



STATEMENT ON THE PROPOSED SUSPENSION OF VAT ON OIL PRODUCTS

The **Makati Business Club**, the **Management Association of the Philippines**, and the **Financial Executives Institute of the Philippines** do not support the proposed temporary suspension of VAT on oil products, for the following reasons:

1. Fiscal stability - The revenue losses for a six-month suspension are roughly estimated to be P27 billion. This would make it more difficult to achieve the Administration's goal of a balanced budget in 2008. The losses could be even greater if the period of suspension is extended, which is a great temptation inasmuch as suspending taxes is a politically popular measure.
2. Policy consistency - The passage of the Reformed VAT Law was unpopular, but it is the singular policy reform measure that set our economy upright. Suspending the law would weaken the legislature as an institution. If the law is a bad law, then it should be abrogated or amended. Obviously, it is not a bad law since the proponents of its suspension want the tax restored after six months. But flip-flopping on policy makes the country less than attractive as an investment destination.
3. Credit rating - The passage of the Reformed VAT Law enabled the country to earn an upgrade in its international credit rating outlook. A higher rating helps the country borrow at lower interest rates. Suspending the law would most likely lead to a downgrade that would affect the government's borrowing costs. So the loss in revenue is compounded by higher interest expenditure. The private sector is also affected as it cannot get a credit rating higher than the sovereign.
4. Conservation - Prices are signals to consumers. Higher prices discourage consumption, thus leading to good habits like conservation. Suspending VAT on oil sends the signal that it is all right to consume as much as when oil was at a lower price level, even if oil prices are now much higher. Is that the signal the government wants to send the consumer?

The likelihood is that high oil prices are here to stay. If the suspended VAT on oil is reimposed, then the benefit is too transient to provide a real solution. On the other hand, if the suspension ends up being a permanent exemption, it would be disastrous for our fiscal health and would jeopardize the implementation of government programs.

We believe price subsidies are inappropriate as they lead to distortions in consumer behavior or even in investment preferences. As experience in other countries has shown, price subsidies may start small, but over time, these may take up a large part of the national budget and crowd out other basic priorities.

High oil prices lead to higher costs that low-income families can hardly afford to pay. As an appropriate response, **we recommend that the government increase targeted expenditures that directly benefit the poor in areas that matter to them, such as health and education.**