Philequity Corner (July 14, 2008)
By Valentino Sy

Scrapping the VAT on oil?

The high and sustained increase of prices of fuel and basic goods has led to public clamor for the government to scrap the VAT on oil. Bending into such short-term fixes, however, would be irresponsible and the effect on the country's financial standing and credibility would be catastrophic.

Different points of view

Last week, the influential Catholic Bishops Conference of the Philippines (CBCP) joined some politicians and populist groups in urging the government to lift the VAT on oil, which it said was pushing up prices and adversely affecting the poor.

Senator Manuel Roxas II, who has been pushing for the lifting of the VAT on oil, said that "*the government should not continue to be dependent on a socially sensitive product for its revenues. It's riding on the people's suffering. It's making the poor pay for the government's inefficiencies*."

But lifting the VAT on oil would mean "*P73.1 billion in forgone revenues, which the government could otherwise use to fund programs to help the poor cope with rising oil and food prices*," according to Finance Secretary Gary Teves.

Already the government has released P4 billion from the initial windfall from the VAT on oil – P2 billion to help small electricity users pay their bills, P 1 billion in loans and scholarships for poor students, and another P1 billion to help jeepney operators and drivers convert diesel engines into those that run LPG and compressed natural gas.

No time for quick fix

Now is not the time for quick fixes or pushing the panic button. We agree with Senator Angara when he said that the government "*should seriously study the effects of repealing the VAT on oil*" given that the rapid rise in oil prices is a global phenomenon. Suspending the VAT on oil will only deplete government resources for food and electricity subsidies.

Senator Angara cited the need to seek long-term solutions by exploring alternative energy sources such as solar, geothermal, hydro and wind energy, for which the Philippines have great and untapped potential.

Short-term and long-term consequences

A removal, suspension or even a reduction of the VAT on oil has the same policy flaws as fuel subsidies (refer to our article "*Be Careful With Subsidies*" on the June 2, 2008 issue of **The Philippine Star**).

While alleviating the consumer from high fuel prices in the short-term, it is likely to harm consumers and the economy in the long-run by encouraging inefficient use of fuel and squeezing other government spending in areas such as health, education and other social services.

Growing public debt puts upward pressure on interest rates which raises the cost of doing business and reduces the capital available to more productive borrowers. The fiscal underperformance will likely depress the Philippine peso, making imported fuel more expensive, and feeding back into the inflation despite the removal of the VAT on oil.

Remain steadfast

At this critical juncture of nervous financial markets, the removal or reduction in the VAT for oil as proposed by the CBCP, will exacerbate our problems. This is similar to those being encountered in most Asian countries, i.e. high inflation, depreciating currency, outflow of capital, declining stock market, worsening consumer confidence, etc. All these will affect the long-term financial progress that the country has earned the past few years.

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