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# Policy Notes

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# Border and behind-the-border restrictions in logistics and trade facilitation in the Philippines: Some results of regulatory dialogues

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The establishment of an ASEAN Economic Community in 2015 is envisaged to foster greater cooperation in trade among the ASEAN member-countries. The logistics sector[1] plays a critical role in trade facilitation. The Philippines' potential to capitalize on the gains of regional economic integration depends on its resolve to address the reform gaps and challenges that undermine the efficient and effective regulation and management of trade facilitation at the border and behind the border.

This *Policy Note* summarizes the findings of the Philippine research team in a study funded by the Economic Research Institute for ASEAN and East Asia (ERIA) that probed the regulatory environment and the remaining border and behind-the-border restrictions in logistics and trade facilitation in the region. The study, which was released as PIDS Discussion Paper No. 2013-47 titled "Towards informed regulatory conversations and improved regulatory regime in the Philippines: Logistics sector and trade facilitation", also covered customs services as these are the forefront services in trade facilitation. The research methodology included surveys, desk reviews, focus groups, and triangulation with industry

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[1] The logistics sector consists of logistics services, maritime transport, air transport, and land transport industries.

*PIDS Policy Notes* are observations/analyses written by PIDS researchers on certain policy issues. The treatise is holistic in approach and aims to provide useful inputs for decisionmaking.

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observers. Based on the findings, the research team formulated some policy recommendations intended to guide the way forward. These are presented in the final section of this *Policy Note*.

## Brief overview of the current regulatory environment

### *Logistics services*

The freight forwarding business component of the logistics services industry is not highly regulated. The primary regulatory requirement for service providers wanting to enter the market is accreditation by the Philippine Shippers' Bureau, a unit under the Department of Trade and Industry. A firm cannot operate a freight forwarding business without a Certificate of Accreditation that is valid for two years. Prices are not regulated and entry and exit are dictated by market forces. Thus, the regulation of the freight forwarding business can be described as light-handed regulation.

### *Maritime transport*

The regulator is the Maritime Industry Authority (MARINA), an attached agency of the Department of Transportation and Communication. The general legislation that governs maritime transport industry competition is Republic Act (RA) 9295 or the Domestic Shipping Development Act of 2004. This law also provides the legal basis for cabotage restriction in maritime transport. Although some regulatory challenges persist, the sector is more liberalized and deregulated now than it was before the 1990s.

### *Air transport*

There are two categories of regulatory activities in the Philippine air transport industry: (i) regulation of commercial air carriers and (ii) regulation of airports and enforcement of air traffic rules. The first category of regulatory activities is being undertaken by the Civil Aeronautics Board (CAB), which is mandated by RA 776 enacted in 1952 to regulate the economic aspect of aviation and to issue Certificates of Public Convenience and Necessity to domestic and international airlines that are allowed to operate in the Philippines. The second category of regulatory activities falls under the mandate of the Civil Aviation Authority of the Philippines. It has corporate attributes and powers by virtue of RA 9497 enacted in 2008 to restructure the civil aviation system and to promote, develop, and regulate the technical, operational, safety, and aviation security functions under the civil aviation authority.

### *Land transportation*

For land transport services supporting the logistics supply chain (e.g., trucking services), the Land Transportation Franchising and Regulatory Board (LTFRB) was set up under Executive Order (EO) 202 series of 1987 as the economic regulator. Economic regulation covers regulation of routes and issuance of Certificate of Public Convenience or franchise to operate. The

LTFRB also examines the appropriateness of the vehicle before granting approval of the franchise (e.g., if the cargoes would be perishable goods or liquefied petroleum gas, the trucks to be used by the applicant should be technically equipped to handle such items). The LTFRB also regulates the maximum age of utility vehicles (e.g., 25–30 years for trucks-for-hire).

The regulation of weight limits is not covered by the LTFRB's mandate. The Department of Public Works and Highways enforces rules on weight limits, the legal basis for which is RA 8794 enacted in 2000 to impose a motor vehicle user's charge or tax.

### *Customs services*

Customs services are carried out by the Bureau of Customs (BOC) under the Department of Finance. The BOC undertook significant reform and modernization programs between 1992 and 1998 but the modernization momentum was not sustained in the succeeding years (Parayno 2004). To sustain the improvements, a computerization improvement program was re-introduced in 2005. The program includes the Electronic to Mobile Customs Project that aims to develop a dynamic and faster end-to-end cargo clearance process through the use of mobile broadcasting and Internet/ electronic data interchange connectivity (Aldaba et al. 2011).

The setting up of a National Single Window (NSW) for customs services is also another modernization effort initiated in 2005 as directed in EO 482. The NSW was supposed to be developed in two phases: Phase 1 for permits and clearances required by government agencies and Phase 2 for the integration of the BOC database with the NSW. Phase 1 targets to connect 40 agencies to the NSW. Thirty agencies responsible for the issuance of permits, licenses, and certificates have already been connected. The BOC aims to connect the remaining 10 agencies, which serve as gateway for data and statistical information, and integrate the BOC and NSW systems in Phase 2.

## Regulatory reforms toward trade facilitation

The regulatory environment in the previously described industries underwent several changes over the years. Briefly highlighted below are the reforms that are in a more advanced stage and has led to better trade facilitation.

The *maritime transport* industry experienced significant progress in liberalization and deregulation. In the 1990s, MARINA and the executive branch of government issued several rules that (i) liberalized route entry or exit and (ii) deregulated shipping rates (Llanto and Navarro 2012).

The major accomplishments in the *air transport* industry had been in the aspects of liberalization and deregulation. The privatization of the Philippine Airlines (formerly the national flag carrier) in 1992 facilitated the liberalization of commercial aviation. The government no longer has any ownership share in Philippine Airlines. The liberalization of entry and deregulation of routes resulted in more players in commercial aviation, especially low-cost carriers. There are now four low-cost carriers that have both domestic and international services (Air Philippines, Cebu Pacific, Sea Air, and Zest Air). Three international low-cost carriers are also flying to and from the Philippines (Jetstar, Tiger Airways, and Air Asia).

## Remaining gaps and challenges

Despite the reforms, there are still gaps and challenges that need to be addressed. Described below are some of the remaining border and behind-the-border restrictions that surfaced in the regulatory dialogues as well as in the research team's review of policies, rules, and regulations.

### *Logistics services*

A major investment restriction is the 60:40 rule on Filipino equity-foreign equity mix that also applies to foreign investments in domestic freight forwarding business in accordance with the Corporate Code of the Philippines.

An operational restriction provided by Presidential Decree (PD) 1466 enacted in 1978 persists. PD 1466 mandates that the exportation and/or importation of all government cargoes, as well as private cargoes paid from the proceeds of loans, credits, or guarantees from government financial institutions, must be carried by Philippine flag vessels. The term "Philippine flag vessels" as used in PD 1466 refers to air carriers or ships duly registered in the Philippines and are owned or controlled, or chartered by Philippine citizens or by a corporation or other entity owned or controlled by citizens of the Philippines. Exemptions to this restriction have to be secured on a case-by-case basis from the CAB and MARINA.

### *Maritime transportation*

Foreign vessels generally cannot provide domestic services, as stipulated in RA 9295 and its implementing rules and regulations. Exception to this cabotage restriction can only be allowed under the following conditions: (i) there is no existing vessel operating in the proposed route/area of operation; (ii) there is no available local vessel to transport the cargo to meet the shipping requirement; (iii) the proposed vessel is contracted by private/public entities; and (iv) in the case of vessel carrying or bringing in foreign tourists, operation calls at domestic ports is part of its itinerary.

The operation and regulation of Philippine ports is another contentious issue. Regulatory activities (e.g., setting of rates for berthing, anchorage, docking, wharfage, ground handling, break bulk cargo handling, concessions, etc.) are usually conducted by port authorities who are also in charge of port operation.

*Air transportation*

At present, the Philippines has open skies agreements with two ASEAN countries, Viet Nam and Thailand. Among non-ASEAN countries, the Philippines has open skies agreement with China and the United States (US), but both agreements have uneven concessions for the Philippines. The use of Chinese airspace is restricted by the Chinese military. Philippine carriers can have unlimited number of flights to only five points in the United States while US carriers can have unlimited number of flights anywhere in the Philippines.

Serious infrastructure capacity constraints also exist. For example, the Ninoy Aquino International Airport (NAIA), the primary international gateway to the country, has limited runway capacity, landing slots, and terminal space to accommodate the growing air traffic. The 7:00 a.m. to 9:00 p.m. take-off and landing slots are considered "very limited".

There are no legislative or regulatory limitations on foreign aviation firms in the provision of own or third-party ground handling, cargo handling, and warehousing services. The inadequate airport space also makes these services unattractive to foreign investors.

*Land transport*

The major behind-the-border restrictions in land transport that impede trade facilitation are traffic congestion and limits on hours of operation of land transport services. These restrictions are highly interrelated because in the effort to reduce the number of vehicles on the road and alleviate traffic congestion, local government units (LGUs) or authorities impose regulations on hours of operation of vehicles. In Metro Manila, the Metro Manila Development Authority (MMDA) implements the Unified Vehicular Volume Reduction Program (UVVRP) that restricts both public and private vehicles from using all national, city, and municipal roads in the metropolitan area from 7:00 a.m. to 7:00 p.m. based on the last digit of the vehicle's license plate. Prohibition days do not include Saturdays, Sundays, and official public holidays. Cargo trucks are exempted from the UVVRP but they continue to be covered by specific regulations concerning truck bans as imposed by the MMDA and LGUs. In Metro Manila, a truck ban is implemented from 6:00 a.m. to 9:00 a.m. and from 5:00 p.m. to 9:00 p.m. every day except Sundays and holidays on specific roads and highways. Although conduct passes for exemption from the truck ban may be granted, these are usually for heavy vehicles only and on a limited basis (e.g., trucks delivering petroleum or heavy vehicles carrying perishable goods).

*Customs services*

Some goods still require import licensing for phytosanitary and quarantine clearances that fall under the WTO general exemptions related to public safety, security, public morals, and the like. Regulations and

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restrictions on importation do not come from the BOC but from other government agencies (e.g., Department of Agriculture, Sugar Regulatory Agency, and Philippine Drug Enforcement Agency) that determine whether an item is freely importable, prohibited, or regulated.

During the interviews conducted by the research team, the BOC representatives claimed that their main task, in so far as regulations and restrictions are concerned, is merely to enforce the laws and regulations issued by the agencies regulating the entry of commodities. Meanwhile, follow-up interviews with importers and exporters revealed a very complex process for getting clearances and permits that leads to costly delays. Though importer and exporter respondents view the government licensing procedure necessary to ensure that the cargoes are safe and legal, they assert that the problem lies in the varying requirements imposed by government agencies and the tedious and time-consuming process of issuing permits and licenses. They consider bureaucratic "red tape" as a serious source of delay that makes obtaining a license complex and costly. Redundancies in requirements have also been reported. For instance, government licensing agencies still require importers or exporters to present certain documents that have been already submitted to the BOC (e.g., mayor's permit and tax clearance). The respondents also suggested that government agencies should only require information directly related to the goods being applied for licenses.

On the use of the NSW, the BOC reported that necessary permits from other agencies can be obtained online but this can happen only if the concerned government agency is already connected to the NSW. Follow-up interviews with importers and exporters revealed they welcome the NSW and the computerization of the lodgment of entries, which are generally viewed as important reforms toward greater efficiency in transactions and reduced costs for importers and exporters. However, they think there are still redundancies because hard copies of the documents that are lodged electronically still need to be submitted to the BOC. This practice defeats the purpose of electronic filing.

## Some recommendations on the way forward

The results of regulatory dialogues and analyses revealed that some of the identified border and behind-the-border restrictions, such as the restrictions related to airport capacity constraints, traffic congestion, and outdated customs processes, can be addressed through more vigorous investments in the logistics sector. The other restrictions, however, may not be easy to address and will require amendments to existing laws and even enactment of new laws.

*Foreign equity restriction in domestic companies*. As a long-standing challenge, addressing this will require changes in the current Corporate Code of the Philippines and in the Constitutional provision on foreign ownership. Public discussions of this issue show how the restriction has constrained investments in the country.

*Restriction imposed by PD 1466 on moving international cargoes*. This is another obstacle that may need new legislation or at least an amendment to the existing law. This protectionist policy has led to inefficient transport of tradable goods due to the absence of competition. Excluding foreign flag vessels from engaging in transport of government cargo, or cargo where the government has financial interest, deprives government entities and local businessmen of options to find the least-cost transport service that competition will ensure. Competition between Philippine flag vessels and nonflag vessels will yield better options to importers and exporters alike. Besides, the motivations mentioned in PD 1466 (i.e., to conserve the country's foreign exchange and to develop the country's air and water transport industries) are no longer binding.

*Cabotage restriction*. Lifting the cabotage restriction in maritime transportation will also require legislative amendment. The cabotage policy is reflected in the Tariff and Customs Code of the Philippines. RA 9295 enacted in 2004 slightly relaxed the restriction by specifying the special circumstances when foreign vessels can be allowed to transport local passengers and cargoes within Philippine territorial waters. However, its implementation depends on the discretionary action of bureaucrats who may have differing interpretation of the "special circumstances" when such foreign vessels can be allowed to ply domestic territorial waters. What is also needed is a clear competition policy in the domestic maritime transport markets.

*Independent regulator of ports*. The issue of a port operator being a port regulator at the same time needs to be addressed through legislative amendments. The functions of port authorities are provided for in corporate charters passed by legislators. There is a need to establish an independent regulator for the ports and leave port operation under the responsibility of port operators.

*Infrastructure issues hindering liberal skies policies*. The government issued EO 29 in 2011 that opened a few airports to foreign airlines. However, the intention to have a more liberal skies policy is constrained by the state of infrastructure in these airports. Foreign airlines could not take full advantage of the liberal policy due to limited airport space, landing and take-off slots, navigational equipment, and other capacity constraints.

*Imposition of truck bans*. Truck bans adds to conveyance costs in the logistics supply chain. Policymakers have responded to traffic congestion in Metro Manila by imposing a truck ban. Traffic congestion may be relieved and truckers spared the huge transaction cost imposed on them by connecting the North Luzon expressway and the South Luzon expressway through a connector road that will encourage truckers and freight forwarders to bypass inner Metro Manila in transporting their cargoes. Strict enforcement of traffic rules and regulations is also necessary to ensure a freer traffic flow.

*Continued customs modernization*. In the regulatory dialogues, a consensus emerged on the need to do away with redundant requirements and procedures and to rely on electronic means of transaction. Customs modernization should be continued and accelerated. It will be more efficient to minimize human discretion through computerization and to have various and modern options for importers and exporters in the release or shipment of their goods. Customs brokers are, however, wary that the proposed bill to modernize customs administration will marginalize their role in customs and trade facilitation (Llanto et al. 2013). This may be addressed through information dissemination on new opportunities that computerization can create for those that are adept and flexible to adjust to changing market conditions.

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