Relaxing the Cabotage Restrictions in Maritime Transport[1]

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Background on the Philippines' cabotage policy

Cabotage is traditionally a shipping term[3] but it is now generally used to refer to the right to carry cargo or passenger via sea, air or land transport within a country. In the Philippine maritime transport sector, cabotage is reserved only for national flag vessels by virtue of two laws—Republic Act (RA) 1937 or the *Tariff and Customs Code of the Philippines* and RA 9295 or the *Domestic Shipping Development Act of 2004*.

The Philippines adopted the cabotage principle from the US Jones Act of 1920 when it was still under United States' colonial control. Republic Act 1937 enacted in 1957 continued the adoption of this principle. Sections 810, 902, 903, and 1009 of RA 1937 restrict the operation of foreign vessels on domestic routes (see **Table 1**).

Table 1. Cabotage Provisions under RA 1937 or the Tariff and Customs Code of the Philippines

Section	Specific Provision
810	**Privileges Conferred by Certificate of Philippine Registry.** — A certificate of Philippine registry confers upon the vessel the right to engage, consistently with law, in the Philippine coastwise trade and entitles it to the protection of the authorities and the flag of the Philippines in all ports and on the high seas, and at the same time secures to it the same privileges and subjects it to the same disabilities as, under the laws of the Philippines, pertain to foreign-built vessels transferred abroad to citizens of the Philippines.
902	**Vessels Eligible for Coastwise Trade.** — The right to engage in the Philippine coastwise trade is limited to vessels carrying a certificate of Philippine registry.
903	**License for Coastwise Trade**. — All vessels engaging in the coastwise trade must be duly licensed annually.
1009	**Clearance of Foreign Vessels To and From Coastwise Ports.** — Passengers or articles arriving from abroad upon a foreign vessel may be carried by the same vessel through any port of entry to the port of destination in the Philippines or articles intended for export may be carried in a foreign vessel through a Philippine port.

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[3] The etymology is derived from the French *caboter* or to sail along the coast.

Section	Specific Provision
	Upon such reasonable condition as he may impose, the Commissioner may clear foreign vessels for any port and authorize the conveyance therein of either articles or passengers brought from abroad upon such vessels; and he may likewise, upon such conditions as he may impose, allow a foreign vessel to take cargo and passengers at any port and convey the same, upon such vessel to a foreign port.

Though Section 1009 of RA 1937 is often cited by advocates of cabotage liberalization in the country, a Department of Justice opinion in 1997 held that it cannot be invoked as a legal basis for allowing foreign vessels to engage in transshipment or transport of passengers from one Philippine port to another Philippine port[4].

In 2004, RA 9295 or the Domestic Shipping Development Act was signed into law. This was viewed as a mechanism to further deregulate the local shipping industry in the country. However, while it introduced reforms such as liberalizing passenger rates, incentives to modernize domestic fleet, ship safety standards, ship classification, and compulsory insurance coverage of passengers and cargoes, the law reiterates and strengthens the cabotage restrictions found in RA 1937. Specifically, Sections 5 and 6 of Chapter 3 of RA 9295 restrict the participation of foreign vessels in domestic operations (see **Table 2**).

Table 2. Cabotage Provisions under RA 9295 or the Domestic Shipping Development Act

Section	Specific Provision
5	**Authority to operate.** – No franchise, certificate or any other form of authorization for the carriage of cargo or passenger, or both, in the domestic trade, shall be granted except to domestic ship owners or operators.
6	**Foreign Vessels Engaged in Trade and Commerce in Philippine Territorial Waters.** – No foreign vessels shall be allowed to transport passengers or cargo between ports or places within the Philippine territorial waters, except upon the grant of Special Permit by the MARINA when no domestic vessel is available or suitable to provide the needed shipping service and public interest warrants the same.

Though Section 6 of RA 9295 stipulates that the Special Permit system in certain cases gives exemption from the cabotage restriction, Llanto and Navarro (2012) point out that this is largely discretionary. While discretionary policy gives bureaucrats the power to promote and support liberalization, it also gives them power to frustrate such policy.

The significance of the Philippines' cabotage policy can be better appreciated by looking at the size and characteristics of the domestic maritime transport industry wherein the cabotage restrictions apply. The 2012 gross value added of the maritime transport industry is PhP 15,453 million (in constant

[4] Lorenzo, E.M. (1997). The Domestic Shipping Industry of the Philippines: A Situation Report. Maritime Industry Authority, Manila.

2000 prices) or 0.24% of the gross domestic product (GDP). Given that the Philippines is an archipelago composed of more than 7,100 islands, the transport of goods and passengers relies heavily on sea and air routes interconnecting the islands. Inter-island trade is therefore largely facilitated by maritime transport, as evidenced by figures on modal split between sea and air transport. Sea cargo traffic stood at 77.47 million metric tons in 2012 or 99.6% of the total sea and air domestic cargo traffic. Sea transport passengers, on the other hand, were 49.5 million in 2012 or 58.1% of the total passenger movements by air and sea transport.[5] The domestic operating fleet is largely comprised of passenger vessels (58% of total) when examined in terms of the number of vessels per type (see **Table 3**). In terms of gross tonnage, however, cargo vessels account for the highest share (also 58% of total).[6]

Table 3. Number and Tonnage of Domestic Operating Fleet in 2011

Type of Vessel	Number of Vessels		Gross Tonnage	
		(% of total)		(% of total)
Passenger	4,236	58%	451,481	26%
Cargo	2,121	29%	1,016,461	58%
Tanker	288	4%	216,395	12%
Tugboats	432	6%	41,182	2%
Others [a]	222	3%	37,186	2%
Total	**7,299**	**100%**	**1,762,705**	**100%**

[a] Others include dredger, yacht, special purpose ship, miscellaneous ship, and other registered vessels for which there is no information on vessel type.

Source: Philippine Statistical Yearbook 2013.

Impacts of the cabotage restrictions

High domestic shipping cost

The very high cost of domestic shipping services provides a strong motivation for exporters and importers to push for the lifting of cabotage restrictions. According to an advocacy paper of the Joint Foreign Chambers of Commerce in the Philippines (JFCCP, 2010), it is cheaper to send a container from Manila to Cagayan de Oro via Hong Kong or Kaohsiung (in Taiwan) than to simply transport the cargo directly from Manila to Cagayan de Oro. Moreover, a local trader could save approximately 43% in shipping costs by transporting cargo from Manila to Cagayan de Oro via foreign transshipment to Kaohsiung rather than by directly availing of domestic shipping services (see **Table 4**).

[5] Sea passenger traffic is based on embarkation and disembarkation in sea ports; air passenger traffic is based on domestic passenger movements in airports.

[6] All figures are from the 2013 Philippine Statistical Yearbook published by the National Statistical Coordination Board (NSCB).

Table 4. Cost of Domestic Shipping vs. Cost of Shipping via Foreign Transhipment, Manila (MNL) to Cagayan De Oro (CGY), in US$

Basis	Domestic Shipping	Foreign Transshipment			Difference
		via Hong Kong (HKG)			
	MNL-CGY	MNL-HKG	HKG-CGY	Total	
20 footer	1,120.00	144.00	500.00	644.00	476.00
40 footer	1,860.00	244.00	900.00	1,144.00	716.00
		via Kaohsiung (KHH)			
	MNL-CGY	MNL-KHH	KHH-CGY	Total	
20 footer	1,120.00	159.00	360.00	519.00	601.00
40 footer	1,860.00	274.00	770.00	1,044.00	816.00

Source: Joint Foreign Chambers of Commerce in the Philippines (2010), *Arangkada* Philippines

A technical paper by the Joint United States Government and Government of the Philippines Technical Team (2011) also shows that compared to Indonesia, Philippine domestic shipping services are higher by 250% on a per-nautical-mile-basis.

Lack of meaningful competition

The high cost of domestic shipping services is attributed by past studies to the lack of meaningful competition in the industry, which is in turn exacerbated by the country’s cabotage policy as more cost-competitive foreign vessels are restricted from engaging in coastwise transport.

Various researches have shown that the domestic shipping industry is nearly cartelized (Austria, 2002; JFCCP, 2010). According to Austria (2002), ten years after the start of deregulation in 1992, the maritime transport industry was still largely dominated by a few players. In 2002, 50% of the primary routes and 70% of secondary/tertiary routes remained a monopoly, 90% of passenger and cargo markets were controlled by only five shipping companies, and almost all of the primary and secondary routes were serviced by these companies. Austria (2002) advised that a more competitive environment be ensured by the government to ensure that the promises of liberalization and deregulation would be fully realized. Otherwise, the market will be subject to possible abuse of market power by the dominant shipping lines. The JFCCP (2010) also makes the claim that the domestic shipping is nearly cartelized.

Recent data from the Maritime Transport Authority (MARINA) also provide evidence of the concentration of domestic operation in the hands of a few players. MARINA (2013) profiled the domestic fleet as being operated by 2,497 entities of which 509 are corporate entities and 1,952 are single proprietors. However, only four major shipping companies serve the country's primary routes while 34 shipping companies serve the secondary routes.

Weak incentives to modernize

The concentration of the maritime transport industry in the hands of a few players results in weak incentives to modernize and become competitive despite the incentives provided by the Domestic Shipping Development Act of 2004 (Llanto and Navarro, 2012). MARINA (2013) reported that the Philippines is considered as the "world's fifth largest shipbuilding country after China, Japan, Korea and Brazil as more local shipyards are building more ships of larger tonnage capacities like bulk carriers, container ships, and passenger ferries." It is ironic, however, that despite this reputation, domestic shipping lines continue to use smaller vessels in transporting cargo, which are uncompetitive compared to foreign counterparts. The domestic operation is dominated by vessels which have a capacity of 200-300 twenty-foot equivalent units (TEU). This capacity pales in comparison to that of foreign container ships that can carry 5,000 TEU (JFCCP, 2010). The small capacity of cargo vessels implies longer transit and more turnaround times in ports and, as a result, higher shipping costs.

The weak incentives to modernize are also evident in the ageing domestic fleet. Llanto, Basilio and Basilio (2007) found out that domestic vessels for cargo in 2007 were generally 20 years old in age. MARINA (2013) reported that in 2012, the average age of cargo vessels was 11 years old while the age of passenger vessels ranged between 18 to 20 years old. The MARINA-reported average age of passenger vessels in 2012 is higher compared to the average age of 5 to 10 years old in the late 1990s as reported by Austria (2002); this indicates a worsened situation.

Cabotage policy in other countries

The cabotage policy in a country may be laid out in a restrictive-to-liberal continuum depending on the degree of access allowed for foreign operators. This is done in Brooks (2009), which studied the range of cabotage regimes in selected countries, as illustrated in **Figure 1** below.

Source: Brooks (2009)

Figure 1. Range of Cabotage Regimes in Selected Countries

Brooks (2009) explains that shipping is one of the most globalized industries and argues that over the past 15 years since 2009, a number of countries have moved towards the right in **Figure 1** in their approach to cabotage regulation. The salient points in Brooks' (2009) country case studies are summarized below.

In Australia, the cabotage policy is very liberal. Coastwise trade is not reserved to Australian vessels and access to cabotage is tied to the payment of Australian wages (i.e., the vessel's crew are paid Australian wages) rather than the flag of the vessel.

New Zealand undertook coastwise[7] trade liberalization in 1995 as a small part of a very comprehensive reform package that included trade, industrial, transport and fiscal policies. By year 2000, 21 vessels were engaged in coastwise trade in New Zealand, 19 of which were flying foreign flags.

In the case of the European Union (EU), in the early 1990s, a number of northern states already had open or mostly open cabotage regimes (United Kingdom, Denmark, Netherlands, Germany and Belgium) but some southern states had closed regimes (Greece, Italy, France, Spain and Portugal). The liberalization of EU's cabotage policy in 1992 involved a transition plan and a phase-in schedule guided by the objective to ensure freedom of access to shipping markets for safe and environment-friendly ships. Today, EU states can participate in the cabotage trades of any other EU state but each state may impose crew nationality requirements, vessel ownership requirements and fiscal requirements on foreign vessels.

In Canada, foreign-owned international ship management companies are allowed to reside in Canada but not to participate in coastwise trade. This cabotage regime, however, presents economic disadvantages. While international operators may be able to access cheaper, global market inputs, they are limited in offering short-sea services. In certain routes, the unused capacity is sufficient to destroy the economics of operations and the cargo is more likely to travel on the road, defeating the energy and greenhouse gas solutions that short-sea shipping offers.

In the US, the support for a closed cabotage regime is based on strategic interest. But the offshoot of this is expensive domestic shipping operations, leading to the use of railways or roads instead for cargoes that could be moved by ships. Thus, despite the protection that domestic operators face, the domestic shipping fleet is suffering a decline, from 291 active ocean-going vessels in 1996 to 100 vessels in 2007.

Japan has a closed cabotage regime. Nevertheless, in the Doha Round of the WTO, Japan committed to make certain service markets accessible to international maritime transport operators on reasonable and non-discriminatory terms. These include the markets for: pilotage services; pushing and towing services; provisioning, fuelling and watering services; garbage collecting and refuse disposal services; port captain's services; navigation aids services; shore-based operational services essential to ship operations, including communications, water and electrical supplies; emergency repair services; and anchorage, berths and berthing services.

In the case of China, the cabotage policy is related to the fact that China's transition to a market economy allowed non-government entities to participate in the shipping market, and this led to a serious over-capacity problem that necessitated market access regulation.

[7] The term used in Brooks (2009) is "coasting" trade.

The Indonesian experience is frequently cited in the cabotage liberalization debate in the Philippines. To illustrate, Palabrica (2013) reported that in the past, the MARINA expressed apprehension towards lifting cabotage restrictions citing the experience of Indonesia. When Indonesia allowed foreign vessels to engage in coastwise transportation, the domestic shipping industry nearly collapsed and the Indonesian government had to restore the closed cabotage regime. Indeed, Indonesia enacted in 2008 a law that restored cabotage restrictions and this law and implementing rules took effect in 2011. However, what often escapes scrutiny is the fact that the law that restored cabotage restrictions also paved the way for liberalization of port management and private sector participation in port development. A port regulator within the Ministry of Transport was established in 2011. This is independent of the four state-owned port operators (Oxford Business Group, 2012). However, Indonesia subsequently had to amend the law and lifted cabotage restrictions in key economic activities in order to avert production losses. BP Migas, Indonesia's energy regulator, estimated in 2011 that offshore oil production could drop by 156,020 barrels a day and gas output fall by 2,549 million standard cubic feet a day if the cabotage restrictions would continue to be implemented in oil and gas exploration. When influential oil exporters raised concern over the ban on overseas shippers, Indonesia exempted certain classes of vessels used in the oil and gas industries from those restrictions (Bloomberg, 2011).

Conclusions and suggested reform path

High domestic shipping cost and the Philippine cabotage policy are closely linked. The protection enjoyed by the domestic shipping industry through cabotage restrictions result in the lack of meaningful competition in the industry and weak incentives for operators to modernize and become competitive. There are of course other reasons for the high domestic shipping cost, such as inadequate port facilities and inefficient port practices. But this does not invalidate the argument for lifting cabotage restrictions and instead only underscores that cabotage liberalization should be accompanied by other needed reforms, such as improving port infrastructure and having an independent port regulator.

The different country experiences point out that although there are still countries which maintain closed cabotage regimes, the general trend is to move towards a more open cabotage policy. The degree and manner of cabotage liberalization also depend on the developmental objectives to be met and are not hostage to the demands of national ship operators/owners alone. Rather, cabotage policy reforms should balance the interests of traders, the labor sector and ship operators/owners.

It is high time that policymakers seriously consider lifting cabotage restrictions, but in a phased-in and well-planned approach. Llanto and Navarro (2012) recognize the various reservations to cabotage liberalization such as "cut throat competition, the survival of domestic shipping firms that would be unable to muster enough financial muscle to stay in business, and the spectre of mass unemployment arising from closure or weakening of domestic shipping and allied business activities." However, Llanto and Navarro argue that fears of foreign players immediately dominating the local shipping industry may be unfounded because market limitations such as market size, lack of familiarity with the domestic markets, and institutional barriers may not allow foreign shipping companies to do business in all

sectors of coastwise trade. The market adjustments by foreign competitors will also give domestic shipping lines ample time to modernize their fleet and operations in order to be more competitive.

The need for reciprocity or lifting of cabotage restrictions in our trading partners has also been raised in the debate (e.g., JFCCP, 2010). However, this is not truly an argument against cabotage liberalization but can be viewed instead as an opportunity to move the debate away from protectionism and towards the demand for reciprocity in opening markets. In this regard, we can take confidence in the fact that this has been included in the roadmap of the ASEAN through the planned ASEAN Single Shipping Market.

Finally, it should be recognized that an immediate blanket removal of cabotage restrictions could be disruptive. There is a need for MARINA to study very closely the likely effects of the removal of cabotage restriction on domestic shipping, trade and movement of passengers and cargo. For example, among others, the study can examine whether or not a flexible cabotage policy that applies only to certain tonnages of cargo and passenger volumes, could be pursued, and whether the reform path should involve a phased cabotage liberalization accompanied by regulatory reforms in the ports sector. Such reforms include the establishment of an independent port regulator, liberalization of port management and greater private sector participation in port development.

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Republic Act 1937 or the *Tariff and Customs Code of the Philippines.*

Republic Act 9295 or the *Domestic Shipping Development Act of 2004.*