Toward relaxing the cabotage restrictions in maritime transport

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and Adoracion M. Navarro

The present cabotage law is considered one of the serious bottlenecks to Philippine economic growth. The perennial inefficiencies in the maritime industry are linked to lack of competition due to barriers to entry, arising from the law’s provision that allows only domestic shipping lines to serve domestic routes. This has resulted in high cost of transporting raw materials to manufacturing sites, finished products and agricultural goods to various destinations, and imported products to distribution areas, thereby increasing operational costs that are passed on to consumers as higher prices. Philippine exports also become less competitive in the international market, which translates to lower export revenues. With few players in the industry, shipowners have less incentive to improve their fleets and services and charge lower fees.

This Policy Note presents the most essential facts about the Philippines’ cabotage policy. Its argument for reform is tackled by discussing the specific impacts of the cabotage restrictions and comparing the national policy with those of other countries. A reform path is suggested in the end and how it can be rationally pursued.

Background on the Philippines’ cabotage policy

Cabotage is traditionally a shipping term 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

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1 The etymology is derived from the French word “caboter” or to sail along the coast.
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. RA 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 (Table 1).

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 (Lorenzo 1997).

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. 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 reiterated and strengthened the cabotage restrictions found in RA 1937. Specifically, Sections 5 and 6 of Chapter 3 of RA 9295 restricted the participation of foreign vessels in domestic operations (Table 2).

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

<table>
<thead>
<tr>
<th>Section</th>
<th>Specific Provision</th>
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<tbody>
<tr>
<td>810</td>
<td>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.</td>
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<tr>
<td>902</td>
<td>Vessels Eligible for Coastwise Trade — The right to engage in the Philippine coastwise trade is limited to vessels carrying a certificate of Philippine registry.</td>
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<td>903</td>
<td>License for Coastwise Trade — All vessels engaging in the coastwise trade must be duly licensed annually.</td>
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<td>1009</td>
<td>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. Upon such reasonable condition as he may impose, the Commissioner [of Customs] 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.</td>
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</table>
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. This may create uncertainty in the shipping market.

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 2000 prices) or 0.24 percent 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. Interisland 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 percent 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 percent of the total passenger movements by air and sea transport. The domestic operating fleet is largely comprised of passenger vessels (58% of total) when examined in terms of the number of vessels per type (Table 3). In terms of gross tonnage, however, cargo vessels account for the highest share (also 58% of total).3

### Impacts of the cabotage restrictions

#### High domestic shipping cost

The very high cost of domestic shipping services provides a strong motivation for

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

3 All figures are from the 2013 Philippine Statistical Yearbook published by the National Statistical Coordination Board (NSCB).
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 percent 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 (Table 4).

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

**Lack of meaningful competition**
The high cost of domestic shipping services has been 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 2003; JFCCP 2010). According to Austria (2003), 10 years after the start of deregulation in 1992, the maritime transport industry was still largely dominated by a few players. In 2002, 50 percent of the primary routes and 70 percent of secondary/tertiary routes remained a monopoly, 90 percent 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 (2003) highlighted the need for government to ensure a more competitive environment so that the benefits 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. Nothing has changed since 2003 when Austria submitted that recommendation. In 2010, the JFCCP made the same claim that the domestic shipping is nearly cartelized.

Recent data from the Maritime Transport Authority (MARINA) also provide evidence

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<th>Basis</th>
<th>Domestic Shipping</th>
<th>Foreign Transshipment</th>
<th>Difference</th>
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<tr>
<td></td>
<td>via Hong Kong (HKG)</td>
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<tr>
<td>20 footer</td>
<td>MNL-CGY</td>
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<td>244.00</td>
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<tr>
<td></td>
<td>via Kaohsiung (KHH)</td>
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<td>20 footer</td>
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Source: Joint Foreign Chambers of Commerce in the Philippines (2010), Arangkada Philippines
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 achievement, domestic shipping lines continue to use smaller and even older vessels in transporting cargo, which are uncompetitive compared to those used by their foreign counterparts. Domestic shipping is still dominated by vessels that have a capacity of 200–300 twenty-foot equivalent units (TEUs). This capacity is inferior compared to that of foreign container ships that can carry as much as 5,000 TEUs (JFCCP 2010). The small capacity of cargo vessels implies longer transit and more turnaround times in ports, resulting in higher shipping costs.

The weak incentives to modernize are also evident in the ageing domestic fleet. Llanto et al. (2007) found out that domestic vessels for cargo in 2007 were generally 20 years old. 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 and 20 years old. The MARINA-reported average age of passenger vessels in 2012 is higher compared to the average age of 5–10 years old in the late 1990s as reported by Austria (2003); this indicates that the situation has worsened.

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 to foreign operators. This is done in Brooks (2009), which studied the range of cabotage regimes in selected countries, as illustrated in Figure 1.

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 toward a more liberal cabotage regime, that is, to the right in Figure 1. 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 trade liberalization in 1995 as a small part of a very comprehensive reform package that included trade, industrial, transport, and fiscal policies. By 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 of ensuring safe and environment-friendly ships freedom of access to shipping markets. Today, EU states can participate in the cabotage trade of any other EU state but each state may impose crew nationality requirement, vessel ownership requirement, 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. The Canadian cabotage regime, however, presents some economic disadvantages. While international operators may be able to access cheaper inputs in the global market, they are unable to follow triangulation routing patterns because of the cabotage regime. In certain routes, the unused capacity is sufficient to destroy the economies of scale in 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 United States, 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 has suffered a decline, from

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4 The term used in Brooks (2009) is “coasting” trade.

Source: Brooks (2009)
291 active ocean-going vessels in 1996 to 100 vessels in 2007.

Japan has a closed cabotage regime. However, in the Doha Round of the World Trade Organization, Japan committed to make certain service markets accessible to international maritime transport operators on reasonable and nondiscriminatory 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 nongovernment entities to participate in the shipping market. This then led to an oversupply of domestic shipping capacity. Market access was regulated in 1987 and non-Chinese companies were not allowed to engage in cabotage trades. In 2002, the cabotage regulation in maritime transport allowed foreign shipping to operate between Chinese ports in exceptional circumstances if permitted by the Ministry of Transport.

The Indonesian experience is frequently cited in the cabotage liberalization debate in the Philippines. Palabrica (2013) reported that, in the past, MARINA expressed apprehension toward 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. This law and its implementing rules took effect in 2011.

However, Indonesia subsequently had to amend the law and lifted cabotage restrictions in key economic activities 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 concerns over the ban on overseas shippers, Indonesia exempted certain classes of vessels used in the oil and gas industries from those restrictions (Bloomberg 2011). In addition, what often escapes scrutiny is the fact that the restoration of a restricted cabotage regime in Indonesia 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 also established in
2011. This is independent of the four state-owned port operators (Oxford Business Group 2012). We surmise that the reason behind this is the general clamor for lower domestic shipping costs and that a more competitive port management will help to bring this about.

Conclusions and suggested reform path

High domestic shipping cost and the Philippine cabotage policy are closely linked. The protection long enjoyed by the domestic shipping industry through cabotage restrictions results in the lack of meaningful competition in the industry and weak incentives for operators to modernize and become competitive. There are obviously 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 that maintain closed cabotage regimes, the general trend is to move toward a more open cabotage policy. The degree and manner of cabotage liberalization also depend on the developmental objectives to be met and should not be constrained by the demands of national ship operators/owners alone. Rather, cabotage policy reforms should balance the interests of consumers, traders, the labor sector, and ship operators/owners.

It is high time that policymakers seriously review and 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 loss of jobs arising from closure or weakening of domestic shipping and allied business activities.” However, we 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 need for market adjustments by foreign competitors interested in engaging in coastwise transport will also give domestic shipping operators ample time to modernize their fleet and operations to be more competitive. Competition provides a credible threat to those who refuse to modernize and maintain efficient operation.

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 as an opportunity to move the debate away from protectionism and toward the demand for reciprocity in opening markets. In this regard, we can take confidence in the fact that the issue of cabotage restrictions has been included in the discussions for a planned Association of Southeast Asian Nations (ASEAN) Single Shipping Market. The Master Plan on ASEAN Connectivity, adopted in October 2010, listed the cabotage issue as one of the key challenges in the formulation of a strategy to realize an ASEAN Single Shipping Market. In trying to draw lessons from the Brunei-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA) initiatives, the master plan reported that intra-EAGA maritime transport routes that were explored and tested by commercial operators were shown to have low load factors and cabotage restriction is one hindrance in achieving economies of scale (ASEAN 2010).

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 or not 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. A recent research paper on the market structure of high-value fruits and vegetables in Mindanao showed the importance of the quality of infrastructure (ports and road network) in interregional trade and recommended reforms in roll-on, roll-off (RORO) shipping services and privatization of port operations where there is scope for doing so (Llanto et al. 2013).

References
Republic Act 1937 or the Tariff and Customs Code of the Philippines.
Republic Act 9295 or the Domestic Shipping Development Act of 2004.

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New Publication

Higher education in agriculture: Trends, prospects, and policy directions
Edited by Roehlano M. Briones and Melvin B. Carlos

The declining enrollment in agriculture, forestry, and natural resources (AFNR) courses is an alarming phenomenon given the unbridled expansion of state universities and colleges (SUCs) in the past few decades. Congress has had a propensity to convert rural high schools into agricultural and forestry colleges, and later, into full-fledged SUCs, as part of political legacy building. The changing dynamics of the higher education sector, however, puts into question the sustainability of their agriculture and related programs, if not the very existence of these institutions themselves. Moreover, the enrollment downturn has dire consequences for the future human resource requirements of the AFNR sector.

This book examines each of these factors and points the way forward in transforming the educational sector to become more responsive to the new demands of the labor market. There is a need to rationalize AFNR higher educational and technical-vocational institutions while addressing skill shortages, degree requirements, and other crucial issues.