THE PHILIPPINES

TRADE SUMMARY

The U.S. goods trade deficit with the Philippines was $1.5 billion in 2012, up $81 million from 2010. U.S. goods exports in 2012 were $8.1 billion, up 4.6 percent from the previous year. Corresponding U.S. imports from the Philippines were $9.6 billion, up 4.8 percent. The Philippines is currently the 33rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to the Philippines were $2.2 billion in 2011 (latest data available), and U.S. imports were $3.0 billion. Sales of services in the Philippines by majority U.S.-owned affiliates were $3.3 billion in 2010 (latest data available), while sales of services in the United States by majority Philippines-owned firms were $37 million.

The stock of U.S. foreign direct investment (FDI) in Philippines was $5.3 billion in 2011 (latest data available), down from $5.4 billion in 2010. U.S. FDI in the Philippines is mostly in the manufacturing sector.

IMPORT POLICIES

Tariffs

In the Philippines, the simple average most favored nation (MFN) tariff applied to imports is 6.1 percent. Five percent of applied tariffs are 20 percent or greater. All agricultural tariffs and about 60 percent of non-agricultural tariff lines are bound in the World Trade Organization (WTO). The simple average bound tariff in the Philippines is 25.7 percent. Products with unbound tariffs include certain automobiles, chemicals, plastics, vegetable textile fibers, footwear, headgear, fish, and paper products. Applied tariffs on fresh fruit, including grapes, apples, oranges, lemons, grapefruits, and strawberries are between 7 percent and 15 percent whereas bound rates are much higher at 40 percent and 45 percent.

High in-quota tariffs for agricultural products under the Minimum Access Volume (MAV) system range from 30 percent to 50 percent, significantly inhibiting U.S. exports to the Philippines. Sugar has the highest in-quota tariff at 50 percent, followed by rice, poultry products, and potatoes at 40 percent. The in-quota tariff for corn is 35 percent, while pork and coffee have in-quota tariffs of 30 percent.

The Philippines has reduced tariffs to below MFN rates through preferential trade agreements with trading partners such as China, Australia, and New Zealand. The Philippines has eliminated tariffs on approximately 99 percent of all goods from ASEAN trading partners.

Quantitative Restrictions

Under the MAV system, the Philippines imposes a tariff-rate quota on numerous agricultural products, including corn, coffee/coffee extracts, potatoes, pork, and poultry and poultry products. Since 2005, the Philippines has maintained MAV quota levels at its Uruguay Round commitments despite increasing Philippine demand for MAV products.

The National Food Authority (NFA) controls rice imports through quantitative restrictions and provides price support to domestic growers of rice. NFA's stated objectives are to achieve self-sufficiency and to ensure sufficiently high and stable food prices to enhance farm incomes and alleviate rural poverty.

According to the WTO, NFA's policies have contributed to the sector's non-competitiveness by reducing incentives for farmers to reduce production costs and improve efficiency.

The special treatment for rice accorded to the Philippines under Annex 5 of the WTO Agreement on Agriculture, under which the Philippines maintains a rice quota of 350,000 metric tons, expired on June 30, 2012. The Philippines is negotiating to extend its exemption from WTO tariffication obligations through 2017 with other WTO Members, including the United States.

Automobile Sector

The Philippines continues to apply high tariffs on finished automobiles and motorcycles, including a 30 percent tariff on passenger cars; tariffs of 20 percent to 30 percent on vehicles for the transport of goods; and tariffs of 15 percent to 20 percent on vehicles for the transport of persons, depending on vehicle weight. ASEAN countries and Japan enjoy preferential import tariffs on new vehicle imports under the ASEAN Free Trade Agreement and the Japan-Philippines Economic Partnership Agreement, respectively. The Philippines continues to extend zero duty treatment on importation of capital equipment, spare parts, and accessories by motor vehicle manufacturers and other enterprises registered under the Board of Investments (BOI).

Motor vehicle production is covered under the Philippine Motor Vehicle Development Program (MVDP). This program, implemented by BOI, is designed to encourage local assembly through low tariffs on components in order to encourage Philippine automotive exports. A 1 percent tariff applies to completely knocked-down kits (CKDs) imported by MVDP-registered participants. CKDs of alternative fuel vehicles enter duty free. Japan and ASEAN nations enjoy zero import tariffs on all CKDs. The policy also prohibits the importation of used motor vehicles.

Manufacture and assembly of motor vehicles, parts, and components is a preferred activity under the 2012 Philippine Investment Priorities Plan (*see Subsidies*).

Safeguards

The Philippines continues to levy safeguard duties on imports of glass products, steel angle bars, and testliner boards. The Safeguard Measures Act allows interested parties a short five-day comment period. An amendment to extend this comment period to 30 days has been pending since 2007.

The Department of Agriculture has a price-based special safeguard on imports of chicken, effectively doubling the effective rate of protection for out-of-quota imports. The imposition of the special safeguard reportedly stems from domestic industry pressure for import protection.

Excise Tax on Distilled Spirits

In March 2010, the United States and European Union brought disputes at the WTO challenging the Philippines tax system on distilled spirits. The Philippines had for many years applied lower taxes to distilled spirits made from typical local raw materials, such as sugar. Under this system, other spirits, including almost all imported spirits, were taxed at a higher rate. In August 2011, a WTO panel found that the Philippine excise taxes on imported distilled spirits are discriminatory and inconsistent with the Philippines' WTO obligations under Article III:2 of the GATT 1994. The WTO Appellate Body affirmed these findings in December 2011.

On December 20, 2012, President Aquino signed into law a new excise tax system for distilled spirits. Under the new system, all distilled spirits are subject to a 20 peso tax, based on a standard size bottle. An

additional *ad valorem* tax of 15 percent by value is being imposed for two years and will increase to 20 percent by value on January 1, 2015. The specific tax of 20 pesos will increase 4 percent per year every year starting January 1, 2016. The United States will carefully monitor implementation of the new system to ensure that it does not discriminate against imported products.

Customs Barriers

Reports of corruption and irregularities in customs processing persist, including undue and costly delays, irregularities in the valuation process (*e.g.*, use of reference prices rather than declared transaction values, 100 percent inspection and testing of some products, and customs officials seeking the payment of unrecorded facilitation fees). Some exporters report, for instance, that the Bureau of Customs arbitrarily will not accept the prices in the documentation provided to it and instead applies a higher dutiable value that is based on information from unspecified sources.

GOVERNMENT PROCUREMENT

Government procurement laws and regulations favor Philippine-controlled companies and locally produced materials and supplies. The Government Procurement Reform Act of 2003 aimed to consolidate procurement laws, simplify prequalification procedures, introduce objective and nondiscretionary criteria in the selection process, and establish an electronic single portal for government procurement activities. However, implementation remains inconsistent. U.S. companies have expressed concern about delayed procurement decisions, delayed payment, and different interpretations of the procurement law among Philippine government agencies.

Since 1993, the Philippines has maintained a countertrade requirement of 50 percent of the price of imports for procurement by government agencies and government-controlled corporations, with penalties for nonperformance of countertrade obligations.

The Philippines is not a signatory to the WTO Agreement on Government Procurement.

SUBSIDIES

The Philippines offers a wide array of fiscal incentives for export-oriented investment, particularly investment related to manufacturing.[1] These incentives are available to companies located in export processing zones, free port zones, and other special industrial estates registered with the Philippine Economic Zone Authority. Incentives include: income tax holiday or exemption from corporate income tax for four years, renewable for a maximum of eight years; after the income tax holiday period, payment of a special 5 percent tax on gross income, in lieu of all national and local taxes; exemption from duties and taxes on imported capital equipment, spare parts and supplies, and raw materials; domestic sales allowance of up to 30 percent of total sales; exemption from wharfage dues, imposts, and fees; zero VAT rate on local purchases, including telecommunications, electricity, and water; and exemption from payment of local government fees (*e.g.,* mayor's permit, business permit, health certificate fee, sanitary inspection fee, and garbage fee). Furthermore, under the Omnibus Investment Code, which is administered by the Board of Investments, tax incentives are available to producers of non-traditional exports and for activities that support exporters.

[1]The WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement") contains provisions prohibiting certain subsidies contingent on export performance ("export subsidies"). Per Annex VII of the SCM Agreement, certain developing countries are not subject to these provisions until particular conditions are met. The Philippines, however, has met those conditions and is subject to the disciplines on export subsidies.

The Philippine government also offers incentives for investment in less developed economic areas. Companies may qualify for fiscal incentives for their activities in preferred sectors and geographic areas, as outlined in BOI's Investment Priority Plan. Such incentives include income tax holidays; tax deductions for wages and some major infrastructure investments; tax and duty exemptions for imported breeding stock and genetic materials; and tax credits on local purchases of breeding stock and materials. An enterprise with less than 60 percent Philippine equity may also enjoy incentives if its projects are classified as "pioneer" under the Investment Priority Plan or if it opts to be an export-oriented firm by meeting an export requirement of at least 70 percent of actual production.

The Philippines has not filed a subsidy notification under the WTO SCM Agreement. The time period covered by the Philippines' last subsidy notification to the WTO is 1996.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

The Philippines is on the U.S. Special 301 Watch List. In recent years, the Philippines has launched numerous initiatives to improve its intellectual property rights (IPR) regime. Recent developments include new rules governing the handling of IPR cases in the regional courts designated as special commercial courts, new legislation to strengthen the copyright law and provide new enforcement authorities to the Intellectual Property Organization (IPO Philippines), a reduction in detections of illegal camcording following passage of an anti-camcording law in 2010, and significant enforcement action to reduce the number of counterfeit and pirated goods available for sale in markets such as Quiapo. IPO Philippines continues to seek the expanded cooperation of rights holders in its efforts to improve enforcement.

U.S. rights holders continue to report concerns regarding Internet-based piracy, cable signal piracy, difficulties in prosecuting IPR cases in the judicial system, and amendments to the patent law that preclude the issuance of patents on certain chemical forms unless the applicant demonstrates increased efficacy. The United States continues to engage with the Philippines on these issues.

SERVICES BARRIERS

Telecommunications

Philippine law defines telecommunications services as a public utility and limits foreign investment to 40 percent. Foreigners may not serve as executives or managers of telecommunications companies, and the number of foreign directors allowed is tied to the proportion of foreign investment in the company. The United States has urged the Philippines to reclassify telecommunications outside of the utility definition, as it has done for electricity generation. The applicability of the public utility designation to value-added services is particularly burdensome and inconsistent with international practice. Foreign equity in private radio communications is limited to 20 percent, and foreign ownership of cable television and all other forms of broadcasting and media is prohibited.

Insurance

The Philippines permits up to 100 percent foreign ownership in the insurance sector; however, its GATS commitment for foreign ownership is 51 percent. Minimum capital requirements increase with the degree of foreign equity.

Generally, only the Government Service Insurance System (GSIS) may provide insurance for government-funded projects. A government order requires sponsors of build-operate-transfer projects and privatized government corporations to secure their insurance and bonding from the GSIS at least to the

extent of the government's interest. All reinsurance companies operating in the Philippines must cede to the industry-controlled National Reinsurance Corporation of the Philippines at least 10 percent of outward reinsurance placements.

Banking

The Philippines applies two general restrictions on foreign participation in the banking sector. First, foreign banks that meet specific requirements, such as diversified ownership, public listing in the country of origin, and global or national rankings, are limited to owning 60 percent of the equity in a locally incorporated banking subsidiary. However, banks that do not meet the criteria, as well as non-bank investors, are subject to a 40 percent ownership ceiling.

Second, majority Philippine-owned domestic banks must control at least 70 percent of the resources or total assets in the banking system. This requirement acts as a secondary limit on foreign participation in the banking system.

Since 1999, foreign investment is limited to existing banks due to a central bank moratorium on the issuance of new bank licenses. Furthermore, foreign banks allowed in the Philippines market under the 1994 Foreign Bank Liberalization Act cannot open more than six branches. Four foreign banks, those which operated in the Philippines prior to 1948 may operate up to six additional branches each.

In June 2011, the Philippine Central Bank announced a phased lifting of branching restrictions for locally incorporated commercial and thrift banks in eight key Metro Manila cities. Before branching restrictions in these key cities are fully lifted in July 2014, priority will be given to banks with fewer than 200 branches in the previously restricted areas. This process will benefit foreign banks with commercial and thrift banking subsidiaries in the Philippines.

Financial institutions must set aside loans for certain preferred sectors. The Agri-Agra Law requires banks to earmark at least 25 percent of their loan portfolios for agricultural credit, with at least 10 percent dedicated to agrarian reform program beneficiaries. Although amendments to the Agri-Agra Law in 2010 widened the scope of eligible credits and investments, the new law also scrapped previously allowed, alternative modes of compliance (*i.e.*, financing of educational institutions, hospitals and other medical services, low cost housing, and cooperatives). In addition, the Magna Carta for Micro, Small, and Medium Enterprises (MSMEs) requires banks to set aside at least 10 percent of their loan portfolios for MSME borrowers. These mandatory lending provisions are more burdensome on foreign banks for a number of reasons, including constrained branch networks and foreign land ownership restrictions that impede their ability to enforce rights over land accepted as collateral.

Financial Services

With respect to mutual funds, all members of the board of directors must be Philippine citizens, although no foreign ownership restrictions apply. Current laws limit foreign ownership of financing and of securities underwriting companies to 60 percent of voting stock.

The 2007 Lending Company Regulation Act requires majority Philippine ownership for credit enterprises not clearly under the scope of other laws.

Advertising

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

Public Utilities

The Philippine Constitution limits foreign investment in the operation and management of public utilities to 40 percent. Philippine law defines "public utility" to include a range of sectors including water and sewage treatment, electricity transmission and distribution (although not electricity generation), telecommunications, and transport. All executive and managing officers of public utility companies must be Philippine citizens, and foreign investors may serve on governing bodies only in proportion to their equity.

Professional Services

The Philippine Constitution limits licensing for the practice of professions to Philippine citizens. Under Philippine law, practice of professions is defined to include law, medicine, nursing, accountancy, engineering, architecture, and customs brokerage.

Express Delivery Services

Foreign equity participation in the domestic express delivery services sector is limited to 40 percent.

Retail Trade

Philippine law restricts foreign investment in small retail ventures to Philippine nationals. Foreigners may own larger retail ventures subject to several requirements, including paid-up capital of approximately $2.5 million or more, an $830,000 minimum investment per store (approximately), and parent company net worth of over approximately $200 million. In addition, the retailer must either own at least five retail stores elsewhere or have at least one outlet with capitalization of approximately $25 million or more. For retailers of high-end or luxury products, the minimum investment in each retail store is approximately $250,000 and the net worth of the parent company must exceed approximately $50 million.

Foreign retailers are prohibited from engaging in trade outside their accredited stores, such as through the use of carts, sales representatives, or door-to-door selling. Retail enterprises with foreign ownership exceeding 80 percent of equity must offer at least 30 percent of their shares to local investors within eight years of the start of operations through public offering of stock.

Civil Aviation

The Philippine government applies the Common Carrier Tax and Gross Philippine Billing Tax on cargo traffic carried by non-Filipino airlines. In March 2013 the government amended its internal revenue code to exempt airlines from these taxes for passenger traffic.

INVESTMENT BARRIERS

Significant restrictions apply to foreign investment in the Philippines. The Foreign Investment Negative List (FINL) enumerates foreign investment restrictions in two parts: restrictions mandated by the Constitution and specific laws (List A), and restrictions mandated for reasons of national security, defense, public health and morals, and protection of small-and medium-sized enterprises (SMEs) (List B). The FINL sets out sectors in which foreign investment is prohibited outright (*e.g.*, mass media, practice of professions, small-scale mining) or subject to limitation (*e.g.*, natural resource extraction, investment in SMEs). The list is updated every two years, most recently in October 2012. The Philippine Securities and Exchange Commission is set to issue implementing rules and regulations that will monitor, investigate, and impose penalties relating to compliance with the foreign equity restrictions by the FINL.

The Philippine Constitution prohibits foreigners from owning land in the country, but allows for 50 year leases (with one 25 year renewal). An ambiguous deed and property system can make it difficult to establish clear ownership of leased land, however, and an inefficient judiciary results in land disputes that can extend indefinitely. U.S. investors report that these disputes can be a particularly significant barrier to investment in the mineral exploration and processing sectors.

Trade Related Investment Measures

The Board of Investment imposes a higher export performance requirement on foreign-owned enterprises (70 percent of production) than on Philippine-owned companies (50 percent of production). U.S. stakeholders have also reported that the Philippine government imposes unwritten "trade balancing" requirements on firms applying for approval of ventures under the ASEAN Industrial Cooperation scheme.

OTHER BARRIERS

The Aquino Administration continues to implement the anticorruption reforms outlined in its Philippine Development Plan 2011-2016 and has committed to actively pursue corruption charges involving prominent public officials. Nevertheless, corruption remains a pervasive and longstanding problem in the Philippines and one that can place U.S. companies at a disadvantage in the Philippine market. Both foreign and domestic investors express concern about the propensity of Philippine courts and regulators to stray beyond matters of legal interpretation into policymaking and about the lack of transparency in judicial and regulatory processes. Some also have reported cases of courts being influenced by bribery and improperly issuing temporary restraining orders to impede legitimate commerce.