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Regulatory challenges in the Philippine logistics industry

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Logistics plays a significant role in a nation's economic development (Radelet and Sachs 1998; Hummels 1999; Limão and Venables 2001; Wilson et al. 2003). An efficient logistics sector contributes to trade performance and economic development by lowering transaction costs and creating more customer value, thus providing firms with opportunities to increase their earnings and enhance their competitiveness (Gannon and Liu 1997; Banomyong et al. 2008). In this era of increasing globalization, the sector is gradually becoming both a differentiating factor and a source of international competitiveness. However, it currently requires a regulatory environment that encourages rather than stifles efficiency and competitiveness.

This *Policy Note* assesses the Philippine logistics industry by looking at its logistics performance index (LPI). It presents the good practices of Singapore that our policymakers should consider in improving the competitiveness of our local logistics sector.

Efficiency in logistics and restrictive regulations

Previous studies have established a link between market access and efficiency in logistics (see Fink et al. 2000; De Sousa and Findlay 2007; Hollweg and Wong 2009; Anderson and Banomyong 2010; Tongzon 2011; Tongzon 2012; Tongzon et al. 2017). For instance, Fink et al. (2000) attributed the differences in shipping costs mainly to the countries' restrictive trade policies and the anticompetitive practices of liner shipping conferences. They added that the deregulation of trade measures, particularly in the provision of port services, and the breakup of anticompetitive shipping alliances can substantially lower shipping costs (Fink et al. 2000). Meanwhile, Hollweg and Wong (2009) noted a negative relationship between logistics regulatory restrictiveness and logistics performance based on the World Bank's LPI.

All these studies have also shown that an improved market access for logistic services can lead to greater efficiency and lower costs of logistics in the country. However, they have also pointed out that the deregulation of logistics services *per se* does not necessarily lead to higher exports and greater economic growth. Instead, the deregulation should be coupled with the necessary reforms to improve the

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country's capacity and international competitiveness. These reforms include the building of the needed infrastructure, the improvement of the regulatory framework, and the implementation of policies that facilitate the transfer of technology from highly efficient foreign logistics firms to their less efficient local counterparts.

Logistics and the Philippine economic development

Due to its archipelagic nature and burdensome, and sometimes inconsistent, regulations, the Philippines currently has the highest logistics cost among the member-states of the Association of Southeast Asian Nations (ASEAN) (DTI 2016). Despite this, the Philippine logistics market has still managed to grow as a result of the country's strong economic growth, growing outsourcing sector, and rising globalization (Ken Research Private Limited 2016). Nonetheless, it has remained fragmented and dominated by foreign transnational players (Tongzon 2011). Local logistics firms have also remained generally small to medium in size, compared to their foreign counterparts, and are mainly offering freight forwarding services (Ken Research Private Limited 2016).

Based on the latest survey undertaken by the World Bank (2016), the Philippine LPI in 2016 was way below those of Singapore, Malaysia, Thailand, and Indonesia (Figure 1). The country even trails behind Viet Nam, considered as one of ASEAN transitional economies. Clearly, the local logistics sector has a competitive disadvantage compared to its counterparts in other older (or original) ASEAN members. World Bank (2016) imputed this weak performance to the country's inadequate and relatively poor quality of infrastructure, inefficient customs, poor competency of its logistics providers, and their limited ability to track and trace shipments.

The excessive fees further worsen the standing of the local logistics sector in the market. According to the Maritime Industry Authority (2016),[1] the high logistics cost in the Philippines is due to the limited cargo base (lack of economies of scale), inadequate port infrastructure, lack of competition in the coastal shipping market due to cabotage, inadequate road transport networks and regulations that lead to excessive road congestion, high cost of port operations, and inadequate investments from the private sector. In terms of the lack of competition, for instance, the local market for shipping has yet to fully open to foreign shipping operators. In fact, only domestic ships are currently allowed to make port-to-port calls within the country, thus constraining the flow of cargoes throughout the logistics chain.

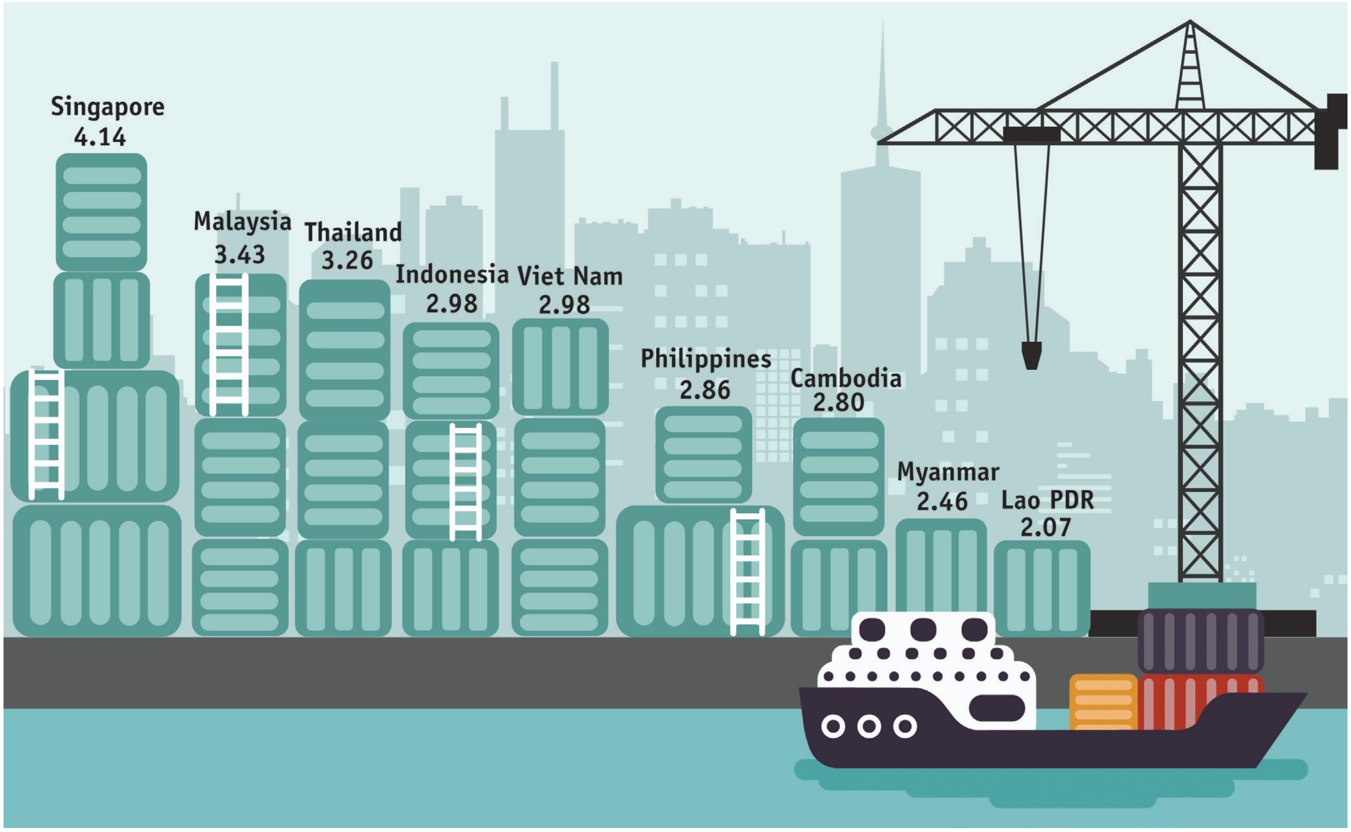
Philippine and Singapore's styles of ports administration

Philippines' PPA and CPA charters

One factor behind the poor performance and low international competitiveness of the Philippine logistics sector is its restrictive and incoherent regulatory framework, as can be seen in the case

[1] Personal interview with MARINA.

Figure 1. ASEAN (sans Brunei Darussalam) cross-country comparison in terms of logistics performance index



Source: World Bank (2016)

of the Philippine ports. The efficiency of the ports matters because their costs account for a large part of maritime transport costs, which providers and shippers usually shoulder by way of increased shipping charges. Delays due to port inefficiency can also lead to higher inventory costs and even loss of business opportunities.

Except for the Port of Cebu, which is under the Cebu Ports Authority (CPA), all Philippine public ports are under the responsibility of the Philippine Ports Authority (PPA). Based on the PPA Charter, the PPA has both operational and regulatory functions. Meanwhile, the CPA Charter also equips the CPA with regulatory and operational functions over all ports in the province of Cebu.

As such, both the PPA and the CPA act as regulators and port operators. Given that they also have shares in the revenue from their port operations,[2] the PPA and the CPA may tend to approve any rate or charge increases applied by the terminal operators and formulate policies and regulations that may be beneficial to the terminal operators, but could be detrimental to the interest of the logistics services providers and shippers. These situations then create a conflict of interest, one of the major factors behind the high level of port inefficiency and exorbitant port charges (Basilio 2003). Corollary to this is the fact that most ports in the country are under the management of the PPA. This situation leads

[2] The entitlement of PPA to a share from cargo-handling revenues is stated under Letter of Instruction 1005-A.

According to the World Bank, the Philippines is among the bottom four Southeast Asian countries on the 2016 logistics performance index. The organization imputed this weak performance to the country's inadequate and relatively poor quality of infrastructure, inefficient customs, poor competency of its logistics providers, and their limited ability to track and trace shipments. The excessive fees further worsen the standing of the local logistics sector in the market. This study urges the government to revisit the management and regulation of ports and enhance the private sector participation in the industry to improve its inefficiency and its international competitiveness. (Photo: Gizelle Manuel)

to lack of interport competition and thus lower port efficiency. Although a somewhat centralized administration of ports can help avert investment duplication and excess capacity, it tends to create a less competitive port environment.

The issue on conflict of interest is actually part of a broader concern regarding the government involvement in the management and operation of ports. Empirical evidence, for instance, leans toward limiting the government involvement in the regulation of ports to ensure their efficiency (Tongzon and Heng 2005).

Singapore's Maritime and Port Authority

The separation of regulatory and operational functions of ports has become a growing trend among ports around the world in the past two decades (WB 2001). One good example of this trend is Singapore's Maritime and Port Authority (MPA), equivalent to our Maritime Industry Authority.

To separate operational from regulatory functions, the Singapore government established the MPA in 1996 through the merger of the Marine Department, the National Maritime Board, and the regulatory departments of the former Port of Singapore Authority (PSA). Since then, the main job of MPA has been to regulate the port and shipping activities in Singapore. Meanwhile, the PSA has been tasked to manage and run the ports.

The PSA was subsequently corporatized to enhance its flexibility and responsiveness to business opportunities. Prior the said corporatization, the commercial operations and regulatory functions were under the responsibility of Singapore's state-owned PSA.

A cautionary note

Less government involvement in the port management and operation, however, does not guarantee an improvement in port efficiency. Just as governments can fail to allocate resources efficiently, there is also such thing as market failure.

Ports can also be considered as a public good with substantial positive economic externalities that cannot be left to the profit-oriented private sector. Under this concept, a port does not have to be profitable or efficient as long as it provides a vital service and contributes to the economic development of a country by facilitating international trade and providing a vital link between various regions in the country.

Moreover, Baird (2000) argued that, due to the specific nature of port investment (long-term payback and high capital cost), an almost total dependence on the private sector to provide both port infrastructure and superstructure will result in delayed investments on crucial operation facilities and equipment. Such delay is obviously contrary to the original objective of port privatization.

Recommendations

Apart from the improvements in transport infrastructure, regulatory reforms are required to address the Philippine ports' inefficiency and lack of international competitiveness. These reforms include the following:

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Revisit the management and regulation of ports

Currently, the PPA functions as both regulator and operator of the relevant logistics nodes in the supply chain. This not only stifles interport competition within the country but could also lead to higher costs and inefficiency as explained earlier. To improve the situation, this study recommends the establishment of one separate entity in-charge solely of port regulation.

Improve competition in logistics industry

More competition among ports in the country should also be enhanced by allowing more private sector participation by way of concessions through build-operate-transfer or lease agreements. Under this setup, the PPA and CPA may grant to the private concessionaires the right to finance, build, and operate a terminal or parts of a port operation for a limited period of time. After which, the facility and its equipment will be transferred free of charge to the PPA and the CPA.

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