Industry Structure and Competitiveness

INTER-ISLAND FREIGHT SHIPPING

Introduction

The development of an efficient transportation system is crucial to the country's economic growth. Economical and reliable means of transportation must be made available to facilitate the movement of people, goods and services within and among the various regions of the country. There are various modes of transport available. However, for purposes of transporting goods within the Philippines, inter-island freight has grown in significance to the economy. Freight is one of the most important structural supports of the economy, providing the backbone of trade. The archipelagic nature of the country has made inter-island freight a key player in trade. It is also the cheapest carrier in terms of ton-mile haulage.

The objective of this study is to analyze the state of competition within the inter-island freight shipping industry, using an analytical framework specifically developed for this purpose, and to make recommendations, if necessary, on how to make the industry competitive or improve its competitiveness. It is hypothesized that the improvement of the input sectors of the Philippine export industry (such as inter-island freight shipping) will translate into competitiveness or better competitiveness of Philippine exports.

Competition and Competitiveness Analysis

I Defining the Relevant Market

A *relevant market* is defined as, "… a product or group of products and a geographical area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a 'small but significant and non-transitory' increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test."[1]

Simply put, a relevant market is defined by the product or service involved, the geographical area in which said product or service is sold, and the sellers and buyers of such product or service.

- Product Market

  The relevant product market is defined as inter-island freight shipping, which is used to move goods within the geographic boundaries of the Philippines.

Based on the proportion of modal share in domestic transport of commodities in 1994 (see Table 1), transport by water accounted for 99.69% share for all types of commodities. The combined share of air and rail in commodity transport was almost negligible at less than 1%.

Table 1. Proportion of Modal Share in the Domestic Transport of Commodities (1994, in %)

Commodity Group	Modal Share		
	Water	Air	Rail
Food and Live Animals	99.34	0.54	0.12
Beverage and Tobacco	99.92	negligible	Negligibl

[1] As defined by Section 1 of the U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines dated 02 April 1992.

			e
Crude Materials, inedible except fuels	99.93	0.06	0.01
Mineral Fuels, Lubricants, Related Materials	99.99	negligible	Negligibl e
Animal and Vegetable Oils, Fats and Waxes	99.99	negligible	Negligibl e
Chemical and Related Products, n.e.s.	99.66	0.28	0.16
Manufactured Goods Classified Chiefly by Material	99.95	0.02	0.03
Machinery and Transport Equipment	99.65	0.32	0.03
Miscellaneous Manufactured Articles	93.67	6.11	0.22
Commodities and transactions, n.e.s.	99.26	0.66	0.08
All Commodities	99.69	0.26	0.05

Source: Philippine Yearbook

The relevant product is inter-island freight shipping, which is used to move goods within the geographic boundaries of the Philippines. Goods may be transported through (a) tramp service, or (b) liner service. Tramp service involves the charter of an entire vessel to transport the goods. Under tramp service, the major cost considerations of the shipper include charter fee, stevedoring charges (*i.e.* loading and unloading), and fuel consumption, which are usually incorporated in the total freight cost. On the other hand, liner service involves vessels that call on specific ports at specific dates, and freight cost is determined on a *per* ton basis.

- Geographic Market

The relevant geographic market is the Philippine national territory as defined by inter-island freight shipping services.

There are two (2) types of water freight services that can be contracted for the purpose of moving goods from one point to another: ocean freight shipping and inter-island freight shipping. Ocean freight shipping allows the transfer of goods from origins outside the Philippines to ports within the Philippines, but not from one Philippine port to another because of the *cabotage* rule as shall be presently discussed. The exception is where the ocean freight shipping line is bringing goods from one international port to another international port. On the other hand, inter-island freight shipping allows the transfer of goods to and from ports within the geographic boundaries of the Philippines. Thus, the relevant geographic market is the Philippine national territory as defined by inter-island freight shipping services.

- Participants in the Market

  The relevant participants in the market are Philippine registered vessels that may engage in inter-island shipping.

Only Philippine registered vessels may engage in inter-island shipping. Foreign ocean freight shipping lines may not engage in inter-island freight shipping because of restrictions in *cabotage*. Cabotage refers to the practice of maritime countries of reserving the privilege of navigating and trading along the coast between two (2) ports within the national territory, only to vessels which are registered in that country. Philippine restrictions, as defined under the Tariff and Customs Code of the Philippines, are:

> "SEC. 901. *Ports Open to Coastwise Trade*. – All ports and places in the Philippines shall be open to vessels lawfully engaged in coastwise trade, subject to the provisions of law applicable in particular cases."
>
> "SEC. 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."
>
> "SEC. 905. *Transportation of Passengers and Articles Between Philippine Ports*. – Passengers shall not be received at one Philippine port for any other such port by a vessel not licensed for

the coastwise trade, except upon special permission previously granted by the Collector; and subject to the same qualification, articles earmarked at a domestic port shall not be transported to any other port in the Philippines, either directly or by way of a foreign port, or for any part of the voyage, in any other vessel than one licensed for coastwise trade." (Underscoring supplied)

The number of cargo vessels in 1996 aggregated to 1,294 with aggregate gross registered tonnage (GRT) amounting to 665,072. This accounts for 25.3% of the total number of domestic operating fleet and 71.1% of total GRT.

Table 2. Number of Domestic Operating Fleet by Type of Service (1996)

Type of Vessel	1996	
	Number	**GRT**
Merchant Fleet	2,384	805,695
Passenger Ferry	492	9,398
Passenger Cargo	154	169,007
General Cargo	979	322,866
Container	17	61,102
Liquid Cargo/ Lighterage	23	7,191
Oil Tanker	121	104,906
Barging	207	2,566
Towing/Salvage	300	27,314
Pleasure	20	574
Pilotage	9	606
Others	62	10,166
No Information		
Fishing	2,729	130,073
Total	5,113	935,768

Source: Maritime Industry Authority

Thus, the relevant participants in the market are only Philippine registered vessels that may engage in inter-island shipping (see Table 2).

Major industry groups include the Philippine Inter-island Shipping Association (PISA) and the Domestic Shipping Association (DSA).

II Calculating Market Share

Domestic freight shipping carriers may operate three (3) types of service routes: national, *i.e.* nationwide, secondary, *i.e.* within a fixed area, and tertiary, *i.e.* from point to point. The size of market shares is not dependent on the number of vessels, but on the number of service routes being operated. At international ports, such as Manila and Cebu, international freight shipping lines compete with the domestic companies operating direct national service routes. Thus, in estimating market shares, it would have been ideal to segregate the market according to service route and then determine the market shares accordingly.

However, data provided by MARINA does not allow segmentation of the market according to service route (see Annex "A"). The market was therefore divided into the two (2) possible segments, namely, (a) petroleum haulers, and (b) other cargo. Tables 3A and 3B below shows the market shares for these segments in 1997 and 1998.

Table 3A. Market Shares: Petroleum Haulers (in %)

Company	Market Shares	
	1997	**1998**
Company 1	15.96	15.29
Company 2	27.42	25.43
Company 3	48.93	49.39
Company 4	7.69	9.89

Source: Maritime Industry Authority

Table 3B. Market Shares: Other Cargo (in %)

Company	Market Shares	
	1997	1998
Company 1	38.24	54.12
Company 2	4.38	4.06
Company 3	11.50	8.89
Company 4	16.08	12.25

Source: Maritime Industry Authority

III Evaluating Level of Concentration

The level of concentration, *i.e.* ownership and structure, in the industry was computed using the Herfindahl-Hirschman Index (HHI). The HHI is an indicator used in the U.S.A. It is the sum of squares of the individual market shares of all the market participants.

Under American law, the HHI is not strictly mandated in any situation, even in mergers. Rather, it is used in guidelines of the U.S. Department of Justice when reviewing mergers. Courts have adopted the guidelines, including the HHI, as useful in analyzing mergers, and they look to the HHI for guidance in other areas of antitrust law as well. While the HHI has no "legal" authority, courts, regulators and economists recognize it as a useful tool in analyzing market concentration in mergers and other areas of antitrust law. An HHI of 10,000 means a pure monopoly, while an HHI approaching zero indicates an atomistic market[2].

Table 4. HHI: 1997-1998

Market	HHI	
	1997	1998
Petroleum Haulers	3459.68	3417.73

[2]To aid in the interpretation of HHI, the U.S. uses the following approach:

below 1,000	⇨	not concentrated
between 1,000 and 1,800	⇨	moderate concentration
between 1,800 and 10,000	⇨	high concentration

An HHI of above 1,800 is considered "highly concentrated" even though it seems a long way from 10,000, i.e., absolute monopoly power. This is because, in the merger context at least, U.S. antitrust laws are concerned not only with mergers that result in a monopoly, but also with mergers that result in a highly concentrated market.

Other Cargo	1872.30	3174.55

The HHIs computed for the industry show high concentration in the market (see Table 4). That the HHIs are high is not surprising considering the market shares that were estimated for each market segment. For petroleum haulers, a single company was responsible for almost half of total freight revenues in 1997 and 1998. The same holds true for companies engaged in other freight with one company accounting for more than 50% of total revenues in 1998.

IV Other Factors Affecting Competition and Competitiveness

Competition within, and competitiveness of, a given industry are also affected by factors other than the behavior of the market participants. This means that a lack of competition within an industry may also be attributable to entry barriers, or the reason for inefficient firms staying on may be due to a punitive exit process. The *un*competitiveness of a domestic industry *vis-à-vis* a foreign industry may also be due to factors that are external to the domestic industry.

➢ Factors Affecting Entry

Conditions affecting entry, to a certain extent, determine the number of participants in the market, *e.g.* whether conditions allow existing players to entrench themselves, effectively limiting competition, or whether the market is open to new participants, thereby fostering greater competition.

Investment Cost

Entry into the domestic freight shipping industry requires a large capital outlay. Expenses are in dollars while earnings are in pesos. Financing for vessel acquisition remains a major problem in the industry and is affected by a defective Ship Mortgage Decree, as will be discussed. Loans are difficult to obtain and, in addition, Philippine interest rates for loans remain one of the highest in the region.

Market Segmentation

Entry is likewise affected by market segmentation. Industry participants prefer to service major routes because of the volume of transactions, neglecting minor routes.

Government Regulatory Agencies

Numerous government agencies[3] regulate and monitor the various aspects and operations, and components of the inter-island freight shipping industry. The principal regulatory agencies determine to a great extent how the market operates.

(a) Maritime Industry Authority – regulates and monitors shipping rates and accreditation of vessels

(b) Philippine Ports Authority – regulates port services

(c) Bureau of Customs – regulates importation and exportation of goods and monitors compliance with laws, rules, and regulations

(d) Bangko Sentral ng Pilipinas – regulates importation and exportation of goods and monitors compliance with laws, rules, and regulations

(e) Philippine Shippers Bureau, formerly the Philippine Shippers Council – created to protect the interests of the exporters, importers and commercial users of water transport. It registers and accredits non-vessel operating common carriers, freight forwarders, cargo consolidators and breakbulk agents.

Note that there are twenty-six (26) other agencies that directly or indirectly regulate the inter-island freight shipping industry, to wit:

(f) Philippine Coast Guard

(g) Philippine National Police Traffic Management Group

(h) Philippine National Police Maritime Command

(i) Bureau of Fisheries and Aquatic Resources

(j) Bureau of Plant Industry

(k) Bureau of Animal Industry

(l) Protected Areas and Wildlife Bureau

(m) Forest Management Bureau

(n) Environmental Management Bureau

(o) Mines and Geosciences Bureau

(p) Professional Regulations Commission

(q) Philippine Overseas Employment Administration

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[3] Interview with Mr. Brendan Eligio, Philippine Inter-Island Shipping Association

(r) Bureau of Immigration and Deportation

(s) Subic Bay Metropolitan Authority

(t) John Hay Poro Point Development Corporation/Bases Conversion Development Authority

(u) Technical Education and Skills Development Authority

(v) Maritime Training Council

(w) Energy Regulatory Board

(x) National Telecommunications Commission

(y) Bureau of Quarantine

(z) Provincial Governor or Mayor (of the area concerned)

(aa) Department of Foreign Affairs

Laws and Regulations

The complete deregulation of the shipping industry is constrained by antiquated and/or defective laws.

- Defective Laws

(a) Public Service Act[4] – provides that public service enterprises must be regulated, including the rates to be charged and the returns on investment. The legislated ceiling on return on investment for utilities is 12%. Congress has repeatedly stalled on acting on amending the PSA. These restrictive government regulations and the bureaucracy contribute to the lack of flexibility of ship owners to respond to business opportunities.

(b) The Ship Mortgage Decree[5] – as currently worded, this law does not provide for ease in foreclosing delinquent secured loans. Extra-judicial foreclosure is not allowed and litigation is necessary in order to attach the mortgaged vessel and subsequently foreclose the mortgage. Foreign banks deem that there is no adequate security and refuse to lend money to the domestic ship owners. Hence, domestic ship owners are unable to avail of cheaper financing abroad.

(c) Domestic Shipping Act[6] – According to an industry source, shipping authorities tend to be more lenient with the application of the cabotage rule for transshipments within the Philippines of cargo coming from abroad. In certain cases, foreign vessels delivering cargo from abroad to a Philippine international port, *e.g.* Manila, are allowed to deliver from said international port (Manila) to another Philippine port, *e.g.* Cebu, if it is also carrying cargo bound for another Philippine port (Cebu). The industry source said that this practice is already a violation of the cabotage rule, yet the shipping authorities allow this.

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[4] Commonwealth Act No. 146 (1936).
[5] Presidential Decree No. 1521 (1978).
[6] Republic Act No. _____.

(d) Philippine Overseas Shipping Development Act[7] – allows a tax incentive in the form of a tax exemption/holiday for the purchase of ships. However, a requisite for availing of the tax incentive is that the ship must be used for shipping in Philippine waters. This requisite practically negates this incentive because the ship owner is restricted as to the use of the new ship and how to earn income with the new ship.

➢ Laws and Regulations Granting Incentives

Several government laws and regulations grant incentives to encourage competition in the industry.

(a) Executive Orders Encouraging Entry of Additional Operators

➲ Memorandum Circular (MC) No. 71 (*s.* 1992), as amended by MC No. 80 (*s.* 1993), encouraged entry into developmental routes while fostering easier entry by additional operators into serviced routes. This may have prevented monopolies as well as provided flexibility in shipping operations.

MC No. 71 requires a minimum of two (2) operators in a route, thereby eliminating monopolies. There is also a presumption of public need for the new route operator, thus shifting the burden of proof of the non-necessity for another operator to those opposing the entry of the new operator. The entry of new/additional operator(s) in established links/routes is allowed, provided the service to be offered is more cost-efficient, of better technology, and of superior or competitive service, or if action/practices of existing operators result in a lack of effective competition. Finally, no limit is imposed on vessel replacement capacities.

[7] Republic Act No. 7471.

➲ Executive Order (EO) No. 185 (*s.* 1994) provided additional dimensions to the deregulation of route entry.

EO 185 was designed to encourage the entry of new operators and investors. Aside from expectations of lower passenger and freight rates and enhanced quality of service, the EO sought to open up all routes to a minimum of two (2) operators, encourage entry into developmental routes, deregulate entry of newly acquired vessels into routes already served by franchised operators, and reroute vessels or amend authorized routes and establish changes in sailing schedules and frequency.

(b) Tariff Policy

➲ The Investments Priorities Plan (IPP) provides for the duty- and tax-free importation of vessels, machinery, spare parts and cargo-handling equipment. Thus, from 1990 to 1997, the MARINA endorsed, for the availment of incentives under the IPP, the importation of 158 vessels, various imports of spare parts, machinery and cargo-handling equipment/materials. Unfortunately, this incentive was only available until 31 December 1999 for enterprises located outside of the National Capital Region and registered on or before 31 December 1994. For all other enterprises, this incentive expired last 31 December 1997. The government, however, is still pressing for the passage of Senate Bill No. 157 -- An Act to Promote the Development of the Inter-island Shipping Industry -- which is currently pending and which will renew old incentives or grant new ones.

➲ Recent changes in the Tariff and Customs Code with respect to articles used by the shipping industry have made these articles more accessible. Ships used for the transport of goods and support facilities listed under Chapter 89 of the Tariff and Customs Code, as amended are generally levied the minimum tariff duty of 3%. Import duty on spare parts and ship machinery, *e.g.* engines, propellers, *etc.*, have likewise been reduced in recent years (see Table 5).

Table 5. Rates of Duty of Ships, Boats, Floating Structures, Machinery, Parts, etc.

HS Hdg. No.	Description	Rate of Duty (%)	
		1999	2000
7326.90 20	Ships' rudders, of steel	3	3
8407.21 00 8407.29 00 8408.10 00	Marine propulsion engines	3	3
8485.10 00	- Ships' or boats' propellers and blades therefor	3	3
89.01	Cruise ships, excursion boats, ferryboats, cargo ships, barges and similar vessels for the transport of persons or goods.		
8901.10	- Cruise ships, excursion boats and similar vessels principally designed for the transport of persons; ferry-boats of all kinds		
8901.10 10	- - - Over 500 GT	3	3
8901.10 90	- - - Other	10	7
8901.20 00	- Tankers	3	3
8901.30 00	- Refrigerated vessels, other than those of subheading no. 8901.20 00	3	3
8901.90	- Other vessels for the transport of goods and other vessels for the transport of both persons and goods:		
8901.90 10	- - - Over 500 GT	3	3
8901.90 90	- - - Other	10	7
8904.00 00	Tugs and pusher craft	3	3
89.05	Light-vessels, fire-floats, dredgers, floating cranes, and other vessels the navigability of which is subsidiary to their main function; floating docks; floating or submersible drilling		

	or production platforms.		
8905.10 00	- Dredgers	3	3
8905.20 00	- Floating and submersible drilling or production platforms	3	3
8905.90 00	- Other	3	3
89.07	Other floating structures (for example, rafts, tanks, cofferdams, landing stages, buoys and beacons).		
8907.10 00	- Inflatable rafts	3	3
8907.90 00	- Other	3	3

Source: Tariff and Customs Code of the Philippines

Factors Affecting Exit from the Industry

The decision to enter a market has a bearing on the ease or difficulty of exiting the same. Based on industry sources, exiting can be accomplished with relative ease. Domestic firms prefer selling to foreign buyers because they can demand payment in foreign currency, preferably U.S. dollars. However, the industry does not rule out mergers or buy-outs with other domestic firms.

If the exiting firm opts to sell to foreign buyers, this implies an opportunity for entry as the exiting firm will leave a market share. This may then be serviced by a new entrant or shared among existing firms.

Factors Affecting Competitiveness

➢ Cost and Quality of Services

(a) Export Shipping Cost – For shippers of export goods, cabotage means additional shipping cost because goods for export have to go through at least three (3) stages before they may be shipped out of the Philippines, to wit

- shipment from provincial ports to the port of Manila, i.e., thru-move freight costs are lower than rates given for purely domestic shipment;

- shipment from the port of Manila to one of the feeder ports, *i.e.* Hongkong, Kaohsiung or Singapore (feedering), has become a necessary leg in the transportation of goods as a result of containerization technology, which Philippine ports are ill-equipped to handle; and

- shipment from any of these feeder ports to the final port of destination.

In certain cases, the additional feedering cost, as well as the inability to take advantage of a lower thru-move freight cost, has resulted in higher shipping cost to shippers.

(b) Domestic Shipping Cost – The higher cost of domestic shipping service *vis-à-vis* foreign shipping can be traced to several factors including: high fuel cost, high interest rates, high insurance premium, low port efficiency and productivity, higher taxes for domestic shipping operations, lack of comparable government support program for domestic shipping, and higher cost in domestic liner operations to subsidize passenger carriage and services in less profitable routes.

Domestic vessels pay 8% to over 51% more for fuel oil, and 24% to over 40% more for diesel oil than foreign vessels. With regard to interest rates, domestic shipowners pay 43.5% to 173.5% more in interest rates than Asian counterparts. High insurance premiums likewise contribute to high shipping expense. Domestic shipowners pay 34% income tax, 10% value added tax and 3% common carrier's tax while foreign counterparts pay only 2.5% tax on gross income. Low port efficiency and productivity likewise contribute to the high cost of domestic shipping. Moreover, foreign shipping lines enjoy better subsidies, *e.g.* American shipping companies enjoy government support such as the Jones Act, Public Law No. 480 and the Merchant Marine Act. Finally, freight rates of domestic vessels are designed to recover cargo carriage costs as well as subsidize passenger carriage operations.[8]

(c) Cargo Vessels – One of the conditions, which would contribute to competitiveness in the inter-island shipping industry, is to ensure a sufficient number of cargo vessels able to answer the needs of the shippers.

At present, both MARINA and the industry confirm an overtonnage. Based on a sampling made by MARINA, the utilization rates (actual carriage *versus* capacity of cargo vessels in major routes indicates overtonnage. Computed utilization rates (URs) are even below the estimated break-even UR of 68% (see Table 6). MARINA attributes the excess supply situation to an improvement in the investment climate.

Table 6. Utilization Rates of Selected Liner Companies in Major Routes[1/]

	WG & A		Nenaco		Sulpicio		Total	
Route	# of vessels	UR (%)	# of vessels	UR (%)	# of vessels	UR (%)	# of vessels	UR (%)
Manila – Cebu & v.v.	8	48.63	-	-	12	8.61	20	29.78
Manila – Davao & v.v.	8	45.83	1	11.57	6	7.67	15	24.15
Manila – Iloilo & v.v.	10	29.34	11	31.89	11	2.93	32	25.89
Manila – Cag. de Oro & v.v.	12	40.98	5	31.72	1	6.85	18	34.26

[1/] *Based on submitted 1996 annual reports of shipping companies.*
Source: The Domestic Shipping Industry of the Philippines: A Situation Report

(d) Efficiency of Service - Another condition contributing to competitiveness is efficiency of service, which can be equated to the age of cargo vessels. New

[8] Manila Bulletin, 28 June 1999.

vessels are more efficient as they require less maintenance and are not as prone to breakdown as old vessels. Consequently they are more cost effective.

1996 statistics show that the average age of cargo vessels is thirteen (13) years (see Table 7). By Japanese standards, vessels belonging to the category of above fifteen (15) years are considered obsolete. Based on the average age *per* type of vessel, most of the domestic passenger cargo, container and liquid cargo/lighterage vessels are considered obsolete. General cargo vessels, on the other hand, are approaching obsolescence.

Table 7. Average Age of Cargo Vessels (1996, by type of vessel, no. of years)

Type of Vessel	Number	Average Age
Passenger Cargo	154	15.05
General Cargo	979	12.40
Container	17	24.12
Liquid Cargo/Lighterage	23	15.50
Total/Average	1,173	12.98

Source: Maritime Industry Authority

Based on industry statistics, majority of the vessels of the five (5) major players in the industry (WG & A Philippines, Inc., Negros Navigation Co., Sulpicio Lines, Inc., Lorenzo Shipping Corp., and Cebu Ferries, Corp.) are obsolete by Japanese standards.

(e) Routes and Frequency of Service - Finally, routes serviced and frequency of service give an indication of the competitiveness of inter-island freight shipping firms. Of the five major players in the industry, WG & A Philippines services more routes, and at greater frequency. Utilization rates of selected liner companies on selected major routes, as estimated by MARINA, show that this firm enjoys a competitive edge over the others.

(f) Support Services – include port facilities, shipbuilding, ship repair and shipbreaking, and shipping services

➲ Ports – Operational ports, which can be public or private ports, serve as entry and exit points for cargoes and passengers. Public ports are classified either as port of entry, sub-port of entry, and municipal port. Both ports of entry and sub-ports of entry service domestic and international cargoes and passengers, while municipal ports exclusively service inter-island traffic.

The number of operational ports in the country increased from 1991 to 1996, by 212.8% or from 429 to 1,342 ports (see Table 8). The number of ports in all regions, including the NCR, increased. In absolute figures, Luzon posted the largest increase (398) followed by Mindanao (287) and Visayas (228). In 1991, Visayas had the most number of port (175). By 1996, Luzon (502) and Mindanao (437) overtook Visayas (403).

Table 8. Number of Operational Ports (by region; 1991 and 1996)

	1991	1996
National Capital Region	12	64
Region 1 - Ilocos	10	35
Region 2 - Cagayan	2	28
Region 3 - C. Luzon	4	42
Region 4 - S. Tagalog	52	235
Region 5 - Bicol	24	98
Region 6 - W. Visayas	53	146
Region 7 - C. Visayas	86	138
Region 8 - E. Visayas	36	119
Region 9 - W. Mindanao	31	69
Region 10 - N. Mindanao	67	186
Region 11 - S. Mindanao	25	105
Region 12 - C. Mindanao	27	36
ARMM	-	41
Total	429	1,342

Source: Philippine Statistical Yearbook

- Shipbuilding, Ship Repair and Shipbreaking – As of December 1996, the MARINA licensed a total of 233 enterprises engaged in shipbuilding, ship repair, afloat repair, boatbuilding and shipbreaking activities. In terms of classification, 37% fall under small shipyard, 4% are medium shipyard, 6% are large shipyard and 53% are without facilities.

  Out of the total licensed enterprises, only 99 have dry-docking facilities such as marine railway, graving dock, floating dock and liftdock, primarily used for the construction and repair of vessels. These 99 shipyards are strategically located all over the country. The rest are licensed afloat ship repairers and ship repairers without facilities, which are only equipped with tools and machines rather than dry-docking facilities, and supply contract workers to the shipyards.

  The existing shipyards with facilities have varying capacities ranging from 50 DWT to 850,000 DWT. The top 10 shipyards ranked according to size account for 74% of the total tonnage capacity offered by the 99 shipyards.

  In terms of manpower resources, the industry registered a total workforce of 34,924 personnel. By 1996, 72% of total number of personnel employed in the industry were categorized as skilled workers; 11% as managerial and administrative personnel; 10% were technical and 6% were semi-skilled.

(f) Freight Forwarding and/or Customs Brokering Services – Many a shippers' headache are caused by late shipments, improper documentation or description, erroneous declaration, misrouting, improper stuffing, mislabeling or mispackaging of, and damages to, cargoes. These problems may be diminished with the assistance of efficient, professional and skilled freight forwarding or customs brokering service.

- PSB and PISFA - Pursuant to the mandate creating it, the Philippine Shippers Bureau (PSB) is tasked to register and accredit freight forwarders which shippers may deal with. In cooperation with the Philippine International Freight Forwarders Association (PISFA), it has sought to standardize the services and charges of freight forwarders. Unfortunately, much is yet to be done to totally professionalize the industry and do away with the pervasive *lagay* system in cargo handling, *i.e.* the imposition of unreceipted "facilitation fee" to expedite the processing of the documents and release of cargo from the customs area for loading to the vessels.

(g) Quality of Shipping Services – A 1995 PDCP Bank study notes that these inefficiencies can be ascribed to the lax enforcement of shipping rules and regulations, and unrestricted penalties for violators.

- Overcrowding of ports during peak season and inadequacy of port facilities have contributed to the inefficiency in shipping services.

- Contributing to the poor quality of service is manpower drain. Well-trained marine officers, ship engineers and navigators favor working for foreign over domestic shipping companies because of higher pay. This problem threatens the safety and efficiency of the domestic shipping industry.

- The more critical problem is the occurrence of maritime accidents, which result in loss of lives and damage to property.

(h) Government Incentives and Programs Affecting Domestic Shipping Rates, Regulation of Government Ports, Administration, Availability of Financing and Maritime Safety – The complete deregulation of the shipping industry is constrained by the Public Service Act (PSA). However, government's current efforts at deregulation provides competitive enhancement measures to the industry.

- Domestic Shipping Rates – EO 213 (*s.* 1994) further deregulated liner shipping rates. MC 117, which implemented EO 213, provided for the further deregulation of domestic shipping rates, specifically cargo freight rates, except for non-containerized basic commodities. Users and providers of domestic shipping liner services undertook rate fixing, which was previously exercised by government. The negotiating and determining of specific rate levels to be adopted on deregulated rate categories was undertaken through the Domestic Shipping Consultative Councils (DOSCONs) established in various regional centers of the country.

- Regulation of Government Ports – EO No. 212 provides for the demonopolization and privatization of government ports. The EO removes the authority of the Philippine Ports Authority to grant extension to cargo handling and waterfront services after the expiration of their contracts, and instead institutionalize the conduct of "competitive public bidding" in the awarding of new contracts. This is expected to bolster competition in cargo handling and other port services in all government terminal facilities. Furthermore, private sector participation is encouraged especially in the operation, maintenance and development of all government ports in the country through capital leases, cargo licenses, service contracts, and tariff review.

The EO likewise mandates the preparation of a National Port Transport Plan by the Department of Transport and Communication to address regional development needs and comply with the privatization program integrating an intermodal transport network that would link road, rail, sea, and air transport systems efficiently (MARINA, 1999).

However, EO 212 was recently replaced by EO 59, which mandates the unification and rationalization of all facility operators and service providers in government ports. While the EO paves the way towards privatization of government ports, it is viewed by the shipping industry as a move towards the creation of monopolies as it mandates that all ports have a single contractor for all port services.

➲ Administration – To make government administration of the domestic shipping industry more responsive and efficient, efforts were directed towards the removal of certain restrictions for easier acquisition of vessels from abroad, adoption of measures to facilitate the grant of vessel franchise to operate, institution of less restrictive procedures for vessel departure clearance in ports, and improvements in the delivery of government services to the shipping clientele. All these are designed to encourage competition and improve the business climate for the industry.[9]

- ➪ In the matter of vessel acquisition, MC No. 81 (*s.* 1993) and reiterated in MC No. 104 (*s.* 1995) lifted the age and size restrictions on vessels to be acquired, but with the requirement that such vessels coming in shall be classed.

- ➪ In the matter of franchise issuances, MC No. 74 (*s.* 1993), provided for the institution of summary procedures in handling franchise operations which fast-tracked the whole procedure; the use of compromise and arbitration for contested cases, also to fast-track the resolution of applications; and the adoption of prescribed periods to render decisions – fifteen (15) and thirty (30) days for uncontested and contested cases, respectively.

➪ In the matter of departure clearances, EO 493 provided for the reduction in required documents to only three (3) copies and designated the Philippine Ports Authority (PPA) as the singular agency, instead of the several agencies, to clear departing vessels.

➪ MC No. 85 (*s.* 1994), provided for more efficient and faster processing of applications by rationalizing documentary requirements and procedures. Functions and activities were gradually decentralized to MARINA Regional Offices.

➲ Financing Incentives – Government was able to source funds from the 19th Yen OECF Loan Package in the amount of ¥15 billion, about P3.91 billion, for the implementation of the Domestic Shipping Modernization Program (DSMP) since 1995. About ¥14.838 billion, or P3.886 billion, is earmarked for relending. The DSMP, administered by the Development Bank of the Philippines, has been providing the needed financing for importation or local construction of vessels to domestic ship owners, at reasonable interest rates. As of 31 December 1997, the DBP has already approved the financing for the acquisition of 97 vessels, thirty-two (32) of which are passenger and general cargo vessels.

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[9] MARINA, 1999.

The program has also financed the completion of a slipway by a shipyard and a terminal facility. As of 30 June 1998, P646.1 million remain available for lending.[10]

- Maritime Safety – Government programs were guided by the need to address the concerns relating to vessel seaworthiness, the need to insure crew competence, and the provision of essential aids-to-navigation.[11]

  - To ensure vessel seaworthiness, the requirement to classify vessels remained a basic policy and was subsequently complemented by the coverage of other vessel types with the Vessel Safety Inspection System pursuant to MC No. 124. Likewise, compliance with the pertinent provisions of STCW Convention as it applies to domestic seafarers has likewise been enforced gradually since 1994 to improve the quality of education and training for seafarers, including their certification. This was designed to address the need to insure crew competence in vessel operations.

  - A number of MARINA circulars have addressed specific concerns on maritime safety and pollution prevention. Improvement in aids-to-navigation facilities have been partially addressed through the Maritime Safety Improvement Project which resulted in the rehabilitation of a number of lighthouses and beacons along the Manila-Cebu route. Moreover, EO 314 (*s.* 1996) provides for the establishment of the National Maritime Safety Coordinating Council and directed the formulation of a National

[10] MARINA, 1999.
[11] *Ibid.*

Maritime Safety Plan. The latter has been completed and is awaiting the President's approval.

MC No. 79 (*s.* 1993) provides guidelines to ensure management competence and financial capability of those who will be allowed to engage in domestic shipping.

The International Management Code for the Safe Operation of Ships and for Pollution Prevention has been officially adopted for implementation to domestic vessels through the issuance of the Flag State Administration Advisory No. 8 on 06 October 1998.

V Assessment of Industry Performance

Financial Performance

Table 9 shows the financial performance of inter-island freight shipping firms listed in the Top 7,000 Corporations as of 1996 and 1997.

Compared with land and airfreight, the biggest aggregate revenues, assets, liabilities and stockholders' equity was posted by inter-island freight shipping services. Inter-island water freight remains the most popular mode of transport for goods because it is the most economical of the three – land, water and air.

Areas for Improvement of Performance/Service

The domestic freight shipping industry can further improve its performance and service in the following areas:

- Revisit Policy of Credit Extension to Improve Cash Flow

The partial deregulation of shipping rates is characterized by a fork tariff, or a floor and ceiling tariff of –15% to +10%. In theory, ship owners and operators can charge an amount within this band but in practice, rates are based on the upper band.[12] This would be likely given the constraints on ROI. But possibly also because of industry's practice of extending 30 to 90 day credit on freight, unlike foreign vessels which require pre-payment on services. Moreover, shipment is on FOB (free on board) basis as against the practice of foreign vessels of charging on CIF (cost, insurance and freight) basis.

- Unbundling Freight Rates

High domestic shipping cost becomes an issue when shippers try to benchmark the cost of shipping in the Philippines *vis-à-vis* the cost of shipping in other countries under comparable terms, *e.g.* cost *per* ton-mile haulage. Industry is willing to sit down with stakeholders and itemize each cost component of freight in order to determine which component can be done with, thereby contributing to a lowering in freight rates.

The industry's willingness to reduce rates is partly anchored on competition from foreign vessels. Comparing domestic and foreign shipping cost, when referring to domestic trade, should be a non-issue since the existence of cabotage limits domestic trade to Philippine registered vessels. However, domestic inter-island shipping loses out on foreign shipping due to high shipping cost, by "default". Industry sources illustrate this by citing foreign vessels, which are allowed to call to more than one international port in the Philippines. For example, a foreign vessel allowed to unload in Cebu and in Manila indirectly competes with inter-island vessels servicing the Cebu-Manila route. If

[12] Villaverde, 1998.

domestic shipping rates were more competitive *vis-à-vis* foreign shipping rates, shippers will look to domestic shipping as a viable and attractive alternative.

The issue on high domestic cost is a major reason for calls to liberalize the country's cabotage. If foreign vessels are allowed to engage in domestic trade, shippers will benefit by availing of lower shipping cost. Moreover, it is argued that the domestic shipping industry will be forced to find ways to improve its competitiveness.

- Industry's Challenge to Exporters

The domestic freight shipping industry is willing to act as agent for exporters in shipping their goods from origin to final destination. They are confident they can negotiate more effectively for lower shipping rates to the benefit of exporters.

VI Conclusions and Recommendations

Conclusions

- High Market Concentration

High entry cost and market segmentation are the primary contributors to high market concentration. The huge capital investment needed to start a shipping business acts as a barrier, and hence induces existing firms to enjoy the established rents and prevent other competitors from entering the market. To a certain extent, competition policy has addressed this difficulty. Deregulation and financing incentives instituted during the past few years have resulted in increasing trend in the number of shipping operators and investments in vessel acquisition. However, a defective Ship Mortgage Decree has impaired financing availment for the latter. Nevertheless, as competition is reduced to value for money, market concentration is expected to increase further and will likely be limited to the most visible firms offering superior services.

- ROI Ceiling and Monopoly Pricing

Although market concentration may indicate the likelihood of abuse of market power, government's policy of a 12% ceiling on ROI precludes a single firm exercising monopoly pricing. While this ceiling may rule out abuse of market power by the dominant player, it is considered anti-competitive. It serves as a disincentive for both efficient and inefficient firms – for the former because the return is not commensurate to the level of service rendered, and for the latter because of a guaranteed return regardless of the quality of service. Coupled with high entry cost, investors looking for a fast turn around of investment will find the industry unattractive.

- Improvement in Shipping Services and Standards

The extent to which government reforms can attain its goal to foster a more competitive market has yet to be determined with certainty. Aside from those earlier mentioned, liberalization and deregulation of government policies as well as other incentives have likewise resulted in a parallel improvement in shipping services and standards, and the partial deregulation of freight rates, although procedures followed in effecting changes in rates remain tedious.

Notwithstanding these, shippers continue to lobby for reforms. As an example, exporters have moved for a more liberal interpretation of cabotage, which will enable foreign registered vessels to transport cargoes from ports within the Philippines, provided these cargoes are intended for an international port. They have justified that the use of foreign vessels will entail less cost associated with thru-move and feedering. However, the current government position has not been favorable to this interpretation[13]. For their part, shipowners are pushing for reforms in their favor, *e.g.* less onerous taxes for domestic shipping lines *vis-à-vis* foreign shipping operators and an increase in their return on rate base as public utilities.

Recommendations

➢ Continue Deregulation Efforts with a Focused Competition Policy

The government has to continue its deregulation efforts in order to improve the competitiveness of the water freight service. A focused Philippine competition policy will further enhance the earlier liberalization initiatives of government. It is therefore important that government agencies continue to work for the improvement of the domestic shipping industry.

Nonetheless, the various sectors in the industry cannot rely solely on government initiatives and efforts to improve and maintain competitive conditions. Unless they show themselves as a strong and united force in the shipping industry, these various sectors will continue to operate under inefficient, corrupt and *un*competitive conditions. Shippers, shipowners and operators, port operators and freight forwarders, should coordinate and work together among themselves and with regulatory agencies, for the greater good of the industry as a whole. Self-interest and petty concerns should give way to reforms for fostering competition in the market.

➢ Maximize Use of Competition Policy

Several issues have been identified which can be addressed by competition policy.

(a) Venue and mechanism for cooperation between industry players, clientele, service providers, and government – With venue and mechanism in

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[13] Department of Justice Opinion No. 73, s. 1997.

place, industry players can meet and discuss together effectively, concerns and problems affecting each sub-group of players, and propose an action plan which will address these concerns and problems on a comprehensive and wholistic basis. With the participation of industry clientele and other stakeholders in open forums, symposia, and conferences, industry players will have a better and open perspective of concerns and problems besetting the industry.

After identifying problem areas, a study may be commissioned on how best to address these concerns and the impact on the industry as a whole.

Guided by this industry study, the players can bring to the attention of the government their problems and proposed solutions thereto. These efforts can include lobbying for reforms, sponsoring bills, and participating in committee discussion and recommendations for legislation.

(b) Consolidate Functions of Regulatory Agencies – For the government to efficiently and effectively undertake its mandate to improve the performance of the shipping service sector, there is a need to reduce the number of agencies regulating the industry.

The government must undertake a review of the mandate and functions of each of the regulatory agencies and determine where inefficiencies and overlaps occur. Then it must consolidate these functions into one or a manageable number of agencies, for more efficient governance and reduction in transaction costs.

Industry sources have suggested the amendment of the charter of PPA, particularly to amend the membership of its board to include representatives from the private sector so they can have a voice in decisions reached by the agency.

(c) Addressing Concerns about EO 59 – Competition policy must ensure that monopolies do not result from the implementation of EO 59. The government can either look into the possibility of having more than one service contractor in major ports where the volume of trade makes it economically viable. Or in ports where having more than one service contractor is not economically viable, it must ensure that the lone contractor does not abuse its position. This may be done by instituting competitive bidding of contracts, periodic review of contracts and periodic change in service contractor(s) to prevent entrenchment, *etc.*

(d) Access to Essential Facilities (*e.g.* infrastructure, utilities), Improved Access to Financing, Additional Incentives for the Development of Support Services – Government must provide a mechanism for industry to access the needed infrastructure, financing, and support services. Moreover, it must subject these to greater competition so that the industry can avail of its benefits, such as competitive pricing and quality service.

(e) Issue on Calls for the Relaxation of Cabotage – Competition policy can address questions on whether the relaxation of cabotage is necessary, will foster greater competition and if the benefits derived from such relaxation will outweigh the costs.

Ultimately, the efficiency of the inter-island freight shipping industry will boil down to higher productivity and lower cost to downstream industries which need to transport their goods from one place to another at any given time.

Table 9. Selected Financial Indicators of the Freight Industry (1995 and 1996, in P'000)

Freight	Gross Revenues		Net Income		Total Assets		Total Liabilities		Stockholders Equity	
	1995	1996	1995	1996	1995	1996	1995	1996	1995	1996
Interisland Freight	3,374,828	3,967,486	53,789	104,138	1,627,065	1,910,155	833,324	1,040,147	793,738	872,006

Annex "A"

ASSOCIATION/COMPANY	FREIGHT REVENUE (In Thousand Pesos)	
	1997	**1998**
Phil. Petroleum Sea Transport Assn.		
(PHILPESTA) - 5 Companies		
Company 1	55,206.00	56,819.00
Company 2	94,833.00	91,505.00
Company 3	169,257.00	188,542.00
Company 4	-	-
Company 5	26,619.00	36,747.00
TOTAL	**345,915.00**	**373,613.00**
Visayan Assn. of Ferry Boat and		
Coastwise Service Operators		
VAFCSO - 13 Companies		
Company 1	4,940.00	3,995.00
Company 2	5,703,514.00	9,787,645.00
Company 3	-	-
Company 4	-	31,947.01
Company 5	2,483.32	5,382.11
Company 6	2,978.13	6,103.99
Company 7	90,608.00	55,998.80
Company 8	4,157.00	2,689.00
Company 9	122,375.00	130,579.00
Company 10	338.00	416.00
Company 11	4,462.06	1,090.88
Company 12	986.66	960.63
Company 13	4,880.48	3,820.00
TOTAL	**5,941,722.65**	**10,030,627.42**
Southern Mindanao Shipowners Assn.		
(SMSA) - 5 Companies		
Company 1	4,205.49	6,271.75
Company 2	3,294.38	3,146.69
Company 3	2,471.00	2,699.00
Company 4	10,821.00	11,091.00
Company 5	4,199.26	1,350.86
TOTAL	**24,991.13**	**24,559.30**
Domestic Shipowners Assn.		
(DSA) - 9 Companies		

Company 1	-	2,455.00
Company 2	254,781.00	272,141.00
Company 3	-	48,594.00
Company 4	-	29,532.00
Company 5	763.51	1,733.69
Company 6	731,614.00	670,653.00
Company 7	653,819.00	734,667.00
Company 8	1,714,619.00	1,607,050.00
Company 9	2,397,844.00	2,215,905.00
TOTAL	**5,753,440.51**	**5,582,730.69**
Other Shipping Companies		
(Manila-Based) - 30 Companies		
Company 1	115,995.00	174,914.00
Company 2	1,198.00	4,134.00
Company 3	-	-
Company 4	-	-
Company 5	-	-
Company 6	-	11,772.36
Company 7	50,230.00	41,073.00
Company 8	-	-
Company 9	-	-
Company 10	-	-
Company 11	72,431.00	55,293.00
Company 12	37,481.00	1,290.00
Company 13	37,481.00	7,141.00
Company 14	36,333.00	25,031.00
Company 15	29,306.32	28,982.29
Company 16	56,177.00	43,908.00
Company 17	-	-
Company 18	-	-
Company 19	-	-
Company 20	-	-
Company 21	38,138.00	44,506.00
Company 22	23,302.00	25,048.00
Company 23	44,019.00	37,014.00
Company 24	125,335.00	166,703.00
Company 25	120,437.00	102,205.00
Company 26	875.40	764.10
Company 27	6,531.00	10,386.00
Company 28	80,600.11	84,497.34
Company 29	111,654.17	120,152.06
Company 30	29,521.00	40,724.00
TOTAL	**1,017,045.00**	**1,025,538.15**

Maritime Regional Office		
(MRO-Based) - 44 Companies		
Company 1	39.70	17.50
Company 2	-	-
Company 3	17,899.75	20,121.83
Company 4	33,199.00	19,633.00
Company 5	2,434.28	1,635.65
Company 6	-	-
Company 7	8,096.98	16,690.30
Company 8	2,997.00	3,611.00
Company 9	1,741.00	1,430.22
Company 10	8,024.46	5,560.81
Company 11	2,485.90	2,941.46
Company 12	7,823.84	8,109.91
Company 13	5,754.41	6,105.99
Company 14	168,203.00	156,608.00
Company 15	9,059.28	9,588.37
Company 16	3,067.66	3,102.50
Company 17	7,591.86	7,705.74
Company 18	175,757.00	152,629.00
Company 19	2,081.00	1,338.00
Company 20	2,496.50	3,255.30
Company 21	11,107.00	18,865.00
Company 22	-	7,132.75
Company 23	4,395.15	4,146.16
Company 24	1,262.80	1,399.10
Company 25	421,325.00	300,295.00
Company 26	298,955.00	328,848.00
Company 27	2,227.00	558.00
Company 28	12,604.00	11,107.00
Company 29	-	-
Company 30	909,090.91	272,727.27
Company 31	5,859.71	6,729.89
Company 32	4,176.63	2,332.34
Company 33	2,153.00	2,079.00
Company 34	5,159.09	6,147.05
Company 35	4,588.00	4,508.77
Company 36	-	-
Company 37	13,258.00	10,257.00
Company 38	3,781.06	5,044.10
Company 39	6,078.39	4,352.02
Company 40	4,017.00	2,892.00
Company 41	1,823.07	4,559.06
Company 42	5,780.39	2,207.13
Company 43	5,150.50	6,648.96

Company 44	1,923.72	3,170.88
TOTAL	**2,183,468.04**	**1,426,091.06**

Source: MARINA