PHILIPPINES

TRADE SUMMARY

The U.S. goods trade deficit with Philippines was $2.4 billion in 2005, and increase of $306 million from $2.0 billion in 2004. U.S. goods exports in 2005 were $6.9 billion, down 2.7 percent from the previous year. Corresponding U.S. imports from Philippines were $9.2 billion, up 1.2 percent. Philippines is currently the 25th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Philippines were $1.5 billion in 2004 (latest data available), and U.S. imports were $1.7 billion. Sales of services in Philippines by majority U.S.-owned affiliates were not available in 2003 ($1.2 billion in 2001), while sales of services in the United States by majority Philippines-owned firms were $18 million in 2003 (latest data available).

The stock of U.S. foreign direct investment (FDI) in Philippines in 2004 was $6.3 billion, up from $5.8 billion in 2003. U.S. FDI in Philippines is concentrated largely in the manufacturing, utilities, and finance sectors.

The United States and the Philippines concluded a bilateral Trade and Investment Framework Agreement (TIFA) in 1989. In recent years, the United States and the Philippines have held regular meetings under the TIFA. The United States has used the TIFA to discuss and seek resolution of many issues that might otherwise inhibit bilateral trade and investment. The United States-Philippines TIFA is a component in the Enterprise for ASEAN Initiative (EAI), which was launched by President Bush in October 2002.

IMPORT POLICIES

Tariffs

In January 2003, the Philippine government announced a reversal in tariff policy and indicated that it would undertake a comprehensive review of all tariff lines. The Tariff Commission issued recommendations for increased tariffs in several sectors and a slowdown of its tariff reduction plans in others. While the increased tariffs, which took effect in 2004, remain below the WTO bound rates, they represent a reversal of the hard fought reforms of successive previous Philippine administrations during the 1990s. Simple average tariffs fell from 9.7 percent in 1999 to 5.8 percent in 2003, but increased to 7.4 percent in 2004.

Previous progress on tariff liberalization took shape through a series of reform programs beginning in 1995. Normal trade relations' (NTR) / most favored nation (MFN) tariff rates on all goods (except sensitive agricultural products) 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 Philippines President Gloria Arroyo in October and December 2003, respectively, raised tariff rates on more than 1,000 product lines and maintained 2002 rate levels for an even greater number of product lines. Affected products include industrial goods produced domestically, such as chemical fertilizers, cement and consumer products including apparel and footwear. The orders raised rates on these products from the previous rates of between 3 percent and 10 percent to between 5 percent and 20 percent. The Philippine government is currently reviewing the tariff program and expects to complete the review by early 2006. In regards to the classification of products within tariff codes, at least one major U.S. company has reported inconsistency by the Bureau of Customs in the application of tariff classifications.

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 or below, 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 by the end of 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 permitted under AFTA, Singapore sought and won compensation from the Philippines for failing to lower Philippine petrochemical tariffs. The Philippines has reduced duties to 5 percent or below on 99 percent of all tariff lines under the AFTA-CEPT. Moreover, as a result of the November 2004 ASEAN Summit, members agreed to implement the ASEAN Sectoral Integration Protocols, which legally bind them to undertake accelerated integration measures in 11 priority sectors. These sectors account for 50 percent of 2003 intra-ASEAN trade and include electronics, E-ASEAN (electronic commerce/usage/connectivity among ASEAN countries), health care, wood-based products, automotives, rubber-based products, textiles and apparel, agri-based products, fisheries, air travel, and tourism. The Philippines is spearheading the formulation of the Electronics Road Map and committed to fast-track tariff elimination of more than 1,000 electronics and ICT products.

Automobile Sector Tariffs

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 Motor Vehicle Development Program (MVDP), 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 program, imports of finished automobiles (completely built-up units) and motorcycles have been subject to the highest duty rate applied to non-agricultural products. Under the MVDP, completely-knocked down (CKD) kits can be imported at preferential tariff rates if they promote efficiency in the domestic industry, increase value-added, create jobs, and transfer technology. The tariff rate on CKD is between 1 percent and 3 percent.

In April 2005, President Arroyo issued Executive Orders 418 and 419 increasing the tariff rates on certain types of automobiles. Executive Order 418 imposed a specific duty of 500,000 pesos (approximately $9,800) on top of the *ad valorem* duty on used vehicles. However, the high tariff imposed on the importation of used vehicles has yet to be implemented since a temporary restraining order was initiated shortly after the passing of EO 418. EO 419 increased from 30 percent to 35 percent the duties on high engine displacement vehicles under a stated pretext as an energy conservation and environmental measure. Under AFTA-CEPT, the tariffs on automobile components will be at 3 percent and 5 percent on passenger cars.

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 large engine displacement, including those from the United States. The August 2003 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", which applied to vehicles containing at least 10 seats including Asian utility vehicles (AUVs), are now taxed under the new system.

Under the revised excise tax scheme, vehicles are divided into four brackets based on their price: (1) for vehicles with a manufacturer's price of 600,000 pesos and below, the tax is 2 percent; (2) for those priced over 0.6 million to 1.1 million pesos, the tax is 12,000 pesos plus 20 percent of the amount in excess of 600,000 pesos; (3) for those priced over 1.1 million to 2.1 million pesos, the tax is 112,000 pesos plus 40 percent of the amount in excess of 1.1 million pesos; and (4) for those over 2.1 million pesos, the tax is 512,000 pesos plus 60 percent of the amount in excess of 2.1 million pesos.

Safeguards

The Safeguard Measures Act, enacted in 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 Philippine government indicated that it would increase the comment period to 30 days, but this change has not been implemented.

In November 2001, the Philippine government put in place a safeguard to protect local cement producers from imports. The Secretary of Trade and Industry imposed the safeguard duty despite the finding of the interagency Tariff Commission's that there was no merit to the cement producers' case. This decision was brought to the Philippine Supreme Court and in July 2004, the Court ruled that the safeguard duty was illegal.

The Department of Trade and Industry appealed the case. The Philippine government has also established safeguard duties on imported ceramic floors and wall tiles, float glass, figured glass and glass mirrors.

Agriculture Tariffs and Import Licensing

The average nominal tariffs on agricultural products (covering HS Codes 01 to 24) remained at 11.3 percent in 2005. High tariffs are still maintained on sensitive agricultural products, including grains, livestock, poultry 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 that 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 generally higher 2002 levels with the exception of pork, poultry, processed meats, corn, coffee and vegetables. Executive Order 264, issued in 2003, raised tariff rates on some product lines. These rates have been extended to an even greater number of food and agricultural products including those for which the United States has a substantial market share.

The U.S. Government continues to closely monitor the operation of the Philippines TRQ system and the allocation and distribution of import licenses. In particular, the U.S. government is monitoring the Philippine government's application of its Veterinary Quarantine Clearance (VQC) certificates for meat and poultry imports, as well as its import permit system for fresh vegetables.

In response to pressure from domestic meat and poultry producers to limit imports as well as to crack down on illegal importation of meat and poultry into the country, the Philippine Department of Agriculture (DA) maintains a VQC import-licensing scheme for imported meat and poultry, although its name connotes an SPS monitoring mechanism. The amended meat import regulation under the Administrative Order (AO) 26 series of 2005 (AO26) reiterates the need for an accredited importer to obtain a Veterinary Quarantine Clearance (VQC) certificate prior to the importation of meat and meat products. A VQC will now be valid for 60 days from the date of issuance, within which the meat or meat products are to be shipped from the country of origin, and may no longer be extended beyond that. The regulation still requires a one-time use of a VQC, meaning that each VQC must be surrendered upon arrival of a shipment of a covered product. When the quantity allowed on a VQC is insufficient to cover the amount in a container, the importer must supply an additional VQC to cover the difference. Any remaining tonnage from that second VQC is subsequently forfeited rather than the importer being given credit for the unused tonnage. This practice creates the appearance of discretionary licensing and fosters imprecision in statistical tracking of import volumes. Although the U.S. Government has registered its concern with the Government of the Republic of the Philippines (GRP) regarding the VQC process and has requested that its application be made more flexible, transparent and WTO consistent, the AO26 still contains the same inflexibilities.

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. The Secretary issues a certificate of necessity when he deems import is essential for achieving food security and the import will not cause serious injury or threat of injury to a domestic industry that produces like or directly competitive products. This process appears to be a discretionary application of import licensing.

Excise Tax on Distilled Spirits and Tobacco Products

President Arroyo signed legislation in December 2004 that raised the taxes on alcohol and tobacco products starting in 2005. The law maintained the preferential treatment the Philippines gives to distilled spirits produced from indigenous raw materials in its excise tax regime, which is a tiered tax structure based on net retail price. This tax regime continues to impede access to the Philippine market for U.S. exports of higher-value distilled spirits and is a primary reason why U.S. exports to this potentially significant market remain quite small.

The December 2004 legislation increased the excise tax by 30 percent for distilled spirits produced from indigenous sources, raising the tax from 8.96 pesos to 11.65 pesos on every liter of distilled spirits made from raw materials such as coconut palm, cane, and certain root crops. It also increased the excise tax by 50 percent on distilled spirits made from other materials (which would apply to most imports) from a range of 84 pesos to 336 pesos per 750 ml bottle to a range of 126 pesos to 504 pesos per bottle. The legislation also increased the excise tax on fermented liquor by 20 percent. Wines with an alcohol content of 14 percent or less by volume are assessed an excise tax of 17.47 pesos per liter, while wines with an alcoholic content greater than 14 percent but less than 25 percent alcohol content by volume are charged an excise tax of 34.94 pesos per bottle. 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 ranging from 145.60 pesos to 436.80 pesos per liter is assessed on bottles of sparkling wine and champagne. The legislation increases these rates on alcohol products by 8 percent every two years until 2011.

The Philippines also maintains a multi-tiered excise tax system based on retail prices for cigarettes, which will increase every other year until 2011. Low-priced machine-packed cigarettes with a retail price below 5 pesos per pack and hand-rolled cigarettes were assessed a tax of 2 pesos in 2005, rising to 2.72 pesos in 2011. Medium-priced machine-packed cigarettes with a net retail price between 5 pesos and 6.50 pesos per pack were assessed a tax of 6.35 pesos in 2005, rising to 7.16 pesos in 2011. High-priced cigarettes with net retail prices above 6.50 pesos up to 10 pesos per pack were charged a tax of 10.35 pesos in 2005, rising to 12 pesos in 2011. Premium cigarettes with net retail prices above 10 pesos per pack were charged a tax of 25 pesos in 2005, rising to 28.3 pesos in 2011. The legislation assessed an *ad valorem* tax of 10 percent on cigars with a net retail price of 500 pesos or lower and, for cigars with a net retail price above 500 pesos, a tax of 50 pesos plus 15 percent of the net retail price in excess of 500 pesos.

The legislation that President Arroyo signed into law in December 2004 also provides that alcohol and cigarette brands being sold in the domestic market as of October 1996 be classified according to their net retail prices for excise tax purposes; and brands introduced between January 1997 and December 2003 be classified according to their net retail prices as of end-2003. This provision effectively provides existing brands/players with preferential excise tax treatment relative to new brands/entrants.

U.S. firms have noted that the Documentary Stamp Tax presents a related national treatment issue with respect to cigarettes. Although the National Internal Revenue Code requires that tax stamps be affixed to all cigarettes sold in the Philippines, this is only effectively enforced on imported cigarettes. Because of lax enforcement, domestically produced cigarettes are often shipped to outlets without the stamps and without paying the connected taxes.

Quantitative Restrictions

The National Food Authority (NFA), a state trading enterprise, controls rice imports and administers an import quota. It imports any shortfall in rice production under the import quota. The 2005 minimum access volume (quota) for rice was set at 238,000 metric tons. Both in and out of quota tariffs are 50 percent, although this tariff is waived when the NFA contracts for these imports. Rice import demand is expected to continue growing in the Philippines due to persistent shortfalls in local production and a high population growth rate (2.4 percent annually). Due to import restrictions, rice is illegally imported into the country on a regular basis from various rice-producing countries in the region.

Among sensitive agricultural products, 15 items (at the four-digit HS level and covering some 60 tariff lines) are subject to a minimum access volume (MAV) administered through tariff-rate quotas (TRQs). The Philippines' 10-year minimum access commitments under the Uruguay Round expired in June 2005. Final-year TRQ commitments are being maintained until such time when the products are liberalized or new commitments are negotiated under the Doha Development Agenda. For rice, a commodity for which the GRP receives special treatment under Annex 5 of the Uruguay Round Agricultural Agreement, the GRP petitioned WTO members for an extension until 2012. In return for various agricultural concessions, nine countries (Thailand, Pakistan, Egypt, China, Argentina, the United States, Canada, India and Australia) have provisionally accepted the GRP's extension. Several products with significant market potential for the United States are subject to TRQs. These include: corn, with an in-quota tariff rate of 35 percent and an out-of-quota tariff rate of 50 percent for 2004/2005; poultry meat, with an equalized in-quota and out-of-quota tariff rate of 40 percent; and pork, with an in-quota rate of 30 percent and out-of-quota rate of 40 percent.

Other Import Restrictions

The Philippines maintains import restrictions on a number of goods. These restrictions are intended to safeguard public health, morals, national security, and to meet international treaty obligations regulating certain products. Imports may only be allowed after securing clearance and permits from appropriate government agencies. Among the restricted products are dangerous drugs, chemicals, penicillin and its derivatives, color reproduction machines, used vehicles and tires.

Customs Barriers

The Philippine government has made progress during the last several years toward bringing its customs regime into compliance with its WTO obligations, but corruption and other irregularities remain commonplace. The Philippine laws R.A. 8181 (1996) and R.A. 9135 (2001), with supporting regulations, provide the legal context for the Philippines' implementation of the WTO Agreement on Customs Valuation. 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.

The 2001 law eliminated private sector involvement in the valuation process. It also clarified that reference values may be used as a risk management tool, but not as a substitute for valuation. The U.S. Government remains concerned, however, about reports of continued 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 Philippine government has 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. The U.S. Government has raised this issue during bilateral trade discussions during the past several years and will continue to closely monitor the situation.

Currently, all importers or their agents must file import declarations with the Bureau of Customs (BOC), which the BOC then processes 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). All shipments channeled through the yellow lane require a documentary review, 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 announced the addition of a "Super Green Lane" (SGL) facility for importers acknowledged as the 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 during the implementation, which was launched in December 2003, the BOC lowered the cost to companies of accessing the facility. By the end of 2004, 86 firms were using these facilities.

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 regularly urged the Philippine government to improve the administration of its customs regime. Customs administration could be strengthened by 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 the 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 91 products, including automotive and motorcycle batteries, cosmetics, medical equipment, lighting fixtures, fire extinguishers, electrical wires and cables, cement, pneumatic tires, sanitary wares, and household appliances. For goods not subject to such 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. Mis-labeling, 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 encourage 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 that 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. Similarly, under a July 2004 protocol, importation of cherries from the United States is permitted.

In January 2004, the DA issued Memorandum Order No. 33 (MO 33), which provided new requirements for beef and beef products imported from the United States. This was in response to the detection of Bovine Spongiform Encephalopathy (BSE) in a single imported dairy cow in the State of Washington in December 2003. Only beef and beef products derived from cattle 30 months of age or less are allowed entry into the country. Other specified requirements include: only deboned and deglanded muscle cuts of beef from healthy and ambulatory cattle devoid of nerves and any specified risk materials (SRMs) will be allowed entry. Moreover, the production or slaughter date of the cattle must be provided on the packaging label.

GOVERNMENT PROCUREMENT

Although the Philippines is not a signatory to the WTO Government Procurement Agreement (GPA), the Philippine government has taken some steps to reform its procurement process. In January 2003, President Arroyo signed the Government Procurement Reform Act to consolidate numerous procurement laws and issuances and to standardize guidelines, procedures, and forms across Philippine government agencies, government-controlled corporations, and local government units. Among others, the law simplified pre-qualification procedures, introduced more objective non-discretionary criteria in the selection process; and established an electronic procurement system to serve as the single portal for government procurement activities. The Government Procurement Reform Act also calls for public monitoring of the procurement process to promote greater transparency and competition, enhance the flow of information, and lessen discretion among agencies.

Nevertheless, the Government Procurement Reform Act's Implementing Rules and Regulations (IRRs) for locally funded government projects/contracts continue to favor purchases from Filipinos and or Filipino-controlled companies. As a general rule, goods and supplies for locally-funded projects must be purchased from enterprises that are at least 60 percent Filipino-owned; infrastructure services from enterprises with at least 75 percent Filipino interest; and consulting services from at least 60 percent Filipino-controlled entities. For infrastructure projects, the law also provides that, for the next five years from the effective date of the law, contractors whose head office is located in the province where the project will take place have the right to match the lowest offer by a non-province based bidder.

The Philippine government, in consultation with foreign donors, has yet to issue IRRs covering procurement for projects/contracts involving foreign financing and/or assistance, reportedly because of strong pressure to favor local suppliers (which would contradict donor procurement policies). The Official Development Assistance (ODA) Act (Republic Act 8182, as amended in February 1998 by Republic Act 8555) remains in force and waives the preference for local suppliers for projects/contracts involving ODA. Foreign donors have been able to implement their procurement regulations under the provisions of the ODA Act. The Build Operate Transfer Law (Republic Act 6957 of July 1990, as amended in May 1994 by Republic Act 7718) allows proponents of Build-Operate-Transfer (BOT) projects to engage the services of Filipino and/or foreign firms for the construction of BOT infrastructure projects.

In February 2004, President Arroyo issued Executive Order 278, which provides preferential treatment for Filipino consultants in public sector infrastructure projects. The Executive Order stipulates that, as much as possible, the government should fund consultancy services for its infrastructure projects with local funds, and using local resources and expertise. When Filipino capability is determined to be insufficient, Filipino consultants may hire or work with foreign consultants, but should be the lead consultants. Where foreign funding is indispensable, foreign consultants must enter into joint ventures with Filipinos. Foreign donors have so far been able to comply with their respective procurement guidelines without violating Executive Order 278. However, because an executive order has the force of law, the specter of problems arising in the future remains. In addition to concerns about discriminatory treatment against foreign firms, U.S. companies continue to raise concerns about corruption in government procurement.

The Philippine government issued Executive Order 120 in August 1993 mandating a counter trade 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 counter trade obligations at a minimum of 50 percent of the import price and set penalties for nonperformance of counter trade obligations.

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. As a general rule, an enterprise should be at least 60 percent foreign-owned and, if export-oriented, export at least 50 percent of production to qualify for BOI incentives. Enterprises with less than 40 percent Filipino equity may qualify provided they engage in projects listed as “pioneer” under the IPP or they export at least 70 percent of production. 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 that 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

In February 2006, the United States lowered the Philippines from the Special 301 “Priority Watch List” to the “Watch List,” after having been on the “Priority Watch List” for the previous five consecutive years. Key government officials, including President Arroyo, are pledging continued momentum and increased effort on IPR initiatives. Although there has been a general improvement in the IPR protection regime, the U.S. Government continues to have serious

concerns about intellectual property rights (IPR) protection in the Philippines. Significant problems remain in ensuring the consistent and effective protection of intellectual property rights. U.S. distributors report high levels of pirated optical discs as well as widespread unauthorized transmissions of motion pictures and other programming on cable television systems. Counterfeit goods such as brand name and designer clothing, handbags, cigarettes, and other consumer goods are widely available. Optical media piracy, including piracy of DVDs and CD-Rs, also continues to be a problem. Although, some improvement is visible in select shopping malls, it is unclear whether this represents a long-term trend. The Philippines has made progress in combating optical media piracy through passage of the Optical Media Act in 2004 and stepped-up enforcement by the Optical Media Board, but the government has failed to improve the prosecution and conviction of IPR violators to create a credible deterrent. Print piracy and end-user piracy of business and entertainment software also are serious problems. The United States has encouraged the Philippines to further improve and sustain enforcement efforts, and to take steps to enhance judicial capacity.

Intellectual Property Laws

The 1997 Intellectual Property Code provides the basic 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, and burdensome restrictions affecting contracts to license software and other technology.

The Philippine government has taken 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 Philippine Supreme Court adopted rules establishing *ex parte* seizure authority in civil cases of IPR infringement (i.e., "seizure without notice to the suspected infringer").

In June 2002, President Arroyo approved legislation designed to comply with 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 a provision exempting local farmers from licensing requirements.

In November 2005, the Senate was considering legislation to reduce patent protection for pharmaceutical products. If passed, this legislation would weaken important patent protection provisions in the Intellectual Property Code.

In addition to adhering to the WTO TRIPS Agreement, the Philippines is a party to the Paris Convention, the Berne Convention, the Budapest Treaty, the Patent Cooperation Treaty, and the Rome Convention. The Philippines, as a member of WIPO, ratified the WIPO Performances and Phonograms Treaty and the WIPO Copyright Treaty in March 2002.

The treaties took effect in October 2002. However, the Philippine government has not yet enacted necessary amendments to its copyright law that would fully implement the requirements of these WIPO treaties into domestic law. The U.S. Government continues to urge the Philippines to enact this needed legislation.

President Arroyo signed into law the Optical Media Act (OMA) on February 10, 2004. The OMA is intended to regulate the import, export and production of optical disks, including tools and materials involved in their manufacture. In addition, the OMA created the Optical Media Board (OMB) as a replacement for the Videogram Regulatory Board. On February 1, 2005, the Congressional Oversight Committee approved implementing regulations for the Optical Media Act. Full implementation and enforcement of this law and regulations, including prosecution of IPR violators, will be critical to strengthening the Philippines IPR regime.

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 estimated the annual losses due to copyright piracy in the Philippines in 2004 at $139 million. U.S. distributors report high levels of piracy of optical disks 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. Trademark infringement in a variety of product lines is also widespread, with counterfeit or pirated merchandise openly available in both legitimate and illegitimate venues.

During bilateral discussions in 2004 and 2005, the U.S. Government encouraged swift action and full funding support for IPR enforcement efforts and judicial capacity building. Furthermore, the U.S. Government continues to encourage the closure of malls and other outlets where pirated optical discs are the primary products being offered. The U.S. Government also urged the Philippines to adopt laws 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 printed materials. The U.S. Government continues to provide technical assistance and training to strengthen capacity within Philippine agencies responsible for the protection of intellectual property.

Serious problems continue to hamper the effective operation of agencies tasked with IPR enforcement. Many enforcement agencies suffer from a lack of resources because IPR issues remain a relatively low priority. Enforcement efforts such as raids and seizures have increased in frequency over the past year, yet have only had a minor deterrent 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. Since February 2005, the IPO has implemented a more robust leadership role on enforcement issues in the Philippines; and in February 2006, was granted oversight authority over law enforcement efforts. Components of the IPO's strategy include a greater emphasis on interagency coordination, enforcement campaigns in partnership with private industry, and sustained outreach efforts to inform the public on IPR issues.

However, the IPO's enforcement coordination efforts are still in the early stages, and the agency should focus more vigorously on reinforcing links among the agencies with responsibilities in this area, including the Department of Justice, the National Bureau of Investigation, the OMB, the Bureau of Customs (BOC), and the National Telecommunications Commission (NTC).

The Philippine government has taken some administrative steps intended to strengthen enforcement. A customs administrative order in September 2002 strengthened the ability of the BOC to prohibit the importation of pirated products, and created an Intellectual Property Unit within the BOC. The order requires the BOC to maintain an IPR registry where property holders may record their rights and other information to facilitate enforcement. Nonetheless, U.S. industry continues to cite the absence of effective border enforcement as a significant concern.

A recent encouraging development, however, regarding IPR protection and enforcement in the Philippines is a new assertiveness emanating from the OMB. Since February 2005, the OMB has moved towards full operational capability in its efforts to combat domestic production of pirated optical media. The OMB has conducted 13 raids of optical media production lines since February and has seized large quantities of production equipment and finished product. Yet the legal system in the Philippines continues to undermine the best enforcement efforts and courts often release suspects picked up in OMB raids and drop their cases on questionable technical grounds.

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 intellectual property 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 crimes are not considered serious and take lower precedence in criminal court proceedings. In late 2005, the Supreme Court created a Task Force on Intellectual Property Rights, which identifies three judges and a team of prosecutors who will focus on IPR cases and receive specialized training. These judges will handle other commercial and criminal cases such as money laundering, but are expected primarily to handle IPR cases. If appealed, IPR cases would still go through the current appellate system, which permits numerous interlocutory appeals and can result in long delays.

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 in 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 enough to serve as a deterrent to IPR violators. For example, the nominal damages awarded by the Philippine courts in most IPR cases add little to the cost of doing business for IPR pirates, with no risk of imprisonment.

SERVICES BARRIERS

Basic Telecommunications

The Philippine Constitution defines telecommunication services as a public utility and therefore limits foreign ownership to 40 percent. This restricts market entry, especially in more capital-intensive applications, such as broadband, where foreign firms are reluctant to invest without majority control. In addition, foreigners are restricted from serving as executives or managers and the number of foreign directors in telecommunication companies must be proportionate to its aggregate share of foreign capital. Foreign equity in the private radio communication network is limited to 20 percent. Operation of cable TV and other forms of broadcasting and media are constitutionally reserved for Filipinos.

An August 2005 ruling of the National Telecommunications Commission (NTC) determined that Voice Internet Protocol (VIP) is a value added service and therefore did not require a legislative franchise to operate. The NTC is currently drafting the guidelines for VOIP operators who are already thriving in this newly competitive business.

During the WTO negotiations on basic telecommunications services, the Philippine government made commitments on most basic telecommunications services and adopted some pro-competitive regulatory principles contained in the WTO Reference Paper. It did not provide market access or national treatment for satellite services (which remain subject to discriminatory rules) and did not allow resale of private leased lines. The Philippine government is now over six years late in ratifying the Fourth Protocol to the WTO General Agreement on Trade in Services (GATS) embodying its proposed obligations under the WTO Basic Telecommunications Agreement, despite regular U.S. urging.

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 Service Insurance System may provide coverage for government-funded projects. Administrative Order 141, issued in August 1994, also required proponents and implementers of Build-Operate-Transfer projects and privatized government corporations to secure their insurance and bonding requirements from the GSIS at

least to the extent of the government's interests. 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 a 51 percent level 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). Such investments can be made only in existing banks since the Bangko Sentral ng Pilipinas (BSP, the central bank) imposed a moratorium on the issuance of new bank licenses in September 1999 to encourage consolidation in the banking system. 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.

Pre-1997 legislation exempted banks' Foreign Currency Deposit Units (FCDUs) as well as Offshore Banking Units (OBUs) from certain non-income taxes (i.e., gross receipts tax, documentary stamp tax, and branch profit remittance tax). In 1997, a Comprehensive Tax Reform Program (CTRP) was signed into law to broaden the tax base. The final version of the CTRP, due to faulty drafting, inadvertently withdrew these tax exemptions by leaving out the phrase "exempt from all taxes." Last year, the Bureau of Internal Revenue (BIR) started to assess current and back taxes on FCDUs/OBUs. Even though one bank has paid the taxes assessed by the BIR for the timeframe 1998-2004, other members of the Bankers Association of the Philippines are still pursuing a blanket removal of these taxes. Legislators have indicated that there was no intention to rescind the exemptions in the CTRP.

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. These limitations also apply to the operation of public utilities under Build-Operate-Transfer and similar arrangements.

The June 2001 Electric Power Industry Reform Act provides for the privatization of the generation and transmission 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). After a series of failed biddings, the government decided to privatize the national transmission grid, known as Transco, by awarding a 25 year concession, renewable for another 25 years. The government will seek a congressional franchise after the concession is awarded. Though stated to be a top priority, only five small hydroelectric generating stations and one large coal-fired power plant had been sold, which represent a mere 12 percent of total generating assets. The privatization and restructuring 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, and engineering, architecture, and customs brokerage services) to Philippine citizens.

Shipping

Under the Philippine's cabotage laws, foreign-flagged vessels cannot engage in the carriage of domestic trade cargoes. In specific cases, Philippine-registered ships engaged in international trade may be issued a special permit to temporarily engage in domestic trade services. These permits can only be issued if: there is no existing Philippine-flagged vessel operating on the proposed route; there is no suitable local vessel available; the vessel is contracted by private or public utilities; and it involves tourist passenger vessels, when the itinerary includes calls at domestic ports. Government cargo is reserved to Philippine-flagged vessels, though exemptions are permitted if these vessels are unavailable at reasonable freight rates. Only Filipino nationals or locally incorporated entities authorized to engage in overseas shipping and with a maximum of 40 percent foreign equity may register a vessel. Philippine-registered vessels must be completely manned by Filipino crews except as supernumerary for up to six months.

Express Delivery Services

Foreign air express couriers and airfreight forwarding firms must either contract with a 100 percent Philippine-owned business to provide local delivery services, or establish a domestic company with a minimum of 60 percent Philippine-owned equity. U.S. companies currently operate hub operations in the Philippines, made possible by partial open skies provisions.

In 2003, the U.S. Government attempted to negotiate amendments to the bilateral aviation agreement with the Philippine government, seeking enhanced passenger rights and cargo seventh freedom rights. Seventh-freedom cargo rights would enable U.S. and Philippine operators to carry cargo between two countries without having to pass through their home country. Talks ended in July 2003 when the Philippine delegation claimed that seventh-freedom rights were unconstitutional. In December 2003, however, President Arroyo signed an executive order permitting cargo seventh-freedom rights for the two international airports located within the Clark and Subic economic zones for carriers of any country. The Civil Aeronautics Board adopted the Implementing Rules and Regulations on April 4, 2005, granting unrestricted flight frequency, aircraft configuration, and non-cabotage traffic rights for carriers who petition for a waiver. Non-cabotage rights would allow any flight schedule except flying between two points within the Philippines for foreign carriers.

INVESTMENT BARRIERS

The 1991 Foreign Investment Act contains two "negative lists", collectively called the "Foreign Investment Negative List" (FINL), enumerating areas where foreign investment is restricted. The Foreign Investment Act requires the government to update and publish the FINL every two-years. The most recent FINL was released in November 2004.

List A restricts foreign investment in certain sectors by mandate of the Constitution and specific laws. For example, 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 certain marine resources, and manufacture of firecrackers and pyrotechnic devices are reserved for Filipino citizens.

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 foreign-assisted projects, (that is, projects that benefit from foreign aid, for which there is no upper limit on foreign ownership). 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 for large-scale projects), educational institutions, public utilities, commercial deep sea fishing, certain government procurement contracts, ownership of condominium units, and rice and corn production and processing. Full foreign participation is allowed for retail trade enterprises: (1) with paid-up capital of $2.5 million or more, provided that investments for establishing each 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. Financing companies and investment houses 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 gaming activities. This list also addresses local small- and medium-sized firms by restricting foreign ownership to no more than 40 percent in non-export firms capitalized at less than $200,000.

In addition to the restrictions noted in lists "A" and "B", firms with more than 40 percent foreign equity that qualify for BOI incentives must divest to the 40 percent level within 30 years from registration date or within such longer period determined by the BOI. Foreign-controlled companies that export 100 percent of production are exempt from this divestment requirement. 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. BOI-registered companies may employ foreign nationals in supervisory, technical or advisory positions for five years from registration, extendable for limited periods at the discretion of the BOI. The positions of elective officers of majority foreign-owned enterprises (i.e., president, general manager, and treasurer or their equivalents) are not subject to this limitation.

The Philippine Constitution also 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. Deeds are difficult to establish, poorly reported and poorly regulated. The deeds and property infrastructure is full of ambiguities, which makes it difficult to establish clear ownership and the court system is not known to settle cases in a timely manner. Land ownership issues such as these need to be clarified for domestic landowners before foreign land ownership can become viable.

Trade Related Investment Measures (TRIMS)

The BOI-imposed, industry-wide local content requirements under its Motor Vehicle Development Program were eliminated in July 2003. 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 was completed by July 1, 2003. The U.S. Government is continuing to closely monitor Philippine implementation of this WTO commitment.

Under a 1987 executive order, the soap and detergent industry is required to use a minimum of 60 percent of locally produced raw materials that do not endanger the environment. The law is intended to require soap and detergent manufacturers to use coconut-based surface-active agents (soft surfactants) 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. Moreover, a 1990 law (Republic Act 8970) prohibits manufacture, importation, distribution, and sale of laundry and industrial detergents containing hard surfactants. Only natural oleo chemicals, including those derived from coconut, palm, palm kernel, sunflower, and rapeseed oils are allowed.

The United States continues to monitor the Philippines' compliance with other TRIMS requirements. Regulations governing the provision of BOI-administered incentives impose a higher export performance requirement for foreign owned enterprises (70 percent of production should be exported) than for Philippine-owned companies (50 percent). 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. Under a 1982 executive order (EO 776), the Bureau of Foods and Drugs requires pharmaceutical firms to purchase semi-synthetic antibiotics from a specific local company, except when these firms can show that the landed cost of imports are at least 20 percent cheaper.

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, provided that the National Power Corporation (NPC) should privatize at least 70 percent of its generating assets located in Luzon and Visayas within three years. Privatization stalled and no asset has been privatized since December 2004 when five small hydroelectric and one large coal-fired power plant were sold. The bidding for a 225 MW Bataan thermal and a 600 MW Calaca coal-fired power plant is currently ongoing. Seventy-five percent of the funds used to acquire NPC assets must be inwardly remitted and registered with the BSP. 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 of 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

The Philippine government defines technology transfer arrangements as: (1) contracts involving the transfer of systematic knowledge for the manufacture of a product; (2) the application of a process, or rendering of a service including management contracts; and, (3) 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.

Mining

The Philippine Supreme Court, in a decision issued in December 2004, reversed its January 2004 ruling that declared key provisions of the Mining Act of 1995 unconstitutional and prohibited majority foreign-owned firms from mining in the Philippines. The reversal opens the sector to direct foreign investment. As such, mineral exploration and processing licenses are open to full foreign equity participation for large projects valued at over $50 million; small and medium-scale mining is reserved for Filipinos. The country’s unexploited mineral wealth is estimated as $840 billion. The Philippines has some of the richest deposits of metallic and non-metallic minerals in the world (e.g., copper and gold). Mining output is currently about $500 million per year. There are nine million hectares where mineral deposits may be found, although the government has issued permits for only 1.4 percent of those lands. Significant barriers to investment remain, such as unresolved disputes regarding land claims and a paucity of progress in implementing key regulatory and administrative reforms.

Other Investment Issues

The Supreme Court recently decided to disallow the Clark Special Economic Zone fiscal incentives provided under the Bases Conversion Development Act, although the underlying court case has been appealed. Over 350 investors, including 10 U.S. firms, maintain investments at Clark. The unforeseen taxes, including retroactive taxation, may lead to investor withdrawals from Clark and discourage new investment.

ANTICOMPETITIVE PRACTICES

The Philippine Constitution provides the government with authority to regulate or prohibit monopolies, and it also bans combinations of entities 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 entrenched economic and political interests.

ELECTRONIC COMMERCE

The Electronic Commerce Law, signed in June 2000, provides that business transactions through an automated electronic system such as the Internet are functionally and legally 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 for unlawful activities conducted using its services 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 law 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 pervasive and a longstanding problem in the Philippines. During discussions under our bilateral TIFA, the United States has conveyed to the Philippines its views on specific cases where corruption appears to be a factor and urged the Philippines to tackle the problem of corruption as a means of improving the country’s investment climate. The Philippines' score in Transparency International's annual Corruption Perceptions Index survey has averaged 2.5 to 2.6 (out of a best score of 10) since 2002, down from 3.6 in 1999. 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 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 or accepting and offering or giving a bribe are criminal offenses, punishable by 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, however, 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.

The government seems to have reinvigorated its anti-corruption drive. The Office of the Ombudsman has reported improved conviction rates. In December 2003, the President issued an executive order creating an anti-corruption watchdog - the Revenue Integrity Protection Service (RIPS) - in the Department of Finance that has worked closely with the Ombudsman to help curb corruption in revenue collection agencies. President Arroyo has articulated her desire to strengthen the Office of the Ombudsman to become as efficient as Hong Kong's Independent Commission Against Corruption. Achieving that goal will require strong political will and significantly greater financial and human resources than currently dedicated to the effort. In November 2004, the Philippines became eligible for the Millennium Challenge Account Threshold Program. In August 2005, the country's concept proposal for the Threshold Program addressing corruption in revenue administration was approved for the development of an approximately $20 million Threshold Country Plan (TCP).

Both foreign and domestic investors express concern over 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 courts influenced by bribery improperly issue temporary restraining orders impeding the conduct of legitimate commerce. Investors also have raised concerns that regulators rarely have any background in economics, business, or a competitive economic system, which enables entrenched interests to manipulate the legal system and regulatory process - whether by bribery or through exploiting the lack of expertise among regulators - to protect market positions.