

WORKING PAPER

Challenges in Trade Facilitation: The Case of the Designated Examination Area (DEA) in Davao

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This working paper is a discussion draft in progress that is posted to stimulate discussion and critical comment. The views expressed herein are those of the authors and do not necessarily reflect the views of Asian Institute of Management or Ateneo de Davao.

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1. Introduction

In January 2010, import tariffs on more than 99 percent of all the products that the Philippines traded with its ASEAN¹ neighbors went down to zero, in accordance with the ASEAN Free Trade Agreement (Habito, 2014). The only remaining ASEAN products not freely imported into the Philippines are rice, sugar, and a few livestock products. Rice imports will continue to be restricted at least until 2017.²

Nevertheless, even if the Philippine economy has all but attained complete free trade in goods in the ASEAN, much work remains to be done to achieve the single market and production base envisaged by the ASEAN Economic Community (AEC).³ It is still quite difficult to move products (whether raw materials, intermediate inputs, or finished goods) across ASEAN due to cumbersome border procedures that impede trade. There are customs procedures and other government requirements on import and export transactions that are not yet standardized and predictable. Corruption and inefficiencies also continue to plague such processes. Thus, the transaction costs incurred to clear export and import shipments at the border could be as important as the import duties that used to prevail.

It is for this reason that the prominent focus in today's trade agreements, including those in the AEC, World Trade Organization, Asia-Pacific Economic Cooperation, and the Trans-Pacific Partnership, has shifted from trade liberalization to trade facilitation. Trade facilitation is defined as the simplification and harmonization of international trade procedures, referring to activities, practices, and formalities involved in collecting, presenting, communicating, and processing data required for the movement of goods in international trade.⁴ The need to provide information, submit declarations, and submit to border checks adds to business costs caused by associated time delays, which then lead to forgone business opportunities and reduced competitiveness. Thus, the aim is to maximize efficiency and reduce cost burdens associated with these trade processes, while safeguarding legitimate regulatory objectives.

¹ ASEAN stands for the Association of Southeast Asian Nations. Its member states are Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam.

² The link to Dr. Cielito F. Habito's article can be found here: <http://opinion.inquirer.net/80229/low-hanging-fruit>.

³ The interested reader can learn more about the AEC here: <http://www.asean.org/communities/asean-economic-community>.

⁴ Definition found here: http://ec.europa.eu/taxation_customs/customs/policy_issues/trade_facilitation/index_en.htm

In order to help illustrate the challenges to upgrading the Bureau of Customs (BOC) to fulfill its trade facilitation mandate⁵, this case elaborates on the issues surrounding the operations of the designated examination area (DEA) in Davao. Among other official and media sources, data was gathered through key informant interviews. In addition, a team from the Asian Institute of Management Policy Center in collaboration with a team from the Ateneo de Davao University conducted several focused group discussions and field interviews.⁶

2. The Case of the CY-OCY and DEA in Davao

2.1 Public-Private-Partnership (PPP)

Philippine ports have been plagued with the problem of congestion. Local representatives of various shipping lines operating in the country have complained about the lack of investments to upgrade ports nationwide. That the Philippines ranked 116th out of 148 countries with respect to Port Infrastructure in the 2013-2014 Global Competitiveness Report just goes to show how grave the issue has become.⁷

Particularly at the Port of Davao, local representatives of American President Lines, Maersk Line, and Regional Container Lines have voiced concerns over the added operating costs caused by needlessly long waiting and servicing times.⁸ One of the solutions put forward was to operate a so-called Container Yard Outside Customs Zone (CY-OCZ), which would also serve as a DEA.

On October 17, 2005, citing congestion, lack of a permanent DEA in the Port of Davao, and the lack of available space in the Philippine Ports Authority (PPA) for a DEA, Deputy Commissioner of the Assessment and Operations Coordination Group of the BOC, Mr. Celso P. Templo, endorsed the creation of a CY-OCZ to be operated by Aquarius Container Yard (ACY),

⁵ The mandate of the BOC is featured here: <http://customs.gov.ph/about/mission-and-vision/>.

⁶ Given the mixture of views and opinions that helped inform the preparation of this case, the authors acknowledge that certain assertions by some interviewees need to be confirmed over time. Hence the authors welcome questions and comments without prejudice to the possible use of this case for teaching purposes.

⁷ Here is a link to the report: http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2013-14.pdf.

⁸ Here is a link to the news article: <http://www.portcalls.com/congestion-hits-mindanao-port-lines-seek-port-expansion/>.

a private entity owned by Mr. Rodolfo C. Reta. This CY-OCZ would then eventually be converted into a DEA.

ACY is mandated to work towards the attainment of the objectives of a CY-OCZ.

Box 1: Objectives of a CY-OCZ

- I. General: To promote the utilization of CY-OCZ as facilities for the proper collection of duties and taxes, the prevention of the entry of drugs and other anti-social goods, and to facilitate the Customs clearance process for containerized consolidated shipments.
- II. Specific
 - A. On proper collection of duties and taxes
 - 1. Ensure that only shipments subjected to Pre-Shipment Inspection are transferred to outside CY-OCZ
 - 2. Provide for sufficient security to cover any losses on goods transferred to the CY-OCZ
 - 3. Set up control measures to prevent unauthorized releases of goods from the CY-OCZ
 - 4. Operate a computerized warehouse inventory and audit system
 - B. On prevention of the entry of drugs and other anti-social goods
 - 1. Installation of drug detection equipment
 - 2. Provision for analysis of chemical shipments by the Philippine Customs Laboratory
 - C. Facilitation of customs clearance process
 - 1. Detail of sufficient Customs examiners and law enforcement personnel to the Customs office at the CY-OCZ
 - 2. Provision for the electronic transmittal of the following to and from concerned Bureau of Customs office and the CY-OCZ Customs office:
 - a. Entry documents
 - b. Examination return
 - c. Delivery authorization

Mr. Templo's letter was followed by additional endorsements by several BOC officials, including Atty. Juan N. Tan (District Collector), Mr. Antonio P. Aguilar (Port Operations Service Officer-in-Charge), and Mr. Napoleon L. Morales (Commissioner). Such favorable endorsements paved the way for ACY to commence operations as a CY-OCZ on April 6, 2006.

After about three years of operating as a CY-OCZ, ACY was eventually converted into a DEA at no cost to the government. ACY was to earn income from fees paid by importers for the hauling/trucking services of the containers from the Sasa Wharf to the DEA for the mandatory x-ray, scanning, stripping and stuffing in case 100% physical examination of cargoes was required and from the lift-on/ lift-off services utilized when the containers are unloaded at the ACY pending release.

On January 9, 2009, the Bureau of Customs (BOC) represented by its Commissioner, Napoleon L. Morales, entered into a Memorandum of Agreement (MOA) with Aquarius Container Yard (ACY) represented by Mr. Rodolfo C. Reta.

Under the MOA whose term was for twenty five (25) years, ACY was identified as the exclusive Designated Examination Area (DEA) of the Port of Davao. ACY's obligation under the contract was: (1) to provide a 10,000 sq. m. parcel of land which shall serve as the DEA; (2) construct a perimeter fence to secure the land and avoid commingling of containers.

The DEA was to be fully manned, operated and maintained under the direct control and supervision of the BOC which bound itself under the MOA not to abandon the premises during the term of the agreement, as long as the same is being utilized as the DEA of the Port of Davao, unless sooner revoked for cause by any of the parties, or renewal thereof, as the case may be.

Last, all suits or actions arising from the interpretation of breach of the agreement may be commenced only in the courts of Davao City or Metro Manila to the exclusion of all other courts.

2.2 Conflict at the DEA

On February 26, 2010, forty (40) containers declared to contain 12,800 bags of construction materials from Thailand on Board the vessel Matthias Claudi were brought to the DEA for the mandatory x-ray and scanning procedure. The import entry documents⁹ reveal that the consignee was Rapzel General Merchandise with address at Quimpo Blvd., Davao City, with Michael Corong as its broker. Reta was informed that gate passes dated February 24, 2010 for the release of the 40 container vans were already issued by Customs Guard II/Acting Assistant Wharfinger Alicodsaman Dimasicil – prior to the actual arrival and inspection of the shipment and moreover instructing immediate release of the cargo.

Reta, assisted by his lawyer, Atty. Manuel P. Quibod, reported the irregular issuance of the gate passes to the District Collector, Port of Davao, Anju Nereo C. Castigador. This he did in compliance with his obligation to “Set up control measures to prevent unauthorized releases of goods from the CY-OCZ.”¹⁰ Instead of acting on the report, Castigador forwarded to Atty. Quibod a letter notifying Reta to cease operations by virtue of his alleged refusal to render lift-on/lift-off services for the examination and release of containers brought to the DEA. The letter also informed Reta that: “in order to protect the interest of the government and to promote trade facilitations and upon verbal instructions of the commissioner of customs, this port in the meantime will conduct the examinations of shipments at the PPA Designated Area, Sasa Wharf.”

After the x-ray and scanning of the cargo, the inspector, Nilo A. Lim, recommended that all the containers be stripped, that is, opened and examined physically. COO I/Acting Customs Examiners, Assessment Division Lerrie L. Natividad and Moctar S. Amir, together with the Michael Corong’s representative, went to the container yard to examine the Rapzel vans. However, when they saw a newspaper correspondent covering the event, they disappeared even before the stripping. The stripping revealed that the vans contained sacks of rice, not construction materials.

On February 28, 2010, by order of Castigador, the Customs Police and other personnel, at gun point, forcibly removed from ACY premises the 40 container vans containing smuggled rice and brought them to the Philippine Ports Authority (PPA) at Sasa Wharf. Alert orders, notice and

⁹ Import Entry and Internal Revenue Declarations Forms with serial nos. 103833721, 103833737, 103888746 and 103833712

¹⁰ Customs Administrative Order (CAO) 5-94

declaration of abandonment, inventory report and sale by public auction of the 40 container vans each containing 320 sacks of rice were all issued and made outside ACY.¹¹

On March 5, 2010, Customs Commissioner Morales revoked the MOA with ACY, noting that by closing down the operations of the DEA, ACY hampered the customs officers' performance of their functions. The strained relationship between ACY and the port officials would also affect port operations. Moreover, the Commissioner no longer saw the need for the DEA, as Atty. Castigador reported that some space within the PPA area could already be allotted for inspections.

2.3 The Legal Battle

Reta filed administrative charges of Grave Misconduct, Serious Dishonesty and Violation of RA No. 6713, otherwise known as "The Code of Conduct and Ethical Standards for Public Officials and Employees" against CCOO/OIC- District Collector of Customs Anju Nereo Castigador, Customs Guard II/Acting Assistant Wharfinger Alicodsaman Palao Dimasicil, and COO I/Acting Customs Examiners, Assessment Division Lerrie L. Natividad and Moctar S. Amir, docketed as OMB-M-A-10-101-D.

Reta also filed criminal charges of violation of the Anti-Graft and Corrupt Practice Act (R.A. No. 3019) docketed as OMB-M-C-10-0103 against CCOO/OIC- District Collector of Customs Anju Nereo Castigador, Customs Guard II/Acting Assistant Wharfinger Alicodsaman Palao Dimasicil, COO I/Acting Customs Examiners, Assessment Division Lerrie L. Natividad and Moctar S. Amir, and private respondent, Customs Broker Michael C. Corong.

The cause of action was the issuance of the gate passes for the container vans even before the mandatory x-ray and examination, in clear violation of the rules, in transferring the examination area of the Rapzel shipment from ACY to PPA without observing due process and in failing to file criminal charges against Rapzel for misdeclaring rice as construction materials.

Reta also filed a case for Breach of Contract against the BOC.

Castigador on the other hand filed direct assault and usurpation of public authority against Reta.

Reta alleged that the unilateral termination of the MOA by Castigador was a subterfuge to stop ACY from operating as a DEA as he had been reporting smuggling activities going on

¹¹ Decision dated November 29, 2012 in Reta vs. Castigador, et al., OMB-M-A-10-101-D

inside the DEA, specially this instance of multi-million rice smuggling to the prejudice of the government and himself. He also disclosed the Colors and Equivalent Cost of Grease Money per container van.

Box 2: The Quick and Easy Release of Containers

Mr. Reta explained that when imports entered through the Port of Davao, goods were classified into categories to determine how much “grease money” would be paid. This “grease money” **(2009 rates)** would be shared with government employees, even from anti-smuggling units. Codes were also used to facilitate the importation.

Code	Type of Articles	Greasing Cost (in Philippine pesos) per container van
Gold	cars, rice, sugar	150,000
Silver	spare parts, onions	80,000
Bronze	clothes, China products	60,000

Thus, a team from the Customs Intelligence and Investigation Service intervened. The team initially discovered that procedures for clearing cargo were either not properly implemented or not implemented at all. Further investigation revealed that the February 26, 2010 shipment was originally consigned to Seven Seas General Merchandise in Davao City. However, Atty. Castigador and other Port of Davao staff surreptitiously changed the consignee name to Rapzel General Merchandise, which was actually a Manila-based shell company, upon the broker’s request. The report thus recommended the filing of criminal charges against Rapzel General Merchandise, as well as administrative sanctions on Port of Davao officials for their lack of oversight.

The Office of the Ombudsman in Mindanao found substantial evidence of grave misconduct against Castigador for preparing gate passes prior to inspection and for failing to file cases against Rapzel. It also found that the unilateral transfer of cargo from the DEA to the PPA was done in bad faith because due process was not followed, and Castigador had no authority to order such a transfer. The Office of the Ombudsman also ordered his dismissal from service.

The BOC and Castigador appealed to the Court of Appeals who sustained the lower courts. Undeterred, they went to the Supreme Court who initially dismissed the petition but later reconsidered and reinstated the petition. As a result, the status quo was restored, which meant that examinations would still be done at the PPA instead of the DEA.

2.4 Current Situation

Up to the time of writing this case, the DEA remains closed. Although Atty. Castigador was replaced as District Collector, Mr. Reta's numerous appeals to succeeding BOC Commissioners to reopen the DEA have yet to bear fruit.

Due to the closure of the DEA and considering the port congestion in Sasa Wharf and the lack of space in PPA¹², port usage has been transferred to private ports as far as Panabo City. Importers have to pay higher fees for transporting and hauling their cargoes. Government loses money because of inefficient revenue collection arising from the dispatch of examiners to various private ports and the non-use of the x-ray in scanning the container vans.

An ocular inspection of the PPA operations at the Sasa Wharf revealed that two portable x-ray machines stand idle and are not being used. This is in addition to the 250 million worth of x-ray equipment that stands idle in the DEA in the premises of ACY that remains closed.

¹² Although reports indicate that the port revenues increased during the operation of the DEA, further analysis of the data reveals that the link between the DEA operations and increased Bureau of Customs revenues in Davao is not clearly established. Prior to the operation of the DEA in 2009 (as established by the MOA between the BOC and Aquarius Container Yard), BOC actual revenues in Davao were already exceeding those targeted (1% above targeted in 2007 and 13.2% above the targeted in 2008 according to BOC data). This continued even after the cessation of operations of the DEA in 2010, with actual collections exceeding targeted in 2011 (19.9%), 2012 (9.3%) and 2013 (2.3% from January to August).

3. Did the CY-OCY and DEA Really Make a Difference?

Since the CY-OCY/DEA was put in the “freezer”, as it were, what has become of the port congestion problem? Perhaps a quick examination of port-related statistics could reveal some interesting trends.

According to PPA data, container traffic (measured in twenty-foot equivalent unit or TEU) increased from 202,016 TEU in 2003 to 500,288 TEU in 2012 (an average annual growth rate of 11.3 percent). However, due to inadequate investments to increase the operational capacity of the Port of Davao (to keep up with the increasing traffic), waiting time per vessel (the average number of hours a vessel had to wait before it got serviced) increased from 0.39 hour in 2003 to 8.02 hours in 2012 (an average annual growth rate of 114.5 percent). Likewise, servicing time per vessel increased from 36.03 hours in 2003 to 46.33 hours in 2012 (an average annual growth rate of 4.3 percent).¹³ It should be noted, however, that when the DEA was operational from 2006 to 2009, waiting time per vessel actually decreased in 2006 and 2007; and servicing time per vessel decreased in 2006, 2008, and 2009, as shown in Table 1.

Table 1: Container Traffic, Waiting Time, and Servicing Time in the Port of Davao

Year	Number of Containers (in TEU)	Waiting Time per Vessel (in hours)	Servicing Time per Vessel (in hours)	Percent Change in Number of Containers	Percent Change in Waiting Time per Vessel	Percent Change in Servicing Time per Vessel
2003	202,016	0.39	36.03	—	—	—
2004	226,018	1.02	39.44	11.9	163.0	9.5
2005	225,721	1.61	34.19	-0.1	58.6	-13.3
2006	258,104	0.23	26.33	14.3	-85.5	-23.0
2007	298,675	0.06	33.15	15.7	-73.6	25.9
2008	349,006	0.16	30.95	16.9	162.6	-6.6
2009	392,029	0.70	28.38	12.3	332.0	-8.3

¹³ The average annual growth rate (AAGR) is the arithmetic mean of a series of growth rates. The formula for AAGR is as follows: $AAGR = (\text{Growth Rate in Period A} + \text{Growth Rate in Period B} + \text{Growth Rate in Period C} + \dots + \text{Growth Rate in Period X}) / \text{Number of Periods}$.

2010	524,498	3.05	35.82	33.8	337.4	26.2
2011	572,317	6.47	43.96	9.1	111.9	22.7
2012	500,288	8.02	46.33	-12.6	24.1	5.4

Note: The TEU is an inexact unit of cargo capacity often used to describe the capacity of container ships and container terminals. Green means increase while orange means decrease.

Source: PPA.

Table 2 also features servicing time per vessel, but the data are classified under domestic and foreign vessels, with and without the DEA. From 2003 to 2012, foreign vessels took much longer to service on average. More importantly, however, the presence of the DEA contributed to time savings for both domestic and foreign vessels.

Table 2: Servicing Time per Vessel (Domestic vs. Foreign, With DEA vs. Without DEA)

Servicing Time per Vessel (in hours)	Domestic Vessels	Foreign Vessels	Total Vessels
With DEA (2006-2009)	26.72	34.06	29.70
Without DEA (2003-2005, 2010-2012)	36.39	46.14	39.29
Average time saved with DEA in operation	9.67	12.08	9.59

Source: PPA.

Therefore, the statistics seem to suggest that the DEA actually contributed to easing port congestion when it was still operational.

4. Conclusion

Indeed, the world will not be standing still as the Philippines races to improve its lot. The AEC is seen to be a huge game changer, and the country's readiness for it will ultimately depend upon how quickly it adopts difficult yet highly beneficial reforms. As Dr. Gerardo P. Sicat notes,

“readiness” implies the ability to take maximum advantage of the opportunities offered by the AEC. Nevertheless, it seems that the most difficult reforms to undertake are often the last ones to be adopted.¹⁴

Improved trade facilitation is one such difficult reform because of the complex political economy surrounding customs. As the case study illustrates, “trade facilitation” in a deeply corrupted context means the circumvention of legitimate control processes to favor those who pay bribes and commit extortion. Changing the system to truly allow for trade facilitation would definitely take all the political will that can be mustered.

As noted in Mendoza et al. (2014)¹⁵, reformers in the BOC have been working on a highly compacted timeline to push key reforms, which include: 1) pre-arrival clearance to expedite the release of cargo; 2) full implementation of the National Single Window (an online platform facilitating all clearances for importation); 3) investments in the computerization and information technology system underpinning customs administration, in order to facilitate information capture, data collection, and reporting platforms to underpin “open government” reforms (e.g., the “Customs ng Bayan” website); and 4) passage of the proposed Customs Modernization and Tariff Act (already filed in 2008 under the 15th Congress and being pursued for finalization by the 16th Congress). Only time can tell whether these reforms will ever be achieved and sustained.

¹⁴ Here are links to Dr. Sicat’s articles on the AEC: <http://www.philstar.com/business/2014/11/05/1388129/ready-asean-economic-community-2015> and <http://www.philstar.com/business/2014/11/12/1390708/how-harness-opportunities-asean-economic-community-2015>.

¹⁵ http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2492897

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Annex: Images from the Case Study



X-ray equipment at the DEA.



Port of Davao.



Ships docked at Sasa Wharf.



Customs offices in ACY.

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