



# POROUS PEACE IN MINDANAO'S FREE TRADE AREA

## SUMMARY

The size, scope and operation of illicit trading across the porous borders of the Sulu Sea and the amounts involved in informal trading hint at its developmental role in Mindanao. At the same time, the associated aspects of foregone tax revenues, clan interests and corruption have an impact on conflict dynamics and subnational statebuilding of the Bangsamoro. This policy brief aims to stimulate discussions around an examination of enabling mechanisms that could harness the development and peace-promotive potentials of this type of trade and curb its violent tendencies. Such mechanisms could help to bring sustained growth and enduring peace in the region, especially in light of the Comprehensive Agreement on the Bangsamoro between the Philippine government and the Moro Islamic Liberation Front. The principal recommendation is for the Bangsamoro Transition Authority and the Bangsamoro government, in the long term, to develop a thorough understanding of the real economy of cross-border trade. This would enable them to design nuanced and conflict-sensitive governance mechanisms that move small traders into the formal economy, to develop the area as a de facto free trade zone, and to implement mechanisms that would maximise the economic gains of such trade and minimise its potential to fuel violent conflict.

## INTRODUCTION

Economic activities across Mindanao's porous borders have become more significant with the signing of the comprehensive peace agreement between the Philippine government and the Moro Islamic Liberation Front (MILF). The very low rates of tax and revenue collection by local and regional governments stand in stark contrast to the hundreds of millions of dollars of illicit cross-border trade<sup>2</sup> in an area that could be a potential source of revenue generation for the proposed Bangsamoro region. The Philippine government foregoes an estimated PHP89-130 billion (US\$1.9-2.9 billion) in annual revenue from illicit commerce (Maceda, 2010).<sup>3</sup> This estimate does not include the impact of illicit cross-border trade on the livelihoods of marginalised groups such as subsistence farmers engaged in food grain production. For example, 'smuggling' of rice comprises about 15-21% of the country's total rice imports (Cosico, 2011).<sup>4</sup>

Categorising illicit cross-border trade as pernicious and deadly does not capture its *real economy*. Illicit trade provides social protection, critical employment and livelihood opportunities to marginalised and vulnerable people in poor communities in situations where the state is absent or weak. However, while it is a coping economy, it can also undermine the peace agreement by providing a potential source of violent conflict and further strengthening a regionalised shadow economy through the traditional trade route that connects Sabah, Malaysia

and Mindanao's island provinces. The vibrant trade in the waters of Sulu does not discriminate between consumer goods such as rice, cooking oil, fighting cocks or cosmetics, and deadly contraband such as illicit drugs and weapons. It is also a well-known entry and exit point for human trafficking. Moreover, without adequate monitoring and control, it can become a source of terrorist contagion, reinforcing the image of southern Mindanao and its neighbouring islands as a bad neighbourhood that everyone should avoid.

*How then can the Bangsamoro benefit from the economic opportunities inherent in southern Mindanao's vibrant cross-border trade without undermining coping livelihoods or creating and reinforcing violent conflict from insurgents, clans and criminal gangs?* The key seems to lie in creating an appropriate and productive arrangement that can harness the trade's role as a lifeline for poor communities and a source of revenues that can contribute to the Bangsamoro statebuilding project, while preventing the trade of pernicious commodities that can provoke or reinforce violent conflict.

## FREEDOM TO TRADE AND TRAVEL

Much has been said about the centuries-old trading between ports in the Sulu Sea. Most of the landing ports for goods and people are known for being important commercial exchanges that created jobs, secured local livelihoods, and allowed traders and local clans to become

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extremely wealthy for centuries. Studies conducted of regional trading prior to colonisation had shown how the "favourable geographical position of the Sulu area to the trading entrepôts in the region, its rich and productive resource base, and the sizeable population enabled the procurement, concentration, and export of local marine products".<sup>5</sup> Meanwhile, the capture, mobilisation and trading of slaves provided the labour that was necessary to procure and export the jungle, marine crafts and other tradable products that reached as far as southern China and the Celebes islands.<sup>6</sup>

There were few barriers to trade, except for the payment of tribute to local sultans and strongmen prior to and during the Spanish colonial period. The US colonial project in the 20<sup>th</sup> century also turned a blind eye to this vibrant trade. The colonisers were more interested in building alliances with local strongmen to stem Moro resistance to their rule.

At the start of the 21<sup>st</sup> century, three inextricable realities shaped the nature of cross-border trade in the Sulu Sea. First, the cross-border trade had become a source of income for small traders and poor communities, which together turned these exchanges into a livelihood and coping economy. Second, the de facto free trade operating in these porous borders had become a potent source of conflict, whether through piracy, the illicit importation of pernicious products, violent competition between various traders, or provision of the means of entry and exit for insurgent and criminal groups. Third, in spite of the huge profits garnered from cross-border traffic, the trade had become emblematic of the state's weak administrative and politico-economic reach in Mindanao and its failure to harness revenues and profits from trade to strengthen governance in Mindanao.

### CROSS-BORDER TRADE AS A COPING ECONOMY

Illicit cross-border trade offers a lifeline for poor communities. International Alert's study shows that the people involved in smuggling rice from Malaysia are mostly lower-middle-class traders, mainly women, who need to concentrate their meagre financial resources to raise at least PHP2 million (US\$44,500) so they can rent a boat to buy and ship rice and other food commodities from Sandakan in Sabah to Jolo in Sulu. They are often seen as a bane to the revenue targets of the state, yet these small traders rarely notice the difference between the formal duties and taxes that official customs officers charge and the 'special arrangements' they need to pay the same customs officers for permission to unload their illicit shipments.

Taken together, small traders take huge risks<sup>7</sup> by investing in smuggled goods, yet they earn the smallest percentage of the total profit compared with the brokers/boat owners and state agents manning the borders.<sup>8</sup> They justify their shadow activities as a way for their families to cope, and further rationalise these activities as benign ways of earning a living in contrast to 'truly unlawful' traders who carry deadly goods, such as illicit drugs and weapons or trafficked humans. Ask anyone involved in the trade and they will say that they are not dangerous smugglers since they mostly hire the slow boats called *kumpit*, which cannot outrun the Coast Guard or Navy. Meanwhile, their more daring counterparts use high-powered speedboats called *sigarillos*, which are used to transport pernicious contraband. Indeed, an effort to apply a uniform or non-discriminatory approach to smuggling in the Sulu Sea may actually penalise marginalised women more than their criminal counterparts.

### CROSS-BORDER TRADE AS A POTENT SOURCE OF REVENUES

The extremely low rate of revenue generation in conflict-affected Mindanao may consign the new autonomous region to long-term dependence on special funds made available by the central Philippine state, thus undermining the very autonomy it is designed to include. Studies have shown that most tax revenues from this region do not come from individual, corporate or value-added taxes but are principally sourced from tax remittance advice (TRA). This sort of tax can be easily collected by the Bureau of Internal Revenue from contractors that are engaged in projects of national government agencies such as the Department of Public Works and Highways, or from international donors such as the Japan International Cooperation Agency.<sup>9</sup> TRA as a percentage of total tax collection in the Autonomous Region in Muslim Mindanao (ARMM) consistently averaged 50% from 2001 to 2006.

The poor record of taxation means that any punitive action against local citizens or any effort to impose new taxes will quickly work to the disadvantage of the Bangsamoro's new rulers, weakening their legitimacy and authority just when they need it most. Indeed, unless the new Bangsamoro can tap into the huge revenues from unregulated trade in the Sulu Sea (Maceda, 2010), they will depend on optimistic estimates of foreign and national direct investment in the region, now that the peace agreement between the Philippine government and the MILF has been signed.

Cross-border trade is thus extremely relevant and strategic for the new Bangsamoro because no single local government unit (LGU) can claim to be in control of the seas off Mindanao. This has led many to conclude that potential revenues brought in by stronger regulation should be managed by the Bangsamoro government and harnessed for development projects that benefit the region.

### CROSS-BORDER TRADE AS A SITE OF VIOLENT CONFLICT

The seas surrounding Mindanao-Sulu have long been a site of criminal activity, notably, piracy against large

and small vessels plying the seas and the smuggling of deadly goods that provoke or reinforce violence. Piracy is a problem for vessels loaded with high-value products such as oil and gasoline, rice, jewellery and other precious minerals that can fetch huge profits in local markets. Many ships have been hijacked and their crew members abducted for the precious cargo they carry, and ship owners and insurers have paid ransom for the return of their vessels and crew. Some vessels also carry illegally trafficked men and women who are exported to meet the growing low-wage labour demand of many fast-developing economies in the region.

However, most of the violence that springs from cross-border trade seldom happens at sea. Violent conflict is often the after-effect of the sale of illicit weapons and narcotics, which is closely linked to inter- and intra-clan wars or electoral battles between warlord-politicians. Such conflict feeds most of the horizontal violence between criminal gangs and Moro clans. The evidence suggests that this deadly trade remains outside the gaze of the state and the glare of media because there are few instances of violent feuding between traders invested in these underground enterprises. Yet, the deadly commodities they market and distribute have reinforced the ability of clans and criminal groups to engage in violent inter- and intra-clan feuds, or to generate enormous profits from illicit drugs to finance violent electoral competition.

## CONCLUSION

The challenge to the Philippine government in general, and the Bangsamoro government in particular, is to harness the revenues from cross-border trade while alleviating its violent effects and protecting the livelihoods of small traders and poor people employed and invested in its operations. These objectives are not mutually exclusive and may be delivered through negotiated arrangements that serve the agendas of various actors.

The overarching strategy should be to gradually integrate cross-border trade into Mindanao's formal economy by creating incentives and penalties that will persuade actors engaged in the trading of food and other consumer commodities to register their businesses. This also requires making it more difficult and costly for other illicit traders to transport contraband and bring these goods into Philippine territory. In short, the national and regional government should begin by offering increased support to enhance the quantity and quality of trade before it begins to impose a regulatory regime geared towards raising tax revenues. This entails a mixture of measures that combines the aims of the state to protect the rights of entrepreneurs and other economic actors with the objective of harnessing trade openness and liberalisation as a source of livelihoods and revenues.

Finally, this policy brief underlines the strategic importance of looking at the future of cross-border trade over the medium and long term to prevent this sector from being hampered by the short-term imperatives of delivering a comprehensive peace agreement.

## RECOMMENDATIONS

The following suggestions are not prescriptive but aim to stimulate multi-agency (national and local governments and the Bangsamoro Transition Authority) and policy discussions around minimising the conflict risks of shadow economies while maximising their economic potentials. These discussions will be particularly relevant to the transition period before and after the enactment of a law that will provide the overarching framework for Bangsamoro governance.

- **Develop a strategy to gradually formalise cross-border trade, beginning with the small traders, to allow them to develop and scale up their activities under the protection and support of the regional state:** While this trade is a coping economy, small traders do not accrue as much benefit from the arrangement. How can the Bangsamoro government protect and incentivise small traders to fall under a regulatory framework that will benefit them and serve their long-term interests? One way could be through a significant improvement in access to finance through the creation of insurance and guarantee schemes along with support from savings and credit programmes, all of which will enable small traders to scale up their economic activities and move to the formal economy.
- **Develop a specific fiscal regime geared towards the interests and needs of micro, small and medium enterprises:** This could include adjusting tax rates and duties and providing traders with easier access to transparent information on taxes and fees. Taxation should be simplified and rates should be adapted to the financial resources of small traders. In the short to medium term, this will help to prevent the risk of high taxes and fees stifling small-scale economic activities that provide livelihood resources mostly for women.
- **Consider the Basilan, Sulu, Tawi-Tawi (BASULTA) area as a de facto free trade zone and develop a viable economic corridor strategy.** A key objective here should be to review existing policies, including new provisions under the basic law creating the Bangsamoro, to locate entry points for joint initiatives by LGUs, government agencies and the private sector to maximise the various trade potentials across borders internal to the Philippines and in trading across the Association of Southeast Asian Nations (ASEAN). The creation of a string of free ports and incentive schemes – for example, free of duties and import taxes for trade within specified areas – will help to develop trade across the economic corridor and propel the competitiveness of Mindanao industries. Mindanao is the Philippines's direct link to the predominantly Islamic countries of the Brunei

Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA) and the Bangsamoro can harness this strategic edge in serving this market.<sup>10</sup>

- **Improve the governance of cross-border trade:** Economic agendas and political interests drive illicit trade. With large sums of money changing hands in the course of these underground economic activities and the vested interests of powerful actors who control the trade nodes, it is important to develop governance mechanisms that take into careful account the engrained political agendas and economic interests at stake. A calibrated approach can be developed through a multi-agency initiative that will map the quantity of trade across Mindanao's borders and how it is organised, sustain the monitoring of trade, and provide a platform for multi-stakeholder participation in developing policies that are adapted to the realities on the

ground. LGUs along with relevant agencies can work together to develop conflict-sensitive governance mechanisms of unregistered private ports and to improve the operations of public ports to accommodate different types of vessels and traders. At the same time, they can work to strengthen customs and immigration processes by professionalising these services and revamping the structure of cross-border operations.<sup>11</sup>

- **Undertake coordinated actions to prohibit human trafficking and the trade in illicit and deadly contraband, such as drugs and weapons, in the transition period towards the formation of the Bangsamoro.** Coordinated actions between state security forces and the Bangsamoro Transition Authority should be vigorously initiated to disrupt human trafficking and the illicit trade in drugs and weapons.

This policy brief was written by Nikki Philline C. de la Rosa, former Programme Manager and current Country Manager at International Alert Philippines. It draws from S.D. Villanueva (2013). 'Cross-border illicit trade in Sulu and Tawi-Tawi: The coexistence of economic agendas and violent conflict', in F. Lara and S. Schoofs (Eds.) (2013). *Out of the Shadows: Violent Conflict and the Real Economy of Mindanao*. Manila: International Alert. pp.197–218 and J.M. Lopez and R. Eguia (2012). *Social and Economic Efficiency of Non-Conventional Sized Ships: The Case of Tawi-Tawi Province*. Working Paper. Davao City: Mindanao Development Authority.

## Endnotes

- 1 Reprinted with minor changes in January 2017 and April 2018.
- 2 This paper uses the terms 'illicit trade' and 'smuggling' interchangeably to describe cross-border economic activities that occur in the shadows and margins of the state, variously described as hidden, unrecorded, unofficial, parallel, clandestine, black, grey, alternative, shadow, illicit, illegal, subsistence, unregulated, non-monetised and criminal.
- 3 E. Maceda. 'Smuggling 101', *The Philippine Star*, 7 September 2010. Available at <http://www.philstar.com/opinion/609482/smuggling-101>
- 4 F. Cosico. 'Bantay Bigas: Guarding our rice industry', *The Manila Times*, 7 July 2011. Available at <http://www.manilatimes.net/index.php/opinion/1327-bantay-bigas-guarding-our-rice-industry>
- 5 F. Lara (2014). *Insurgents, Clans and States: Political Legitimacy and Resurgent Conflict in Muslim Mindanao, Philippines*. Quezon City: Ateneo de Manila University Press.
- 6 J. Warren (1982). 'Slavery and the impact of external trade: The Sulu Sultanate in the 19th century', in A. McCoy and E. de Jesus (Eds.). *Philippine History: Global Trade and Local Transformations*. Quezon City: Ateneo de Manila University Press.
- 7 These include accidents at sea, piracy, the threat of arrest and imprisonment from both sides of the border, or even the sudden fluctuations in the price of goods they buy.
- 8 Based on interviews with 'old-timer' cross-border traders in Sulu and Tawi-Tawi, small traders get only about 16%; payments for 'special arrangements' with state agents eat up 18%, with brokers/boat owners pocketing the biggest share of about 50% of total profits.
- 9 F. Lara (2014). Op. cit.
- 10 C. Habito. 'Bangsamoro's economic prospects', *Philippine Daily Inquirer*, 8 April 2014. Available at <http://opinion.inquirer.net/73420/bangsamoros-economic-prospects>
- 11 One entry point is the memorandum of understanding already signed by the BIMP-EAGA (Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area) Transport Ministers on Establishing and Promoting Efficient and Integrated Sea Linkages, with a view to developing and formalising a mechanism that will enable mutual recognition and monitoring of safety standards, security requirements, environmental protection and ship-manning across borders.

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