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TRADE SUMMARY

The U.S. trade deficit with the Philippines was $2.1 billion in 2003, a decrease of 1.6 billion from 2002. U.S. goods exports in 2003 were $8.0 billion, up 9.8 percent from the previous year. Corresponding U.S. imports from the Philippines were $10.1 billion, down 8.4 percent. Philippines is currently the 19th largest export market for U.S. goods.

U.S. exports of private commercial services (*i.e.*, excluding military and government) to the Philippines were $1.5 billion in 2002 (latest data available), and U.S. imports were $1.3 billion. Sales of services in the Philippines by majority U.S.-owned affiliates were $1.2 billion in 2001 (latest data available), while sales of services in the United States by majority Philippines-owned firms were $18 million.

The stock of U.S. foreign direct investment (FDI) in the Philippines in 2002 was $4.1 billion, up from $3.3 billion in 2001. U.S. FDI in the Philippines is concentrated largely in manufacturing, and finance sectors.

IMPORT POLICIES

Tariffs

In January 2003, the Philippines government announced a reversal in tariff policy and indicated that it would undertake a comprehensive review of all tariff lines. By early 2004, the Tariff Commission had issued its recommendations for increased tariffs in several sectors and a slow down of its tariff reduction plans in others. While the increased tariffs remain below WTO bound rates, they represent a reversal of the hard fought reforms of successive previous Philippine administrations during the 1990s.

Previous progress on tariff liberalization took shape through a series of reform programs beginning in 1995 that gave most-favored nation (MFN) tariff rates to all goods (except sensitive agricultural products). These tariffs were to be gradually reduced to the following target rates: 3 percent for raw materials and 10 percent for finished products by January 2003; and a uniform 5 percent tariff rate for all remaining products by January 2004.

Executive Orders 241 and 264, signed by President Arroyo in October and December 2003, respectively, raised tariff rates on more than 1,000 product lines and maintained 2003 rates for an even greater number of product lines. Products affected include industrial goods produced domestically, such as chemical fertilizers, cements, consumer products such as apparel and footwear, and raw materials. The orders raise rates on these products from the current rates of between 3 percent to 10 percent to between 5 percent and 20 percent. These rates are expected to remain in effect until 2007.

The Common Effective Preferential Tariff (CEPT) Agreement for the ASEAN Free Trade Area (AFTA) requires that tariff rates among ASEAN members on a broad range of products be reduced to between zero percent and 5 percent, while quantitative restrictions and other non-tariff barriers are to be eliminated. ASEAN members agreed on a firm timetable leading up to the full realization of AFTA in 2003. President Arroyo signed an executive order on January 9, 2003, which temporarily suspended the AFTA tariff reduction schedule on petrochemical resins and certain plastic products. As allowed for under AFTA, Singapore sought and won compensation from the Philippines for failing to lower Philippine petrochemical tariffs.

Automobile Sector Tariffs

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On April 17, 2001, the Arroyo Administration issued an order lowering the tariff on automotive vehicle components from 10 percent to 3 percent under the Philippine government's Commercial Vehicle Development Program, a program designed to rationalize the auto industry and transform the Philippines into a regional hub for automotive production.

To promote local assembly under the Philippine Motor Vehicle Development Program, imports of finished automobiles (completely built-up units) and motorcycles have been subject to the highest duty rate applied to non agricultural products. As part of the comprehensive tariff review, the 30 percent tariff rate for finished automobiles and motorcycles was extended through 2007 by Executive Order 241, reversing a previous order that scheduled a drop to 5 percent in 2004. Completely knocked-down vehicles imported under the Motor Vehicle Development Program are scheduled to decline to 5 percent in 2004 from the current 10 percent.

The Philippines imposes a 30 percent tariff on motorcycles and a 3 percent tariff on crude oil and most refined petroleum products.

Safeguards

The Safeguard Measures Act, effective August 10, 2000, authorizes the Secretary of Trade and Industry or the Secretary of Agriculture to raise a tariff or, in the case of an agricultural good, impose a quantitative restriction, to protect a domestic industry from an import surge. The U.S. Government has expressed reservations concerning the Philippine safeguards legislation, noting in particular that the five days afforded to foreign industry to comment on proposed safeguards is not a reasonable period of time as provided for in the WTO Agreement on Safeguards. The U.S. Government has requested that the Philippines lengthen the statutorily mandated period. The Philippines government has responded that, under certain circumstances, the time to comment can be extended administratively to 21 days.

In November 2001, the Philippine government implemented safeguards to protect local cement producers from imports. These safeguards still remain in effect. The interagency Tariff Commission is currently reviewing a safeguard request by local industry for protection against imported float glass and mirror glass.

Agriculture Tariffs and Import Licensing

The Philippines maintains high tariff rates on sensitive agricultural products, including grains, livestock and meat products, sugar, frozen and processed potatoes, onions, coffee, and fresh citrus, including oranges, lemons, and grapefruit.

In 2002, the Philippines issued several executive orders (E.O. 83, 84 and 91), which provided for tariff reductions for most agricultural products through 2004. However, in January 2003, the Philippines reversed this policy by issuing Executive Order 164, which set tariff rates for most agricultural products at their 2002 levels with the exception of pork, poultry, processed meats, corn, coffee and vegetables. Tariffs on other less-sensitive goods were maintained at 7 percent in 2003 while tariffs for several vegetables such as lettuce, broccoli and cauliflower were raised from 7 percent to between 20 percent - 25 percent.

Among sensitive agricultural products, 15 items (at the four-digit HS level) are subject to a minimum access volume (MAV) and tariff-rate quotas (TRQs). Several products with significant market potential for the United States are subject to TRQs, including corn (with an in-quota tariff rate of 35 percent and for 2003/2004 an out-of-quota tariff rate of 50 percent), poultry meat (in-quota and out-of-quota tariff rates equalized at 40 percent on July 1, 2003), and pork (in-quota rate of 30 percent through 2004, out-of-quota at 40 percent through 2004).

The United States had expressed concerns in the past that TRQs for pork and poultry meat were administered in a manner that allocated the vast majority of import licenses to domestic producers who had no interest in importing. Following intensive consultations, the U.S. and Philippine governments concluded a Memorandum of Understanding in February 1998 that resolved the United States' primary concerns over the Philippine TRQ system. The U.S. Government continues to closely monitor the operation of the Philippines TRQ system and the allocation and distribution of import licenses. While import permits are issued and MAV fill-rates are improving, permit issuance is often unpredictable, which has made some importers reluctant to apply for permits. The practice creates the appearance of discretionary licensing, a system which could be WTO-inconsistent.

The Philippine Fisheries Code permits importation of fresh, chilled, or frozen fish and fish products only when certified as necessary by the Secretary of Agriculture and upon issuance of an import permit by the Department of Agriculture. Among the criteria the Secretary is mandated to consider in determining whether to approve importation is whether there is serious injury or threat of injury to a domestic industry that produces like or directly competitive products.

Excise Tax on Distilled Spirits

The Philippines differentiates between domestically produced and imported spirits in its excise tax regime, discriminating heavily against imported spirits. Distilled spirits produced from indigenous materials (such as coconut palm, cane, and certain root crops) are subject to a specific tax of 8.96 pesos per proof liter. Distilled spirits produced from other raw materials (which would apply to most imports) are subject to a specific tax ranging from 84 pesos to 336 pesos per proof liter (depending on the net retail price per 750 ml bottle). Wines with an alcohol content of 14 percent or less by volume are assessed an excise tax of 13.44 pesos per liter, while wines with an alcohol content greater than 14 percent but less than 25 percent alcohol content by volume are charged an excise tax of 26.88 pesos per liter. Fortified wines (containing greater than 25 percent alcohol content) are taxed as distilled spirits. Depending on the net retail price per bottle, an excise tax of 112 pesos per liter for wines or 336 pesos per liter for sparkling wines is assessed.

A bill pending in the House of Representatives since 2002 would revert the tax rates to more equitable levels through indexation. The bill would also reclassify alcohol and tobacco products based on their net retail prices in order to ensure that the appropriate tax rate is applied. Most importantly, the bill would address the inherent bias of the present structure in favor of locally manufactured brands of distilled spirits produced from native materials. This bill continues to be deferred and action is not expected prior to mid-2004 at the earliest.

Excise Tax on Automotive Vehicles

In August 2003, the Philippine Congress passed legislation changing the automotive excise tax structure from one based on engine displacement to a system based on vehicle value. The old system generally discouraged imported vehicles with larger engine displacement, including those from the United States. The new law covers most types of imported and locally manufactured vehicles, except for some trucks defined as motor vehicles designed for cargo; and buses, which are classified by their tonnage. Vehicles that had been tax-exempt under the 10-seater rule, including Asian utility vehicles (AUVs) will now be taxed under the new system.

Under the new excise tax scheme vehicles are divided into four brackets based on their price. The approved tax rates are as follows: (1) for vehicles with a manufacturer's price of PHP600,000 and below, the tax will be only 2 percent; (2) those priced over PHP600,000 to PHP1.1 million, the tax will be PHP12,000 plus 20 percent of the amount in excess of PHP600,000; (3) those priced over PHP1.1 million to PHP2.1 million, the tax will be PHP112,000 plus 40 percent of the amount in excess of PHP1.1 million; and (4) those over PHP2.1 million, the tax will be PHP512,000 plus 60 percent of the amount in excess of PHP2.1 million. The Secretary of Finance is considering indexing the brackets reflecting the manufacturer's net price every two years.

Quantitative Restrictions

The National Food Authority administers quantitative restrictions on rice imports. The minimum access volume (quota) for rice is 194,135 metric tons for 2003 and 224,005 metric tons for 2004. Both in and out-of-quota tariffs are 50 percent. Rice import demand is expected to continue growing in the Philippines due to persistent shortfalls in local production and rapid population growth (2.4 percent annually). Due to this restriction, rice is commonly illegally imported or smuggled into the country from various countries, including Thailand and Vietnam.

In 2003, the Philippine Department of Agriculture opened up the importation of rice to the private sector. Prior to this, only the National Food Authority could legally import rice. While the opening to private sector participation is a welcome development, the U.S. Government has raised concerns that the existing plan to transfer import rights to domestic rice farmers ("Farmers as Importers" and "Farmers as Distributors") may result in discriminatory treatment against imports.

Other Import Restrictions

The Philippines maintains other import restrictions. Since April 15, 1999, the National Telecommunications Commission (NTC) has required cellular telephone service providers or authorized equipment dealers to obtain an import permit prior to importation of cellular phone handsets.

Customs Barriers

The Philippine government has made progress during the last several years toward bringing its customs regime into compliance with its WTO obligations. It enacted legislation, R.A. 8181 (1996) and R.A. 9135 (2001) and a series of supporting regulations, which provide the legal context for the Philippines' implementation of the WTO Agreement on Customs Valuation. With these measures, the Philippines discontinued use of Home Consumption Value and adopted transaction value for the purpose of calculating *ad valorem* rates of duty. Supporting regulations also provided the Bureau of Customs with the authority to create a post-entry audit unit, a risk management unit and a border control unit charged with IPR enforcement.

Notably, the 2001 law eliminated private sector involvement in the valuation process and clarified that reference values may be used as a risk management tool, but not as a substitute value for valuation purposes. The U.S. Government remains concerned, however, about reported private sector involvement in the valuation process, particularly in the activities of the Import Specialist Team, which has the authority to review all green lane entries for possible valuation-related offenses. The U.S. Government raised this issue during bilateral trade discussions during the past several years and will continue to closely monitor this issue.

Prior to March 31, 2000, the Philippines employed a preshipment inspection regime (PSI) operated by *Societe Generale de Surveillance*. Under the preshipment inspection system, U.S. exporters frequently reported abuses, including arbitrary and unjustified increases or uplifts' of the invoice value of imports, often on the basis of inappropriate or questionable information. Following the expiration of the preshipment inspection regime, the Philippine government made improvements to the valuation system, but periodic procedural irregularities continue to occur, including requests by Customs officials for the payment of unrecorded facilitation fees.

Currently, all importers or their agents must file import declarations with the Bureau of Customs (BOC). The BOC then processes these entries through its Automated Customs Operating System (ACOS). ACOS uses its selectivity system to classify shipments as low-risk (green lane), moderate-risk (yellow lane) or high-risk (red lane). The BOC requires a documentary review of shipments channeled through the yellow lane, while red lane shipments require both documentary review and physical inspection at the port. Green lane shipments are not subject to any documentary or inspection requirements. In early 2002, the BOC also added a "Super Green Lane" (SGL) , which is a facility for the importers acknowledged to be lowest risk. The import transactions of Super Green Lane importers are not covered by the selectivity system and thus are exempt from documentary and physical examination. Because of low throughput (only about 80 companies have made use of this facility so far), BOC, with USAID technical assistance, adjusted the cost to companies of accessing the facility. The new Super Green Lane facility was launched in December 2003. Use of these facilities is expected to increase to 120 low-risk importers by February 2004 and to approximately 1,200 low-risk importers by the end of 2004.

Despite these improvements, the U.S. Government continues to have concerns about inconsistent application of customs rules and procedures, undue and costly processing delays, and corruption. The United States has continued to urge the Philippine government to improve administration of its customs regime. Two key areas where administration could be strengthened are improving classification of entries and providing precise descriptions of imported articles to reduce discretionary authority of customs officials. During bilateral trade discussions in 2003, the Philippines reviewed progress on administrative reforms, including efforts to reduce average clearance time for goods passing through Customs and ongoing internal efforts to eliminate corruption. Reform and modernization within the Bureau of Customs is being supported through technical assistance by USAID and several other donor organizations.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Industrial Goods

Local inspection for compliance with mandatory Philippine national standards is required for 75 products, including cosmetics, medical equipment, lighting fixtures, electrical wires and cables, cement, pneumatic tires, sanitary wares, and household appliances. For goods not subject to mandatory standards, U.S. manufacturers' self-certification of conformity is accepted. Labeling is mandatory for textile fabrics, ready-made garments, household and institutional linens, and garment accessories. Mislabeling, misrepresentation, or misbranding may subject an entire shipment, rather than just the offending goods, to seizure and disposal. The "Generic Act" of 1988 aims to promote the use of generic drugs by requiring that the generic name of a particular pharmaceutical appear above its brand name on all packaging.

Agricultural Goods

The Philippine Department of Agriculture (DA) established plant health regulations in 1995 which allow the import of U.S. apples, grapes, oranges, potatoes, onions, and garlic, provided these products, when necessary, undergo a specified cold treatment to control targeted pests. Importation of Florida grapefruit, oranges, and tangerines into the Philippines is permitted under a March 2000 protocol between the Philippines and the United States.

The DA continues to use Veterinary Quarantine Certificates (VQCs) and import inspections to limit poultry meat imports. U.S. industry reports delays of up to one month in DA issuance of VQCs, and DA limits on the issuance of VQCs to holders of MAV licenses. The U.S. Government continues to urge the Philippine government to address this issue, which appears to be a WTO-inconsistent form of discretionary licensing.

In September 2002, the DA announced plans to introduce mandatory third-party Hazard Analysis and Critical Control Point (HACCP) inspections for all meat and dairy plants exporting to the Philippines as of April 1, 2003. In February 2003, however, the Philippine government postponed indefinitely implementation of this new regulation. The order would have required a third-party quarterly audit of all foreign meat and milk plants exporting to the Philippines for compliance with internationally recognized standards of the HACCP program. The United States and other countries raised serious concerns about the consistency of this new requirement with the Philippines WTO Sanitary and Phytosanitary commitments. U.S. industry estimated the proposed new requirement would result in losses of $55 million, roughly the value of U.S. trade to the Philippines in the affected commodities.

As of December 2003, public consultations were about to take place regarding a proposed regulation that would require all pet food importers to be DA accredited. The proposed pet food regulation will accredit an importer only after a mandatory physical inspection (the cost of which is to be charged to the importer) of the originating pet food plant. The United States has expressed concern over this proposed regulation, which duplicates inspections already undertaken by the U.S. Government and is without scientific basis. The United States is monitoring developments on this draft regulation.

GOVERNMENT PROCUREMENT

Although the Philippines is not a signatory to the WTO Government Procurement Agreement (GPA), the Philippine government has taken some modest initial steps to reform its procurement process. Nonetheless, in awarding contracts, the Philippine government continues to provide preferential treatment to local suppliers of pharmaceuticals, rice, corn, and iron/steel materials for use in government projects, and in locally-funded government consulting requirements. Contractors for infrastructure projects that require a public utility franchise (*i.e.*, water and power distribution, telecommunications, and transport systems) must be at least 60 percent Filipino-owned.

In January 2003, President Arroyo signed the "Government Procurement Reform Act." The law calls for public monitoring of the procurement process to promote greater transparency and competition, enhance the flow of information, and lessen discretion among agencies. It also establishes an electronic procurement system to serve as the single portal for all government procurement and requires that all bidders use standardized forms. However, the law allows, in the interest of availability and timeliness, the procuring entity to give preference to the purchase of domestically produced and manufactured goods, supplies and materials. Consulting services and infrastructure projects are exempt from this provision, putting foreign firms on equal footing with local firms in these sectors. For infrastructure projects, the law provides that, for the next five years, contractors whose head office is located in the province where the project will take place have the right to match the lowest offer made by a non-province based bidder. In addition to these concerns about discriminatory treatment against foreign firms, U.S. firms continue to raise concerns about corruption in government procurement.

In 1993, the Philippine government mandated a countertrade requirement for procurements by government agencies and government-owned or controlled corporations that entail the payment of at least $1 million in foreign currency. Implementing regulations set the level of countertrade obligations at a minimum of 50 percent of the import price and set penalties for nonperformance of countertrade obligations. The U.S. Government continues to monitor implementation of these laws.

EXPORT SUBSIDIES

Enterprises and exporters engaged in activities under the Philippine government's "Investment Priorities Plan" may register with the Board of Investments (BOI) for fiscal incentives, including four-to six-year income tax holidays, a tax deduction equivalent to 50 percent of the wages of direct-hire workers, and tax and duty exemptions for the importation of breeding stock and genetic materials. BOI-registered firms that locate in less developed areas may be eligible to claim a tax deduction of up to 100 percent of outlays for infrastructure works and 100 percent of incremental labor expenses. Firms in government-administered export processing zones, free trade zones, and other special industrial estates registered with the Philippine Economic Zone Authority (PEZA) enjoy similar incentives, as well as tax and duty-free imports of capital equipment and raw materials, and exemption from customs inspection. In lieu of national and local taxes, PEZA-registered firms are subject to a 5 percent tax on gross income. Firms that earn at least 50 percent of their income from exports may register with BOI or PEZA for certain tax credits under the Philippines' Export Development Act, including a tax credit on incremental annual export revenue.

Automotive Export Subsidies

To further promote the local assembly and export of vehicles from the Philippines, President Arroyo signed Executive Order 156 in October 2003. The export incentives program allows any auto manufacturer which exports finished vehicles from the Philippines to receive a benefit equivalent to $400 per vehicle. This benefit will be provided in the form of a reduced tariff rate on finished vehicles the manufacturer imports into the Philippines. The reduced tariff rates are: MFN rates of 30 percent and 20 percent will be reduced to 10 percent and the ASEAN Common External Preferential Tariff (CEPT) rate of 5 percent will become 1 percent for imports from the other ASEAN countries. This export incentive will be equivalent to $400 per unit exported for year one to two of the program, $300 for year three, and phased down to $100 by year five.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The U.S. Government continues to have serious concerns about intellectual property protection in the Philippines, despite President Arroyo's commitment to strengthen the IPR regime. In April 2003, for the third consecutive year, the U.S. Government named the Philippines to the Special 301 Priority Watch List. The U.S. concerns include the Philippine government's failure to implement key legislation, lack of sustained enforcement efforts and lack of judicial remedies. Optical media piracy has significantly increased in the past year, and the Philippines is now a net exporter of pirated optical media. The Philippines has become a haven for organized piracy and counterfeiting, as other countries in the region strengthen their enforcement efforts against violators of IPR.

The Intellectual Property Code

The 1997 Intellectual Property Code provides the legal framework for IPR protection in the Philippines. The 2000 Electronic Commerce Act extends this framework to the Internet. However, the code contains ambiguous provisions relating to the rights of copyright owners over broadcast, rebroadcast, cable retransmission, or satellite retransmission of their works; burdensome restrictions affecting contracts to license software and other technology; and the judiciary's lack of authority to order the seizure of pirated material as a provisional measure without notice to the suspected infringer.

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The Philippines government took several positive steps in recent years to address legislative deficiencies in its IPR regime. In 2001, the Philippines enacted a new law to protect layout designs (topographies) of integrated circuits. In January 2002, the Philippines Supreme Court adopted rules establishing *ex parte* authority in civil cases of IPR infringement. In June 2002, President Arroyo enacted legislation to comply with its TRIPS Article 27.3 (b) requirements on the protection of the exclusive rights of breeders with respect to their new plant varieties. However, U.S. seed company representatives have expressed concern about the vagueness of key provisions of the law, particularly relating to rules that could affect their operations and the provision exempting local farmers from licensing requirements.

In addition to its commitments under the WTO TRIPS Agreement, the Philippines is a party to the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Berne Treaty on the International Recognition of the Deposit of Microorganisms, the Patent Cooperation Treaty, and the Rome Convention. The Philippines, as a member of the World Intellectual Property Organization (WIPO), ratified the WIPO Performances and Phonograms Treaty and the Copyright Treaty in March 2002. The treaties took effect in October 2002.

President Arroyo signed into law the Optical Media Act on February 10, 2004. The new law is intended to regulate the import, export and production of optical disks, including the tools and materials involved in the replication of optical disks. Full implementation of this law, including prosecution of IPR violators, will be critical to its effectiveness. During bilateral trade discussions in 2003, the U.S. Government continued to raise concerns regarding insufficient legal protection and enforcement of IPR. The U.S. Government also urged the Philippines to enact legislation to address optical media piracy, adopt amendments that would extend further IPR protection to the Internet by accommodating electronic commerce and outlawing online piracy, and take further steps to combat piracy of textbooks and other protected printed materials. The U.S. Government, through various agencies, continues to provide technical assistance and training to strengthen capacity within Philippine agencies responsible for the protection of intellectual property.

IPR Enforcement

The United States continues to have serious concerns regarding the lack of consistent, effective and sustained IPR enforcement in the Philippines. U.S. industry estimates the annual losses due to copyright piracy in the Philippines in 2002 at $121 million. U.S. distributors report high levels of pirated optical disks of cinematographic and musical works, and computer games, business software, and widespread unauthorized transmissions of motion pictures and other programming on cable television systems. Trademark infringement in a variety of product lines also is widespread, with counterfeit or pirated merchandise openly available in both legitimate and illegitimate venues.

Serious problems continue to hamper the effective operation of agencies tasked with IPR enforcement. Many enforcement agencies suffer from a lack of resources while IPR issues remain a relatively low priority. Enforcement efforts such as raids and seizures often have only a temporary effect due to ineffective post-raid enforcement. Lack of effective interagency coordination also has had a negative impact on enforcement efforts. The Intellectual Property Code of the Philippines stipulates that the Intellectual Property Office (IPO) has jurisdiction to resolve disputes concerning alleged infringement and licensing. However, the IPO has been unable to effectively coordinate enforcement activities among the agencies responsible, including the Department of Justice, National Bureau of Investigation, Videogram Regulatory Board (to be replaced by the Optical Media Board), the Bureau of Customs, and the National Telecommunications Commission). The IPO's administrative complaint mechanisms have also been ineffective.

Nonetheless, the Philippine government has taken some administrative steps intended to strengthen enforcement. A customs administrative order in September 2002 strengthened the ability of the Bureau of Customs (BOC) to prohibit the importation of pirated products, and created an Intellectual Property Unit within the BOC to oversee IPR violations at ports of entry. The BOC is required to maintain an IPR registry where property holders may record their rights and other information to facilitate enforcement.

In addition, as a result of a memorandum of agreement that the BOC signed with the Videogram Regulatory Board in June 2003, the Philippine government has conducted more raids on suspected counterfeit products resulting in the seizure and destruction of pirated goods valued in the millions of dollars. Nonetheless, significant quantities of pirate products continue to enter the country.

The Philippines created specialized Intellectual Property Courts in 1995, but in practice those courts were not exclusive to IPR cases and thus lacked technical expertise. These courts remained subject to backlogs and delays. In June 2003, the Supreme Court issued a resolution transferring all IP cases to the newly designated Special Commercial Courts, effectively revoking the previously existing 34 special IPR courts. The Special Commercial Courts handle cases formerly adjudicated by the Securities and Exchange Commission, in addition to cases involving IPR issues. It is unclear whether the judges have sufficient time or adequate technical knowledge of IPR issues to be effective. Moreover, IPR cases are not considered serious crimes and take lower precedence in court proceedings.

In October 2003, a new law increased the compensation of judges, with the long-run objective of recruiting more judges to fill up court vacancies. The Department of Justice has also created a task force on intellectual property piracy, with 28 state prosecutors tasked to handle the preliminary investigation of IPR complaints filed with the task force.

There have been very few successful cases of prosecution and imprisonment. Some companies have invested significant resources with investigations and litigation, but many cases remain unresolved as long as a decade after the initial complaint. The Philippines has failed to establish punitive sanctions sufficient to serve as a deterrent to IPR violators. For example, the nominal damage awarded by the Philippine courts in most IPR cases adds little to the cost of doing business, with no risk of imprisonment.

SERVICES BARRIERS

Basic Telecommunications

The Philippine Constitution limits foreign ownership of telecommunications firms to 40 percent. During the WTO negotiations on basic telecommunications services, the Philippines made commitments on most basic telecommunications services and adopted some procompetitive regulatory principles contained in the WTO Reference Paper. It did not provide market access or national treatment for satellite services and made no commitments regarding resale of leased circuits/closed user groups. The Philippine government has yet to ratify the Fourth Protocol to the WTO General Agreement on Trade in Services (GATS), embodying its proposed obligations under the WTO Basic Telecommunications Agreement, despite U.S. urging.

In February 2003, the Philippine Long Distance Telephone Company (PLDT) and other major Philippine telephone companies announced on the same day, the same increase in termination rates for foreign carriers, and some cut off direct service to carriers which refused to pay. The U.S. Federal Communications Commission ruled that this action was anti-competitive and ordered U.S. companies to cease payments to the Philippine carriers involved. As of March 2004, all Philippine carriers had restored service and reached agreements with U.S. carriers. As a result, the FCC has now lifted the stop payment order with respect to all Philippine carriers.

Financial Services

The Philippines also has yet to ratify the Fifth Protocol to GATS, embodying its obligations under the WTO Financial Services Agreement.

Insurance

Although current practice permits up to 100 percent foreign ownership in the insurance sector, the Philippines only committed in the GATS to a maximum of 51 percent equity participation and grandfathered existing insurers with more than 51 percent foreign equity. Under current regulations, minimum capitalization requirements increase with the degree of foreign equity. As a general rule, only the state-owned government insurance system may provide coverage for government-funded projects. A 1994 administrative order extended this policy to public and private build-operate-transfer projects. Private insurance firms, both domestic and foreign, regard this as a significant trade barrier. Current regulations require all insurance/professional reinsurance companies operating in the Philippines to cede to the industry-owned National Reinsurance Corporation of the Philippines at least 10 percent of outward reinsurance placements.

Banking

Pursuant to 1994 legislation, 10 foreign banks were permitted to open full service branches in the Philippines or to own up to 60 percent of a new or existing local subsidiary. Foreign branch banks are limited to six branches each. Four foreign-owned banks that had been operating in the Philippines prior to 1948 were each allowed to operate up to six additional branches. The Philippines only committed to foreign ownership at 51 percent in its 1997 WTO financial services offer and included a reciprocity test for authorization to establish a commercial presence. The General Banking Law of 2000 (signed in May 2000 to succeed the 1948 General Banking Act) created a seven-year window during which foreign banks may own up to 100 percent of one locally incorporated commercial or thrift bank (up from the previous 60 percent foreign equity ceiling). However, for the first three years, such foreign investment may be made only in existing banks, reflecting the current emphasis of the Bangko Sentral ng Pilipinas (BSP, the central bank) on banking sector consolidation. Current regulations mandate that majority Filipino-owned domestic banks should, at all times, control at least 70 percent of total banking system assets. Rural banking remains completely closed to foreigners.

Securities and Other Financial Services

Membership in the Philippine Stock Exchange is open to foreign-controlled stock brokerages that are incorporated under Philippine law. Foreign equity in securities underwriting companies is limited to 60 percent. Securities underwriting companies not established under Philippine law may underwrite Philippine issues for foreign markets, but not for the domestic market. Although there are no foreign ownership restrictions governing acquisition of shares of mutual funds, current law restricts membership on a board of directors to Philippine citizens. The Philippines took an MFN exemption on foreign equity participation in securities firms, stating that Philippine regulators would approve applications for foreign equity only if Philippine companies enjoy similar rights in the foreign investor's country of origin.

Advertising

The Philippine Constitution limits foreign ownership of advertising agencies to 30 percent. All executive and managing officers of advertising agencies must be Philippine citizens.

Public Utilities

The Philippine Constitution specifically limits the operation of certain utilities (water and sewage, electricity transmission and distribution, telecommunications, public transport) to firms with at least 60 percent ownership by Philippine citizens. All executive and managing officers of such enterprises must be Philippine citizens.

The June 2001 Electric Power Industry Reform Act provides for the privatization of the transmission and distribution assets of the National Power Corporation. Transmission and distribution require a public utility franchise under the Act, which would be subject to a 40 percent foreign-ownership ceiling (1986 Constitution). Legislation facilitating the privatization of the national transmission grid, known as Transco, continues to languish in the Senate, although the Arroyo Administration has taken steps to sell transmission and generating assets without additional legislation. The privatization and modernization of the sector is considered critical to attracting additional foreign investment.

Practice of Professions

As a general rule, the Philippine Constitution reserves the practice of licensed professions (*e.g.*, law, medicine, nursing, accountancy, engineering, architecture, customs brokerage) to Philippine citizens. Philippine law (R.A. 8182) also requires that preference be given to Philippine citizens in the hiring of consultants and other professionals necessary for the implementation of projects funded by foreign assistance. Legislation signed in February 1998 (R.A. 8555) gives the Philippine President the authority to waive this and other preferences applicable to the procurement of goods and services funded with foreign assistance.

Shipping

The Maritime Industry Authority prohibits foreign-flagged vessels from engaging in the provision of domestic carriage services. The country's bareboat chartering laws stipulate that Philippine-flagged vessels should be manned by a Filipino crew and disallows foreign crew/officers, except as supernumeraries.

Express Delivery Services

Foreign air express couriers and airfreight forwarding firms must either contract with a 100 percent Filipino-owned business to provide delivery services or establish a domestic company with a minimum of 60 percent Philippine-owned equity. U.S. companies currently operate hub operations with the Philippines, made possible by partial open skies provisions. In 2003, the U.S. Government attempted to negotiate a full all-cargo open skies agreement with the Philippines government, including Seventh Freedom Rights, to enable the companies to provide more services to their customers. Seventh Freedom enables an air courier to shuttle between two countries without having to pass through its home country. During aviation talks in July 2003, the Philippines delegation claimed that Seventh Freedom was unconstitutional. The Philippines government is currently reviewing the issue. Nonetheless, on December 3, 2003, President Arroyo signed an executive order permitting Cargo Open Skies (including Seventh Freedom rights) for the two international airports located within the Clark and Subic economic zones.

INVESTMENT BARRIERS

The 1991 Foreign Investment Act contains two "negative lists" enumerating areas where foreign investment is restricted. The restrictions stem from a constitutional provision that permits the Philippine

Congress to reserve for Philippine citizens certain areas of investment. The scope of these lists was last revised on October 22, 2002. The Executive Branch will review the list again in 2004.

List A restricts foreign investment in certain sectors because of constitutional or other constraints. For example, the practice of licensed professions such as engineering, medicine, accountancy, environmental planning, and law is fully reserved for Filipino citizens. Also reserved for Filipino citizens are enterprises engaged in retail trade (with paid-up capital of less than $2.5 million, or less than $250,000 for retailers of luxury goods), mass media, small-scale mining, private security, cock fighting, utilization of marine resources, and manufacture of firecrackers and pyrotechnic devices. Up to 25 percent foreign ownership is allowed for enterprises engaged in employee recruitment and for public works construction and repair (with the exception of build-operate-transfer and foreign-funded or -assisted projects, that is, foreign aid, where there is no upper limit). Foreign ownership of 30 percent is allowed for advertising agencies, while 40 percent foreign participation is allowed in natural resource extraction (although the President may authorize 100 percent foreign ownership), educational institutions, public utilities, commercial deep sea fishing, government procurement contracts, rice and corn processing (after 30 years of operation, before which time 100 percent foreign participation is allowed). Up to 40 percent foreign ownership of private land is allowed. Full foreign participation is allowed for retail trade enterprises with (1) paid-up capital of $2.5 million or more provided that investments for establishing a store is not less than $830,000, or (2) specializing in high end or luxury products, provided that the paid-up capital per store is not less than $250,000. Enterprises engaged in financing and investment activities, including securities underwriting, are limited to 60 percent foreign ownership.

List B restricts foreign ownership (generally to 40 percent) for reasons of national security, defense, public health, safety, and morals. Sectors covered include explosives, firearms, military hardware, massage clinics, and gambling. This list also seeks to protect local small- and medium-sized firms by restricting foreign ownership to no more than 40 percent in nonexport firms capitalized at less than $200,000.

In addition to the restrictions noted in the "A" and "B" lists, the Philippines generally imposes a foreign ownership ceiling of 40 percent on firms seeking incentives with the BOI under the annual investment priorities plan. While there are exceptions to the ceiling, divestment to reach the 40 percent level is required within 30 years of the initial investment, or longer as allowed by the BOI. As a general policy, the Philippine Department of Labor and Employment allows the employment of foreigners provided there are no qualified Philippine citizens who can fill the position. However, the employer must train Filipino understudies and report on such training periodically. The positions of elective officers of enterprises (i.e., president, general manager and treasurer) are exempt from the labor market test and understudy requirements.

The 1987 Constitution bans foreigners from owning land in the Philippines. The 1994 Investors' Lease Act allows foreign companies investing in the Philippines to lease land for 50 years, renewable once for another 25 years, for a maximum 75 years.

Trade Related Investment Measures (TRIMS)

The BOI imposed industry-wide local content requirements under its Motor Vehicle Development Program were eliminated in July 2003. The U.S. Government is continuing to closely monitor Philippine implementation of this WTO commitment.

In 1995, pursuant to the WTO TRIMS Agreement, the Philippines notified the WTO of its maintenance of local content and foreign exchange balancing requirements to promote investment. Proper notification allowed the Philippines to maintain such measures for a five-year transitional period, ending January 1,

2000. In October 1999, the Philippines requested a five-year extension for the measures in the motor vehicle sector. After extensive consultations on this issue with the United States, the Philippines agreed in November 2001 that it would discontinue the exchange balancing requirements immediately and remove all local content requirements in the motor vehicle sector by July 1, 2003, following the implementation of a phase-out program begun in January 2002. The final phase out of the local content and foreign exchange requirements occurred in July 1, 2003.

Under a 1987 executive order, the soap and detergent industry is required to use a minimum of 60 percent of raw materials that do not endanger the environment, and prohibits imports of laundry soap and detergents containing less than 60 percent of such raw materials. The law is intended to require soap and detergent manufacturers to use coconut-based surface-active agents of Philippine origin. In 1999, the Philippine Department of Justice determined that this executive order conflicts with the Philippines' obligations under the WTO TRIMS Agreement and since then, while not repealed, the order has not been enforced.

The United States continues to monitor other TRIMS requirements. Regulations governing the provision of BOI-administered incentives impose a higher export performance for foreign owned enterprises (70 percent of production should be exported) than for Philippine owned companies (50 percent). A 1987 executive order requires that pharmaceutical firms purchase semisynthetic antibiotics from a specific local company, unless they can demonstrate that the landed cost of imports is at least 20 percent less than that produced by the local firm. A 1984 measure, which requires mining firms to prioritize the sale of copper concentrates to the then government-controlled Philippine Associated Smelting and Refining Company (PASAR), has yet to be repealed despite PASAR's privatization in 1998. In addition, there appear to be unwritten "trade balancing" requirements for firms applying for approval of ventures under the ASEAN Industrial Cooperation scheme.

TRIMS and Retail Trade

Legislation passed by the Philippine Congress in February 2000 requires that foreign retailers, for 10 years after the bill's enactment, source at least 30 percent (for retail enterprises capitalized at no less than $2.5 million) or 10 percent (for retail enterprises specializing in luxury goods) of their inventory, by value, in the Philippines. In addition, prospective investors in the retail sector face a reciprocity requirement. The Retail Trade Act states that only nationals from, or juridical entities formed or incorporated in countries that allow the entry of Filipino retailers, shall be allowed to engage in retail trade in the Philippines.

Public Utilities

The Philippine government's most important privatization effort, the June 2001 Electric Power Industry Reform Act, requires the National Power Corporation (NPC) to privatize at least 70 percent of its generating assets within three years. Seventy-five percent of the funds used to acquire NPC assets must be inwardly remitted and registered with the Philippine Central Bank. However, foreign participation may be restricted pursuant to a constitutional provision regarding utilization of certain natural resources (such as water and geothermal resources) and power generation as well as provisions requiring a minimum 60 percent Filipino ownership to obtain water rights for hydropower generation under the implementing rules of the 1976 Water Code of the Philippines.

Licensing of Technology

Technology transfer arrangements are defined as contracts involving the transfer of systematic knowledge for the manufacture of a product, the application of a process, or rendering of a service including management contracts, and the transfer, assignment, or licensing of all forms of intellectual property rights, including computer software (except for software developed for the mass market). The Intellectual Property Office requires that all technology transfer arrangements comply with provisions outlined in R.A. 8293, including the prohibition of the use of certain clauses in such arrangements. The scope of these provisions is extremely broad and serves to obstruct the normal contracting process between unrelated parties or as part of intra-company business.

ANTICOMPETITIVE PRACTICES

The 1987 Constitution provides the Philippine government with the authority to regulate or prohibit monopolies, and it also bans combinations in restraint of trade and unfair competition. However, there is no comprehensive competition law to implement this constitutional provision. Instead, there are a number of laws dealing with competition, including the 1930 Revised Penal Code, the 1961 Act to Prohibit Monopolies and Combinations in Restraint of Trade, 1949 Civil Code, the 1980 Corporation Code, the 1991 Price Act, and the 1932 Consumer Act. However, enforcement agencies do not effectively enforce these laws, as they do not have the resources or capability to challenge well-entrenched economic and political interests.

ELECTRONIC COMMERCE

The Electronic Commerce Law, signed June 2000, provides that business transactions entered into through an automated electronic system such as the Internet are functional and legal, equivalent to a written document protected under existing laws on commerce. Business-to-business transactions include domestic and international exchange of information, arrangements and contracts for procurement, payments, supply management, transportation, and facility operations. An Internet service provider (ISP) generally is not criminally liable if the ISP does not directly commit any infringement or other unlawful activities or does not cause another party to commit any unlawful act. The act includes provisions to penalize, among other offenses, hacking or cracking (unauthorized access into or interference in a communications system) and piracy (or the unauthorized reproduction, distribution, importation, use, removal, alteration, and downloading, or broadcasting of copyrighted works including legally protected sound recordings). Electronic transactions are not currently subject to any tax measures. However, a reciprocity clause specifies that all benefits, privileges, and advantages established under the act will be enjoyed only by parties whose country of origin grants the same benefits and privileges or advantages to Philippine citizens.

OTHER BARRIERS

Corruption is a pervasive and longstanding problem in the Philippines. The Philippine Revised Penal Code, the Anti-Graft and Corrupt Practices Act, and the Code of Ethical Conduct for public officials are intended to combat suspected corruption and related anticompetitive business practices. The Office of the Ombudsman investigates cases of alleged graft and corruption involving public officials. The Sandiganbayan (anti-graft court) prosecutes and adjudicates cases filed by the Ombudsman. In addition, a Presidential Commission Against Graft and Corruption is tasked with prosecuting corruption cases linked to the former Marcos regime.

Soliciting/accepting and offering/giving a bribe are criminal offenses, punishable with imprisonment of between six and 15 years, a fine and/or disqualification from public office or business dealings with the government. As with many other laws, enforcement of anti-corruption laws has been inconsistent. The Philippine government launched an initiative to strengthen public and private governance, including anticorruption efforts, in cooperation with bilateral and multilateral aid donors in May 2000. To date, results of this initiative have been limited.

PHILIPPINES

An October 2000 USAID-funded survey of more than 600 randomly selected Philippine and foreign-invested enterprises in the capital region suggests that graft remains a serious problem at many levels in all branches of the Philippine government. Almost three-fourths of the enterprises surveyed had extensive or moderate personal knowledge of public-sector corruption on matters directly related to their sector of business. Nearly one-half believed companies need to give bribes to win public sector contracts, whether local or national. The Bureau of Customs; Bureau of Internal Revenue; Department of Public Works and Highways; Department of Education, Culture and Sports; and the Philippine National Police were rated as the most corrupt agencies. The Philippines is not a signatory to the OECD Convention on Combating Bribery.

Both foreign and domestic investors have expressed concern about the propensity of Philippine courts and regulators to stray beyond matters of legal interpretation into policymaking functions and about the lack of transparency in these decision-making processes. In addition, there are many reports that influenced by bribery, courts improperly issue Temporary Restraining Orders. Investors complain that these officials rarely have any background in economics, business, or a competitive economic system and that entrenched economic interests are able to manipulate the legal system and regulatory process to protect market position. For example, spectrum allocation and licensing in the telecommunications sector is well guarded by incumbent firms, despite regulations that require transparent distribution of these rights.