; where PV is unavailable, the appraiser's value on file is used to upgrade the importer's value; or domestic prices computed backwards are used instead. PVs are consulted in choosing the highest of possible values from among the IV, the CRF, and the PV.

H. SGS Estimates

SGS has estimated the increase in revenue (which includes both tariffs and value-added tax) and in landed cost for the top five commodity groups during the period of global CISS. For all five groups, the percentage change in revenue was 19.96 percent, while the increase in landed cost was 4.41 percent.

We estimated the VAT-inclusive revenue impact of a shift from HCV to IV by replacing the t in the formula for revenue change with $[(1 + t)(1 + v) - 1]$. This yielded -6.1 percent (low e) and -4.7 percent (high e) before globalization, and -9.5 percent (low e) and -7.5 percent (high e) after globalization. These are slightly greater than the estimates using the t alone. Note, however, that the revenue base is just the VAT, rendering this not additive to the previous revenue loss estimates. The VAT-inclusive total change in revenue is the weighted average of the percentage changes in VAT-revenue and in tariff-revenue.

Table 10 enables us to compare the estimates based on SGS figures with our weighted average HCV/IV. The increase in valuation after CISS globalization is computed from SGS data as the ratio of total revenue payable to the difference between this total and the additional revenue payable as a result of SGS intervention. These are generally a bit higher than our estimate, but this is probably because the VAT is included. Looking at each section, however, it can be seen that the estimates are close for some commodities. The average shown at the bottom of the table (1.095) is also

Table 10
COMPARISON OF HCV/IV ESTIMATES FROM SAMPLE AND SGS DATA

SITC	Sample Entries Weighted Average	SGS Commodity Sections	Increase in Valuation
0 Food	0.95	Prepared foodstuffs; beverages,tobacco	1.11
		Vegetable beans, wheat, flour, malt, starch, seeds, gum	1.326
		Milk, cream, buttermilk, whey	1.31
1 Beverages and tobacco	1.05	Prepared foodstuffs; beverages, tobacco	1.11
2 Crude materials, inedible	1.13	Wood pulp; paper and paperboard	1.18
		Wood, articles; charcoal; cork; straw; basketwork	1.121
		Raw hides and skin, leather, furskin, saddlery, etc.	1.096
3 Mineral fuels	1.12	Mineral products	1.129
4 Animal and vegetable oils and fats	1.12	Animal, vegetable fats and waxes, prepared edible fats	1.109
5 Chemicals and products	1.06	Chemicals and products	1.213
6 Manufactured goods by materials	1.04	Wood pulp; paper and paperboard	1.18
		Raw hides, skin,leather,furskin,saddlery, etc.	1.096
		Wood,articles; charcoal; cork,articles, straw, etc.	1.121
		Plastic, rubber and articles	1.172
		Base metals and articles	1.077
		Articles of stone, plaster, cement;ceramic, glass	1.178

Table 10 *continued...*

SITC	Sample Entries Weighted Average	SGS Commodity Sections	Increase in Valuation
7 Machinery and transport equipment	1.18	Precious, semi-precious metals	1.02
		Machinery and mechanical appliances	1.154
8 Miscellaneous manufactures	1.08	Transport equipment	1.103
		Miscellaneous manufactured articles	1.187
		Optical, photography, cinematography equipment, musical instrument, clocks	1.277
		Athletic shoes, artificial flowers, umbrellas Arms and ammunitions; parts and accessories	1.095 1.154
9 Commodities, n.e.c.	1.13	(Total IV of CRFs Issued + Uplift in Dutiable Value) / (Total IV of CRFs Issued)	1.095
All Commodities, except SITC 9	1.11	(Duties payable per CRF) / (Duties payable per declaration)	1.156

close to our estimate (1.11), yet the latter is a weighted figure while the former is a simple average.

I. Import Response

The percentage change in imports due to a shift from HCV to IV was also calculated for dutiable imports, i.e., SITC 1 to 8 (Table 11). The results yielded an increase in imports of from 0.58 (low *e*) to 3.09 percent (high *e*).

Table 11
IMPORT CHANGE WITH A SHIFT FROM HCV TO IV

SITC	HCV/IV Before	HCV/IV After	Low <i>e</i>	High <i>e</i>
0 Food	1	1	0.0000	0.0000
1 Beverages and tobacco	1.101	1.054	0.0001	0.0003
2 Crude materials, inedible	1.081	1.13	0.0006	0.0039
3 Mineral fuels	1.05	1.12	0.0001	0.0037
4 Animal and vegetable oils and fats	1.164	1.118	0.0000	0.0005
5 Chemicals and products	1	1.063	0.0001	0.0004
6 Manufactured goods by materials	1.067	1.044	0.0013	0.0077
7 Machinery and transport equipment	1.056	1.183	0.0032	0.0119
8 Miscellaneous manufactures	1.058	1	0.0004	0.0023
9 Commodities, n.e.c.	1.202	1.121	0.0000	0.0000
All Commodities, except SITC 9	1.045	1.074	0.0058	0.0309

VI SUMMARY AND CONCLUSIONS

1. Global CISS had a minimal effect, as shown by a moderate weighted HCV/IV ratio, ranging from 1.07 before to 1.11 after the globalization, but these are widely dispersed across commodity groups. The simple averages, however, were higher than the weighted ratios, indicating that larger IVs (which were used as weights) tended to have smaller ratios, either because of bulk discounts or of the propensity of the assessor to impose lower valuation for large shipments. The wide dispersion of ratios among commodity groups indicates an additional distortive effect of the valuation method.

2. The low averages are not really surprising because averages hide a lot of variations. Grouping the ratios between those below or equal to unity and those above unity highlighted the unevenness of the HCV/IV ratio and, thus, its distortive effect. Before GCISS, the share of imports with close to unity ratio was around 51.1 percent. This went down slightly to 48.0 percent. The average HCV/IV ratio for the above unity group was 1.173 before and 1.263 after the GCISS. Thus, the rationale for HCV becomes weaker. Where the ratio is close to unity, HCV is not necessary, but where the ratio is high, HCV imposes an additional tax unevenly.

3. Separating the nine countries covered by CISS from those not previously covered yielded ratios that increased for both groups between the two time periods. The ratios, however, were small, 1.107 to 1.134 for previously covered countries, and 1.004 to 1.055 for those not previously covered.

4. Revenue losses due to a shift from HCV to IV or EP are summarized in Table 12, using the low and high elasticities to differentiate the immediate impact from the longer-term impact. In general, the losses, at 2.1 to 4.7 percent for the first year and decreasing through time, are not as large as

Table 12
SUMMARY OF THE REVENUE IMPACT
OF THE CHANGE IN VALUATION METHOD

	HCV to IV	HCV to EP
First two months (zero e)	-0.065	
From Table 9		-0.026
From Table 10		-0.054
Next two months (low e)	-0.062	
From Table 9		-0.025
From Table 10		-0.052
Last two months (high e)	-0.039	
From Table 9		-0.019
From Table 10		-0.031
Average annual change*	-0.047	
From Table 9		-0.021
From Table 10		-0.038

*Simple average weighted by the number of months.

expected. This does not mean that there will actually be revenue losses after the first year. The change only compares revenue using the HCV and revenue using the IV or EP. For the first two months, the zero elasticity assumption is applied, yielding an estimated 2.6 to 6.5 percent revenue loss. These can be overestimates, even though they are compatible with the results of SGS computations, because they represent an extreme case. The estimated 2.5 to 6.2 percent for the next two months, and 1.9 to 3.9 percent

for the rest of the year, may also be on the high side since import demand is not really that inelastic in the very short run. With the elimination of uncertainty or arbitrariness caused by HCV, imports will be more responsive and revenue losses smaller. The impact after one year is a weighted average of the first three periods (two, two, and eight months). In the long run, say two years, revenue change can even be positive due to these non-price factors.

5. Revenue losses from a shift to EP are expectedly lower. However, this is more likely for a one-year period because of reduced uncertainty as a result of a shift to a lower valuation base. The estimates show that revenue losses can be reduced by using a valuation base where there are effective checks to the price.

6. The response of imports ranged from 0.6 percent to 3.1 percent, and this may be applicable in the short run. The VAT- inclusive revenue impact ranged from 6.6 percent to 7.8 percent, although this cannot be simply added to the tariff-revenue loss.

After globalization, the impact of HCV method was expected to be manifested more clearly. However, our estimates showed smaller ratios, indicating that either the HCV was not an effective check to underdeclaration (and this was shown for half of our sample) or the ratios were true values, suggesting that the pre-inspection scheme was in fact not needed. The HCV has resulted in additional costs due to uncertainty and distortions, and has contributed to a higher valuation base, affecting investment decisions.

Considering that administering the GCISS is not costless and that it covers only about half of dutiable imports (based on the available PVs), the government is not being cost-effective (the SGS has two to three times the budget of the entire BOC). At present, it is not realistic to use HCV for all imports, only to a certain percentage of them. Although HCV curbs smuggling of certain imports, it does so in a distortive manner. With the TV, as defined by GATT, the country can focus on cases where smuggling is

rampant, but minus the distortions. In other words, the country needs to concentrate its limited resources on where they will count most in a least distortive manner.

The above estimates strengthen the position that the shift from HCV should be made since the feared huge revenue losses are in fact small and will be true only in the short run. The low HCV/IV figures further imply that the use of HCV as a valuation base has not resulted in large additional revenues, at least not to the extent that a 20 percent increase in valuation would produce. In other words, revenue collections of the BOC do not necessarily reflect the change in valuation. The more pressing reason for shifting to a transaction-based valuation is the distortionary impact of HCV on the protection structure and its negative effect on direct foreign investments.

Initially, it is possible for IV to fall below the estimates under the HCV regime. This means that revenue loss can be higher than estimated. However, it is also possible that increased trade facilitation, removal of uncertainties and arbitrariness, and reduction in transaction costs of importing—all a result of a change from HCV to transaction-based valuation—can counteract such a tendency, making imports more elastic. This will push the estimates downward, although which is stronger cannot be quantified at the moment. Some safeguards, such as using an export value (or check price), can help prevent serious revenue losses in the short run, but this will not bring in a meaningful trade facilitation which the investment climate badly needs.

The use of transaction value can promote greater trade facilitation. On the other hand, the continued use of HCV can have a considerable “non-revenue” impact. As the importers claim, it increases the cost of doing business (e.g., submitting appeals to the BOC-SGS grievance committee can be very costly in terms of time and money). It has a nuisance effect on the inflow of foreign direct investment, not only because it increases the cost of business, but more probably because investors have to adjust to a very different system (especially for new investors unused to an HCV system), since the Philippines is perhaps the only country that uses it.

While not absolute, the low estimate of the revenue impact is based on solid data. Some factors could make it underestimated or overestimated (depending on the final shape of the valuation system) considering the “everything also being equal” assumption. Still, it is robust. Moreover, considering that a large proportion of Philippine imports consists of intermediate or capital goods, the duties payable missed by the BOC should be captured by the internal revenue system. The computerization plan of the BOC and the BIR should help ensure that the evaded duties will eventually be paid as income taxes.

Finally, if ever the revenue impact is underestimated, other positive benefits of moving away from HCV are enough incentives. Some short-term losses in tariff revenues can be translated into internal/income tax revenue gains although with some time lag, but effecting on the whole an increase in overall tax revenues.

APPENDIX A

METHODOLOGY

One of the objectives set by this study was to assess the impact of HCV on the level and structure of protection. For this reason, the gap between HCV and Transaction Value (TV) is measured. This is done by estimating first the ratio between HCV and Invoice Value (IV). Then the revenue impact of a change in valuation system from HCV to an alternative customs valuation base is estimated.

A. The HCV/IV Ratio

The ratio between HCV and the true TV is used to assess the impact of HCV on the protection structure. A valuation base different from the true TV implies a different effective tax rate. For example, if TV is the true transactions value, HCV the valuation base, and t the tariff book rate, then the effective tariff rate t_e is not t but:

$$t_e = t(\text{HCV}) / \text{TV} = t(\text{HCV} / \text{TV}) = t(1 + h)$$

where

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

In other words, tariff protection is enhanced by $1 + h$.

The problem, however, is how to obtain the true TV which is very difficult to document. For this study, it is assumed that TV is closely approximated by the IV. This assumption is necessary because there is no other source of documented information on import transactions except the import entries which form the data base for this study. The possibility of the invoice being undervalued is noted; the presence of SGS, however, checks

this tendency because the importer will still have to reckon with the HCV no matter what the IV is.

The basic approach, therefore, is to calculate the gap between the HCVs and the IVs in each import entry, which is the document submitted by the importers to the BOC. Import entries are differentiated by commodity groups, then by pre-GCISS country coverage, to find out how the ratios vary across commodities and origins. Two periods are examined: before and after the GCISS, the cut-off date being 16 March 1992. This separation is thought useful because the IV comes from other different sources before the GCISS and is likely to reflect changes in Published Values due to pre-inspection after the GCISS.

A total of 3,000 import entries is the targeted sample size; random numbers are generated and those entries which match the numbers are picked. The two main sources of import entries are the Port of Manila, with 1500 entries divided equally between the two periods, and the Manila International Container Port, with 1500 entries also divided equally between the two periods.

The information copied from each entry consist of the following: Importer's Name, L/C Date, Country of Origin, Tariff Heading, Product Description (including quantity or weight), Declared Value, BOC Assessed Value (HCV or FMV), Invoice Value (specifying whether CIF, C&F or FOB), Freight from the Bill of Lading, and HCV in the Clean Report of Finding (CRF).

The HCV used in calculating is in FOB terms. Thus, the three values needed for our purpose are the BOC-HCV or value assessed by the BOC (FMV in the CRF, thus, excluding dutiable changes) and actually paid by the importer, the IV, and the CRF-HCV or the value assessed by SGS. Although the BOC is supposed to base its assessment on that of SGS, there are occasions when it has a different assessment because of the Customs valuation rule that whichever is highest of the different values (e.g., from Published Values) should be used as basis for valuation.

The ratios computed are the BOC/IV and the CRF/IV; the average for each commodity group and country coverage is also calculated and

weighted using the IV separately. The ratios for each period are then compared, and the standard deviations calculated. These ratios are used in estimating the revenue impact, the methodology of which is given below.

B. Revenue Change

It is usually pointed out that a major problem in switching from HCV to TV is the possible revenue losses resulting from that switch. Hence, the next step is to estimate the revenue impact of a change in customs valuation base from HCV to an alternative one.

The methodology for estimation in this study simply makes use of trade elasticities. Given the meager time and resources, a more sophisticated econometric model for estimation is not feasible, nor is it necessary considering that a negative revenue impact of a change in valuation base is likely to occur only in the short run. Hence, the need only for short-run estimates which trade elasticities can adequately provide.

We look at two different cases: (1) a shift to TV using the IV, and (2) using the Export Price (EP). Theoretically, they should be one and the same. With the tendency to undervalue, however, the IV can be lower than the EP assessed by customs authorities (whether through SGS or some other means).

If the shift is from the use of HCV to the use of IV, the formula for estimating the change in revenue is as follows:

Let $R(0)$ be the revenue level when the IV is used,
 $R(h)$ the revenue level when the HCV is used,
 h the ratio between HCV and IV less one,
 from $(1+h) = \text{HCV}/\text{IV}$,
 m the level of imports,
 P_b the import price given by the IV, and
 t the tariff.

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

With a change from HCV to IV, $P_b (1+h)$ becomes P_b , that is, the valuation base goes down to P_b . Even in the short run (especially for periods longer than two to three months), import demand elasticity is not zero. That is, a lowering of the price will induce a greater demand for the product. In other words, the level of imports will change depending on the import demand elasticity, denoted by e_m in absolute values. Hence, we have

$$R(0) = t P_b \cdot (m + \Delta m),$$

where

$$m = -e_m \cdot m \cdot \Delta P/P,$$

or

$$\Delta m/m = -e_m \Delta P/P$$

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

Let

$P(h)$ be the domestic price of the import when the HCV is used,
 $P(0)$ the domestic price of the import when the IV is used,

Then

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

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

and

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

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

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

or

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

so that

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

The change in revenue is derived, for $t \neq 0$, as

$$\begin{aligned} \Delta R/R &= \frac{R(0) - R(h)}{R(h)} \\ &= \frac{t P_b(m + \Delta m) - t P_b(1+h)m}{t P_b(1+h)m} \\ &= \frac{m + \Delta m - m - mh}{(1+h)m} \\ &= \frac{\Delta m/m - h}{1+h} \end{aligned}$$

and substituting for $\Delta m/m$,

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

For commodity group i ,

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

Note that if ..

$$\bar{e}_{mi} = 0 ,$$

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

To get the sum of the revenue change, we use estimates of revenue as weights, given by

$$\frac{\bar{t}_i \bar{m}_i}{\sum \bar{t}_i \bar{m}_i}$$

such that for SITC groups 1 to 9,

$$\sum_1^9 \left\{ \frac{\Delta R_i}{R_i} \right\} \frac{\bar{t}_i \bar{m}_i}{\sum \bar{t}_i \bar{m}_i}$$

gives the revenue change estimate.

This formula is, therefore, applied by broad SITC commodity groups, given that the ratio $(1+h)$ varies across groups because the tendency to undervalue depends on the type of good. Furthermore, the response to price changes differs between groups, hence, the different elasticities. Estimates of the latter are obtained from secondary sources; unfortunately, there have been no recent elasticity estimates after those done by GATT (1985) and R.M. Bautista (1977), whose data covered the period 1952-1972. These are as follows:

SITC	GATT Range			BAUTISTA
	low	high	median	
0	-0.9	-1.59	-.78	-1.236
1				-0.462
2	-0.17	-1.15	-.50	
3	-0.1	-2.78	-.96	-1.206
4	(with SITC 2)			-0.015
5				-0.383
6				-4.260
7	-.74	-2.64	-1.34	-0.703
8			-0.422	
9				
all	-.42	-1.37	-1.06	

Now, suppose that the shift in valuation base is from HCV to EP. Based on our earlier notation,

$$\text{HCV} / \text{IV} = 1 + h.$$

Let

$$\text{HCV}/\text{EP} = 1 + c,$$

but we constrain EP such that $\text{IV} \leq \text{EP} \leq \text{HCV}$. This is based on the assessor's general perception of the relationship between the three values: the IV is the least since it is the amount the importer claims to have paid;

the EP in most cases exceeds the IV because it is the amount the exporter charges regardless of the buyer; and the HCV is the highest because it is the price prevailing in the domestic market.

Contrary to what could actually be, the reason for using c is to set a minimum valuation base to prevent the expected undervaluation from being realized when switching from one base to another. The rationale is that even with HCV in place, a lot of undervaluation still takes place, and c allows us a minimum base given the imperfections of the system.

$$\begin{aligned} \text{If } h \geq c, \text{ then } \frac{EP}{IV} &= \frac{1+h}{1+c} \text{ and } \frac{\Delta P}{P} = \frac{P(EP) - P(HCV)}{P(HCV)} \\ &= \frac{P_b \left[1 + \left(\frac{1+h}{1+c} \right) t \right] - P_b [1 + (1+h)t]}{P_b [1 + (1+h)t]} \\ &= \frac{(1+h) \left(\frac{1}{1+c} \right) t}{1 + (1+h)t} = \frac{(1+h) \left(\frac{-c}{1+c} \right) t}{1 + (1+h)t} \\ &= \frac{\left(\frac{1+h}{1+c} \right) (-c) t}{1 + (1+h)t} \end{aligned}$$

From

$$\frac{\Delta m}{m} = \frac{e_m \left(\frac{1+h}{1+c} \right) (c) t}{1 + (1+h)t}$$

e_m and c are absolute values.

We have

$$\frac{\Delta R}{R} = \frac{R(EP) - R(HCV)}{R(EP)}$$

$$\begin{aligned}
 &= \frac{tP_b \left(\frac{1+h}{1+c} \right) (m + \Delta m) - tP_b (1+h) m}{tP_b (1+h) m} \\
 &= \frac{1}{1+c} \left(1 + \frac{\Delta m}{m} \right) - 1 \\
 &= \frac{1}{1+c} \left[1 + \frac{e_m \left(\frac{1+h}{1+c} \right) c t}{1 + (1+h) t} \right] - 1
 \end{aligned}$$

However, if $h < c$ and we assume that $IV \leq EP \leq HCV$, then there are two possible cases:

Case 1: $EP = IV$. That is, IV is close to the true export price, and revenue change may be computed as derived above. HCV cannot be lower than EP ; furthermore, whenever HCV is close to IV , the possibility that IV is close to the true EP is even greater.

Case 2: $EP = HCV = IV(1+h)$. When h is small, it could mean that HCV is close to EP , and there is no revenue change.

The average tariffs used in the estimation are obtained from averages classified by Tariff Heading, matched with their corresponding SITC, and averaged across the number of Tariff Headings per SITC. The total average tariff will, however, exclude SITC 9 (Commodities n.e.c.) which have zero tariffs. To get revenue, these average tariffs are applied to 1991 CIF import levels. Weights are then calculated from these.

APPENDIX B

Revenue changes with a shift to the EP (Tables 1 and 2) are expectedly smaller, given that the EP is between the IV and the HCV. Thus the figures are from a low of -1.9% (high e) to a high of -2.5% (low e) assuming EP = HCV for $HCV/IV < 1.1$ (Table 9); or -3.05% (high e) to -5.15% (low e) assuming EP = IV for $HCV/IV < 1.1$ (Table 10). These estimates are much lower than with a shift to the IV. What this means is, if huge revenues will be lost in the short run, some safeguard mechanism could be implemented to curb such losses.

Table 1
REVENUE CHANGE WITH A SHIFT FROM HCV TO EP (assuming EP = HCV for $HCV/IV < 1.1$)

SITC	Description	HCV/IV before GCISS	HCV/IV after GCISS	Low elasticity	High elasticity	Zero elasticity
0	Food	0.870	0.947	0.0000	0.0000	0.0000
1	Beverages and tobacco	1.101	1.054	-0.0010	-0.0005	-0.0010
2	Crude materials, inedible	1.081	1.130	-0.0095	-0.0078	-0.0098
3	Mineral fuels	1.094	1.120	-0.0034	-0.0026	-0.0034
4	Animal and vegetable oils and fats	1.194	1.118	-0.0020	-0.0012	-0.0019
5	Chemicals and products	0.930	1.063	0.0000	0.0000	0.0000
6	Manufactured goods by materials	1.067	1.044	0.0000	0.0000	0.0000
7	Machinery and transport equipment	1.072	1.183	-0.0091	-0.0069	-0.0099
8	Miscellaneous manufactures	1.058	1.076	0.0000	0.0000	0.0000
9	Commodities, n.e.c.	1.202	1.126	0.0000	0.0000	0.0000
All commodities, except SITC 9		1.070	1.110	-0.0250	-0.0190	-0.0260

Table 2
REVENUE CHANGE WITH A SHIFT FROM HCV TO EP (assuming EP=IV for HCV/IV < 1.1)

SITC	Description	HCV/IV before GCISS	HCV/IV after GCISS	Low elasticity	High elasticity	Zero elasticity
0	Food	0.870	0.947	0.0075	0.0070	0.0095
1	Beverages and tobacco	1.101	1.054	-0.0015	-0.0007	-0.0015
2	Crude materials, inedible	1.081	1.130	-0.0175	-0.0145	-0.0179
3	Mineral fuels	1.094	1.120	-0.0064	-0.0051	-0.0070
4	Animal and vegetable oils and fats	1.194	1.118	-0.0019	-0.0015	-0.0019
5	Chemicals and products	0.930	1.063	0.0002	0.0002	0.0000
6	Manufactured goods by materials	1.067	1.044	-0.0100	-0.0014	-0.0120
7	Machinery and transport equipment	1.072	1.183	-0.0162	-0.0124	-0.0175
8	Miscellaneous manufactures	1.058	1.076	-0.0055	-0.0025	-0.0060
9	Commodities, n.e.c.	1.202	1.126	0.0000	0.0000	0.0000
	All Commodities, except SITC 9	1.070	1.110	-0.0515	-0.0305	-0.0545