

## Development of an Alternative New Port in the National Capital Region: What Went Wrong?

### Study points:

Students are expected to gain an understanding of the planning and implementation of development projects by focusing on the story of a failed development of an alternative new port in a hypothetical National Capital Region as outlined by the director of the project management office of the implementation agency responsible. Through this case discussion students will be able to further elaborate their experience of development planning for the future.

### Basic information

- Region: Southeast Asia;
- Issue: Planning and implementing an alternative port development project in a National Capital Region;
- Key words: Sea port development, alternative port, demand forecast, industrial structure, operation and maintenance through concessions;
- Country: Southern Cross;
- Year: 2019.

### Characters

Characters	Description
Dr. Catherine Gonzales	Project Director for the Vega City Port Development Project, Ministry of Transport, Southern Cross.

### Abbreviations

GICS	Gemini International Container Services
ICA	International Cooperation Agency
MOT	Ministry of Transport
NCR	National Capital Region
TEU	Twenty-foot Equivalent Unit <sup>1</sup>
USD	United States Dollar

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<sup>1</sup> Unit of cargo capacity often used to describe the capacity of container ships and container terminals.  
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**Summary**

The Port of Orion is situated in the National Capital Region of the country of Southern Cross and has become congested by the rapid increase in cargo volumes handled due to the economic development of the country. Since the further expansion of container cargo handling facilities at this port was considered difficult, to decongest the Port of Orion, the government of Southern Cross promoted an alternative port development project in Vega City as the Port of Vega in the National Capital Region (NCR). However, the operating efficiency of the container terminal constructed at the Vega Port remains extremely low. Dr. Catherine Gonzales, Project Director for the Vega City Port Development Project, Ministry of Transport of the Government of Southern Cross has been called to testify at the Transport Committee of the Congress of the country next week to explain the current situation and the prospects for change. She has been wondering how she should explain the situation to Congress.

**Key questions in reading this case**

Students who will assume the position of Project Director Gonzales are required to discuss the following:

1. What are the questions that might be asked by the Committee to Project Director Gonzales?
2. How should she answer these questions?
3. What are the causes of the low volume of containers handled at the Port of Vega Development Project?
4. What should have been done during the planning stage to avoid the failure of the Port of Vega Development Project?
5. What should have been done during the implementation stage to avoid the failure of the Port of Vega Development Project?
6. What are the lessons to be learnt from the failure of the Port of Vega Development Project?
7. What are the possible remedial measures that could be taken now to revitalize the Port of Vega Development Project?
8. What should ICA have agreed with the government of Southern Cross in the loan agreement and related documents on the Port of Vega Development Project?
9. How should ICA have monitored the Port of Vega Development Project after signing the loan agreement for the project?

10. Are the failures which happened in the Port of Vega Development Project to be found in your country? Please explain your comments with reasons.

## **1. Prologue**

Dr. Gonzales has been thinking about what went wrong with the Port of Vega Development Project. She had devoted her entire 40s to this national flagship project. She was very proud of herself when she was appointed as the Project Director at the Ministry of Transport (MOT) of the government of Southern Cross for this critically important project to develop an alternative seaport in the National Capital Region (NCR) and thereby reduce congestion at the port of Orion.

Development and improvement of the Orion port had not been appropriately undertaken even though the cargo volume being handled at the port had been rapidly increasing due to economic development and internationalization. With this background, further rapid increases in the number of containers passing through the Orion port was forecast due to the concentration of economic activities in the NCR. Decongestion of the port of Orion and the expansion of container cargo handling facilities were considered urgent issues to maintain the sustainable economic growth of the country. Since the further expansion of container cargo handling facilities at the Port of Orion was considered difficult, the government of Southern Cross had promoted an alternative port development project at Vega City in the NCR to decongest the Port of Orion, to be known as the Port of Vega.

However, to everyone's surprise, the Port Vega development project has been faced with several serious issues since the ground-breaking ceremony in 2006, including delays in construction, delays in selecting the private port operator, and most seriously the volume of containers handled through the port has not increased at all. The operating efficiency of the terminal constructed by this project remains low, the number of containers falling far short of the projected target volume. According to the development plan for the Port of Vega, projected container volume three years after the completion of the project was to be 800,000 TEU per year but the actual volume handled was only 90,122 TEU in 2018, three years after the completion of the port. This operating volume is just over 10% of the total designed capacity.

The government of Southern Cross borrowed USD 250 million from the International Cooperation Agency (ICA) for the construction of this seaport project. Since the grace period of this loan will end soon, the government will have to start repaying the principal. With these negative developments, the Transport Committee of the Congress of Southern Cross called for MOT to explain the situation and the prospects for the Port Vega project. Dr. Gonzales was asked by the Minister of Transport to testify at the committee the following week.

## **2. Congestion of the Port of Orion**

One of the most pressing challenges facing Southern Cross has been the congestion problem in the NCR. Infrastructure development in the country has not kept pace with rapid urbanization and the increasing demand for infrastructure services. The congestion problem not only at the Port of Orion but also in the entire National Capital Region, with a population of more than 10 million, has disrupted normal port operations causing significant delays in sending out exports and releasing imports.

Orion City, the national capital of Southern Cross, started as harbor city a century ago. The offices of the central government's ministries, major private companies, and prestigious universities are all located within the vicinity of the Orion Port. All the trucks moving in and out of the Port of Orion must cross these office and educational areas.

At the Orion Port cargoes pile up, which creates chaos. Delays in the unloading of international vessels increases container inventory resulting in slower yard production and higher vessel dwell time and causes undue strain on port resources. Truck turnaround has worsened affecting the normal delivery of supplies and aggravating traffic congestion along the major roads in Orion city. The domino effect has led to a breakdown in the road logistics cycle, which further disrupts the supply chain in the Metro Orion area. Many ships are unable to berth and must wait outside at anchorage for a berth to become available at the Port of Orion.

The problem of congestion and the resulting inefficiency in the delivery system in the Port of Orion has affected related port service costs including the price of shipping and trucking services. Trucking fees have also increased due to the higher demand for this service and the general uptrend in the related costs of such items as fuel, spare parts and labor. These price increases in the end drive higher prices for imported commodities including those products with imported components, at the expense of the consuming public.

Decongestion of the Port of Orion by an expansion of the container cargo handling facilities there was considered an urgent issue to be addressed to maintain the sustainable economic growth of Southern Cross. However, expansion of the port of Orion is not possible from both the engineering and financial points of view since the port area is closely surrounded by office areas. Thus, the government of Southern Cross had promoted an alternative port development project in NCR to decongest the port of Orion and road traffic in the center of Orion city and NCR.

### **3. Planning of New Alternative Seaport Development in the NCR**

With this background, MOT, in 2002, came up with the following conditions for the location of an alternative port in the NCR:

- a) within 100km of the capital;
- b) with highway access already constructed or planned;
- c) with deep water alongside;
- d) with a neighboring area of export processing zones;
- e) with geographical features that can shield ships from bad weather such as inside a bay.

With these conditions, MOT decided in 2003 on the Port of Vega as the location of alternative seaport for the NCR. Vega port at that time was just a local and natural harbor of Vega city handling both cargo and passengers. Vega city is about 80 km from the capital but there was a plan for construction of a highway between them. The city is about 30 km from major export processing zones which are located between Vega city and the capital. Water depth is almost the same as the Orion Port.

The new Vega port was expected to have two main functions:

- a) to serve as alternative port to complement the Port of Orion;
- b) to serve as a central port for the region that contributes to the economic development of the hinterland of Region Vega and surrounding regions that are expected to be key industrial areas of the country as economic process zone policies are implemented.

### **4. Developments during the Implementation of the Port of Vega**

#### **(1) Progress of the Project Implementation**

Development of Vega port as alternative seaport in the NCR of Southern Cross commenced in 2006 after feasibility studies were completed, approval by the Investment Committee at the Cabinet level had been obtained, and funding of USD 250 million secured with loan from ICA. Although the container terminal was initially planned for completion in 2012, it was not completed until 2015 due to delays in land acquisition and other issues.

#### **(2) Concession for the Operation and Maintenance of the Port of Vega**

At the planning stage, the operation and maintenance of the Port of Vega was planned to be delegated to a private company through a concession agreement after completion of construction.

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Lacking information about competent international operators, Dr. Gonzales's office sent invitations to embassies and published notices of biddings in newspapers with a national circulation, however, only a few groups showed interest in participating in the failed two biddings. The reason being that the Port of Vega is a new port, and the viability of cargo throughput needed to be established. Finally, at the third bidding, the winning bidder, Gemini International Container Services (GICS), an international port operator and one of the two largest private port operators in the country, was awarded a concession contract in 2016 to manage and operate the Port of Vega for 25 years. GICS has taken over several major ports in the world, thus making it a very competent port operator.

Because no qualified contractor participated in the first and second biddings, and bidding had to be conducted three times, the process of selecting appropriate operators for this project took plenty of time. This resulted in delays to the project. This was partly due to insufficient ability in the MOT to set appropriate bidding conditions and to actively transmit information to many relevant companies during the bidding process.

#### (3) Highway Project to Vega City

At the time of the planning stage of Port Vega, the construction of a highway from the Metro Orion area to Vega city that had been estimated for completion in 2010 was much delayed due to land acquisition and cost overruns. The highway project instead finished in 2017.

#### (4) Economic Situation

In contrast to the average economic growth rate of 5.9% estimated for Southern Cross from 2005 – 2015 at the time of planning of the Port of Vega project in 2003, the actual rate was 4.2% partly because of the influence of the “Lehman Shock” in 2008.

#### (5) Industrial Structure

With the passing of the Southern Cross Economic Processing Zone Law in 2000, construction of industrial parks, mainly for export, in the Vega region accelerated in the 2000s and 2010s. Prior to 2000, there were only a few such parks. By 2010, the number of industrial parks had reached 56. However, many of the products produced by the companies in these parks are IT-related, mostly semiconductors, other electronic components, and service sector products, instead of the

manufacturing sector products targeted at the time of the planning of the Vega Port in 2003.

#### **(6) Port of Orion**

During the construction stage, Dr. Gonzales overheard from colleagues in MOT that a concession agreement for the operation of the Port of Orion, including the container terminal, had been concluded in 2011 with one of the two private major port operators in the country, GICS. At that time, she did not pay much attention to this development but later found out that this concession agreement included capacity expansion of the Port of Orion. The container terminal of the Port of Orion and its cargo handling capacity has been expanded since the conclusion of this concession agreement even though further expansion of Orion Port was initially thought to be difficult. Expansion of the Port of Orion turned out to be possible, and Orion International Container Berth No. 5 was constructed during the project implementation period of the Vega Port, and moreover, construction of an additional Berth No. 6 was completed in 2016 by GICS.

### **5. Epilogue**

The number of container ships that have called at the Vega Port since the project was completed is much less than expected; 2,021 ships in 2018 against 22,000 ships planned. The actual handling volume of container cargo as of 2018 is only about 10% of the projected volume.

In addition, since the number of ships that make calls is much less than projected, permanent offices of brokers/custom agents dealing with cargoes, shipping lines, container truckers, and warehouse/storage operators are not properly established at the Vega Port. It is expected that if the number of ships that call at Vega Port increases, the relevant enterprises/entities would establish a permanent office, and loading/unloading of cargoes, custom clearance process, and transport by trucks will be done more smoothly, which would in turn lead to more ships calling at the Vega Port.

In this situation, promotional measures such as reducing port charges to half the original value have been implemented since 2018. Vega Port, together with its terminal operator, has actively undertaken attraction/promotion activities after the terminal began to operate. If the on-going attraction/promotion activities are successful, the newly generated/induced volume (cargos created by newly

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moved in enterprises, increases in the number of regular ship calls, and ship calls by new shipping lines) and the total handled volume are expected to increase.

The port operator, GICS, has been creating profits at a certain level and has reserved the necessary financial resources for operation and maintenance. However, since the volume of container cargo handled through the port is much lower than expected a significant deficit is emerging with this project. Moreover, the volume of container cargo is not predicted to grow rapidly. However, according to the contract signed between the MOT and GICS, the fixed fee payable by the port operator will increase. Thus, considering the entire situation, the financial situation for the project itself will continue to be tight. Therefore, there is a possibility that the port operator might discontinue the concession agreement in the future. GICS is supposed to pay the MOT a fixed fee and an additional variable fee linked to the sales amount every year.

During promotion of the Vega Port, it was found that companies situated between the Orion Port and the Vega Port do not transport their cargo by themselves. Rather, they contract the job to shipping companies who then select which port will handle the cargo. For shipping companies, the factors involved in selecting a port to handle cargo are not simply the overland transport costs between Orion and Vega as had been assumed at the time of the planning of the project. In choosing the deployment route for a container ship, all costs are taken into account, including those for maritime transport. The cost of overland transport between Orion and Vega is only a small fraction of the total transport cost that includes those applicable in the sea routes between Southern Cross and destinations like Singapore, Hong Kong, Europe, and Japan.

In addition, the Southern Cross based offices of shipping companies do not select the routes for container ships. The companies' main offices select them. Therefore, having the port operator contact the locally-based offices of shipping companies will have only a limited effect. Because of the large risks associated with changing container cargo shipping routes, shipping companies are extremely cautious when it comes to adjusting routes or changing the port that handles their cargoes.

Thus, even though the potential demand was as anticipated by the Vega Port development proposal, it is not only the development of port facilities that is important in addressing such demand; favorable attraction and promotional



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activities to the brokers/custom agents, shipping lines, container transporters, warehouse/storage operators and other relevant business sectors are also essential. In addition, various incentives and/or preferential treatment including the reduction/exemption of taxes, lowering charges and tolls, the simplification of examination documents, and reductions in processing time need to be considered.

With these outcomes in mind, Dr. Gonzales has been wondering how she should explain the Port of Vega situation to the transport committee of the Congress next week. Is she the one to be criticized? What went wrong with the Port of Vega Development Project to establish an alternative port to the Port of Orion in the NCR of Southern Cross?

[END]

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