



*Technical Report*

# Reducing the Cost of Inter-Island Shipping

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# Preface

This report is the result of technical assistance provided by the Economic Modernization through Efficient Reforms and Governance Enhancement (EMERGE) Activity, under contract with the CARANA Corporation, Nathan Associates Inc. and The Peoples Group (TRG) to the United States Agency for International Development, Manila, Philippines (USAID/Philippines) (Contract No. AFP-I-00-00-03-00020 Delivery Order 800). The EMERGE Activity is intended to contribute towards the Government of the Republic of the Philippines (GRP) Medium Term Philippine Development Plan (MTPDP) and USAID/Philippines' Strategic Objective 2, "Investment Climate Less Constrained by Corruption and Poor Governance." The purpose of the activity is to provide technical assistance to support economic policy reforms that will cause sustainable economic growth and enhance the competitiveness of the Philippine economy by augmenting the efforts of Philippine pro-reform partners and stakeholders.

This technical report was written by Enrico L. Basilio and Jennifer C. Llarena in October 2005 as requested by the National Economic Development Authority and the Philippine Chamber of Commerce and Industry.

The views expressed and opinions contained in this publication are those of the authors and are not necessarily those of USAID, the GRP, EMERGE or the latter's parent organizations.

## Executive Summary

The Ports and Shipping Team was tasked to continue the assistance provided in previous USAID/Philippines projects, EGTA and the TAPS program of PhilExport, to the Philippine Chamber of Commerce and Industry (PCCI), the NEDA Director General, Secretary Romulo Neri, and the Development Bank of the Philippines (DBP), in promoting RoRo shipping as a way of improving competition in the ports business and reducing costs of inter-island shipping. Under the new terms of reference, the team was tasked with achieving 4 deliverables. These are:

- a) Conversion of private non-commercial ports into commercial ports under the Road Roro Transport System (RRTS). In realizing this, an Executive Order was drafted by the team and the EO was signed by the President on September 19, 2005;
- b) Review the RoRo Law and submit recommended amendments. The team drafted its version of the RoRo law and submitted it to Rep. Augusto Baculio, Chairman of the House Committee on RoRo and Railways with the endorsement of the Federation of Philippine Industries;
- c) Program for affected port workers. The team was tasked to draft an action plan outlining a program for affected port workers, including possible sources of funds to finance the program. An action plan was drafted by the team and was included in the original version of the proposed EO. The proposed program for displaced port workers was included in the original draft EO 170-B as one of its provisions. However, since the provision on Chassis on RoRo (CHaRo) was excluded and was recommended to be the subject of a separate EO, the provision on the proposed program for port workers was likewise excluded; finally
- d) Comment on PPA Administrative Order 03-2004 or Guidelines on the Development, Construction, Management and Operations of Ferry Terminals under the RRTS. The team likewise included comments on the new draft PPA Administrative Order seeking to amend by substitution PPA AO 06-95 and provide for the new guidelines, taking into consideration existing and recent policy issuances (e.g., EO 170 and 170-A & B) on the development, construction, management and operation of private ports.

### About the Authors

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**Jennifer C. Llarena** is currently a research associate of the USAID-EMERGE project. She has done various research in transport economics particularly on the shipping and ports sectors. She has co-written a number of articles on ports and shipping. Prior to the EMERGE project, she served as ports associate of the USAID AGILE and EGTA projects. She was also a research associate of the Transport and Logistics Center of the Center for Research and Communication. She is currently working on her thesis to complete her Master of Arts in Applied Business Economics from the University of Asia and the Pacific. She obtained her Bachelor of Arts in Political Science from the University of the Philippines in Diliman in 1993.

## Reducing the Cost of Inter-Island Shipping

The archipelagic character of the Philippines makes transport efficiency a development imperative. Shipping facilitates at least 80% of inter-island movement of both passengers and cargoes. The government is currently implementing programs that seek to improve the efficiency of shipping and ports operations and to reduce overall transport cost.

Past studies (USAID, JICA, SHIPDECO) recommended the extensive use of RORO shipping for domestic inter-island transport in the country. In January 2003, upon the recommendation of the private sector, President Arroyo issued EO 170 – defining the Road-RORO inter-modal policy and promoting private sector investment in the Road-RORO Terminal System (RRTS).

The TAPS Project continued the activities of AGILE/EGTA this year with the preparation of pre-feasibility studies on the Manila-Cebu, Cebu-Cagayan de Oro RORO shipping routes as well the development model for a small RORO port. A road-show in certain municipalities/cities in the Visayas and Mindanao resulted in the forging of a Memorandum of Understanding between the private sector and six (6) local government units:

- LGUs – Cordova (Cebu); Getafe, Ubay and Loay (Bohol); Maasin (Southern Leyte); Jasaan (Misamis Oriental)
- Private Sector – cargo shippers (DMAP, NORMINSA), RORO shipping operators (Lite Shipping, Phil Harbor), RORO shipbuilder (PICMW), truckers (Ansuico, Fast Cargo)

The team was tasked to deliver four deliverables under the approved terms of reference. Below is the team's accomplishments vis-à-vis the approved scope of work.

### **1. Conversion of private non-commercial ports into commercial ports under the Road Roro Transport System (RRTS)**

The PPA port system is composed of 115 public and 400 private ports. Under the public port network (PPA-owned) only 25-30 ports can handle RORO traffic. On the other hand, only 30 ports out of the 400 private ports are allowed to handle commercial traffic. More than 350 private ports are non-commercial ports handling cargoes of their industrial (private company) owners. As such, a policy that will not necessarily force private non-commercial ports to convert to commercial ports status but merely open the doors to these private non-commercial port operators who would like to offer their port facilities for commercial traffic and operating under the Road RoRo Terminal System (RRTS) was deemed necessary in order to first and foremost expand the existing RoRo ports network. RoRo ports would no longer have to be built since existing ports can serve as additional RoRo ports. Also, as an access to un-served markets or establishment of new routes serving hitherto un-served markets since some of the private non-commercial ports are located in areas that are not currently being served by the existing commercial port system. This will facilitate the development of new routes and markets. Finally, this will translate into savings and/or reduction in port development cost. The development of new RORO ports under EO 170 requires an investment of around P20-25 million (based on TAPS pre-feasibility study). The conversion of existing non-commercial ports into commercial ports will entail very minimal investment costs.

The team was then tasked mainly to draft an Executive Order that will allow private non-commercial ports to convert to private commercial ports under the Road RoRo Terminal System (RRTS). The EO was to be called EO 170-B, an addendum to the existing EO 170, which was

the first policy encouraging private sector participation in the development of the Road RoRo Terminal System (RRTS) and EO 170-A, which sought to expand the coverage of RRTS routes by lifting the 50-nautical mile limitation.

In drafting the Executive Order, the team worked together with their government counterpart, Secretary Romulo Neri of the National Economic Development Authority (NEDA), Secretary Arthur Yap of the Department of Agriculture, as well as with Undersecretary Agustin Bengzon of the Department of Transportation and Communication (DOTC). Private sector allies such as Distribution Management Association of the Philippines (DMAP) an association composed of big multinational companies, the Federation of Philippine Industries, and the Mindanao Shippers Association were likewise consulted as these groups include the country's biggest shippers and port users.

The team drafted the working draft of the EO which was routed for comments to the concerned government agencies. The final version of the working draft was revised for submission to the Office of the President and eventually for signature of the President.

The Executive Order 170-B "Encouraging Further Expansion of the Country's Road Roll on/Roll off Terminal System (RRTS) and Reduction of Transport Cost through Increase in the Number of RoRo Capable Ports and Conversion of More Private Non-Commercial Port Operations to Private Commercial Port Operations" was then finally signed by President Gloria Macapagal Arroyo on September 19, 2005.

During the duration of the project, the team was invited to participate either as participants or resource speakers at the National Pre-Export Congress, the DMAP Logistics Convention, and the Mindanao Shippers Congress. Moreover, the team was invited to serve as resource persons during meetings of the Export Development Council, NEDA Regional Development Committee Meeting, and at the Pre-Cabinet and NEDA Cabinet meeting to discuss the proposed EO.

## **2. Review the of the RORO Law and submit recommended amendments**

The team was tasked to draft a RoRo Law which would basically cover Eos 170 and 170-A as well as EO 170-B and more.

As early as September 2004, the team has had a series of meetings with key ally Mr. Meneleo Carlos, Chairman of the Federation of Philippine Industries who then endorsed the draft RoRo Bill to Rep. Augusto Baculio, Chairman of the House Committee on RoRo and Rail

Rep. Baculio pointed out that EO 170 "Promoting Private Sector Participation in the Development and Operation of the Road RoRo Terminal System (RRTS)" and its amendments should be transformed into an omnibus RoRo law which he will sponsor.

A few months after, Rep. Imee Marcos filed HB 335 which basically translated EO 170 into the form of a bill. However, since HB 335 was merely a translation of EO 170 into the form a bill, private sector allies saw the need to come up with an improvement of the bill which would include other aspects such as streamlining of regulations, safety and standards, and sanctions and penalties. As such, the team came up with their own RORO bill which they submitted to Rep. Baculio with the endorsement of Mr. Meneleo Carlos of the Federation of Philippine Industries.

The team's version of the RoRo Law features the inclusion of EO 170 and 170-A as well as EO 170-B "Encouraging Further Expansion of the Country's Road Roll on/Roll off Terminal System (RRTS) and Reduction of Transport Cost through Increase in the Number of RoRo Capable Ports and Conversion of More Private Non-Commercial Port Operations to Private Commercial Port Operations". It also contains provisions on service and safety standards as well as sanctions and penalties. Finally, it calls for the streamlining of regulations.

The extent of the team's technical assistance with regard to the RoRo law involved drafting of the bill taking into account EO 170 and the draft EO "Encouraging Private Port Operators to Convert their Operation Into Commercial Port Operation In Order To Expand The Country's Road-Roro Terminal System (RRTS) Network". The team also met and discussed with stakeholders in the industry such as the Philippine Chamber of Commerce and Industry (PCCI), the Distribution Management Association of the Philippines (DMAP), the Confederation of Philippine Exporters (PhilExport), the Export Development Council (EDC) and the Federation of Philippine Industries.

### **3. Program for affected port workers**

The full implementation of RRTS will reduce cargo handling costs and result in more efficient transport of goods. However, port workers who used to handle cargo and related services may be adversely affected. The government has recognized this potential problem and needs assistance in developing an action plan that provides a safety net for affected port workers.

The team was tasked to draft an action plan outlining a program for affected port workers, including possible sources of funds to finance the program.

An action plan was drafted by the team and was included in the original version of the proposed EO.

The proposed program for displaced port workers was included in the original draft EO 170-B as one of its provisions.

Essentially, under the EO, the Philippine Ports Authority (PPA) shall collaborate with the Office of Transport Cooperatives (OTC) of the DOTC in order to organize the port workers into transport cooperatives so that they can participate in the RRTS as transport service providers. Moreover, an amount of P100 M shall be allocated to finance the undertaking. The said amount shall come from the PPA's port development fund. Port workers can avail of the fund via soft loans. Another option for the port workers is that they can also put up a workers enterprise where they can go into small business. The port workers may also undergo a retooling of skills with the help of TESDA.

However, since the provision on allowing the Chassis on RoRo (CHARO) operations was excluded from the signed EO 170-B and was suggested to be the subject of a separate Executive Order, the safety net provision was likewise excluded and

### **4. Clarification of rules on the privatization of public RORO ports under PPA Administrative Order 03- 2004 on RRTS**

Almost two (2) years after the issuance of EO 170, the PPA finally came out with a draft Administrative Order (AO) that will govern RORO port development under the RRTS. Aside

from the guidelines on the development and operation of ports under the RRTS, the draft AO also contains rules on the privatization of public RORO ports.

There is a need to review the draft PPA AO and advocate for revisions/refinements in order to ensure that the implementing rules carry the spirit of the law and attract private sector-LGU investment/participation in the RRTS.

Thus, the team was tasked to review and comment on the PPA AO 03-2004. PPA Administrative Order (AO) 03-2004 - *Guidelines on the Development, Construction, Management and Operations of Ferry Terminals under the RRTS* - was issued by the Philippine Ports Authority (PPA) on December 15, 2004. It defines the processes and requirements involved in the privatization of PPA-owned RORO terminals listed under the following links or sub-systems – western, central and eastern nautical highways. According to PPA, there are already some 90 RORO terminals participating in said RORO links.

Presently, PPA is circulating a draft of a new AO seeking to amend by substitution PPA AO 06-95 and provide for the new guidelines, taking into consideration existing and recent policy issuances (e.g., EO 170 and 170-A & B) on the development, construction, management and operation of private ports. Thus, the team included comments on this as well.

Below are the team’s comments on the two AOs.

- **On PPA AO 03-2004**

1. PPA should provide for a specific timeframe in the privatization of its RORO-owned terminals/ports. There should be a clear program accompanying this AO, to encourage private interest in taking over PPA-owned RORO terminals/ports. Simply having the AO will not ensure or achieve port privatization. It is therefore recommended that a program be developed to attain the following port privatization goals:

Timeframe	Goal
Within 3 years from implementation of PPA AO 03-2004	30% of PPA-owned RORO ports should have been privatized
Within 5 years from implementation	70% of PPA-owned RORO ports should have been privatized
Within 8 years from implementation	All PPA-owned RORO ports should have been privatized

2. Pursuant to EO 170-B Section 4 (*Encouraging conversion to Private Commercial Ports*), the PPA should also prepare and implement a program that would encourage the conversion of private non-commercial ports into commercial ports under the RRTS.

Under the same section, it should be emphasized that *proximity to and direct competition with a public port shall not be a valid cause for non-approval of any private port conversion.*

## ▪ **ON THE PROPOSED PPA AO ON PRIVATE PORTS**

The proposed AO (series of 2005) is very similar to the draft Memorandum Circular (MC) that PPA circulated more than 6 years ago. The MC was strongly opposed by the private sector due to its anti-competition provisions. For example, “*all private commercial ports that are near a PPA port (within 50 kilometer radius) must revert to a non-commercial port status.*” This is how PPA tries to prevent competition (instead of promoting it). PPA uses its regulatory powers to prevent competition (that might undermine its competitiveness) to protect its own interest even at the expense of public interest (A good example of this is Harbour Centre, a private commercial port that has been denied by PPA the permit to handle foreign containerized cargoes because it will compete against its own ports - MICT and South Harbor).

Fortunately, the proposed PPA MC was never issued. However, the proposed AO can be considered as a new attempt by the PPA to protect its interest contrary to stated national policy of promoting competition, transparency/good governance and greater private sector participation. The same provisions are being proposed, to wit:

### **PERTINENT SECTIONS**

Section 3.6. Private commercial ports shall be established if it is located outside the 50 kilometer distance radius to avoid the redundancy in investment resulting to non-viability of port operations.

COMMENT: Putting up a private port is a business decision and business decisions are predicated on the opportunity to make/earn a profit. In a competitive environment, price, efficient service and good quality of service are the main determinants of success. The PPA should not be afraid of competing against private port operators if it operating efficiently.

This is the reason/spirit behind the provision in EO 170-B that directs the PPA not to deny an application for conversion into commercial ports on the basis that it is near a PPA port and/or it will provide competition against a PPA port.

As a general policy, the PPA should not use its regulatory powers to deny the public of the benefits of competition.

Section 3.8. Private non-commercial ports issued temporary permit/s to operate commercially, shall revert back to their original registration status at the end of the temporary authority granted to them.

COMMENT: PPA might resort to issuing only temporary permits to private non-commercial ports to be able to operate commercially so that they will always have to revert back to non-commercial port status. This is akin to the policy of the PPA to issue 1-year provisional contracts (renewable) to cargo handling operators.

### Section 4. Basic Rules

4.1 Private port development is encouraged in instances or cases where:

4.1.1 There is no available government port facility to serve the community/locality and its immediate environment

- 4.1.2 There is no immediate or future development plan by PPA on the area applied for by the applicant
- 4.1.3 There is no other means of transport or trade link within the sphere of influence of the locality

COMMENT: This section must be deleted. As mentioned earlier, private port development and operation is a business decision. Therefore, it should not be constrained by limiting the opportunities that may be taken/considered by potential private port operators.

This section is contrary to the national government's policy of privatization. The PPA should even give to the private sector port operations that are already profitable and with developed markets. Allow the private sector to take over areas (from the government) where they can be more effective.

More and more the PPA should concentrate on developing unserved markets/missionary routes and then privatizing the same when there are already interested private sector operators. (The private sector will only go into these unchartered areas if the opportunities for profit exist and/or the incentives given by the government are attractive enough for them to come in and participate).

Section 9.2. Meanwhile, private commercial ports built adjacent to or within the 50 kilometer radius from a government (PPA) port shall be charged corresponding 10% of the annual gross from domestic operation and 20% of the income from foreign operation as applied to government ports in addition to the annual privilege fee.

COMMENT: This is definitely an unlevelled playing field. PPA is effectively putting a burden on the profitability and viability of the private commercial port by confiscating a portion of its income. This may also be a way of PPA to recover its potential losses due to competition.