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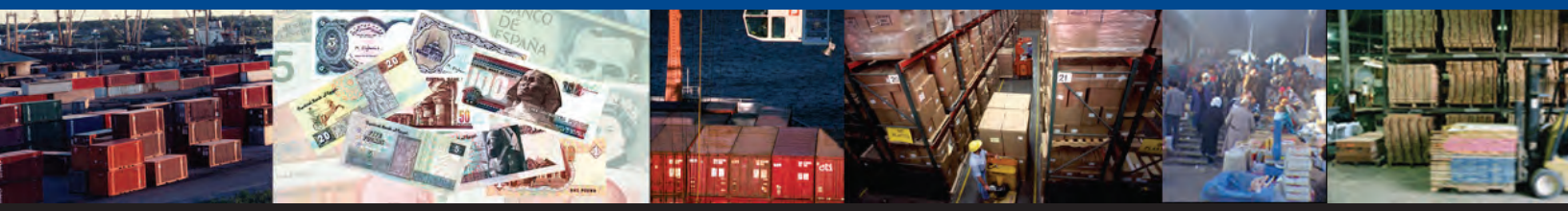
SOUTHEAST ASIA COMMERCIAL LAW AND TRADE DIAGNOSTICS – THE PHILIPPINES

FINAL REPORT



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UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

SOUTHEAST ASIA COMMERCIAL LAW & INSTITUTIONAL REFORM AND TRADE DIAGNOSTIC—THE PHILIPPINES

FINAL REPORT

JULY 2007

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I. Introduction

A. The Philippines: A History of Change

The Philippines is an archipelago of more than 7,000 islands with a combined size just greater than the U.S.'s Arizona, and with a population of more than 90 million persons. It is located in the South China Sea between Taiwan, China, Vietnam, and Malaysia. It is a collection of various ethnicities, although ethnic identity is considered fluid and informal. Identifying what characteristics define these groups often changes depending on circumstance (although it usually centers on ancestry, language, or one's home region). Most are of Malay ancestry; a significant and influential Chinese minority also exists. Perhaps the only overtly differentiating characteristic is religion. More than 90 percent of the population is Christian (and more than 80 percent Catholic) as a result of centuries of Spanish rule. In the Mindanao region in the south of the country, however, exists a large Muslim population that accounts for approximately five percent of the total population. While upwards of 90 languages are spoken throughout the islands, three—Cebuano, Tagalog, and Ilocano—are spoken by the majority of the population. To encourage national unity, the government has promoted Pilipino, a derivative of Tagalog, as a national language. In addition, English is the language of business and government.

In terms of political stability, over the past century the country has moved through a variety of forms of governance. After gaining control of the country from Spain in 1898 as a spoil of the Spanish–American war, the United States in 1935 passed a law creating a 10-year transition period to Philippine independence. In 1942, the country was occupied by the Japanese. The United States and the Philippines fought together to end this occupation, as were successful at end of the World War II in 1945. In 1946, despite the shaken nature of the country as a result of the war, the Philippines became officially independent. Of particular relevance to commercial law and trade, the history of mixed rule by Spain and then the United States has resulted in a legal system that contains elements of both civil and common law.

During the initial period of independence, democracy failed to take hold. As a result of the on-going political instability, in the mid-1960s Ferdinand Marcos began a 20-year autocratic rule that suppressed democratic institutions, led to widespread corruption and cronyism, and limited economic growth. After Marcos' ouster in 1986, a new attempt at democracy was undertaken. Buttressed by the 1987 Constitution, which remains in force today, this effort has held despite periods of challenge. Today, the Philippines remains a representative republic with a bicameral congress – modeled after the United States. The long-term stability of this structure remains in question, however, as one president has been forced from office as a result of corruption and the current president operates under the threat of similar action.

In terms of security, the government faces threats from both terrorist groups and communist insurgents. Rising crime and concerns about the security situation have had a negative impact on tourism and foreign investment. The terrorist Abu Sayyaf Group, which gained international notoriety with its kidnappings of

foreign tourists in the southern islands, remains a major problem for the government, although progress has been made to reduce the terrorist threat in recent periods.

In the post-war period, the Philippines has gone from being one of the richest countries in the region, alongside Japan, to one of the poorest. Since the end of Marcos' rule, however, the Philippines has enjoyed a period of relative growth, in large part because of the microeconomic and macroeconomic reform programs of subsequent administrations. Except for 1998—when drought and other weather-related disturbances pulled down agricultural harvests, combining with the contraction in industrial sector production—gross domestic product (GDP) has recorded positive growth, with a peak of 6 percent in 2004. This is at least in part because of a growing services sector that now accounts for over 50 percent of GDP and employs almost 50 percent of the population. Significantly, the Philippines was less severely affected by the Asian financial crisis than its neighbors, aided in part by the stability of the services sector and annual remittances from overseas Filipino workers that exceeded $10 billion in 2005. (On the other hand, the Philippines never enjoyed, like many of its neighbors, a period as an "Asian tiger.")

Other important sectors of the Philippine economy include agriculture at 14 percent of GDP, and industry, in particular garments and electronics assembly, which accounts for almost 35 percent of GDP. Mining has great potential in the Philippines, as it possesses significant reserves of numerous minerals, natural gas, and coal. In terms of international assistance, over recent years the United States and other donors have contributed hundreds of millions of dollars to assist with stabilizing democracy and furthering development. Despite these positive signs, over 40 percent of the population remains in poverty.

This diagnostic report, while not exhaustive, will not only provide a snapshot of where the Philippines is today with respect to its framework of commercial and trade laws and institutions, but will also function as a tool for determining how, where, and when help might be applied to help move the Philippines from its current poverty levels and its situation of seemingly great potential but unrealized opportunity. This diagnostic recognizes that there are few easy answers and that important decisions will necessarily require a balancing of many competing interests and cultural dynamics. With that in mind, the diagnostic offers recommendations for making improvements.

B. The Philippines Diagnostic: Continuing USAID's Investigation of Southeast Asia

This report constitutes the fourth installment of five of a USAID-sponsored initiative to understand and respond to economic growth, harmonization, and integration efforts in five emerging economies of South-East Asia: Vietnam, Laos, Cambodia, Indonesia, and the Philippines. The South-East Asia Commercial Law and Institutional Reform and Trade Diagnostic Activity (SEA CLIR Trade) is designed to allow various organizations to better understand the opportunities for reform in Southeast Asia's commercial law and trade environment. These bodies include USAID's Regional Development Mission/Asia, USAID bilateral missions in the region, the governments of these countries, and other interested entities. It also establishes a baseline on which USAID and others can prioritize their future regarding regional technical assistance.

SEA CLIR Trade first examines the status of commercial law and trade facilitation in each of the participating states, including each country's respective strengths, weaknesses, and opportunities for development. Specifically, through the comprehensive methodology established through USAID's Seldon Project for Global Trade Law Assessment and Assistance, the diagnostic examines the following topics:

- Company Law
- Contracts Law and Enforcement
- Real Property Law

- Secured Transactions Law
- Bankruptcy
- Competition Law and Policy
- Commercial Dispute Resolution (CDR)
- Court Administration
- Foreign Direct Investment
- International Trade Law
- Flows of Goods and Services across Borders
- Flow of Money
- Flow of People
- Financial Crimes
- Intellectual Property
- Trade-Related Flows of People
- Trade-Related Financial Flows
- Agriculture

Then, based on individual country reviews and organized opportunities for broad-based response to the country findings, SEA CLIR Trade is designed to yield both specific country and later overall regional diagnostic observations that will:

- Make intra-regional and subject-matter comparisons of international trade and commercial legal frameworks and associated institutions
- Identify regional commercial law reform and trade-capacity needs and establish program- and project-level priorities
- Benchmark and evaluate regional progress toward an international trade- and business-friendly legal and regulatory environment
- Provide analytical and planning tools and metrics that will help to design new regional strategies and approaches for sustainable, cost-effective reform activities.

C. The Methodology of Diagnostic: A 360° Review

The examination of commercial law and institutions and trade-related law and institutions in Southeast Asia, from both an individual country and regional perspective, involves a comprehensive yet flexible framework for analyzing a complex and dynamic development challenge. Taking data from a broad spectrum of stakeholders, the diagnostic builds a "360° picture" of the challenge:

Legal Framework. The diagnostic first examines the laws and regulations that the SEA CLIR Trade countries have in place. These serve as the structural basis for their ability to achieve and sustain market-based development. The diagnostic poses the following questions: *How closely do existing laws reflect emerging global standards? How well do they respond to commercial realities that end users face? What inconsistencies or gaps are present in the legal framework?* Often discovered through this review are opportunities to make relatively small changes that may result in significant openings for business development and expansion.

Implementing Institutions. Next, the diagnostic examines those institutions that hold primary responsibility for implementation and enforcement of the legal framework and subsidiary laws, regulations, and policies governing one or more of the areas addressed in this report. For example, courts are usually a crucial institution in the examination of commercial law. Problems uncovered with the courts often relate to bureaucratic inefficiency, lack of resources and training, and, of paramount concern,

real or perceived corruption. On the other hand, with respect to the flow of goods, services, and people, customs and immigration authorities are the chief implementing institutions.

Supporting Institutions. The diagnostic then considers the environment of organizations, individuals, or activities without which the legal framework or policy agenda cannot be fully developed, implemented, or enforced. Examples include notaries, lawyers, banks, business support organizations, professional associations, universities, and other, similar ancillary service providers. Of particular interest with respect to supporting institutions is whether they have any meaningful involvement in *what the law says*. Where there has been buy-in from affected constituencies, a law and its commensurate system for implementation are more likely to be understood, to be used properly, and to achieve their overall purpose.

Social Dynamics. Finally, studying social dynamics entails asking whether the affected constituencies of a law or policy perceive a need for change, and, if so, how they are demonstrating this need. Are they effectively lobbying those institutions that can make a change? Is the media seizing the issue as a topic of public concern? Are individuals speaking out? Or, have social dynamics taken a less positive approach, for example, is the "gray economy" growing as a response to overly burdensome conditions for market entry? Analysis of social dynamics may affect how an assistance project is ultimately designed. Where outside participation is strong and public understanding high, a reform program may simply involve a relatively small number of government officials who are capable of meeting the demands. In contrast, where mistrust and misunderstanding are abundant, an approach that involves significant engagement of end users will likely be necessary.

Following the first country diagnostic of Vietnam in September 2005, the SEA CLIR Trade continued in Cambodia and Laos before coming to the Philippines. The bilateral assessments will conclude with an assessment of Indonesia in summer 2007, which will be followed by a regional conference and report later in 2007.

Team Members

The diagnostic team in the Philippines consisted of the following individuals:

- Amy Allen (Co-team Leader—Assessment Coordination)
- Peter J. Baish (Flow of Goods and Services)
- Joanne Cornelison (Flow of Goods and Services)
- Dan Fitzpatrick (Bankruptcy, Secured Transactions)
- James Hamill, Federal Trade Commission (Competition Law and Policy)
- Judge Eileen Hollowell (Contract Law, Real Property Law)
- Blake Lingle, Federal Trade Commission (Competition Law and Policy)
- James Newton (Team Leader, Flow of People)
- Anne Simmons-Benton (Intellectual Property Rights, International Trade Law and Policy)
- Charles Schwartz, USAID (Intellectual Property Rights)
- Judge D. Brooks Smith (Commercial Dispute Resolution, Court Administration)
- Allen Welsh (Financial Crimes, Company Law)
- Art Westnest (Agriculture)
- Louise Williams (Foreign Direct Investment, Flow of Money)

Through a series of meetings with a far-reaching representation of over 100 public and private actors who participate in the Philippine economy, and in concert with a comprehensive review of many documents that touch upon one or more aspects of the SEA CLIR Trade initiative, the team developed broad findings

with respect to the Philippines' relative strengths, weaknesses, and opportunities. To conclude the in-country portion of the assessment process, the team conducted a roundtable discussion with representatives of the government, the private sector, and the donor and diplomatic community, with over 150 attendees. This event provided insights, from representatives of several stakeholders, pertaining to the team's preliminary findings.

This report now summarizes the team's findings in each of the four areas of review—legal framework, implementing institutions, supporting institutions, and social dynamics—and includes recommendations for specific areas of reform. Although this report centers specifically on the commercial law and trade environment in the Philippines, its overriding purpose remains comparative. It will be especially useful as the SEA CLIR Trade initiative examines the same set of issues in the other SEA CLIR Trade countries.

Over two weeks, the team received invaluable assistance in preparing for, facilitating, and executing its assessment from the USAID mission in the Philippines, including the generous guidance of Mission Director Jon D. Lindborg, Chief of the Office of Economic Development and Governance within the Mission Robert Wuertz, and in particular Economist Tyler Holt from that same office. In addition, the team received invaluable assistance from the USAID regional mission in Thailand, through the support of USAID Regional Development Mission Director Tim Beans as well as Skip Kissinger, the Director of its General Development Office, and USAID's Bureau of Economic Growth, Agriculture, and Trade, in particular Senior Commercial Law Reform Advisor Charles Schwartz. The team is particularly grateful to the Government of the Philippines and USAID's Economic Modernization through Efficient Reforms and Governance Enhancement (EMERGE), Rule of Law (ROL), and Asia Foundation projects for their respective participation and assistance. Scores of individuals from throughout the Philippine government, including various public-sector institutions, as well as from the private sector, the donor community, the university community, and a wide sample of supporting institutions proved enormously helpful in providing a candid and thorough view of the commercial law and trade sectors. The team is very grateful for the assistance and contributions of all of these individuals and institutions.

D. Summary of Subject-Specific Findings

The findings of the 16 subject-matter areas examined in this diagnostic are summarized as follows:

Company Law and Corporate Governance

Company law and, in particular, corporate governance present a challenge, if not an obstacle, to economic development in the Philippines. Resulting from the historical underpinnings of colonialism, much of the corporate wealth in the Philippines is concentrated in a few families and large companies. Despite reforms that, for the most part, put the corporation code in line with international norms, these companies have been able to influence corporate law and policy to limit both domestic and international competition. As a result, this concentration in corporate ownership and control leaves relatively few shares on the market for public trading, and similarly few opportunities for others to succeed in the market. In this environment, minority shareholders find that they have no meaningful opportunities to influence business decisions or even to enforce their rights under the black letter of the law. At present, numerous reform programs that should be supported are underway through a variety of donors. However, one point should be incorporated into each: that the case for reform should be made from a Filipino standpoint, rather than from an outsider's standpoint as the latter currently seems to be the case. For example, while training on the importance and efficacies of corporate governance is needed, it should not refer heavily to the good governance checklists of the Organization for Economic Cooperation and Development (OECD), the New York Stock Exchange, the European Bank for Reconstruction and Development, or other outside indicators, and instead should focus on issues from the Philippine perspective.

Contracts Law and Enforcement

As with many areas of law and trade in the Philippines investigated in this report, the legal framework with respect to contracts is sound and aligned with modern commercial practice. The institutions responsible for the enforcement of contracts and contract law, however, lack predictability and efficiency, causing a chilling effect on some forms of commerce in the country. The recommendations with respect to CDR and court administration, discussed below, therefore apply here as well as to those areas that investigate the bodies responsible for contract law and enforcement, in particular the courts. One recommendation should be noted and emphasized here, however. While a few designated and specific commercial courts exist, their set-up is not supportive of the development of an expertise in commercial law, in particular the contractual issues that form the foundation of a commercial trading system. Despite being designated as "commercial courts," these bodies still have other matters, such as criminal cases, on their dockets. The creation and/or designation of more, and truly specific, commercial courts would benefit trade and commerce in the country through greater efficiencies and expertise.

Real Property Law

The real property system in the Philippines is governed by a patchwork of laws, regulations, and institutions that make land transactions at a minimum difficult, limiting an individual land holder's ability to unlock the benefits, such as greater access to capital, of land ownership. Over the last century, a dozen laws related to real property have been enacted and numerous institutions created which often operate in conflict with each other. This has led to a system where only those with the means and time are able to successfully register or claim title to property. Because of the complexity of the system, it is also not uncommon for illegal facilitation fees to be necessary for success. In addition, specific provisions, such as limitations on the ability of foreign nationals to become landowners, have a chilling effect on property investment. A number of simplifications are needed, therefore, including the consolidation of land management into one agency, or, alternatively, improved communication between those agencies involved in real property issues. At a minimum, staff in these offices should receive training to help increase efficiency. Similarly, a simplified system of land valuation is needed. As with contract law, courts would benefit from hearing only civil cases in that they would be able to develop expertise in commercial land matters.

Secured Transactions Law

A complete system of secured transactions includes a legal framework supportive of the use of multiple kinds of movable property as collateral, a system for registering the property, and a means to collect on that property in the event of a debtor default. Fragments of each of those components exist in the Philippines. It has a legal framework consisting of a chattel mortgage law (a law for mortgaging movable property) and a series of quasi-security arrangements based on various provisions in the civil code and other legislation. The registry handles only chattel mortgages and is entirely paper-based. The system for enforcement, which allows for extra-judicial foreclosure of assets, is prone to delay and inconsistency. The result is a legal regime that provides sufficient comfort to lenders willing to take as collateral automobiles and other moving vehicles (aircraft, ships), the ownership rights of which must be filed in parallel registration systems (such as the automobile registry at the Land Transportation Office). On far fewer occasions, however, are lenders willing to take equipment, inventories, or future crops as security, all of which lack the benefit of a parallel registry system. Ongoing reforms in this area, however, are working to change this situation and should be supported. For example, current efforts to modernize and computerize the registry are of particular importance so that borrowers and lenders alike can make accurate assessments of their ability to engage in a secured transaction. Of equal importance, however, is the need to develop a stronger constituency for the reform of the secured lending system. A variety of draft laws and other reform efforts have been undertaken but the interest in, and accordingly the effect of,

these has been limited.

Bankruptcy

The current bankruptcy regime is widely seen as a suboptimal arrangement badly in need of reform, namely through the passage of a comprehensive law encompassing international best practices in both liquidation and rehabilitation. Numerous obstacles, however, reduce the chances for passage of a new bankruptcy law in the next several years. Therefore, a series of smaller, incremental reforms might be better pursued. Among others, these would include strengthening the institution of the bankruptcy receiver or administrator, which is at present unlicensed and often under qualified. A study of the performance of commercial courts that have been tasked with hearing bankruptcy cases over the last six years should be done, as there is no understanding at present, outside of anecdotal information, of how the courts have performed. Such a survey would allow for both improvements within the system itself as well as with the practice of bankruptcy law, with which the country has limited experience.

Competition Law

The Philippines has neither a comprehensive law of competition nor a specialized enforcement entity that might be expected of a nation of its size and economic standing. There are, however, Philippine laws and government entities vested with authority to challenge trade restraints. However, no real Philippine jurisprudence on competition exists because virtually no cases have been litigated and the law does not define, explain, or establish criteria for what constitute the elements of a violation. While there are specific sectors that have made headway to open competition, there is no central government authority responsible for competition law or policy. At present, a national competition law—or an agency to enforce it—is not a high priority, and consequently there is insufficient political will to push forward one of the several existing draft competition laws pending in the Philippine House and Senate. Moreover, there is no widespread public constituency for competition law, and little public understanding of its potential benefits to consumers and new business entrants.

Commercial Dispute Resolution

In many ways, the state of commercial dispute resolution (CDR) in the Philippines is more advanced than in other nations in the region. The legal architecture promoting alternative dispute resolution (ADR), for example, continues to develop, but the use of this resource has been slow. Nonetheless, contracts involving foreign direct investment often contain arbitration clauses that permit adjudication in foreign venues and such clauses are, for the most part, enforced by Philippine courts. Problems arise, however, with a court system that lacks predictability, efficiency, and transparency. This as a result acts as a deterrent to both domestic and international actors from engaging in commercial activities in the country. As with other areas, the development of specialized commercial courts would greatly benefit commercial disputes and help ameliorate such problems. Moreover, the role of judges should be given greater credibility through, for example, further increased salaries. This would help to attract the most qualified individuals to these important roles. In addition, while the use of arbitration has been increasing, the use of mediation, the success of which would further unburden the courts, needs support to meet international standards. This could be accomplished through, for example, the training of mediators in complex commercial litigation.

Court Administration

The state of court administration in the Philippines is promising because of a stable legal architecture to manage and resolve cases, and supporting institutions to aid in implementation. However, the efficacy and efficiency of this legal system are hampered by ineffective implementing institutions. Any reform of

the court administration process in the Philippines should attempt to close the gap between how the Philippine legal system presents itself on paper and how the system actually operates for those who engage the judiciary. Numerous steps are needed in this regard, from revising the regulations that govern the hiring of court administrative staff and granting the judiciary greater control of its own budgets, to more strictly enforcing pretrial rules and changing the rules regarding judicial misconduct to afford judges greater protections. On a practical level, providing regular statistics throughout the court system on case management (i.e., how many cases were opened, pending, or resolved in a court over a given period) could increase friendly peer pressure on judges to clear their dockets, as has occurred in the United States.

Foreign Direct Investment

Amid a pervasive sense that the Philippine economy is underperforming and the barriers that foreign investors face are significant, certain areas of optimism do emerge. Factors that point toward "more sustainable, stronger growth" and overall improved investor confidence in 2007 and beyond include a recently reduced deficit; a decreased rate of inflation; a "remittances boom" that creates new potential markets for investors; growing opportunities in business process outsourcing and mining; and a strengthened banking sector.[1] A variety of steps can still be taken to further bolster this situation, including greater availability of timely trade statistics, improvements in the agriculture and tourism sectors to attract greater foreign investment, and continued efforts to ameliorate corruption, which has been cited as a deterrent to the interest of foreign investors in the country.

International Trade Law

The Philippines has a solid and extensive framework of laws and institutions that have developed since its admission into the World Trade Organization (WTO). For an effective trade policy formulation that enables economic growth and business development, in addition to various trade-related laws, an effective coordination system between ministries and that includes private sector participation is essential. The Philippines needs to further develop effective decision-making processes to produce rules and regulations concerning trade that enable trade, comply with the standards of the WTO, and affect growth. This would include addressing services, which is a key area with growth potential. While the goal of involving the private sector is espoused, this is often done too late or ad hoc. A system of notice to all interested stakeholders to allow their input is lacking at this point. The one example of effective streamlining that was voiced by many is the Philippine Export Zone Authority (PEZA).

Flows of Goods and Services

Given its position in Southeast Asia, the Philippines is well-situated to be an ever-growing hub for the receipt and transshipment of goods in the region and beyond. While positive examples within the trading and customs systems exist—such as the Philippines Exporters Confederation (PHILEXPORT) and PEZA, which both operate efficiently and support the flow of goods—and both legislative and institutional reforms are being pursued, numerous steps are needed for this opportunity to be realized. From the outset, each step of reform must include a look at how to alleviate the widespread corruption in many aspects of the trading system, without which any other reforms will not achieve the desired result. A second overarching goal would be to create a true public–private partnership in designing and pursuing reforms. Legislatively, perhaps the most obvious need is to accede to the Revised Kyoto Convention, which provides a practical blueprint for modern and efficient customs procedures. Within the Bureau of Customs, steps such as the full use of the information technology systems at its disposal, which could be the envy of the region, must be undertaken.

[1] Merrill Lynch, *Philippines: Stepping it Up* (January 25, 2007), p. 3.

Trade-Related Financial Flows

Cross-border transactions represent an ever-increasing component of the Philippine economy. Of special interest in the Philippines is the flow of remittances, which now represent 11 percent of the country's GDP. Overall, the laws, public institutions, and private stakeholders effectively support trade-related money flows in the Philippines. A variety of regional and international currencies are available, and flows take place through physical, and increasingly electronic, means. Basic trade finance products are widely available to traders. New technologies and competition from foreign banks have led to expanded service offerings and, to a lesser degree, improved internal governance practices by domestic banks. Most recently, improvements in the fiscal environment have resulted in increased investor confidence. In fact, assuming continued progress in the incorporation of international standards into local practices, the Philippines can serve as a regional leader with respect to trade-related money flows.

Trade-Related Flows of People

In the Philippines, the eased immigration of business persons, tourists, and other foreigners is a priority of the government in order to encourage and support foreign investment. Current laws, regulations, and institutions are adequate for this need, in that no part of current immigration requirements serve as a deterrent to prospective foreign entrants. It should be noted that administrative obstacles and delays do exist, but not to the point of causing persons to rethink entering the country, and a solid cadre of knowledgeable professionals are available to assist with this issue.

Financial Crimes

Beginning in 2000, when the Philippines was first listed on an international blacklist with respect to the fight against money laundering and terrorism financing, the country began a fervent process of enacting legislation and creating institutions to reverse this finding. By 2004, even ahead of enactment of all the necessary legislation, sufficient progress had been made to remove the Philippines from the list of non-cooperative countries. It had created a financial intelligence unit (FIU), instituted a system of inter-governmental agency cooperation to fight financial crimes, trained staff, and established working relationships with other governments to assist with investigations. In fact, the Philippine FIU has become a model for the region. Nonetheless, greater strides can still be taken with respect to interagency cooperation, training of relevant officials in areas such as law enforcement, and improved information technology systems used for analyzing millions of pages of financial transactions.

Intellectual Property

The Philippines has a strong legal framework and has recently made substantial improvement in its intellectual property (IP) protections. In its 2006 Special 301 Report by the United States Trade Representative, the Philippines was lowered from the "Priority Watch List" Category to "Watch List." While improvements were recently made in several areas, continued attention is needed with respect to, for example, business associations, law schools, and other institutions of higher learning, non-governmental organizations (NGOs), and even the media. The purpose is to build basic public understanding of the principles and benefits of IP protection for the Philippines. In addition, while laws are, for the most part, adequate, improvements with respect to enforcement of these laws are needed. Given that the present administration has stated that this area is a priority, pursuit of such reforms should be done in the near term to take advantage of this supportive political climate.

Agriculture

Similar to the real property system, the agriculture sector is set in a complex legal and institutional framework that is both wide and deep. There are multiple government departments involved: Agriculture, Agrarian Reform, Justice, Interior and Local Government, Labor and Employment, Trade and Industry, Science and Technology, Social Welfare and Development, Transportation and Communications, Finance, Education, and Health. There are three distinct legal systems (formal, administrative, and local (*barangay*)), and a collection of Republic Acts, Presidential Decrees, Executive Orders, and Administrative Orders that all affect the agriculture sector. In recent years, the government has placed a high priority on the transformation of agriculture into a modern, dynamic, and competitive sector. It is believed that a sustained expansion of the national economy requires sustained growth in the agricultural sector. To assist in this process, a comprehensive review across the government of laws and regulations affecting agriculture and the rural sector should be conducted. This review should identify areas of overlap and contradiction, and propose reforms to simplify the system.

E. Cross-Cutting Themes in the Business Enabling Environment

The Philippines has been subject to the influence of various cultures and political structures throughout its history, from the colonial control of far-away powers to the local rule of would-be despots. Even today, as the country settles more deeply into a system of representative democracy, there is seemingly still doubt as to the durability and sustainability not only of particular leaders, but at times of the system more generally. Not too coincidentally, this historical pattern of shifting and changing power structures has led to a business environment with many—and sometimes clashing—stripes. While this report describes specific areas of commercial and trade practice, certain of these stripes, or themes, permeate most, if not all, of the areas of investigation. They thus merit separate discussion for readers to be able to fully understand not only the mechanics of a particular area of practice but also the culture in which it operates.

It should first be noted that as a result of, or, perhaps in some areas, in spite of, its diverse legal background, the Philippines has a **strong legal framework on the books** in almost all major areas that support the business environment. Perhaps the most common thread that was woven through almost every interview and discussion held as part of this diagnostic, however, was the corrupt practices within the public and private institutions that make up business-enabling environment. This not only makes the functions of important institutions suspect, but also limits the effectiveness of the otherwise rich legal framework. **Corruption**, obviously, it is a sensitive and difficult issue. Interviewee after interviewee, however, related anecdotes and patterns of corruption in many of the key institutions needed for business: the Bureau of Customs and other trade-related agencies, the courts, the registries, etc. The forms of corruption described to the diagnostic team were of many different varieties, but the most commonly cited was that of facilitation fees, or payments made outside normal and legally required fee structures to move a good, or a case, or a property title through the respective system. The fault is difficult to pinpoint—there were as many stories of private individuals volunteering these facilitation fees as there were of public officials seeking them out. In many ways, such fees have become accepted as part of the cost of doing business in the Philippines. The **complicated bureaucratic systems** and acceptance of the resultant chaos by design that a businessperson must traverse in the Philippines to achieve proper licensing, registration, etc. makes the payment of facilitation fees more appealing and, to some, arguably necessary. Quite simply, the onerous administrative procedures faced by businesspersons within most of the various agencies related to business, and the acceptance of this inefficiency, provide a disincentive to formalization and innovation, and impede growth.

Sadly, as a result, the country's image has been tarnished, raising the eyebrows of current and prospective investors in the country, both local and international. This is not to say, however, that the Philippines has turned a blind eye to its plight. Both the Office of the Ombudsman, responsible for investigating and

prosecuting government officials in the Philippines who are allegedly guilty of crimes, and the *Sandiganbayan* court, with jurisdiction over criminal and civil cases involving graft and other illegal practices committed by public officers and employees, have clear mandates to fight corruption. Nonetheless, the problem persists with far-ranging effects including lowered government revenue—making the provision of government services more difficult—to established political patronage. Most directly relevant to this diagnostic, however, there is a loss of investor confidence and higher costs of doing business. When the choice for a businessman is between spending extensive amounts of time in lengthy bureaucratic processes that may not, in the end, achieve the desired result, or attempting to work around this process through illegal payments, many will opt for a third choice and take their business and money elsewhere. Tackling the pervasive problem of corruption would lead to greater efficiencies for all. Most significant, it would assist the smaller businessperson—for whom as of this point the costs of doing business are too high—as only those with the time, money, and access are able to regularly and successfully achieve the desired results.

In this regard, historical patterns have led to a well-developed corps of family businesses who have become the controlling shareholders in a few large companies. This has led to **centralized wealth** into the hands of a few. Throughout the Spanish and American periods and until World War II, a small number of families first amassed land holdings. They then continued their growth through the development of trading companies. As the breadth and depth of their businesses expanded, wealth grew and was passed on to their heirs over several generations. The industrial elite have maintained highly concentrated ownership and wealth, have influenced—and continue to influence—commercial policy, and have profited from government protection against competition. As a result, micro, small, and medium enterprises within the Philippines struggle to survive, **chilling entrepreneurship** and the desire to affect the changes necessary to allow them equal access to services and opportunities. The repercussions of this are far-reaching, as banks, for example, are less likely to extend credit to such businesses due to a lack of trust that borrowers will be able to repay.

A **well-educated, highly literate population**—for both males and females, with one of the highest literacy rates in the region—remains a regional comparative advantage, although concerns over this advantage have begun to arise. Importantly, a significant portion of the population speaks English, giving the Philippines an advantage over many of its neighbors in the Association of Southeast Asian Nations (ASEAN), and leading to high-capacity human resources ready for broad international commerce. Investors and local businesses have leveraged this **English-language advantage** to expand various sectors. For example, call centers and tourism have both expanded in large part because the providers of these services are English speakers.

Concerns have arisen in this regard, however. A shortage in teachers and space for students is challenging the ability to maintain these high levels of education. A secondary problem is that while overseas Filipino workers (OFWs) are an important part of the economy because they remit significant sums of money into the country, those that leave are often the best and brightest, leaving a gap at home that is difficult to fill. It is a reflection of the **quality and importance of these OFWs**, however, that they are sought-out worldwide to fill a variety of positions. The Philippine government has invested significantly to ensure that such workers have more than adequate support to find jobs abroad, are supported while there, and have assistance when resettling at home. In any case, while the government has recently invested in education, more is needed. This will not only encourage continued widespread English-language proficiency, but will also help to ensure that education for more of those seeking advanced degrees in commercial law and trade will receive instruction of the quality necessary to participate in an international market.

Perhaps arising from the high levels of education is a **broad and deep civil society** that can freely communicate with the government to address needed reforms. More than other countries investigated in

the SEA CLIR region to date, the Philippines has a glut of organizations, chambers, and associations poised to contribute to the commercial process. Significantly, many agencies serve not only local but also foreign investors who are in a position to participate as well. In addition, **the media** are large and active and report on all facets of business and commerce (although there are reports of a lack of objectivity within that sector).

Despite regular interaction with agencies and widely available technology to support such interaction, however, such organizations and other supporting institutions regularly reported that they feel that their positions are not heard. In many cases the private sector reported that the partnerships they had with the government were "less than meaningful." Throughout the business environment, from having greater participation in the needed re-engineering of import processes to being able to officially provide comment on implementing regulations of various commercial bodies, greater participation of the private sector in developing new processes and rules would be advantageous. It would create a sense of ownership in the system, greater respect for the implementation of such changes, and increased overall confidence in the system. It also would help to ensure that such changes were actually meeting the needs of end users.

Woven through all of these issues as well as the specific subject matter discussions is a sense that many in the Philippines are either content with or overwhelmed by the status quo, and accordingly the diagnostic team was often left with the feeling that **change is difficult to achieve**. While there are many who are eager to seek and achieve improvements, questions of who is responsible for those activities and how they are to be sought often makes it difficult to see the trees for the forest. A number of other issues, the combination of which is unique to the Philippines relative to other developing nations, bring about this slower pace of change: a large and educated population (a large portion of whom lives abroad); a large and bustling economy that is resistant to shocks from the larger international economy; a strong international presence, both in the sense of businesspersons and international assistance organizations; a complex array of laws based on both common and civil law traditions; and wealthy and sophisticated businesspersons and politicians. These characteristics make for a complex situation where broad and bold strokes of reform, while needed in some areas, may not be feasible. Nonetheless, reform is both possible and needed, and this report provides guidance in that regard.

II. Company Law and Corporate Governance

A. Introduction

The corporation, an artificial person, offers at least three essential advantages to its shareholding owners. One advantage is longevity. Whether the business is a large or small, ownership can easily be passed from one generation to the next or from one set of owners to another, whether or not offspring or partners survive or care to carry on the business. A second advantage is access to capital through the sale of shares, an advantage reserved directly for larger firms but not without important advantages to the public at large. Thirdly, modern corporate laws may protect a shareholder's personal assets from creditors of the corporation, creating a powerful incentive for a wider public to participate in the economy.

One mark of the modern era of the corporate sector of the Philippines is the Corporation Law of 1906, based on United States law. Post-World War II policies also shape today's corporate sector in the Philippines. From the 1950s through the early 1980s, nationalistic government policy favored strong intervention in business and economic matters. The emerging industrial elite influenced policy and profited from government protection against foreign competition. Import tariffs and currency manipulation were important weapons in the fight against competition. Eventually, however, the capital necessary to sustain artificially protected growth necessarily became scarce.

Transitional policies arrived none too soon in the 1980s. A modern corporation law was adopted, the Corporation Code of 1980. The new corporation law removed many barriers to business in the corporate form and instituted basic principles of good corporate governance. Tariffs were reduced and imported raw materials became cheaper, and tariff reform programs continued into the 1990s. These reforms among others contributed to increased competition and some reduction of corporate concentration. In the latter half of the 1990s, growth in gross domestic product (GDP) in the Philippines would match its regional competitors, but only in time for the Asian currency crises of 1997. From 1988 to 1997, return on equity and return on assets compared favorably with other Asian countries, averaging an annual growth of 12.6 percent and 5.3 percent, respectively.

Despite the reforms of the 1980s and 1990s, corporate ownership and control remain highly concentrated. In a study of 1997 data, the top shareholder owned over 40 percent of the market value of the average, publicly-listed business corporation in the Philippines. The holdings of the top five shareholders equaled nearly 65 percent of the market value of an average public company, and about 59 percent of the value of an average financial institution. The top 20 shareholders of business corporations controlled 75 percent of corporate value, on average, among listed companies.

Concentration in corporate ownership and control leaves relatively few shares on the market for public trading. In this environment, minority shareholders find that they have no meaningful opportunities to influence business decisions or even to enforce their rights under the letter of the law. Commentators armed with exhaustive studies have assessed blame upon the current state of corporate governance for volatile share prices and illiquidity. In the meantime, an underdeveloped securities market restricts access to capital and reduces a variety of direct and indirect opportunities for Filipinos to participate in the economy and benefit from the economic growth that otherwise ought to ensue.

Company law and corporate governance present a challenge, if not an obstacle, to economic development in the Philippines.

B. Legal Framework

The Corporation Code was adopted in 1980. It replaced a 1906 law that was based on a U.S. model, and incorporated modern principles and local experience. The Philippine Securities and Exchange Commission (SEC), with assistance from supporting institutions, proposes and advocates amendments to the corporation law from time to time.

The requirements of articles of incorporation are simple. Though the articles must state specific purposes rather than general purposes, the rule is interpreted liberally by the SEC, and corporations are not restricted from pursuing any lawful activity. A corporation requires at least five incorporators and paid-up capital of at least Php 5,000 (approximately US$100). Simple forms for articles of incorporation are contained in the Corporation Code. The intervention of a notary is a formality and not expensive. The usual fee for filing articles of incorporation is Php 2,000.

Shareholder rights are protected under the law in accordance with standard corporate practice. The Code permits cumulative voting for directors. Shareholders have appraisal rights in appropriate circumstances. Shareholders have preemptive rights to avoid dilution of shares. They can vote by proxy. The code addresses potential conflicts of interest between shareholders and management. Shareholders have clear authority to inspect company records. The law imposes strong sanctions against insider trading. The law prohibits removal of a director to deprive minority shareholder representation.

The Securities Regulation Code was adopted in 2000 with donor assistance with a view toward conformance to international models and best practices. The Code sets forth the powers and duties of the SEC. The Code provides regulation for securities registration, pre-need plans, reporting, brokering, and exchange trading. The Code protects shareholder interests with provisions on tender offers, proxy solicitations, and accounting requirements. There are strong sanctions against fraud, manipulation, and insider trading.

C. Implementing Institutions

The SEC is the primary implementing institution for company law and corporate governance in the Philippines.[2] The SEC serves as the corporation registrar, filing articles of incorporation, amendments to articles of incorporation, articles of merger and dissolution, and other events of organic corporate change. The SEC's authority as corporation registrar derives from the Corporation Code of 1980. The SEC is tasked to encourage the "widest participation of ownership" in enterprises, to enhance the "democratization of wealth," and ensure corporate compliance, as provided by the Securities Regulation Code of 2000. The SEC organizes its responsibilities into four core functions.

Core Function 1—Capital Market Development and Regulation

Three departments serve this core function. The market regulation department develops regulations for all securities market participants, ensures compliance with securities registration requirements, and refers violations to the enforcement department. The corporation finance department registers securities before public sale and regulates public information with regard to the public listings. The non-traditional securities and instruments department licenses pre-need plans, commodities futures contracts, and other instruments.

[2] While the courts are involved in the functions of corporations and enforcement of contracts, this is discussed in this report's chapters on contract, commercial dispute resolution, and court administration.

The SEC regularly proposes updates to the corporation law and other business legislation. Recent years have seen the adoption of securitization laws and regulations. In 2005, the SEC collected over 22,000 reports required by law or regulation from broker dealers, finance companies and investment houses, issuers of securities, and other entities. Only 47 on-site audits were performed, however. The value of securities registered by the SEC in 2005 increased 53 percent over the value for 2004.

Year	Value of registered securities
2003	Php 58.7 billion
2004	Php 67.8 billion
2005	Php 103.9 billion

Core Function 2—Company Registration and Monitoring

The company registration and monitoring department registers corporations and partnerships, approves amendments to articles and by-laws, grants licenses to foreign corporations doing business in the Philippines, and fulfills other similar duties as required by the Corporation Code.

In 2005, about 17,000 new corporations were chartered and about 2,000 partnerships were registered. To provide better coverage throughout the country, the SEC has extension offices in Baguio, Legazpi, Cebu, Iloilo, Cagayan de Ora, Davao, and Zamboanga. Total filing fees from all locations in 2005 was Php 634 million in 2005 and about Php 800 million in 2006.

Core Function 3—Enforcement

The compliance and enforcement department has authority to enforce compliance with all regulations against all market participants. Fraud is a focus of this division. The SEC closed 24 companies in 2005 found to be in illegal use of toll-free lines, fake addresses and websites, pre-paid cell phone cards, etc.

The SEC opened 78 new cases in 2005 involving stock manipulation, unregistered securities, securities fraud, and other securities violations. There were 22 criminal cases and 28 administrative cases pending with respect to securities law violations.

Core Function 4—Support Services

This area encompasses three areas. The human resources department provides information to the public from the records of the SEC, provides training for SEC staff as needed, and oversees personnel and administrative duties. The financial management department provides the SEC with budget, fiscal, accounting, and treasury support. Lastly, the economic research and information department provides the SEC with technological and research support.

The SEC has a methodical program for digitization of historical records. In 2005, the SEC digitized 2.3 million pages, adding them to the database of 19.7 million pages. The benefit to the public is clear. In 2001, less than 20 percent of document requests could be satisfied in less than one hour. In 2005, however, more than 75 percent of document requests were satisfied in less than one hour. Easy access to documents has contributed to a nearly 30 percent increase in document requests, from 88,500 in 2001 to 114,000 in 2005. Income from responses to document requests has more than tripled since 2001, from Php 4 million to over Php 12 million.

About 1,300 people received training from SEC staff in 2005, mostly for employees, but including one public seminar on international accounting standards.

A Note on SEC Capacity and Resources

The SEC employed 383 staff at the end of 2005. SEC leaders consider the agency to be understaffed. A reorganization in 2000 saw reductions in force and increases in salaries. Still, talented staff take their training with them to the private sector too often, after one or two years with the agency. While the attrition rate in 2005 was less than seven percent, officials worry that it those who leave are too often the people who are most needed. Salary levels remain a problem.

Before the reorganization in 2000, the corporation registration departments employed 250 persons. Automation was deemed justification to cut registration staff to 58 employees today (there are also 15 independent contractors who are retained in that status pursuant to a cost-saving strategy). With automation, an opportunity was missed to shift personnel from routine data collection to monitoring and compliance. Staff members devoted to corporation supervision and monitoring were reduced from 92 in 2000 to 15 in 2005. Five of the staff members are independent contractors.

SEC leaders consider the regulatory framework to be in conformance with international standards, but they are concerned that the agency is increasingly limited in its ability to do hands-on regulation. Brokers are audited sporadically. No audits are required by anti-money laundering regulations. The agency is limited, in the view of some officials, to "checking off boxes" to ensure compliance with filing requirements.

In contrast to staffing woes, SEC income is healthy. The SEC collects Php 800 million per year in fees paid by those who file articles of incorporation, register securities, or consume other SEC services. SEC budget planners estimate that Php 450 million would provide significantly improved responsiveness to policy goals and legal requirements. The appropriated budget, however, falls Php 100 million short of that requirement.

D. Supporting Institutions

Philippine Organizations

Professional and trade associations with interests in corporation law and corporate governance have long existed and are considered effective at protecting their interests. Private-sector interest groups include organizations such as the Management Association of the Philippines, the Financial Executives Institute, and the Makati Business Club, which are influential with policy makers and regulators. The Integrated Bar Association is highly respected and is routinely consulted by legislative committees and executive agencies.

Academic institutions offer programs in law and business where curricula expose students to issues of corporate governance and scholarly publications address current issues and cases. Notably, the Asian Institute of Management is a frequent sponsor of seminars and roundtable discussions on corporate governance and seeks to promote governance reform.

The Philippines has long been recognized as a center in the region for accounting expertise. The Institute of Internal Auditors of the Philippines and the Philippines Institute of CPAs are respected organizations that serve their members with educational programs designed to keep members up to date with law, regulations, and professional standards.

World Bank

In 2001 and again in 2006, the World Bank conducted its Review of Observance of Standards and Codes

(ROSC) with respect to corporate governance.

ROSC-1. The first ROSC benchmarked the Philippines against the OECD Principles of Corporate Governance. It created an extensive set of recommendations summarized here on (1) disclosure of non-financial information; (2) the rights of minority shareholders; (3) the role of the board of directors; and (4) the independence of the audit:

Disclosure of non-financial information

- Ensure a mechanism for both the regulators and shareholders to identify the component parts of the capital structure and the beneficial ownership of holdings in excess of an agreed margin (five percent).
- Promote improved transparency; make the register of beneficial owners publicly available via the Internet and for on-site inspection by the SEC.

The rights of (minority) shareholders

- Empower minority shareholders to play a more effective role in corporate governance by introducing a provision to allow shareholders to convene directly a meeting of the company, without having to petition the regulator, and for the company to circulate the agenda.
- Introduce a provision to allow shareholders to put forward proposals to the agenda, or counter-proposals to management agendas. Ensure these are practical for minority shareholders regarding cost, timetable, and information.
- Review provisions governing duties of the majority in relation to the minority, and consider limiting voting rights on matters where the majority has a conflict of interest.
- Review the minimum free float for listed companies, ensuring that it corresponds with the special voting protections for minority shareholders (such as the qualified majority provisions of two-thirds, which would only be effective with a greater than one third holding by minorities).
- Consider introducing a provision for voting by mail.
- Consider the establishment of an association or institution to protect the interests of minority shareholders, which could provide independent advice, research, and voting services.
- Consider the introduction of a requirement for fiduciary investors, such as pension funds, to disclose their policies on corporate governance, to exercise their voting rights in the sole interests of the beneficiaries.

The role of the board of directors

- Strengthen the mechanisms by which the board of directors governs the affairs of the company as mandated by law.
- Strengthen provisions governing self-dealing and conflicts of interest for directors.
- Review disclosure provisions for directors to ensure they allow shareholders to fully assess independence to include all relevant information, particularly in relation to previous corporate directorships.
- Require disclosure of board practices on corporate governance benchmarked against a Philippine code of best practice that reflects international norms (including the establishment of independent audit committees, statements on internal control and going concern, disclosure of attendance at board meetings, nomination and review of performance, and stakeholder relations).
- Consider the introduction of training requirements for directors, and continuing professional education, with disclosure of training undertaken, particularly to ensure a

full understanding of legal duties and liabilities.

- Introduce a requirement for directors to review and sign off on the auditor's long form report.

The independence of the audit

- Require disclosure of all personal or business relationships, past or current, between the audit firm, its partners, the company, its directors and all related parties.
- Require disclosure of full audit and non-audit fees paid to the audit firm by the company and its related parties.
- Review general provisions regarding independence, including rotation of audit partner or firms.
- Require the establishment of audit committees composed of a majority of independent directors, with responsibility for both internal and external audit.
- Require training for members of audit committees to ensure financial numeracy.

The Capital Markets Development Council (CMDC) used the 2001 ROSC as a roadmap for a series of reform projects. A number of strong measures were taken, including the passage of the Securities Regulation Code (SRC). This code strengthened enforcement powers at the SEC and clarified the scope of rules on insider trading and market manipulation. The SRC also protects minority investors through the requirement of a mandatory tender offer, and delegation of certain regulatory powers to self-regulatory organizations, such as the Philippines Stock Exchange. Also, the SEC issued a Code of Corporate Governance, and established new requirements for the training of directors.

The Institute of Corporate Directors (ICD) was established pursuant to ROSC-1 with funding from the World Bank. With progressive and energetic leadership, ICD promotes governance reform through educational programs, a corporate governance scorecard, a parallel program aimed at good public governance among local government institutions, and an approach that treats good governance as "a performance issue, not a compliance issue." In other words, ICD strives to convey that good governance is, in the final analysis, in a firm's self-interest.

ROSC-2. In a follow-up report to the 2001 review, released in May 2006, the World Bank recognized the progress made as "significant" and urged that attention be turned to the challenges of implementation.
Asian Development Bank

An exhaustive study of concentration in corporate ownership and control was conducted by Cesar G. Saldana for the Asian Development Bank (ADB), published in *Corporate Governance and Finance in East Asia, vol. II*. The study examines patterns of ownership and control through agents, and identifies patterns of financing. The study analyzes the impact of governance on corporate performance, corporate finance, and family-based conglomerates.

Analyzing the period from 1987 to 1999, the study shows that the top shareholder owned over 40 percent of the market value of the publicly listed business corporation in the Philippines. The top five shareholders held about 65 percent of the average market value of an average public company, and about 59 percent of the value of an average financial institution. The top 20 shareholders controlled 75 percent of corporate value, on average, among listed companies.

But who are the top shareholders? Holding companies, often family-based, control 52 percent of publicly listed companies as of 1997. Investment trust funds control the second largest bloc. Financial institutions controlled 7.2 percent of market value, but control of financial institutions also bears a strong dose of family-conglomerate control. Individuals held an average of 2.2 percent of publicly listed shares.

The 50 largest corporate entities accounted for 53 percent of total sales of the top 1,000 corporations in 1997. The three largest entities were family-based groups: Cojuangco, Lopez, and Ayala. Of the top 50 entities, 25 were family conglomerates.

E. Social Dynamics

How well does corporate law respond to users? The answer depends on how one defines "users." The leaders of family-based conglomerates may view the law as responsive to their needs, as they perceive them. In the meantime, millions of Filipinos are limited in the ways that they can participate in the economy. For them, law and institutions may seem quite unresponsive, yet an improvement in their ability to participate in the economy does not necessarily come at the expense of others. The economic pie can grow for everyone.

Perhaps the most common chord struck by interviewees was: "We have good law but there is simply no enforcement." Indeed, this is the explicit conclusion in a nutshell of the ROSC-2 study which, after commending the Philippines for adequate lawmaking, recommends (in summary):

- Strengthening the enforcement of the existing laws and regulations by the SEC and PSE, particularly those involving insider trading, tender offer rules, and disclosure.
- Improving the protection of minority shareholder rights through better enforcement.
- Strengthening monitoring of compliance with International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) and requiring additional disclosure of internal controls and governance issues by listed firms.
- Encouraging the development of advocacy institutions to promote minority shareholder rights.

Who would not want better enforcement? Whether or not it is in the interest of some economic actors, lack of enforcement is assured by under-funded and understaffed institutions. Nearly every private sector interviewee cited the SEC as capable of fulfilling its well-defined mandate, if only it had appropriate resources. SEC officials agreed.

Political will seems to be the barrier between black letter law and true institutional reform. The aversion to institutional reform, however, may be based on a faulty premise. A respected legal academic interviewed for this assessment observed that "good corporate governance is an idea imported from the United States that cannot work well in the Philippines." The reference, of course, was the influence of the family-based conglomerates and that the idea that good corporate governance is in the self-interest of even the family-based conglomerates (as increased shareholder value is a primary goal of good corporate governance) still has not taken hold. The Philippines has the smallest market capitalization of all ASEAN countries. If, through transparent capital markets, market capitalization can rise while more people participate, everyone will win. A prosperous Philippines, after all, will likely be more prosperous even for the concentrated ownership class, even if the concentration were diluted by a few percentage points. Could it be that the nexus between corporate governance and prosperity is not yet clear to all?

F. Recommendations

Recent reforms have necessarily focused on new law and regulation, primarily in the form of the new Securities Regulation Code and a number of subsequent SEC circulars. Two complications have ensued. First, for the governed, good governance looks increasingly like more paperwork at best and a threat to self-interest at worst. Second, the SEC, whose resources were stretched by the reorganization of 2000, now sees its burden compounded by the regulatory reform that it has ambitiously undertaken. This is ironic given that consumers of SEC services, who presumably expect service in proportion to fees they pay, generate annual revenue in an amount twice the SEC's budget.

Impressive arrays of donor resources have been deployed over a decade to analyze the need for reform in corporate governance, lay the black letter groundwork, and detail next steps for implementation. There is no reason to attempt to improve upon that extensive and exhaustive work here, but is should be noted that efforts will need continued support to achieve lasting success.

There is a gap, however, that should be filled. While existing studies may provide an adequate plan for reform, the case for reform appears to be made from an outsider's standpoint rather than from a Filipino standpoint. In fact, the international call for reform arrived in large part as a reaction to the Asian currency crisis. Many Filipinos may see reform, in part, as a condition of international assistance in the wake of that crisis—a condition that need not be taken too seriously now that the crisis seems to have passed. Filipinos, other than those in donor-sponsored NGOs, do not speak of good corporate governance in terms of value for Filipinos.

This report makes the following recommendations:

- Greater efforts should be made to train businesspersons on the efficacies of corporate governance, particularly that greater corporate governance can increase wealth for all and need not be, as appears more commonly perceived, a threat to established wealth.
- A Philippine case for good corporate governance should be made. To accomplish this, the Philippine case for reform should not refer heavily to the good governance checklists of the OECD, the New York Stock Exchange, the European Bank for Reconstruction and Development, or other outside indicators, instead focusing on issues from the Philippine perspective. The Philippine case for reform would:

    - Establish the Philippine nexus between good corporate governance and prosperity
    - Calculate the gains to be expected from true institutional reform
    - Calculate the loss and opportunity cost suffered from lack of institutional reform.

Effective institutional reform will require support from those who hold economic and political power. That audience may respond to an indigenous economic call to action more aggressively than it appears prepared to respond to an external prescription.

III. Contract Law and Enforcement

A. Introduction

The ability to create and enforce contracts under a clear, consistent legal framework is a critical component of economic growth. Where there is widely held expectation that agreements freely entered into between businesses or individuals will be subject to enforcement by a court or other tribunal, a marketplace can be transformed. Namely, what was once mere hope for performance based on a personal relationship or vague insinuation becomes a legitimate expectation of delivery. When business partners are in fact required to do what they have said that they will do—pay money, deliver goods, provide services, and so forth—risk diminishes and the recipients of a promise can better plan for the future. With decreased risk, the cost of doing business goes down, thereby elevating the private sector's prospects for profit.[3] Philippine contract law is comprehensive and generally consistent with modern commercial codes. However, the institutions responsible for the enforcement of contracts lack predictability and efficiency, causing a chilling effect on some forms of commerce in the country.

B. Legal Framework

Contract Law

Book IV—Titles I and II of the **Philippine Civil Code** define obligations and contracts. Title VI of Book II governs sales contracts. Governmental activities, including infrastructure projects, goods, and consulting services, are governed by the terms of the **Government Procurement Reform Act** (Procurement Act).

Contract Formation. Formation of a contract requires: (1) consent of the parties; (2) object (subject matter of the contract); and (3) cause of the obligation (consideration).[4] Generally, everyone, other than incapacitated parties, is free to enter into contracts. However, there are constitutional limitations on foreign ownership and foreign leasing of real property.

Parties are generally free to establish whatever terms they want in a contract as long as the terms are not contrary to public policy.[5] Parties are, therefore, free to include choice of law and liquidated damages provisions in their contracts and are generally free to make decisions regarding venue and choice of forum unless other applicable law requires otherwise. For example, litigation regarding real property titles will usually have to be brought in the appropriate court where the property is located.

There are no special exceptions for governmental parties when they enter into contacts, but most government contracts will be controlled by the Procurement Act.

Non-Performance. Equitable doctrines, such as estoppel rescission, voidability, and unenforceability of contracts are recognized in circumstances where a contract is made with an unrepresented minor, where fraud is present, or where contracts have been induced by violence, undue influence, etc. An obligation may be extinguished if it involves the delivery of a "determinant" thing which is destroyed through no

[3] See World Bank, *Doing Business 2007, How to Reform* (2006), p. 49 (discussing economic benefits that arise from improved systems of contract enforcement).

[4] Philippine Civil Code, Article 1347.

[5] Id. at Article 1306.

fault of the obligor.[6] Generally, fault is presumed to exist except in cases of earthquake, floods, storm, or other "natural calamity".[7]

Remedy and Enforcement. Philippine law recognizes commonly used remedies for breach, including: the right to damages,[8] including liquidated and penalty damages;[9] the right to specific performance;[10] and the right to seek deficiencies.[11] Rights are also generally assignable to third parties.[12]

Implied warranties of title, condition, and fitness are generally recognized in contracts involving the sale of goods.[13] In a breach of warranty case, the buyer can either withdraw from the contract or demand a reduction in price and, in either case, will be entitled to damages. Damages available for non-warranty breaches of sale agreements are set forth in Articles 1594-1598. Those remedies are consistent with most modern commercial codes. If the buyer breaches, the seller has a right to the price of the goods or the right to rescission and repossession. If the seller breaches, the buyer may demand specific performance.[14]

In short, the Civil Code and case law generally provides an adequate legal structure to determine the law on contracts.

Arbitration Law

In 2004, the **Alternate Dispute Resolution Act** was passed which adopted the Model Law in International Commercial Arbitration (Model Law) for international commercial arbitration. It also adopted sections of the Model Law in domestic arbitration proceedings which continue to be governed by the Arbitration law (R.A. 876). In addition, construction arbitrations are governed by a separate **Construction Industry Arbitration Law** (Executive Order 1008). The court system has, since approximately 2000, had a court-annexed mediation program which requires that almost all civil actions go through mediation. If that fails, such actions then go to a judge-led settlement conference.

C. Implementing Institutions

Courts

The basic court structure includes municipal (outside Manila) and metropolitan trial courts (within Manila) (first instance courts), Regional Trial Courts (second instance courts), and Courts of Appeal. Because the First Instance Courts' jurisdiction is limited to smaller amounts in controversy, most commercial contract disputes will fall within the jurisdiction of the Regional Trial Courts.

Regional Trial Courts are courts of general jurisdiction which also handle criminal cases. In Manila, a typical Regional Trial Court's caseload is approximately 30 percent civil cases. Even Regional Trial Courts that have been designated as special commercial courts to handle some intellectual property,

[6] Id. at Article 1262.
[7] Id. at Article 1262.
[8] Id. at Article 1170.
[9] Id. at Articles 1226-1230.
[10] Id. at Article 1165.
[11] Id. Article 1177.
[12] Id. at Article 1112.
[13] Id., Articles 1547, 1562-1566.
[14] Id., Article 1598.

corporate reorganization, and corporate disputes, are put on the case raffle and therefore carry criminal cases on their docket.

The Regional Trial Courts face a number of challenges. They are not computerized and there is no uniform case management system. Judges handle their own calendaring systems. Continuous trial days do not exist at the Regional Trial Court level. The judges recently received living allowances which effectively doubled their pay, but their staffs are underpaid. Payment of facilitation fees to court staff and judges is presumed to be a fact of life, as described by many interviewed for this report. While the Philippines has a large number of law schools, judges are unable to use externs or volunteer law clerks to help them with research because the acceptance of such "free" services would violate the anti-corruption laws. According to some studies the situation is not improving. A checklist of steps needed to enforce a contract in the Philippine courts has been developed by the World Bank as part of its Doing Business reports. It includes 25 steps. The time needed to enforce a contract increased to 360 days in 2006 from 164 in 2004. While these numbers rank highly among the other countries assessed as part of the SEA CLIR process, they still present barriers to adequate contract enforcement in a modern trading country.[15]

Because of clogged court dockets, the perception that many judges are not well acquainted with commercial law, and concerns about corruption and payment of "unofficial" fees, most lawyers interviewed indicated that they try to avoid the court system in resolving contract disputes. An exception exists for collection, property foreclosure, and rent eviction matters where the creditor/landlord may have few alternatives to the court and may also need to use the sheriff for executions and evictions.

Government Procurement Policy Board

Contracts which fall under the Government Procurement Act are subject to the regulatory authority of the Government Procurement Policy Board (GPPB), which has its own set of rules and regulations. The GPPB issues procurement manuals, public bidding documents, checklists, and sample forms. It also issues regulatory opinions about public contracts, such as opinions on the validity of contract extensions, setting prequalification procedures for certain bids, etc. Breaches of a Government Procurement Act contract are not resolved by the GPPB.

Arbitration Boards

Court-Annexed Mediation. Court-annexed mediation refers to the 2001 program of mediation mandated by the Supreme Court. It is administered by the Philippine Mediation Center (PMC), which is operated by the Philippine Judicial Academy, a body with the primary responsibility of selecting and training judges. PMC units have been established throughout the country. Initial success rates have been very high, especially in the courts of first instance. However, success rates in the Regional Trial Courts , especially the commercial courts, have not been as good.

Alternate Dispute Resolution. The Alternative Dispute Resolution Act of 2004 created an office for Alternate Dispute Resolution, an agency attached to the Department of Justice. As of the date of this assessment, the office was not yet fully established. However, a number of business groups are supporting and apparently funding staff for a "National Center of Mediation" where over 30 business mediators have received training. Nine of those organizations, including the Philippine Chamber of Commerce, have reportedly entered into covenants to resolve disputes through the Center with other signers of the covenants.

[15] See www.doingbusiness.org. Among the other countries in the SEA-CLIR assessment, the Philippines was first in terms of steps and second in time: Cambodia: 31 steps, 401 days; Indonesia 34 steps, 570 days; Lao People's Democratic Republic (PDR) 53 steps, 443 days; and Vietnam 37 steps, 295 days.

Construction Industry Arbitration. The Construction Industry Arbitration Commission (CIAC) handles arbitrations involving construction disputes, including workmanship disputes, contract breaches, contract interpretation, changes in cost, delay claims, etc. It is attached to the Department of Trade and Commerce. It only arbitrates construction cases where the contract includes an arbitration clause or where the parties agree to submit the dispute to the CIAC. As of October 2006, its statistics indicate its cases take between four to nine months to complete.

Private Mediation and Arbitration. Almost all commercial contracts involving foreign businesses include arbitration clauses requiring arbitration, usually in Singapore or Hong Kong. Mandatory arbitration provisions are also increasingly used in Philippine commercial agreements.

D. Supporting Institutions

Notaries

Notarization of contract documents is common. Notaries are lawyers and therefore are regulated by the Philippine Supreme Court, which in 2004 issued Rules on Notarial Practice. Those detailed rules were promulgated in response to perceived abuses by notaries. The rules set fees and include detailed record keeping requirements. Interviewees stated that overall notarization is not a burdensome process.

Sheriffs

Court judgments are executed by sheriffs. Every court includes a sheriff. The procedure for execution is set out in the National Labor Relations Commission Manual on Execution of Judgment and, where applicable by the Rules of Court, the Rules of Civil Procedure—such as the rules on attachment (Rule 57). Fees for a sheriff's services are published by the court. According to interviewees for this report, there is a widespread practice of payment of unofficial and facilitation fees related to execution services provided by sheriffs.

Lawyers

The Philippine Integrated Bar is actively involved with the Philippine Judicial Academy in assisting with the training of mediators for the court-annexed mediation program. Under the Alternative Dispute Resolution Act of 2004, the President of the Bar appoints the arbitrators in ad hoc arbitrations.

Lawyers are also a major force in court case management. Lawyers complain about court delays, but routinely seek continuances. Continuous trial day settings are presumed to be impossible and undesirable, and therefore trials languish, moving one step at a time at each hearing scheduled over a period of months instead of a continuous trial. The main concern about continuous trial days expressed by lawyers, law school professors and deans, and judges is the perceived unfairness to other litigants whose matters would be further delayed if a court devoted entire days to just one matter. Judges are reluctant to impose any strict case management rules on lawyers because to do so may result in the filing of a judicial misconduct complaint against the judge. Such complaints can take years to resolve.

While there is good social interaction between lawyers and judges, judges, especially at the lower court levels, are rarely held in high esteem by lawyers. Complaints about judges' work habits and capacity to understand a complex contract dispute were common. Nonetheless, due to the underfunded state of many of the first instance and Regional Trial Courts, some local bar associations have worked to provide equipment and other support to local courts.

Trade Organizations

As previously noted, some organizations in the business community, such as the Philippine Chamber of Commerce, are actively participating in alternate dispute resolution to resolve contractual disputes. Efforts by the business community to use a quick and efficient way to resolve commercial conflicts is important to attracting local and foreign investment.

One segment of the business community, however, appears to benefit from a law which effectively uses the court system as a collection agency. It is a common practice in the Philippines for loans for cars/residential leases or other consumer items to be secured by more than a year's post-dated checks. Under the "**bouncing check law**" (BP-BLG 22), bouncing a check is a criminal offense punishable by imprisonment of between 30 days and one year for each bounced check and/or the imposition of a fine. If a fine is imposed and not paid, the check maker can be imprisoned. The check maker is also subject to civil suit on the unpaid debt.

Prosecutors appear to have little discretion about the filing of such cases. As a result, bad-check criminal complaints clog the first instance court dockets. Recently, the Supreme Court has issued circulars which suggest that fines, rather than imprisonment, be considered in "non-negligent" cases. Borrowers are still confronted with criminal liability, however, for loan defaults where lenders may have actually required post-dated checks be issued as part of the transaction. Lenders argue that without the threat of criminal liability, they would be unable to collect their debts. Whatever the merits of the policy arguments, the cases are consuming a great deal of judicial time and resources.

E. Social Dynamics

A number of cases decided by the Philippine Supreme Court or actions taken by the executive branch in the last decade appear to abrogate contract rights and have influenced the political economy surrounding contract law.[16]

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[16] Those cases were summarized in a September 6, 2006 column in the *Manila Standard*:

- 1995/Privatization of Manila Hotel: The Supreme Court overturned the winning bid by the Malaysian Renong group as the hotel was said to be part of Philippine heritage and should now therefore be offered first to Filipinos even at a lower cost.
- 2001/Keppel (Subic Shipyard): The Supreme Court declared JG Summit as winner five years after Keppel won the project, saying shipyards are a public utility and should be at least 60 percent Filipino. But shipyards are not in the Foreign Investment Negative List. The decision has now been reversed—but JG Summit is appealing the case.
- 2001/Renegotiation of Contracts with Independent Power Producers (IPP): President Gloria Macapagal-Arroyo ordered the renegotiation of IPP contracts due to insistent public clamor to bring down electricity rates. The objective was to search for government savings by reducing state guarantees offered to IPPs in the early 1990s when the country was in serious power crisis. Twenty contracts have so far been resolved resulting in about $1-billion savings for the government which, of course, means US$1 billion less than expected for the companies.
- 2002/Philippine International Air Terminals Co. for the Ninoy Aquino International Airport (NAIA) Terminal-3 project: President Arroyo declared the NAIA-3 contract null and void after the government's legal office found onerous provisions in the contract. The government later on took over the NAIA-3. It is now in litigation in the U.S. and Singapore, and the government has refused to pay a Php 3 billion bond.
- 2002/Waste-to-Energy Project with Australian Firm Jancom Environmental Corporation: Bowing to opposition from various groups, President Arroyo canceled the garbage project five years after its approval.
- 2003/Camp John Hay Redevelopment: The Supreme Court voided tax incentives granted to Camp John Hay locators.
- 2004/Western Mining Corporation (WMC): The Supreme Court voided the financial and technical assistance agreement between the government and WMC, a 100 percent foreign–owned firm, for a mining project in Mindanao, declaring the FTAA unconstitutional. The Supreme Court later reversed its decision, but WMC left.
- 2005/Clark incentives: The Supreme Court nullified the fiscal incentives granted to some 300 investors in Clark Ecozone.

Because of such decisions and because of the perceived weakness and unreliability of the courts, the inclusion of mandatory arbitration clause is standard in all international contracts. Such arbitrations are generally conducted in Singapore or Hong Kong. Commercial contracts between Filipinos increasingly also include standard arbitration clauses. In short, the commercial law community does its best to avoid the courts.

While contractual arbitration clauses may avoid initial litigation in the courts, they are not a complete extra-judicial solution. Arbitration clauses and arbitration awards have to be enforced and, in some cases under Philippine law, confirmed by the courts. It is simply not possible to completely avoid or work around the court system.

F. Recommendations

As stated, the legal framework for law of contracts is adequate to meet the needs of trade and commerce in the Philippines. The majority of the recommendations with respect to contract law would therefore involve reforms to the courts system which are discussed in greater detail in the chapters on commercial dispute resolution and court administration. Nevertheless, one recommendation bears worth repeating at this time: it would be of great benefit to the court system if those courts currently designated as commercial courts were able to clear their docket of additional cases dealing with non-commercial matters. In addition, having more courts designated as commercial courts would benefit the court system. Among other reasons, judges and court staff would then develop specializations in commercial matters, allowing for a more expeditious disposition of cases.

IV. Real Property Law

A. Introduction

Real property law is crucial in market economies; it provides the legal environment for a business to own, use, and sell land and buildings as well as to use them as collateral to obtain credit. *Good* property law is especially critical in transition-economy countries; a good law enables entrepreneurs—domestic and foreign—to acquire land freely to produce goods and services in a secure ownership environment, which is a necessity for planning for the long term. A good property law must also be accompanied by an objective, standardized titling system.

Such a system is lacking in the Philippines, where a complex and conflicting system of laws, regulations and costs (both official and unofficial) make land transactions difficult. As a result, individuals are not able to gain access to the benefits of land ownership, such as increased access to capital.

B. Legal Framework

Philippine real property law is governed by the **1987 Constitution** and a patchwork quilt of laws, local ordinances, agency regulations, and court rules. The history and complexity of Philippine real property law was recently summarized by the Secretary of the Department of Environment and Natural Resources (DENR):

> Our current land administration laws have a long and rather complicated history. In 1902, the Philippine Commission, through Act 496, adopted the **Torrens System of Registration of Land Titles**. A year later, Act 926 gave us our **First Public Land Act**, through which the state disposed of alienable public lands through grants, sales and leases. These were followed by the **Cadastral Act of 1913** (Act 2259); the **Second Public Land Act** in 1919 (Act 2874); the **Third Public Land Act** in 1936 (Commonwealth Act 141), which provided for administrative legalization (through free patent) and judicial confirmation of imperfect or incomplete titles; the **Agricultural Land Reform Code** of 1963 (R.A. 3844); the Tenant Emancipation Decree or **Land Reform Program of 1972** (P.D. 27), which granted emancipation patents and certificates of land transfers to tenant farmers; P.D. 892 of 1976, which discontinued the use of Spanish titles as evidence in land registration proceedings; the **Property Registration Decree of 1978** (P.D. 1529), which codified and superseded all previous land registration laws; the **Comprehensive Agrarian Reform Law of 1988** (R.A. 6657); and the **Indigenous People's Rights Act of 1997** (R.A. 8371), for the recognition and titling of ancestral domains and ancestral lands. In between these landmark laws, others were issued, providing for the creation and jurisdiction of land registration authorities and courts.[17]

Ownership

Section 11 of the Public Land Act (Commonwealth Act 141) limits alienable lands in the public domain to agricultural lands. Public alienable land can be disposed of by sale or lease to individuals or other legal entities. It may also be subject to transfer under various agrarian reform laws.

[17] From a paper delivered at High-Level Policy Forum on Land Administration and Management of the Philippines on January 19, 2007.

Philippine law imposes significant limitations on land ownership. The 1987 Constitution bars foreign citizens from owning land and prohibits more than a 40 percent foreign ownership interest in entities that acquire land. There is an exception to the land ownership prohibition for Philippine émigrés who are entitled to dual citizenship. More recently, an exception has also been created for foreigners who wish to acquire real property in the Philippines for a retirement residence.

There are also restrictions on the term for which foreigners can lease real property with the general limit being 25 years. There is an exception for leases, which involve long-term foreign investment, which permit up to a 75-year lease term, but "prime" farmland is not available to such investors. A number of laws and presidential decrees regarding agricultural reform also limit the alienability of real property formerly owned by the government. For example, sections of the Public Land Act place restraints on alienation of certain "free patent" titles which can be obtained over previously untitled or imperfectly titled land. The Public Land Act bars sale or encumbrance (except to a government-owned bank) for the first five years after a free patent title is registered. It also requires the approval of the DENR for transfers that occur between 5 and 25 years after the issuance of a free patent. The Comprehensive Agrarian Reform Act of 1988 (CARP) limits the extent of individual (but not corporate) land ownership and provides for redistribution of certain agricultural land to the landless. (Agrarian reform law is discussed in this report's chapter on agriculture.) Under the National Internal Revenue Code, a five percent tax is imposed on "idle" lands.

Title and Registration Law

Title. There are a number of procedures which involve multiple agencies and/or the courts under which land can be titled.

Administrative Titling—Patents
If the land is alienable and disposable public land under the Public Land Act, then title can be obtained through patents issued by the DENR. The most frequently issued parents are:

(i) Homestead patent: Applicant is a natural-born citizen of the Philippines aged 18 or over, the land does not exceed 16 hectares, and the land is actually being cultivated.
(ii) Free patent: Applicant is a natural-born citizen aged 18 or over, the land does not exceed 16 hectares, and the land was occupied and cultivated by the applicant or his or her predecessors in interest for the 30 years prior to 1990.
(iii) Sale patent: Applicant is a Philippine citizen who does not own any other land in the city where the 1,000 square meter lot is located, if a house is constructed on the lot, and the applicant and his or her family actually live in the house. There are no restrictions on transfers of sale patent lands.

Land Reform and Ancestral Land Titling
(1) If previously untitled land falls under the CARP redistribution program, the landowner must apply to the DENR for a free patent. If the DENR issues an order of approval for the free patent, the Department of Agrarian Reform (DAR) issues the landowner a Certificate of Land Ownership (CLOA).
(2) If previously untitled land is the ancestral land of an indigenous cultural community since "time immemorial," then the DENR will issue a Certificate of Ancestral Domain Claim (CADC) to the land owner. Another agency, the National Commission on Indigenous People (NCIP), also issues certificates of ancestral title.

Courts
(1) Under the Land Registration Act, the courts may issue titles to anyone who has been in "open and notorious" use of public disposable agricultural land since June 12, 1945.

(2) Under the Property Registration Decree and Cadastral Registration Act, courts have jurisdiction to hear title cases, including issuances of original certificates of title (OCTs) and validating transfers of certificates of title (TCTs).

Registration

The Philippines uses a Torrens title system where title is guaranteed by registration. Under a "pure" Torrens system, the land title is a registered legal description on which the state records all of the various interests in the land: ownership, mortgage, leases, covenants, easements, etc. Under the Land Registration Act, all titles, transfers and encumbrances must be registered at the office of the Registrar of Deeds (ROD) where the real property is located.

Land Use Regulation

There are detailed laws and regulations in place on land use, including a **National Building Code** (R.A. 6541). The Land Use Regulatory Board, a national government agency, has the planning and regulatory responsibility for land use development, real estate, and housing regulations. Under the Local Government Code and other laws and regulations, local government units (LGUs) are also involved in land use planning and zoning decisions.

Taxes

Capital gains, documentary stamps, and inheritance taxes are imposed under the National Internal Revenue Code upon land transfers. Real estate taxes which are collected by LGUs are governed by the **Real Property Tax Code** (P.D. 464). Tax rates on real estate are to be based on fair market value as determined by schedules maintained by local government assessment offices. The Bureau of Internal Revenue (BIR) also produces separate zonal value property schedules which it uses in calculating taxes which it collects with respect to real property transfers.

Mortgage Law

The Civil Code of the Philippines, in Articles 2085-2092 and 2124-2131, provides most of the formal framework law for real property mortgages. However, the extent of a mortgage is governed by the banking laws. Under those laws, a loan secured by real property cannot exceed 70 percent of appraised value.[18] The banking laws also restrict the portion of a bank's portfolio which can be devoted to real estate debt.

Mortgages can only be given by the owner of the property. Mortgages are not binding on third parties unless properly recorded in the appropriate ROD. The security interest granted in a mortgage extends to rents and proceeds and fruits of the property, but not to after-acquired property because the mortgagor must be the absolute owner of the property at the time the mortgage is given. Mortgages are assignable, but to bind third parties the assignment must be registered at the ROD.

Mortgages may be foreclosed judicially or extra-judicially. Judicial foreclosures are governed by Rule 68 of the **Rules of Court**. Extra-judicial foreclosures are governed by a number of different statutes and rules, including laws regulating banking and court rules. Extra-judicial foreclosures must be confirmed by a court. Whether a foreclosure occurs judicially or extra-judicially, the sale is conducted by public auction held by a sheriff who is an officer of the local court. There is a redemption period of one year for individuals. For juridical persons, the redemption period expires the date the foreclosure sale is registered

[18] Section 10 of P.D. 1828, amending Section 78 of R.A. 337, the "General Banking Act."

at the ROD or three months after the foreclosure auction, whichever date is earlier.[19] Deficiency balances may generally be pursued, unless the foreclosed property is a "homestead," which only applies to specific agricultural properties.

The doctrine of equitable mortgage, where the arrangement is a mortgage in form, but the grant of a security interest in substance, is recognized by Philippine courts. "*Paco de Retro*" sales—sales which give the seller a right to repurchase—are authorized under Section 1606 of the Civil Code. Such sales are often used in rural areas where there is an extensive market of informal mortgages between individual mortgagors and mortgagees.[20] Contracts "to sell," where title remains in the seller until the purchase price is paid in full, are also recognized under Philippine law.

C. Implementing Institutions

As summarized in the table below, while the time to complete a transaction may be in line with the standard by OECD nations, other challenges remain:

Indicator	Philippines	Region	OECD
Procedures (number)	8.0	4.2	4.7
Time (days)	33.0	85.8	31.8
Cost (percent of property value)	5.7	4.0	4.0

Source: World Bank, *Doing Business 2006*

There are multiple agencies involved in implementing real property law. The World Bank has estimated that up to 12 different agencies may become involved in real property transactions. This report will focus on two of the primary implementing agencies: the Land Registration Authority (LRA) and the DENR. It will also focus on the role of the courts in enforcing real property mortgage law.

Land Registration Authority

The Land Registration Authority (LRA) is attached to the Department of Justice. Its mandate is to be the "central repository of all land records involving registered or titled lands." The LRA operates approximately 160 RODs throughout the country. In addition to operating the RODs, the LRA conducts verifications and approvals of the subdivision of titled lands, which is also a responsibility of the DENR.

The LRA currently keeps its records on microfiche. It has a contract to begin record computerization under the government's "Build, Operate, Own" program, but ongoing litigation with the provider has stalled the upgrade. The records of the RODs are maintained in chronological order. There is currently no cross-referencing with the partially completed cadastral mapping system which is under the jurisdiction of a division of the DENR.

The LRA publishes its fee schedule and some of its administrative procedures in circulars which are available to the public at the ROD offices. The fee for transferring title or for registering a security interest in real property is based on a sliding scale tied to the value of the property. The values used are generally the "zonal values" published by the BIR. The LRA collects more fees than it uses to operate, but because there is currently an Executive Order (EO-103) which has frozen all civil service hiring and pay raises, the LRA is understaffed. In the last three years, staff has declined from 3,085 to approximately 2,700.

[19] R.A. 8791, Section 47.

[20] August 2004 Report C48 of Philippines – Australia Land Administration and Management Project (LAMP).

The level of staff expertise, especially at smaller ROD offices, is often substandard. The LRA supervisors try to compensate for staff inexperience by providing detailed checklists of each step involved in registering a particular type of instrument (the average number of steps is eight). The checklists are available to the public. While the LRA management staff attempts to do outreach by communicating with the press and TV stations about its programs, it is unlikely that most members of the general public know how to register routine changes in title such as a transfer of title to the heirs by their name.

Payment of unofficial facilitation fees or "fees to expedite" is common in the RODs, even though it can be the basis for disciplinary action against the employee(s) charging the fee. The ROD registers titles from many sources including DENR, DAR, the National Commission of Indigenous Peoples, private-party title transfers, and court-ordered certificates and transfers of title. However, there is no common map available to the various issuing entities that shows where the titled lots are actually located. As a result, there are ongoing problems involving incorrect, duplicate, and/or false titles. The problem of false titles has led the LRA to create a Clean Titles Task Force which tries to educate staff and the public on how to recognize a fake title. A ROD may refuse to register a document that appears fake or altered. LRA Circular 13-A establishes a "Consulta" procedure which governs the appeal rights of a party where an instrument or deed is not accepted for registration.

The LRA—in particular, the line staff of the RODs—has actively opposed the pending Land Reform Administration Act (LARA), which has been passed by the House of Representatives. The reasons are concerns that the creation of one central agency in charge of all land classification, surveying, titling, and registration will lead to layoffs by the LRA. Senior management of the LRA is more receptive to a one agency solution, but only if the new agency is headed by a lawyer because of the quasi-judicial nature of some titling decisions.

Department of Energy and Natural Resources

Through its field offices and Lands Management Bureau (LMB), the DENR is in charge of classifying, managing, and disposing of alienable government lands not placed under the jurisdiction of other government agencies. The LMB, through its geodetic surveys division, is in charge of surveying and mapping both public and private lands.

As noted in the legal framework section of this chapter, the DENR administratively titles land by the issuance of different types of patents. The LMB is in charge of surveying lands and its duties include completing a cadastral survey. As of 2004, there were over 337 ongoing municipal cadastral surveys. The LMB has also embarked on the creation of a computer-based inventory of land records (the LRMIS). The DENR is involved in efforts to create improved land management services through interagency coordination and agreements. It has received loans and other funding from the World Bank and funding and technical assistance from AusAID through the Land Administration and Management Project (LAMP). LAMP is now in phase two of a five-year, multi-donor program whose goals include: reform of the land administration system through a variety of initiatives, including support for legislative and regulatory reform; support for adoption of uniform valuation standards; and a single valuation base for taxation.

The DENR supports passage of LARA, under which it would become the lead agency.

Courts

The courts are the implementing institution for the foreclosure of real property mortgages. They may also sit as land registry courts determining title. The court system is plagued by delay which can make it difficult to enforce real property security interests or obtain a prompt title determination. Lawyers routinely expressed a desire to keep their cases, including foreclosure and title proceedings, out of court because of delay, uncertain outcomes, and costs. According to interviewees, unofficial costs in the form of facilitation fees are widespread, including charges by sheriffs who must conduct foreclosure auction sales. Summary procedures, such as confirming an extra-judicial foreclosure of a mortgage, are rarely summary in fact because the foreclosed party often asserts that the extra-judicial procedures were not properly followed. In these instances, the cases become *de facto* judicial foreclosure proceedings.

Because there are no continuous trial days under current calendaring procedures, presentation of evidence is disjointed and can require multiple hearings. In 2000, the courts initiated a court-annexed mediation program which seems to have a high success rate, at least in the first instance courts. However, if one party to the proceeding—such as the party being foreclosed—is seeking delay, the party can request a mediation procedure which requires the parties to go with a judge-led settlement conference if mediation fails, simply adding more time to an already lengthy process.

More complex real property disputes can take more than five years to conclude. Out of court discovery of evidence is rarely used in Philippine court proceeding, so all of the evidence, including expert opinion evidence, is often first heard at trial. This causes additional delays, as the opposing party will request time to prepare for cross examination. While there are some specialized courts, such as family and juvenile courts, the average Regional Trial Court docket consists of a mixture of civil and criminal cases. Criminal cases are subject to a speedy trial act. As a result, criminal cases generally take priority over civil cases on a court's docket. In 2003, a number of Regional Trial Courts were designated as special commercial courts, but their special jurisdiction is limited to corporate restructure, shareholder disputes, and some intellectual property cases. The specially designated commercial courts continue to participate in the general case raffle and therefore carry a criminal docket. Under the current structure, therefore, the special commercial courts are not able to expedite the resolution of land title cases in a meaningful manner.

D. Supporting Institutions

Professional Associations

The members of a number of realtor and banker associations routinely interact with LRA and the DENR. A number of those associations have supported passage of LARA, but have otherwise not been especially active on land use issues. When asked which professional associations had been helpful to the LRA, the response was that the LRA was more often asked to help bankers and realtors' associations than given any help by those groups by, for example, lobbying for more staff for the RODs.

Local Government Assessors

While each local government unit maintains a schedule of real property values, this data is not routinely updated and is not viewed as reliable. As a result, the local assessment property value roles are rarely used as the basis for real property fair market valuations and can vary widely from jurisdiction to jurisdiction.

Bureau of Internal Revenue

The BIR's separately maintained schedule of zonal values are viewed as being closer to true market values and are most often used as the basis for determining applicable taxes and registration fees for real property tax and taxable land transactions. The system for setting zonal values is not, however, transparent, and interviewees reported problems with this system as well. As a result, zonal values often do not reflect actual fair market value.

Lawyers

The Philippines has an integrated bar in which the Philippine Supreme Court exercises the ultimate authority over admission and discipline of lawyers. In the day-to-day conduct of the courts, however, lawyers appear to exercise a great deal of control over court time and management. While lawyers complain about delay in the courts, they expect courts to routinely accommodate requests for continuances. While the Appellate and Supreme Courts appear to be generally respected, there is a much lower level of respect for the lower courts. Filing judicial misconduct complaints against judges after the issuance of adverse decisions is not an uncommon litigation tactic. Such complaints can take years to resolve. In such an environment, it is difficult for judges to effectively use calendar management programs to shorten proceedings for fear of incurring such a complaint. Overall, there has been, at best, lukewarm support in the legal community for a better, more professional court system.

Notaries

Notarization of documents is required before some documents can be registered with an ROD. Notaries must be members of the integrated bar of the Philippines and are regulated by the Supreme Court. In an effort to better control reported abuses by notaries in 2004, the Supreme Court issued Rules on Notary Practice which tightened the procedures which notaries must follow. The role of notarization is not seen as overly problematic with respect to land issues.

E. Social Dynamics

Under the current land use system, only the rich and well-connected can afford to navigate the morass of agencies involved in land transactions. Even those with the resources to accomplish the necessary workarounds—i.e., knowing the procedures, people, and informal fees to get a transaction acted upon—are nevertheless confronted with delay. Interviewees reported that at best, the time needed to register a deed, even when a facilitation fee is paid, is approximately five days. In contrast, in Thailand, it may only take a few hours to register a property transaction. The time needed to gain approval for building a subdivision, which frequently involves conversion of alienable agricultural land to urban use, is measured in years—with two years being an optimistic minimum. One interviewee said that in one particular instance it took 120 visits to various administrative offices, which at times also included the payment of some type of unofficial facilitation fee, to get a subdivision plat and building plan approved.

The restrictions on foreign investment in real property also dampen economic growth. An example was the reported impact of a Supreme Court decision in 2003 classifying reclaimed land on Manila Bay as public land. The decision held back investment by Tokushukai Medical, a Japanese healthcare provider. Tokushukai had planned to invest US$100 million to construct a 1,000-bed hospital on the reclaimed property, beginning April 2006. The firm shelved the plan in March 2005 because it did not want to undertake the project through a joint venture with a local company—the only option allowed by Philippine law.

Notwithstanding the constraints against foreign land ownership, an expansion in real estate investment is now taking place. That expansion is fueled, to a large extent, by investments made by Filipino expatriates who are making either income investments or acquiring second or retirement homes. While many of those investments are being made through land development companies with the resources to invest in the workarounds needed to get a subdivision approved and title transferred to buyers, there are still problems. For example, two different agencies—the DENR and the LRA—are responsible for subdivision approvals, which results in the creation of two different sets of parcel maps in two different unlinked land reference systems.

In some cases, in an effort to circumvent the delays associated with administrative processes, developers reportedly will begin construction of homes before they have obtained the necessary clearances from the DENR, such as approving the conversion of the property to non-agricultural use, leading to further complications. This is the result of a lack of coordination between the DENR and the Housing and Urban Development Authority, the agency which issues building permits. The result is that homeowners may move into a house and incur debt to pay the house, but the builder is not legally able to convey title. As a result, banks are uneasy. It is common that they require that builders enter into buy-back agreements of up to two years. Under those agreements, the builders bear the burden of early loan defaults and the risk associated with any titling problems.

The lack of a single-mapping system to identify lot locations and legal descriptions, combined with the fact that multiple agencies and the courts have jurisdiction over title determinations, leads to the registration of overlapping and multiple transactions on the same parcel of land. A related and apparently growing problem is the proliferation of fake deeds and titles which, once registered, are difficult to eliminate.

The problem created by a dysfunctional land use system falls disproportionately on the poor and those living in rural areas. It is worth noting, however, that a separate informal lending system has evolved in those areas where individual lenders use tax receipts instead of titles as evidence of land ownership. This is because in rural areas, obtaining titles, even under the administrative “patent” titling system, has proved too expensive and too difficult.

The valuation and tax regimes have also had a negative impact on the land use system. There are no reliable real property schedules that can be used to determine the tax base for various local and national taxes related to real estate transactions. A common practice has developed of reporting and registering sales at lower zonal values to limit the payment of taxes. In such transactions, the parties enter into a separate side agreement for the balance of the sales price. The result is an undervaluation of the land and possibly an unenforceable contract for the balance of the sales price. Tax avoidance of inheritance taxes may also be a significant reason why many families are reportedly living on property titled to their grandparents.

F. Recommendations

This report makes the following recommendations:

Land Administration Agencies

- Consolidation of land management into one agency, either under LARA or some other legislative vehicle, is a key step for simplifying the land use regime. More of the affected interest groups, including trade and business associations, need to become educated and involved in pushing for such legislative reform.

- Interim steps should also be undertaken to encourage more communication among the various agencies as well as more efficient processing. The one-stop centers proposed under the LAMP program appear to be such a viable interim step. More technical training for line staff at the RODs and a reduction of the steps necessary to register most transactions may also be achievable short-term goals.

Courts

- Better training is needed on enforcing the summary nature of extra-judicial foreclosures. Courts should demand a minimum threshold of documentary evidence to support a claim that an extra-judicial foreclosure sale was improperly conducted. A change in the law should be considered that would make extra-judicial foreclosures truly extra-judicial (i.e., no need for the court to confirm the sale or for a court sheriff to conduct an auction). Any requirement for court-annexed mediation in judicial foreclosure cases should be removed. Parties would still be free to settle, but, in extra-judicial foreclosures that end up in court, one party (the defaulting borrower) is clearly benefited by delay. Requiring the extra steps for mediation simply gives a greater advantage to one side in the case.
- A change in case assignments should be considered to relieve the Regional Trial Courts designated as special commercial courts of criminal cases. Parties should be permitted to transfer land titling and land use permitting cases to the special commercial courts. In that way, those courts can begin to develop expertise on titling and land use matters.
- Consideration should also be given to dividing larger Regional Trial Courts into civil and criminal divisions. Because there are separate procedural rules for civil and criminal cases, having strictly criminal and civil dockets should result in faster administration of both types of cases. Judges can be rotated in and out every few years, or the system can be structured to assign some judges permanently to a division.

Supporting Institutions

- A uniform system for property valuations should be established. Commercial appraisers are required by the rules of the Institute of Philippine Real Estate Appraisers to be certified and to obtain ongoing education. However, it is not clear that those professional standards are enforced uniformly.

V. Secured Transactions Law

A. Introduction

Secured lending is an essential element of an effective and vibrant market economy. It allows a businesses or persons to offer their movable assets to a lender as security.[21] The most basic example of this is a pawn shop transaction, where the lender takes possession of the property as well as the right to sell the item in the event of non-payment.

A modern secured lending regime goes beyond the pawn shop transaction, by allowing a borrower to maintain possession of the asset offered as security. This allows it be used more productively, increasing the borrower's opportunity to generate the funds to repay the loan. The downside is that the lender's risk increases substantially when the pledged asset is no longer in his or her control.

To give lenders the confidence to enter into these types of transactions, a country's secured lending environment needs to include several elements. There must, of course, be the proper legal framework, allowing the taking of secured interests and their registration with a state-sanctioned authority. An effective registration system in turn requires a functioning registry. Finally, should the debtor default, resulting in a need to exercise the creditor's rights, there must be effective enforcement.

Fragments of each element exist in the Philippines. It has a legal framework consisting of a chattel mortgage law (a law for mortgaging movable property) and a series of quasi-security arrangements based on various provisions of its civil code and other legislation. The registry handles only chattel mortgages and is entirely paper-based. The system for enforcement, which allows for extra-judicial foreclosure of assets, is prone to delay and inconsistency. The result is a legal regime that provides sufficient comfort primarily to lenders willing to take as collateral automobiles and other moving vehicles (aircraft, ships), the ownership rights of which must be filed in parallel registration systems (such as the automobile registry at the Land Transportation Office). On far fewer occasions are lenders willing to take equipment, inventories, or future crops as security, all of which lack the benefit of a parallel registry system.

At the same time, small- and medium-sized enterprises (SMEs) need operating capital. With a substantial portion of their assets useless for raising funds, they instead rely on: (a) government-provided or mandated credit; (b) credit offered at onerous rates; and/or (c) a legal regime that subjects business owners to criminal penalties for non-payment of post-dated checks.

Efforts to reform the system for secured transactions should focus on amendments to the legal framework and the modernization and expansion of the current chattel mortgage registry. Enforcement of rights in the event of default could also be improved, especially as it relates to property subject to rapid spoilage or instances where the debtor enters insolvency proceedings.

B. Legal Framework

Chattel Mortgage Law

The **Chattel Mortgage Law** (Act 1508), which was enacted in 1906, is the principal legislative framework for secured lending. This law has been amended and supplemented by provisions in the Civil Code, the Criminal Code, and Supreme Court jurisprudence.

[21] The use of immovable property (land and buildings) as security is treated in the section on land.

The Chattel Mortgage Law allows for the creation of a non-possessory lien over a broad range of movable properties. Liens are created through registration of a mortgage agreement at the chattel mortgage registry. Theoretically, anything not characterized as real property under the civil code may be the subject of a chattel mortgage.

Examples of things recognized as mortgageable include:

- Ships
- Motor vehicles
- Shares of stock in a corporation
- An interest in a business
- Machinery

Although the Chattel Mortgage Law does not explicitly state as much, the successful registration of a chattel mortgage has the effect of putting all parties on notice as to the non-possessory lien of the creditor. Unless the asset were sold out of inventory in the normal course of the debtor's business, a creditor would likely have recourse against the asset in cases where it was transferred to third parties.

Questions remain over the extent to which a chattel mortgage may extend to inventory that is subsequently acquired by the mortgagor or future obligations. The Chattel Mortgage Law specifically excludes "like or substituted property thereafter acquired by the mortgagor and placed in the same depository as the property originally mortgaged." Nonetheless, the Supreme Court has ruled that this prohibition does not apply to assets that are by their nature revolving or floating, or that are perishable and are naturally expected to be replaced. Clearer is the prohibition on future obligations. The law requires that the mortgage specifically relates to an obligation existing at the time of its creation. The Supreme Court has ruled that this prohibits the mortgage from applying to obligations entered into by the parties in the future.

Both of the limitations described above hamper opportunities for debtors with limited bankable assets (such as land) from obtaining loans secured by collateral. During the assessment process, no real public policy reasons for supporting these limitations were discovered. They appear to simply be vestiges of a 100-year-old law and are accordingly in need of reform.

Enforcement Procedures

Enforcement of rights in the event of a default of a chattel mortgage can be characterized as a two-part process. First, the mortgagor needs to gain possession of the property. Second, the property needs to be sold and the proceeds distributed in accordance with law.

The Chattel Mortgage Law says nothing about regaining possession. In instances where the debtor refuses to surrender the property voluntarily, the creditor will have to apply for a writ of possession with the court. However, interviewees indicated that debtor cooperation is more likely where the debtor has signed a series of post-dated checks that he or she has failed to honor in connection with the debt. The threat of filing a criminal complaint in connection with a dishonored check has the effect of persuading a debtor to surrender the asset without having the creditor resort to a court order.[22]

[22] For more discussion of the bad check writing issue, please see this report's chapter on contract law and enforcement.

The creditor may elect to sell the property and have the proceeds distributed through either judicial or extra-judicial procedures. Extra-judicial procedures, which despite the name require court intervention, are used far more often than the former. The requirements for conducting an extra-judicial foreclosure are set forth in the Chattel Mortgage Law. In summary, a creditor initiates extra-judicial foreclosure proceedings by making an application to the court. This is necessary to utilize a sheriff, i.e., an officer of the court who, under the Chattel Mortgage Law, is required to conduct the sale. A sale may occur no earlier than 30 days after the debtor's default. The notice of an upcoming sale must be publicly posted no later than ten days before the scheduled sale. Likewise, the debtor and other mortgagees (if any) must be notified of the pending sale no later than then 10 days before it occurs. Finally, the sheriff must conduct the sale through public auction.

Where the property is not subject to a parallel registration system (such as that for motor vehicles), finalization of the sale is relatively simple. The buyer tenders the amount he or she bid at the auction and the sheriff/creditor transfers possession in return. Where there is a parallel registration system, however, finalization requires recordation of the change of owner at the appropriate registry. In such cases, any fees or taxes due on the particular asset must be cleared before this can take place.

After the sale is finalized, the sheriff reports this to the chattel mortgage registry. This report serves to cancel the mortgage over the asset. Proceeds from the sale are distributed first to cover related costs. The remaining proceeds are distributed to the creditor/mortgagee and any other subsequent secured creditors with claims on the asset. If any proceeds remain, these are returned to the debtor.

Theoretically, a debtor objecting to an extra-judicial foreclosure can petition a court to enjoin the proceedings if he or she can show great or irreparable harm. The issuance of such temporary restraining orders has often occurred in the context of extra-judicial foreclosures of real estate mortgages. This does not appear to be as extensive a problem with respect to chattel mortgages. Instead, a debtor wishing to delay the proceedings is more likely to refuse to surrender the asset, thereby forcing the creditor to initiate a court proceeding for a writ of possession.

An alternative defensive measure is for the debtor to either initiate or threaten to initiate corporate rehabilitation, a procedure roughly akin to Chapter 11 proceedings in the United States. Such proceedings have the effect of prohibiting secured creditors from enforcing their rights against collateral. As these proceedings and the accompanying "stay" on enforcement may go on for months—or even years—creditors with claims secured by property subject to depreciation (as is the case with many forms of movable property) are particularly vulnerable to erosion of their status as secured creditors.

Enforcement can also be frustrated if the debtor is liquidated under insolvency proceedings. The current rules, as interpreted by case law, do not provide sufficient comfort to secured creditors that their claims will receive priority payment.

But, even with a relatively docile debtor, enforcement under the current rules is likely to be insufficiently rapid when the collateral is property subject to spoilage or rapid depreciation. The 30-day waiting period under the Chattel Mortgage Law, combined with the procedures for applying for an extra-judicial foreclosure, makes it unlikely that assets could be sold within even a 60-day period.

In cases where the claim of a secured creditor is not fully satisfied by the proceeds from the sale of the collateral, the creditor may sue the debtor for the deficiency. In such cases, the creditor would have to initiate a case in court and would have the status of an unsecured creditor.

Quasi-Security Arrangements

In addition to the regime for chattel mortgages, Philippine law and jurisprudence provide for several other methods of obtaining something similar to a non-possessory lien over movable property: (a) trust receipts; (b) assignments by way of security; (c) conditional sales; and (d) sale-leasebacks. These instruments or arrangements are relatively straightforward.

Trust receipts are issued by the recipient of particular products or materials that are either stored or earmarked for processing. The recipient is the trustee over the items. Ownership remains with the supplier notwithstanding any transformation of raw materials into processed goods.

Assignments by way of security usually involve receivables. A lender (usually a bank) takes control of the bank account of the borrower. Almost always, the debtor's account is at the lending bank and the account is the one to which the payments by the borrower's customers are directed. These payments are swept by the bank and credited against the debtor's account.

In a conditional sale, the seller of an asset maintains an ownership interest in sold goods until the buyer has made payments in full.

In a sale-lease back, the supplier of capital (usually a leasing company) takes ownership of assets transferred by a customer for a specified sum. The assets remain in the customer's hands, however, under a leasing arrangement. Payments on the lease serve to draw down the amount initially transferred to the customer.

In each of these arrangements, the parties attempt to create an ownership interest (as opposed to a lien) on the part of the supplier of capital. These efforts stemmed from a desire to move beyond some of the doctrinal limits in the Chattel Mortgage Law and to provide greater protection to the suppliers of capital in the event that the debtor comes under insolvency or corporate rehabilitation proceedings.

Nevertheless, these arrangements have their drawbacks. For instance, in none can the supplier of capital publicly register an ownership interest in the property that is in the hands of the debtor/counterparty. They are thus vulnerable to transfers of property to third parties, regardless of whether the debtor/counterparty might be subject to criminal sanction for such transfer.

C. Implementing Institutions

The Registry

The Chattel Mortgage Registry is operated by the Land Registry Agency (LRA), a sub-division of the Department of Justice. The LRA operates hundreds of land registries throughout the country. In addition to land titling issues for immovable property, each local land registry may receive registrations of chattel mortgages when (a) the mortgagor is in its jurisdiction and/or (b) the property that is the subject of the mortgage is in its jurisdiction. To be valid, the mortgage must be registered in the town or province where the debtor is located. If the property is in another locale, a second registration must occur at the corresponding chattel mortgage registry office. When the chattel is a ship or automobile, the chattel mortgage registration needs to be followed up by making an annotation on the deed corresponding to the ship or automobile for which a chattel mortgage has been registered. In the vast majority of cases, the chattel that is the subject of the mortgage is a vehicle.

The registry is paper-based and requires the filing of the mortgage agreement that created the lien. If an application to register a chattel mortgage is deemed sufficient by registry officials, it is placed in the registry day book for chattel mortgages. This process can take as little as a few hours. Within several days, this registration makes its way to the registry itself, which is merely a series of books with entries containing more detailed information on the mortgage and a reference to where the mortgage agreement itself is located within the registry office.

The fee for registration of the mortgage is determined by a sliding scale based on the amount of the mortgage. The formula results in fees that are not insubstantial, often times amounting to one or two percent of the amount of the secured debt. Companies offering leases as an alternative regularly point to the savings that result from avoiding registration of a chattel mortgage.

Within the framework of these limits, the system works relatively smoothly. Most users reported that registration is relatively prompt where all the proper papers and formalities are in order. Where issues or irregularities with an application do arise, the document inspector raises them with the filer and they are resolved in a relatively informal and efficient manner. The number of daily filings varies from registry to registry. At some of the more busy locations, a staff of up to three officials handles as many as 100 filings per day. In other, smaller jurisdictions, one individual may process as few as a handful of applications on any given day.

The registry's greatest reported shortcoming is the inability to conduct an efficient search for prior mortgage holders. In the case of vehicles, however, this is alleviated by the parallel registry at the Land Transportation Office. Checking for prior lien holders under this registry (which is organized by vehicle) is relatively straightforward. The ability to ensure oneself of a clean mortgage no doubt contributes to the popularity of vehicles as chattel mortgages.

Where the property is not subject to mandatory registration at a parallel registry, searching is far more problematic. It can be done, however, by having a legal assistant sit in a room at a given registry and pour through volume after volume of registry entries. This exercise has been known to take several weeks when the chattel has been in existence for a considerable time.

To a certain extent, a provision in the penal code gives parties to these transactions some comfort. A debtor may be held criminally liable for transferring mortgaged assets to third persons or taking an additional mortgage on the asset without obtaining permission of the initial mortgagee. Criminal prosecutions for such violations are not a common occurrence, however. It is not clear whether this stems from deterrence at work, or reluctance in prosecution.

The Enforcement Agency

As mentioned above, sheriffs enforce the rights of a creditor/mortgagee when the debtor defaults. Such cases are distributed among the sheriffs in a particular region by means of a raffle conducted by the clerk of court for the executive judge. Performance of sheriffs in seizing and selling property is hard to ascertain accurately without undertaking a detailed review of a substantial set of cases. Nonetheless, it appears that parties to these secured transactions appear to be generally satisfied with the performance of sheriffs in this area.

D. Supporting Institutions

Supporting institutions with secured transactions are notary publics, lawyers, and their legal assistants.

While documents are required to be notarized in connection with these types of transactions, it is well recognized that obtaining notarization is relatively easy. Notaries in the Philippines function as a means of certifying the identity of a party that is signing a document. Further, on the rare occasions where a sheriff is not available to conduct an extra-judicial mortgage, a notary public is allowed to perform this function.

The legal profession appears to have facilitated the use of chattel mortgages, establishing a relatively straightforward practice in drafting the necessary document and using specialized legal assistants who are well aware of the procedures for their filing. Further, the legal profession has shown creativity in developing and popularizing the use of the quasi-securities described in section B of this chapter.

There are not, however, any specific organizations or committees within the Philippine Integrated Bar Association devoted to issues of secured transactions.

E. Social Dynamics

Reform of the secured transactions regime would appear to be an attractive option in the Philippines. Experience in other countries has demonstrated that reform in this sector offers considerable benefits to both borrowers and lenders. Furthermore, such legislation appears to threaten few, if any, established interest groups. Nonetheless, the social dynamics connected with secured transactions in the Philippines does not appear to be conducive to reform. This comes despite a widely held perception that: (a) small- and medium-sized enterprises (SMEs) are an important factor in economic growth and job creation; and (b) these enterprises are underserved by suppliers of credit. The most common response to this need, however, is to increase government-sponsored or subsidized lending programs to SMEs or to mandate financial institutions to direct a portion of their lending activity to this sector. Neither the business sector nor the government agencies addressing SME activity appear to place a high priority on structural reform of the secured transactions regime.

The legal profession has a greater perception that the system “has its glitches” (as one experienced transactions attorney put it). Nonetheless, lawyers seem relatively comfortable with the chattel mortgage regime and the supplementary quasi-security arrangements that have been developed over the years.

A group from the law faculty of the University of the Philippines has developed a draft Code on Security Devices, which was recently sent to several members of Congress. The draft legislation seeks doctrinal clarification of the provisions regarding chattel mortgage, real estate mortgage, and other types of quasi-securities. It does not, however, mandate the computerization of the registry or its expansion to include other the types of interest in movable property. Instead, it contemplates the establishment of an additional, parallel registry for recording assignments of receivables. This registry would be administered by the Land Registry Agency. Similar legislation was submitted several years ago in the Philippine Congress. It was submitted to a Congressional committee and has yet to be reported out favorably.

This lack of enthusiasm stems from a combination of factors:

- The system, despite its limits, works reasonably well within the framework it encompasses.
- The direct users of the system (primarily attorneys and their legal assistants) are familiar and comfortable with it.

- Reforming the framework for secured transactions lacks the immediacy and the political visibility of implementing a subsidized or directed loan program.
- Lenders and other users are not confident that reforms in this area will stimulate lending when assets, regardless of their registration as collateral, are liable to simply disappear.
- The current bankruptcy regime (specifically, the procedures for corporate rehabilitation) has often failed to provide adequate protection to the rights of creditors that have claims secured by mortgages of property which are subject to fairly rapid depreciation.
- Numerous other legislative priorities are vying for the attention of legislators and the executive branch.

International and bilateral donor organizations have attempted to catalyze reform efforts on an intermittent basis. In the late 1990s, the World Bank sought to jump start reform in this area. Soon thereafter, the Asian Development Bank sponsored a comparative analysis of secured lending regimes of its developing member countries. More recently, the Asian Development Bank has initiated a technical assistance program that will begin to assess and address reforms in this area. At the time of this writing, however, this effort was only beginning.

F. Recommendations

This report makes the following recommendations:

- Efforts by the Asian Development Bank to catalyze reforms in this area should be supported and perhaps even supplemented by other donor agencies. Particular emphasis should be given to expansion and computerization of the chattel mortgage registry.
- A far more in-depth analysis than offered here should be undertaken. A recent International Finance Corporation (IFC) publication sets out a detailed roadmap for conducting such a survey, with the goal of developing constituencies for secured transactions reform.
- The bankruptcy regime should provide greater protection to creditors with claims secured by movable property when the debtor comes under corporate rehabilitation or when the property is liquidated during insolvency proceedings. Protection could come through legislative or regulatory reform, or simply through greater clarifications of these protections in published decisions.
- The proposed Code on Securities Devices represents a good beginning, though it could stand to be supplemented, particularly with respect to mandating computerization of the registry.

VI. Bankruptcy Law

A. Introduction

An effective bankruptcy regime supports economic growth in two fundamental ways. First, it encourages more lending by providing greater certainty that creditor claims will be treated fairly when an enterprise comes under economic stress. Second, it liberates otherwise productive assets trapped in non-functioning or semi-functioning enterprises. It does this by either reinvigorating the enterprise through rehabilitation/reorganization or by moving the assets to a third party through liquidation.

When ineffective, a bankruptcy regime erodes creditor confidence in lending to any but the most financially healthy enterprises. When enterprises do come under financial distress, ineffective bankruptcy systems usually aggravate rather than resolve the problem. The usual unhappy result is a judicial limbo where creditors in a bankruptcy proceeding can neither enforce their claims (due to a judicially imposed stay of enforcement rights) nor force a decision as to the debtor enterprise's fate.

The Philippines' legislation on bankruptcy (the **Insolvency Act**) provides debt resolution mechanisms for both natural persons and legal entities. The 1909 act, however, it is perceived as being obsolete in approach and outmoded in style. It is rarely applied to corporations and almost never to individuals. To more fully address the needs of enterprises in financial distress, the Philippines has established an entirely separate set of proceedings for corporate rehabilitation. Based on a bare-bones Marcos-era decree, corporate rehabilitation proceedings are governed by a set of interim rules that were promulgated by the Supreme Court in 2000. Petitions for corporate rehabilitation are heard by approximately 60 Regional Trial Courts specifically designated to hear commercial cases.

The current bankruptcy regime is widely seen as a suboptimal arrangement badly in need of reform through the passage of a comprehensive law encompassing international best practices in both liquidation and rehabilitation. Numerous obstacles, however, reduce the chances for passage of a new bankruptcy law in the coming years. Under these circumstances, the most realistic approach may be to look for second-best solutions that are more likely to be successfully implemented in the nearer term.

B. Legal Framework

Most bankruptcy regimes offer two alternative routes when a person or legal entity comes under financial distress: liquidation (i.e., the sale of the debtor's assets to pay off creditors to the greatest extent possible) or rehabilitation (the adjustment of the debtor ownership and its arrangements with its creditors to give it a chance to repay its debts, avoid liquidation, and continue operations). The Philippines follows this pattern. The two routes, however, fall under entirely different legislative frameworks.

Liquidation Proceedings in the Event of Insolvency

Liquidation proceedings in the event of insolvency are governed by the Insolvency Act. It applies to both natural persons and legal entities. Some of its salient points are summarized below.

<u>Initiation of Proceedings and Management of the Debtor</u>. Both debtors and creditors may initiate proceedings by filing a petition in the Regional Trial Court where the debtor is located. To start a proceeding, a debtor essentially needs to show an inability to pay its debts and a willingness to surrender its property to repay its creditors. For a creditor to start a proceeding, it needs to join with two other debtors and allege that the debtor has conducted an act of insolvency (e.g., "failing to have property subject to execution sufficient to satisfy a judgment"). Proceedings begin if the debtor cannot show cause

why it should not be declared insolvent. If the court finds the petition sufficient, it will issue an order declaring the debtor insolvent. Upon issuance of the order, all "all civil proceedings pending against the said insolvent shall be stayed."[23] The stay applies to secured creditors as well.

The property of the debtor is initially managed by the sheriff of the municipality in which the debtor is located. The sheriff manages the property until the creditors meet to elect a liquidator (referred to in the Insolvency Act, and hereinafter, as an "assignee").[24] The meeting of creditors to elect an assignee occurs approximately eight weeks after initiation of the case. There, creditors vote by number and by size of claim. Secured creditors, however, are allowed to vote for an assignee only to the extent that they concede that their claims are unsecured.

In order to be elected, an assignee needs the support of one half the creditors holding one half of the amount owed by the debtor. If the creditors fail to elect an assignee, the court may appoint one. Upon the assignee's appointment, the court is required to convey the debtor's property to the assignee.

Scrutiny of Fraudulent Transactions. Under the Insolvency Act, the assignee may bring an action to set aside a fraudulent transfer. The law defines such transfers quite broadly as it subjects to scrutiny any transactions made 30 days before the filing of the insolvency petition. Transactions outside the ordinary course of business, or where the debtor received less than fair value for the product or service, are vulnerable to reversal. This power, however, is most likely more theoretical than actual. At least one commentator has observed that these actions are seldom enforced in the Philippines.[25]

Sale of Assets. The assignee's duties and powers include selling the debtor's assets. The assignee may sell encumbered property either free and clear (after payment of the claims secured by the property) or subject to existing liens. In general, property is sold by public auction. The court may allow a private sale if it determines that it is in the best interest of the debtor's estate.[26]

Treatment of Claims. The Insolvency Act fails to establish a specific deadline for creditors to submit their claims. If a creditor wishes to vote for the assignee, however, he or she must submit a claim to the clerk of the court at least two days before the election.

Any interested party may object to any claim of a creditor, so long as he or she does so at least one day before the election. The court then makes a summary decision to determine whether the challenged creditor has the right to vote. A late-filing creditor can assert his or her right to payment if sufficient funds remain and the delay did not result from the creditor's neglect. The law mandates that disputes over claims prior to election of an assignee be settled summarily. In other cases, the law requires a full trial to resolve whether a creditor with a disputed claim deserves a liquidation dividend.

Priority of Claims. The priority of claims in an insolvency proceeding is far from clear. The hierarchy of creditors is established by the **Philippine Civil Code**. The Code treats secured creditors apart from unsecured creditors and creates a hierarchy of approximately 10 different categories of unsecured claims. On this list, the claims associated with administering the debtor come behind claims of workers and those of the state for criminal penalties. Legislation and case law subsequent to the passage of the Civil Code has served to muddle the applicable rules in this area. Article 110 of the Labor Code elevates workers to

[23] Insolvency Act, Section 18.

[24] Id., Section 78.

[25] T. Regala, *Report on the Philippines 58* (submitted in connection with the Asian Development Bank Symposium on Insolvency Law Reforms, January 1999).

[26] Insolvency Act, Section 36, par. 4, and Section 39.

first priority. The Supreme Court, however, subsequently ruled that the priority of workers applied only with respect to unencumbered assets.[27] In another decision, the Supreme Court ruled that the claims of the tax authorities are paramount, trumping even claims of creditors secured by liens.[28] With this combination of statutes and case law (some of it conflicting), it is not unusual to get three different answers from any three different lawyers as to the rankings of creditors in an insolvency case.

Dissolution of the Corporate Debtor. The Insolvency Act fails to give guidance on the legal fate of a corporation after its property has been sold and its claims have been paid off to the extent possible. Indeed, the Insolvency Act states that a corporate debtor, unlike an individual, does not have the right to a discharge of its debts.[29]

The Corporation Code contains provisions whereby a corporation may be formally dissolved. However, it fails to contemplate such a dissolution within the context of a proceeding under the Insolvency Act.

Corporate Rehabilitation Proceedings

The Insolvency Act contains something akin to corporate rehabilitation procedures. The "suspension of payments" provisions in the Act give an illiquid (but solvent) debtor temporary breathing space to attempt to make arrangements with its creditors. These provisions, however, had relatively strict deadlines, allowed unsecured creditors full autonomy in deciding whether to approve a plan to adjust the claims of the debtors, and allowed secured creditors to continue to enforce their claims during the course of the proceedings. For various reasons, these provisions were not considered adequate to deal with corporate financial distress. The result was a 1981 presidential decree that allowed corporate debtors to petition the SEC to come under corporate rehabilitation proceedings.

For nearly 20 years, the SEC essentially served as the country's corporate bankruptcy court, adjudicating high-profile cases involving the country's flagship airline and one of the country's largest sugar refineries. During this period, the proceedings at the SEC were criticized as being skewed towards debtors and lacking sufficiently clear and detailed rules of procedure.

In 2000, legislation on the securities market transferred jurisdiction over corporate rehabilitation cases to the courts. In response, the Supreme Court designated 60 Regional Trial Courts to these cases and promulgated the **Interim Rules of Procedure on Corporate Rehabilitation** (Interim Rules), summarized below.

Availability. The proceedings established under the Interim Rules are available to any corporation, partnership, or association that "foresees the impossibility of meeting its debts when they respectively fall due." They are also available to creditors of such entities, where the creditor, either singularly or jointly with other creditors, holds at least 25 percent of the debtor's liabilities.[30] The Interim Rules establish a checklist of required information and attachments to initiate the proceedings.[31] One of these documents

[27] E.g., Development Bank of the Philippines v. NLRC, G.R. 97175 (1993).

[28] Republic of the Philippines vs. Peralta, GR No. L-56568 (1987).

[29] Id., Section 52.

[30] Interim Rules, Rule 4, Section 1. Although not made explicit in the rules, a petitioning creditor would likely have to allege and prove that the debtor was not able to meet its obligations as they came due in order to initiate a case.

[31] Id., Rule 4, Section 2.

is a rehabilitation plan that has been formulated according to the minimal requirements of the Interim Rules.[32]

Issuance and Scope of a Stay Order. The court is required to act on the petition no later than five days from the date of its filing. If it finds the petition on its face to be legally sufficient, the court issues a stay order that, among other things, fixes a date for an initial hearing no later than 60 days from the date the petition was filed. The petitioner is required to publish the order in a newspaper of general circulation.

The stay order suspends all legal actions against the debtor, including foreclosure actions by secured creditors. Concurrently, the order initiating the case is required to enjoin the debtor from disposing of assets outside the ordinary course of business and making any payments on liabilities outstanding as of the date when the petition was filed.[33]

Appointment and Role of the Rehabilitation Receiver. The Interim Rules require the court to appoint a rehabilitation receiver. The receiver is required to meet standards of competence and expertise set forth in the Interim Rules and should be free of any conflicts of interest.[34] Considered to be an officer of the court, the receiver is "tasked to study the best way to rehabilitate the debtor and to ensure that the value of the debtor's property is reasonably maintained pending the determination of whether or not the debtor should be rehabilitated."[35] Rather than replacing the management of the debtor, the Interim Rules call on the receiver to oversee and monitor the debtor's operations. To this end, the Interim Rules endow the receiver with unfettered access to the debtor's "employees, premises, books, records and financial documents . . ."[36]

Initial Hearing. The first opportunity for creditors and interested parties to formally participate in the proceeding is at the initial hearing. The Interim Rules contemplate the initial hearing as an opportunity for creditors and other interested parties to have the petition dismissed for failure to comply with the filing requirements. Such a right is dependent on the interested party filing a written opposition with the court no later than 10 days before the date of the initial hearing.[37] If the petition survives the initial hearing, the court is required to submit the petition and proposed rehabilitation plan to the rehabilitation receiver.

Administrative Expenses and Post-Petition Financing. The Interim Rules specifically require the debtor to make payments for administrative expenses,[38] which are defined as "expenses incurred in the ordinary course of business after the issuance of the stay order, excluding interest payable to creditors."[39] The Interim Rules, however, do not provide for any super-priority for creditors offering post-petition financing. Further, a prohibition against encumbering assets outside the ordinary course of business in the Interim Rules would appear to preclude new financing secured by the collateral of the debtor.

[32] Id., Rule 4, Section 2(e).
[33] Id., Rule 4, Section 6.
[34] Id., Rule 4, Section 13.
[35] Id., Rule 4, Section 14.
[36] Id., Rule 4, Section 14(p).
[37] Id., Rule 4, Section 10.
[38] Id., Rule 4, Section 6.
[39] Id., Rule 2, Section 1(a).

Voidability of Fraudulent Transfers and Preferences. The Interim Rules specifically allow the court to unwind transactions or preferences made by the debtor in violation of the stay order.[40] However, in contrast to the Insolvency Act, the rules are silent as to the right of the court to unwind transactions or preferences made before the imposition of the stay.

Adequate Protection for Secured Creditors. The Interim Rules provide a secured creditor with specific remedies should depreciation or neglect threaten the value of its collateral during the course of the proceedings. In such instances, the rehabilitation receiver is required to intervene to protect the collateral (e.g., making insurance payments current or providing for the property's maintenance or safekeeping). Alternatively, the receiver may be ordered to "make payments or otherwise provide additional or replacement security such that the obligation is fully secured."[41] If such arrangements are not feasible, the court is required to lift the stay against the secured creditor.

Exception to Adequate Protection When It Jeopardizes a Rehabilitation. Although the Interim Rules establish a coherent framework for providing secured creditors with adequate protection, they nonetheless deny the remedies set forth therein when "such remedies would prevent the continuation of the debtor as a going concern or otherwise prevent the approval and implementation of a Rehabilitation Plan."[42] They are silent as to the alternative remedies that would be available to a secured creditor under such circumstances.

Contents of the Rehabilitation Plan. The Interim Rules provide an outline of what a plan should entail. The plan should provide "desired business targets . . . and the duration and coverage of the rehabilitation." It should also disclose how the plan will be implemented "giving due regard to the interests of secured creditors." For purposes of assisting creditors in deciding to support the plan, the Interim Rules require that the plan contain a liquidation analysis that would estimate the dividend "creditors and shareholders would receive if the debtor's properties were liquidated" and other "relevant information to enable a reasonable investor to make an informed decision" on the plan's feasibility.[43]

Creditor and Shareholder Participation in Plan Formulation. The Interim Rules allow interested parties to provide input on the plan, both through court filings and discussions with the debtor and rehabilitation receiver. Interested parties may file a comment or opposition with the court within 120 days from the date of the initial hearing. The Rules specifically contemplate the rehabilitation receiver meeting with creditors to discuss the plan.

Submission of the Rehabilitation Plan for Court Approval. Upon expiration of the comment period by the receiver and interested parties, the debtor may move for court approval of the plan or submit a modified plan for final approval. The deadline for submission of a modified plan is one year from the date of the initial hearing.[44]

Creditor Objection and Possibility of Override. If the creditors holding a majority of the total liabilities of the debtor oppose the plan, the Interim Rules implicitly suggest that the court has the right and duty to disapprove the plan, lift the stay order, and dismiss the proceedings. Nonetheless, the Interim Rules allow the court to approve the plan despite the objections of a majority of creditors if it deems that the

[40] Id., Rule 4, Section 8.
[41] Id., Rule 4, Section 12.
[43] Id., Rule 4, Section 5.
[44] Id., Rule 4, Section 22.

opposition is "manifestly unreasonable." For guidance in this determination, the Interim Rules provide the courts with specified criteria. A plan may be approved despite creditor objections if:

(1) It provides the creditors with compensation greater than they would have received if the debtor were liquidated.

(2) The shareholders or owners of the debtor lose at least their controlling interest as a result of the plan.

(3) The rehabilitation receiver has recommended approval.

The Rules appear to require the court to make such a finding as part of any order to approve the plan over the objections of the creditors.

Effect of Plan Approval. The Interim Rules resolve a contentious issue that had previously plagued efforts to rehabilitate companies in the Philippines: the power of a court to unilaterally alter the contractual rights of the debtor with his creditors. Under the Rules, the terms of an approved plan "shall be binding upon the debtor and all persons who may be affected by it, including the creditors, whether or not such persons have participated in the proceedings, or opposed the plan or whether or not their claims have been scheduled."[45] These alterations are irreversible, even if the plan fails: "Any compromises on amounts or rescheduling of timing of payments by the debtor shall be binding on creditors regardless of whether or not the plan is successfully implemented."[46]

Dismissal If No Plan Approved. The Interim Rules require the court to dismiss the case if no rehabilitation plan is approved within 180 days of the initial hearing. The court may extend this period if it finds by clear and convincing evidence that the debtor may be rehabilitated. In no circumstances, however, may the court allow the proceedings to exceed 18 months.[47]

A Shortlist of Shortcomings in the Current Legislative Framework

This analysis focuses on five major shortcomings in the current framework:

No Licensing and Regulation of Assignees and Receivers. The standards for appointment of such individuals are relatively lax under both the Insolvency Act and the Interim Rules, amounting to merely some education and experience. This stands in contrast to regimes in numerous other countries where individuals aspiring to these positions, before they can be appointed, must undergo formal examinations and/or extensive on-the-job training under guidance of another insolvency professional. Licensing also brings other benefits: the ability to monitor these individuals and hold them accountable. Errant receivers could be fined by the licensing authority, with their license revoked or suspended if they refuse to pay.

Inability of Creditors To Replace the Receiver. In a liquidation under the Insolvency Act, the creditors have the opportunity to elect an assignee. In a corporate rehabilitation, they do not. Instead, the petitioner proposes three individuals, but the final decision rests with the judge, with no guarantee that he or she will appoint one of the nominees. It is understandable that the court appoint an interim receiver to handle initial aspects of a case before creditors are gathered and organized. But there are few if any logistical reasons why creditors should not be able to decide to replace the initial receiver with their own favored nominee. Such a person will have a mindset far more in line with the creditors.

[45] Id., Rule 4, Section 24(a).
[46] Id., Rule 4, Section 24(e).
[47] Id., Rule 4, Section 11.

Complexity and Confusion Regarding Creditor Rankings. As noted earlier, few people are capable of predicting with certainty the payout in a liquidation proceeding. The statutory rankings are complex. Conflicting legislation and jurisprudence add to the confusion. The Supreme Court, however, has emphasized equality of treatment among creditors in a rehabilitation case. Arguably, this should be practiced in a liquidation as well. Indeed, numerous countries have moved to distribution regimes where all unsecured creditors, including the state for unpaid tax claims, are treated equally. This greatly simplifies matters in both liquidating the debtor and in voting on a rehabilitation plan.

Lack of Clarity with Respect to Voting on a Rehabilitation Plan. As discussed earlier, the Interim Rules contemplate a process by which creditors holding a majority of the debtor's liabilities object to a plan. In such a case, the court may overrule the objections to the plan if they are "manifestly unreasonable." The Interim Rules then propose criteria for guiding the court on whether to override the objection(s). The objections are unreasonable if: (a) the plan gives the creditors more than they would receive in a liquidation; (b) the shareholder's equity is significantly diluted; and (c) the receiver approves the plan. These are commonly known as the "cram down criteria."[48]

Essentially, the Interim Rules have the effect of creating a single class of creditors for voting on the plan. While there is merit to such simplicity, it fails to work properly if creditors are not equal in terms of their entitlements in a liquidation. Under the rankings established by the Civil Code, subsequent case law, and jurisprudence, there are at least six different classes of creditors all expecting something different should the debtor be liquidated.

As a result, it is not unusual to find unsecured creditors (who are likely to get little in a liquidation) voting for a rehabilitation plan, while secured creditors (who would likely get far more in a liquidation) remain quite skeptical. The objections of some creditors may be perfectly reasonable while other objections may be utterly senseless. The only way to reconcile these two approaches is to either bring class differentiation into the rehabilitation voting process or substantially reduce the classes in liquidation.

Bringing class differentiation to rehabilitation would greatly complicate matters. Plans would have to treat each class differently and each class would have the right to veto the plan by failing to approve it. This greatly increases the likelihood that a plan supported by most creditors would fail. This then leads to provisions such as the cram down criteria in the Interim Rules. Cram down rules further complicate and muddle matters, shifting power from the creditors to the court, and encouraging appeals that delay the outcome of the case. They are also of doubtful constitutional validity.[49]

Reducing the number of classes in a liquidation to two—secured creditors and unsecured creditors—would match the egalitarian approach currently associated with rehabilitation proceedings. It would also make it easier for creditors to bargain among themselves and with the receiver. Further, it would reduce the possibility that a small group of holdout creditors could veto the proceedings. It would also likely reduce the chance of the court needing to use cram down provisions. Indeed, in countries where the approach to classes is this simple, cram downs are often not allowed.

No Automatic Liquidation If a Rehabilitation Plan Is Rejected. Under the Interim Rules, if a debtor fails to get a plan approved, the case is dismissed and the stay is lifted. Creditors are free to resume their cases

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48 The term stems from the metaphor of a court cramming the plan down the throats of the majority of the creditors.

49 See Security Bank Corporation v. Silahis International Hotel, CA-G.R.-SP No. 9263 (Court of Appeals, Manila, October 12, 2006) at 34:"[t]he view has been expressed whether such 'cram-down' power of the RTC to impose the terms of the rehabilitation against opposing secured creditors, which would effectively novate their security arrangements or specific corporate property, could withstand constitutional attack on the bases of violation of the due process and non-impairment of contract clauses of the Constitution . . ." (quoting C. Villanueva Philippine Corporate Law, at 59 (2001)).

against the debtor or to bring new cases. The debtor is free to apply again for rehabilitation. If a creditor or the debtor files a petition for insolvency proceedings, the case is likely to end up before a new judge, squandering all the insight and experience accumulated by the judge who handled the rehabilitation proceedings.

C. Implementing Institutions

The major implementing institutions include the Regional Trial Courts designated to hear commercial cases, the Regional Trial Courts, and the rehabilitation receivers. Assignees, who conduct liquidations under the Insolvency Act, are too few and far between to be considered an implementing institution.

Commercial Courts. For corporate rehabilitation cases, the main implementing institution consists of the approximately 60 Regional Trial Courts that have been designated to hear such matters.[50] No comprehensive study exists on the performance of the courts in the six years since the courts took over rehabilitation cases from the SEC. Instead, anecdotal information and high-profile examples are the primary means of gleaning patterns in court performance.[51]

According to this evidence, the performance of the courts has been, at best, mixed. Several judges have shepherded cases through the system, resulting in the rehabilitation and recovery of several distressed debtors. Other examples arise, however, of situations where the courts have let proceedings drag on or have favored the debtor at the expense of the creditors. Secured creditors have expressed particular dissatisfaction, complaining that the rehabilitation plans approved by some courts imposed onerous conditions or did not adequately differentiate their claims from unsecured creditors. In other cases, outcomes have been clouded by appeals filed by various parties. Appeals in some cases have remained pending for several years.

Regional Trial Courts. Insolvency cases are heard by the Regional Trial Court where the debtor is located. It is nearly impossible to determine the performance of these courts in handling these cases. The Supreme Court does not track these cases separately. Some observers estimate, however, that only a handful of cases are filed each year.

Rehabilitation Receivers. As mentioned above, rehabilitation receivers are not licensed. There is a widespread perception among creditors and other observers that the quality of receivers is extremely variable. A few that are well-versed in the Interim Rules and company restructuring techniques have turned around several companies that might otherwise have been liquidated or shut down. Others have tended to align themselves with the interest of the debtor and its owners. Other creditors and observers have gone so far as to suggest that receiver actions have been distorted by financial incentives offered by the various competing parties in a case. Indeed, several qualified individuals, while expressing interest in serving as a receiver, have tended to shy away from the job, commenting that the business is not ethical under current practices.

Several years ago, in the wake of the transfer of the rehabilitation cases to the Regional Trial Courts, several insolvency practitioners formed an association. Interest in this association has waned somewhat over the years, despite the efforts of its president to keep it viable.

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[50] For liquidations under the Insolvency Act, the main implementing institution consists of the Regional Trial Courts. No specialized courts have been designated to hear such matters.

[51] The Supreme Court collects basic information on rehabilitation cases (e.g., cases initiated, cases dismissed). Personnel at the Supreme Court provided this information to the assessment team.

D. Supporting Institutions

Supporting institutions include domestic secured creditors, foreign and specialized secured creditors, attorneys, and financial advisors.

Domestic Secured Creditors. Domestic secured creditors consist primarily of banks. In general they have shown only moderate aggressiveness in addressing debtors with non-performing loans. This is reflected in the increasing amounts of loans in the Philippines that were classified as non-performing. The amount of non-performing loans on the books of banks was approximately US$4 billion in late 2004[52] and has since fallen quite dramatically. This drop, however, stems primarily from banks selling these claims to foreign and specialized investors rather than addressing these issues directly.

Although some banks have developed work-out departments and zealously pursue claims against creditors, others remain content to focus their efforts on less risky and lucrative markets, such as high-end corporate business, trade and remittances, and government treasuries.

Foreign and Specialized Secured and Unsecured Creditors. Foreign and specialized secured creditors have emerged on the scene only recently. They are involved with insolvency and rehabilitation cases because they bought non-performing loans from banks under specialized legislation. Many of these creditors (or their representatives) are well-versed in corporate distress techniques used in other countries and are rapidly gaining experience in how to apply them in the Philippines.

The interaction in rehabilitation between these creditors and their domestic counterparts has proven interesting. While perhaps displaying more aggressiveness than their domestic counterparts have traditionally shown, the foreign and specialized creditors have also shown a greater willingness to compromise their claims in the context of in-court or out-of-court debt restructurings. This is because they have often bought the claims at substantial discounts, at prices amounting to less than 30 percent of the face value of the claim. This provides them with the flexibility to compromise and still make a profit.

The perceptions of these creditors are also telling. Some have expressed extreme disappointment at how the commercial courts are implementing the Interim Rules. This has prompted many of them to seek out-of-court settlements whenever possible. The result is that debtors often threaten to seek corporate rehabilitation as a means of extracting concessions from creditors.

Lawyers. Since the Asian Crisis in the late 1990s, more attorneys have sought expertise in both domestic bankruptcy and in associated international best practices. At this point, however, they do not appear to be very enthusiastic about sharing their knowledge through specialized associations or other means. Nevertheless, an informal insolvency bar is growing. Familiarity with the lawyers on the other side in an insolvency case can produce more manageable negotiations and more predictable outcomes.

Financial Advisors. This group consists of accountants, appraisers, and rehabilitation plan writers. The accounting profession for the most part enjoys general respect. This is especially true with accountants from firms that have ties with the larger international accounting firms. More questions surround the quality of the work of appraisers in rehabilitation and insolvency cases. One experienced attorney remarked that in a corporate rehabilitation case, he would be more suspicious of appraiser valuation than he would of a CPA's financial report.

[52] Price Waterhouse Coopers, NPL Asia (April 2005), at 2.

The plan writers have garnered mixed reviews. While some plans have been well developed, many are written with the ostensible purpose of confusing the creditors and pulling the heartstrings of the judge hearing the case.

E. Social Dynamics

Lingering and Unhelpful Attitudes Associated with Bankruptcy Proceedings

Bankruptcy is an emotional issue. It is also difficult to fully understand. The two characteristics frequently lead to misperceptions. One particularly unhelpful emotion is the stigma surrounding bankruptcy, especially with respect to individuals. Personal bankruptcy is virtually unheard of in the Philippines. This attitude has been observed in other Asian countries as well. While the causes of this attitude have been attributed to the need to avoid loss of face and other cultural values, the effects of this no-bankruptcy attitude with individuals is less clear. In the Philippines it is not unusual for consumers to borrow money and later default on their obligations. This is reflected at least in part by the tens of thousands of bounced check cases clogging the courts. It is unclear whether the onerous criminal judgments associated with these cases are pushing debtors out of the formal economy. One of the benefits of a personal bankruptcy regime is that it provides heavily indebted consumers with a way back into the formal economy. Until attitudes about personal bankruptcy change, opportunities for renewal through bankruptcy will be sorely underutilized.

Another unhelpful attitude is the characterization of the debtor as a patient needing care and the creditor as either the viruses making the patient sick, or the greedy relatives waiting for the patient to die. Under this view, the courts and the receiver are the doctors entrusted to save the patient and to avert knock-on economic catastrophe. These metaphors often lace media discussion of bankruptcy issues in the Philippines and they often work their way into rehabilitation plans and even judicial opinions.[53]

Difficulties in Passing Legislation on Bankruptcy Reform

Bills purporting to offer comprehensive reform of the Philippines bankruptcy regime have been pending in Congress since at least 2000. As yet, none has come close to passage. The Philippines remains one of the few countries in the region that has not passed comprehensive insolvency reform legislation in the wake of the Asian financial crisis. Several observers are convinced that no new legislation will be passed in the next several years.

The failure to enact comprehensive bankruptcy reform has been attributed to several factors:

- The absence of a financial crisis: The financial crises in Indonesia and Thailand helped make insolvency law reform more politically acceptable in those countries.
- The lack of a focused legislative or private sector champion: The interests potentially affected by bankruptcy legislation are diverse and hard to identify. The most obvious private sector group—banks—has multiple interests other than bankruptcy reform and tends to look at the issue primarily from the perspective of protecting secured creditor rights rather than comprehensive reform.

[53] A paradigm more instructive than "debtor versus creditor" is "creditor versus owner." The negotiations in many in-court and out-of-court restructurings boil down to an attempt by the owner or owners to minimize their dilution while persuading the creditors to make concessions on their claims. Put in this light, the bias against creditors is less compelling. Owners differ from creditors only in their expectations of profit and their willingness to take risk. In a successful company, owners get rich while creditors merely get paid back. On the other hand, when misfortune calls, owners should absorb the losses before their creditors are forced to.

- Complexity of the bills before Congress: The bills before the Philippine Congress are broad in scope and include detailed procedures on how bankruptcy cases should be adjudicated. This detail and complexity hamper efforts of committees and legislators come to general consensus on a bill that should move forward. The emphasis on writing procedures in Congress is also curious in that the Philippine constitution makes the promulgation of procedures a power of the Supreme Court.[54]
- Legislators favoring debtors: Several legislators have expressed biases toward protecting the rights of debtors in insolvency proceedings. This erodes the possibility that pro-creditor legislation will be adopted.

In short, legislation develops in the Philippines relatively slowly. Numerous bills compete for the attention of the legislators and the President. Under this environment, it is difficult to imagine bankruptcy reform legislation moving to the front of the pack.

A Growing Reluctance to Use the Courts

In the meantime, bankruptcy participants are voting with their feet when it comes to in-court debt resolution procedures. Over the past several years, non-performing loans against perhaps thousands of companies have been sold to foreign or specialized investors. At the same time the number of rehabilitation cases that one can identify as actually moving forward in any real manner amount to 50 or fewer. The number of Insolvency Act cases is estimated at far fewer than that. The market has decided that there are better ways than in-court proceedings to resolve indebtedness.

This is unfortunate, as in-court proceedings offer arrangements that the private sector cannot replicate. In-court rehabilitation proceedings allow creditors to negotiate a plan while not having to worry that other creditors are moving against the debtor unilaterally. Once approved by the requisite majority and ratified by the court, a rehabilitation plan binds the minority, dissenting creditors, something impossible to do through contractual provisions outside of court.

With regard to corporate liquidation and dissolution, each year thousands of companies just stop operating without bothering to clean up their affairs or properly pay off debts and distribute assets. This leads to creditors' rights being compromised as assets disappear with claims remaining unpaid. Alternatively, it often results in assets being underutilized as they remain locked up in non-operating companies. Finally, it leads to judicial inefficiencies as individual debtors pursue claims against these companies when they could have done it more efficiently through a collective proceeding.

Despite these benefits, private parties are under using the courts. If the costs and risks associated with in-court proceedings could be ameliorated, then more cases would be resolved properly, and greater benefits would flow to society.

F. Recommendations

This report makes the following recommendations:

- *A closer look at corporate rehabilitation cases*. The past six years of litigating corporate rehabilitation cases in the Philippines likely offers many lessons on how the system could work better. This data needs to be mined and analyzed closely.

[54] Philippine Constitution, Article VIII, Section 5(5).

- *Amendments to the Interim Rules*. Based on the results of the study suggested above, the Interim Rules should be amended with the goal of increasing efficiency and shoring up creditor rights. It should be noted, however, that certain shortcomings with respect to corporate rehabilitation can only be addressed by legislation. For example, in most modern bankruptcy regimes, the rejection of a rehabilitation plan usually results in a seamless conversion to liquidation proceedings under the same case. The stay on claims continues and the rehabilitation receiver often becomes the liquidator. Such an arrangement promotes expediency and efficiency. If possible, it should be adopted in the Philippines.
- *A 10-page bankruptcy bill*. Procedural rules make up a very large portion of the bankruptcy bills that have been before Congress, none of which have made much headway. It would be unorthodox, but not impossible, to write a bankruptcy bill that focuses almost entirely on substantive rights, leaving all procedures to the Supreme Court (which has both the expertise and constitutional authority to promulgate court procedures). This would allow more legislators to have a meaningful debate on what a bankruptcy law should, or should not, accomplish. Such a bill may also spur passage in Congress.
- *Specialized bankruptcy case tracking*. Bankruptcy cases are very different from a typical party-A-versus-party-B dispute. Case tracking software and other methods of monitoring judicial performance often fail to take the differences in bankruptcy into account. Increased efforts to track the progress of bankruptcy cases, despite this challenge, will likely spur increased performance by the judges hearing these cases.
- *Consolidation of the courts hearing corporate rehabilitation cases*. While some of the 60 commercial court judges are hearing several corporate rehabilitation cases, there are many, especially outside the major metropolitan areas, where such cases make up only a small portion of the docket. Such infrequency hampers the buildup of relevant expertise. The number of courts authorized to hear these cases should be reduced, resulting in fewer judges hearing more cases of this type. This would likely increase judicial expertise and efficiency.

VII. Competition Law and Policy

A. Introduction

Competition law goes by many names, such as antimonopoly law, combinations law, price discrimination, and others. Collectively, these prohibit or restrict acts or practices that result in limits on the choices of prices and products available to consumers by unlawfully restricting access of competition to the marketplace. Consumer and national welfare is enhanced where open markets permit both incumbent firms and newer entrepreneurs to compete openly for consumer favor through different combinations of price, quality, and innovation. The ultimate aim of competition law is not to license or favor a particular form of commerce, but to protect the process of natural market and entrepreneurial forces. Competition laws address such trade restraints as collusive agreements between competitors on price or market allocation, abuse of market dominance or monopolization in certain circumstances, and potentially anticompetitive mergers and acquisitions of competitors. An open and free marketplace promotes economic growth and development and may lead to greater direct foreign investment attracted by the potential for expanding domestic and international trade.

The Philippines should be fertile ground for a national competition law and policy. The country experienced nearly a half-century of rule under the legal and political traditions of the United States. The Philippines Constitution recognizes the "indispensable role of the private sector (and) encourages private enterprise."[55] It authorizes the state to regulate or prohibit monopolies when the public interest so requires, and disallows any combinations in restraint of trade or unfair competition.[56] Yet the Philippines has neither a comprehensive law of competition nor a specialized enforcement entity.

Some Philippine laws and government entities are vested with authority to challenge trade restraints, and these laws provide remedies. There is, however, no substantive Philippine jurisprudence on competition because virtually no cases have been litigated. Litigation of cases also would be difficult because the law does not define, explain, or establish criteria for what constitutes the elements of a violation. While there are specific sectors that have made headway to open competition, there is no central government authority responsible for competition law or policy. At present, a national competition law—or an agency to enforce it—is not a high priority with the current administration or with Philippine lawmakers. Consequently, political will is insufficient to push forward one of the several existing draft competition laws pending in the Philippine House and Senate. Moreover, there is no widespread public constituency for competition law, and little public understanding of its potential benefits to consumers and new business entrants. This apparent domestic complacency contrasts with the Philippines' sensitivity about its role as a regional economic and political influence. In the ASEAN trade organization, where the common goal is a single market, the Philippines is falling behind as other member states that have adopted competition laws are developing a body of law and experience.

B. Legal Framework

At the level of national legislation of broad application there are five important enactments that relate to competition law and policy:

[55] Constitution of the Republic of the Philippines, Article II, Section 20.
[56] Id. at Article XII, Section 19.

Section 186 of Act 3815 (l930), as amended, the Revised Penal Code. This section resembles section two of the U.S. Sherman Act and makes monopolies and combinations in restraint of trade criminal violations. Illegal monopolies are defined as monopolizing any merchandise or object of trade or commerce, or combining with anyone else to do so, in order to alter the price thereof by spreading false rumors or making use of any other artifice to restrain free competition in the market. Illegal combinations in restraint of trade are: "1) any agreement, whether in the form of a contract or conspiracy or combination in the form of trust or otherwise, resulting in the restraint of trade or commerce; (2) preventing by artificial means free competition in the market; or (3) any manner of combination, conspiracy or agreement between or among manufacturers, producers, processor, or importers of any merchandise or object of commerce, or with any other persons, for the purpose of making transactions prejudicial to lawful commerce, or increasing the market price of such merchandise or object of commerce or any other article in the manufacture, production, or processing, or importation or which such merchandise or object of commerce is used." This law is enforced by the Department of Justice, and proof of a violation must be established beyond a reasonable doubt, as in the United States. (In the event that a criminal action fails to result in guilt, a civil action can be commenced on the same facts, but with the burden of proof reduced to a preponderance of the evidence.) The penalties available for violations of this law include a range of prison terms and/or statutory fines.

This law suffers many deficiencies. It does not define the terms *monopoly*, *contract*, *combination*, or *conspiracy in restraint of trade*, and it does distinguish differences between and among these terms. The law does not define an unlawful cartel or other monopolizing organization. It does not indicate a requirement for anticompetitive effects in any situation, nor does it shed any light on the Constitution's admonition that unlawful monopolies must somehow offend an undefined public interest. The statute includes terminology that does not lend itself to clear criminal proceedings, such as:

- "Altering a price by spreading false rumors"
- Making use of "any other artifice to restrain free competition"
- "Preventing by artificial means" free competition in the market
- Actions for the purpose of making "transactions prejudicial to lawful commerce"
- "Actions increasing the market price..."

The Consumer Act of the Philippines. R.A. 7394 (1932) imposes penalties for deceptive, unfair, and unconscionable sales practices in both goods and credit transactions. Other provisions relate to product quality and safety standards. This is a bustling area of the law for the Bureau of Trade Regulation and Consumer Protection of the Department of Trade and Industry (DTI), an agency with an interest in any new competition agency. Given the country's population, the Philippines is a huge marketplace for consumer products and any alleged fraud. DTI maintains a consumer hotline with multiple operators, and disseminates consumer education materials. There is vigorous discussion about and controversy surrounding efforts to establish and regulate consumer credit transactions.

R.A. 386 (1949). This Act imposes civil liability for unfair competition, a term that is not defined, but which results "through the use of force, deceit, machination, or other unjust, oppressive or highhanded method." This law contemplates a treble damage civil lawsuit by "the person suffering damage." Because in the Philippines a government entity possesses investigative authority over all businesses over which it has jurisdiction, these civil law provisions may also empower any government office willing to investigate. None has yet chosen this course.

R.A. 7591 (1991). The Act protects consumers by making price manipulation illegal, whether through hoarding, profiteering, or cartels. At first blush, this might be characterized as a civil anti-cartel law. However, the legislation is actually a price stabilization safeguard. The law helps stabilize the prices of

basic necessities and prime commodities and prescribes measures against abusive price increases during emergencies and other critical situations through price controls and mandated price ceiling mechanisms. Price increases by a dominant firm might conceivably be viewed as an abuse of its dominance, or an increase in price by a cartel might be challengeable. There are no standards or criteria set out in the law for assessing market conditions (particularly entry conditions), or competitive effects. If anything, the law would seem to stand for the proposition that stable prices serve the public interest.

Philippine Corporation Code *Batas Pambansa Bilang 68* (1980). This law provides for rules and procedures to approve all combinations, mergers, and consolidations. The SEC reviews financial statements and is responsible for detecting fraud or abuse. However, the law carries no mandate to examine the potential competitive effects of proposed transactions. Instead, the SEC inquiry is into whether the public interest is served by gains in efficiencies. As a practical matter, the Philippines has no merger law as it is understood in the world competition community. Substantial mergers have taken place without any determination of their effect on competition. (The SEC also has authority over insider trading and manipulation of security prices (*Batas Pambansa Blg* 178, (1982)).

In addition to these five main laws, a number of laws regulate competition in various specific situations or industry sectors, discussed below. In addition, there is a law directed to intellectual property and related laws applicable to patents, trademarks, and copyrights (R.A. 8293 (1997)). There are regulations of banks and banking. As befits an island trading nation, there are a host of regulations on imports, particularly as they relate to alleged dumping of foreign goods (R.A. 8752, (1999)).

None of the main competition laws has reached the Philippine courts, but on at least two occasions, the Supreme Court has dealt with competition issues. It has discussed at length its understanding of the Constitutional proscriptions, including some discussion of the economic underpinnings of antitrust law. These cases also show deference to and reliance on U.S. primary and secondary legal authorities for analysis and conclusions in this field. In one case,[57] the Court dealt with a situation where a rival beer manufacturer acquired enough stock in the San Miguel Beer company to obtain a seat on its board of directors. San Miguel's board produced by-laws that led to the ouster of the intruder, on the grounds that a competitor's presence on the board compromised San Miguel's ability to compete. The Philippine SEC agreed and upheld the ouster of the director, who obtained review of this quasi-judicial administrative decision before the Supreme Court. In U.S. terms, this was an interlocking directorate between competing firms, unlawful under U.S. law unless the competitive product or service overlap is *de minimus*. The Court caught the point of this law in noting, "A common director of two or more competing corporations would have access to confidential sales, pricing, and marketing information and could be in a position to coordinate policies or to aid one corporation at the expense of the other, thereby stifling competition." The Court concluded that a by-law barring a competitor from sitting on a board of directors was valid and reasonable.

The second case was significant in that it ruled unconstitutional the law purporting to deregulate the downstream market for petroleum distribution. It did so largely on competition policy grounds. The decision justifies itself as pro-consumer, and rests its rulings on failure to pay sufficient heed to the Constitution's proscriptions against monopolies that are not operating in the public interest. In this case, petroleum refining was under the control of only three foreign firms. The Court's view was that the new law was insufficient to assure the legislative intent of increased competition downstream:

> A market controlled by one player (monopoly) or dominated by a handful of players (oligopoly) is hardly the market where honest-to-goodness competition will prevail. Monopolistic or oligopolistic markets deserve our careful scrutiny and laws which

[57] Gokongwell v. SEC, et al. G.R. No. L-45911, 89 SCRA 339 (1979).

> barricade the entry points of new players in the market should be viewed with suspicion.[58]

The Court criticized key features of the law, including one provision that it claimed failed in its avowed purpose to ban predatory pricing to deter new entry. Local commentators on this decision believe it wrongly describes the economics of this market, even if it reaches the "right" result in favor of more comprehensive deregulation. Congress quickly adopted new legislation that is discussed later.

Summaries of Pending Competition Legislation

As has been the case for many years, numerous legislative proposals regarding competition are pending before the Philippine Congress. These proposals commonly address three themes. First, they either attempt to define the elements of restraints of trade or list additional offenses to those named in existing statutes. Second, many proposals call for creation of a Free Trade or Fair Trade Commission to implement the law. Third, most proposals establish tough new remedies in recognition of the total inadequacy of existing ones. Some of the current proposals include:

Senate Bill 210 (**Fair Trade Act of 2004**), introduced by Senator S. R. Osmena III, consolidates existing antitrust laws and defines price regulation, monopolies, and mergers and acquisitions. It also establishes a Fair Trade Commission, housed under the Department of Trade and Industry. The Fair Trade Commission, along with local law enforcement agencies, would investigate and impose penalties for antitrust violations. Penalties range from suspending business practices to significant fines. The Department of Justice and Office of the Solicitor assist with enforcing the Act. Workers associations, authors and artists, and exporters are exempt. The Act also contains a procedure for pre-merger notification.

More than one bill amends the **Price Act, R.A. 7851. Senate Bill 272**, also introduced by Senator S. R. Osmena III amends the Price Act to define a *prima facie* cartelization case to assist with the enforcement of the prohibition of cartels. **Senate Bill 512**, introduced by Hon. Manuel D. Villar, Jr., amends the Price Act to strengthen penalties for cartels, up to life in prison and a fine of Php 5 million.

Senate Bill 511 (**Philippine Anti-Trust Act of 2004**), also introduced by Hon. Manuel D. Villar, Jr., "seeks to provide for more effective implementation of the constitutional mandate against monopolies, combinations in restraint of trade, and unfair methods of competition by redefining and strengthening the existing laws, processes, and structures governing the same." It has specific prohibitions for telecommunication, public utilities, and banking. Penalties can be up to 10 years in prison and Php 1 million for an individual, and up to Php 100 million for a corporation. It establishes an Antitrust Commission to investigate and enforce the Act. Regional Trial Courts are given jurisdiction over antitrust cases.

Senate Bill 1199 and House Bill 2958 (**Philippine Anti-Trust Act**), introduced by Senator Juan Ponce Enrile and Representatives Egdar L. Valdez, Ernesto C. Pablo, and Sunny R.A. Madamba, specifically penalize illegal combinations or conspiracies in restraint of trade, monopolies, price discrimination, lease/sale contracts, stock or asset acquisitions, and board memberships in competing corporate bodies. Cases are filed by the Secretary of Justice in Regional Trial Courts. Criminal penalties range from up to five years in prison and Php 1 to 10 million. Civil penalties can be up to five times that amount. Labor, agriculture, and horticulture are exempt from penalties.

[58] Tatad v. Lagman, et al., G.R. No. L-124360 and 17867, Decision en banc, 5 November, 1997.

House Bill 116 (**Philippine Competition Act**), introduced by Joey Sarte Salceda, sets the rules for competition law and creates the Philippine Competition Commission. It specifically prohibits and/or defines the following trade practices: agreements in relation to prices and quantity, "boycotts secondary," misuses of market power, monopolies, resale price maintenance, withholding supplies, "statement of the minimum price," and acquisitions. The Philippine Competition Commission investigates and enforces the trade practices above. Penalties for refusing to cooperate in an investigation can be up to Php 250,000 and/or one year in prison. For violating the Act, small companies can be fined up to Php 1 million, medium companies up to Php 5 million, and large companies up to Php 10 million. Other penalties include: recovering business damages, cease and desist, retraining orders, and divestiture.

There appears to be no shortage of Philippine law on the subject of competition. Why is this law perceived as so insufficient that new legislation is necessary?

First, competition law is spread around numerous agencies. Investigative powers are vested in the governmental bodies that have jurisdiction over particular industries or economic sectors. There is little hope that a coherent understanding—much less application—of competition policy can emerge from such diverse and diffuse sources. Legislative proposals gravitate towards a single national agency that co-authors hope can make sense of an area of law in which no one has had much experience.

Second, there is inadequate Philippine jurisprudence to guide the judicial interpretation of the competition laws. The laws are untried and untested. There is vagueness and lack of clarity in the laws, and no training in or understanding of their meaning or application. Monopoly is not illegal per se, but only when it is contrary to the "public interest," but the law provides no guidance as to the public interest. Criminal proceedings requiring proof of guilt beyond a reasonable doubt are particularly vulnerable because of the lack of definition in what constitutes unlawful conduct. Monetary penalties are modest, hardly justifying the expense of litigation. Legislative proposals advance much stronger remedies, but may add confusion by expanding lists of acts and practices that may be deemed illegal. The United States faced this dilemma when the general formulations of the Sherman Act gave way to efforts to expand the range of violations, in the Clayton and Federal Trade Commission (FTC) Acts.

C. Implementing Institutions

As there is at best limited jurisprudence with respect to competition law and no national competition authority, discussion of the implementation of competition law and policy must turn elsewhere, and in the Philippines that means the regulated, or "special sectors," of the economy. Philippine law has rules applicable to agriculture, civil aviation, electrical energy, maritime shipping and ports, petroleum, telecommunications, and even water-borne commerce, among others.

To the extent that competition is being witnessed in major Philippine industries, it is primarily in the regulated, special sector industries, each subject to its own legislative mandate. If this trend continues and competition does spread throughout the regulated sectors, to the benefit of consumers in terms of choices of prices and quality, the case could eventually be made that a national approach across all fields of commerce might be a wise policy choice. Particularly if consumer welfare were enhanced in practical terms, citizens might support incremental efforts to increase competition, helping to create the political will to promote change and reform.

Heretofore, the regulated sector has been safely in the hands of regulators who are beholden to and protective of the interests they regulate, so that regulatory decisions could be counted upon to support traditional ways of doing business, the status quo. In Philippine terms, this meant the enjoyment of closed markets by powerful incumbent financial interests. This phenomenon of "regulatory capture" is well-understood in the country. In fact, it has been the primary target of those supporting reform, who have learned to maneuver around issues skillfully to neutralize the capture effect.

Telecommunications. Most interviewees cited telecommunications deregulation as the leading example of where monopoly power has yielded to a more competitive market. Through a process of legal evolution that began with two Executive Orders in 1993, the nation's only telephone company, the Philippine Long Distance Telephone Company (PLDT), was required to provide interconnections between its facilities and new firm franchises. Foreign equity ownership in new firms was also allowed. International gateway operators were required to provide local exchange service as well. The result of this has been an expansion of service (mainly through cellphones), and decreases in price. PLDT remains in control of over half the domestic market.

The most recent controversy has been a proposal by the National Telecommunications Commission (NTC) to impose "significant market power obligations" on PLDT to require it to lower the cost of access to certain of its facilities that are an alleged "bottleneck" preventing the expansion of new competition into Internet services. PLDT argues that the regulator should be focused on expanding telephone service nationwide, and in attracting new investment—particularly in infrastructure—not in imposing costs on PLDT's success. This struggle continues.

Electricity. Under the Electric Power Industry Reform Act (R.A. 9136 (2001)), electricity rates set by the Energy Regulatory Commission (ERC) were deregulated, and the assets of the government-owned National Power Corporation (NPC) were to be privatized to create new competition. The law limited a single firm's share of the market to 25-30 percent. NPC represented about half the market, and the law required sale of 70 percent of its assets in power generation and transmission. Assets in the transmission business were sold to a private monopoly, Transco, which would then be required to share its business with others. Because Congress has been slow to clarify Transco's freedom to operate its business, investors have refrained from trying to obtain franchises. Sales of power generating assets (power plants) lagged at first but have expanded recently. Once the sell-offs of NPC assets have been completed, the goal of the law is to establish open access among large electricity users, such as rural electric coops and power suppliers, to spur creation of a wholesale electricity spot market.

Downstream Oil Industry Deregulation Act. (R.A. 8479 (1998)) In 1996, in R.A. 8180, the Philippines historically opened up its downstream oil distribution system to new entrants. This law removed price controls, prohibited cartelization, and liberalized the entry of new players. This law was held unconstitutional by the Supreme Court and quickly replaced by the existing statute. As a result of the law, 50-70 new entrants appeared in retailing, bunkering, and storage and transhipment. New entry and major new investment in the industry took place in regard to bulk sales to industry players and sale of LPG liquid propane. Predatory pricing has been made a criminal offense. Notwithstanding the fact that Philippine consumers may have more brands of gasoline to choose among, three firms still control refining in the country.

Financial Sector. The Philippine financial sector has been dominated by large commercial banks. In 1995, the government lifted a decades-old ban on most foreign banks. Restrictions have also been lifted on foreign bank control of existing domestic banks. Bank mergers have therefore proliferated, and none have been blocked. Foreign insurance companies enjoy full operating licenses as required by the WTO, and 1997 legislation eased restrictions on foreign investment in finance companies and investment houses.

Civil Aviation. International passenger travel by air from Asia to the Philippines has been dominated by Philippine Airlines, which has effective control of access to Manila's main airport. As a result, the supply of seats is constrained, flight choices are limited and prices are high. The Philippines has the most airports and least number of international flights anywhere in Southeast Asia. The Civil Aeronautics Board (CAB) is a prime example of "regulatory capture" to its critics, assuring that competing airlines do not have full access to Manila's main airport. Reformers have succeeded in arguing that secondary airfields—such as the former U.S. airbase at Clark Field, 56 miles outside Manila—would benefit from greater air traffic, by simply opening up to outside carriers. The result has been a tremendous increase in the number of Asian discount charter air passengers coming into the country on such carriers as Asiana, Tiger, Hong Kong and Air Asia, an increase from 7,000 persons in 2003 to 500,000 in 2006. Recently, however, the President issued an Executive Order limiting access to Clark.

Domestic Maritime Shipping. As an island nation, the Philippines depends on domestic maritime shipping. The island of Luzon has the largest population, and is the major producer of beef and poultry. Rural Mindanao in the South is a major producer of fruits and vegetables, including corn. (Two-thirds of the Philippines' yellow corn production is in Mindanao, and 53 percent of all yellow corn produced in the Philippines is consumed by livestock and poultry in Luzon.) As a result, the Philippines' major domestic agricultural trade is between these two islands, the nation's largest. Previously, ships using inter-island trade routes faced the need to use stevedores and cargo loading terminal facilities to move cargo, at a cost equal to 46 percent of sea transport costs. This system was largely maintained by the Philippines Ports Authority (PPA), which received 10 percent of the cargo handling costs as a fee. Reformers came into this situation allied with farmers, Mindanao politicians, exporters, and the support of the Development Bank of the Philippines' Sustainable Logistic Development Program (SLDP). The reform movement backed "Roll-on, Roll-off" or RO-RO vessels that eliminated cargo handling by allowing trucks, cars, and buses simply to drive onto specially designed ships to be carried along with their cargo and passengers to the ultimate destination. This innovation was authorized by President Arroyo's Executive Order 170 in early 2003, creating the Strong Republic National Highway—a 919-kilometer route between the major Philippine islands, with Luzon the northern terminus, and Mindanao the southern. The advantages of RO-RO are the almost total elimination of cargo handling costs, faster turnaround of vessels, reduced efforts in collecting usage and freight charges, less cost in maintenance of port facilities, and less need to inspect and verify cargo quantities loaded and unloaded. Both business and consumers gained through the reduction in the cost of sea transport and the viable operation of significant new RO-RO tonnage. Instead of one maritime freight carrier, there are now several.

D. Supporting Institutions

Starting with existing government entities, the Department of Trade and Industry has long supported reform and operates as a kind of repository of information gathered from participation in various workshops and seminars and conferences. DTI would aspire to be the parent ministry of any new competition authority. According to interviewees, DTI's main goal now is to try to bring together a number of different pending legislative proposals to form a single proposal that would serve as a "government bill."

The National Economic Development Authority (NEDA) is the central planning agency of the Philippine government. The President has charged NEDA with accelerating consideration of whether new competition law is needed, or whether existing law or amended law is sufficient. Presently, NEDA is circumspect about the likely outcome of its study of the adequacy of existing competition law.

The Tariff Commission has previously been a source of support for legal reform, and is a rival to DTI as a parent agency for a competition body. The Tariff Commission is reported to be working with the

Australian government on a new law. Many legal reform advocates were previously associated with the Tariff Commission.

While there are some potentially powerful supporters of legislative change, it is likely that there would be some government opposition. For example, special sector regulatory agencies could strongly assert, for the industries under their jurisdiction, that additional legislation is unnecessary. Given the strong political undercurrents related to regulatory capture by both the regulators and the regulated, these claims must be carefully evaluated. In the present Philippine economy, however, experiments with competition that have measurable benefits are more likely to be seen in specific sectors than in the general economy.

Lawyers and economists are groups one would expect to have a view on these matters, and among the leaders of reform in competition law are representatives of both professions. Yet the Integrated Bar of the Philippines does not have a competition committee or working group, and the law schools do not offer the subject in their catalogs (they do offer consumer protection law as an elective). Undergraduate economics courses often use standard American textbooks that hold a chapter or two on the subject. Economists are often educated in the United States and have exposure to microeconomics and public policy issues. Many of these economists, along with lawyer allies, have found voice in such think tanks as the Philippine Institute for Development Studies (PIDS), which led to the 2002 publication, *Toward a National Competition Policy for the Philippines*. This volume contains a number of studies that highlight the role of new competition in the specially-regulated sectors.

The Philippine media pays attention to competition issues and reports on the introduction of new legislation and ongoing proceedings before regulatory agencies. News reports in the business press also reviewed some of the studies sponsored by PIDS, including such issues as whether a “culture of competition” is missing in Philippine society on account of the long economic dominance of a very few interests. It cannot be said, however, that the press is a source of pressure to achieve reforms. Further, allegations are made that the press can be financially induced to write articles favorable to particular points of view.

Within the foreign business community, the sense is that the Philippine economy was closed to outside competition and investment to a significant degree. One estimate was that potential annual investments as high as US$8-9 billion were being withheld by European businesses alone, because of the uncertainties of doing business. The Philippine economy was described as locked down by a small minority that benefited greatly from the status quo. While welcoming money from outside, entrenched interests were unwilling to accelerate investment flow by any modifications to the existing legal structure at their expense. The incumbent interests have no desire for increased competition.

E. Social Dynamics

It is said that the Philippine domestic economy is dominated by an oligarchy of a few dozen families. Some trace their origins to the system of *haciendas*, or landed estates, maintained by Spain during its 377 years of colonial rule. The top 5.5 percent of landholding families own 44 percent of all tillable land, and the richest 15 percent of all families control 52.5 percent of the national income. Vestiges of this hold over wealth are visible in monopolies and oligopolies in such agricultural products as rice and flour, and other basic products such as cement, iron and steel, fertilizer, pulp and paper, tobacco, tire manufacture, cable television, and production of home appliances. Also included are such highly concentrated industries as domestic maritime shipping, civil aviation, petroleum distribution, electricity, and telecommunications.

Business interests are opposed to any improvement in the competition law picture. They perceive competition law as anti-business, laden with red tape and costly regulation, and a threat to established customs and traditions in many native businesses and industries.

Philippine society may not lack for competition laws, but some hypothesize that it lacks a culture of competition, i.e., a societal appreciation for the fact that the give and take of the free marketplace produces combinations of goods, services, quality, and prices that permit consumers to make decisions. If true, this observation may reflect long acceptance of basic control of the consumer economy in very few hands, and lack of familiarity with multiple sellers having to contend for consumer favor on the basis of price and quality.

One also has the impression that even if the Philippines adopted competition policy, it might not apply it vigorously. Competition is perceived as a threat to the established order; there is a view that the national wealth should be enjoyed locally, rather than employed in economic expansion. The current situation threatens the ability of the Philippines to fuel economic growth and development by maintaining an attractive marketplace for foreign investment. Just as the Philippines Constitution declares support of competition and opposition to monopoly, it sounds a nationalistic tone in favor of Filipino control and ownership. "The state shall develop a self-reliant and independent national economy effectively controlled by Filipinos."[59] Foreigners are limited in their ability to own land or to own any equity interest in the mass media. Ownership is limited to a minority share in public utilities, advertising, and natural resources. Foreigners are expected to use Filipino labor and materials. In addition, the State is mandated "to protect Filipino enterprises against unfair foreign competition and trade practices."[60]

As a result of these and other restrictions on doing business in the country, the Philippines lags behind other countries in the region in its attraction of foreign direct investment (FDI). A United Nations Conference on Trade and Development (UNCTAD) study determined that in 2004, the Philippines was 15th of 16th among Asian economies in its attractiveness of FDI.

F. Recommendations

This report makes the following recommendations:

- The Philippines should consider steps to allow increased competition to assure its future growth and development, and to attract foreign direct investment.
- The Philippines should review the models provided by others in the region to achieve this end. ASEAN partners Indonesia, Thailand, Vietnam, and Singapore have competition laws that the Philippines may consider. The Philippines should be in the forefront as ASEAN moves towards construction of a single market, as greater trade will contribute to greater competition.
- Efforts should continue to encourage the expansion of competition into the special sectors, where consumer welfare and business entry effects can be achieved and studied. This is a hard fight, involving regulatory capture issues, conflicting political priorities, and shifting alliances of interests. But if, as a result of this process, benefits to the Philippine people and its economy can be demonstrated, the argument for the national law will be made easier.

[59] Id. at Article II, Section 19.
[60] Id. at Article XII, Section 1.

VIII. Commercial Dispute Resolution

A. Introduction

Systems for commercial dispute resolution consist not only of a county's courts of various levels, but also of out-of-court processes such as arbitration and mediation, as well as more informal, local, and customary processes. Whether or not foreign companies, for example, operate in a country depends at least in part upon whether they feel their investments are legally protected. The survival of local companies often depends on the swift and transparent enforcement of obligations, without which they often do not have the resources to survive.

The CDR situation in the Philippines is mixed. In many ways, CDR is more advanced than in other nations in the region. The legal architecture promoting alternative dispute resolution (ADR) continues to develop, but the use of this resource has been slow. Certain sectors, like the construction industry, have mechanisms that provide for a specialized commission with exclusive and original jurisdiction over relevant disputes. Contracts involving foreign direct investment often contain arbitration clauses that permit adjudication in foreign venues. Arbitration clauses are, for the most part, enforced by Philippine courts.

Any reforms of the CDR process in the Philippines should attempt to enhance the predictability, efficiency, and justness of the system. The Philippine legal education system has begun to incorporate mediation and arbitration into its curriculum, but not yet at a rate that would change cultural attitudes against non-court dispute resolutions. Further, the lack of technical expertise by courts handling these disputes presents a serious impediment to the court system's ability to resolve them in a way that would not deter both domestic and international actors from investing in the Philippines.

B. Legal Framework

The Philippines is governed under a **Constitution** that was adopted in 1987. Its Supreme Court, established in 1901, issues binding opinions that have the force of law and has the power to overturn unconstitutional laws passed by the Philippines' bicameral legislature. While its legal system contains elements of both the civil code and common law, "most of the more significant laws governing trade and commerce, taxation, labor relations, and governmental operations, as well as the principle of judicial precedents are an American derivation."[61]

There are several potential avenues to resolve commercial disputes. Even though the Philippine court system contains two specialized courts with specific expertise to handle tax and public corruption cases, there is no specialized court for domestic or foreign commercial disputes sufficient enough to assuage concerns by potential litigants and investors about the efficiency and efficacy of the court system. However, several administrative agencies like the SEC, the Intellectual Property Office, the Board of Investments, and the Construction Industry Arbitration Commission have statutory mandates to hear specialized disputes.

Alternative dispute resolution is also promoted as a viable, and in many ways preferable, form of settling civil disputes. The **Alternative Dispute Resolution Act of 2004** (ADRA) states that "it is hereby declared the policy of the State to actively promote party autonomy in the resolution of disputes or the

[61] ABA-Asia Law Initiative, *Judicial Reform Index for the Philippines* (2006), *p. 6.*

freedom of the party to make their own arrangements to resolve their disputes."[62] Section 25 states that "[i]n interpreting the Act, the court shall have due regard to the policy of the law in favor of arbitration." Several international actors, including USAID's Legal Accountability and Dispute Resolution Project, helped craft the Act.

The ADRA represents a major step toward institutionalizing ADR as part of the Philippine legal architecture. The ADRA modified the previous major arbitration law enacted in 1953, and provides more guidance for international arbitration than the 1953 law. As stated in the ADRA, however, domestic arbitration shall continue to be governed by the 1953 law as amended by the ADRA.[63] Importantly, that chapter of the law incorporates in domestic arbitration many of the elements that apply to international arbitration.[64]

International Commercial Arbitration (ICA) is governed by chapter 4 of the ADRA, which states that the UN's Model Law on International Commercial Arbitration will control the arbitration process.[65] Chapter 4 adopts a broad definition of "commercial"; it appears several types of international disputes will be subject to the Act.[66] ("An arbitration is 'commercial' if it covers matters arising from all relationships of a commercial nature, whether contractual or not.") Chapter 4 leaves open for interpretation several issues regarding its relationship to the UN's Model Law. These issues, relating to how the Model Law will be interpreted in the Philippines, presumably will be decided by the Supreme Court.[67]

The ADRA also governs the recognition and enforcement of foreign arbitral awards, and states that the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) applies.[68] The Philippines acceded to the New York Convention in 1958, but the ADRA provides domestic implementing legislation for it. Foreign arbitral awards, when confirmed by the relevant Regional Trial Court in the Philippines, shall be enforced "in the same manner as final and executory decisions of courts of law of the Philippines."[69] With this language, the ADRA distinguishes foreign arbitral awards from foreign judgments.[70] Decisions by Regional Trial Courts with respect to foreign arbitral awards may be appealed to the Court of Appeals.[71]

Like the chapter on mediation, chapter 4 also provides for confidentiality of the proceedings. Section 23 states that the "arbitration proceedings, including the records, evidence and the arbitral award, shall be confidential and shall not be published except (1) with the consent of the parties, or (2) for the limited purpose of disclosing to the court relevant documents in cases where resort to the court is allowed

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62 R.A. 9285 (Apr. 2, 2004)

63 ADRA Sec. 32.

64 Id. at Sec. 33.

65 Id. at Sec. 19.

66 Id. at Sec. 21.

67 See Leslie Chew, "The New Philippine Arbitration Law: Some Preliminary Observations," 31 J. Integrated Bar of the Philippines 75, 77 (2005).

68 Id. at Sec. 42.

69 Id. at A Sec. 44.

70 See id. "A foreign arbitral award when confirmed by a court of a foreign country, shall be recognized and enforced as a foreign arbitral award and not a judgment of a foreign court."

71 Id. at Sec. 46.

herein."[72] If the latter exception to confidentiality applies, the court to which the information has been disclosed may issue a protective order to prevent further disclosure.

The Alternative Dispute Resolution Act of 2004 reaffirms that "[t]he arbitration of construction disputes shall be governed by Executive Order 1008, otherwise known as the Construction Industry Arbitration Law."[73] E.O. 1008 grants original and exclusive jurisdiction of construction disputes to the Construction Industry Arbitration Commission. A party may appeal a Commission decision to the Court of Appeals.

Chapter 2 of the ADRA governs non-court-annexed mediation. Among the highlights of this chapter is that a settlement agreement achieved through mediation may be deposited with the clerk of the appropriate Regional Trial Court; any party may petition this Court to enforce the settlement agreement.[74] Court-annexed mediation tends to focus less on complex commercial disputes and more on familial civil disputes, local civil disputes, collection cases, and other types of low-dollar value disputes. While the Supreme Court has begun to allow appeals in cases involving the ADRA, it is still unclear how the Court will interpret most of the provisions of this potentially sweeping law.[75]

C. Implementing Institutions

The Philippine judiciary is not well-equipped to handle complex commercial transactions. As a result, many foreign investors will either draft provisions to settle disputes outside of the Philippine court system or avoid the country entirely. The perception of a lack of transparency and accountability at all levels of government—including the judiciary—deters foreign capital from entering the Philippines. One recent survey of expatriate businessmen in Asia placed the Philippines at the top of the list of most corrupt countries in the region and toward the bottom of the list of FDI.[76]

Besides corruption, the lack of specialized expertise in complex commercial matters has also hampered the development of CDR. Special Commercial Courts exist for particular types of commercial disputes such as intellectual property and insolvency. However, these courts do not have the capability or capacity to resolve commercial disputes to the extent that investors would view the Philippine court system as reliable and effective. Further, because these courts are still burdened by criminal cases, they are unable to specialize sufficiently.

It should come as no surprise that there has been a strong push toward resolving commercial disputes outside of the court system. There remains a shortage of qualified individuals, however, to train commercial mediators and arbitrators. The lack of accredited mediators and arbitrators who can effectively and reliably adjudicate commercial disputes inhibits investors from choosing to have their disputes resolved in the Philippines. One expert interviewed for this assessment noted that the various types of ADR (e.g., mini-trials and early expert evaluation) are like "Latin or Greek" to most of the relevant actors. Many attorneys also suggested that commercial ADR is not as popular as court litigation because attorneys receive more fees by taking a case to trial.

Various organizations are attempting to supply commercial mediators and arbitrators to fill this void. The Philippine Chamber of Commerce (PCC) has established the Philippine Dispute Resolution Center, Inc.

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[72] Id. at Sec. 23.

[73] Id. at Sec. 34.

[74] Id. at Sec. 17(c).

[75] See, e.g., Gonzalez v. Climax Mining Ltd., G.R. No. 161957 (Jan. 22, 2007); Insular Savings Bank v. Far East Bank and Trust Co., G.R. No. 141818 (June 22, 2006); Transfield Philippines, Inc. v. Luzon Hydro Corp., G.R. No. 146717 (May 19, 2006).

[76] "Philippines Most Corrupt, Survey Says," International Herald Tribune (March 13, 2007).

(PDRCI) as a non-profit organization to serve both domestic and international clients. The PDRCI also works with foreign arbitration centers in other parts of the region to make arbitration agreements more compatible across the continent.

Commercial arbitration agreements are only effective if they are well-crafted and if the Philippine court system accords them proper deference. The UNCITRAL Model Law, adopted by the Alternative Dispute Resolution Act of 2004, provides a legal framework to govern international commercial arbitration. In addition, the ADRA reinforces in modified form the previous procedure for domestic commercial arbitration.

Chapter 7 of the ADRA governs judicial review of domestic and international arbitral awards. For domestic arbitration, a party may seek judicial confirmation of an award if the opposing party does not comply with the arbitral award. Once confirmed, a domestic award "shall be enforced in the same manner as final and executory decisions of the Regional Trial Court."[77] These awards are subject to judicial review for correction and modification and appeal to the Court of Appeals for questions of law. If arbitration is undertaken pursuant to the New York Convention, that Convention controls. Even if a foreign arbitral award falls outside of the New York Convention, a court may, on "grounds of comity and reciprocity, recognize and enforce a nonconvention award as a convention award."[78] For international arbitration, "[a] decision of the Regional Trial Court confirming, vacating, setting aside, modifying or correcting an arbitral award may be appealed to the Court of Appeals."[79]

D. Supporting Institutions

One of the reasons for the lack of a judiciary with technical expertise in complex civil litigation is that judges are seriously underpaid. A judge with this type of specialization can earn much more money practicing law. There has been a recent push to increase the pay of judges, and their salaries have doubled since 2003. However, a law firm partner in Manila who specializes in complex CDR still earns much more than a trial court judge.[80]

Increased pay will help draw more qualified judicial candidates, as will more comprehensive training on pertinent topics. The Philippine Judicial Academy (PHILJA), with USAID and the Asia Foundation, has held national conferences on ADR mechanisms that accredit mediators. This first step towards developing the intellectual capital to handle commercial disputes has helped create an atmosphere of competence, but has not yet altered the perception of inefficiency and corruption held by litigants and investors.

Another effort at building this intellectual capital is being made through legal education. Judges and lawyers are subject to continuing legal education (CLE) requirements, and participation by judges is one factor considered in the promotion process. Lawyers must undertake extensive CLE training annually, much of which focuses on CDR. Law schools are beginning to incorporate ADR into their curricula, although one attorney stated that the law schools teach only mediation and not arbitration.

Several actors in the donor community emphasize the importance of developing proficient CDR mechanisms. The World Bank, for example, publishes a simple list of how a party may enforce a contract

[77] ADRA Sec. 40.
[78] Id. at Sec. 43.
[79] Id. at Sec. 46.
[80] JRI 28.

in the Philippines.[81] Groups like USAID, the Asia Foundation, AusAID, the Canadian International Development Agency, are all participating along with the World Bank in judicial reform programs. While several groups do collaborate on some of these reform programs, concern was expressed that full coordination of these efforts has not been achieved, and that therefore these programs have not reached maximum effectiveness.

Whether a party obtains a valid judgment through a court order or a court confirmation of an arbitration award, enforcement of judgments represents another inefficiency in the judicial system. Typically, sheriffs enforce judgments, but will often demand a separate "facilitation" payment from the party seeking to have the judgment enforced. Some judges prevent this practice, although demanding such payments seems to be the norm rather than the exception.

E. Social Dynamics

The social dynamics of CDR illustrate that the government, the private sector, and the donor community are willing to contribute to establishing the legal architecture to make CDR more effective and amenable to domestic and foreign investment. However, the cultural dynamics surrounding this architecture restrict much of its success.

One large law firm practitioner noted that a lack of transparency, accountability, and efficiency has led to massive unpredictability in the court system. This unpredictability causes many to suggest that their commercial clients avoid the court system when possible. This lawyer stated that "what needs to be done is to create pockets of integrity" within this system. One way to attempt to create such a pocket would be for the Supreme Court to commission a study to look into the creation of a special commercial division of a Regional Trial Court focused exclusively on commercial litigation. This pilot project, perhaps best situated in Manila, would handpick judges with demonstrated skills in case management. The primary focus of this project would be to introduce emphasize continuous trials and the full use of pre-trial procedures to increase the efficiency and predictability of this special commercial division.

Unlike court resolution, the social dynamics of mediation point to a high level of support for this form of dispute resolution. One should be careful, however, not to view mediation as a cure for all of the ills of the Philippine judiciary. Mediation takes a variety of forms, and its level of effectiveness varies depending on the type of dispute being mediated. While an accredited mediator is not required to be an attorney, it would be beneficial for a class of mediators with specialized knowledge and training to mediate commercial disputes. Such a requirement would also benefit mediation at the Court of Appeals because of the potential complexity of legal questions. Successful mediation of commercial disputes—especially those of any complexity—depends not only on the communication skills of the mediator, but also on his or her understanding of the substance of the underlying dispute.

One recent mediation innovation in the Philippines separates the process into two stages. The mediator at the first stage is not a judge. If this first mediation fails, the parties do not go directly to court. Rather, the mediation passes to a judge. Several attorneys and judges expressed reservations that this two-stage process would cause additional delay in case resolution. This concern is well-grounded, as these parties reportedly often fail to take the first stage seriously because mediation will continue anyway.

Some recent case inventory statistics suggest that the rise in mediation has decreased the backlog and congestion in the court system. Statistics that showed how mediation affected the efficient resolution of the *other* cases that continued on through the traditional litigation track, however, were not available. The common assumption is that, by decreasing the total number of cases in the court system, mediation leads

[81] See http://www.doingbusiness.org/ExploreTopics/EnforcingContracts/CaseStudy.aspx?economyid=153.

to decreased resolution time even for non-mediated cases because judges have more time to spend on them. To determine how mediation affects the overall efficiency of the court system, the Supreme Court should commission a study of the impact of mediation on all cases.

F. Recommendations

This report makes the following recommendations:

- Judges' salaries should be increased to attract candidates with advanced commercial litigation skills.
- Efforts should be taken to limit or eliminate facilitation payments to sheriffs to help ensure the transparent enforcement and collection of judgments.
- A pilot program should be established to create a Regional Trial Court focused solely on commercial litigation, with the express purpose of using already-existing pre-trial procedures and continuous trials.
- A requirement that mediators have law degrees for complex commercial disputes at trial courts and any mediation at the Court of Appeals should be instituted to assist these processes. Moreover, mediators with specific knowledge of these issues should be sought.
- The two-stage process for mediation should be abolished in favor of a unified one-stage process.
- Further analysis should be undertaken to show the impact of mediation on the timeliness of the resolution of non-mediated cases in the court system. This study would analyze whether, because courts have more time to devote to non-mediated cases, these cases are not subject to the typical delays in the court system. This study should account for mediation on a national basis.

IX. Court Administration

A. Introduction

Courts are normally the last resort for resolving commercial disputes, but when they come into play, they may be the only resort. Consequently, they are fundamental for ensuring the overall integrity of the conflict resolution systems. Properly understood, court administration—how a court operates—is a system, not an event. The proper execution of that system is of vital importance to not only the protection of an entity's interests, but also of the attractiveness of a country, region, city, and town as a place to do business.

The state of court administration in the Philippines is promising. A stable legal architecture exists to manage and resolve cases, with supporting institutions to aid in implementation. However, ineffective implementing institutions hamper the efficacy and efficiency of this legal system. At the same time, there has been a recent push toward non-court resolutions of disputes, mediation, and commercial arbitration. Any reform of the court administration process in the Philippines should attempt to close the gap between how the Philippine legal system presents itself on paper and how the system actually operates for those who engage the judiciary.

B. Legal Framework

Section One of Article VIII of the **1987 Philippine Constitution** vests the judicial power in one Supreme Court, and in such lower courts as may be established by law. It states that judicial power "includes the duty of the courts of justice to settle actual controversies involving rights which are legally demandable and enforceable, and to determine whether or not there has been a grave abuse of discretion amounting to lack or excess of jurisdiction on the part of any branch or instrumentality of the Government."

To execute this mandate, the Philippine judiciary is divided into four basic levels. First-Level courts include Metropolitan Trial Courts, Municipal Trial Courts in Cities, Municipal Trial Courts, and Municipal Circuit Trial Courts. These courts function as trial courts for civil cases and for criminal cases when metropolitan or municipal ordinances have been violated. Second-Level courts are known as the Regional Trial Courts (RTCs), with one RTC district for each of the 13 regions in the country. An RTC is a trial court with statutorily prescribed jurisdiction, residual jurisdiction from cases not tried at the First Level, and appellate jurisdiction from cases tried at the First Level. Since 1997, Family Courts have been established at the Second Level to have original jurisdiction over several types of family law cases.[82] The Third-Level Court of Appeals, organized in 23 divisions with three members in each division, takes appeals from the RTCs as well as the quasi-judicial agencies, and may review questions of fact and mixed questions of fact and law. The Court of Appeals also has jurisdiction over death penalty cases. Two other Third-Level courts that have specialized jurisdiction are the *Sandiganbayan* for anti-graft cases and the Court of Tax Appeals. In areas governed by Islamic regions or provinces, Shari'a courts offer a sanctioned parallel judicial system. Shari'a Circuit Courts (analogous to a First-Level Court) and Shari'a District Courts (analogous to a Second-Level Court) apply the Muslim Code on Personal Laws. The Third-Level Courts, which take appeals from the lower Shari'a courts, are known as the Shari'a Appellate Courts. The Fourth-Level court is the Supreme Court. Subject to narrow exceptions for certain criminal cases, there is no appeal to the Supreme Court as a matter of right.

The Supreme Court has promulgated **Rules of Court**, which "concern the protection and enforcement of constitutional rights, pleading, practice and procedure in all courts, the admission to the practice of law,

[82] ABA-Asia Law Initiative, Judicial Reform Index for the Philippines 6 (2006) (hereinafter "JRI"), at 7.

the Integrated Bar, and legal assistance to the underprivileged." These 144 Rules govern Civil Actions (Rules 2-71), Special Proceedings (Rules 72-109), Criminal Procedure (Rules 110-127), Rules of Evidence (128-134), and Legal Ethics (135-144).

Aside from this court-specific legal framework, ADR and mediation also play an important and growing role in the Philippine judiciary. As discussed in this report's chapter on CDR, the **Alternative Dispute Resolution Act of 2004** provides a framework for the settlement of disputes for ADR and non-court-annexed mediation. Court-annexed mediation began to become favored in 2001, when the Supreme Court began to issue several Supreme Court circulars, memoranda, and administrative orders that moved this form of mediation toward the center of the resolution of certain types of disputes.[83] Court-annexed mediation goes through local units of the Philippine Mediation Center, and a greater percentage of First- and Second-Level Court cases must go through this type of mediation as a pre-trial measure.[84] Failed mediation results in the case going back into the court system.

C. Implementing Institutions

Effective implementing institutions seem to be required by the 1987 Constitution, which states that "[a]ll persons shall have the right to a speedy disposition of their cases before all judicial, quasi-judicial, or administrative bodies."[85]

However, speedy disposition of cases is not one of the hallmarks of the Philippine justice system. Case backlog and clearance rates for 2005 presented high numbers of unresolved disputes.[86] Vacancy rates for First-Level Courts ranged from one quarter to one half of all positions.[87] Vacancies are especially hard to fill in the provinces. Easily disposable cases that clog dockets linger in the system through postponements and delays. The lack of efficient case management further prevents speedy disposition of cases. The lack of resources at almost all levels of the judiciary impedes the creation of a centralized docketing system, although the Court Administration Management Information Systems (CAMIS) tracks the number of cases filed and disposed of on a monthly basis. For example, a substantial portion of trial court dockets consists of cases involving bad checks. While these cases involve no technical legal issues and should be disposed of in one or (at most) two court proceedings, they are often delayed and become part of these courts' enormous backlog and step-by-step trial process.

With respect to personnel, judges may be overstaffed without being well-staffed. Relevant parties expressed concern that a judge had too many employees, but that some of these employees did not fit the particular needs of the judge's courtroom. It appears that the Supreme Court sitting *en banc* does all of the hiring for individual judges. This micro-management includes the hiring of clerks, stenographers, and other staff.

One threat to judicial independence at the trial court level in both rural and urban areas is the fact that these courts receive significant funding from the localities in which they sit. The problem with this practice is that these courts hear cases in which the same localities that fund them have an interest. Because this funding is discretionary, some trial judges expressed concerns that an adverse ruling would affect future funding.

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83 See, e.g., Circular No. 82-2001.
84 See A.M. No. 01-10-5-SC-PHILJA.
85 Art. III, Sec. 16.
86 JRI 43.
87 Id.

Most trial courts only have one computer, but it appears that three computers per court are needed to properly automate the case management system. In several instances, interviewees stated that judges were forced to buy office computers out of their personal funds. Because local governments play a major role in the funding of court personnel and premises, the number of computers per courtroom varied greatly across courts in the Philippines.

Aside from these personnel and resource issues, several sources stated that judges did not fully use existing pre-trial rules that could expedite cases and separate meritorious from frivolous lawsuits. Rules 16-18 and 23-29 provide specific guidelines for pre-trial proceedings in the Regional Trial Courts. Rule 16 governs motions to dismiss, while Rule 35 provides for summary judgment where appropriate. As in other areas of the Philippine judiciary, the legal architecture for an efficient, predictable court system is already in place. Stricter adherence to these rules by judges would lessen the case congestion at the trial level, and would not require additional qualified personnel or proper resources.

Recent judicial reforms, as seen in the Davide Watch, seek to implement the delivery of justice in a timely fashion. The Davide Watch, named after former Chief Justice Hilario Davide, established the Action Program for Judicial Reform (APJR). APJR promotes the following goals:

- Speedy and fair dispensation of justice to all
- Judicial autonomy and independence from political interference
- Improved access to judicial and legal services
- Improved quality of external inputs to the judiciary
- Efficient, effective, and continuously improving judicial institutions
- A judiciary that conducts its business with dignity, integrity, accountability, and transparency.[88]

The Supreme Court created the Program Management Office to achieve these goals. The Program Management Office publishes reports, holds seminars, and engages in similar types of activities to support the goals. The APJR works closely with multiple international aid organizations like USAID, CIDA, and the World Bank.

At the village level, minor civil and criminal matters are often resolved through the *Katarungang Pambarangay* system. One of the benefits of this system is that it is easier for poor citizens to engage with a judicial system at this local and more informal level as compared to the official court system. Where applicable, this implementing institution may be viewed as "pre-court" in the sense that a case must go through this mediation before it is allowed to advance to the court system.[89]

While these efforts represent positive steps, one of the major causes of the lack of efficiency in the Philippine court system is the piecemeal approach to appeals. Rule 65 permits petitions for *certiorari* and prohibition in a broad variety of circumstances.

> Section One of Rule 65. When any tribunal, board or officer exercising judicial or quasi-judicial functions has acted without or in excess of its or his jurisdiction, or with grave abuse of discretion amounting to lack or excess of jurisdiction, and there is no appeal, or any plain, speedy, and adequate remedy in the ordinary course of law, a person aggrieved thereby may file a verified petition in the proper court, alleging the facts with certainty and praying that judgment be rendered annulling or modifying the proceedings

88 "Action Program for Judicial Reform 2001-2006 (with Supplement)," (Aug. 2001).

89 Carmelo V. Sison & Myrna S. Feliciano, "Philippine Judicial Reforms 1987-2000," 36-37 (July 2000).

> of such tribunal, board or officer, and granting such incidental reliefs as law and justice may require.
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> Section Two of Rule 65. When the proceedings of any tribunal, corporation, board, officer or person, whether exercising judicial, quasi-judicial or ministerial functions, are without or in excess of its or his jurisdiction, or with grave abuse of discretion amounting to lack or excess of jurisdiction, and there is no appeal or any other plain, speedy, and adequate remedy in the ordinary course of law, a person aggrieved thereby may file a verified petition in the proper court, alleging the facts with certainty and praying that judgment be rendered commanding the respondent to desist from further proceedings in the action or matter specified therein, or otherwise granting such incidental reliefs as law and justice may require.

By permitting appeals for vaguely defined "grave abuse[s] of discretion," these provisions create an incentive for parties to seek review over practically any matter that a party believes was incorrectly decided by the lower level court. According to the Supreme Court:

> "Grave abuse of discretion defies exact definition, but generally refers to 'capricious or whimsical[']exercise of judgment as is equivalent to lack of jurisdiction. The abuse of discretion must be patent and gross as to amount to an evasion of positive duty or a virtual refusal to perform a duty enjoined by law, or to act at all in contemplation of law, as where the power is exercised in an arbitrary and despotic manner by reason of passion and hostility."[90]

The problem with this definition is that it is broadly applicable to a variety of non-final orders, which slows down the resolution of cases. "Grave abuse of discretion" may be contrasted with Rule 45 appeals based on questions of law. A major problem with the "grave abuse of discretion" standard unaccompanied by reasonable limits on where the phrase might apply is that a party seeking to prolong litigation can overuse this avenue of interlocutory relief in meritless circumstances.

Rule 65 "does not encompass an error of law. Nor does it include a mistake in the appreciation of the contending parties' respective evidence or the evaluation of their relative weight."[91] While the Supreme Court has made these statements, the phrase "grave abuse of discretion" permits appeals on an ill-defined range of issues. Because of the lengthy backlog of cases on the Supreme Court's docket, appeals based on Rule 65, while routinely dismissed, take up a great portion of appellate court resources and retards the resolution of disputes.[92] The Supreme Court should revise Rule 65 to streamline the appeals process. The interlocutory nature of the vaguely defined "grave abuse of discretion" leads to an unwarranted number of appeals that shut down litigation. Art. VIII, Sec. 1 of the Constitution states that "[j]udicial power includes the duty of the courts of justice to settle actual controversies involving rights which are legally demandable and enforceable, and to determine whether or not there has been a grave abuse of discretion amounting to lack or excess of jurisdiction on the part of any branch or instrumentality of the Government." Rule 65, though, permits these appeals as interlocutory rather than as final, after a case has been resolved. For purposes of efficiency, these types of appeals should occur in nearly all instances only after a final order has been issued.

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90 People of the Philippines v. Court of Appeals, G.R. No. 128986 (June 21, 1999).

91 Romy's Freight Serv. v. Castro, G.R. No. 141637 (June 8, 2006).

92 See, e.g., De Peralta v. Porras-Gallardo, G.R. No. 147688 (July 10, 2006).

D. Supporting Institutions

Supporting institutions, such as bar associations, schools, chambers of industry, etc., are numerous in the Philippines. They may be capable of bridging the implementation gap between the judiciary's structure and its functions. The Philippines Supreme Court has an education arm with a yearly budget of over US$500,000, the Philippine Judicial Academy (PHILJA). This body functions as a "training school for justices, judges, court personnel, lawyers and aspirants to judicial posts."[93] To this end, PHILJA conducts courses for aspiring, newly established, and seasoned jurists through its pre-judicature program, orientation seminars for newly appointed judges, and regional judicial career enhancement programs. PHILJA similarly provides education and training for court personnel.

PHILJA also routinely holds meetings and seminars on a variety of topics. In November 2006, for example, PHILJA held a two-day conference with USAID and the Asia Foundation on Court-Annexed/Referred Alternative Dispute Resolution Mechanisms. Several PHILJA projects are conducted with a variety of governmental and nongovernmental actors, including individual countries and intergovernmental organizations like the World Bank and the United Nations. Additionally, PHILJA provides monthly and quarterly newsletter updates for members of the legal community that discuss PHILJA's activities, recent Supreme Court opinions, resolutions, orders, and circulars, and other contemporary legal discussions. This information is disseminated through a variety of media, including PHILJA Bulletins, the *PHILJA Judicial Journal*, and electronic updates.

Working in conjunction with PHILJA is the Integrated Bar of the Philippines.[94] The Integrated Bar, a mandatory bar association created in the early 1970s, regulates all attorneys practicing in the Philippines.[95] Its goal is to "elevate the standards of the legal profession; to improve the administration of justice; and to enable the Bar to discharge its public responsibility more effectively." The roughly 40,000 members pay dues to the Integrated Bar, and the government also provides funding.

Several outside governmental and nongovernmental organizations work with PHILJA and the Integrated Bar to further support the Philippine judiciary. The Philippine Bar Association, in existence for over a century, also supports similar goals as the Integrated Bar. This voluntary organization has, for example, worked with the ABA-Asia Law Imitative (ABA-ALI) to deliver more effective continuing legal education programs. ABA-ALI is also one of the more notable supporting institutions is ABA-ALI. Since late 2003, it has been implementing a comprehensive Program in Support of Law Reform in the Philippines. Activities include supporting efforts to: (1) develop judicial and lawyer ethics codes and enforcement processes; (2) reform the legal profession, including improvements to the bar exam and mandatory continuing legal education; (3) improve legal and judicial education; (4) conduct judicial assessments and capacity building; and (5) develop an effective anti-corruption and anti-terrorism framework with maximum stakeholder input.[96]

If successful, these reforms will help to bridge the divide between the country's legal architecture and how this structure actually plays out on the ground. The ABA's *Judicial Reform Index for the Philippines* (2006) notes the problems and prospects of the Philippine judiciary. The Judicial Reform Index (JRI) rates various factors on a scale of positive, neutral, or negative. The Philippines judiciary scored well in its institutions that work to improve the way the judiciary operates. The Philippines judiciary did not

93 R.A. 8557 (Feb. 26, 1998).

94 See http://www.ibp.org.ph/.

95 See R.A. No. 6391 (Sept. 17, 1971).

96 *http://www.abanet.org/rol/asia/philippines.html*.

score well with respect to "most factors related to financial resources and efficiency of justice."[97] ABA-ALI made a point to publicize the results of this JRI through various venues like seminars and judge-to-judge dialogs. Nearly 1,000 copies of this recent JRI have already been distributed to judges and practitioners in the Philippines. ABA-Asia and PHILJA have also worked together to train judicial staff on the conduct of court personnel.

As discussed in the previous chapter, one of the primary focuses of external supporting actors emphasizes the need to streamline CDR through the increased use of ADR. USAID, the Asia Foundation, and several other organizations aid in these projects.

This brief discussion of supporting institutions has not, in the interest of space, covered the several hundred domestic and international actors working to improve the Philippines judiciary. The purpose of this brief snapshot has been to point out that the Philippines judiciary has a solid legal framework and multiple and diverse supporting institutions, yet there are still severe shortcomings in the legal system.

E. Social Dynamics

The social dynamics of court administration largely mirror those of CDR, with one important additional factor: most cases are unnecessarily delayed several times prior to their resolution. First, the continuous trial is practically unknown in the Philippines. Because attorneys are compensated by the number of appearances in a courtroom rather than by the hours expended on a case, there is an incentive to seek delays in the proceedings to increase the number of these paid appearances, regardless of how long this stretches a case. Second, the high number of judicial vacancies due to low salaries and questionable physical security for judges contribute to overloaded dockets. Over a dozen judges have been murdered in recent years. Third, the vast majority of cases go to trial rather than settle. One attorney estimated that only five percent of all cases settle prior to trial. If a case makes its way up to an appellate court, the likelihood of settlement is reduced further.

These factors contribute to an environment where trial judges routinely grant continuances at the request of attorneys. The relationship between judges and attorneys gives the appearance that the legal system is run by attorneys rather than judges. Several sources noted that attorneys often use unmerited administrative complaints against judges an intimidation tactic. These complaints often take several months to get resolved, which places a cloud of suspicion over the particular judge. Because judges do not wish to become embroiled in these controversies, they will grant continuances to attorneys who seek them out of apprehension that failure to do so will result in unpleasant consequences. One possible solution to the threat of meritless complaints is to prohibit complaints directly related to the merits of a decision or procedural ruling, as is part of civil procedure in the United States.[98] This prohibition insulates judges from judicial misconduct complaints that would arise out of refusing to grant a continuance.

In addition to delays through continuances, the judiciary's reputation is further clouded by the perception of impropriety by judges at all levels of the judiciary. Rule 137 provides for when a judge should be disqualified from a case. In addition to having a pecuniary interest in a case or relation to the parties or counsel, the Rule states that "[a] judge may, in the exercise of his sound discretion, disqualify himself from sitting in a case, for just or valid reasons other than those mentioned above." The perception of unfairness by litigants of judges relates not only to outright corruption, but also norms of patronage and reciprocity. There is widespread belief that a judge would aid litigants who had helped the judge in the past.

[97] Id. at 1.
[98] 28 U.S.C. § 352(b)(1)(A)(ii).

F. Recommendations

This report makes the following recommendations:

- Efforts to encourage stricter adherence to existing pre-trial rules promulgated by the Supreme Court should be supported to promote efficiency, settlement, and disposal of cases.
- In the interests of judicial independence and efficiency, the Supreme Court should decentralize staff hiring by delegating the process to the individual judges, or at least a lower court administrative apparatus where hiring judges could have substantial input.
- Discretionary locality funding of local trial courts should be prohibited. The budget for the judiciary would be better prepared at the federal or regional level.
- Rule 65, relating to the determination of hearing appeals, should be revised so that grave abuses of discretion are only appealable as final orders rather than as interlocutory appeals.
- Judicial misconduct complaints that are directly related to the merits of a decision or procedural ruling should be prohibited. This prohibition will help to insulate judges from judicial misconduct complaints that would arise out of refusals to grant a continuance.
- Monthly reports of case management statistics should be distributed for all First-, Second-, and Third-Level courts so that every judge on a tier will be able to access and compare the statistics of that judge's colleagues. To further decrease the use of delays in case resolution, First-, Second-, and Third-Level courts should receive monthly reports that reveal case management statistics of all the judges on their tier. For example, a Regional Trial Court judge would receive statistics from all of the Regional Trial Courts related to case backlog, number of cases with motions pending for more than six months, and number of cases three years or older. These reports have been effective in the United States federal courts for placing friendly peer pressure on judges to clear their dockets because of the wide dissemination of this information to peers.
- Revise Rule 137 from "[a] judge may, in the exercise of his sound discretion, disqualify himself from sitting in a case, for just or valid reasons other than those mentioned above" to "[a] judge may [or shall], in the exercise of his sound discretion, disqualify himself in any proceeding in which his impartiality might reasonably be questioned." A second possible solution is to strengthen the sanctions for violations of Rule 137. A strong sanction is beneficial because it allows judges to externalize their decisions to not engage in improper relations with parties.
- Require that appeals from all final orders be based on issues that were raised below, or else the appellate court should deem the issue waived.

X. Foreign Direct Investment

A. Introduction

Amid a pervasive sense that the Philippine economy is underperforming and that foreign investors face significant barriers, certain swaths of optimism still emerge. Factors that point toward "more sustainable, stronger growth" and overall improved investor confidence in 2007 and beyond include a recently reduced deficit and a decreased rate of inflation; a "remittances boom" that creates new potential markets for investors; growing opportunities in business process outsourcing and mining; and a strengthened banking sector.[99]

Comparing the Philippines to the World: The Rankings that Foreign Investors Notice

Ease of Doing Business
World Bank *Doing Business in 2006*
126 out of 175

Economic Freedom
Heritage Foundation
Index of Economic Freedom 2006
97 out of 157

Corruption
Transparency International
Corruption Perceptions Index (2006)
121 out of 163

Competitiveness
World Economic Forum
Global Competitiveness Index (2006)
71 out of 125

GDP per Capita (purchasing parity $5,000)
CIA World Factbook (2006)
130 out of 229

During the course of this diagnostic, various foreign investors, local officials, domestic private-sector representatives, NGO representatives, and others enunciated a number of shared concerns and priorities with respect to developing and sustaining foreign investment in the Philippines. Though not exhaustive of the range of topics pertaining to foreign direct investment (FDI),[100] each issue warrants continued, high-level policy consideration. They include: (a) managing the influx of business process outsourcing, including through rehabilitation and maintenance of a strong cadre of human resources; (b) promoting increased competition in critical sectors; (c) improving the environment for agricultural investments; (d) addressing the insecurity of contracts as a deterrent to foreign investment; (e) recognizing the significant role of overseas foreign workers (OFWs) as investors; and (e) dealing with the problem of corruption.

In addition, the Philippines is undergoing an important public debate concerning the relative impact of financial incentives for foreign investors versus the need for tax revenues that support an infrastructure conducive to trade and further investment. This debate deserves a thoughtful exchange of ideas and a conclusion that is strategic and long-term with respect to anticipating the country's role as an investment destination in the region and the world.

B. Legal Framework

The legal framework through which FDI enters a country and is then regulated consists of the country's constitutional provisions, laws, regulations, policies, and practices that define the rights and obligations of both the foreign investor and the host state. In the Philippines, as in other countries, bilateral treaties or multilateral trade agreements are also an intrinsic part of this framework. For the purposes of this diagnostic, they are discussed in the chapter on international trade.

99 Merrill Lynch, *Philippines: Stepping it Up* (January 25, 2007) at 3 (hereinafter Merrill Lynch Report). Reform issues within the banking sector are set forth in this Report's chapter on Flow of Money.

100 The issues set forth here are those that coalesced as major policy topics during the first quarter of 2007. Other investment-related priorities are set forth in a recent ADB study entitled I*mproving the Investment Climate in the Philippines*, which details issues of investment from a three-part perspective: (a) macro-fundamentals; (b) infrastructure; and (c) governance and institutions. Similarly, important insights about private sector development strategies generally can be found at ADB, *Private Sector Assessment* (2005).

The Philippines has a number of routinely updated, free-of-charge, comprehensive sources of laws in English—both in print and over the Internet—that outside investors can access when they are considering the possibility of investing. In general, investors report satisfaction with the framework for investment-related law in the Philippines, although restrictions on foreign ownership of land and the impact of agrarian reform limit their optimism for the future. In addition, investors complain that well-intentioned laws tend to be undermined by failures in implementation.

Article 12 of the **Constitution of 1987** sets forth the basic rights of all investors and enterprises, including the following:

- Freedom from expropriation without just compensation
- The right to remit profits, capital gains, and dividends within the guidelines of the Bangko Sentral ng Pilipinas (BSP), the country's central monetary authority
- The right to remit the proceeds of the liquidation of investments
- The right to obtain foreign exchange to meet principal and interest payments on foreign obligations.

Although these rights are meant to meet the expectations of foreign investors and aligned with international best practices, Article 12 of the Constitution also prohibits foreign ownership of land in a proportion of more than 40 percent. In the eyes of many observers, this restriction obstructs the potential in the Philippines for future large-scale foreign investment.

Beyond the Constitution, the legal and regulatory framework for investments in the Philippines is relatively clear and accessible. Outsiders need to consider the following laws when contemplating an investment in the Philippines:

- *Executive Order 226 (Omnibus Investments Code of 1987)*. Implemented by the Board of Investments (BOI), the Code provides a comprehensive set of incentives for local and foreign enterprises engaged in activities considered by the government to be a high priority for national development.

- *R.A. 7042 (Foreign Investments Act of 1991)(FIA)*. This law liberalized the entry of foreign investments into the Philippines. Its enactment marked the end of decades of protectionism for local businesses. The FIA established the Foreign Investments Negative List (FINL). FINL enumerates the activities where foreign equity participation is restricted or limited. Under the FIA, foreign companies are generally allowed to conduct business in the Philippines subject to restrictions spelled out in the FINL. The FINL has two components: List A enumerates the areas of activities reserved to Philippine nationals by mandate of the Constitution and other specific laws; List B contains the areas of activity and enterprises regulated pursuant to law. Among these are defense or law enforcement-related activities and those with implications on public health and morals. List B includes domestic SMEs with paid-in equity capital less than the equivalent of US$200,000, unless they involve advanced technology as certified by the Department of Science and Technology or unless they employ at least 50 direct employees, in which case a minimum paid-up capital of US$100,000 is allowed.

- *R.A. 7916 (Special Economic Zone Act of 1995)*, signed into law on February 24, 1995. The law was passed to encourage economic growth through the development of special economic zones. The main implementing institution of this Act is the Philippines Economic Zone Authority, discussed in the next section.

- *R.A. 7227 (Bases Conversion and Development Act of 1992)*. This law created the Bases Conversion Development Authority, the Subic Special Economic and Freeport Zone, and the Subic Bay Metropolitan Authority and provided for their powers and their functions.

- *R.A. 7652 (Investor's Lease Act of 1993)*. This law allows for long-term leases (for a maximum of 50 years, extendible by 25 years) of private lands by foreign investors for the purpose of investment. Conditions for leasing include the following:

    - The initial lease can be up to 50 years, renewable only once for another 25 years.
    - The leased area must be used solely for investment.
    - The lease must conform to the Comprehensive Agrarian Reform Law and the Local Government Code.

- *R.A. 7844 (Export Development Act of 1994).* This law provides for incentives to exporters to encourage investments in the export sector. Typically, the incentives are as follows:

    - A three-to-six year tax holiday (projects with "pioneer status" receive longer holidays)
    - Five percent rate of corporate income tax following the tax holidays
    - Duty-fee imports of capital equipment and raw materials.

    Pursuant to the Export Development Act, foreign companies may export 30 percent of what they produce into the Philippines. Domestic companies may bring 50 percent of their products into the Philippines.

There are also special laws that provide for investment incentives in specific industries such as mining, iron and steel, and book publishing. In addition, R.A. 6957, as amended by R.A. 7718, is a **"Build-Operate-Transfer (BOT) Law.**" It provides for participation of private-sector entities in the development of infrastructure projects and the provision of services that are normally the responsibility of the government. BOT laws represent a very attractive option for large foreign investors who are not allowed to own land in sectors such as power and other utilities.

All foreign investments in equity or in securities listed in the Philippine Stock Exchanges or in certificates of indebtedness issued by the Philippine government or its agencies should be registered with the BSP. This is so these investments can be serviced with foreign exchange purchased from the local banking system. Foreign investments duly registered are entitled to privileges of full and immediate capital repatriation and remittance of dividends and interest.

Labor and employment law in the Philippines, as enshrined in the **Labor Code** (Presidential Decree 442, as amended), is considered unfavorable to private enterprise generally and to FDI in particular. As summarized by a foreign owner of a small software company, "Hiring is never a problem, but getting rid of [employees] is harder." In other words, the Philippines lacks the degree of labor market flexibility that has been found to contribute greatly to lower unemployment rates, higher worker productivity, and the ability of businesses to grow and innovate.[101] Information about labor policies and practices is, however, readily accessible.[102]

The Philippines is a full member of the Multilateral Investment Guarantee Agency (MIGA). Investments entered through MIGA are protected against risks associated with host-government restrictions on

101 See Richard Caballero, et al., *Effective Labor Regulation and Macro Economic Flexibility* (2004).
102 See Department of Labor and Employment website, http://www.dole.gov.ph/.

currency conversion and transfers, expropriation, war, revolution, or civil disturbance. MIGA further guarantees foreign investments against contract repudiation by the host government, including co-insurance with and reinsurance of political risk insurers against noncommercial risks. The Philippines also has a bilateral agreement with the United States (1986) which allows U.S. companies to access investment guarantees provided by the U.S. government's Overseas Private Investment Corporation.

C. Implementing Institutions

Oversight of foreign investment policy takes place within the Department of Trade and Industry and is executed chiefly by the Board of Investments (BOI). Foreign investors report general satisfaction with both institutions, stating that they are relatively non-bureaucratic and are not caught up in the culture found in other government agencies of charging facilitation fees to users. The BOI serves as a one-stop action center in which investors can establish their relationships with various government agencies and ministries, including customs, the BSP, the Department of Labor, the tax authorities, the SEC, and others. In addition to its domestic staff, the BOI hosts representatives from various foreign countries, including the United States, Japan, Korea, Germany, Italy, Spain, and the United Kingdom. These representatives, whose salaries are paid by a variety of non-Filipino sources, assist their fellow nationals in the navigation of the investment arena of the Philippines.

The BOI is charged with informing investors about the range of incentives that are available to them. Three categories of incentives are promoted:

(1) **Fiscal incentives**, including tax holidays, duty exemptions on imported capital, exemption from various export fees, tax credits (for exporters only), and labor and infrastructure-related tax deductions

(2) **Non-fiscal incentives**, including employment of foreign national, simplification of customs procedures, 10-year importation of consigned equipment, and bonded warehouse privileges

(3) **Incentives for regional headquarters and regional operating headquarters**, including multiple entry visas for expatriates, tax-and duty-free import of household goods and personal effects, and a variety of tax exemptions.[103]

Philippine Export Zone Authority (PEZA) at a Glance

- 112 zones, with 1,436 firms operating within the zones
  - 57 for manufacturing
  - 53 for information technology parks and buildings
  - 2 for tourism
- 86 percent of total manufactured exports from the Philippines come from PEZA-operated zones
- PEZA zones employed 545,000 workers in 2006, with 100,000 of those workers added in the past year
- 75 percent of raw materials for the zones are imported, while about 25 percent are produced domestically
- Future plans include a medical tourism economic zone and agro-industrial

In cooperation with the BSP, the BOI is charged with maintaining statistics relating to foreign investment. This is approached in two ways: (1) through self-reported statements by made by investors registering *intended* investments (versus *actual* investment, which may differ); and (2) BSP records as gathered through reporting requirements, stock market figures, and other valuation methods. The quality of investment statistics receives mixed reviews—one foreigner says that she "trusts the data more here than in China"; another calls it "good"; and a third says that reliable statistics are "elusive." Registration information is supposed to be public, but reportedly is often kept confidential; moreover, actual investments may be subject to exaggeration with respect to their true value. The four agencies in which

[103] See BOI pamphlet, *Investments with Incentives.*

investments may be registered—the BOI and the three major export zone authorities discussed below—are required to share information, but reportedly often fail to do so in practice. This issue is symptomatic of an information sharing deficit generally found in state institutions. One foreigner with many years of experience working in the Philippines comments that "most government problems concern the failure to coordinate."

There are three major authorities for administering export zones in the Philippines. First, the Philippine Export Zone Authority (PEZA) is a government corporation established through the **Special Economic Zone Act of 1995** and attached to DTI. (See box above.) By regional standards, PEZA is considered to be an enormously effective investment promotion agency—investors report having "nothing but praise" for its leadership, administration, and orientation toward customer service. PEZA administers fiscal and non-fiscal incentives to developers of economic zones, export producers, and information technology (IT) service exporters. PEZA offers ready-to-occupy locations to foreign investors who are export producers or IT service exporters in a variety of economic zones and IT parks and buildings. With respect to trade-related flows of money, PEZA provides registration services with the BSP and effectively handles the needs of exporters who seek to bring foreign exchange into the country (for example, to finance imports or pay for local services).

In addition to PEZA, special economic zones are operated at the two former U.S. military bases in the Philippines: Clark Freeport Philippines and the Subic Bay Freeport Zone. Since Clark was transformed into an enterprise zone, some 389 foreign and domestic investors have moved into it, generating Php 24.3 billion (US$501.1 million) in investments. As of March 2007, over 47,000 people, mostly from the local provinces, are employed at Clark. Subic employs about 60,000 people, nearly twice the number of local employees that worked at the base when it was a U.S. military installation. Clark and Subic do not provide tax holidays, but companies that operate there can also register at the BOI and receive tax holidays within their package of incentives.

Observers report that the two major legislative bodies, the Senate and the House of Representatives, tend to be slow and ineffectual with respect to pressing forward with the concerns of domestic and foreign investors. Meaningful action is said to come through Executive Orders of the President, rather than through legislation achieved through consensus.

D. Supporting Institutions

The attractiveness of an investment environment turns significantly on the stability of the macroeconomic environment. Until recently, the Philippines has suffered the results of heavy government borrowing. Over the past two years, the Department of Finance (DOF) has guided the Philippines toward substantial reductions in the country's budget deficit through measures such as decreased or frozen domestic spending and the increase of value added tax (VAT) rates in 2005. These efforts have contributed to decreased short-term domestic interest rates, which are now on par with rates in the United States.[104] The improved fiscal situation has also led to strengthened peso and a declining rate of inflation, which settled at around 4.3 percent at the end of 2006, as compared to 8.5 percent at the beginning of 2005. One financial analyst reported that recently "bankers [have] come from Hong Kong and Singapore" seeking to purchase "stocks, bonds, and property."

The various domestic and foreign chambers of commerce in the Philippines actively participate in public dialog, engage in advocacy, and serve the needs of their private-sector members. The Philippines Chamber of Commerce and Industry represents businesses of all sizes in the Philippines and, though it is

[104] Merrill Lynch, Philippines: Stepping it Up (January 25, 2007) at 3.

reputed to have a "protectionist history," it is perceived to have evolved and now supports free trade-oriented approaches to economic policy. Certain large investors report, however, that, although they are active in PCCI and other trade associations, they may in fact have more influence as an individual corporation when advocating for certain issues. The Makati Business Club is an elite organization that represents some of the most prosperous enterprises in the country. It is a strong and independent voice on political and economic issues.

An expansive representation of for-profit law firms and consulting companies exist to help potential investors navigate the Philippine legal environment once they launch a more detailed inquiry into the country. The supporting environment also includes significant communities of foreigners from the region, including a marked influx of tourists and investors from Korea and China in the past two years.

The courts and the judiciary generally are regarded as a negative factor with respect to foreign investors. The sluggishness of the courts is notorious, with the threat that any commercial court case can easily get tied up indefinitely in the appeals process.

Universities, particularly three major ones—the University of the Philippines, Ateneo de Manila, and De La Salle—are considered quite strong in the region. Beyond these three, the quality of public and private higher education is reported to decline. However, the Philippine system of higher education compares favorably with those of its ASEAN neighbors. Faculties are considered to have academic freedom and considerable access to continuing education in their fields. Through the creation of independent think tanks, NGOs, and degree programs, they also work closely with the many regional and international organizations that are active in the Philippines.

The print media in the Philippines are "rowdy and extraordinarily free," as phrased by one long-time foreign observer. The respect for the role of journalism, however, is not matched by a high degree of professionalism. Information about issues of interest to foreign investors is widely available, particularly in the more responsible international press. Domestically, a local tradition of "journalists for hire" persists.

E. Social Dynamics

The Business Process Outsourcing Influx

Whereas garment manufacturing represented the bulk of exports from the Philippines in the 1970s and 1980s, they now only represent about 1.3 percent of exports, according to PEZA. Today, the major growth industry is in the services sector, such as business process outsourcing (BPO), which includes such functions as customer contact, "back office" work, software development, medical transcription, animation, engineering design, data transcription, legal transcription, and development of digital content. Employment in these areas in 2006 totaled 266,000 workers and is projected to reach over 1 million workers by 2010.[105] The Philippines is a popular destination for BPO for a variety of reasons. For U.S. investors, the "American accent" of Filipino workers is a desirable quality, particularly in comparison to workers in India, who tend to speak with a British accent. Yet investors are encountering a lack of first-class office facilities, according to one foreigner who has recently watched supply decrease while Manila-based rents increase.

[105] Merrill Lynch Report at 9.

Maintaining the Human Resources Advantage

Although the Philippines maintains the highest rate of literacy among the countries examined by SEA CLIR (see box), its competitive advantage in English-language skills, among other important competencies, is said to be highly vulnerable. In the wake of austerity programs, public schools have deteriorated. Classrooms are inordinately large—75-100 people, according to observers—and often stock no books. Political sentiments in the mid-1990s opposed training in English language and resulted in a supply of good English-language speakers that is not meeting the increasing demand of the BPO sector. Foreign investors speak of human resources as one of the critical policy issues before them in the Philippines. The fact that 10 percent of the population of the Philippines works overseas—among them a huge segment of the educated workforce—puts negative pressure on the supply of qualified workers in an economy that is oriented toward value-added outputs. On the other hand, the Philippines is remarkably strong in its promotion and support of women's participation in the economy, an advantage that is recognized as a major driving force in support of economic growth.[106]

A National Tradition:
High Rates of Literacy*

Country	Men	Women	Total
Cambodia	84.7	64.1	73.6
Indonesia	92.5	83.4	87.9
Laos	77.4	55.5	66.4
Vietnam	93.9	86.9	90.3
The Philippines	92.5	92.7	92.6

Source: CIA *World Factbook* (2002 figures)
*Defined as the rate of individuals over age 15 who can read and write.

Lack of Competition in Key Sectors

As long as the Philippines permits the oligopolies to persist, foreign investment will not reach its potential. As detailed in the competition law and policy chapter of this report, certain sectors remain heavily regulated and virtually closed to competition, notwithstanding initial attempts to dismantle various monopolistic structures in the 1990s.[107] As one observer points out, due to state-sanctioned constraints on competition, the Philippines operates the "most number of airports [in the region], but the fewest number of flights." (For example, Indonesia has 2.7 times the population of the Philippines, but about 3.6 times as many air passengers.)[108] This situation, in turn, hampers foreign interest in the tourism sector, among others. The desire to build resorts and hotels is quelled significantly not only by restrictions in foreign ownership of land, discussed above, but also by the sense that tourists do not have fluid air access to critical regions.

Limitations on Agricultural Investment

Foreigners feel pessimistic about agriculture as an area in which to launch investment or increase investment for several reasons. First, of course, is the issue of foreign ownership of land. Though long-term leases represent one way to cope with this restriction, there is strong interest not only among foreigners but within the local business community to change the Constitution—a change that, at this time, has negligible chances of coming into effect. Second, although the agrarian reform movement of the 1970s brought some improvements to the quality of life in the Philippines, particularly in rural areas, its long-term prospects include grave disadvantages to investors interested in developing large tracts of land. To do so typically requires state assistance in consolidating tracts and paying the sellers for their land, a

106 See Editorial, "The Importance of Sex," *The Economist* (April 12, 2006).

107 For example, in 1995, President Ramos issued Executive Order 219, beginning efforts to liberalize the airline industry.

108 Noel G. Reyes, "Flight Plan: The local airline industry undergoes a makeover," *Philippine Business* (October 2006) at 14.

process that takes an inordinate amount of time and is notorious for its unanticipated costs. Administration of land held by cooperatives in particular is a bureaucratic headache for major foreign investors.

Third, the country's poor infrastructure for transport and high expense of domestic shipping add costs that undermine the Philippines' potential as a major exporter of agricultural products. Fruit delivery by truck from Manila to Davao on the southern island of Mindanao requires two ferry crossings and three days to cover 850 kilometers (510 miles); spoilage remains a critical issue.[109] Five ocean carrier companies that combine both passenger and cargo hauling on the same vessel control domestic shipping. This situation represents 93 percent of total ship movements in the Philippines and is aptly characterized as "cartel-like."[110] Domestic shipping costs exceed international liner costs and, according to the World Bank, the cost of exporting a 20-foot container averages about 30 percent higher in the Philippines than in other Asian countries.[111]

Fourth, any litigation over land, whether within the courts or the Cooperative Development Authority or another agency, takes unreasonable amounts of time, discouraging foreign investors from involvement with projects that require consolidation of properties or significant tracts of land. Fifth, security concerns in parts of the Mindanao province discourage foreign investment in certain lands that could become valuable agricultural concerns.

Finally, failures in bureaucratic support result in neglected opportunities, according to a variety of observers. One interviewee raised the example of coconut oil, for which there is considerable worldwide demand, as an under nurtured potential export. Another pointed out that certain agriculture processing industries, such as canned asparagus and fruit and processed fish, do not receive sufficient support from the state. State bureaucracies "are not using their resources well, so they do not have the ability to generate more resources" through taxation, according to one investor who wishes to develop agricultural exports. A third investor noted that Mindanao *should* be a major destination for agricultural investment, because, unlike other places in the region, it is relatively free from typhoons.

Insecure Contracts

A variety of foreigners attest that one of the greatest disincentives to investing in the Philippines is the inadequacy of the legal system, in particular the insecurity of both private contracts and contracts with the government. "The local community does not value contracts, and the courts are no help," states one foreigner, based on recent experience. This issue is detailed further in this report's chapters on Contracts and Commercial Dispute Resolution.

Overseas Foreign Workers as Investors

A phenomenon referred to by a few observers as the "I Have Arrived Market" is having a clear impact on the investment environment in the Philippines. Large companies promote investment opportunities—chiefly ownership of homes and condominiums—to OFWs (overseas Filipino workers) and other Filipinos living in countries all over the world. Many OFWs are known to purchase real property over the Internet, relying on their local friends and relatives to assist with inspecting the property and other

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[109] USDA, Economic Research Service, "Asia-Pacific Transportation Infrastructure: Linking Food Sources to Urban Centers," *Amber Waves* (September 2005).

[110] Salvador P. Catelo, *The Philippines*, "Pacific Food System Outlook," 2004-05, at 1.

[111] World Bank, *Doing Business in 2006 (Philippines – Trading Across Borders)*, at *http://www.doingbusiness.org/ExploreEconomies/?economyid=153*.

logistics. In addition to helping "stabilize private consumption through the ups and downs in economic cycles," remittances increasingly support investment-related activities, particularly high-end real estate investments.[112]

Corruption

Although the Philippines has acknowledged the existence of pervasive corruption and has even launched a wide-scale initiative to combat this threat, the effect of this priority has yet to penetrate the day-to-day practices faced by businesses in all phases of operation. Throughout this diagnostic, local and foreign investors commented about the pervasiveness of informal facilitation fees and an overall lack of transparency in areas where public officials are in a position to garner private gain. The Philippines recently received more unfortunate publicity in this regard, ranking last in a 2007 survey of perceived corruption among foreign businesspeople.[113] As summarized by the *International Herald Tribune*:

> To the question "How effective is the judicial system at prosecuting and punishing individuals for corruption when abuses are uncovered?" the respondents gave the Philippines a score of 9.06, with 10 being "ineffective."
>
> To the question "To what extent is corruption a deterrent to your willingness to invest and expand your business?" the Philippines scored 8.50, with 10 reflecting "a major deterrent."
>
> Local corruption monitors confirm that graft and bribery in the Philippines remain rampant. Corruption has penetrated every level of government, from the Bureau of Customs (BOC) down to the traffic police officers who pull over motorists to demand bribes.
>
> Nearly US$2 billion, or roughly 13 percent of the Philippines' annual budget, is lost to corruption in the country each year, according to the United Nations Development Program.[114]

The Issue of Incentives

Recent legislation in the Senate has proposed streamlining the country's system of incentives that are granted to foreign investors. The legislation, which is expected to be revived after 2007 elections, proposes to remove tax holidays offered across the board, focus on incentives for certain sectors only, and reduce other incentives, while at the same time lowering the corporate tax rate for everyone. Proponents of change to the incentive structure, which include the Ministry of Finance and the Makati Business Club, assert that tax holidays and other benefits are often granted to companies "that would have come anyway," while the state has been deprived of much-needed revenue. They further contend that commensurate revenue increases would result in the ability to improve the country's infrastructure and education system, which would improve the environment for investment generally.

Opponents to this change include DTI, the BOI, and the foreign chambers of commerce. These constituencies argue that, in order to be perceived as an attractive investment environment, the Philippines must match or exceed investment incentives found throughout the region. This debate deserves a thoughtful exchange of ideas and a conclusion that is strategic and long-term with respect to anticipating

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112 Merrill Lynch Report at 5.

113 Political and Economic Risk Consultancy, Ltd., *The Dangers of Underestimating Corruption*, (March 14, 2007), found at http://www.asiarisk.com/subscribe/aiindex html.

114 Carlos Conde, "Philippines Most Corrupt, Survey Says," *International Herald Tribune* (March 13, 2007).

the Philippines' role as an investment destination in the region and the world. The International Finance Corporation has identified its interest and willingness to assist in the debate.

F. Recommendations

This report makes the following recommendations:

- Improve the timeliness, maintenance of, and accessibility to investment statistics and other statistics of interest to foreign investors.
- Study and develop policy initiatives concerning the relationship between foreign investment in tourism in the Philippines and the following constraints on foreign investment: (a) land restrictions, including foreign ownership restrictions; (b) domestic and international transport, including air transport; (c) capacities in human resources; and (d) enforcement of contracts.
- Study and develop policy initiatives concerning the relationship between foreign investment in agriculture in the Philippines and the following constraints on investment: (a) land restrictions, including foreign ownership restrictions; (b) domestic and international transport, including shipping; (c) security; and (d) bureaucratic inefficiencies.
- Support continued dialog and long-range planning with respect to the future of investment incentives in the Philippines.
- Continue implementation of anti-corruption measures that target everyday, low-level corruption, including that faced by foreigners.

XI. International Trade Law

A. Introduction

International trade is important to transformational development and economic growth. A liberalized trade regime is beneficial since it helps a country's economy to grow and thus can help to reduce poverty if the growth is widespread. Moreover, it can make an economy more productive and competitive by allowing for specialization. The highly literate work force in the Philippines coupled with its strategic location within Asia provides it with a competitive advantage to benefit from trade.

"You can display no greater wisdom than by resisting proposals for needless legislation. It is much more important to kill bad bills than to pass good ones."

— Calvin Coolidge

The Philippines has a solid and extensive framework of laws and institutions that have developed since the country's admission into the WTO. For an effective trade policy formulation that enables economic growth and business development, an effective coordination system between ministries, and that includes private-sector participation, is essential, in addition to the laws. The Philippines needs to further develop effective decision-making processes to produce rules and regulations that enable trade, comply with the standards of the WTO, and that effectuate growth. This would include addressing services, which is a key area with growth potential. While the goal of involving the private sector is espoused, this is often done too late or ad hoc. A system of notice to all interested stakeholders to allow their input is lacking at this point. Both government and the private sector noted that the Philippine Export Zone Authority, or PEZA, was an example of effective streamlining across the myriad of implementing and support institutions in the international trade arena.

B. Legal Framework

The Overall Legal Framework

The Philippines is one of the original members of the WTO. The WTO has had a significant impact on the development of the trade rules in the Philippines, and on the parameters for the way business and trade is conducted.[115] Since 1995, the Congress has put in place several laws that span, among others, the shift in customs valuation; trade defense measures (anti-dumping, countervailing duties and safeguards); and intellectual property protection, and for which the Government continued to pass legislation that amended them.[116] The framework is extensive and is comprised of many Republic Acts (R.A.s), Executive Orders (EOs), Administrative Orders (AOs), and other rulings. While the legal framework is comprehensive, the numerous amendments through EOs, AOs, and other rulings have made the framework so cumbersome and complex that it in itself can be an impediment to the growth of trade. A system of updating and at the same time streamlining the legislation with the input from the private sector would be beneficial.

Anti-Dumping Act of 1999 (R.A. 8752). Whenever any product, commodity, or article of commerce imported may be considered to meet the definition of dumping, the Secretary of Trade and Industry or the Secretary of Agriculture, in the case of agricultural product, after formal investigation and affirmative finding of the Tariff Commission, shall impose an anti-dumping penalty. The decision on whether or not to impose a definitive anti-dumping duty remains the prerogative of the Commission.[117] Since 1991, the DTI has initiated 13 anti-dumping investigations, five of which resulted in rulings against four countries: Indonesia and Malaysia on float

115 *The Philippines in the World Trade Organization*, A Non-Paper by the Bureau of International Trade Relations.

116 Id.

117 More detail on the law can be found at the Department of Trade and Industry's website at: http://www.business.gov.ph/Laws.php.

and drawn glass, South Korea on polypropylene resin, Malaysia on cold-rolled sheet and coil, and Russia on steel billets.[118]

Fundamental Indicators: Foreign Trade

Foreign Trade (% growth)	2005 Actual	2006 Estimates	2007 Forecast
Exports of goods and services	4 2	12 1*	4 4
Imports of goods and services	2 4	2 5*	5 2
Foreign Trade (% of GDP)			
Exports of goods and services	47 3	46 6*	43 6
Imports of goods and services	52 0	48 3*	44 6
Trade Figures (US$ Billion)			
Current account balance	2 0	4 4	4 8
As a percent of GDP	2 0	3 7	3 6
Goods: exports freight on board (fob)	40 3	44 7	45 5
Goods: imports fob	-48 0	-51 6	-53 5
Trade balance	-7 8	-6 9	-8 0
Services: credit	4 4	5 1	5 6
Services debit	-5 9	-5 6	-6 0
Services: balance	-1 4	-0 5	-0 4

* Actual figures
Source: Economist Intelligence Unit, *Country Forecast Philippines*, March 2007.

Consumer Act (R.A. 7394). This Act provides guidance for setting standards and technical regulations. Implementing agencies are the Department of Health (for food, drugs, cosmetics, devices and substances), the Department of Agriculture (for products related to agriculture), and the Department of Trade and Industry (for other consumer products).[119]

Countervailing Act of 1999 (R.A. 8751). This act describes the process when an injury to a domestic industry is determined by the Tariff Commission within the Secretary of Trade and Industry in the case of a nonagricultural product, commodity or article, or the Secretary of Agriculture in the case of an agricultural product, commodity or article, and details the imposition of countervailing duties.

Electronic Commerce Act (R.A. 8792). The Department of Trade and Industry supervises electronic commerce in the country.

Export Development Act (R.A. 7844). The Department of Trade and Industry (DTI) and Department of Finance, or DOF, in consultation with the Export Development Council, are responsible for formulating the rules and regulations related to export. The law develops and promotes a Philippine Export Development Plan, a three-year rolling plan prepared by the Department of Trade and Industry (DTI) which forms part of the medium-term Philippine Development Plan (MTPDP). The law emphasizes the other incentives granted to exporters: exemption from import duties, tax credit for imported inputs and raw materials used in production, and other incentives as provided by the Omnibus Investment Code and applicable laws.

Foreign Investment List (EO 286). In 1998, the Foreign Investment List was released. The list defines restrictions on foreign ownership and areas or industries which are closed to foreigners. Restrictions exist in the following areas: mass media; services involving the practice of professions such as engineering, medical and allied profession, accountancy, criminology, architecture, law, etc.; retail trade; cooperatives;

118 The Economist Intelligence Unit, Country Commerce 2006: Philippines, p 88.

119 More detail on the laws can be found at the Department of Trade and Industry's website at: http://www.business.gov.ph/Laws.php

small-scale mining, use of marine resources; ownership and operation of cockpits; manufacture, repair of nuclear weapons and other biological, chemical weapons, etc; and other areas. Local content of 75 percent is required in the following: private recruitment, whether for local or overseas employment; locally funded public works except for infrastructure/development projects and foreign-funded or assisted projects. Up to 30 percent foreign equity is allowed in advertising, while a maximum of 40 percent is granted for: exploration, development, and use of natural resources; ownership of private lands; operation and management of public utilities, educational institutions; rice and corn administration; contracts to supply materials, goods and commodities to government-owned or controlled corporations, and government agencies; project proponent of a BOT project in public utilities; deep-sea commercial fishing vessels operation and condominiums. The law also allows 60 percent ownership in financing companies regulated by the SEC and investment houses.

Foreign Investment Act (R.A. 8179). This act was signed into law in 1991. The law details the procedures for the registration and grant of incentives to foreign investors. The act's implementing rules and regulations were prepared by the National Economic Development Authority (NEDA), in consultation with the Board of Investments (BOI), SEC, and other government agencies. Procedures for the registration of foreign investments with various government agencies, such as the SEC and the Bureau of Trade Regulation and Consumer Protection (BTRCP) of the Department of Trade and Industry (DTI), are included in the law. The Foreign Investment Negative List is separate from the Foreign Investment Act. It is included in EO 286 above.

Price Act (R.A. 7581). This Act passed in 1992 deals with price controls. Implementing agencies include the Departments of Agriculture, Health, Environment and Natural Resources, and DTI.

Safeguards Measures Act (R.A. 8800). This Act provides measures to protect domestic industries and producers from increased imports that cause or threaten to cause serious injury to those domestic industries and producers. The Secretary of DTI makes the determination on injury and imposes the measure.

Transaction Value Act (R.A. 9135). This Act superseded the old Transaction Value Act (R.A. 8181) and amended certain provisions of Presidential Decree No. 1464, otherwise known as the Tariff and Customs Code of the Philippines. Its purpose is to change the basis of dutiable value of imported articles subject to an ad valorem rate of duty from home consumption value (HCV) to transaction value (TV).[120]

Retail Trade Liberalization Act (R.A. 8762). This was enacted on March 7, 2000. It repealed the previous Retail Trade Nationalization Law (R.A. No.1180) that limited retail trade activities to Filipinos and corporations wholly owned by Filipinos, and opened it to foreign players. The Act exempted a number of activities and imposed safeguards such as setting high ceilings on capitalization. The Act also details the role of the agencies involved: DTI, SEC, NEDA, and BSP.

Other laws that have an impact on trade are: Joint Department Administrative Order No. 2, series 2006,[121] Laws on Graft and Corruption,[122] Omnibus Investment Code (EO 226),[123] Restructuring of

[120] More detail on the law can be found at the Department of Trade and Industry's website at: http://www.business.gov.ph/Laws.php.

[121] Guidelines implementing R.A. 8792 on the Electronic Payment and Collection System (EPCS) in government by DTI and the Department of Finance (DoF).

[122] More information can be found on the website at the Office of the Ombudsman at: http://www.ombudsman.gov.ph/.

[123] This Executive Order details the incentives for foreign investors and requires BOI to develop an Investment Priorities Plan each year to be submitted to the President.

the Motor Vehicle Development Program (EO 156),[124] simplified uniform procedure for filing cases with DTI (DAO 7, s2006), and Tobacco Regulation Act (R.A. 9211).

Tariff and Customs Code of the Philippines (TCCP). The Tariff and Customs Code has been undergoing reform. It has as its basis Presidential Decree No. 1464, as amended by numerous Executive Orders and Republic Acts.[125] The Philippines is targeting changes in the law, regulation, and practices to abide by the Revised Kyoto Convention. This is covered in the section on customs in this report.

Trade Agreements

The Philippines, an original Member of the WTO, continues to participate actively in the organization, remains committed to the multilateral system, and provides at least MFN treatment to all its trading partners. It is also a member of the ASEAN FTA (AFTA), and intends to pursue further regional trade agreements, bilaterally and collectively through ASEAN, where appropriate. Since its last WTO review, the Philippines has concluded, in principle, major elements of its first bilateral agreement with Japan. However, the Philippines' main FTA activity has been through various ASEAN FTAs being negotiated or considered. The first parts of the ASEAN-China Framework Agreement on Comprehensive Economic Cooperation (ACFTA on goods) and the Regional Trade Investment Area with India have entered into force; and ASEAN FTA negotiations were scheduled to start in 2005 with Japan, Korea, Australia, and New Zealand. Through such arrangements, the Philippines is establishing a regional network of bilateral trade agreements.[126]

U.S. and Philippines TIFA. 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.[127]

Japan and Philippines (JPEPA). On September 9, 2006, the President of the Philippines and the Prime Minister of Japan signed the Japan-Philippines Economic Partnership Agreement (JPEPA). According to the DTI Secretary, Peter Favila, "Almost 95 percent of Philippine industrial and agricultural exports (in terms of value) will face zero duties… For agriculture, several products will benefit from either immediate or gradual elimination of tariffs; or the implementation of tariff rate quota (TRQ), where in-quota tariff could go down all the way to zero duty." Products that will particularly benefit include those where the Philippines is already dominant: bananas, pineapples, shrimp and crabs, cane molasses and muscovado sugar (raw sugar was excluded), chicken, and tuna. Among the Philippine manufacturing industries which will particularly benefit are iron and steel, auto and auto parts, electrical and electronic appliances and their parts, and textiles and apparels.[128]

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124 This Executive Order bans the import of used vehicles and parts except under certain conditions and restructures MFN tariff rates to protect the development of the Philippine automotive industry. The law can be found at: http://www.business.gov.ph/Laws.php.

125 http://www.tariffcommission.gov.ph/links1 html.

126 Trade Policy Review of the Philippines, WT/TPR/S/149, 7 June 2005, at www.wto.org.

127 http://www.ustr.gov/assets/Document_Library/Reports_Publications/2006/2006_NTE_Report/asset_upload_file223_9202.pdf.

128 http://www.business.gov.ph/Trade_News.php?newsID=11.

ASEAN Free Trade Agreement (AFTA). The ASEAN Free Trade Area (AFTA) covers the 10 countries of the Association of South-East Asian Nations (ASEAN)[129]. It has resulted—in theory—in the reduction of tariffs for over 4,000 categories of products since 2000.

The Common Effective Preferential Tariff (CEPT). Agreement on a broad range of products for the ASEAN Free Trade Area (AFTA) requires that tariff rates among the original six ASEAN members (including the Philippines) be reduced to between zero percent and 5 percent or below by the end of 2003, while quantitative restrictions and other non-tariff barriers were to be eliminated. ASEAN members agreed on a firm timetable leading up to the full realization of this initial stage of AFTA by the end of 2003. 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. In January 2007, ASEAN leaders added Information and Communications Technology as the 12th priority sector for liberalization. These sectors account for 71 percent of 2003 intra-ASEAN trade. They include electronics, E-ASEAN (electronic commerce, usage, connectivity among ASEAN countries), health care, wood-based products, automotive products, rubber-based products, textiles and apparel, agri-based products, fisheries, air travel, and tourism.[130]

Customs and Tariffs

The Philippine government is currently reviewing the tariff program. It had expected to publish a five-year (2006 to 2010) tariff program schedule via Executive Order before the end of 2006, though it had not done so as of March 2007. With regard to the classification of products within tariff codes, at least one major US company has reported inconsistency by the BOC in the application of tariff classifications.[131] As noted above in the section on regional trade agreements, the Philippines has reduced duties to 5 percent or below on 99 percent of all tariff lines under the AFTA-CEPT.

Trade Remedies

The Philippines has made use of the trade remedy provisions. The Safeguard Measures Act of 2000 (Republic Act 8800) provides for the imposition of general safeguard measures, and a special safeguard measure on agricultural products. The Secretary of DTI or the Secretary of Agriculture is authorized to take action with either a tariff or in the case of agriculture, a quantitative restriction. The Philippines has levied safeguard duties on float glass, figured glass, glass mirrors, ceramic floors, and wall tiles, and places provisional safeguard duties on sodium tripolyphosphates.[132]

Anti-dumping and countervailing duties are provided for in the Anti-Dumping Act of 1999 (Republic Act 8752), and the Countervailing Act of 1999 (Republic Act 8751). The Philippines has imposed anti-

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129 The Association of Southeast Asian Nations or ASEAN was established on 8 August 1967 in Bangkok by the five original member countries, namely Indonesia, Malaysia, Philippines, Singapore, and Thailand. Brunei Darussalam joined on 8 January 1984, Vietnam on 28 July 1995, Lao PDR and Myanmar on 23 July 1997, and Cambodia on 30 April 1999. More information about ASEAN can be found at: http://www.aseansec.org/.

130 *USTR NTE Report 2007*. This can be found at: http://www.ustr.gov/assets/Document_Library/Reports_Publications/2007/2007_NTE_Report/asset_upload_file702_10975.pdf.

131 *USTR NTE Report 2007*. This can be found at: http://www.ustr.gov/assets/Document_Library/Reports_Publications/2007/2007_NTE_Report/asset_upload_file702_10975.pdf.

132 http://www.tariffcommission.gov/ph/safeguar html.

dumping duties on the following: sodium tripolyphosphates from China, and clear gloat glass from Indonesia and Malaysia.[133] There are no products on which a countervailing duty is imposed.

C. Implementing Institutions

The institutional setting in which trade policy operates is more important for economic performance than the levels at which specific trade barriers are set.[134] A multitude of institutions have been formed and are active in the trade law and policy formulation area in the Philippines. While this indicates a strong and well developed framework, it increases the need for coordination. This is an area that needs strengthening in order for the Philippines to have a coherent and cohesive policy that can be responsive to the changes in the global trading system, as well as enforce its obligations under the WTO.

There are numerous agencies that play a role with respect to trade, industry, and investment in the Philippines:

- *DTI – Department of Trade and Industry*—Under Executive Order 133, the DTI serves as the primary agency for trade, industry, and investment activities. At present, DTI exercises its mandates through 20 line bureaus/support offices, 14 attached agencies and over 5,000 employees. It has 16 regional and 78 provincial offices nationwide.[135]
- *NEDA – The National Economic and Development Authority*—NEDA, as mandated by the Philippine Constitution, is the country's independent economic development and planning agency. It is headed by the President as chairman of the NEDA board, with the Secretary of Socio-Economic Planning (concurrently NEDA Director-General) as vice-chairman. All Cabinet members as well as the Central Bank Governor are members of the NEDA Board.[136] Executive Order 230 mandated the NEDA Board to be comprised of: the President as Chairman, Director-General of the NEDA Secretariat as Vice-Chairman, and as members the Secretaries of the Ministries of Finance, DTI, Agriculture (DA), Environment and Natural Resources, Public Works and Highways, Budget and Management, Labor and Employment, and Local Government. Six government agencies are attached to NEDA for administrative supervision. These include the Tariff Commission, or TC, Philippine National Volunteer Service Coordinating Agency (PNVSCA), National Statistical Coordination Board (NSCB), National Statistics Office (NSO), and Statistical Research and Training Center (SRTC).
- *PIDS – The Philippine Institute for Development Studies*—PIDS is also attached to the NEDA for policy and program coordination or integration. While this organization looks ideal from an inter-ministerial coordination perspective, in actuality the framework is not used as well as it could be to support the formulation of trade policy.
- *Department of Agriculture Task Force on WTO Agreement on Agriculture*—On 28 September 1998, the then-Secretary of the Department of Agriculture, through Special Order No. 538[137], duly constituted the Task Force on WTO Agreement on Agriculture (TF-WAR) negotiations. This is a multi-sector task force composed of 28 representatives from farmer groups, industry associations, business federations, NGOs, grassroots organizations, and other relevant government institutions and agencies.[138] The main responsibility of the TF-WAR was to

133 http://www.tariffcommission.gov.ph/semi-ann1.html.

134 "Trade Policy Reform as Institutional Reform," *Development, Trade and the WOT, A Handbook*, Dani Rodrik, p.9.

135 Additional information about DTI can be found at: http://www.business.gov.ph/About_Mandate_History.php.

136 Additional information about NEDA can be found at: http://www neda.gov.ph/.

137 http://www.wto.org/english/res_e/booksp_e/casestudies_e/case36_e.htm#fnt5#fnt5.

138 http://www.wto.org/english/res_e/booksp_e/casestudies_e/case36_e.htm#fnt6#fnt6.

consider, develop, evaluate, and recommend Philippine negotiating positions and strategies for the new round of negotiations.

- *BOI – Board of Investments*—The BOI is the lead investment promotion agency of the Philippine government. It promotes investments in industries and in the regions of the country for balanced economic development.
- *PEZA – Philippine Economic Zone Authority*—PEZA is in charge of attracting foreign investors to develop or put up export manufacturing plants or regional warehouses in world-class, environment-friendly economic zones. It administers and manages the incentives of 114 approved special economic zones in various parts of the country. (Both the private sector and the government note its success in streamlining trade).
- *BETP – Bureau of Export Trade Promotion*—BETP delivers assistance to exporters to enhance their competitiveness in international markets.
- *ICO-CA – International Coffee Organization Certification Agency*—ICO-CA negotiates and implements the International Coffee Agreement (ICA) between the Philippines and other countries. It also acts as the export marketing and promotional arm of the Philippine coffee industry.
- *BITR – Bureau of International Trade Relations*—BITR engages and represents the country in bilateral and multilateral trade and investment negotiations.
- *FTSC – Foreign Trade Service Corps*—FTSC promotes Philippine exports and investments overseas through various marketing activities and commercial intelligence work.
- *MECO – Manila Economic and Cultural Office*—MECO promotes Philippine trade, investments, tourism, labor, and scientific and cultural cooperation with Taiwan in coordination with Philippine government agencies and the private sector.
- *GTEB – Garments and Textile Export Board*—GTEB manages and supervises the garment textile quota system set up under the Agreement on Textiles and Clothing (ATC) which governs world trade in textiles and garments.
- *BIS – Bureau of Import Services*—BIS assists imports, administers import regulation on selected items, and monitors the importation of liberalized and sensitive items. It initiates and conducts preliminary investigations on dumping, countervailing, and safeguard protests.
- *BPS – Bureau of Product Standards*—BPS develops, promotes, and implements standards and related programs nationwide. It participates and represents the country in various standards-related activities worldwide. It is an active member of the International Organization for Standardization (ISO), the International Electrotechnical Commission (IEC), the Asia Pacific Economic Cooperation (APEC), and the ASEAN Consultative Committee for Standards and Quality.
- *BTRCP – Bureau of Trade Regulation and Consumer Protection*—BTRCP functions as a policy-making body and oversees the overall implementation of trade and consumer protection laws.
- *CIAP – Construction Industry Authority of the Philippines*—CIAP promotes, accelerates, and regulates the construction industry. Its implementing boards are the Philippine Contractors Accreditation Board (PCAB), Philippine Overseas Construction Board (POCB), the Philippine Domestic Construction Board (PDCB), and the Construction Industry Arbitration Commission (CIAC).
- *PSB – Philippine Shippers Bureau*—PSB assists the development and growth of foreign trade and the national economy by helping exporters identify the most economical and fastest shipping modes.
- *IPO – Intellectual Property Office*—IPO oversees and enforces the overall implementation of intellectual property rights, trademarks, and patents. (This topic is covered in detail in a separate chapter.)

- *BDT – Bureau of Domestic Trade*—BDT promotes efficient marketing and distribution of local products and services in the domestic market. It expands and strengthens linkages among and between small, medium, and large enterprises from all over the country through information exchange and market matching.
- *CITEM – Center for International Trade Expositions and Missions*—CITEM assists exporters by developing their core competencies in marketing, promotion, and capability building through professionally managed and well-selected programs and activities such as organizing international trade fairs.
- *PDDCP – Product Development and Design Center of the Philippines*—PDDCP promotes industrial design as a tool for improving the quality and competitiveness of Philippine products. It services the design needs of entrepreneurial groups and associations from every level of industry.
- *CITC – Cottage Industry Technology Center*—CITC provides production-related training and technical assistance to furniture, gifts and house wares, fine jewelry, and leather footwear industries all over the country.
- *CMDF – Construction Manpower Development Foundation*—CMDF oversees the development of human resources of the construction industry in all levels: skilled craftsmen, engineers, supervisors, managers, and contractors. It draws up an overall construction manpower development plan and relevant strategies, and develops and implements manpower training and certification programs.
- *PTTC – Philippine Trade Training Center*—PTTC designs and implements training programs on export marketing and management, entrepreneurial management, quality management and productivity, and trade exhibition management and participation. It also provides entrepreneurial training to youth.
- *SBCorp – Small Business Guarantee and Finance Corporation*—SBCorp supports the development of small enterprises by promoting various modes of financing and credit delivery systems.
- *BOC – Bureau of Customs*—In any country, the customs bureau is often viewed as the "face" of a country's commitment to trade; that is, the effectiveness and professionalism of its officers generally reveal whether trade is viewed by the state as an opportunity for economic development or as a way-station of bureaucracy, political favoritism, or individual enrichment. At this time, the perception of the Philippines' Bureau of Customs, notwithstanding a modernized computer system, is the latter view. Please see the chapter on the flow of goods and services for a full discussion of the challenges facing customs in the Philippines.
- *DA – Department of Agriculture*—DA is a member of NEDA and the Tariff Commission and plays an important role with all agricultural trade issues.
- *DOH – Department of Health*—DOH plays a role in the health safety issues in trade.
- *Tariff Commission***.** By virtue of Republic Act 911, the Tariff Commission was created in June 1953 under the Office of the President. Since its inception, the Commission has undergone several reorganizations. In 1956, it was transformed into a division of the then Department of Finance. In 1957, the Congress of the Philippines enacted R.A. 1937, otherwise known as the ***Tariff and Customs Code of the Philippines***, restoring the Tariff Commission as an independent body under the supervision of the Office of the President and headed by a Commissioner and an Assistant Commissioner. In October 1973, by virtue of the Integrated Reorganization Plan (Presidential Decree No.1), the Commission was reconverted into a collegial body headed by a Chairman and Member Commissioners and placed under the administrative supervision of the National Economic and Development Authority (NEDA). In October 1996, the Commission's top management agreed to create a proposed organizational structure designed to accommodate the expanded role of the Commission in the years ahead.[139]

[139] http://www.tariffcommission.gov.ph/aboutus html.

CTRM – The Committee on Tariff and Related Matters—CTRM is composed of the Secretary of Trade and Industry as chairman, and the Director-General (DG) of NEDA as co-chairman. Its members are: Executive Secretary, Secretaries of Foreign Affairs, Agriculture, Transportation and Communications, Environment and Natural Resources, Budget and Management, Finance, Governor of the Central Bank, and Chairman of the Tariff Commission. The CTRM does the following: advises the President and the NEDA Board on Tariff and related matters and on the effects on the country of various international developments; coordinates agency positions and recommends national positions for international economic negotiations; recommends to the President a continuous rationalization program for the country's tariff structure. The Tariff Commission is tasked with the implementation of the following provisions of the Tariff and Customs Code, namely: Section 301 – Anti- Dumping Investigations,[140] Section 302 – Countervailing Investigations,[141] Section 401 – Flexible Clause,[142] Section 402 – Promotion of Foreign Trade,[143] Section 505 – Trade Monitoring,[144] Section 506 – Assistance to the President and Congress of the Philippines,[145] Section 1313A – Tariff Commodity Classification (TCC),[146] and R.A. 8800 – Safeguard Measures Act.[147]

- *Export Development Council*—The Export Development Council was created to oversee the implementation of the export plan and come up with measures to support the export sector.

While the Philippines has the number of implementing institutions similar to a developed country, the coordination and intra-ministerial aspect is lacking. References to a new organization structure exist in various forms but these have not been acted upon. The government section that is in charge of the services area is located in NEDA, while other trade sections are in DTI, which adds a degree of separation

140 The Commission conducts formal investigations including public hearings on petitions filed against the importation of articles at dumping prices to determine whether or not the domestic industry is injured or threatened with injury as a result of this importation. The Commission submits a report of findings, whether favorable or not, to the Secretary to issue the Department Order.

141 The Commission conducts investigations on petitions against imported articles directly or indirectly granted any bounty, subsidy, or subvention. The Commission submits a report of its findings to the Secretary. The countervailing law is governed by Republic Act 8751.

142 Under the "Flexible Clause" provision, the Tariff Commission undertakes investigations including public hearings on petitions to increase, reduce, or even remove existing rates of duty, including any necessary change in tariff classification, for the purpose of protecting local industries or the economy as a whole. The Commission prepares and submits its findings and recommendations to the National Economic and Development Authority (NEDA), the agency that makes the final recommendation for the President's approval.

143 Before any trade agreement is entered into with any foreign government for the purpose of expanding foreign markets for Philippine products as a means of assistance in the economic development of the country, and in establishing and maintaining better relations with other countries, the Commission conducts an investigation to determine whether or not such an agreement is in the national interest. These trade agreements include those entered into under WTO and ASEAN. The report of its findings is submitted to NEDA; NEDA then makes its recommendation to the NEDA Board and the President.

144 The Commission monitors trade developments that result from the implementation of trade-related policies, programs, and regulations such as the import liberalization programs (ILPs) and exemptions from the payment of import duties.

145 The Commission provides information and other forms of assistance to the President and Congress on the evaluation of tariff and tariff-related matters.

146 The Commission issues tariff classification rulings after thorough research and analysis on the commodities imported or to be imported. Such classifications are binding upon the Bureau of Customs unless the Secretary of Finance rules otherwise. As a policy, the Commission does not issue rulings on specific commodities subject to a protest.

147 The Commission conducts the formal investigation of safeguard cases. It is mandated to complete its investigation and submit its report to the Secretary within 120 calendar days from receipt of the referral by the Secretary, except when the Secretary certifies that the same is urgent, in which case the Commission shall complete the investigation and submit the report to the Secretary within 60 days.

to an important trade area for the Philippines. This increases the need for coordination to take advantage of and to maintain competitiveness in this key sector.

D. Supporting Institutions

The Philippine Chamber of Commerce and Industry (PCCI) is a non-stock, non-profit, and non-government organization of small, medium, and large enterprises, local chambers, and industry associations representing various sectors of business. The roots of the chamber movement can be traced as early as the 1890s with the formation of the Camara de Comercio de Filipinas. This was followed with the creation of the Chamber of Commerce of the Philippines (CCP) in 1903. The rise of industries in the 1950s prompted several industry groups to create an association which would be representative of their interests. Thus the Philippine Chamber of Industry (PCI) was formed. In July 1978, the Chamber of Commerce of the Philippines (CCP) and the Philippine Chamber of Industry (PCI) merged to become the PCCI. That same year, by virtue of Letter of Instruction No. 780, President Ferdinand E. Marcos recognized the PCCI as the sole official representative and voice of the entire private business community.[148] While this is no longer the case as other organizations now exist, the PCCI still plays a very influential role in the business community.

The foreign chambers are very active in the Philippines. These include the American Chamber of Commerce, the European Chamber of Commerce, the Federation of Filipino-Chinese Chambers of Commerce and Industry, Inc., the Korean Chamber of Commerce, the Japanese Chamber of Commerce, and the Australia-New Zealand Chamber of Commerce. In addition, the Joint Foreign Chambers of Commerce (JFCC), as well as the chambers individually, review upcoming legislation and urge the Congress to pass legislation that creates a better business environment. The JFCC members include the American, Australia-New Zealand, Japanese and Korean chambers, and the Philippine Association of Multinational Companies Regional Headquarters, Inc.

The Philippines has a pervasive media, including newspapers, magazines, television stations, and Internet-based outlets. There is an abundance of information on the different areas of trade, but there doesn't appear to be an Official Gazette where agency notices and information to concerned stakeholders can be promulgated, such as those concerning updated laws and regulations, tariff schedules, schedules for other fees, and statements regarding licenses. Many of the government bureaus and agencies within the trade sphere advocate the need for private sector input, but there is no clear channel of information to reach all stakeholders, nor does the private sector have a clear way to respond and provide input.

The Semiconductor and Electronics Industries in the Philippines (SEIPI) is the leading and largest organization of foreign and Filipino semiconductor and electronics companies in the country. It plays a very active role advocating for this sector. According to the National Statistics Office (NSO), the main exports of the Philippines are electronic components and garments. Electronics constituted approximately two-thirds of all export revenue. In 2006, the electronics industry employed 438,000 people this sector.[149]

SEIPI strives to help its members achieve global competitiveness by improving the core competencies of the work force. It also advocates for its members to the government and other institutions in the following areas: power and infrastructure issues, labor policies, security, trade facilitation, movement of goods, finance related matters, and the environment. SEIPI provides members and others with data on the industry, and serves as a "one-stop shop" for the Philippine electronics industry. SEIPI also provides its members with networking and business and consultancy services. There are more than 200 Filipino

148 More information can be found at http://www.philippinechamber.com.

149 Philippine Board of Investment (BOI) and PEZA.

member-companies in SEIPI. Not only does SEIPI play a role in policy formulation for the electronics sector, but essentially advocates for changes that affect other trade areas as well.

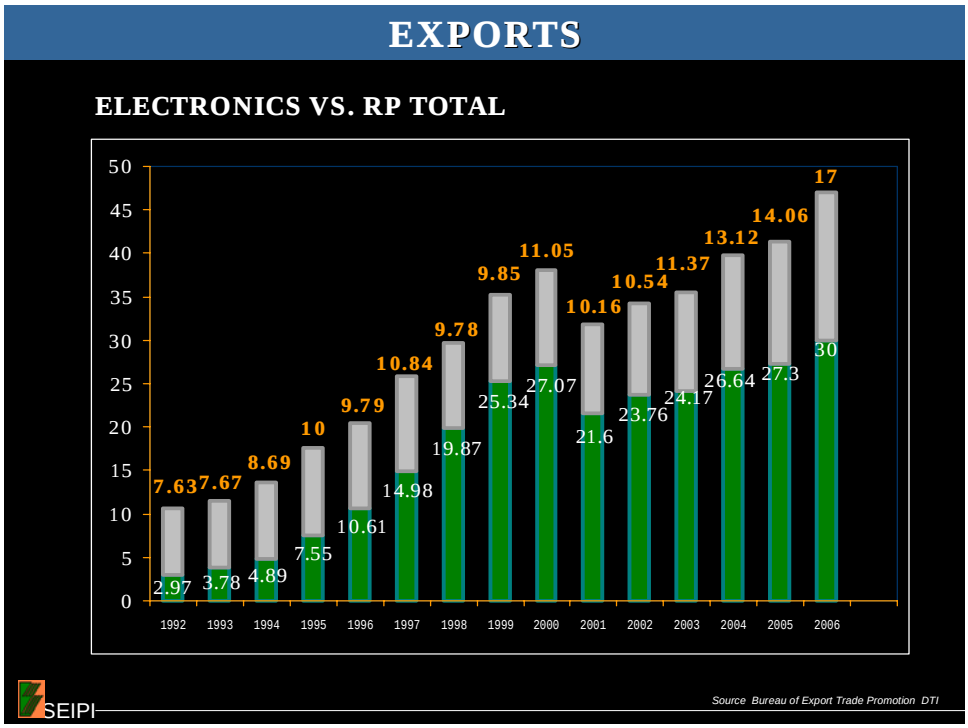

Figure 1: Electronics are two-thirds of total Philippine exports. Note "RP" means Republic of the Philippines.

The Philippine Services Coalition is an organization that the government, donors, and private sector have backed to support the role of services in the economy. The Philippine Coalition for Services Export Promotion was launched in May 2005 to enhance Philippine trade in services as a factor of economic development. It comprises a partnership of concerned stakeholders from government, the private sector, and academe, and was established through funding from the European Commission and technical assistance from the International Trade Center (ITC) in Geneva. In January 2006, Foreign Affairs Undersecretary for International Economic Relations Edsel T. Custodio signed a Memorandum of Agreement (MOA) with the Deutsche Gesellschaft für Technische Zusammenarbeit GmbH (GTZ, the German Technical Cooperation). The MOA was to gain GTZ' assistance in conducting a study on the export potentials of the Philippine health and wellness sector as part of the work of the Coalition to profile a number of services sectors.

E. Social Dynamics

Donors

Donors have been very active in the Philippines for quite some time. The multilateral donors in the trade field are: Asian Development Bank, European Union, International Monetary Fund, United Nations Development Programme, United Nations Industrial Development Organization, and the World Bank.

Bilateral donors include: Canadian International Development Agency, Australian Agency for International Development, German Agency for Technical Cooperation, Japan International Cooperation Agency, the Netherlands, Sweden, and the US Agency for International Development.

Remittances

In 2005, worker remittances were up to an all-time high of US $10.85 billion[150] and comprised one of the main sources of dollars. This is an area that can be channeled into productive resources. It is covered in the chapter of the report on investment.

Services

In the 2005 Trade Policy Review, WTO members noted the growing importance of the manufacturing and services sector in the Philippines' economy. Members expressed their appreciation of reforms in the services sector, in particular in financial services and transport. Many members urged the Philippines to ratify the fourth and fifth protocols of the GATS. Some members noted the growing importance of overseas remittances in the Philippines economy, and in this context, of Mode 4 liberalization.[151] Unfortunately, the Philippines maintains several discriminatory measures against foreign service providers. The Constitution prescribes 40 percent investment ceilings for foreigners in several service sub-sectors and public utilities. Also, the Constitution contains provisions for preferences to domestic service providers in government procurement. This area needs improvement.

The area for services is strong in the Philippines. The high literacy rate coupled with language skills and its geographic position give the nation a strong advantage. Maintaining that advantage is critical at this time to stay competitive and to grow. Outsourcing, Business Process Outsourcing (BPO), data processing, medical and legal transcriptions, and call centers are also a very large part of the economic growth that the Philippines has been experiencing recently, but the potential is much greater. In addition, medical tourism, eco-tourism, and tourism in general have much room for growth. Nevertheless, the comparative advantage of the Philippines is diminishing relative to its neighbors and to other areas in the world. In the area of semi-conductors and electronics, the Philippines was a center for development and assembly. Higher levels of math and science are required for the development aspect, while assembly is not as complicated and can be done in many areas of the world where the education is more limited. Yet this does not apply to development of new products or research and development where higher education is required. SEIPI is working to increase the core competencies in these areas in addition to wafer fabrication.

Monopolistic Areas

A number of very strong families have control over certain key areas of the economy that are important to a competitive, trade-focused economy. This detracts from the Philippines' comparative advantage. In addition, one of the monopolistic areas is in the transportation field. Despite the Philippines' logistical advantages, the ability to fly directly and inexpensively is not possible due to the monopoly in the transportation arena. These areas must be opened to domestic and foreign competition for the Philippines to reach its potential.

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150 *Country Commerce: Philippines* 2006, The Economist Intelligence Unit.

151 *WTO Trade Policy Review of the Philippines*, July 2005 This can be found at: http://www.wto.org/english/tratop_e/tpr_e/tp249_crc_e.htm.

Education Base

There is a long history of strong academic institutions in the Philippines, including education in English and the higher math and sciences fields. This has allowed the Philippines to become extremely competitive in the electronics field and in the services area. However, the financial resources dedicated to primary and secondary education have been significantly decreased, and the nationalistic trend to place English as a second language is beginning to show up in the skills of the workforce. While the government is beginning to increase the budget in this area, it is not a significant increase. Anecdotal evidence points to China hiring English teachers from the Philippines to increase their competitiveness. The Philippines has the educational infrastructure; it needs to dedicate additional resources to keep the status quo. Additional effort to increase competencies in research and development and in the math and sciences fields will help it to stay competitive in the semiconductor field, electronics, and in BPO.

Private Sector Participation in Trade

The government's strategies and goals enunciate private sector participation as an important principle. Nevertheless, meaningful dialog with, and timely solicitation of comments from, the private sector does not take place. The nature and speed of trade and commerce requires the input and guidance of the private sector. A system should be devised that automatically promulgates draft laws and regulations for public comment. In addition, the private sector needs bolstering in order to define their areas of concern and a strategy to solve them. Some sectors have sufficient supporting institutions like SEIPI that are able to do the research and advocate on their behalf, but that is not the norm.

F. Recommendations

In light of the above, this report makes the following recommendations:

- Education at the primary, secondary, and tertiary levels need to receive additional resources in the areas of English, science, and mathematics for the Philippines to maintain its competitiveness in international trade. The curriculum in math and science needs to be updated to reflect the current demands of the market place, especially for the semiconductor industry.

- The burgeoning services sector needs to be supported through concerted government and private sector support. Restrictions concerning foreign participation should be relaxed; knowledge transfer and greater expertise will result. In addition, a study on how services can be better incorporated into the trade policy formulation process would be useful for strengthening the institutional arrangements necessary for cohesive policy formulation.

- The government should establish a uniform process across all ministries on the promulgation of new regulations, fees, laws, and procedures. There should also be one source identified that can be used to publish all notices so that the public is informed and can effectively comment and participate.

- A comprehensive program of updating and streamlining the laws, regulations, administrative decisions, and executive orders should be undertaken so that the rules and procedures are clear Further, a process of notice and comment should be included, as noted above.

- Study and replicate the successful features of the PEZA in order to undertake streamlined processes in this field.

- Monopolistic practices in the transportation field need to be dismantled. Trade facilitation and logistic support areas need to be expanded in a competitive manner to capitalize on the Philippines' advantage as a logistical hub. Stakeholders need to understand the benefits from expanding the participation in this field, and realize that this can have greater benefits for all, including the current monopolistic owners. An outreach program that shares examples of how monopolistic practices actually limits profit for the owners and that uses practices from other countries may be useful to encourage change.

- The Philippines should continue to focus on building its trade institutions, continuing compliance with its WTO commitments, and liberalizing trade.

- The Philippines should strategically look at the ways that it can benefit as a member of ASEAN and how it can become the logistical hub for the region.

- A strategy for harnessing remittances as a way to stimulate growth and enable the financial sector to support credit should be developed. In addition, remittances should be evaluated as capital to increase competitiveness in the trade field.

XII. Flow of Goods and Services

A. Introduction

This chapter analyzes the legal, institutional, and operational constraints that impede trade expansion, and recommends practical steps to minimize those constraints. The analysis begins with an examination of the Philippines's legal framework for the Philippines' BOC, which is subordinate to DOF, the Department of Finance, and responsible for the collection of customs revenues and enforcing the provisions of the Philippines' customs law and any other relevant legislation. This chapter then considers the institutional issues regarding BOC management, organizational capacity, and operations. Next, the chapter reviews other key public institutions involved in trade facilitation, including ports, airports, and other customs stations. Then, it describes key supply chain partnership groups such as customs brokers, freight forwarders, carriers, and other intermediaries/representatives of the trading community. Finally, this chapter advances recommendations to improve trade facilitation in Philippines.

B. Legal Framework

To provide an environment truly conducive to trade expansion, laws and regulations *must* provide the following:

- An adequate and coherent authority structure for the essential trade-related institutions
- Clearly stated regulations and procedures that form a basis for an adequate balance between facilitation and necessary controls
- The means to legally employ modern risk management techniques using selective inspections and post-release audits to accomplish their respective missions
- A productive environment of cooperation and procedural coherence among government agencies with border control responsibilities.

Philippines Customs Law

The Philippines is a charter member of the WTO; however, it is still in the process of adopting many of the model statutes recommended by the WTO. From 1992 to 1998, the Customs Reform and Modernization Program sponsored many needed legislative changes such as the **R.A. Number 7650** (April 1993), which abolished 100 percent mandatory inspections of cargo, paving the way for selectivity. The current project targeting changes to the Philippines' law, regulation, and practices in accordance with the Revised Kyoto Convention (see below) will, if completed, harmonize BOC procedures and processes to international standards.

Revised Kyoto Convention

This convention reflects the current economic and technological changes necessary for a modern customs administration conforming to international standards and practices. The Revised Kyoto Convention (RKC) also incorporates the best practices of member administrations. The RKC was adopted by 114 customs administrations attending the WCO's 94th Session in June 1999, and came into force on February 3, 2006. The RKC is an excellent means for facilitating trade, ensuring economic growth, and improving the security of the international trade system. As such it is a practical blueprint for modern and efficient customs procedures. Accession to the RKC has been made a priority by the current Commissioner,

Napoleon L. Morales. In conjunction with the Partnership and Advocacy for Competitiveness and Trade (PACT), the BOC has performed a gap analysis between the Philippines Customs Law and the RKC.[152]

The review identifies 40 gaps between Philippine law and practices and the RKC General Annex. The following gaps are the most significant:

- The Philippine value law still requires the use of lists rather than the WTO standard of transaction value. While this should be changed in the long run, because of the large amount of fraudulent values, the BOC should not abandon its lists until the Post-Release Audit program is functioning adequately and the BOC is confident of the compliance of at least its major, high-value importers.
- The current broker's law prohibits anyone but a licensed broker to file import or export declarations. By international standards, importers and exporters are given the right to file their own declarations. Undoubtedly, this already controversial issue will result in a loss of business for brokers and most likely will face stiff opposition.

Accession is a legal process that will require Philippine Senate confirmation, which may require several years. After accession, countries are given three to five years to change legislation, regulations, and processes as necessary.

C. Implementing Institutions

The cost of moving goods across international borders is now as important as tariffs in determining the cost of landed goods. The ability of countries to deliver goods and services in time and at low costs is a key determinant of their participation in the global economy. Easier movement of goods and services clearly drives export competitiveness and FDI. Delays in border formalities can raise the cost of goods and hurt a country's competitiveness vis-à-vis rivals. A country's reputation for inefficient and ineffective customs and international logistical regimes will discourage international companies from doing business in that country.

The Philippines Bureau of Customs, or BOC, is the principal government agency for border control. It fulfills the traditional responsibilities of a lead border agency:

- Determining the value of goods and collecting the related revenue
- Detecting, preventing, and reporting smuggling
- Detecting and evaluating violations of the customs law
- Participating in preparing and signing international agreements and conventions in customs matters, in accordance with customs legislation
- Assisting other federal border agencies with quarantine, health, and safety responsibilities in the fulfillment of their missions
- Carrying out all other activities, such as export reporting and control, determined by customs legislation
- Preparing, collecting, and distributing foreign trade statistical data to the National Statistics Office and other public institutions
- Supervising customs goods throughout the entire customs territory of Philippines by regulating international carriers, importers, exporters, and intermediaries
- Exercising customs control over customs areas
- Maintaining customs records

[152] See www rkcphil.net for details.

The BOC maintains a staff of approximately 5,000 civilian customs officers and support personnel responsible for policy executive management and revenue collection. A ceiling of over 6,000 positions is authorized, but the government-wide **Attrition Law** of the early 1990s prevents this ceiling from being reached. If automated and more modern selective processes are introduced to replace inefficient manual and hybrid (a blend of manual and automated) processing, BOC staffing needs could be reduced to 4,000-4,500 or fewer employees.

Automation

The BOC is converting its automated system, the Automated Customs Operations System (ACOS). ACOS will use as its core system ASYCUDA World, the latest version of the U.N.'s solidly performing off-the-shelf customs execution software. It is an upgrade from its existing ASYCUDA++ because it is web-enabled: the upgraded system will allow most transactions, including payments, declarations, and manifest information, to occur over the Internet. The hardware (e.g., servers, routers) and dedicated communications network are state-of-the-art.

However, the BOC has not even realized the full potential of its *current* automated system because its business processes are not adapting quickly enough:

- The carrier manifest function is not automated fully nor is the data being used for targeting or selectivity. Failure to activate and implement the manifest function means that import entries and export declarations are not being reconciled automatically with the carrier's reports (bills of lading/airway bills) of manifested goods. Besides improving the accuracy of matching, un-released shipments can be readily identified while providing a large labor saving compared to the present manual processing. The source carrier data can also be used for targeting and selectivity. Most important, analysis of the combined data set of entry and manifest can reveal potential integrity violations. For example, one officer who releases multiple shipments for a single shipper would not be a normal occurrence. Normally, one officer would service numerous importers; therefore, the possibility for collusion in the former case would be high and the shipments may contain wrongly declared merchandise for resale or even contraband. Automated manifest processing is the norm for most of the world's customs administrations.
- The data warehouse of ACOS is an excellent source of data for monitoring and evaluating the performance of the port personnel. For example, the number of declarations that are designated RED/YELLOW/GREEN can be monitored and, if the results/findings of the declarations are recorded, the efficacy of the physical examinations can be monitored. The data can also be used for a variety of purposes such as targeting companies for post-release audit, analyzing trends, and measuring release times.
  The automated system can provide the foundation for the single window concept where all the federal agencies with data needs are served, or where the system is used to perform required selectivity functions. The system can also be used to receive electronic licenses, permits, or certificates, thus eliminating paper filings for the other control authorities. This will simplify import transactions and reduce costs. A very active project to achieve this single window vision with the various components of the Department of Agriculture has already begun with a Memorandum of Understanding signed on February 22, 2007. (This development of this project began after four containers of meat from China were removed under suspicious circumstances from a BOC warehouse in 2006.) The agriculture single window procedures and automation can be expanded to other agencies after a successful implementation.
- Improvements to collections can be made using the ASYCUDA World implementation, especially for the larger and more frequent payers. Accumulating payments for multiple entries into lump sums on daily or weekly basis instead of individual checks or payments per declaration can ease the burden on the private sector, Customs' cashiers, and cooperating banks when

combined with the ACH payment feature. Additionally, a more sophisticated automated collections process could be used to ferret out counterfeit surety bonds presented by unscrupulous traders.

Intellectual Property Rights

In recent years, the Philippines has moved from being a source of pirated materials to a major recipient of goods in violation of intellectual property rights. The Philippines now faces increasing amounts of these goods being directly imported. Moreover, the country is increasingly used as transit point for such goods. Training in identifying counterfeit goods does not occur, and border officials are unfamiliar with procedures to be followed when counterfeit goods are encountered.

Risk Management

Risk management is a systematic approach to making decisions under uncertain conditions by identifying, assessing, understanding, planning, and communicating risk issues. It forms the basis for selectivity and is the single most important facilitative measure that a customs administration can take. For customs and border agencies, it is a means to move from an attempt to achieve total control of documents and goods for *every* shipment to a rational, data-driven process to select only high-risk cargo for intensive examination. Most countries have adopted a risk management approach to assist the international movement of goods from compliant importers while devoting their customs and other control agency resources to goods that have the highest potential negative impact on revenue, the economy, and especially the health and welfare of its citizens. Risk management deployment simply means that a large proportion of international shipments can cross the border quickly with no inspection and minimal formal requirements. As a result, opportunity for bribe solicitation and payment is reduced because of increased transparency and the removal of customs officers' opportunity to hold cargo for bribe solicitation.

The move to capture transaction data in a modern automated system such as ASYCUDA World provides the essentials for a risk management regime. Use of risk management and the selective examination technique are very limited in the Philippines. While we were unable to obtain exact selectivity figures, we were told that YELLOW and RED shipments far outnumber the GREEN shipments. In other words, individuals inside and outside of customs told us that 70-80 percent of the shipments require holding by customs until the individual officer is satisfied with the shipment. In most cases, a facilitating payment is required for release.

Selectivity is driven by criteria, and some customs authorities use hundreds of criteria to select which cargo deserves scrutiny. In the Philippines, the criteria are very broad and unrefined, which results in high rates of examination. Two examples of this are mandates that all refrigerated cargo and all cargo from China be designated as color RED. These shipments constitute a large percentage of the Philippine's shipments and lead to the high examination rates.

A special program called the Super Green Lane (SGL), which was created to allow certain importers to move their goods through customs in an expedited process, has not been a success. Although nominal fees are collected, normal processing and even RED, or full inspection, processing were comparable to the SGL's performance. Some interviewees said the RED lane is faster because facilitation fees led to more rapid service. Problems with delays in verifying bank collections are partly to blame. Additionally, unlike other "Gold Card" type customs processing, the SGL is based upon the commodity rather than the company. Most "Gold Card" programs offer expedited release based upon the high compliance rates and customs expertise of the candidate importers.

Post-Release Audit

Post-release audit is an excellent means to verify compliance and refine risk management techniques. The post-release audit is not a financial audit—rather, it serves to determine the level of compliance with all laws and regulations applicable to importers and is an evaluation of company practices and records. It assists in judging the integrity of information supplied in the customs declaration and the importer's level of compliance with customs' legislative requirements. Customs' overall aim should be to achieve private-sector compliance on a company by company basis while assuring itself that the company's import department is knowledgeable with customs' laws and regulations. True compliance exists when systems and/or departments at importing companies are aware of and take steps to comply with customs' laws and decrees. This includes internal company audits and self-assessments.

Ideally, customs would be able to move most international shipments from compliant companies to the low-risk or GREEN lane in confidence after a successful audit, instead of verifying the flow of goods across the border on instance-by-instance in real time. Additionally, declared values from these companies could be verified against the company's purchase and financial records, obviating the need for general value listings or ranges making use of transaction values in a high-risk environment.

Since the 1990s, the BOC has received extensive training and assistance to establish a post-release audit program, but very few audits have been performed. A renewed effort is being made to establish the program in effect for the first time. A new Deputy Commissioner with an audit background is now in charge, and 128 audits are scheduled for this year. Employees believe that the training they have received to date is insufficient.

Establishing a new post-release audit program in a country for the first time poses particular problems because the traders will not be prepared for the rigors of the audit. Some will have been careless in their business practices, some will not have a dedicated customs compliance department, and many will be unaware of their responsibilities as importers since intermediaries handle their clearances.

Many of our interviewees believe that value fraud is widespread in the trading community and that customs' auditing techniques will readily detect the violations. To add to the challenges of the audit group, vague recordkeeping requirements by customs hamper the auditors' efforts, while self-reporting of violations is hindered by the absence of a prior disclosure procedure in the BOC regulations.[153] A prior disclosure procedure helps companies that desire compliance deal with self-discovered issues without incurring punishments suitable to deliberate violators.

Finally, problems with retrieving entry files from other customs departments for the audit have hindered the audit preparation efforts.

Corruption

Virtually every interviewee acknowledged that persistent, widespread, and deeply-rooted corruption was an inherent part of doing business in the Philippines. A recent survey revealed that expatriate businessmen in Asia view the Philippines as the most corrupt country in the region: "Local corruption monitors confirm that graft and bribery in the Philippines remain rampant. Corruption has penetrated every level of

[153] Prior disclosure is a "safe harbor" by which importers and drawback filers may report to customs errors in classification or valuation, and other incorrect information associated with the filing of import or drawback entry. Duties and taxes are collected and usually penalties are lessened by a prior disclosure.

government, from the Bureau of Customs down to the traffic police officers who pull over motorists to demand bribes."[154]

Illegal facilitation fees paid by importers to BOC staff are accepted as a fact of life during the customs clearance process. These payments can equal 60 percent to 70 percent of the total clearance fees charged by intermediaries such as customs brokers. Illegal activities in customs and other public institutions in the Philippines total approximately US$2 billion annually, according to recent estimates.[155] In addition to bribes, the inefficient processing that enables such illegal activities also raises costs because of delays, demurrage charges,[156] and extra handling. Failure to use electronic documents alone can raise the overall costs anywhere from 1.5 to 15 percent of the landed cost of an imported item compared to a more efficient competing country.[157] Investors may simply avoid doing business or investing in a country with a poor rating or a reputation.

Customs administrations face three main areas of corruption:

Facilitating payments. Importers (or more likely the customs broker or a representative) pay bribes to obtain a normal or trouble free release.

Customs complicit fraud. By circumventing procedures, importers try to pay reduced (or no) duty, taxes, and fees compared to competitors who follow the law. This can involve other control agency jurisdictions such as food purity and plant/animal quarantine strictures. Customs officers either "look the other way" or become actively involved in the fraud. Free riders then are able to sell goods in the marketplace at greater profit than their law-abiding competitors.

Criminal corruption. Operators pay bribes to permit a totally illegal, lucrative operation to use customs channels for illicit purposes (e.g., drugs and other contraband to arms and munitions). During extensive interviews with the trading community and customs, interviewees described various examples of corrupt practices:

- Every Friday afternoon, a distribution of pooled facilitating payments collected during the week is made to ensure fair allocation of payments to those with less opportunity to receive such payments. This practice is familiarly referred to as "Christmas."
- Importers and brokers can gain quick, effortless release of cargo by passing their entry to a cooperative customs officer with whom they have established a relationship. This practice is familiarly referred to as the "Suki system."
- The dock facilities close at 4:00 p.m. in Manila. Because there is less scrutiny at this time, this is reportedly when containers with false or non-inspected release documents are taken out of the facility, which is threat to public health and safety. For example, at the time of this report, a number containers of Chinese beef that were released without agriculture clearance.

154 International Herald Tribune, "Philippines Most Corrupt, Survey Says", Carlos H. Conde, published March 13, 2007, available at http://www.iht.com/articles/2007/03/13/business/peso.php.

155 Nearly $2 billion dollars, or roughly 13 percent of the Philippines' annual budget, is lost to corruption in the country each year, according to the United Nations Development Program.

156 Demurrage is a charge required as compensation for the delay of a container or freight car or other cargo device beyond its ordained due date. Usual charges can be hundreds of dollars per day per container.

157 Wilson, John S. S., Mann, Catherine L., and Otsuki, Tsunehiro, "Trade Facilitation and Economic Development: Measuring the Impact," March 7, 2003. World Bank Policy Research Working Paper No. 2988. Available at SSRN: http://ssrn.com/abstract=636350.

- According to more than one account, in 1999, the board of directors of a prestigious organization that sponsors a bonded warehouse decided that facilitation payments of Php 800 (US$16.64) per shipment would end. When no shipments were released, a backlog of Php 300,000,000 (US$6,246,000) in held goods ensued. In a Pyrrhic victory of sorts, the impasse was resolved when a broker was hired who made the payments, and the goods were released.

Considering the perniciousness of corruption in the BOC, it is not surprising that several honest and determined attempts at limiting or eliminating corruption in customs processes have been blunted, rolled back, or abandoned.[158]

When corruption is present and flourishing in a customs administration, several factors are usually contributing to an entrenched system of illicit payments:

- A tacit acceptance of corruption by political and civil service employees
- A discretionary interface between customs officers and private operators where value is realized by either the release of goods or the quick solving of problems, real or contrived
- Willing accomplices or a group of accomplices within the customs organization and the trading community who may participate in or facilitate the payments
- A lack of efficient controls, checks and balances, and honest, motivated supervisory oversight

The BOC has the means and infrastructure readily at hand to institutionally combat corruption, including post-release audit and a world-class computer system to do risk management/selective examinations. Use of this infrastructure can greatly lower the amount of interface between customs officers and the trading community that often leads to facilitation payments. The lack of progress over the years in implementing these reforms suggests that corruption is so ingrained that its eradication must be carefully planned and be fully supported by the President and the top officials of the Department of Finance.

Training

Formal training in the customs professions consists of only a two-week general orientation for all employees. Ad hoc training currently occurs on the job. One floor in the main customs building has been refurbished for classrooms and a computer lab is being set up. Curriculum and lesson plans for basic and advanced customs training do not exist. Without a customs academy, correct practices, knowledge of laws and regulations, *esprit de corps*, and advanced courses, performance improvements will be difficult to achieve. Additionally, without a basic customs course, an important opportunity to filter out weaker candidates during a probationary period is lost. Also, in many offices, customs lawyers are used as investigators and prosecutors. Customs investigations uses many specialized analytical, tactical, and interrogation methods and techniques. No specialized customs formal training is given for these critical job categories.

Organizational Structure

The customs organizational structure is very flat: those reporting directly to the Commissioner include all the deputy commissioners and the principal field officers in the BOC. A draft "Rationalization Plan," while it includes many improvements to the organizational structure, expands the Commissioner's list of direct reports to 22.

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158 "Fighting Corruption In Customs Administration: What Can We Learn From Recent Experiences?", Irene Hors, Working Paper No. 175, OECD Development Centre, April 2001, available at: http://miranda.sourceoecd.org/vl=2481870/cl=25/nw=1/rpsv/workingpapers/18151949/wp_5lgsjhvj79kl htm.

Emphasis on Collections

A heavy reliance on customs collections and meeting national targets has caused concerns in the Philippine trading community and has proven counterproductive to trade facilitation. In a growing economy such as Philippines, too great an emphasis on increasing customs collections can cause customs to arbitrarily take measures that raise collections. These include ceasing payment of deserving refunds, increase the number of unwarranted seizures and penalties, and misclassifying goods to achieve higher duty rates. While these practices may raise revenue, one unintended consequence may be inhibiting foreign trade. The BOC is currently implementing the **Attrition Act of 2005**, which not only sets revenue targets for the BOC, but allows for employee bonuses to be paid based upon a percentage of amounts in excess of the targeted amounts.

D. Supporting Institutions

Although the BOC is the main implementing institution for the movement of goods, an efficient trading system relies on an interdependent process that includes other trade-related public sector institutions, trade service providers, and the importers and exporters themselves. Their capacities, honesty, and performance can result in significant costs (or savings) within the trading system. Optimized trade facilitation depends on the active and positive involvement of the supporting institutions. A customs administration that is not supported by a compliant, automated, and sophisticated private sector will not achieve a high degree of facilitation. Additionally, like the BOC, the trade-related public agencies also need sound management, well-trained staff, modern equipment, modern facilitative procedures, and active dialog with the trading community to respond quickly and predictably to issues while guarding the public safety and security of the country. The private-sector trading community also adds its expertise and familiarity with expert legal and logistical knowledge to the import/export process and, as such, is crucial to the efficiency and overall compliance of international trade movements.

Likewise, the other border agencies with responsibility for the health and safety of the people of the Philippines and other duties such as trade statistics, environment, and endangered species must be receptive and able to use increased customs' functionality through a sophisticated automated platform such as ACOS.

Public Institutions

Traditional border agencies (other control authorities) are present in Philippines. Most approvals are based on pre-filing and pre-approval for goods falling under their jurisdiction. Interviewees did not report any significant delays or burdens with clearances by the Department of Agriculture or the Minister of Health.

Currently, there is limited coordination between BOC and the other control authorities. Each trader or customs clearance agency must arrange its individual clearance; forms containing duplicative information on the same shipments abound.

However, there is an outstanding example of interagency cooperation with PHILEXPORT's One-Stop Export Documentation Center. All the primary border agencies are present:

- The Bureau of Animal Industry (BAI)
- Bureau of Customs (BOC)
- Bureau of Fisheries and Aquatic Resources (BFAR)
- Bureau of Plant Industry (BPI)
- Department of Trade and Industry (DTI)

- Fiber Industry Development Authority (FIDA)
- National Statistics Office (NSO).

Another important development is the positive cooperation evidenced by an MOA between DOF and DOA on actions to prevent smuggling. The MOA provides detailed guidance for both customs and DOA officials overseeing the importation of live animals, meat and fish, dairy, and plant products. ASYCUDA World will be modified to act as a platform for both agencies to ensure that proper procedures are followed.

While none of the agencies was considered a serious impediment to trade, each experiences problems with staff retention and antiquated processes and technology. Further, limited training has been given to customs for detection of other control agency shipments problems and issues, particularly in the area of animal and plant diseases.

Private Institutions

The traditional private-sector institutions that support international trade include:

- Importers
- Exporters
- Customs brokers
- Freight forwarders
- Air, sea, and road transporters
- Port authorities
- Air express carriers
- Bonded warehouse operators
- Trade associations

Within the Philippines, the port authority is a public entity.

Exporters

Seventy percent of the Philippine exports (US$30 billion of the US$47 billion total in 2006) are produced by one sector: the semiconductor and electronic industry. This sector is predominately foreign-owned (72 percent); Japan, the United States, and Korea are the major investors. Because Asia is the major market for these products, the Philippines is strategically located to allow same-day service to and from most major suppliers and consumers. This industry ships almost exclusively via air through Manila. With direct employment at 438,000 and investments at US$747 million in 2006, the sector has been successful in improving its import and export process.

Most electronic manufacturers operate within special economic zones to take advantage of financial incentives such as tax holidays and duty and tax exemptions. These zones are overseen by the Philippine Economic Zone Authority (PEZA). Relations between PEZA and this sector are good and exhibit high levels of cooperation and partnership. In fact, private companies operating within the zones are represented on the PEZA Board of Directors. One-stop shops for the handling of all customs and PEZA matters relating to transfer of goods are located directly within the zones.

In partnership with customs, SEIPI, the Semiconductor and Electronic Industries in the Philippines, Inc., provided both the required hardware and software for the Automated Export Declaration System (AEDS) for electronic submission and release of its export products. This system now processes about 2,400 declarations monthly. A fee of US$1.50 per declaration is paid to SEIPI for this service. Required

governmental approvals are granted within hours of submission. Currently AEDS is only available to members of SEIPI located in economic zones that ship by air. However, this group's membership of 240 firms accounts for up to 95 percent of the export volume of the sector.

While the actual import/export process is considered generally facilitative, mainly because of the close relationship with PEZA and the positive influence of the industry on policies impacting its growth, many challenges confront the sector. Principal among these are the inefficient, non-transparent process of setting up a business, including the lack of a single authority to grant such authorizations, high power costs, and the lack of adequate infrastructure.

Garments, minerals, machinery, and agricultural produces account for the remaining 30 percent of total exports. The garment trade has dwindled significantly over the last few years due to the global shift to lower labor cost sites like Cambodia and China.

Generally, export processing is facilitative, performed at low costs, and free of significant regulatory fees. Non-receipted facilitation fees are minimal. One-stop shops for exporters, run by customs and by PHILEXPORT at a cost of about US$20 per declaration, have cut export processing time from two days to 30 minutes. The nine government agencies involved in exportation are collocated within these centers. Exceptions to well-facilitated export processing include fees and processing times by government agencies involved with the export of food and drugs, both raw and processed.

Public-private partnership within the export sector is good and the vehicle used, the Export Development Council (EDC), has been effective in developing and implementing programs and a level of service that promote a facilitative export process while maintaining a sustainable export industry. The EDC is the highest export policy-making body in the country. It has the authority to impose sanctions on government agencies or officers that impede the flow of exports.

Importers

The electronic industry represents the largest import sector because it imports 65 percent of its raw materials. Because it operates with special economic zones under PEZA administration, its import process is fairly efficient. Its products are exempt from duty and taxes and do not fall under the normal customs import clearance procedures. The regular importers of consumer goods or other products are subject to an inefficient, non-transparent import process regulated and controlled by the BOC.

Delays between arrival and release are lengthy, on average approximately three days. Lack of timely submissions by the customs broker, use of a complicated, multi-step manual processing system within the BOC, under use of risk management techniques, and little or no coordination between the involved government agencies contribute to and cause delays.

Further complicating imports, the interpretation of law and policies by customs officers is arbitrary, creating an unpredictable, non-transparent environment for the trader. Many traders believe that the BOC interprets the law to its own advantage (especially if it raises revenue) without regard for the economic impact on the trading community.

Unfortunately, the trading community and the BOC regard each other with distrust and disrespect, and this lack of partnership has prevented the private sector from becoming fully engaged in the customs modernization process. Consultation between BOC and traders usually occurs after promulgation of policies and operational procedures and is initiated by the private sector. A recent example is the unilateral imposition of a US$25-50 fee for container scanning on all import and export shipments,

whether customs scans them or not. The parties are now seeking resolution through after-the-fact meetings.

Transport Sector

More than 95 percent of domestic transport, including international cargo that must be transferred to and from international hubs, occurs by sea. International port and air facilities in the Manila area handle 80-90 percent of all international cargo. These include South Harbor and the Manila International Container Terminal (MICT) within the Port of Manila (POM) and Ninoy Aquino International Airport (NAIA).

Domestic transport costs exceed the cost of the international movement. The 2006 World Bank *Report on Cross Border Trading* showed the Philippines as having the highest internal transport costs in the region at US$1,336 per 20' container. Nearest in cost was Thailand at US$848, with China at about US$350. With 2.1 million international containers shipped from the Philippines yearly, the overall excessive cost borne by the private sector in comparison with its next highest cost ASEAN partner is US$1 billion. Non-integrated domestic sea infrastructure requiring multiple cargo handling charges for containers and high port fees are the major contributors.

Serious challenges face the transport sector in the Philippines. The government's ability to address the complex infrastructure problems is questionable. Lack of transparent, credible contracting hinders realization of anticipated benefits from use of the resources of the international lending institutions focusing on infrastructure improvements.

Road transport. Trucking companies play an important role in the transport of international cargo, despite the predominance of sea cargo lanes. Such cargo often originates from or is destined for an overland location from the port. Most trucking companies are small operators with only one to two vehicles in the fleet. Multiple trucking organizations represent this sector. The largest, with about 8,000 companies as members, accounts for only about 20 percent of the total fleet. Total working fleet stands at around 267,000 vehicles, with the general condition fair to good. Capacity exists to haul all types of goods, from containers to bulk to heavy construction equipment.

The following major problems will hamper fleet modernization and the institution of modern business practices:

- Poor organization impedes effectiveness: The numerous small, ineffective associations should consolidate membership to provide better service for their member's needs and promote effective advocacy. An alternative would be to form a national umbrella group or coordinating council to speak as one voice for the sector.
- Limited reinvestment in the fleet: Profitability is low due to intense competition because of an oversupply of fleet vehicles and high diesel costs. Few large trucking companies can afford to maintain and upgrade their fleets. Small operators cannot access credit to finance needed purchases. When available, the limited funds are reinvested in used, reconditioned Japanese and U.S. trucks whose durability and quality are often questionable.
- No centralized authority: No single government authority exists to regulate the industry or address its needs, making it difficult for the industry to resolve its issues effectively.
- Inefficient truck registration: Time to complete registration of a truck for hire is a cumbersome, lengthy process taking anywhere from two to five years.
- Industry practices run contrary to acceptable norms: Overloading, although prohibited by law, is a common practice to make a worthwhile profit. Also, the use of contracts in the industry is limited, making collection of fees and resolution of problems difficult. Companies do not normally invest

in insurance to cover losses. Additionally, employment of modern information technology to improve operational efficiency is very limited.

- Time restrictions regarding use of trucks on roads: In the Manila and Calabazon regions, truck use is limited to certain times, which limits profitability. These strictures result in only one haul by day per vehicle, almost all of which have no backloads.

This assessment did uncover positive developments. Security has improved in recent years due to the implementation of a National Police task force to reduce hijacking. Improved facilitation at the major container handling facility at the Manila Port, MICT, has eliminated human intervention at the port and decreased processing times significantly. However, lack of investment in infrastructure at South Harbor, operated by Asian Terminals Inc. (ATI), causes lengthy delays for the trading sector.

Marine Transport The Philippine Port Authority (PPA) is a government corporation charged with financing, managing, and operating the major cargo ports. Its jurisdiction includes 112 ports, 21 of which are designated for international use. Cargo handling operations at these international sites have been privatized. PPA also exercises approval and oversight of the 600 to 800 private ports that principally serve only one user, who is also the operator.

The total volume of containers handled at the ports in 2006 was 2.1 million TEUs (a twenty-foot container equivalent unit). The country's premier international port is Manila/Northern Luzon. Two of its privately operated concessions process the vast majority of all containerized cargo for the country. MICT, the Manila International Container Terminal, ranks as the premier location, handling slightly more than half of the total volume. PPA turned over the management and operation of this location to the private firm International Container Terminal Services, Inc. (ICTSI) in June 1988 under a 25-year contract.

The operation at MICT has appropriate infrastructure to meet the international maritime security standards of the UN International Shipping and Port Facility Code and the security requirements of the U.S. Department of Homeland Security, although issues continue. Average transfers per hour occurred so slowly that they increased the cost of doing business, according to the trading community. Recent installation of a weighing service at the entrance gates at a cost of US$2.00 per load is effective in detecting pilferage in export containers that occurs during transit to the port, and ensures the proper loading of containers in larger, faster ships. Adequate space is available for expansion.

Information technology is used to track movements, administer the operation, and post releases. However, it does not tie into the international carriers' automated manifest system, which is the key starting point for all modern port systems. This failure prevents efficient and effective manifest reconciliation for all concerned parties to ensure proper disposition of all loaded and unloaded cargo. Time from arrival to release is excessive by international standards, averaging three to four days due to late filing by customs brokers and inefficient processing by customs.

The other major, private, international cargo handler in Manila Port is Asian Terminals Inc. (ATI). ATI operates out of South Harbor on a series of finger piers. The draft of the vessel occasionally requires barging the cargo to and from the pier.[159] This double-handling operation significantly increases cargo handling fees and delays loading and unloading. Congestion at the port, inadequate dredging, and poor infrastructure plague this location.

[159] Finger piers are structures with warehouses that jut into the waterway like the fingers of a hand. These facilities predate containerization. They are best suited for the cargo net operations of break bulk cargo. Modern container berths contain adequate space to spot thousands of loaded and empty containers. They employ large container cranes and specialized equipment to move and store containers awaiting delivery.

Approximately 40-45 international container carriers call at the Philippines, using feeder vessels that stop at smaller regional transshipment hubs to carry cargo to and from locations like Hong Kong and Singapore. Most call at only one location. These firms seek to use ports where there is a long improvement plan for future growth, with adoption of world standards for operation.

Poor port infrastructure, despite improved investment and productivity in the last few years, continues to be a concern among international carriers. Costs of calling in the Philippines are high and do not compare favorably with other destinations in the area like Hong Kong, Singapore, and Taiwan. These fees are the result of inefficient processing, cumbersome documentation, lengthy discharge and loading times, and the failure to adopt uniform countrywide rules to reduce complications in port operations. Other contributing factors are high BOC examination rates and the delay by the port and its private operators in implementation of modern system management systems. All these factors prevent the Philippines from effectively using its strategic location to become a major regional transshipment hub for intra-ASEAN shipments. Failure to lower costs through needed improvements will make it difficult for carriers operating out of the Philippines to compete with the more efficient operations of low-cost countries such as China.

Gross revenue for the PPA amounted to US$125 million in 2006. Half of the net profit of US$58 million is required to be remitted to the national treasury. The rest subsidizes non-viable ports and funds infrastructure improvements. PPA collects wharfage, port dues, and berthing charges directly from the international carriers. Cargo handling fees are collected by the private operators; a percentage (10 to 20 percent) is remitted to the PPA. The PPA regulates and controls the cargo handling fees for its ports, although these fees are deregulated at private ports.

The legal mandate of the PPA presents a conflict of interest for the organization and should be altered to improve competition and lower costs. In addition to being a regulator, it is also a port developer and receives a significant part of its operating budget from the collection of fees that it sets. Competition that would lower rates has a negative impact on the PPA and therefore is kept to a minimum. Private cargo handling operators at PPA ports are limited in number and contracts are extended significantly before expiration, even though performance to date has not met existing contractual obligations. Although the Philippines already has the highest port and cargo handling fees in the region, the PPA increased fees in both 2005 and 2006.

Despite the high number of private ports, most are operated by the user only for its own cargo. Therefore they do not compete directly with PPA ports. One significant exception is the private port in the Manila area, Harbor Center Port Terminal Inc. (HCPTI) that the PPA has licensed to handle international bulk shipments. This resulted in a 40 percent lowering of rates and the transfer to this facility of about 40 percent of the bulk cargo previously handled by ATI. Although this same port is equipped to handle containerized cargo as well, the PPA has not approved its request to expand to this service. PPA's failure to respond to this request contradicts an executive mandate requiring promotion of competition among the ports and the granting of HCPTI permission to operate fully as a private port.

Unless otherwise arranged with a private operator, infrastructure improvements are the responsibility of the PPA at the ports with multiple users. By 2010, 10 major ports are schedule to be upgraded to international standards; however, the country's ability to achieve this goal is in doubt. Much attention and money (US$146 million) has been directed to developing state-of-the-art terminal facilities at Batangas port by December 2007. The PPA anticipates that up to 40 percent of the cargo currently handled out of Manila will relocate there, relieving congestion. However, international carriers are awaiting the results of these efforts before making plans to increase calls at that location.

Five ocean carrier companies that combine both passenger and cargo hauling on the same vessel control domestic shipping. This activity represents 93 percent of the total ship movements in the Philippines. Domestic shipping costs exceed international liner costs, and average US$500 per container. Lack of dedicated cargo ships on the domestic routes is a major contributor to this high cost. Often, several carriers will be involved in transport of a container from origin to international loading, resulting in multiple handling charges. The donor community is now formulating a detailed comparative study on transport costs in the Philippines in relation to its neighbors. It will provide the basis for validating these estimates.

Cost reductions of up to 40 percent can be achieved in inter-island domestic transport through the use of Roll On-Roll Off,[160] which eliminates cargo handling. Although Executive Order 170 approved this process in 2003, full use of this service has not occurred due to lack of competition and due to limitations put on its use.

Air The air cargo industry is a critical factor within the country, because the principal international trade sector, electronics and semi-conductors, depends on it almost exclusively for import of its raw materials and export of its final products. The remaining international air cargo consists generally of fresh fruit and vegetables and pharmaceuticals. The Civil Aeronautics Board (CAB) regulates the industry.

Eighty to ninety percent of air cargo flights currently use Ninoy Aquino International Airport (NAIA) in Manila. Although air transport is still dominated by Philippine Airlines (PAL) (it controls approximately 35 percent of the trade in this sector), bilateral air service agreements concluded with 50 countries permit international cargo to be carried by other airlines. These bilateral arrangements generally place limits on the tonnage and number of flights allowed by foreign carriers; these restrictions prevents airlines from adjusting schedules to accommodate changing demands. Seventy percent of air cargo is carried in the hold of passenger flights.

Generally, with much at stake, vested interests within the country heavily influence national air policy generated by the regulatory authority, often chilling any openings to competition. This arrangement results at higher costs and limited service to the trading community. However, a more positive outlook occurs at the former Clark Air Base, where a pocket “open skies” policy was implemented in 2003. A significant increase in passengers and international freight has occurred. One particular success story has been the export of agricultural products, especially asparagus to Japan, because Clark is close to major agricultural production areas. The vision is to convert the Clark airfield into a major regional air cargo hub and have it serve as a regional maintenance, repair, and overhaul facility. The open skies policy gave international cargo carriers the assurances required for investing in expansion within the country. Ongoing infrastructure improvements in both the road and rail links to the Clark area, principally the Subic-Clark-Tarlac expressway, should expedite transit times and lower costs associated with using this facility. However, restrictions such as non-renewable and short time limits for landing rights regulated by BOC inhibit full realization of this vision.

Customs Brokers/Freight Forwarders

Customs brokers in the Philippines must meet the highest qualifications requirements within the region. Yet a significant portion of the industry does not deliver professional services at a high level of quality, due in large part to the way that the sector is organized. Brokers are required to complete a four-year college course in customs administration prior to applying to the Professional Regulatory Commission (PRC) to become a licensed customs broker. The PRC test, prepared with little or no customs

[160] Roll On-Roll Off is achieved by using ramps to allow vehicles, containers, and other rolling stock to access the cargo holds of the ship. Cranes and special handling are not necessary.

involvement, is usually given annually and has about a 75 percent pass rate. About 4,000 individuals currently hold PRC licenses; of those, 1,000 actively practice. All registered license holders are automatically made members of the Chamber of Customs Brokers, Inc. (CCBI); self-policing is one of that organization's functions.

All import and export formalities are prepared by customs brokers either in-house or at outside private companies. Small-scale brokers serving one to two clients prepare almost half of the total volume of transactions. These individuals perform all activities related to preparation and release of shipments, including personally escorting the file through customs processing. The Federation of Accredited Customs Brokers and Forwarders of the Philippines Inc. (FACFOB) represents almost all the major firms (i.e., those that handle more than five clients) operating in the sector. It is very active in its continuous education efforts of the sector, hosting seminars on changes in customs policies and procedures regularly. Attendance is open to all interested parties, including customs officers.

The significant volume of work handled by small individual brokers creates disadvantages in promoting modern business practices and providing good quality of service. Individual brokers depend largely on personal connections to one or more customs officers to move their transactions through the process. Generally, instances of complicity in irregular activity between a trader, broker and/or customs are higher in this environment because of the greater degree of dependency in the relationship. Typically, if an importer balks at paying a bribe, the broker will advise the client of the dire consequences of such a decision. Cargo will run into a series of hurdles such as delays and 100 percent intensive inspections. Investment in information technology needed to upgrade service is not a feasible option.

At less than 10 percent, the level of automated capabilities within the customs broker community is low. Knowledge of modern customs procedures and international trade standards is limited to the larger international firms. This will hinder full use of the upcoming implementation of ASYCUDA World. To date, customs policies have not encouraged brokers to automate. Fees for direct trader input (DTI) are much higher than the Php 40 fee charged at the Entry Encoding Centers that provide that service. Modern automated customs systems rely on a high percentage of edited and complete electronic information from the private sector. No agency or association is providing effective oversight of this vital sector. If any revocations do occur, they are temporary, despite the severity of the transgression.

Document preparation time takes too long, averaging two to three days from arrival. Modern business practices must be employed to encourage pre-filing of the customs documentation. Lack of ability to transmit tax and duty electronic payments to the bank on a 24/7 basis and the bank batch processing techniques contribute to delays because proof of payment is generally required prior to entry submission.

One current issue involves section 29 of R.A. 9280 passed in March 2004, which has yet to be implemented. This section has been interpreted to prohibit importing and exporting firms from conducting customs brokerage functions within house, instead requiring them to use the services of an outside broker. Philippine brokers support this law on the grounds that it will increase professionalism within their sector, but the law runs contrary to accepted international best practices. The provisions of the Revised Kyoto Convention (as stated previously, the Philippines is in the process of acceding to this document) allow for the importer or exporter to either prepare its own documentation or to employ the services of a broker.

More than 100 freight forwarding companies operate in the Philippines.[161] Firms handling air cargo are considered public utilities and must have 60 percent Philippine ownership. This does not apply to sea cargo handlers. A recent trend toward consolidation has led to a few international players dominating the

[161] Freight forwarders act as logistical intermediaries and consolidators for importers and exporters.

current market. This has improved the quality of service and lowered costs through use of modern information technology.

Air Express Carriers

The four major international air express carriers—DHL, FedEx, UPS, and TNT Express—operate in the Philippines. UPS and FedEx operate regional hubs in the Philippines, although FedEx will move to China in 2008. The move is the result of increased cargo volumes in and out of China, not dissatisfaction with the current operational environment. All the carriers are members of the Philippine Chamber of Air Express Operators, which is associated with the Confederation of Asia Pacific Express Carriers (CAPEC). While the original objective of the organization was to jointly address issues with customs, that mandate has been extended to include all sector issues. Good cooperation between the players is evident. This group is a significant service provider to the international trading community, particularly when speed is required to deliver spare parts and commercial samples. Increased use of just-in-time delivery methods by the international players has transformed these carriers from document handlers to traditional cargo transporters.

Processing and release of transit and export goods is expeditious and efficient. Modern practices are used in the import process as well. Customs reviews the carrier's electronic manifest in advance of arrival to select import shipments for formal entry processing. Selections represent less than five percent of total packages. Despite these efficiencies, however, the import process is not predictable or transparent. The BOC does not follow the WCO's Express Guidelines, which establish international standards.

The major reason for the lack of transparency or predictability is BOC's lack of any provisions within its legal code for the treatment of this industry. Each firm operates on its individual formal MOU with customs. Indications are that treatment under these agreements is not uniform within the industry. One example is different monetary limits for the requiring of filing of formal entries. Treatment at each of the carrier's hub relies principally on personal relationships with the assigned BOC officers.

In a further complication to the smooth movement of international shipments, some provincial governments exclude use of a commercial vehicle on the road one day per week. In order to not lose a day of door-to-door service, therefore, a 20 percent increase in the normal fleet requirements is needed by this sector, adding costs to each delivery. A requirement that a Philippine-owned company must perform delivery directly to the importers' premises is a key element of this sector. Therefore, most carriers contract out of this service.

The following illustrates the lack of facilitation within the import process: the BOC charges high overtime costs for service outside normal working hours. Other countries in South East Asia, such as Malaysia and Indonesia, either offer customs service 24/7 or charge lower overtime rates. Overtime pay is also inflated through the customs practice of assigning more officers than are needed to perform the work.

The customs law for "*de minimus*," which establishes the value under which a shipment can be cleared without documentation or duty payments, is too low. It was established at the equivalent of US$0.19 in 1957. Internationally, customs generally allows shipments to be cleared informally between US$25-100 in practice. Not having a reasonable amount fixed in law, however, allows too much discretion and opportunity for solicitation of illegal facilitation fees by BOC officers. Estimated revenues collected from low value shipments account for no more than 0.1 percent of total collections. Statistically, there would be little impact on revenue if limits on entry filing were raised.

The inability to deposit duty and taxes electronically with the bank on a 24-hour a day, seven-day a week basis particularly impedes release of goods for those that operate outside normal working hours.

Time of release for formal entries (those valued at more than about US$200 or more) is too long, taking one to three days from arrival. Much of the import trade for this sector involves critical just-in-time inventory where time is of the essence.

Customs Common Bonded Warehouses

The country has many different warehouse regimes to serve the international trader. One of the most significant are the common bonded warehouses, which store imported materials that will be transferred to a manufacturer who will use them to produce an export product. Goods placed in these facilities are exempt from payment of duty and taxes. Three non-reimbursable customs officers, each with a specific type and function, are assigned to common bonded warehouses to monitor activities.

More than 100 such warehouses nationwide processed about US$2.5 billion in imports from June 2005 to June 2006. Thirty percent of all exporters use these facilities. The Customs Bonded Warehouse Operators Federation Inc. (CBWOCI) represents 13 firms in the Metro Manila area that handle 60 percent of the total volume of warehoused goods nationwide. These facilities generally serve small and medium enterprises (SMEs) that cannot afford to manufacture in special economic zones.

By law, two categories of goods are stored in common warehouses: garment/apparel products and miscellaneous. These cannot be commingled in one facility, and a separate accreditation from customs must be obtained for each operation. Users apply to the Institute of Trade and Development with a formula of manufacturing conversion showing the raw imported material that will be used in the final productions. The formula must state the monthly amount of goods to be imported based upon submitted purchase orders or letters of intent.

Specification of stated monthly import amounts and required strict adherence to them denies exporters the ability to respond immediately to a buyer's demand for increased purchases. Customs tracks these quantity limitations carefully and requires the users to pay duty on any excess. Securing of amendments to initial quantities is time-consuming and cumbersome.

Customs guidelines for operations of bonded warehouses, issued in 1991, are inefficient and outdated. All movements in and out of the warehouses are required by customs policy to move under supervision of a customs guard rather than relying on information technology to track shipments and post-audit reviews. Customs has not acted on recommendations and drafts for revision submitted by the trade since 1996.

Up to five different customs offices perform spot checks and audits of warehouse operations. Since these are not coordinated, it is not unusual for a particular user to be checked five to six times per year, even if previous checks have revealed no wrong-doing. Attempts by the industry to resolve this issue have not been successful.

The cost of doing business for this sector is rising. Facilitation fees to customs officers assigned to the warehouses are significant. The average cost for clearing a container into a bonded warehouse range from US$350 to US$400, up to 60 percent of which is for non-receipted fees. Warehouse assignments are highly sought after within the BOC; incumbents often refuse promotions rather than leave the post. Further, since the posts are lucrative, these and similar facilities tend to be overstaffed.

Domestic producers complain of major leakage from these installations. When these leaked goods are released on the black market at reduced prices, these producers are unable to compete. Although smuggled goods are recognized as a major problem, a study conducted several years ago indicated that warehoused goods represented only three percent of the total. However, the proposed anti-smuggling bill

requires duty payment on importation for all merchandise now entering bonded warehouses. Enactment of this legislation in its current form would close down bonded warehouses and prevent SMEs from participating in the current duty exemptions on goods incorporated into exported products. The resulting increased costs will probably force many of these small firms to shut down.

The second category of customs warehouses has to do with public bonded warehouses, which are located where international cargo is loaded or unloaded. These are used as temporary storage facilities for cargo awaiting BOC or other agency clearance. Rates for storage are set by the BOC and presently amount to Php 0.585 per kilo per day for most cargo. Goods average about three days in these warehouses, with most of the delay consumed by preparation of import documentation by the broker. Routine use of these facilities would be eliminated with pre-arrival clearance of imported goods, a routine practice in most modern customs services.

Special Economic Zones

Special economic zones (ecozones) are a critical element in international trade in the Philippines, accounting for 86 percent of the total manufactured export products. The current 112 ecozones service a total of 1,436 companies and employ 545,000 direct employees, an increase of 100,000 over the previous year. All zones are required to be located outside the Manila area to encourage regional development.

Fifty-seven of the 112 ecozones are set aside for export manufacturing and require the users to export 70 percent of their finished products. Such zones typically accommodate 40-50 firms. The remainder of the ecozones are industrial parks and buildings that offer export of services, such as tourism. Although the developers/operators must be 60 percent Philippine-owned, there are no such restrictions on the users, which are predominately foreign companies.

All ecozones, except four, are privately owned and operated. The four public operations were grandfathered in when new zone legislation was enacted. The current law, R.A. 7916, the **Special Economic Zone Act of 1995**, mandates private development and established the Philippine Economic Zone Authority (PEZA) under the DTI to regulate the zones. PEZA is governed by a Board of Directors composed of a representative of the nine different governmental agencies involved in zone operations as well as a representative of the labor sector and businesses located in the zones.

The export processing zones offer their users tax- and duty-free importation of all raw materials and manufacturing equipment incorporated into the final export product as well as a four-year tax holiday. When the latter expires, the only tax assessed is five percent on gross profits. Zone operators pay a yearly administrative fee of US$1,000 to PEZA for each firm located in the zone.

Most firms located in the zones are engaged in the production of consumer electronics. Garments, rubber products, fabricated metals, plastics, electrical machinery, transport equipment, and industrial chemicals are also produced. Although garments used to be a major zone activity, it now represents only 1.3 percent of total production. The garment trade has relocated to other countries in the region that offer lower labor costs.

The process for moving goods in and out of the zone is efficient. There can be a four-day turnaround between arrival of an input in-country and delivery of the finished product to the foreign party when air shipments are used. The reason for this efficiency is the active role that PEZA takes in overseeing all steps in the operation and in ensuring customer satisfaction. It is far more than a regulatory body.

Although customs still must release and examine goods, it does so in concert with the PEZA officer who assumes management of the function. PEZA officers are present in the Customs Documentary Unit at all

import and export locations to ensure facilitation. All examinations are done in the zone jointly by Customs, and PEZA Service is offered on a 24/7 basis. Only in an unusual situation, such as involving a high-pilferage item like garments, does a public officer accompany the shipment from the zone to the export site.

PEZA reviews available transport companies, freight forwarders, and customs brokers, and accredits those of a high standard that all zone users must employ. Only about 500 companies qualify nationwide. Reported leakages are promptly attended by PEZA investigators. Resolution is conducted in concert with the BOC.

PEZA is perceived by the trading community to be a well-run public entity, responsive to their needs and intolerant of governmental abuses. An active partnership exists between its leadership and the user, and a culture of customer service permeates the organization. The fact that quality service breeds trade expansion is well-understood and is used as a promotional tool. PEZA leadership recognizes that many countries in the region are completing for the same business, and understands that success depends on zone administration that is efficient, corruption-free, and able to provide quality infrastructure and services.

Businesses operating under these special regimes are generally protected from any corrupt practices encountered in the normal import/export trade. This gives them a distinct advantage over direct imports overseen entirely by the BOC.

In addition, since the zones report directly to PEZA, they are exempt from provincial government interference and demands. PEZA leadership is strong, effective, and efficient. PEZA's clear and single point for resolution assists problem solving. Having an active private community offering the same services as the public operator allows for an openly competitive environment, which in turn allows for increased efficiencies and therefore lowers costs.

The planned expansion of zone services into the agro-industrial sector where goods can be both grown and processed should deliver great benefits. **The Bases Conversion & Development Act of 1992** designated seven previous military bases as Special Economic Zones, with Subic Naval Base and Clark Air Base as the major locations. These operate outside the PEZA structure and also offer expanded international economic opportunity.

Due to the demand for increased revenues, the government is reviewing the current tax holidays offered to ecozones users. Representatives of foreign chambers of commerce and operators of economic zones, however, expressed concern over the possible detrimental impact to the zones and foreign investment if tax holidays in the ecozones were lowered or eliminated.

Trade Associations/Public Private Partnership

The number of well-entrenched trade associations that perform valuable service to their constituencies is high in the Philippines. Most firms engaged in international trade, regardless of size, are members of multiple associations. The multitude of well-established, high-membership trade associations ensures that all trade sectors have an advocacy conduit and opportunity for continuous training. Although the trade associations are not usually solicited for input by the public agencies in policy promotion, they continue to actively push for modernization and facilitation practices on their own initiative. One notable exception to this pattern was the work done in preparation for accession to the Revised Kyoto Convention, where there was active public-private trade partnership.

The PCC, the Philippine Chamber of Commerce, is recognized by the trading community as an important player in improving the trade and investment climate, although at times its views have a somewhat protectionist leaning. The principal foreign chambers work collectively through the Joint Chamber of Commerce to advocate for needed reforms and are considered a major player in advancing issues requiring attention.

PHILEXPORT is a strong organization with good representation throughout the country. It is by law the principal export association, and its membership accounts for about 75 percent of the total value of national exports. It operates as a 50/50 private-public enterprise, running the largest bonded warehouse as well as 11 one-stop export shops throughout the country. The group uses its membership on the Export Development Council, a private-public group composed of nine exporters and representatives of the nine government agencies involved in exports, to address issues. The group also meets quarterly with the President, giving it a well-established and effective venue for resolution of export-related issues.

The Port Users Confederation is a unique association of 23 of the trade associations that are involved in port operations, ranging from truckers to warehouse operators and freight forwarders. This collective voice influences policy and encourages dialog within the varied sectors of the trading community.

Although customs process is recognized as a major impediment to eased trade facilitation, there is no clearly defined or established procedure for dialog and cooperation between the trade and the BOC. While customs will occasionally solicit input from the appropriate trade association prior to issuance of a procedural change, in most cases this does not occur. The private sector is left to react and marshal its efforts after the fact. This lack of true partnership and the current environment of distrust and suspicion that prevails between the BOC and the private sector hinder real reform that would benefit all sides.

E. Social Dynamics

Philippine public trade institutions are generally too weak and influenced by outside forces to reform from within. This dampening of initiative within the public sector and its control by vested interests in the private domain are the key factors prohibiting substantial progress in facilitation of the flow of international trade. While major international investors have learned to work within the system and succeed, new players, usually SMEs, continue to be marginalized with the current environment, hindering their entrance into, and growth within, the marketplace.

There is generally a lack of political will to improve inefficient processes surrounding the flow of goods, in particular the BOC policies (which seem almost immune to change). Although the agency has adequate information technology to migrate to modern business practices, the poor results indicate a lack of commitment to the task. Even when there was success in a previous administration, the reforms were eroded and the agency reverted to previous levels of inefficiency and corruption.

A culture of facilitation generally does not exist within the regulating institutions. A lack of a proactive approach in anticipating and resolving problems also hinders the flow of goods. Change occurs usually upon orders from a higher echelon that is the result of continuous pressure by the affected private stakeholders. This process has its limitations. Sometimes the change does not result in the needed institutional reforms, and executive orders can be overturned or superseded, thus creating a less predictable environment for the trading community.

The trading community, principally through its trade associations, is vocal and committed to pushing for liberalization and facilitation of current trade practices. This pressure seems to be the most effective engine of change. But because this community is not a full partner in reform efforts, improvements are generally only incremental and are not always sustained.

Although corruption is recognized as a major impediment to investment and trade facilitation, there appears to be neither a serious effort nor a plan to address it by the government. On paper, the Office of the Ombudsman, which is tasked with investigation and prosecution of all public officials, is a strong agency with wide-reaching authority. However, its real effectiveness is limited by its inadequate, poorly-trained staff and by corruption within the agency itself.

As a force in society, the Catholic Church has been active in fighting corruption at the local level, cooperating with the office of the Ombudsman to identify corrupt local officials to be investigated and participating in oversight of awarding of local contracts.

Although the legislative branch is not generally well-versed in trade issues and is often seen as siding with protectionist policies to protect its local constituencies, there are a few champions pushing trade liberalization.

F. Recommendations

This report makes the following recommendations:

- Involve the strong private sector institutions as full partners in the reform of the flow of goods processes. Form working groups with the involved public institutions and empower them to review the current process, identify problem areas, and develop innovative solutions that meet the needs of the public and private sectors. Timetables, benchmarks, and desired results should be clearly defined. Examples of where this partnership has worked include the PEZA-SEIPI-BOC model that created AEDS and the streamlined, almost corruption-free economic zone process. Areas where this could be effective include:
    - Simplification of bonded warehouse procedures—Use of information technology must be employed to migrate to less physical oversight and control by customs. Documentation must be streamlined and use of the customs security to accompany shipments in and out of the warehouse should be eliminated.
    - Standardization and reduction of port documentation requirements for international carriers—Use the regional knowledge of the international carriers calling at the Philippines to identify and emulate best practices in the region.
    - Reduction of import process times—Employ measures that encourage high volumes of direct trader interface; allow electronic bank transfers 24/7 and establish pre-filing of documentation as a goal for the majority of imports.
    - Establishment of a private/BOC broker compliance program—Encourage quality performance through training and spot checks and establish a strong self-policing policy within the broker sector; establish appropriate consequences for poor or irregular activities by customs.
    - Development of standard operating procedures for the air express industry in line with ASEAN and WCO standards—The local association, as a member of its ASEAN counterpart, has access to the current suggested guidelines that would serve as the basis of the reform. Areas needing attention include guidelines for the cutoff for formal entries, increase in the "*de minimus*" rule, and other agency cooperation.
- Develop a strategic plan in full partnership with the trade and public regulators to address the issues of the trucking industry. Identify one public institution as a one-stop shop for problem resolution. Consider reorganization of the industry into cooperatives to increase an individual company's ability to compete, increase profitability, and reinvest.
- Modify the current reorganization plan for the BOC (Rationalization Plan Pursuant to EO 366) to decrease the Commissioner's span of control, install a Deputy Commissioner to act as a Vice-Commissioner, create a new Assistant Commissioner of Field Operations to supervise the fee

collectors, and change the titles of the current Deputy Commissioners to Assistant Commissioners and make them subordinate to the new Deputy Commissioner. This would make for clear lines of authority similar to many other customs organizations.

- Institute customs policies that encourage the customs brokers and large importers to automate and modernize, especially in the area of direct trader input. By establishing Entry Coding Centers and similar operations with the implementation of ASYCUDA World where the private sector can have their documents input into the customs processing system at a low cost, customs discourages the development of modern business practices within the broker community. While these might be appropriate at the initial phases of automation, timelines should be established for their abolition, because the centers become counterproductive over time. If the broker associations, as a private sector initiative, want to establish them as a service for their smaller members, that should be allowed. Customs should have a plan that encourages direct data input rather than the use of these services. This should include, at a minimum, guaranteed faster, low-cost service.
- Take firm action against corruption. Besides supporting the national anti-corruption campaign and strategies, institute a customs-specific integrity program that includes:
    - Establishing high standards for recruits, and checking backgrounds, finances, and references prior to employment
    - Ending the practice of appointments to customs of recruits who are sponsored by legislators, governors, and other political figures
    - Using basic training of new employees to filter out weaker candidates
    - Periodically reinvestigating all personnel for the reasonability of financial worth and checking for law enforcement violations and criminal associations
    - Performing “life-style checks” on lower-level employees to ensure that these employees are living within their means
    - Paying a salary that is commensurate with a professional position of honor and trust, that will attract high quality personnel, and that will support a reasonable standard of living without the need for supplementary income
    - Continuing to simplify the tariff and customs procedures and ensure transparency in all customs matters
    - Establishing internal controls and audit processes/systems to prevent breaches of integrity and establish audit trails to identify and uncover violations
    - Publishing standards for cargo clearance and all customs services and providing appeals for customs decisions
    - Continuing the automation of customs processes, building in internal audits and controls, and eliminating bottlenecks while expanding means for direct deposit of customs duties and fees to financial institutions
    - Teaching and enforcing a customs code of conduct based that lists core values and includes a table of discipline that addresses integrity at all levels of the organization. This code of conduct should establish a “bright line” for integrity violations so that employees are able to clearly delineate violations and wrongful acts
    - Establishing an internal affairs organization within BOC to oversee and protect the integrity of the organization, its systems, and employees. Professional, well-trained investigators should staff the internal affairs office
    - Creating an environment in which importers and carriers feel comfortable bringing integrity issues to the attention of proper authorities
    - Making it clear to the trading community that corruption on the its part or that of customs should not be tolerated
    - Ensuring that appropriate sanctions are in place for both Customs and business violators.
- Establish a special program for compliant large importers to speed their goods through customs formalities. This approach could be implemented immediately while the major reforms and programs proceed. Numerous countries have adopted this “Account Management” approach to

allow their limited resources to focus on high-risk shipments while providing tangible benefits to legitimate businesses. Treating these companies as accounts, appointing customs-employed account managers, and instituting a special set of compliance, risk criteria, and post-release audit for select companies could allow many legitimate companies a "green line" or expedited service, and will allow for the separation of these shipments from the flow of riskier imports. Similar programs in Jordan, Egypt, the United States, and Canada have provided a high level of trade facilitation while assuring that the companies admitted to this "Gold Card" type program remain compliant and low-risk.

- Balance the need to maintain revenue targets with facilitation efforts while remaining vigilant to abuses that would raise revenue through counterproductive actions.
- Professionalize the customs workforce through the establishment of a Customs Academy that offers basic and advanced courses taught by full-time instructors. The courses should be mandatory and a passing grade should be required. Those that fail the course should be terminated from their employment.
- Proceed with ASYCUDA World implementation with an emphasis on ensuring that the modules that provide manifest accountability, selectivity, and improved collections are faithfully implemented. Additionally, Direct Trader Input (DTI) should be mandated or at least encouraged. Giving a higher priority and increased chances for GREEN line expedited service should be offered as an incentive for DTI.
- Expand AEDS, the Automated Export Declaration System, to all exporters. This direct electronic interface with the BOC and exporter is a significant facilitation measure and its limited application to air shipments of electronic goods is unwarranted.
- Initiate manifest release reconciliation and internal post-release audit reviews as part of an anti-corruption program. All cargo of significant volume entering the country would be recorded within the electronic manifest system of the carrier. Releases are also posted to this system, usually with the details including the releasing officer. Explore how this can be used to ensure that proper documents have been filed to secure release. A post-release audit review team using a scientific approach to selecting files for review, including visits to the importers for a quick check of their files when needed, should also be established.
- Use post-release audit to identify importers that are compliant and knowledgeable about customs and other control authority laws and regulations, and then put their shipments in the GREEN lane.
- Reduce human contact and the need for customs intervention between the customs officer and the broker by excluding the private sector from the BOC official entry processing units. Brokers should have a designated box for submission of their documents that should be time- and date-stamped. They should retain a copy of the stamped entry as evidence of submission. Customs personnel using a one-stop shop concept should exclusively handle the package from that point. Final documents needed by the trade should be placed in a single area for pick-up.
- Institute a modern risk management program using the ASYCUDA World module for selectivity that allows a high percentage of GREEN shipments while preventing interventions from customs officers. The BOC should establish specific targets for RED/GREEN/YELLOW shipment with the goal of making no more than 10-20 percent either RED or YELLOW.
- Conduct a detailed cost study to assess the loss attributable to non-viable ports consuming PPA funds. Non-viable ports consume too much of PPA (Philippines Ports Authority) funds and exist principally due to political influence over the port designation process. This study could serve as the basis of a serious attempt to phase out their operations.
- Sector organizations hat have led successful efforts in changing public policies and procedures which affect them negatively should develop a collective policy for reduction of facilitation fees.
- Proposed anti-smuggling legislation must be reviewed carefully to measure the consequences of the reform on the honest trader. There are reasonable alternatives to the tightening of controls on an operation while maintaining a balance on facilitation.

XIII. Flow of Money

A. Introduction

The ability of money to flow across borders is a critical aspect of a successful environment for international trade and foreign investment. Importers must have the means to pay for the goods they receive, and in the currency expected by their suppliers. Exporters need to have confidence that funds being sent to them are safely captured and accessible. Foreign investors seek confidence that the money they earn through their investments can be repatriated to their home countries in the currencies they need with minimal bureaucratic intervention.

In the Philippines, cross-border transactions represent a steadily increasing component of the economy. In 2005, trade flows increased by 5.9 percent, cumulating at US$88.67 billion, up from US$83.72 billion in 2004.[162] Specifically, exports receipts amounted to US$41.26 billion, 4 percent higher than 2004 figures.[163] Expenditures on imported goods rose by 7.7 percent to US$47.42 billion, up from US$44.04 billion reported a year earlier.[164] In the first eight months of 2006, foreign investments rose to US$1.36 billion, 20.6 percent higher than the same period in the previous year.[165]

Of special interest in the Philippines is the flow of remittances. Nearly 11 percent of the GDP is now attributable to monies sent from abroad by OFWs; this is the highest rate of remittances in the region.[166] A recent sharp increase in remittances is attributable not only to increased exports of Filipino labor—a phenomenon which, of course, entails myriad social consequences despite the positive economic impact—but also to the increased use of formal (and accordingly measurable) channels, including new banking products through which OFWs transmit their monies.

Overall, the laws, public institutions, and private stakeholders effectively support trade-related money flows in the Philippines. A variety of regional and international currencies are available, and flows take place through physical and, increasingly, electronic means. Basic trade finance products are widely available to traders. New technologies and competition from foreign banks have led to expanded service offerings and, to a lesser degree, have improved internal governance practices by domestic banks. Most recently, improvements in the fiscal environment have resulted in increased investor confidence. In fact, assuming continued progress in the incorporation of international standards into local practices, the Philippines can serve as a regional leader in future trade-related money flows.

B. Legal Framework

The **Central Banking Act of 1993** and the **General Banking Law of 2000** provide a comprehensive, modern legal framework for regulating banks and financial institutions that have quasi-banking functions in the Philippines. Significant regulations pertaining to trade-related flows of money are promulgated under the authority of the BSP, which took over in 1993 for the Central Bank of Philippines as the country's central monetary authority.

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162 Foreign Trade Statistics of the Philippines (2005), found at http://www.census.gov.ph/data/sectordata/sr06227tx.html.
163 Id.
164 Id.
165 Foreign investment in the Philippines up 20.6 percent, Philippine News (November 15, 2006).
166 Merrill Lynch, Philippines: Stepping it Up (January 25, 2007) at 3 (hereinafter Merrill Lynch Report).

The Foreign Exchange regime

Throughout the world, foreign exchange rules typically exist to protect the value of a nation's currency and to ensure that the country's reserves of foreign currency are maintained at an adequate level to guard against uncertainty or instability. As of 2006, the Philippines held reserves of foreign exchange and gold in the amount of US$22.97 billion, a relatively healthy 20 percent of the country's GDP.[167]

Liberalization of foreign exchange policies began in the early 1990s, when the Philippines launched a very deliberate plan to align its foreign exchange laws and regulations with international best practices. On April 13, 1993, the BSP issued **Circular 1389**, which generally consolidated the nation's policies on foreign exchange transactions and lifted the previous requirement that residents must convert their foreign exchange receipts to Philippine pesos through the banking system. Circular 1389 has been amended or clarified many times by various modifying "circular letters" over the years. A single, revised circular that consolidates all of the amendments is anticipated in the near future.

These are the central features of the current foreign exchange regime:

- Residents and non-residents alike may open foreign exchange accounts in the Philippines.
- Foreign currencies may be purchased from any lawful source, including non-banks. This rule has enabled the emergence of non-bank providers of financial services, such as Western Union and Thomas Cook.
- Besides certain reporting requirements, there are no restrictions on the use of foreign currencies for trade transactions (i.e., import and export).
- Similarly, foreign currencies may be used for service transactions, including foreign travel, medical, and educational expenses.
- A maximum of Php 10,000 (US$209) can be imported or exported without BSP approval. Amounts greater than Php 10,000 must be reported to the BSP (Circular 223, 1999). This limit is considered low, and will likely rise to Php 15- Php 20,000 in the future.

In general, banks are expected to implement the country's foreign exchange regulations. For example, banks that provide foreign currencies to importers must file reports to the BSP on their behalf. Similarly, banks and other financial service providers must report the sale of foreign exchange to Philippine residents for trade and non-trade transactions to the BSP.

Banks report that, aside from occasional ambiguities in discrete areas, the Philippines' rules pertaining to foreign exchange are relatively transparent and easy to understand. They generally agree that, with respect to the flow of money, "Bringing money in is simple—but it is more difficult to take money out." With respect to the latter, documentary requirements are perceived as "voluminous" to such an extent that smaller businesses may attempt to avoid formal channels. However, banks are becoming increasingly efficient in reporting foreign exchange transactions.

Trade-related financial instruments

The Philippines' legal regime supports all major varieties of trade financing, and the larger banks offer most of them. As explained by one banker, as opportunities in international trade grow, "importers *need* the formal economy" to facilitate their deals. Letters of credit are widely obtainable, with many variations available depending on the importer's needs and creditworthiness. For importers who lack sufficient cash

[167] CIA Factbook, the Philippines (2007).

flow, trust receipts are also an option, providing them with the ability to take physical possession of imported goods and to sell them for the bank's account (i.e., to turn over the proceeds of the sale to the bank). Various non-letters of credit trade services are available to importers as well; although they provide no security to the exporters, they are in place to facilitate seamless flows of money into and out of the country.

Instruments to facilitate remittances

Remittances have increased as a percentage of the Philippine GNP from around 8 percent in 2004 to almost 11 percent in 2006. According to a number of interviewees, the rapid increase in monies reported as flowing into the Philippines can be traced not just to increased numbers of OFWs and their increased incomes, but also to vast improvements in the methods through which remittances are transferred. In less than two years, options in electronic transfers of money have significantly expanded in accessibility and affordability.

Thus, rather than depending on less trustworthy, informal, and expensive methods of sending monies home, individual OFWs and communities are increasingly using formal channels that, in turn, are reported through standard mechanisms and then captured in statistics. For example, since 2005 banks have introduced many new products, including "remittance cards," which allow beneficiaries to access remittance funds at automated teller machines (ATMs) within the Philippines. Similarly, private companies have emerged over the years that facilitate "rapid remit" transfers through the use of "online-to-online" transfers, "door-to-door" services, and offices located in major international centers that are dedicated to facilitating money flows. These institutions are governed by the financial and consumer protection legislations in the countries where they operate; their partners in the Philippines must comply with reporting requirements set in place by the BSP. On a micro-level, families in the Philippines also have access to money transfers over cell phones, a service often provided by less regulated, non-bank financial service providers.

Accompanying the increase in remittances is an apparent shift in how the monies that flow into the country are being used. Namely, in addition to helping "stabilize private consumption through the ups and downs in economic cycles," remittances are increasingly supporting investment-related activities.[168] High-end real estate investments have been significantly driven by remittances. Also, recent growth in the banking sector is attributable in part to "fund flows" in remittances.[169]

C. Implementing Institution

The Bangko Sentral ng Pilipinas

Until May 1993, the Central Bank of the Philippines, as the country's monetary authority, enforced the country's foreign exchange policies. Pursuant to R. A. 7653, the Central Bank was replaced by the BSP.

Access to information about regulations governing foreign exchange and other cross-border flows of money is open, especially for users who have access to the Internet. The BSP's website provides extensive information, including directions to regulated agencies, copies of circulars and other regulatory authority, and additional information about its requirements and services. The BSP is headed toward practices that significantly diminish the need for paper filings; at this time, however, most reports must be filed on paper, and the BSP's electronic capabilities are not integrated into daily practices. Moreover, the reporting requirements imposed by the BSP are not insignificant—banks contend that reporting

168 Merrill Lynch Report at 5.

169 Asian Development Bank, Asian Development Outlook 2006 at 215.

requirements can be slow to catch up with the regulation changes that may result in diminished paperwork requirements. "We definitely are sending in more reports than ever," one banker said.

The BSP is a leader among state institutions in providing continuing education to its staff, although continuing education on international trade issues and contemporary business practices is always in demand. The BSP is generally respected by its constituents as one of the more effective state institutions in the country. It is known to work closely with the community of supporting institutions in the banking industry through public education and professional training opportunities. It is also reputed to avoid dependence on the informal facilitation fees that abound in other state institutions.

Banks

The Philippines has a comprehensive banking system encompassing various types of banks, ranging from large universal banks to small rural banks, and including various non-bank providers of financial services. There is, in fact, a "glut" of banks,[170] although the BSP reportedly is actively encouraging mergers and acquisitions among them.[171] The Philippines currently has 17 universal banks (i.e., commercial banks that hold the authority to act as investment houses); 23 commercial banks; 84 thrift banks; 711 rural banks; 44 credit unions; and 12 non-banks with quasi-banking functions—all licensed with the BSP.[172] Within this vast array of banks, nearly all types of services are available, including a wide network of ATMs, various domestic lending products (though there are continued problems with access to capital, as discussed in other chapters of this report), and numerous trade-finance products.

Recently, banks in the Philippines have been regarded as risk-averse and reluctant to lend due to a variety of factors, among them the vulnerability exposed by the 1997-98 financial crisis in South East Asia. A 2005 report by the ADB called the banking sector "weak and relatively underdeveloped" and attributed these weaknesses to:

- The concentrated nature of the banking sector and the propensity of banks to channel funding to their preferred (and often related) customers.
- High interest rates.
- Weak corporate governance.
- An ineffective insolvency regime
- Weak implementation of the regulatory framework.[173]

Since the ADB's assessment, significant improvements have been made in some of these areas. Short-term interest rates are reportedly now in-line with rates in the United States, a state of affairs that is vastly superior to that found in many emerging markets.[174] The increasing presence and influence of major foreign players in the banking sector, as well as the relatively savvy expectations of the increasingly influential OFW community, place pressure on internal banks to improve their own structures and practices of corporate governance.[175] Moreover, the Philippines has experienced significant reductions in the rate of non-performing loans, moving from a peak of 18.8 percent in 2001 to 7 percent in

170 Merrill Lynch Report at 6.

171 The acquisition of iBank by UnionBank in June 2006 is an example of this trend.

172 Id.

173 ADB, Private Sector Assessment, Philippines (2005) at 33.

174 Merrill Lynch Report at 3.

175 An example of this responsiveness to external pressure can be found in UnionBank, whose marketing campaigns over the decade have emphasized improvements in internal governance and efficiency and corporate soundness and responsibility.

November 2006, although a range in the low single-digits (3 to 5 percent) is considered necessary for outsiders to feel fully confident to invest in the environment.[176] Recent increases in outstanding bank loans suggest that banks are generally feeling more confident about lending, and the economy may, in turn, benefit.

The most important major players in the Philippines' banking system are—

- **The Metropolitan Bank and Trust Company.** Commonly known as Metrobank, it is the largest bank in the Philippines in terms of assets with Php 641.5 billion (US$13.1 billion) as of December 2006. It is also the largest Philippine bank in terms of overseas presence. It has a diverse offering of financial services, including all major trade-finance tools. The Metrobank Group has a combined network of over 800 local and international branches/offices, remittance offices, and subsidiaries worldwide. It has 557 domestic branches and 32 offices in major international cities.
- **The Bank of the Philippine Islands (BPI).** BPI is the oldest bank in the Philippines and is the second-largest bank in the country in terms of assets. BPI is the largest bank in terms of market capitalization (Php173 billion, or US$3.604 billion as of December 2006) and, according to its own literature, is the most profitable bank in the Philippines. It is owned by the Ayala Corporation and promotes itself as a dynamic institution that caters to clients that represent various sectors of Philippine society. BPI pioneered rural banking in the Philippines, as its countryside banking operations preceded that of many other banks' rural banking operations by many years. Today, BPI maintains a large rural branch network, with some branches dating bank to the Spanish or American colonial periods. Its network of more than 800 domestic branches is the largest branch of bank networks in the Philippines.
- **Company-owned banks**. Many large and small banks in the Philippines are owned by large commercial players that use the banks to finance their own operations. The trade-finance services provided by these banks are typically directed at the import operations of their own companies. These banks are perceived as having the weakest practices of corporate governance and the least amount of transparency. They have reportedly resisted reforms to their internal governance practices, and, due to their great political capital, have largely succeeded in avoiding reforms that the BSP would otherwise seek to effect.
- **Rural and Cooperative Banks.** These represent 27 percent of the total number of bank branches in the Philippines, and represent an important source of finance for the country's poorer and rural-based constituencies.[177] Although these banks are chiefly oriented toward serving the domestic needs of their customers, they do contribute to the overall environment for trade-related flows of money. Since the late 1990s, they have entered into agreements with such institutions as Western Union, Uniteller, and others to formally offer remittance services.[178] They also have been active in promoting the use of cell phones to transfer funds (see below).
- **Foreign banks.** Foreign banks have a strong and active presence in the Philippines, including international players such as HBMC, Citigroup, J.P. Morgan Chase Bank, and Bank of America, as well as important regional banks from China, Japan, and Korea. These institutions typically serve the interests of large and mid-sized foreign institutions through trade-finance mechanisms, and do not play a significant role in lending to domestic enterprises. The constitutional prohibition against foreign ownership of physical property makes lending to domestic enterprises a non-starter for most foreign banks, due to their inability to seamlessly assume ownership of collateral in the event of default.

176 Merrill Lynch Report at 6.

177 Experiences of the Philippines' Rural Banks in Microfinance at 2.

178 Id. at 7.

Non-Bank Financial Services

The loosening of constraints on foreign exchange combined with the increased importance of remittances in the economy has resulted in the emergence of a large community of non-bank financial service providers. From the bare-bones moneychangers on the streets to the more formal and regulated services such as Western Union and Thomas Cooke, this sector has significantly contributed to the trade-related flow of money into the Philippines. Non-bank financial intermediaries include investment houses, financing companies, securities dealers, investment companies, fund managers, lending investors, pawnshops, and venture capital corporations.[179]

One initiative supported by USAID focuses on the use of cell phones to facilitate domestic money transfers. A service launched in 2001 called "G-Cash" turns a cell phone into an electronic wallet that can be used to send and receive payments via text message. Filipinos use G-Cash to make payments to utility companies, pay tuition to schools, make purchases at retail outlets, and even pay business registration fees. Globe Telecom, one the largest mobile phone companies in the Philippines and a partner to the Rural Banker's Association, introduced G-Cash as a way to let Filipinos send and receive money using their cell phones. According to a project press release, as of March 2006, 1.3 million people were using the G-Cash system, which handles about US$100 million per day. [180]

The increasing presence of these loosely-regulated institutions raises concerns over the promulgation of money laundering and terrorist financing, as discussed in this report's chapter on Financial Crimes.

D. Supporting Institutions

Government agencies

The availability of money for traders to borrow depends substantially on interest rates, which are largely a function of fiscal policy. Over the past two years the Ministry of Finance has guided the Philippines toward substantial reductions in the country's budget deficit, significantly contributing to lower short-term domestic interest rates, which are now on par with rates in the United States.[181] The improved fiscal situation has also led to a strengthened peso and a declining rate of inflation, which settled at around 4.3 percent at the end of 2006, as compared to 8.5 percent at the beginning of 2005. These factors indirectly contribute to import suppliers' confidence level when considering the viability of letters of credit and other trade-finance tools.

In addition, PEZA is a government corporation established through the Special Economic Zone Act of 1995 and attached to the Department of Trade and Industry. By regional standards, PEZA is considered to be an enormously effective investment promotion agency. PEZA grants fiscal and non-fiscal incentives to developers of economic zones, export producers, and IT service exporters. PEZA offers ready-to-occupy locations in a variety of economic zones and IT parks and buildings to foreign investors who are export producers or IT service exporters. With respect to trade-related flows of money, PEZA provides registration services with the BSP and effectively handles the needs of exporters who seek to bring foreign exchange into the country (e.g., to finance imports or pay for local services).

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179 See John Owens and Meliza Agabin, "Experiences of the Philippines' Rural Banks in Microfinance," A*DB Finance for the Poor Quarterly Newsletter* (June 2006).

180 Chemonics, Inc., *Mobile Phone Banking Expands into Rural Philippines* (May 24, 2006).

181 Merrill Lynch, Philippines: Stepping it Up (January 25, 2007) at 3.

NEDA is well regarded for its independence and thoughtful contributions to the environment for economic growth. With particular respect to trade-related flows of money, NEDA recently launched an initiative to reduce the costs to export by creating an Export Promotion Fund, which will be "tasked to supplement the financing for the promotion and development of local exports."[182]

Trade and Business Associations

Among the Philippines' strengths is the vibrancy of its non-government sector. The following organizations are supporting institutions, and have various levels of activity and influence:

- The Bankers Association of the Philippines
- The Rural Bankers Association of the Philippines
- The Association of Banks Compliance Officers of the Philippines, Inc.
- The Association of Bank Lawyers of the Philippines
- The Association of Bank Remittance Officers, Inc.
- The Bankers Institute of the Philippines
- The Bank Marketing Association of the Philippines;
- The Bank Security Management Association
- The Chamber of Thrift Banks
- The Investment House Association of the Philippines
- The Money Market Association of the Philippines
- The Trust Officers Association of the Philippines.

Many of these institutions provide training to professionals and the to public, and work with international donors to explore new products and opportunities to improve the flow of money in the Philippines. As a sector, however, the role of supporting institutions in the banking and financial services area may not be fully understood. A useful exercise might be to examine of each of these organizations for their respective areas of interest and emphasis, for their overall strengths and contributions, and for the relative strengths of their internal governance structures. In light of the continuing perception that the Philippines has grave troubles with self-dealing, cronyism, and corruption,[183] supporting institutions might serve as an important avenue for developing professional codes of conduct, educating the public about their rights, and engaging in other anti-corruption measures.

Donors

In recent years, the donor community, including the ADB and the International Finance Corporation, has engaged in trade-finance support programs aimed at strengthening the ability of smaller and mid-sized banks to provide letters of credit or to increase confirmation limits that they can provide on a letter of credit. USAID has supported alternative financial services, particularly those geared toward rural users such as money transfer through cell phones. Although these are all useful programs, none can substitute for improved fiscal policies that give outsiders greater confidence in the trade and investment environments in the Philippines.

182 Government Plans to Reduce the Cost of Export, Rare AdZ Bulletin (Vol. 2, No. 1), at 1. See also NEDA website, found at http://www neda.gov.ph/.

183 "Philippines Most Corrupt, Survey Says", *International Herald Tribune* (March 13, 2007).

Media

The business media in the Philippines is vibrant, though perceived by most observers to be enmeshed in poor journalistic habits, such as selling or hyping stories and providing incomplete coverage. At the most sophisticated levels, however, outside investors are satisfied with the international media coverage of the Philippines. The Philippines' poor reputation for providing meaningful, accurate, and timely statistical information, however, is a drag on outsiders with interests in trading with or investing in the Philippines.

E. Social Dynamics

It is significant that, notwithstanding certain progress in the financial sector in recent years, the Philippines continues to receive low marks in its overall environment for economic freedom, particularly with respect to so-called monetary freedom.[184] In early 2007, the Heritage Foundation reported—

> Inflation in the Philippines is high, averaging 6.9 percent between 2003 and 2005. Relatively high and unstable prices explain most of the [poor] monetary freedom score. Additionally, the government is able to influence prices through state-owned enterprises and utilities. Price controls exist for electricity distribution, water, telecommunications, and most transportation services. Price ceilings are usually imposed only on basic commodities for emergencies. The President can impose price controls to check inflation or ease social tension, but this authority has rarely been exercised. An additional 10 percent is deducted from the score to account for these policies.[185]

This assessment suggests that improvements in trade-related money flows have yet to make a full impression on international observers—observers who are enormously important in promoting impressions of a country and, ultimately, affecting increased trade and investment. Reduced inflation may leave a better impression next year. The issue of financial freedom in the Philippines received slightly higher marks:

> The government has opened the financial system to foreign competition, has raised capital standards, and has improved oversight in the wake of a 1990s devaluation and financial crisis. Non-performing loans are declining. Two banks are fully state-owned, and one is partially state-owned, including the fourth and seventh largest domestic banks as of March 2005. Credit is generally available at market terms, but the government requires banks to lend specified portions of their funds to preferred sectors. Foreign banks are not permitted to own over 30 percent of banking assets. Foreign firms are allowed to fully own insurers and may set up local subsidiaries. Capital markets are centered on the stock exchange.[186]

Outside impressions of the Philippines remain mixed.

Domestically, remittances are the overriding social issue relating to the flow of money into the Philippines. One Filipino observer summarized the situation:

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184 Heritage Foundation, Index of Economic Freedom (January 2007).
185 Id.
186 Id.

> At the national level, the remittance bonanza has conveniently kept the government from pursuing real policy reforms that would have improved the performance of the domestic economy and reduced the need for overseas employment.[187]

Although beyond the scope of this discussion, that people, i.e. overseas foreign workers, are arguably the Philippines' "main export"[188] warrants deep social and political introspection. Throughout the course of this diagnostic, the economic impact of remittances was significantly tempered by concern over the domestic loss of educated workers, as well as the impact to families, many of which experience long-term separations of parents from children. The less educated and less fortunate migrants endure humiliating treatment by unscrupulous employers in the countries where they work.

F. Recommendations

This report makes the following recommendations:

- Consider raising the minimum threshold for reporting monies that enter and leave the Philippines to levels that are consistent with those in developed countries. Minimum thresholds for reporting (currently about US$200) are too low, and current plans to raise them are not sufficient.
- Automation and efforts by the BSP to reduce paperwork should be encouraged and pursued.
- Improved governance structures within the domestic banks should be pursued to increase overall investor confidence in the Philippines.
- Supporting institutions should be regarded as an important resource for educating professionals and the public about anti-corruption measures that increase outsider confidence in the Philippine economy.

187 Ernesto M. Pernia, Diaspora, Remittances, and Poverty in RP's Regions (July 2006) (abstract at 2).
188 "South-east Asia's Migrant Workers," *The Economist* (January 18, 2007).

XIV. Flow of People

A. Introduction

This section reviews the efficiency of trade-related flows of people across borders. The primary focus of the section is on the ability for legitimate importers, exporters, and their related facilitators (e.g., attorneys, accountants, business development professionals) to move across borders with as few impediments as possible as they trade their goods and services.

As with the trade-related flows of money, in a well-functioning trading system, the movement of short-term visitors is often a minor administrative detail in the trading scheme. Yet in countries with overly restrictive policies, entry into a country creates logistical and financial obstacles for legitimate traders, and acts as a disincentive to trade in that country. On the other hand, security policies and procedures are necessary to prevent entry of persons with illegitimate purposes, such as terrorists and criminals. Flows of people for illicit purposes, when increased, can lead to instability in the trading system as a whole.

In the Philippines, the eased immigration of business persons, tourists, and other foreigners is a government priority in order to encourage and support foreign investment. Current laws, regulations, and institutions are adequate for this need—the current immigration requirements do not deter prospective foreign entrants. While administrative obstacles and delays do exist, they do not cause persons to re-think entering the country, and a solid cadre of knowledgeable professionals are available to assist travelers.

In addition to these relatively standard issues, the Philippines has a somewhat unique set of issues given the large level of OFWs that exit and enter the country. The Philippines has been—and continues to be—one of the largest and most organized migrant labor source countries in the world. Large numbers of Filipinos continue to settle abroad for work and then later return to visit or to resettle. In cooperation with several governments and international organizations, the government has established a legal and institutional structure to support these OFWs.

B. Legal Framework

In general, laws are in place to support business and tourist entrants to the Philippines. The **Philippines Immigration Act of 1940** (PIA), as amended, defines numerous categories of immigrant and non-immigrant classes. Section 9 of the PIA provides for the admission of non-immigrants. In the simplest cases, a regular entry, or Section 9A entry in the PIA, permits nationals from an extensive list of countries to enter the Philippines without a pre-issued visa for a stay not exceeding 21 days. This is provided that they prove their intent to leave upon entry (e.g., tickets for their return journey or to their next destination), and provided that their passports are valid at least six months longer than their contemplated period of stay. At their discretion, Immigration Officers may admit holders whose passports are valid for less than six months past their stay, but not less than 60 days beyond the initially allowed period of stay. It is not necessary to obtain a 9A visa ahead of entry.

Before the expiration of this first 21-day period, entrants may apply for a visa waiver at the Bureau of Immigration (BI) to extend their stay for another 38 days. This 59-day total period of stay may be extended for another two months at a time, up to a maximum of one calendar year from the date of their arrival.

To convert from a 9A to a 9G visa, a nonimmigrant category used for prearranged, long-term employment visas, an entrant must have a Filipino sponsor. This conversion process, usually approved if all

documentary requirements are met, takes approximately two to three months to complete. Previously, entrants were issued provisional permits during this period that allowed them to work for approximately one week while awaiting a new visa. Reports of abuse, however, caused changes to the law and eliminated this provisional permit. The Alien Employment Permit, issued by DOLE, was created as a replacement. This is issued automatically if all documentary requirements are met, and takes approximately one month to issue. During this one-month period, entrants are not legally permitted to work; this is a source of frustration for many businesspersons.

A final requirement for immigrants is the Alien Certification of Registration of Immigration. This requirement is relatively straightforward and does not impinge upon the process of acquiring a visa.

Other provisions of interest regarding immigration relate to OFWs. Generally, most OFWs leave to seek higher-paying work and remit a significant portion of their earnings.[189] The largest destinations for OFWs are Saudi Arabia, Hong Kong, Japan, the UAE, Taiwan and Singapore. Once having earned and/or saved enough money, often over a period of many years, many OFWs return to the Philippines to retire or open businesses. In immigration terms, re-entry of such individuals is straightforward. In some cases, however, OFWs have taken oaths of citizenship in the countries where they have worked and are subject to the entry requirements outlined above. Fears over this process reportedly contribute to many illegal exits and entries—while there are reportedly approximately three million documented OFWs, there is estimated to be almost two million additional undocumented OFWs. The **Citizenship Retention and Reacquisition Act of 2003**, R.A. 9225, and the **Balikbayan Act**, P.D. 185 are intended to alleviate this issue. Both Acts assist such Filipinos in reacquiring citizenship and/or purchasing property without being subject to the limitations to property ownership that exist for other foreign nationals.

In addition, there is the **Migrant Workers and Overseas Filipinos Act of 1995 R.A. 8042,**[190] which requires the government to provide: legal support for OFWs should an OFW enter into legal difficulty while abroad; traditional consular services; and support services to ensure that OFWs are not mistreated while working abroad.

C. Implementing Institutions

The BI, which operates under the auspices of the DOJ, is principally responsible for the following tasks:

- Administering and enforcing the immigration and citizenship laws, as well as the admission of foreign nationals in the Philippines;
- Acting as the primary enforcement arm of the government by ensuring that all foreigners within its territorial jurisdiction comply with the existing laws;
- Assisting local and international law enforcement agencies in securing the state against foreign nationals whose presence or stay in the country is deemed as threat to national security, public safety, public morals, and public health; and
- Acting as the chief repository of all immigration records pertaining to entry into and exits from the country.

[189] Remittances are discussed on this report's chapter on Flow of Money.

[190] RA 8042 became the government's response to the case of Flor Contemplacion, an OFW who was executed in Singapore for a murder to which she had confessed. Great controversy surrounded her execution, including from the Philippine domestic and OFW communities. Moreover, the public sympathized with her because of the often poor treatment educated Filipino migrant workers are subjected to in overseas countries. This prompted legislation to be passed that ensured the greatest assistance possible for OFWs.

In the discharge of its functions, the BI, through its Board of Commissioners, exercises administrative and quasi-judicial powers to—

- Head and decide deportation cases
- Investigate entry applications and admissibility of aliens upon arrival
- Administratively determine the citizenship status
- Cancel immigration documents
- Execute exclusion or deportation orders
- Issue identification and certification of immigration documents
- Extend the stay of temporary visitors
- Arrest and detain erring foreign nationals after due process of law.

The Commissioner of Immigration is empowered to issue warrants of arrest against violators of relevant immigration laws. The BI also has supervision and control of their 11 district offices and 31 field offices nationwide.

Other agencies involved with immigration are the Department of Labor and Employment (DOLE) and BIR. DOLE is responsible for the issuance of work permits and related materials, and the BIR is responsible for the collection of fees associated with certain classes of entrants. An example is retirees and investors who intend to be permanent residents and are required to make a refundable (and later investable) deposit with the BIR as evidence of their intent to immigrate and in order to offset their use of Philippine services without paying taxes.

Processing of entrants at border crossings was not cited as a problem, and individuals are usually granted the initial 21-day visa without difficulty. While there are anecdotal reports of OFWs being subject to extensive questioning and extortion by immigration officials in order to exit the Philippines, and of other immigration officials accepting bribes from persons involved in human trafficking, BI officials appear to execute their duties within acceptable norms. Interviewees stated, however, that the BI is slow to process longer stay visa requests, a point of particular frustration given that most visas are granted on a relatively *pro forma* basis. Reasons for this are varied. First is a lack of adequate information technology systems to support rapid processing. Second is a shortage of staff and inadequate training for existing staff. Third is a lack of coordination between the various agencies involved, particularly between DOLE and BI. Finally, interviewees cited a lack of dynamic leadership within BI to help drive more expeditious processing. Reportedly, there is currently no consensus on the priorities within the BI, leading to limited action being taken to improve the Bureau.

D. Supporting Institutions

Generally, there are sufficient lawyers and people who are knowledgeable about Philippine immigration issues and processes to assist foreigners seeking entry for business.

The Department of Tourism is charged with encouraging, promoting, and developing tourism as a major socioeconomic activity. Tourism generates foreign currency and employment—benefits both the private and public sectors enjoy. As part of promoting the Philippines as a tourist destination domestically and internationally, the Department of Tourism facilitates the exit and entry of visitors. Almost one half of the tourists to the Philippines come from East Asia, in particular Korea and Japan, with tourists from the United States also accounting for a significant portion of the overall total.

Numerous organizations exist to support OFWs while abroad and upon return. The Department of Foreign Affairs, Office of the Undersecretary for Migrant Workers Abroad (DFA-OUMWA) provides legal and consular assistance to OFWs and works in coordination with various stakeholders, including

elected officials, other government agencies, OFWs and their families, mass media, private organizations, international organizations, NGOs, and religious groups.

The Philippines Overseas Employment Administration assists OFWs in finding work abroad, and optimizes the benefits of the country's overseas employment program. It facilitates labor market information relevant to OFWs, limits illegal recruitment activities toward OFWs, helps OFWs repatriate and reintegrate, and provides other services to enable potential and current OFWs to make informed decisions regarding employment and movement.

A variety of other organizations exist to support OFWs both while they are abroad and upon return. For example, the Mission for Filipino Migrant Workers is an NGO that exists in other countries to support OFWs abroad. The *Unlad Kabayan* Migrant Services Foundation Inc. is another non-government, non-profit organization established to respond to the urgent need for OFWs to better plan their returns and make sound business decisions.

Some support comes from the donor and international communities, particularly from the International Organization for Migration and International Labor Organization. A variety of programs exist to help improve immigration processes with respect to trafficking and the welfare of OFWs abroad and upon reentry and reintegration. These programs also promote better management of the Philippine's extensive borders.

E. Social Dynamics

With respect to immigration for business and tourism, it is the policy of the Philippine government to facilitate the flow of people to support and encourage foreign investment in the country. Nonetheless, some obstacles exist in the immigration processes and there are only sporadic efforts to change these processes. Instead, the majority of immigration and related efforts revolve, unsurprisingly, around OFWs. OFWs are extremely important to the Philippine economy and they form a constituency to whom the government and its elected officials are directly responsible. Historically, OFWs and their families at home have been able to generate popular support for their issues, perhaps limiting the government's ability to focus on other needed reforms.

F. Recommendations

This report makes the following recommendations:

- Assist the BI with designing a comprehensive roadmap for reform.
- Modernize and upgrade automation for processing people at the border and for visa processing for business entrants. Development of a stronger information technology system for this purpose should be pursued.
- Train immigration officials to help improve visa processing times.
- Work to ensure cooperation between the BI and DOLE.

XV. Financial Crimes

A. Introduction

In June 2000, the Philippines had no laws against money laundering and found itself on the "NCCT List"—a list of non-cooperative countries and territories in the international fight against money laundering and terrorism financing. Immediately, hard-working and highly motivated public servants began—in advance of legislation—to work towards reversing their country's status on the list. By 2004, sufficient progress had been made to remove the Philippines from the list of non-cooperative countries. The following activities helped reverse the Philippines' status:

- The creation of an FIU and the Anti-Money Laundering Council (AMLC). They immediately set up centralized law enforcement resources for prevention, detection, suppression, investigation, and prosecution of financial crimes;
- High-level policy councils were established to coordinate the financial crime fighting efforts of the DOJ and various governmental agencies;
- Civil forfeiture and other enforcement mechanisms were put into place with the Supreme Court and the Office of the Ombudsman;
- Working relationships were established with the FIUs of other nations, quickly resulting in action upon 80 requests from 17 nations for investigatory assistance; and
- Training courses were organized for development of a highly professional staff (the Secretariat) for the AMLC.

The Secretariat of the AMLC has characterized the removal of the Philippines from the list as "redemption" for the nation after suffering an uncomfortable period of international scorn. The FIU services provided by the AMLC are a model for the region. Squarely on the right track, the AMLC and the Philippines now strive to offer world-class services in the fight against money laundering, terrorist financing, and other financial crimes.

B. Legal Framework

The government of the Philippines has signed all international anti-money laundering and anti-terrorism financing conventions, including the **U.N. Convention against Illicit Traffic in Narcotic Drugs and Psycho-tropic Substances Money**, and the **U.N. International Convention for the Suppression of Financing Terrorism**. There are two primary legislative acts on financial crimes in the Philippines: **The Anti-Money Laundering Act (AMLA) of 2001**, amended significantly in 2003, and the **Anti-Terrorism Act of 2007**.

The Anti-Money Laundering Act (AMLA)

The AMLA criminalized money laundering and created the AMLC, an FIU oversight body composed of the head officials of the BSP, the insurance commission, and the SEC. The AMLA imposes requirements on customer identification at financial institutions, and requires recordkeeping and reporting of covered and suspicious transactions. Bank secrecy laws are relaxed for the purpose of investigating covered and suspicious transactions. The AMLA authorizes and regulates the freezing, seizure, forfeiture, and recovery of laundered assets. International cooperation is authorized.

Money Laundering Offenses and Penalties. The following are some of the offenses defined in the AMLA:

- Negotiating any monetary instrument or transferring property that involves the proceeds of unlawful activity. The penalty is seven to 14 years of imprisonment and a fine of no less than Php 3 million, but no more than twice the value of the asset.
- Failure to disclose and file any transaction that is required to be disclosed and filed with the AMLC. The penalty is six months to four years imprisonment or a fine of no less than Php 100,000, but no more than Php 500,000, or both.
- Failure to keep required records at a covered institution for five years after the date of the transaction. The penalty is six months to one year of imprisonment or a fine of no less than Php 100,000, but not more than Php 500,000, or both.
- Malicious reporting of money laundering transactions against any person is punished by six months to four years imprisonment and a fine of no less than Php 100,000, but no more than Php 500,000, at the discretion of the court. The offender may be denied probation.

"Unlawful activity" is an offense that generates proceeds to be laundered and is commonly referred to as the "predicate crime." Unlawful acts include:

- Kidnapping for ransom
- Drug trafficking and related offenses
- Graft and corrupt practices
- Plunder
- Robbery and extortion
- Jueteng and Masiao (forms of gambling)
- Piracy
- Qualified theft
- Swindling
- Smuggling;
- Violations under the Electronic Commerce Act of 2000
- Hijacking, destructive arson, and murder, including those perpetrated by terrorists against non-combatant persons and similar targets
- Fraudulent practices and other violations under the Securities Regulation Code of 2000
- Felonies or offenses of a similar nature that are punishable under the penal laws of other countries.

Breach of confidentiality. When reporting covered or suspicious transactions to the AMLC, covered institutions, their officers, and employees are prohibited from communicating the facts or contents of the report with others. The media are barred from reporting a suspicious transaction. Violators, including reporters and editors, may be punished by three to eight years of imprisonment and a fine of no less than Php 500,000, but no more than Php 1 million.

Covered Institutions. Covered institutions are those mandated by the AMLA to submit covered and suspicious transaction reports (STRs) to the AMLC. These are banks and other entities supervised by the BSP, insurance companies, and other institutions supervised by the Insurance Commission, securities dealers, pre-need companies, foreign exchange corporations, and other entities supervised or regulated by the SEC.

Covered and Suspicious Transactions. Covered transactions are single transactions in cash or other equivalent monetary instruments involving amounts in excess of Php 500,000 within one banking day. Regardless of the amounts involved, any of the following circumstances are considered suspicious transactions:

- There is no underlying legal or trading justification
- The client is not properly identified
- The amount involved is beyond the business or financial capacity of the client
- The transaction is structured to avoid reporting requirements under the AMLA
- There is a deviation from the client's profile
- The transaction is related to an unlawful activity or offense under the AMLA.

Freezing of Monetary Instrument or Property. Without notifying any other party, the AMLC may apply for a freeze order from the Court of Appeals if probable cause exists that an asset is related to an unlawful activity. The Court may issue a 20-day freeze order effective immediately, and this order may be extended. The AMLC may examine deposits and investments with a financial institution upon court order when probable cause of an unlawful activity or a money laundering offense is established. No court order is required in cases involving kidnapping for ransom; drug trafficking and related offenses; hijacking, destructive arson, and murder, including those perpetrated by terrorists against non-combatant persons and similar targets.

Anti-Terrorism Act of 2007

The Anti-Terrorism Act defines terrorism as "those crimes committed with the purpose of sowing and creating widespread and extraordinary fear and panic in order to coerce the government to give in to an unlawful demand" and includes:

- Piracy in general
- Mutiny in the high seas
- Rebellion and coup d'état
- Murder
- Kidnapping
- Destruction of property through arson
- Highway robbery and hijacking
- Illegal possession of firearms and explosives.

Punishments may reach 40 years imprisonment.

Suspects arrested without a warrant can be detained no longer than three days. Law enforcement is required to present arrested suspects to a judicial official or representative of the Commission on Human Rights. Php 500,000 compensation may be awarded for every day a terrorist suspect is detained if the person is later found innocent of the charges, a provision that many believe will have a chilling effect on enforcement.

The Act allows law enforcement agencies to conduct surveillance on suspected terrorists through wiretapping upon a written order from the Court of Appeals. The Act covers conversations and communications between suspected terrorists and journalists. The exchanges must be deposited with the court in sealed packages and cannot be opened for prosecution purposes without a court order. A court order is also needed to reveal, disclose, replay, divulge, or read any of the intercepted communications.

The Act bans "extraordinary rendition." Suspects cannot be brought to another country "unless his or her testimony is needed for terrorist-related police investigations or judicial trials in the said country and unless his or her human rights, including the right against torture, and the right to counsel, are officially assured by the requesting country and transmitted accordingly and approved by the Department of Justice."

C. Implementing Institutions

Anti-Money Laundering Council

The AMLC aspires to be a world-class FIU in an effective, internationally compliant anti-money laundering system. The AMLC seeks to fulfill the requirements of international conventions on fighting money laundering and terrorism financing. The AMLC cooperates in international investigations and prosecutions of money launderers and terrorist financiers.

Organization. The AMLC is chaired by the Governor of the BSP. Members of the AMLC include the Commissioner of the Insurance Commission and the Chairman of the SEC. The AMLC acts unanimously in the discharge of its functions. The AMLC is assisted by a Secretariat headed by an Executive Director, and consists of four units:

- Compliance and Investigation Staff
- Legal Evaluation Staff
- Information Management and Analysis Staff
- Administrative and Financial Services Division.

Functions. The AMLC requires reports of covered or suspicious transactions. AMLC orders are addressed to the appropriate supervising authority (the BSP, IC, or SEC) or a covered institution to determine the true identity of the owner of any asset involved in a covered or suspicious transaction report, or of any person identified in a request from a foreign state.

The AMLC institutes civil forfeiture proceedings and all other remedial proceedings through the Office of the Solicitor General, and can file complaints directly with the DOJ or the Ombudsman for the prosecution of money laundering offenses. The AMLC has the authority to impose administrative sanctions for the violation of laws, rules, regulations, and order.

The AMLC cooperates with other organizations in numerous ways. It works with foreign governments and territories and their law enforcement agencies through a sophisticated network of communications and database sharing. It develops educational programs on money laundering, covering the methods and techniques used in money laundering, the viable means of preventing money laundering, and the effective ways of prosecuting and punishing offenders. It enlists the assistance of other governmental agencies, including government-owned and controlled corporations, in undertaking anti-money laundering operations. This assistance includes the use of personnel, facilities, and resources.

To ensure compliance with AMLA, the BSP may inquire into or examine any deposit or investment with any banking institution or non-bank financial institution when the examination is made during a periodic or special examination in accordance with the rules of examination of the BSP.

Component Agencies of the AMLC

The BSP, the Insurance Commission, and the SEC function individually as implementing institutions, as well as collectively in their role as the AMLC. These three component agencies of the AMLC issue regulations governing their regulated entities, and requiring compliance with best practices, recordkeeping, and reporting. While regulations are in place, agency officials acknowledge that their institutions are understaffed and inadequately funded to monitor compliance with the law beyond merely filing the required reports. For example, the BSP requires the registration of foreign exchange businesses

(even though the businesses are otherwise not subject to BSP supervision), but concedes a lack of resources to require reporting that can be effectively monitored.

National Bureau of Investigation, Customs, and local law enforcement agencies

The National Bureau of Investigation (NBI), the Customs Bureau, and local law enforcement are essential implementing institutions in the financial crimes regime. These agencies have the primary responsibility for detecting and investigating predicate crimes. Their relationship to the AMLC is crucial.

Institutional linkages between law enforcement and AMLC are secure, and lines of communication are free and open. Leaders of law enforcement agencies, however, concede a lack of training and funding for the fight against financial crimes. For example, the forensic accounting skills that the Secretariat possesses at AMLC have not been transferred to teams within the ranks of local law enforcement agencies. Basic accounting for law enforcement is a skill that would greatly enhance the Philippines' capacity to fight financial crimes. Curricula exist and the need is perceived. Only the lack of resources seems to stand in the way of improving financial crime law enforcement.

D. Supporting Institutions

Financial Action Task Force

The Philippines is a member country of the international Financial Action Task Force (FATF). The AMLC strives to comply with policy goals of the FATF, and fully cooperates with FATF reviews. The FATF, established by the 1989 G-7 Summit, is an inter-governmental organization devoted to policy on money laundering and terrorist financing. Created in 1989, the FATF seeks to generate support for legal reform. The FATF publishes recommendations to meet its objectives. There are 40 general recommendations and nine special recommendations.[191]

Egmont Group

The Philippines joined the Egmont Group in June 2005, recognizing that money laundering and terrorist financing are international issues that can only be effectively addressed through international cooperation and coordination. The Egmont Group is an informal body of FIUs that enhance mutual cooperation and share information for detecting and fighting money laundering.[192]

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191 The FATF currently has 33 members. The FATF has continued to examine the methods used to launder criminal proceeds and has completed two rounds of mutual evaluations of its member countries and jurisdictions. A third round of mutual evaluations has commenced. It has also updated the Forty Recommendations to reflect the changes that have occurred in money laundering and has sought to encourage other countries around the world to adopt anti-money laundering measures. In 2001, the development of standards in the fight against terrorist financing was added to the mission of the FATF. The work of the FATF focuses on three principal areas: (1) Setting standards for national anti-money laundering and counterterrorist financing programs; (2) Evaluating the degree to which countries have implemented measures that meet those standards; and (3) Identifying and studying money laundering and terrorist financing methods and trends.

192 In a decade, Egmont has grown to become an international network of more than 100 countries that have implemented national centers to collect information on suspicious or unusual financial activity from the financial industry, to analyze the data, and to make it available to appropriate national authorities and other FIUs for use in fighting terrorist funding and other financial crime. Egmont is organized into working groups:

- The Legal Working Group reviews the candidacy of potential members;
- The Outreach Working Group identifies candidates for membership and works with those countries to ensure that they meet international standards;
- The Training Working Group identifies training opportunities for FIU personnel;
- The Operational Working Group brings FIUs together on strategic projects; and

Egmont's FIU members exchange information freely with each other bilaterally on the basis of reciprocity or mutual agreements. Egmont members agree that information exchanged between FIUs may be used only for the specific purpose that the information was sought or provided. The requesting FIU may not transfer information shared by a disclosing FIU to a third party, nor make use of the information in an administrative, investigative, prosecutorial, or judicial purpose without the prior consent of the FIU that disclosed the information.

Agencies of the U.S. Government

The AMLC has close working relationships with many agencies of the United States government, including FinCEN, the United States FIU, the Federal Bureau of Investigation, the Secret Service, and the U.S. Treasury. These and other U.S. agencies have provided the Philippines with technical assistance, long-term advisors, and equipment..

Asian Development Bank

The ADB has a strong working relationship with the AMLC. In late March 2007, ADB will conclude an exhaustive study of AMLC operations, including a process map of all functions and all interagency relationships. AMLC has fully cooperated with the study for the purpose of identifying strengths and deficiencies in institutional capacity.

Courts and law enforcement agencies

Although AMLC has its own staff of investigators and prosecutors, it must rely on other law enforcement agencies such as the police forces and Customs. The judicial system is also crucial to effectively battle financial crime. Challenges of the judicial system are discussed throughout this report. Many people cited the time required to bring civil and criminal charges as an obstacle to effective law enforcement. The AMLC has created an in-house civil execution office that can be used to freeze and foreclose upon assets prior to bringing charges, in appropriate cases. This has alleviated some of the problems of judicial inefficiency.

E. Social Dynamics

An effective FIU requires seamless cooperation with national and local institutions and law enforcement agencies, and with the FIUs and law enforcement agencies of other nations. For example, local institutions, such as financial institutions, have primary responsibility for detecting suspicious transactions, while the BSP has responsibility for assuring institutional compliance. The teamwork of these entities enables the FIU to enforce the AMLA effectively. Lack of collaboration contributed to the FATF's listing of the Philippines on the register of non-cooperating countries.

Progress toward de-listing by the FATF began even before passage of the AMLA in 2000. Regulations provided for the FIU's establishment. The Supreme Court adopted rules to facilitate investigations and prosecutions by FIU staff. The 2001 AMLA and subsequent amendments in 2003 enabled even greater progress.

As of December 2004, the AMLC had received a total of 5,451 STRs. The BSP had 800 bank examiners, of which 78 were AML specialists. It had conducted 438 onsite examinations, including 31 universal and

- The Information Technology Working Group examines new software applications that might facilitate analytical work and focuses on such issues as data mining, information fusion, and security.

commercial banks from September 2003 to December 2004.
By 2007, Php 1.084 billion had been frozen, of which Php 692 million were subsequently unfrozen, leaving Php 293 million in frozen accounts pursuant to AMLC law enforcement. In January 2005, the BSP issued a circular to formally regulate and supervise money services providers that are not subsidiaries or affiliates of banks. Eleven money laundering investigations related to terrorist financing, drug trafficking, and other crimes were initiated as a result of STRs from this source. In 2005, the AMLC signed Memorandums of Understanding (MOUs) with a number of foreign counterpart FIUs. On the basis of this progress, the FATF de-listed the Philippines in February 2005. At that time, the FATF indicated that it would continue to monitor the Philippines for a period of time in accordance with its standard monitoring process to ensure adequate and continued implementation in formerly non-cooperating countries.

AMLC has sought to reduce the number of threshold transactions reported and allowed greater focus on the analysis of suspicious transactions. AMLC received 2,951 STRs in 2005, a 10 percent increase from 2004. Of 34 money laundering cases, however, only one was submitted for decision. Twenty-three were still being tried before special AMLC courts and 10 were under preliminary investigation. The AMLC was admitted to the Egmont Group in June 2005. On the basis of this progress, in February 2006 the FATF ended heightened monitoring of the Philippines.

The AMLC and its staff are justifiably proud of the progress made in such a short time. AMLC partners in law enforcement and regulatory agencies also take their responsibilities seriously and are striving to do well. It is in the area of interagency cooperation, however, where most progress is needed. While the regulations are properly in place, there is a shortage of resources for staff, equipment, and training. The Secretariat of the AMLC is seen by advisors as under staffed and under funded.

F. Recommendations

This report makes the following recommendations:

- Greater coordination of donor assistance should be supported. When the ADB's exhaustive process mapping of anti-money laundering law enforcement in the Philippines is released later in 2007, it will provide the AMLC, governmental agencies, and financial institutions with a robust set of recommendations for improvement.
- A basic accounting training program for law enforcement would greatly improve interagency cooperation at a low cost. This is important because the police and the NBI are primarily responsible for detecting predicate crimes for referral to the AMLC, but these agencies are under trained.
- The AMLC accumulates a database of over 80 million records from financial institutions and other sources, but the resources for risk management and random sampling of data need strengthening. The AMLC needs software tools, such as "Analyst Notebook," and training in order to properly use its software, merge databases, and identify suspicious activity patterns.

XVI. Intellectual Property

A. Introduction

The Philippines has a strong legal framework and has recently made substantial improvement in its intellectual property protections. In the 2006 Special 301 Report by the United States Trade Representative, the Philippines was lowered from the Priority Watch List Category to Watch List.[193] While improvements were recently made in several areas, attention should not be relaxed. The perception among foreign investors and local professionals in the Philippines is that enforcement needs work and that it affects their choice of business location. Beneficially, the present administration has made this area a priority (see box). The Philippines has a strong music industry and is a developer of software. In the interest of competitiveness, among others, a stronger protection regime is necessary.

> "Fighting piracy is fighting poverty because it enables Filipino excellence and enterprise to rise in the global arena, expanding opportunities and jobs along the way. Upholding IPR [Intellectual Property Rights] promotes diffusion of knowledge, develops local talent and creativity, and at the same time encourages more foreign investors to endow their strong qualities in the Philippine market…. "
>
> *President Gloria Macapagal-Arroyo made the previous policy statement in a luncheon for the National Committee for Intellectual Property Rights (NCIPR)*

B. Legal Framework

In 1997, the Philippines enacted a comprehensive law that covers all aspects of protection of intellectual property rights (IPR). It incorporated, amended, and replaced the former Copyright Law, Patent Law, and the Trademark Law to make them consistent with various agreements, including the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS).

BASIC TERMS OF PROTECTION	
Copyright	During the life of the author and for 50 years after his death
Trademark	Ten years; may be renewed for periods of 10 years each
Invention Patent	Twenty years from the filing date of the application
Utility Model	Seven years from the filing date of the application, without renewal
Industrial Design	Five years from the filing date of the application and may be renewed for no more than two consecutive periods of five years each
Layout design of Integrated Circuit	Ten years from the filing date of the application
New Plant Variety	Twenty-five years from the date of grant for trees and vines, and 20 years for all other types of plants[194]

193 Office of the United States Trade Representative, 2006 Special 301 Report, Watch List at 40-41.

194 Intellectual Property Code, Republic Act No. 8293.

The **Intellectual Property Code** (IPC, R.A. 8293) took effect on January 1, 1998. The following areas are included within "intellectual property"[195] (IP) for purposes of the IPC:

- Copyright and related rights
- Trademarks and service marks
- Geographic indications
- Industrial designs
- Patents
- Layout designs (topographies) of integrated circuits
- Protection of undisclosed information
- Technology transfer arrangements.

The Philippines has a number of conventions and treaties in force relating to IP:

- Berne Convention for the Protection of Literary and Artistic Works
- Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure
- Film Register Treaty (Treaty on the International Registration of Audiovisual Works)
- Paris Convention for the Protection of Industrial Property
- Patent Cooperation Treaty
- Phonograms Convention (Convention for the Protection of Producers of Phonograms Against Unauthorized Duplication of their Phonograms)
- Rome Convention (International Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations)
- World Intellectual Property Organization (WIPO) Copyright Treaty
- WIPO Convention
- WIPO Performances and Phonograms Treaty.[196]

The IPC was enacted to bring into one law the separate laws that had existed before. Interested parties, such as the Bar, were consulted and their views were taken into account. New procedures were added to help clear the backlog of registrations at the Intellectual Property Office, such as the procedure to allow for "class registrations"—one registration for a whole class of products bearing the same trademark, rather than a separate registration for each product in the class.

Copyright

Copyright is covered by Part IV of the Intellectual Property Code. Literary and artistic works are protected as follows:

"Literary and artistic works, hereinafter referred to as 'works,' are original intellectual creations in the literary and artistic domain protected from the moment of their creation and shall include in particular:

(a) Books, pamphlets, articles and other writings
(b) Periodicals and newspapers

195 Id. at Sections 4.1 and 4.2.

196 See World Intellectual Property Organization international treaties page, available at http://www.wipo.int/treaties/en.

(c) Lectures, sermons, addresses, dissertations prepared for oral delivery, whether or not reduced in writing or other material form
(d) Letters
(e) Dramatic or dramatico-musical compositions; choreographic works
(f) Musical compositions, with or without words
(g) Works of drawing, painting, architecture, sculpture, engraving, lithography or other works of art; models or designs for works of art
(h) Original ornamental designs or models for articles of manufacture, whether or not registrable as an industrial design, and other works of applied art
(i) Illustrations, maps, plans, sketches, charts and three-dimensional works relative to geography, topography, architecture or science
(j) Drawings or plastic works of a scientific or technical character
(k) Photographic works
(l) Audiovisual works and cinematographic works and works produced by a process analogous to cinematography or any process for making audiovisual recordings
(m) Pictorial illustrations and advertisements
(n) Computer programs
(o) Other literary, scholarly, scientific and artistic works."[197]

These works are protected "from the moment of their creation"[198] and "by the sole fact of their creation."[199]

There are certain derivative works which are also protected by copyright. They include dramatizations, translations, adaptations, abridgments, and arrangements, as well as collections of literary, scholarly or artistic works, and compilations of data and other materials "which are original by reason of the selection or coordination or arrangement of their content."[200]

Registration of Copyright

Within three weeks of dissemination or performance of the work, in order to complete the records of the National Library and the Supreme Court Library, two complete copies of the work must be registered and deposited with the Copyright Division of the National Library. The form is available at the Copyright Division Office or online, or can be ordered by e-mail, fax or regular mail. The fee is Php 100 plus Php 10 for documentary taxes.[201] If the deposit and fee requirements are not met, then the copyright owner will be liable to a fine of the amount of the fee per month of delay, plus the amount of the retail price of the best edition of the work.[202]

Moral Rights

In addition to Copyright or Economic Rights[203] the IPC also deals with moral rights of the copyright owner,[204] such as the rights to:

197 Intellectual Property Code, Republic Act No. 8293, Section 172.1.
198 Id.
199 Id. at Section 172.2.
200 Id. at Section 173.
201 About US$2 at the time of the team's visit to the Philippines.
202 Intellectual Property Code, Republic Act No. 8293, Section 4.
203 Id. at Section 177.

- Have his name prominently displayed as the creator of the work
- Alter the work prior to, or withhold from, publication
- Object to any distortion or modification of or other derogatory action in relation to his work that would be prejudicial to his honor or reputation
- Restrain the use of his name with respect to any work not of his creation or in a distorted version of his work.

The IPC provides that "an author cannot be compelled to perform his contract to create a work or for publication of his work already in existence. However, he may be held liable for damages for breach of such contract."[205]

Trademarks

Section 122 of the IPC provides that the rights in a "mark" are acquired through registration. A "mark" is defined in Section 121.1 of the IPC as "any visible sign capable of distinguishing the goods (trademark) or services (service mark) of an enterprise and shall include a stamped or marked container of goods." Notwithstanding this statutory definition, there is also "acquisition through use." In the case of *Canon Kabushiki Kaisha*, the Philippines Supreme Court held that since the petitioner had registered its trademark CANON under a certain class of goods (paints, chemical products, toner, and dyestuff), the respondent could use the trademark CANON for its goods classified under another class (sandals). The Philippines Supreme Court stated: "Clearly, there is a world of difference between the paints, chemical products, toner, and dyestuff of petitioner and the sandals of private respondent…The certificate of registration confers upon the trademark owner the exclusive right to use its own symbol only to those goods specified in the certificate, subject to the conditions and limitations specified therein. Thus, the exclusive right of the petitioner in this case to use the trademark CANON is limited to the products covered by its certificate of registration."[206]

Patents

Pursuant to Section 28 of the IPC, a patent belongs to the inventor, his heirs, or assignees. When two or more persons have made the invention, the right to a patent belongs to them jointly. There is a "first to file rule" under Section 29 of the IPC: when two or more persons have made the invention separately and independently of each other, the right to the patent belongs to the person who first filed an application, or when two applications have been filed for the same application, to the applicant with the earliest filing date or the earliest priority date. Section 31 of the IPO provides the requirements for priority. (See Article 4 of the Paris Convention for the Protection of Industrial Property in this section.)

Optical Media

An area of concern worldwide, but of special concern in Southeast Asia, is the copying of optical media (e.g., audio discs and visual discs). The Philippines has responded to this issue by passing the **Optical Media Act of 2003** (OMA).[207] The OMA establishes a system for licensing and registering persons involved in businesses concerning optical media—these businesses include the importation, exportation, sale, or distribution of optical media, manufacturing equipment, parts and accessories, and manufacturing

[204] Id. at Section 193.
[205] Id. at Section 194.
[206] Canon Kabushiki Kaisha vs. Court of Appeals, et al., 336 SCRA 266 (2000).
[207] Optical Media Act of 2003, Republic Act No. 9239.

materials used for the manufacture, mastering, or replication of optical media; the possession, sale, or operation of such equipment and materials; and the mastering, manufacturing, replication, importation, or exportation of optical media.

To effectuate the registration and licensing, the OMA established the Optical Media Board (OMB), with powers to license, conduct inspections, obtain search warrants and seize property, act as a complainant in criminal prosecutions under the OMA, and hear and resolve administrative cases against violators of the OMA.

Licensing by the OMB is a condition precedent to getting business permits, licenses and permissions from the relevant authorities, or to releasing manufacturing equipment, parts, and materials intended for use in mastering and/or manufacturing optical media from customs and economic zones exercising independent customs laws.[208] The OMB may even conduct inspections in special economic zones.[209]

Substantial criminal penalties, including imprisonment and fines, can be assessed by the court at its discretion for various violations of the OMA,. For example, for importing optical media without the necessary license, the violator can be imprisoned for three to x years and fined Php 0.5 to Php1.5 million. Lesser jail terms and fines are set forth for other types of violations.[210]

> "Protecting and promoting IPR is a strategic and critical component to the country's socio-economic development and the government's efforts to raise the level of competitiveness of Philippine businesses."
>
> *President Gloria-Macapagal-Arroyo's policy directive on 16 November 2006 entitled "Sustaining Our Gains In Protecting Intellectual Property Rights"*

The Philippines has also been dealing with issues of advanced technology in the protection of new plant varieties. The **Philippine Plant Variety Protection Act of 2002** (R.A. 9168) establishes the National Variety Protection Board, which can grant a Certificate of Plant Variety Protection to breeders. The Implementing Rules and Regulations provide that such Certificate is "the document issued by the Board pursuant to the Act and these Rules for the protection of the new plant variety. It is prima facie evidence that the person to whom it is issued is the owner of the plant variety protection."[211]

C. Implementing Institutions

The Intellectual Property Code (IPC) replaced the Bureaus of Patents, Trademarks and Technology Transfer with an Intellectual Property Office (IPO), which has consolidated all of those areas into one office. Both the public and private sectors have noted deficiencies in the communication of changes in legislation and in the implementation of regulations or comment periods. As noted earlier, the OMA of 2003 set up the OMB, which replaced the previous Videogram Regulatory Board. The OMB has more powers and is able to impose stiffer penalties, as noted above.

The DTI has jurisdiction over appeals, as does the Office of the President, if a complainant is unhappy with the IPO's decision. The National Library is where copyright claims are filed, although they can also be registered at the Library of the Supreme Court. In addition, the following entities have responsibilities related to enforcement:

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208 Id. at Section 13 (c).

209 Id. at Section 10 (d).

210 Optical Media Act of 2003, Republic Act No. 9239, Section 19.

211 Philippine Plant Variety Protection Act of 2002 (Republic Act No. 9168) at Rule 3(e)).

- Bureau of Customs (BOC)
- Department of Justice (DOJ)
- National Bureau of Investigation (NBI)
- Philippine National Police (PNP)
- Philippine National Police-Criminal Investigation and Detection Group/Anti-Fraud and Commercial Crimes Division (PNP-CIDG/AFCCD)
- National Bureau of Investigation-Intellectual Property Rights Division (NBI-IPRD)
- Department of Justice-Task Force on Anti-Intellectual Property Piracy (DOJ-TFAIPP).

In 2005, the Philippines drafted a 2005-2006 strategy in response to the Special 301 Report.[212] This strategy works on strengthening coordination among the various agencies, focusing on specific sectors (software, cable, and copyright piracy) and enhanced enforcement.

The Courts

In December 2005 the Supreme Court designated a team of judges and prosecutors to handle IPR cases exclusively.[213] The backlog of IPR cases mirrors the backlog found in other areas throughout the country. Many of these cases do not go to trial and are settled due to the long delay and unpredictable results. This is reflected in the conviction rates: one conviction in 2004 and four convictions in 2005.[214]

Customs

The Bureau of Customs is beginning to have a deterrent effect due to changes in border control measures, and it is acknowledged that the United States Trade Representative (USTR) played an important role in this development. The owner of a registered mark, a copyright, etc., deposits Certificate of Rights Owner with Customs. When Customs makes a random inspection and discovers that branded products are being imported, the rights owner is notified. Such owner is then given 24 to 48 hours to go to the port and declare whether the goods are counterfeit. If Customs is convinced that the goods are counterfeit, then they are seized and may be destroyed.

D. Supporting Institutions

A number of institutions provide substantial support for IP protection.

The Bar

The Bar is active in IP in a number of ways. Members of the Bar are active in professional associations, such as the IP Coalition (described below). In addition, there is a patent attorney's association called the Intellectual Property Association of the Philippines. The Integrated Bar of the Philippines (IBP) has a Committee on Legislation, and while the IBP tries to make its position known on proposed legislation, its actual impact has not been measured.

Professional Associations

Professional associations play an important role in protecting intellectual property and promoting its awareness. The Business Software Alliance is active in working against infringement of software, such as

212 http://ipophil.gov.ph/ipenforcement/IPRCampaign2005-2006.pdf.
213 Country Commerce: Philippines, *The Economist Intelligence Unit*, March 2006, pg 38.
214 Id.

"pre-loaded" software (i.e., a software program placed on a new PC). The Philippine Association of the Record Industry is very focused on enforcement in connection with pirated music. Copyright holders are often members of the Philippine Reproduction Rights Organization.

The IP Coalition is a group made up of a number of supporting institutions, such as the Business Software Association, the American Chamber of Commerce (AmCham), PCCI, and the Songwriter's Guild. It is partnered with the Development Academy of the Philippines, a think tank. The IP Coalition looks at regulatory reform, enforcement monitoring (including the courts), and public education and awareness. It has been instrumental in commenting on proposed legislation and regulations, and is seeking to raise awareness of the importance of IP protection among the general population.

The Cable & Satellite Broadcasting Association of Asia, a regional organization, is looking at the issue of cable piracy, which has come under increasing scrutiny.

Law Faculties

Law faculties play an important role in developing an interest in IP and in developing an Intellectual Property Bar. For example, at least two of the major law faculties teach IP. Traditionally, IP has been offered only as an elective, even though the bar examination in the Philippines tests on the subject.

An example of the subject matter covered can be found in the Catalogue of the Ateneo de Manila Law School for the school year 2006-2007. Its course on IP is described as follows:

> "The course, which is divided into three (3) modules, is a study of both international and local intellectual property laws. The first module, the law on Copyright, covers copyright ownership, exploitation and infringement; and copyright issues related to emerging technologies, e.g. the Internet. The second module, the law on Trademark, covers trademarks, goodwill and infringement; domain name issues and alternative dispute resolution. The third module shall be on Patent, which includes inventions, utility models and industrial design; issues and Internet and business method patents; and Technology Transfer Arrangements, including compulsory and voluntary licensing. (3 units)"[215]

The description illustrates that the course deals with current issues, such as emerging technologies. On the other hand, all of the above is contained in a three-unit course. The Catalogue indicates that 158 units are required for a four-year undergraduate program leading to the J.D. Degree, of which 22 units are from electives and four units are from summer apprenticeships.[216]

Academia does give importance to IP. For example, the September 2006 issue of the *Ateneo Law Journal* contains an interesting article on proposed amendments to the Intellectual Property Code of the Philippines, and whether these amendments "are consistent with the Philippines' obligations under the WTO, particularly under the TRIPS Agreement."[217]

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215 Ateneo Law School 2006-2007 Catalogue, p. 43.

216 Id. at 24 – 25.

217 WTO Compliance Review: Proposed Amendments to the Intellectual Property Code of the Philippines. 51 *Ateneo Law Journal* 335, 338 (2006).

E. Social Dynamics

Both the private and public sectors maintain that much of the progress that has been made by the Philippines can been attributed to its inclusion on the Special 301 Priority Watch List and to the pressure from USTR. While the framework is in place for IP protection, the procedures and enforcement mechanisms do not support it. Demand for change is primarily from external sources and the private sector. Despite this, there is still a lack of understanding among much of the population, and even among some in the Bar, about the importance of IP and its protection. To help improve this situation, the IPO is preparing a program to share information with the public on the benefits of IP protection for the Philippines.

F. Recommendations

This report makes the following recommendations:

- Formalize the procedures relating to notice and comment periods for changes in legislation and procedures so that there is more meaningful private sector input – with respect to many areas of law but also IP.
- Target the community of supporting institutions—including business associations, law schools and other institutions of higher learning, NGOs and even the media—to build basic public understanding of the principles and benefits of IP protection for the Philippines.
- Work with the Philippine Trade Training Center, law schools, bar associations, and the judicial academy to build IPR courses into the training efforts and curriculum on a more continuous and perhaps mandatory basis.
- Strengthen enforcement and coordination for each of the entities that deal with enforcement. The work that was started in 2005 by President Gloria Macapagal-Arroyo needs to be continued.

XVII. Agriculture

A. Introduction

Philippine agriculture plays a vital role in the country's economy. Seventy percent of the Philippine population lives in rural areas, and two-thirds of these people depend on farming for their livelihood. In terms of employment, about one-half of the labor force is engaged in agricultural activities. The sector's contribution to the economy is important, but has declined from 23 percent of GDP in 1995 to 14.5 percent in 2003. After years of erratic performance, the growth rate of agriculture strengthened to 5.5 percent in the first quarter of 2005.

Philippine agriculture is a mix of small, medium, and large farms. The majority of the farms average about two hectares (ha.), and are family-owned and operated. Two-thirds of all farms in 1988 were no larger than three ha. Eighty-five percent of all farms were no more than five ha. A typical subsistence farm produces a major crop (e.g., rice, corn, or coconut) and a few heads of livestock and poultry. From 1986 to1996, the proportion of small farms has been expanding as a result of effective implementation efforts under the Agrarian Reform Law (R.A. 6657). As a result, however, agriculture generally suffers from low productivity, low economies-of-scale, and inadequate infrastructure support. Prior to agrarian reform, large plantations produced rubber, coffee, oil palm, cacao, banana, and pineapple. Contract growing schemes operate in corn seeds, banana, tomato, cucumber, oil palm, asparagus, and broiler chicken.

Land resources in the country are generally classified into forest land, alienable land, and disposable land. The Philippines has a total land area of 300,000 square kilometers, or 30 million ha., of which 13 million ha. are classified as agricultural land. Prime agricultural lands are located around the main urban and high population density areas.

Agricultural land is distributed among food grains, food crops, and non-food crops. Food grains occupied 31 percent (4.01 million ha.), food crops used 52 percent (8.33 million ha.), while 17 percent (2.2 million ha.) were used for non-food crops. For food grains, the average area used by corn was 3.34 million ha., while rice occupied 3.31 million ha. Of the total area under food crops, coconut accounted for the biggest average harvest area of 4.25 million ha., sugarcane with 673,000 ha., industrial crops with 591,000 ha., 148,000 ha. with fruits, 270,000 ha. with vegetables and root crops, 404,000 ha. with pasture, and 133,000 ha. with cut flowers.

In recent years, the government has placed a high priority on the transformation of agriculture into a modern, dynamic, and competitive sector. It is believed that a sustained expansion of the national economy requires sustained growth in the agricultural sector.

B. Legal Framework

The agriculture sector is set in a complex legal framework that is both wide and deep. Multiple government departments are involved: Agriculture, Agrarian Reform, Justice, Interior and local government, Labor and Employment, Trade and Industry, Science and Technology, Social Welfare and Development, Transportation and Communications, Finance, Education, and Health. There are three distinct legal systems (formal, administrative, and local [*barangay*]), plus a confluence of legal traditions (Spanish, American, Filipino, and Islamic). Laws and regulations affect most factors of production, marketing activities, and international trade. In addition, the Philippines has a rich legal environment with an ample provision of republic acts, presidential decrees, executive orders, and administrative orders.

Given this richness of issues and relationships, this chapter will focus on a few indicative areas. First, a discussion of the three legal systems illustrates the intricacies of the justice system as it extends into administrative and local-level justice. Second, an attempt is made to illustrate the number of agencies associated with agriculture and the rural sector. Third, selected supportive institutions and processes followed will be discussed in an overview of some of the social dynamics uncovered during the survey.

Three Legal Systems

The Philippine agricultural and rural sector communities are regulated by three distinct legal systems. The first is the formal judicial system made up of a judicial branch of government under the jurisdiction of the Supreme Court and the Department of Justice. The second is the administrative justice system, part of the executive branch. Typically, the administrative system adjudicates disputes over government regulations. In the case of the Philippines, the clearest example of administrative justice is found in the DAR. The third is the judicial system administered by the Local Government Units (LGUs) and found at the municipal or *barangay* level. *Barangay* legal procedures are under the jurisdiction of a third department, the Department of Interior and Local Governance.

Formal Justice. The formal system of justice (the Judiciary Branch and the Department of Justice) is discussed in greater detail elsewhere in this report. For agriculture and other economic sectors, the formal justice system is the overarching legal framework; administrative and *barangay* justice remedies are subordinate.

Administrative Justice. Administrative judicial procedures are found within executive branch departments and agencies and typically address disputes over administrative rules and regulation. The Department of Agriculture, for example, has multiple offices attached to it that administer a wide variety of regulations affecting agriculture (e.g., pesticide, sanitary and phytosanitary, and animal health). There is no indication that the Department of Agriculture has a system of administrative justice to handle regulatory disputes.

By way of contrast, the DAR has a relatively elaborate system for hearing land dispute cases within its administrative structure. Proceedings are spelled out both in R.A. 6657, the **Comprehensive Agrarian Reform Law**, and in R.A. 3844, the **Agricultural Land Reform Code**. As explained in an interview, land cases may begin at the local level with the *Barangay* Agrarian Reform Committee. This interagency committee acts under the authority of the DAR, not the Department of Interior. Appeals of Committee decisions pass to the Municipal Agrarian Reform Officer (a mediator) and, if resolution of disputes is not achieved at this level, passes on to the Provincial Agrarian Reform Office. Legal counsel is engaged at this point in the process. Appeals at this level are heard by the Provincial Agrarian Reform Adjudication Board. Final appeals are heard by a department-level Agrarian Reform and Adjudication Board. The Department of Finance also has an internal process for adjudicating tax assessment rates for land.

LGU (*Baranagay*) Justice. The *Barangay* Justice System (BJS) has emerged as an important part of the non-judicial justice system in the Philippines. Introduced in 1978 by P.D. 1508, the ***Katarungang Pambarangay* Law** formally institutionalized a system of dispute settlement at the LGU level. The administration of the BJS is set within the Department of Interior and Local Government and, from 1978 to 1991, Interior administered the Law directly. On January 1, 1992, R.A. 7160, the **Local Government Code of 1991**, revised the *Katarungang Pambarangay* Law and expanded its jurisdiction and modified selected procedures. At this time, responsibility for administering the Law devolved on each LGU. Each is now responsible for funding and efficiently administering the BJS.

The BJS is meant to achieve the following objectives:

- Obtain a just, speedy, and inexpensive settlement of disputes at the local level
- Preserve local culture and dispute resolution traditions
- Relieve case congestion of the formal court dockets
- Enhance the quality of justice.

BJS procedures are invoked if parties are unable to settle disputes themselves through negotiation. Under the jurisdiction of the *Katarungang Pambarangay*, the case is brought before a local official. If a mediated or arbitrated settlement is not achieved, the case is referred to a three-member panel that is empowered to conciliate, mediate, or arbitrate the case. Should the case fail to be resolved at this level, the case may be referred to the formal court system.

A dispute is eligible for BJS consideration unless—

- One party is the government, including subordinate government agencies
- One party is a public officer/employee and the dispute relates to the performance of official duties
- An offense is punishable by imprisonment exceeding one year or a fine exceeding Php 5,000
- An offenses involves no private offended party
- The dispute involves real property located in different cities or municipalities (unless the parties agree to a venue)
- The dispute involves parties residing in different *barangays* (unless they adjoin and the parties agree to a venue).

An agreement reached through the process is legally binding and recognized by both the formal courts and the administrative justice procedures of DAR. The BJS, however, is not part of the formal judicial system. Lawyers are banned from BJS proceedings.

C. Implementing Institutions

Because the agriculture and rural sectors are influenced by many departments, multiple implementing institutions are involved. For the purposes of this chapter, primary attention is given to the Departments of Agriculture and Agrarian Reform, the DENR, and the Departments of Justice and Interior.

The Department of Agriculture (DA). The DA traces its origins back to June 23, 1898, just after Philippine independence from Spain. Its most recent guiding legislation is R.A. 8435, the Agriculture and Fisheries Modernization Act of 1998 (AFMA). Each bureau and attached administrative unit operates under mandates laid out by legislation, presidential decree, or administrative order.

The Department of Agrarian Reform (DAR). Philippine agrarian reform got its start with the 1954 Agricultural Tenancy Commission and became part of the government administration in 1963 when Section 49 of R.A. 3844, the Agricultural Land Reform Code, created the Land Authority. In 1971, R.A. 6389, the Code of Agrarian Reform of the Philippines (CARP), created DAR and later became more structured and organized through EO 120-A. The DAR now operates under a legal mandate established in 1988 by R.A. 6657, the Comprehensive Agrarian Reform Law (CARL).

The Department of Environment and Natural Resources (DENR). Philippine administrative interest in natural resources is traced back to 1917 and the creation of the DENR. The current DENR mandate is found in EO 192 of 1987. The role of the DENR is particularly germane to the effort to register property and works closely with DAR.

The Department of Justice. The DOJ was created in 1898. The 1987 Constitution re-established the DOJ in modern times. In addition to representing the executive (prosecutorial) arm of the formal justice system, it plays a role in agrarian reform as the official keeper of land deeds and titles.

The Department of Interior and Local Government. Dating to the time of Philippine independence, the Department of Interior has a history as long as the modern Philippines itself. The present department dates back R.A. 6975 of 1990 and to EO 262. LGUs are established through the Local Government Code.

Given the number of departments that oversee discrete elements of economic activity and resource management in the agricultural and rural sectors, the number of implementing institutions is sizeable. There are bureaus, agencies, offices, and attached agencies, many of which have clearly defined regulatory authority. For example—

- Within the DA, there are nine administrative bureaus, 12 agencies, and 21 attached agencies. These are the principle administrative offices of the agriculture program. For example, the Bureau of Plant Industries is the key agency for establishing and enforcing sanitary and phytosanitary regulations. Interviews indicate that this bureau is well managed and follows established international protocols.
- The DAR is composed of five bureaus and seven services. The five bureaus are the Bureau of Land Acquisition and Distribution, the Bureau of Land Development, the Bureau of Agrarian Legal Assistance, the Bureau of Agrarian Reform Information and Education, and the Bureau of Agrarian Reform Beneficiaries Development. Each of the five bureaus is critical to the agrarian reform effort designed to distribute land to smallholder farmers. Land reform is controversial. Interviews and research suggest that the DAR is achieving its targets, seeking to renew its legislative mandate, and attempting to provide greater services to its farmer clients.
- The DENR is composed of six bureaus and five attached agencies. The Lands Management Bureau is perhaps the most significant for agriculture. It is leading the effort to modernize property registration using the Torrens system whereby each lien holder to a piece of land is recorded on the single land registry document. The technical services of the Lands Management Bureau exhibit an expertise and operational capacity that surpassed international norms.
- The DOJ is central to the administration of Philippine justice. In the case of agriculture, two of its offices are particularly important: The Land Registration Authority and the Commission on the Settlement of Land Problems. The Land Registration Authority is responsible for the maintenance of land titles and is the focus of reform efforts, sometimes contentious, designed to streamline property registration and management.
- The Department of Interior and Local Government manages the police and corrections functions as well as the administrative framework for the LGUs. Interior's Local Government Sector is composed of the two bureaus identified below, three offices, and six support services. The LGU is the key venue for regulating disputes outside the formal legal system. In addition, LGUs implement farm-level extension programs.
- The DOF has two bureaus of particular importance to agriculture: BIR and the Bureau of Local Government Finance. In addition, it has three relevant agencies: the Central Board of Assessment Appeal, the Philippine Export-Import Credit Agency, and the Cooperative Development Authority. Through BIR, the Department of Finance oversees the Bureau of Local Government Finance, which is responsible for funding the LGUs. It and its National Tax Research Center are closely allied with the DENR's Lands Management Bureau.

D. Supporting Institutions

Multiple organizations, including those listed below, support the agricultural and rural sectors.

Farmer organizations

There are two major farmer organizations in the Philippines: the Federation of Free Farmers Cooperatives International (FFFCI) and the National Movement of Farmers' Organizations. The FFFCI has 40 primary regional-level affiliates with about 400 cooperative chapters at the *barangay* level. Total membership is estimated to be 20,000 farmers and fishers. The FFFCI got its start in 1953 among Catholic laymen and has built its strength through a successful agricultural credit program. The FFFCI has been especially effective in providing production, subsistence, and input loans to members, and in assisting with post-harvest marketing and processing. It has had a significant and positive effect on farmer economic viability.

Universities and Research

The Philippine university system includes 11 agricultural universities, all of which are members of the Asian Association of Agricultural Colleges and Universities. Philippine universities are an integral part of agricultural research programs in the country.

Extension

As a result of the **Legal Code of 1991**, agricultural extension service responsibilities devolved to the LGUs.[218] The Agricultural Extension Service is now a regional advisory service at the regional level, and serves as an advisor to the LGUs. The extension service, as currently organized, does not provide adequate coverage, especially to farmers that are newly acquiring land and independent farm management responsibilities through the agrarian reform process.

Banks and Credit Institutions

The Philippines has an extensive system of banking that includes about 23 commercial banks, 17 universal banks, 84 thrift banks, 711 rural banks, 44 credit unions, and 12 quasi banks. All are licensed with the BSP. Rural banks provide credit to farmers, merchants, cooperatives, and to the rural public.

The Philippines also has an active micro-credit community. The Philippine Federation of Credit Cooperatives (PFCCO) was founded in 1960 and registered under R.A. 2023. It works with the Cooperative Development Authority and unites savings and loan cooperatives into a national cooperative financial intermediary. Its eight registered Regional Leagues provide business and non-business services to members.

The World Council of Credit Unions, for example, manages the Credit Union Empowerment and Strengthening (CUES III) program to establish a deposit insurance facility for credit union savings deposits and to restructure more cooperatives. CUES III covers Mindanao and parts of Visayas. The program works with the Mindanao Alliance of Self-Help Societies/Southern Philippines Educational Cooperative Center and Philippine Federation of Credit Cooperatives/Mindanao League.

[218] The field of agriculture extension started to help share new knowledge of agricultural practices through farmer education, and now encompasses a wider range of communication and learning activities organized for rural people by professionals from different disciplines, including agriculture, health, and business studies.

In addition to formal banks, there are informal credit institutions in the form of high-interest, short-term local lenders and storefront pawn shops. These are popular providers of quick, ready cash.

During interviews, questions were raised about the effectiveness of the banking system, particularly in its ability to serve the interests of the agrarian reform movement and the real property market. Some interviewees described the disconnect between the formal banking system and the public as a problem caused by mutual mistrust. Symptomatic of this lack of trust is the sizeable informal banking system featuring high-interest, short-term local lenders and store-front pawn shops.

Industry Organization

Organizations representing agricultural industries are plentiful in the Philippines. One example of such an industry organization is the United Coconut Association of the Philippines (UACP). Working with the Philippine Coconut Authority, the UACP is a non-stock, nonprofit, confederation of associations and organizations. Its secretariat provides members, the government, and international organizations with services relevant to production, trade processing, policy research, library facilities, and publications. It has 10 federated members and 11 associate members. For example, the Virgin Coconut Oil Producers and Traders Association of the Philippines, Inc.—a federated member—represents 59 private enterprises. The UACP is dynamically engaged in promoting the production and sale of coconut products both domestically and internationally. It was instrumental in the passage of the **Biofuels Act of 2006**, a law that mandates the blending of biofuels into gasoline and diesel.

Labor Unions

There are about 21,000 labor unions (2004) in the Philippines (1.5 million workers). Many unions belong to the 10 national labor centers and 171 labor federations. This number is deceptive. Only 9 percent of the labor force (16.7 million) is paid wages and salaries and only 254,369 workers (17 percent of claimed union membership) are covered by 1,296 collective bargaining agreements.

The Labor Code of the Philippines. P.D. 442 (amended) is applicable to farm tenants and rural workers. Labor unrest among farm and mill workers has led to strikes and strike-related violence in the past.

E. Social Dynamics

Agrarian Reform

Land in the agricultural sector is the most important factor of production; it is a source of livelihood and social security for many. It has been at the center of the Philippine political economy since the days of the Spanish colonists. In a national effort to broaden the base of land ownership, the agrarian reform movement has registered successes over the past several decades. From 1974 to 2004, the DAR distributed 3,564,102 ha. of 4,290,453 ha. (83 percent) of available lands. The number of direct beneficiaries totaled 2,022,926 farmers. In addition, 82,416 ha. have been covered through leasehold operations, benefiting roughly 40,000 farmers. While this distribution of land seemed immediately beneficial, the inability of individuals to develop larger farms and the economies-of-scale that allow for production efficiencies is now limiting the ability of farmers to grow their businesses. As a result, farm land is seriously underutilized as a production input, as savings, and as a means for capital borrowing. The DENR estimates the value of these underutilized assets at US$240 billion.

The prospect of engaging land assets in a modern Philippine economy is seductive. However, serious issues have been raised as to the appropriateness of breaking up large land holdings into smaller ones. This process of enmiettement (i.e., ever decreasing parcel size) may make social sense, but ultimately

reduce modern farm efficiency—an efficiency necessarily built on larger land parcels. In addition, the lack of extension services available to new beneficiary farmers may leave farmers with land but without the technology or the know-how to manage it. Reportedly, farmer beneficiaries that lack adequate technical support resell their newly acquired land and return to tenant farming.

Extension Services

There is a clear link between a lack of technical services in support of agrarian reform and the current structure of the agricultural extension services. At present, the DA provides extension services to the regional level. At the local level, extension services are the responsibility of the LGUs. Because the LGUs now hire and pay extension agents, the transfer of responsibility from the national to the local government has translated into an abrupt reduction in the number of extension workers serving the agriculture and rural sectors. In one interview, the reduction cited was 50 agents to one. As a result of the change in the extension service model, the DAR is now providing extension services and seeks further international assistance to help it build technical services.

Credit Institutions

At the *barangay* level, credit is often supplied by local lenders on short payback, high-interest terms. In addition, pawn shops provide quick and ready cash. This evidently extensive informal credit system serves much of the public better than the formal commercial banks. One interviewee framed the issue of this disconnect as one of trust. That is, the informal sector does not trust the banks and the banks do not trust the informal sector. In the area of land reform, however, commercial banks are able to come to terms with the informal sector because the lack of ready credit leads to invalid land titling. In turn, this limits the ability of banks to make loans against land assets.

Taxes

Loopholes in the land valuation system lead to taxes based on low assessed values. This leads to an effort to recoup tax losses through higher tax rates. Higher rates lead to tax avoidance and to an increased effort to find ways around tax payments, such as falsified sales information. This downward spiral runs the risk of generating an unhealthy reduction in real and perceived government authority. In addition, interviewees suggested that tax assessment rates were commonly negotiated outside of official channels.

Commercial Register of Agricultural Laws

It is apparent from interviews that there is a need to compile a register of the laws and regulations affecting agriculture and to organize their presentation in ways that make sense to commercial investors in the agriculture and rural sectors. As this report indicates, the laws and regulations affecting agriculture involve numerous areas of code and regulation and a variety of agencies. In addition, there is the sense that some of the laws are contradictory. The DA sees such a rationalization of agricultural laws and regulations as a key component of a proposed Agro-Business Investor Center.

F. Recommendations

This report makes the following recommendations:

- A comprehensive cross-government review of laws and regulations affecting the agricultural and rural sectors should be conducted. This review should identify areas of overlap and contradiction, and propose reforms to simplify the system. Laws affecting agriculture in ways that assist agro-business entrepreneurs and investors should be documented and highlighted.

- Efforts to establish an Agro-Business Investor Center at the DA should be supported.
- The agricultural extension system should be reinvigorated. In addition to providing technical services to the agricultural and rural sector producers, the extension system should play a vital role in explaining laws and regulations affecting agriculture and citizens' rights within the system.
- Agrarian law reform efforts should be supported to allow for consolidation of land parcels, perhaps through cooperatives, into cost-effective production units without reducing farmers' rights to land ownership. The economics of land in agriculture production systems is an important consideration and should be strengthened.

ATTACHMENT 1: COMPILATION OF RECOMMENDATIONS

COMPANY LAW AND CORPORATE GOVERNANCE

No.	Type	Recommendation	Priority	Duration
1	Training and Education/ Corporate Governance	Greater efforts should be made to provide training in the efficacies of corporate governance. This training should focus on how greater corporate governance can increase wealth for all. However, it can also act as a threat to established wealth.	Medium	Short-Term
2	Corporate Governance	A Philippine case should be made for good corporate governance. To accomplish this, the Philippine case for reform should not refer heavily to the good governance checklists of the OECD, the New York Stock Exchange, the European Bank for Reconstruction and Development, or other outside indicators. Instead, it should focus on issues from the Philippine perspective. The Philippine case for reform would—: • Establish the Philippine nexus between good corporate governance • Calculate the gains to be expected from true institutional reform • Calculate the loss and opportunity cost suffered from lack of institutional reform.	Medium	Medium-Term

CONTRACT LAW AND ENFORCEMENT

No.	Type	Recommendation	Priority	Duration
1	Judicial System Reform	Commercial courts should clear their docket of additional cases dealing with non-commercial matters.	High	Long-Term
2	Judicial System Reform	In order to allow judges and court staff to develop specializations in commercial matters, and thus to expedite the disposition of cases, more courts should be designated as commercial courts.	Medium	Medium-Term
3	Wage Reform	Judges' salaries should be increased to attract candidates with advanced commercial litigation skills.	High	Short-Term
4	Judicial System Reform	Efforts should be made to limit or eliminate facilitation payments to sheriffs to assist in the enforcement and collection of judgments.	Medium	Medium-Term

REAL PROPERTY LAW

No.	Type	Recommendation	Priority	Duration
1	Land Administration Reform/ Training and Education	Consolidation of land management into one agency, either under LARA or another legislative vehicle, is a key step to simplifying the land use regime. More of the affected interest groups, including trade and business associations, need to become educated and involved in pushing for such legislative reform.	High	Medium-Term
2	Land Administration Reform/ Training and Education	Interim steps should also be undertaken to encourage more communication among the various agencies and more efficient processing. The one-stop centers proposed under the LAMP program appear to be such a viable interim step. More technical training for line staff at the RODs and a reduction of the steps necessary to register most transactions may also be achievable short-term goals.	Medium	Short-Term
3	Judicial System Reform/ Education and Training/Legal Reform	Better training is needed on enforcing the summary nature of extra-judicial foreclosures. Courts should demand a minimum threshold of documentary evidence to support a claim that an extra-judicial foreclosure sale was improperly conducted. A change in the law should be considered that would make extra-judicial foreclosures truly extra-judicial (i.e., no need for the court to confirm the sale or for a court sheriff to conduct an auction) and remove any requirement for court-annexed mediation in judicial foreclosure cases. Parties would still be free to settle, but, in extra-judicial foreclosures which end up in court, one party (the defaulting borrower) is clearly benefited by delay. Requiring the extra steps for mediation simply gives a greater advantage to one side in the case.	High	Short-Term/ Medium-Term
4	Judicial System Reform	A change in case assignments should be considered to relieve the regional trial courts designated as special commercial courts of criminal cases. Parties should be permitted to transfer land titling and land use permitting cases to the special commercial courts. By doing so, those courts can begin to develop expertise on titling and land use matters.	Medium	Medium-Term
5	Judicial System Reform	Consideration should also be given to dividing larger regional trial courts into civil and criminal divisions. Because there are separate procedural rules for civil and criminal cases, having strictly criminal and civil dockets should result in faster administration of both types of cases. Judges can be rotated in and out every few years, or the system can be structured to permanently assign some judges to a division.	Medium	Long-Term
6	Institutional Reform	A uniform system for property valuations should be established. Commercial appraisers are required by the Institute of Philippine Appraisers Rules to be certified and to obtain ongoing education; however, it is not clear that those professional standards are enforced uniformly.	Medium	Medium-Term

SECURED TRANSITION LAW

No.	Type	Recommendation	Priority	Duration
1	Institutional Reform	Efforts by the ADB to catalyze reforms in this area should be supported and perhaps even supplemented by other donor agencies. Particular emphasis should be given to expansion and computerization of the chattel mortgage registry.	Medium	Short-Term
2	Further Analysis	A far more in-depth analysis needs to be undertaken. A recent IFC publication establishes a detailed roadmap for conducting such a survey, with the goal of developing constituencies for secured transactions reform.	High	Medium-Term
3	Legislative/ Regulatory Reform	The bankruptcy regime needs to provide greater protection to creditors with claims secured by movable property when the debtor comes under corporate rehabilitation or when it is liquidated in insolvency proceedings. This could come through legislative or regulatory reform, or simply through greater clarifications of these protections in published decisions.	High	Short-Term
4	Regulatory Reform	The proposed Code on Securities Devices represents a good beginning, though it could stand to be supplemented, particularly with respect to mandating computerization of the registry.	Low	Medium-Term

BANKRUPTCY LAW

No.	Type	Recommendation	Priority	Duration
1	Further Analysis	Take a closer look at corporate rehabilitation cases. The past six years of litigating corporate rehabilitation cases in the Philippines likely offer many lessons on how the system could work better. This data needs to be mined and analyzed closely.	Medium	Short-Term
2	Regulatory Reform	Interim Rules should be amended. Based on the results of the study suggested above, the Interim Rules should be amended to increase efficiency and shore up creditor rights. It should be noted, however, that certain shortcomings in corporate rehabilitation can only be addressed by legislation. For example, in most modern bankruptcy regimes the rejection of a rehabilitation plan usually results in a seamless conversion to liquidation proceedings under the same case. The stay on claims continues and the rehabilitation receiver often becomes the liquidator. Such an arrangement promotes expediency and efficiency. If possible, it should be adopted in the Philippines.	Medium	Medium-Term

3	Legislative Reform	A 10-page bankruptcy bill should be drafted. Procedural rules make up a very large portion of the bankruptcy bills that have been before Congress, none of which have made much headway. It would be unorthodox, but not impossible, to write a bankruptcy bill that focuses almost entirely on substantive rights, leaving all procedures to the Supreme Court (which has both the expertise and Constitutional authority to promulgate court procedures). This would allow more legislators to have a meaningful debate on what a bankruptcy law should—or should not—accomplish. Such a bill may also facilitate passage in Congress.	Medium	Short-Term
4	Audit Strategy Reform	Specialized bankruptcy case tracking should be implemented. Bankruptcy cases are very different from a typical party-A-versus-party-B dispute. Case tracking software and other methods of monitoring judicial performance often fail to take the differences in bankruptcy into account. Increased efforts to track the progress of bankruptcy cases, despite this challenge, will likely spur increased performance by the judges that are hearing these cases.	Medium	Long-Term
5	Judicial System Reform	Courts hearing corporate rehabilitation cases should be consolidated. While some of the 60 commercial court judges are hearing several corporate rehabilitation cases, there are many, especially outside the major metropolitan areas, where such cases make up only a small portion of the docket. Such infrequency hampers the buildup of expertise in this area. The number of courts authorized to hear these cases should be reduced, resulting in fewer judges hearing more cases of this type. This would increase judicial expertise and efficiency.	Medium	Long-Term

COMPETITION LAW AND POLICY

No.	Type	Recommendation	Priority	Duration
1	Education	The Philippines should consider education on the issue to allow increased competition, to assure its future growth and development, and to attract foreign direct investment.	Medium	Medium-Term
2	Country Strategy Reform	The Philippines should review the models provided by others in the region to achieve this end. ASEAN partners Indonesia, Thailand, Vietnam, and Singapore have competition laws that the Philippines might consider.	Medium	Medium-Term
3	Regulatory Reform	Efforts to encourage the expansion of competition into various special sectors, where consumer welfare and business entry effects can be achieved and studied, should continue. Attention should be paid to the challenges of regulatory capture, conflicting political priorities, and shifting alliances of interests.	High	Long-Term

COMMERCIAL DISPUTE RESOLUTION

No.	Type	Recommendation	Priority	Duration
1	Wage Reform	Judges' salaries should be increased to attract candidates with advanced commercial litigation skills.	High	Short-Term
2	Judicial System Reform	Efforts should be take to limit or eliminate facilitation payments to sheriffs to assist in the enforcement and collection of judgments.	Medium	Medium-Term
3	Judicial System Reform	A pilot program should be established to create a regional trial court focused solely on commercial litigation, with the express purpose of utilizing already-existing pre-trial procedures and continuous trials.	Medium	Short-Term
4	Regulatory Reform	A requirement that mediators have law degrees for complex commercial disputes at trial courts and any mediation at the Court of Appeals should be instituted to facilitate these processes. Moreover, mediators who have specific knowledge of the issues at hand should be sought after.	High	Short-Term
5	Regulatory Reform	The two-stage process for mediation should be abolished in favor of a unified one-stage process.	High	Medium-Term
6	Further Analysis	Further analysis should be undertaken to show the impact of mediation on the timeliness of the resolution of non-mediated cases in the court system. This study would analyze whether or not, because courts have more time to devote to non-mediated cases, these cases are subject to the typical delays in the court system. This study should take into account mediation countrywide, not just in Manila.	Medium	Short-Term

COURT ADMINISTRATION

No.	Type	Recommendation	Priority	Duration
1	Procedural Reform	Efforts to encourage stricter adherence to existing pre-trial rules promulgated by the Supreme Court should be supported to promote efficiency, settlement, and disposal.	High	Medium-Term
2	Procedural Reform	Hiring practices for court staffs should be shifted from the Supreme Court to the individual judges.	Medium	Short-Term
3	Regulatory/ Legislative Reform	Discretionary locality funding of local trial courts should be prohibited. The budget for the judiciary would be better prepared at the federal level, or by regions.	Medium	Medium-Term
4	Regulatory Reform	Rule 65, relating to the determination of hearing appeals, should be revised so that grave abuses of discretion are only appealable as final orders rather than as interlocutory appeals.	High	Short-Term

5	Regulatory Reform	Judicial misconduct complaints that are directly related to the merits of a decision or procedural ruling should be prohibited. This prohibition will help to insulate judges from judicial misconduct complaints that arise out of their refusal to grant a continuance.	Medium	Short-Term
6	Procedural Reform	Monthly reports of case management statistics should be distributed for all first-, second-, and third-level courts so that all judges on a tier are able to see and compare their colleagues' statistics. To further decrease the use of delays in case resolution, one suggestion is for the first-, second-, and third-level courts to receive monthly reports that reveal case management statistics of all the judges on their tier. For example, a Regional Trial Court judge would receive statistics from all of the Regional Trial Courts related to case backlog, number of cases with motions pending for more than six months, and number of cases three years or older. These reports have been effective in the United States federal courts by placing friendly peer pressure on judges to clear their dockets because of the wide peer-to-peer dissemination of this information.	Medium	Medium-Term
7	Legislative Reform	Revise Rule 137 from "[a] judge may, in the exercise of his sound discretion, disqualify himself from sitting in a case, for just or valid reasons other than those mentioned above" to "[a] judge may [or shall], in the exercise of his sound discretion, disqualify himself in any proceeding in which his impartiality might reasonably be questioned." The Supreme Court should investigate a more sweeping change that would replace "may" with "shall" in Section 1. A second possible solution is to strengthen the sanctions for violations of Rule 137. A strong sanction is beneficial because it allows judges to externalize their decisions to not engage in improper relations with parties.	High	Medium-Term
8	Judicial System Reform	Require that appeals from all final orders be based on issues that were raised before the lower level courts, or else the appellate court should deem the issue waived.	Medium	Medium-Term

FOREIGN DIRECT INVESTMENT

No.	Type	Recommendation	Priority	Duration
1	Procedural Reform	Improve timeliness of, maintenance of, and accessibility to investment statistics and other statistics of interest to foreign investors.	Medium	Medium-Term
2	Further Analysis	Study and develop policy initiatives concerning the relationship between foreign investment in tourism in the Philippines and the following constraints on foreign investment: (a) land restrictions, including foreign ownership restrictions; (b) domestic and international transport, including air transport; (c) capacities in human resources; and (d) enforcement of contracts.	Medium	Short-Term

3	Further Analysis	Study and develop policy initiatives concerning the relationship between foreign investment in agriculture in the Philippines and the following constraints on investment: (a) land restrictions, including foreign ownership restrictions; (b) domestic and international transport, including shipping; (c) security; and (d) bureaucratic inefficiencies.	Medium	Short-Term
4	Procedural Reform	Support continued dialogue and long-range planning with respect to the future of investment incentives in the Philippines.	Medium	Long-Term
5	Institutional Reform	Continue implementation of anti-corruption measures that target everyday, low-level corruption, including that faced by foreigners.	High	Medium-Term

INTERNATIONAL TRADE LAW

No.	Type	Recommendation	Priority	Duration
1	Procedural Reform	Primary and secondary education needs to receive additional resources in the areas of English, science and mathematics.	High	Short-Term
2	Institutional Reform	The burgeoning services sector needs to be supported through concerted government and private sector support.	High	Medium-Term
3	Procedural Reform	The government should establish a uniform process across all ministries on the promulgation of new regulations, fees, laws, and procedures, and identify one source where it will publish the notices so that the public is informed and can participate.	Medium	Short-Term
4	Legislative/ Regulatory Reform	Laws, regulations, administrative decisions, and executive orders should be streamlined so that navigating the rules and procedures is clear.	High	Long-Term
5	Country Strategy Reform	The success of the PEZA should be replicated throughout the country so that the Philippines is one PEZA zone.	Medium	Medium-Term
6	Institutional Reform	Trade facilitation and logistic support areas need to be expanded in a competitive manner to capitalize on the Philippines advantage as a logistical hub.	Medium	Medium-Term
7	Country Strategy Reform	The Philippines should focus on its continuing compliance with its WTO commitments.	High	Medium-Term
8	Country Strategy Reform	The Philippines should strategically look at the ways that it can benefit as a member of ASEAN.	Medium	Long-Term
9	Country Strategy Reform	Develop a strategy for harnessing remittances as a way to stimulate growth and enable the financial sector to support credit.	Medium	Short-Term

FLOW OF GOODS AND SERVICES

No.	Type	Recommendation	Priority	Duration
1	Private Sector Institutional Reforms	Involve the strong private sector institutions as a full partner in the reform of the flow of goods processes. Form working groups, in conjunction with the involved public institutions, and empower them to review the current process, identify problem areas, and develop innovative solutions that meet the needs of both the public and private sectors. Timetables, benchmarks, and desired results should be clearly defined. Examples of where this partnership has worked include the PEZA-SEIPI-BOC model that created AEDS and a streamlined, almost corruption-free economic zone process.	High	Long-Term
2	Procedural Reform	Simplify bonded warehouse procedures—the use of information technology must be employed to migrate to less physical oversight and control by Customs. Documentation must be streamlined and the use of the Customs guard to accompany shipments in and out of the warehouse should be eliminated. The use of the Customs guard for movements related to ecozones should also be eliminated.	Medium	Medium-Term
3	Procedural Reform	Standardize and reduce port documentation requirements for international carriers. Use the regional knowledge of the international carriers calling at the Philippines to identify and emulate best practices in the region.	High	Long-Term
4	Procedural Reform	Reduce import process times. Employ measures that encourage high volumes of direct trader interface, allow electronic bank transfers 24/7, and establish pre-filing of documentation as a goal for the majority of imports.	High	Medium-Term
5	Training/Anti-Corruption	Establish a private/BOC broker compliance program. Encourage quality performance through training and spot checks and establish a strong self-policing policy within the broker sector and appropriate consequences for poor or irregular activities by Customs.	Medium	Medium-Term
6	Procedure Development	Develop standard operating procedures for the air express industry inline with ASEAN and WCO standards. The local association, as a member of its ASEAN counterpart, has access to the current suggested guidelines that would serve as the basis of the reform. Areas needing attention include guidelines for the cutoff for formal entries, increase in the “de minimus rule,” and other agency cooperation.	Medium	Short-Term
7	Procedure Development	Develop a strategic plan in full partnership with the trade and public regulators to address the issues of the trucking industry. Identify one public institution as a one-stop-shop for problem resolution. Reorganize the industry into cooperatives to increase individuals’ ability to compete, increase profitability, and reinvest is an option that has worked in other countries in the region.	Medium	Short-Term

8	Anti-Corruption	Modify the current reorganization plan for the BOC (Rationalization Plan Pursuant to EO 366) to decrease the Commissioner's span of control; install a Deputy Commissioner to act as a Vice-Commissioner; create a new Assistant Commissioner of Field Operations to supervise the fee collectors; and change the titles of the current Deputy Commissioners to Assistant Commissioners and make them subordinate to the new Deputy Commissioner. This would create clear lines of authority similar to many other Customs organizations.	Medium	Short-Term
9	Regulatory Reform	Institute customs policies that encourage the customs brokers and large importers to automate and modernize, especially in the area of direct trader input. By establishing Entry Coding Centers and similar operations with the implementation of ASYCUDA World, where the private sector can have their documents input into the Customs processing system at a low cost). Customs discourages the development of modern business practices within the broker community. While these might be appropriate at the initial phases of automation, timelines should be established for their abolition since, over time, the centers become counterproductive. If the broker associations, as a private sector initiative, want to establish them as a service to their smaller members, that should be allowed. Customs should have a plan that encourages direct data input rather than the use of these services. This should include guaranteed faster and low cost service at a minimum.	High	Medium-Term
10	Anti-Corruption	Establish high standards for recruits and check backgrounds, finances, and references prior to employment.	Medium	Short-Term
11	Anti-Corruption	End the appointments to Customs of recruits who are sponsored by legislators, governors, and other political figures.	High	Medium-Term
12	Anti-Corruption	Use basic training of new employees to filter weaker candidates.	Medium	Short-Term
13	Anti-Corruption	On a periodic basis, reinvestigate all personnel for the reasonable financial worth, and check for law enforcement violations or criminal associations.	High	Long-Term
14	Anti-Corruption	Perform "lifestyle checks" on lower level employees to ensure employees are living within their means.	Medium	Medium-Term
15	Anti-Corruption	Pay a salary that is commensurate with a professional position of honor and trust, that will attract high quality personnel, and that will support a reasonable standard of living without the need for supplementary income.	High	Short-Term
16	Anti-Corruption	Continue to simplify the tariff and customs procedures and ensure transparency in all Customs matters.	High	Long-Term
17	Anti-Corruption	Establish internal controls and audit processes/systems to prevent breaches of integrity, and establish audit trails to identify and uncover violations.	Medium	Short-Term
18	Anti-Corruption	Publish standards for cargo clearance and all customs services, and provide appeals for customs decisions.	Medium	Medium-Term

19	Anti-Corruption	Continue the automation of customs processes, building in internal audits and controls, and eliminate bottlenecks while expanding means for direct deposit of Customs duties and fees to financial institutions.	Medium	Long-Term
20	Anti-Corruption	Teach and enforce a Customs code of conduct based upon the national standard (i.e., a listing of core values that includes a table of discipline that addresses integrity at all levels of the organization). This code of conduct establishes a "bright line" for integrity violations so that employees are able to clearly delineate violations and wrongful acts.	Medium	Short-Term
21	Anti-Corruption	Establish an internal affairs organization within BOC to oversee and protect the integrity of the organization, its systems, and its employees. Professional, well-trained investigators should staff the internal affairs office.	Medium	Medium-Term
22	Anti-Corruption	Create an environment where importers and carriers feel safe bringing integrity issues to the attention of proper authorities.	High	Long-Term
23	Anti-Corruption	Make it clear to the trading community that corruption on their part or that of Customs should not be tolerated.	High	Medium-Term
24	Anti-Corruption	Ensure that appropriate sanctions are in place for both Customs and business violators.	High	Short-Term
25	Procedural/ Regulatory Reform	Establish a special program for large, compliant importers to speed their goods through Customs formalities. Importers who display excellence and are competent and compliant pose little risk to Customs. This approach could be implemented immediately while the major reforms and programs proceed. Numerous countries have adopted this "Account Management" approach to allow their limited resources to focus on high-risk shipments, while providing tangible benefits to legitimate businesses. Treat these companies as accounts by appointing Customs-employed account managers and instituting a special set of compliance, risk criteria, and post-release audits. Separating these select companies could allow many legitimate companies to "green line" or expedite service and separate their shipments from the flow of riskier imports. Similar programs in Jordan, Egypt, the United States, and Canada have provided a high level of trade facilitation, while assuring that the companies admitted to this "Gold Card"-type program remain compliant and remain low-risk.	High	Medium-Term
26	Institutional Reform	Balance the need to maintain revenue targets with facilitation efforts while remaining vigilant to abuses that would raise revenue through counterproductive actions.	Medium	Long-Term
27	Training and Education	Professionalize the Customs workforce through the establishment of a Customs Academy that offers basic and advanced courses taught by fulltime instructors. The courses should be mandatory and a passing grade should be required. Those that fail the course should be terminated.	Medium	Medium-Term

28	Country Strategy Reform	Proceed with ASYCUDA World implementation, emphasizing that the modules that provide manifest accountability, selectivity, and improved collections are faithfully implemented. Additionally, as stated previously, Direct Trader Input (DTI) should be mandated or at least encouraged. Giving a higher priority and increased chances for green line expedited service should be offered as an incentive for DTI.	Medium	Medium-term
29	Procedural Reform	Expand AEDS to all exporters. This direct electronic interface with the BOC and exporter is a significant facilitation measure and its limited application to air shipments of electronic goods is unwarranted.	Medium	Medium-term
30	Procedural Reform	Initiate manifest release reconciliation and internal post-release audit reviews as part of an anti-corruption program. All cargo of significant volume entering the country is recorded within the electronic manifest system of the carrier. Releases are also posted to this system, usually with the details including the releasing officer. Explore how this can be used to ensure proper documents have been filed to secure release. Also establish a post-release audit review team that uses a scientific approach to selecting files for review, including where review is needed, and that visits importers for a quick check of their files.	High	Medium-Term
31	Procedural Reform	Use Post-Release Audit to identify importers that are compliant and knowledgeable about Customs and Other Control Authority laws and regulations and put their shipments in the green lane.	High	Short-Term
32	Procedural Reform	Reduce human contact and the need for Customs intervention between the Customs officer and the Customs broker by excluding the private sector from the BOC official entry processing units. Brokers should have a designated box for submission of their documents that should be time and date stamped. They should retain a copy of the stamped entry as evidence of submission. Customs personnel using a one-stop-shop concept should exclusively handle the package from that point. Final documents needed by the trade should be placed in a single area for pick up.	Medium	Medium-Term
33	Procedural Reform	Institute a modern risk management program using the ASYCUDA World module for selectivity that allows a high percentage of green shipments while preventing interventions from Customs officers. The BOC should establish specific targets for red/green/yellow shipments with the goal of making no more than 10 to 20 percent either red or yellow.	Medium	Medium-Term
34	Further Analysis	Non-viable ports consume too much of PPA funds. These primarily exist because of political influence over the port designation process. With the current budget deficits, a detailed cost study should be conducted to quantify this loss and that would support a serious attempt to phase-out their operations.	Medium	Short-Term

35	Anti-Corruption	Sector organizations that have led successful efforts to change public policies and procedures should develop a policy to reduce facilitation fees. Public agencies need private trade cooperation for their collection, and only a well-planned and united effort by the payers will be successful. One example of sector-related success is the refusal of the express air carrier industry to pay the announced higher overtime charges imposed by Customs. Service continues at the lower rates.	Medium	Medium-Term
36	Legislative Reform	Proposed anti-smuggling legislation must be reviewed carefully to measure how reform will affect the honest trader. There are reasonable alternatives to tightening of controls. One specific concern relates to the abolition of the common bonded warehouse scheme, which is used to great advantage by the smaller importer/manufacturing exporter. Current drafts of legislation would remove this advantage.	High	Short-Term

FLOW OF MONEY

No.	Type	Recommendation	Priority	Duration
1	Legislative/ Regulatory Reform	Consideration should be given to raising the minimum threshold for reporting monies to levels that are consistent with the norms of developed countries. Minimum thresholds for reporting monies entering and leaving the Philippines (about US$200) are too low, and current plans to raise them are not sufficient.	High	Short-Term
2	Procedural Reform	Automation and reduced paperwork efforts by the BSP should be encouraged and pursued.	High	Medium-Term
3	Corporate Governance	Improved governance structures within the domestic banks should be pursued. They would increase overall investor confidence in the Philippines.	Medium	Long-Term
4	Improvement of Public Awareness	Supporting institutions should be regarded as an important resource for educating professionals and the public about anti-corruption measures that would increase overall outsider confidence in the Philippine economy.	Medium	Medium-Term

FLOW OF PEOPLE

No.	Type	Recommendation	Priority	Duration
1	Strategy Reform	Assist the BI with designing a comprehensive roadmap of reform.	Medium	Short-Term
2	Modernization of Processes	Modernize and upgrade automation for people processing at the border and visa processing for business entrants. Development of a stronger information technology system for this purpose should be pursued.	High	Short-Term
3	Training and Education	Train immigration officials to help improve visa processing times.	High	Short-Term
4	Strategy Reform	Work to ensure cooperation between the BI and DOLE, with an investigation of creating ‘one-stop’ services for certain categories of immigrants.	Medium	Long-Term

FINANCIAL CRIMES

No.	Type	Recommendation	Priority	Duration
1	Donor Assistance Coordination	Greater coordination of donor assistance should be supported. With the ADB's exhaustive process mapping of anti-money laundering law enforcement in the Philippines to be released later in 2007, this goal can be achieved. It will provide the AMLC, governmental agencies, and financial institutions with a robust set of recommendations for improvement.	Medium	Long-Term
2	Training and Education	A basic accounting training program for law enforcement would greatly improve interagency cooperation at a low cost. This is important because the police and the NBI are primarily responsible for detecting predicate crimes for referral to the AMLC—even though these agencies are under trained.	High	Medium-Term
3	Resource Improvement	The AMLC accumulates a database of over 80 million records from financial institutions and other sources, but the resources for risk management and random sampling of data need strengthening. AMLC needs software tools, such as "Analyst Notebook," and software training in order to merge databases and find suspicious patterns of activity.	High	Short-Term

INTELLECTUAL PROPERTY

No.	Type	Recommendation	Priority	Duration
1	Procedural Reform	In the area of IP, as in several others, the procedures relating to notice and comment periods for changes in legislation and procedures should be formalized so that there is more meaningful private sector input.	Medium	Medium-Term
2	Training/ Education	Target the community of supporting institutions—including business associations, law schools, other institutions of higher learning, NGOs, and the media—to build basic public understanding of the principles and benefits of IP protection for the Philippines.	High	Medium-Term
3	Training/ Education	Work with the Philippine Trade Training Center, law schools, bar associations, and the judicial academy to build IPR courses into the curriculum on a continuing basis.	High	Short-Term
4	Legislative/ Regulatory Reform	Enforcement and coordination needs to be strengthened for each of the entities that deal with enforcement. The work that was started in 2005 by President Gloria Macapagal-Arroyo needs to be continued.	Medium	Long-Term

AGRICULTURE

No.	Type	Recommendation	Priority	Duration
1	Further Analysis	A comprehensive, cross-government review across of laws and regulations affecting agriculture and the rural sector should be conducted. This review should identify areas of overlap and contradiction, and propose reforms to simplify the system. Laws affecting agriculture in ways that assist agro-business entrepreneurs and investors should be documented and highlighted.	Medium	Short-Term
2	Institutional Reform	Efforts to establish an Agro-Business Investor Center at the DA should be supported.	High	Medium-Term
3	Institutional Reform	The agricultural extension system should be reinvigorated. In addition to providing technical services to the agriculture and rural sector producers, the extension system should play a vital role in explaining laws and regulations affecting agriculture and citizen rights within the system.	Medium	Medium-Term
4	Legislative Reform	Agrarian law reform efforts should be supported to allow for consolidation of land parcels, perhaps through cooperatives, into cost-effective production units without reducing farmers' rights to land ownership. The economics of land in agriculture production systems is an important consideration and should be strengthened.	High	Medium-Term

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