THE PHILIPPINES

TRADE SUMMARY

The U.S. goods trade deficit with the Philippines was $1.0 billion in 2009, up $606 million from 2008. U.S. goods exports in 2009 were $5.8 billion, down 30.4 percent from the previous year. Corresponding U.S. imports from the Philippines were $6.8 billion, down 22.0 percent. The Philippines is currently the 30th largest export market for U.S. goods.

U.S. exports of private commercial services (*i.e.*, excluding military and government) to the Philippines were $2.1 billion in 2008 (latest data available), and U.S. imports were $2.6 billion. Sales of services in the Philippines by majority U.S.-owned affiliates were $2.4 billion in 2007 (latest data available), while sales of services in the United States by majority Philippines-owned firms were $47 million.

The stock of U.S. foreign direct investment (FDI) in the Philippines was $5.9 billion in 2008 (latest data available), down from $7.1 billion in 2007. U.S. FDI in the Philippines is mostly in the manufacturing sector.

IMPORT POLICIES

Tariffs

In 2009, the Philippine simple average bound tariff, *i.e.*, the level that it cannot exceed under WTO rules, was 25.8 percent, while its simple average applied tariff was 7.1 percent, according to the Philippine Tariff Commission. All agricultural tariffs and approximately two-thirds of non-agricultural tariff lines are bound. Products with unbound tariffs include automobiles, chemicals, plastics, textiles, clothing, fish, and paper products. High tariffs – some at 30 percent – are charged on chemical waste, automobiles, motorcycles, and some automotive parts. Additionally, products with tariff-rate quotas (TRQ) have high in-quota tariffs ranging from 30 percent to 65 percent. Sugar has the highest tariff at 65 percent, followed by rice at 50 percent. Other products with TRQs are poultry, swine, potatoes, coffee and coffee extracts. Meat and edible meat offal, sausages, prepared and preserved meat, cabbages, carrots, manioc (cassava), sweet potatoes, and animal feeds (except dog and cat food) have applied tariffs between 30 percent and 45 percent. Products subject to tariffs of 30 percent and above account for 5 percent of total Philippine tariff lines.

Automobile Sector Tariffs

The Motor Vehicle Development Program (MVDP) seeks to promote domestic automobile production with the objective of transforming the Philippines into a regional hub for automobile production as well as spurring regional exports. Tariffs on components are low and designed to encourage local assembly, whereas finished automobiles and motorcycles are subjected to the highest tariff rates applied to any nonagricultural product. The Philippines imposes a 30 percent tariff on passenger cars, 20 percent to 30 percent on vehicles for the transport of goods and 15 percent to 20 percent on vehicles for the transport of persons, depending on vehicle weight. A one percent tariff applies to completely knocked-down (CKD) kits by MVDP-registered participants, except for CKDs of alternative fuel vehicles, which are duty-free.

An Automotive Export Program grants export credits to qualified Completely Built Units, which may be applied to pay import duties otherwise due on qualifying imported finished automobiles. This system effectively reduces the applied tariff rate to 10 percent. In addition, the Philippines charges value added

taxes of 12 percent on vehicle imports and excise taxes based on the price of vehicles, with more expensive vehicles taxed at much higher rates.

Consistent with the objectives of the MVDP, Executive Order 156 (2002) imposed a general import prohibition on used motor vehicles. However, used vehicles account for a considerable portion of new vehicle registrations in the Philippines. In 2008, new vehicle registrations totaled 177,451 units, while local industry sales were recorded at 124,449 units, a discrepancy of nearly 30 percent of all new registrations. The local automobile industry attributes a significant portion of the difference to imports of used vehicles.

Safeguards

The Philippine government continues to levy safeguard duties on ceramic floor and wall tiles, glass products, and steel angle bars. Under the Safeguard Measures Act, the current period for filing answers by interested parties is five days; the Philippine government has drafted amendments to the Safeguard Measures Act to extend this period to thirty days in response to concerns expressed by the United States and other governments, but this amendment has been pending since 2007.

Excise Tax on Distilled Spirits

The Philippines maintains an excise tax regime for distilled spirits that imposes significantly higher excise taxes on spirits made from non-indigenous raw materials, which apparently disadvantages imports. In October 2009, the United States participated as a third party in WTO dispute settlement consultations between the European Union and Philippines on this issue in Manila. On January 14, 2010, the United States requested WTO consultations on the same issue.

Quantitative Restrictions

The Philippine government imposes a tariff-rate quota (TRQ) on several agricultural products, including corn, pork, and poultry. Since 2002, the Philippine government has maintained a special safeguard (SSG) for out-of-quota chicken imports, which effectively doubles the out-of-quota tariff. In the wake of a recent series of typhoons, the Philippine Department of Agriculture recently suspended the SSG for imported chicken entering the country in December, and then extended the suspension through January 2010.

The U.S. Government continues to monitor the administration of the TRQ system known as the Minimum Access Volume (MAV) system, which regulates the distribution of import licenses for certain agricultural products, including pork and poultry. In October 2007, the Philippine Department of Agriculture announced a review of the MAV system, prompting concern among U.S. exporters. The U.S. Government urged the Philippines not to implement changes to the MAV system because of their potentially harmful effects on trade. In February 2009, the Philippines Department of Agriculture announced it would maintain the current system.

Customs Barriers

The Philippine government has made progress in improving its customs regime since its implementation of the WTO Agreement on Customs Valuation in 2001. It is currently taking steps to accede to the World Customs Organization's Revised Kyoto Convention, efforts supported by U.S. technical assistance programs. President Gloria Macapagal-Arroyo signed the Philippine Instrument of Accession and submitted it to the Philippine Senate for concurrence on March 16, 2009. The Philippine Senate Committee on Foreign Relations conducted a hearing on May 22, 2009 and filed its report signed by all

16 members on October 14, 2009. Sponsorship is expected in early 2010. Reports of corruption and other irregularities in customs processing persist, however, including undue and costly delays, continued private sector involvement in the valuation process, the use of reference prices rather than declared transaction values, and of customs officials seeking the payment of unrecorded facilitation fees. The U.S. Government will continue to seek to address these issues with the Philippines.

GOVERNMENT PROCUREMENT

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. Government procurement laws and regulations favor Philippine-controlled companies and locally produced materials and supplies in government procurement. The Philippines is not a signatory to the WTO Agreement on Government Procurement.

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

EXPORT SUBSIDIES

The Philippines offers a wide array of incentives for export-oriented investment through export processing zones, free port zones, and other special industrial estates registered with the Philippine Economic Zone Authority. Along with reduced taxes, most zones offer simplified trade and tax transaction processing.

The Philippine government also offers export subsidies as an incentive for investment in less-developed economic areas. Qualified enterprises engaged in activities in preferred sectors and geographic areas registered with the Board of Investments for the Investment Priorities Plan (IPP) may take advantage of fiscal incentives. These include income tax holidays, additional income tax deductions for wages and for the development of necessary and major infrastructure works by the company, and tax and duty exemptions for the importation of breeding stock and genetic materials, as well as tax credits on local purchases of such stock and materials. To qualify for the incentives, enterprises must be 60 percent or more Philippine-owned and export at least 50 percent of their production, if the proposed activity is not listed in the IPP. An enterprise with less than 60 percent Philippine equity may qualify if its projects are classified as “pioneer” under the IPP or it exports at least 70 percent of total production.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

While the Philippines has enhanced its focus on addressing IPR issues, it remained on the Special 301 Watch List in 2009. The top U.S. concerns include lack of progress in prosecuting IPR violators in Philippine courts, the spread of camcording and peer-to-peer piracy, the growth of illegal mobile downloads, and pharmaceuticals legislation that carves out new governmental authority to curb the exercise of IPR. U.S. distributors continue to report high levels of piracy of optical discs of films and musical works, computer games, and business software, as well as widespread unauthorized transmissions of motion pictures and other programming on cable television systems.

In October 2009, a Philippines special working group delivered a proposal to expedite and clarify the judiciary’s IPR litigation process. The working group members represent the IPO, National Committee on IPR, state prosecutors, law enforcement, customs, regional trial court judges, and private sector

lawyers. The proposed rules aim for cases to be resolved within an average of one year. Specific provisions include procedures for the quick destruction of seized counterfeit goods, streamlined procedures for subject matter expert testimony, alternative dispute resolution, and the establishment of specialized IP courts with national jurisdiction. The Supreme Court is directing the formation of a judicial study committee to review the proposed rules and present the revised procedures to the Supreme Court for adoption.

SERVICES BARRIERS

Basic Telecommunications

Philippine law defines telecommunications services as a public utility, and as such, foreign ownership is limited to 40 percent. Foreigners may not serve as executives or managers of telecommunications companies, and foreign directors are limited by 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 out of step 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.

Financial Services

The Philippines has not ratified the Fifth Protocol to the General Agreement on Trade in Services, which embodies its obligations under the WTO Financial Services Agreement (GATS).

Insurance

Regulations permit up to 100 percent foreign ownership in the insurance sector, although minimum capitalization requirements increase in proportion to a company's foreign equity. Although full foreign ownership is allowed, the Philippines only committed in the GATS to a maximum of 51 percent equity participation while grandfathering existing insurers with more than 51 percent foreign equity.

Generally, only the state-owned Government Service Insurance System (GSIS) may provide coverage for government funded projects. A 1994 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. Private insurance firms, both domestic and foreign, regard this as a significant trade barrier. All reinsurance companies operating in the Philippines must cede to the industry-controlled National Reinsurance Corporation of the Philippines at least ten percent of outward reinsurance placements.

Banking

Numerous limitations on foreign participation exist in the banking sector. Foreign banks that meet qualification requirements under the law currently may own no more than 60 percent of a locally-incorporated banking subsidiary. Foreign banks that do not meet qualification requirements (such as wide ownership and public listing in the country of origin, as well as global and/or national rankings) and non-bank investors are subject to a lower 40 percent ownership ceiling. Majority Philippine-owned domestic banks must control at least 70 percent of total banking system assets.

Because of a central bank moratorium on the issuance of new bank licenses since 1999, foreign investments are limited to existing banks. Furthermore, foreign banks cannot open more than six branches, although four banks operating in the Philippines prior to 1948 are partially exempt from this limitation and may operate up to six additional branches each.

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. 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.

Securities and Other Financial Services

Foreign equity in securities underwriting and finance companies is limited to 60 percent. In the area of mutual funds specifically, all members of the Board of Directors must be Philippine citizens, although no foreign ownership restrictions apply. The 2007 Lending Company Regulation Act sets forth majority-Philippine ownership for those few classes of 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 utilities, including water and sewage treatment, electricity transmission and distribution, telecommunications, and transport, to 40 percent. All executive and managing officers of utility companies must be Philippine citizens.

Practice of Professions

Only Philippine citizens may be licensed under the Philippine Constitution to practice law, medicine, nursing, accountancy, engineering, architecture, and customs brokerage services.

Express Delivery Services

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

Retail Trade

The Retail Trade Liberalization Act of 2000 limits retail ventures with paid-up capital less than $2.5 million to Philippine nationals. Foreign investment in retail enterprises is permitted if it meets several requirements: paid-up capital is $2.5 million or more; a $830,000 minimum investment per store; the parent company must have a net worth of over $200 million; and the retailer must own at least five retail stores elsewhere or at least one outlet with capitalization of $25 million or more. In addition, at least 30 percent of inventory, by value, must be sourced from the Philippines. For retailers of high end or luxury products the investment in each retail store is $250,000, the net worth of the parent company must exceed $50 million and at least 10 percent of inventory must be sourced from the Philippines. These sourcing requirements are set to expire in 2010.

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 shares of stock.

Civil Aviation

Category 2 Status

In 2007, the U.S. Federal Aviation Administration (FAA) downgraded the Philippine civil aviation air safety system to Category 2 status. The Civil Aviation Authority of the Philippines was created in 2008 to promote the aviation industry with an emphasis on aviation safety. Category 2 status prevents Philippine air carriers from increasing flights to the United States and limits them to the current level of service, with exceptions for wet leases – whereby one airline provides an aircraft, complete crew, maintenance, and insurance to another airline – with airlines accredited by Category 1 countries. At least one U.S. airline claims that the Philippine Civil Aviation Board (CAB), responsible for issuing airline operating permits has retaliated against it as a result of the FAA's Category 2 rating. This airline claims that the CAB continues to issue only temporary operating permits even though the airline complies with all requirements for a permanent operating permit.

In October 2009, the International Civil Aviation Organization (ICAO) reviewed Philippine air safety under its Universal Safety Oversight Audit Program. The audit focused on the Philippine government's capability for providing safety oversight by assessing the 16 ICAO safety annexes (which includes three annexes audited by the FAA). The final report will be published by ICAO within nine months of the date of inspection.

Airline Taxation

The Philippine government imposes Common Carrier Tax and Gross Philippine Billing Tax on foreign airlines operating in the Philippines. The International Air Transportation Association (IATA) asserts that these taxes are discriminatory, and are inconsistent with ICAO resolutions, and have contributed to the departure of some foreign carriers from the Philippine civil aviation market, including British Airways, Lufthansa, Air France, and Alitalia. The Philippine Bureau of Internal Revenue maintains that taxes are imposed lawfully, but is reviewing its authority to adjust these taxes.

INVESTMENT BARRIERS

Significant restrictions apply to foreign investment in the Philippines. The 1991 Foreign Investment Act contains two "negative lists" (List A and List B), collectively called the "Foreign Investment Negative List (FINL)," enumerating foreign investment restrictions. The Act requires the government to update the list every two years. At the time of writing, the 7th FINL remains in effect and updates – originally scheduled for release in early 2009 – remain pending.

List A reflects foreign investment restrictions mandated by the Constitution or specific laws. The list includes sectors in which foreign investment is prohibited (*e.g.*, mass media, small-scale mining) or limited (*e.g.*, natural resource extraction). List B contains limitations on foreign ownership imposed for reasons of national security, defense, public health, safety, and morals. Under this list, explosives, firearms, military hardware, and gaming activities are limited to 40 percent foreign equity. List B also limits foreign ownership in small- and medium-sized enterprises with less than $200,000 in capital to 40 percent.

The 1987 Philippine Constitution bans foreigners from owning land in the Philippines, although the 1994 Investors' Lease Act allows foreign investors to lease land for 50 years with one 25 year renewal. It is difficult to establish clear ownership and to lease land, however, due to an ambiguous deed and property system, a situation further exacerbated by a judiciary that does not decide cases in a timely manner. Some U.S. investors consider unresolved land disputes a particularly significant barrier to investment in the mineral exploration and processing sector.

Trade Related Investment Measures

The Board of Investments imposes a higher export performance requirement for foreign-owned enterprises (70 percent of production) than for Philippine-owned companies (50 percent). Some investors claim that the Philippine government maintains unwritten "trade balancing" requirements for firms applying for approval of ventures under the ASEAN Industrial Cooperation scheme.

OTHER BARRIERS

Corruption is a pervasive and longstanding problem in the Philippines. Reports of corruption remain common despite recent governmental efforts to enhance transparency and accountability. Foreign and domestic investors express concern over the propensity of Philippine courts and regulators to stray beyond matters of legal interpretation into policymaking and about the lack of transparency in these processes. There also are reports of courts being influenced by bribery and improperly issuing temporary restraining orders to impede legitimate commerce.