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POLICY OPTIONS FOR LIBERALIZING PHILIPPINE MARITIME CABOTAGE RESTRICTIONS

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Policy options for liberalizing Philippine maritime cabotage restrictions[1]

Contents

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Executive Summary

Introduction

1. **Being an archipelago, the Philippines requires an efficient water transport system. However, this is presently not the case. The domestic shipping industry is characterized by high costs, low quality of service, and a poor safety record** (Table 1). Logistics costs account for 24-53 percent of wholesale price, while shipping and port handling cost around 8 percent of wholesale price and 5 percent of retail price.[2] Philippine domestic shipping is generally more expensive than in Malaysia or Indonesia—2 other archipelagos. Moreover, it is more expensive to transport goods between 2 Philippine ports than between 2 Philippine ports via an international port. In the East Asia region, the Philippines trails behind its neighbors in various logistics performance and connectivity indices. For instance, in liner shipping connectivity, the Philippines ranked 66th out of 157 countries in 2013, and performs the worst among a group of East Asian comparators.[3,4] Delays in shipment, slow cargo handling, and frequent accidents are the top complaints of businesses. In the East Asia Region, the Philippines has the highest absolute casualty rate, which is 40 percent higher than the second-ranked country, Indonesia.[5] On average, there are 228 ships involved in accidents and 303 casualties per year in the Philippines.

2. **Among the probable causes of the poor state of the domestic shipping industry is the lack of competition from more efficient foreign shipping companies.** More competition can serve as a disciplining force or an incentive to be more efficient. However, the country's laws restrict foreign shipping companies from serving domestic routes. This is known as cabotage.[6]

3. **Cognizant of these issues, the President has given priority to the reform of the country's cabotage provisions.** In his July 2013 state-of-the-nation address, President Aquino identified cabotage liberalization as a priority reform and asked congress to amend the cabotage provisions. Aside from cabotage reform, the government is also looking to enhance competition among domestic shipping firms and improve the efficiency of the ports system.

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[2] These prices are averages based on a sample of goods. See Tables 6 and 7 for a list of references for these goods.

[3] The Liner Shipping Connectivity Index captures how well countries are connected to global shipping networks. It is computed by the United Nations Conference on Trade and Development (UNCTAD) based on 5 components of the maritime transport sector: number of ships, their container-carrying capacity, maximum vessel size, number of services, and number of companies that deploy container ships in a country's ports.

[4] It can be argued that Philippine ships serving domestic routes are less efficient than Philippine ships serving international routes, given the high rate of maritime accidents and complaints from businesses. In this case, the liner shipping connectivity score for the Philippines provides an upper bound for the performance of domestic ships.

[5] The Philippines also has the highest relative casualty rate, surpassing Myanmar. This is measured by the ratio of total casualties to total fleet size.

[6] Cabotage traditionally refers to shipping along coastal routes, port to port, in the same country. Originally a shipping term, cabotage now also covers aviation, railways, and road transport. Cabotage restrictions are often defined as the exclusive right of a country to operate land, air, or sea traffic within its territory.

The objective of this package of reforms is to foster more competition in the shipping industry, help reduce shipping costs, and improve the services and safety standards in the industry. The National Economic and Development Authority (NEDA) was tasked to lead the reform efforts and asked the World Bank Group for advice on how to carry out this reform package.

4. **This policy note is part of a series of policy notes on improving the efficiency of the country's maritime sector.** Cabotage liberalization only addresses part of the overall challenge. It can help lower shipping costs of export and import goods and domestic container cargo, but is unlikely to lower the cost of transporting agricultural products, which are often carried in bulk. Complementary and more fundamental reforms in domestic shipping and ports are also needed to address these concerns. In this regard, 2 other notes were prepared together with the cabotage note. One policy note looks at how domestic competition in the shipping industry can be enhanced. The other note looks at how the efficiency of the ports system can be enhanced especially when cabotage is liberalized. All 3 notes are to be presented to the Cabinet Economic Cluster in the third quarter of 2014.

Table 1. Characteristics of the Philippine maritime sector

Sector Features	Measurement Indicator	Philippines	EAP
Weak competition	Share of primary routes served by a single operator (%)	40	NA
High shipping costs	Share of logistics costs to wholesale price (%)	24-53	20
High shipping costs	Share of shipping and port handling costs to wholesale price (%)	8.4	NA
High shipping costs	Share of shipping and port handling costs to retail price (%)	4.9	NA
Small domestic trading volumes	Domestic market throughput (millions of metric tons)	74	782
Low quality of services	Rank in liner shipping connectivity (out of 157)	66	17
Poor port infrastructure	Rank in quality of port index (out of 148)	116	47
Low profitablity	Average return on equity (%)	1	NA
Old vessel age	Average age of ships (years)	30	22
Poor safety standards	Average number of yearly accidents	228	32
Poor safety standards	Average number of yearly casualties	303	60

Sources: World Bank (2013), World Economic Forum (2013), JBIC (2002), Securities and Exchange Commission, MARINA, National Statistical Coordination Board, World Development Indicators, and Board of Maritime Inquiry, UNCTAD (2011), Various country statistical offices

Note: Average age of ships used was global average in the absence of data

Select East Asia and the Pacific countries are Singapore, Hong Kong, China, Malaysia, Thailand, Viet Nam, and Indonesia

A group of 5 international comparator shipping firms from the region were used for average return on equity

Philippine cabotage restrictions

5. **The legal basis for Philippine cabotage is found in the 1987 Constitution and several related laws and jurisprudences.** Article XII Section 11 of the 1987 Constitution restricts the ownership and operation of public utilities to citizens of the Philippines or to corporations with at least 60 percent Filipino equity. The term public utility is defined in the deliberations of the Constitutional Commission and in jurisprudences (i.e., decisions of the Supreme Court).[7] The

[7] See for instance Albano vs. Reyes (G.R. No. 83551, 11 July 1989) and Iloilo Ice and Cold Storage Co. vs. Public Utility Board (G.R. No. L-19857, 2 March 1923)

main laws which govern cabotage are: i) the Public Service Act (Commonwealth Act 146 of 1936 as amended by Republic Act [RA] 2677), ii) the Tariff and Customs Code of the Philippines (RA 1937 of 1957), and iii) the Domestic Shipping Development Act (DSDA) (RA 9295 of 2004).

6. **Foreigners are only allowed to engage in domestic shipping activities under 2 conditions:** i) through equity infusion of at most 40 percent in a Filipino shipping company, or ii) via a special permit as provided by Section 6 of the DSDA.

Benefits of cabotage liberalization

7. **International evidence suggests that opening up the domestic shipping industry to international competition can improve efficiency.** The experience of other countries points to a number of benefits from cabotage liberalization. For example, in New Zealand, freight rates declined between 25 and 50 percent following cabotage liberalization in 1995. Yet, the benefits can materialize even without actual entry of foreign shipping companies into the market. This is because the mere threat of competition from more efficient foreign shipping companies can serve as a disciplining force or an incentive to be more efficient, thereby lowering shipping costs. For certain types and quantities of cargo (mostly containerized cargo), the use of larger and more advanced foreign-flagged vessels can reduce costs by taking advantage of economies of scale and cargo optimization. For instance, allowing the shipment of domestic cargo in the domestic leg of an international vessel with spare capacity due to imbalanced trade could be cheaper than shipping them on smaller domestic ships that lack scale and transferring them to an international ship. Similarly, export and import cargo can benefit from economies of scale by avoiding unnecessary cargo transfers from a domestic vessel to an international vessel. Finally, with complementary reforms in the ports and roads sector, shipping costs can be reduced further.

8. **Cabotage liberalization can help improve service and safety standards.** Adherence to international safety standards and good practices, introduction of improved technology, and a reduction in the acquisition costs of new and safer vessels can come with cabotage liberalization. These can help the domestic maritime industry raise its service and safety standards, resulting in more efficient travel and freight delivery, and fewer maritime accidents.

9. **Economy-wide, cabotage liberalization can help raise real income, create more and better jobs, and reduce poverty.** The entry of global technology and expertise alongside cabotage liberalization can help the Philippines become more integrated into the international and regional shipping industry. In addition, it can further strengthen its comparative advantage as a world-class provider of maritime manpower, as the Philippines already accounts for 25 percent of global seafarers. Potential reduction in prices brought about by cabotage liberalization can open up new market opportunities and create new jobs. With improved service and safety standards, more goods will arrive on time and the risk of maritime accidents

will be lowered, thereby reducing business volatility and the need for costly insurance. In turn, this can further contribute to lowering consumer prices and increasing business profitability. Finally, cabotage reform can help the country develop its exports sector and create jobs in manufacturing, while helping the Philippines prepare for more intense competition in a future open ASEAN market.

Forms of cabotage liberalization

10. **Cabotage restrictions can be liberalized by increasing the scope of exemptions or making the nationality criteria more inclusive.** Exemptions can cover the following: i) the non-availability of a suitable ship (e.g., a large enough ship to address scale), ii) ancillary cargo (i.e., export or import cargo), iii) adjunct cargo (i.e., domestic cargo on the domestic leg of an international vessel with spare capacity), and iv) specific high impact activities such as routes between major ports, major import and export products, and ships that are large enough to provide scale. Options to make the nationality criteria more inclusive include: i) gradually increasing the allowable share of foreign equity from the current 40 to 100 percent, ii) allowing foreign management of shipping companies, iii) facilitating the entry of leased vessels and other forms of vessel importation, iv) allowing dry docking (i.e., repair and maintenance of ships) outside the country, v) allowing foreign crew members when no Filipinos qualify, and vi) easing the process of acquiring time and bareboat charters.[8]

Reform options

11. **Liberalizing cabotage restrictions can be implemented either swiftly and radically, or gradually**. Typically, a swift and radical approach implements the various components of a reform simultaneously, while rallying key supporters who will make implementation easier. While this approach requires considerable political support, the main premise is that speedier and more comprehensive reforms would yield larger immediate returns, making the reform package quickly irreversible.

12. **On the other hand, a gradual approach would implement the reforms over a longer period of time**. This approach would work best when vested interests are strong within the status quo and uncertainties surround the outcome, thereby putting a premium on lessons learned from the implementation of earlier components of the reforms. The country's past reform experiences have mostly followed a gradual approach (e.g., banking, aviation, and retail trade). A gradual approach may be less contentious and thus more politically feasible. It has several other advantages. It can give affected parties ample time to adjust, provide

[8] Time charter refers to leasing a vessel with its own crew. Bareboat charter refers to leasing only the vessel. The Philippines allows time charters up to a maximum of 1 year while bareboat charter is allowed for a minimum of 1 year.

policymakers room to learn from earlier phases and improve the next phases of liberalization, generate early results to convince skeptics of the benefit of the reform, and build momentum and support for the more difficult reform—constitutional change. However, a more gradual approach could also provide opportunities to delay and postpone the reforms.

13. **A swift and radical approach goes directly to amending the 1987 Constitution.** Being the fundamental source of cabotage, an amendment to the constitution would remove the fundamental barrier to cabotage liberalization, making the reform swifter and more decisive. This reform entails removing the foreign ownership restriction on shipping, and all other public utilities, and relegating the decision to impose restrictions to Congress or the President via the bi-annual Foreign Investment Negative List. By lifting restrictions on all public utilities, cost reduction for the entire logistics chain can be better realized than if only shipping were to be liberalized.

14. **Following a constitutional amendment, a new shipping law could be enacted to gradually liberalize cabotage restrictions over a specified period of time**. The new legislation could: i) gradually increase the allowable foreign equity share from 40 to 100 percent, ii) allow foreign vessels to carry ancillary and adjunct cargo between two domestic ports, and iii) expand the list of exemptions over time to explicitly include specific activities that have high economic value. However, the phasing in of reforms should be time-bound, so as to avoid uncertainty and distortions arising from lengthy processes.

15. **Alternatively, a more gradual approach could be adopted, beginning with steps that only require executive action, such as simplifying procedures, granting more special permits, and promoting time and bareboat charters (see Table 2 for a summary).** Special permits could be given more frequently to ancillary and adjunct cargo, and high impact routes as these can help lower shipping cost and improve efficiency—2 reasons that can justify the public interest criterion for the grant of special permits. Time and bareboat charters could be promoted to facilitate the access of domestic firms to better ships and more innovative maritime technologies and practices from abroad. Chartering lowers the upfront investment costs for deploying better and more efficient ships, particularly those that comply with international safety standards.

16. **Moreover, to facilitate partnering between domestic and foreign operators without requiring constitutional change, the government could facilitate the licensing of combined "international-domestic" routes (e.g., Hong Kong-Manila-Cebu) for domestic shipping lines**. Currently, the licensing of such routes requires special permits for each conversion from a local to an overseas route and vice versa. Such reforms would enable local shipping companies to partner with foreign companies, giving them access to better prices for the purchase or lease of new ships, a larger market, and state-of-the-art shipping management and information systems. Because of stricter enforcement of safety standards on international routes, this would result in an upgraded domestic fleet and consequently fewer maritime accidents. Most importantly, it would allow operators to maximize the cargo load of ships with an optimum mix of domestic and export cargo.

17. **Gradual liberalization should be accompanied by measures to level the playing field between foreign and domestic firms**. Concerns about the vulnerability of domestic firms to foreign competition can be addressed by a number of complementary measures. These include i) removing the requirements for domestic ships to dry dock and refuel exclusively in the Philippines, thereby reducing operational cost, and ii) introducing tax measures that would treat domestic and foreign shipping companies on equal footing. Since international vessels are not subject to income tax like domestic firms are, a tonnage tax could be introduced. The tonnage tax would be charged only on income from the particular shipping operation, but not on all operations of the shipping company. It would allow for more equal competition, as the difference in the cost of conducting operations between domestic and international sectors of the industry would be reduced.

18. **Reforms which require legislation and constitutional change can then follow in the medium-term.** These could include amending the Domestic Shipping Development Act (DSDA) to define aspects of shipping that can be considered as a non-public utility, followed by amending the Constitution and enacting a new shipping law that would gradually phase out cabotage.

Table 2. Gradual approach

Steps	Details
Take executive action	i. Simplify procedures surrounding the issuance of certificates of public convenience. ii. Grant more special permits using lower cost and improved efficiency as justifications for the public interest criterion. iii. Promote time and bareboat charters. iv. Facilitate the licensing of combined "international-domestic" routes (e.g., Hong Kong-Manila-Cebu) for domestic shipping lines.
Enact complementary reforms in domestic shipping to level the playing field	i. Remove the requirements for domestic ships to dry dock (i.e., repair and maintenance of ships) and refuel in the Philippines. ii. Introduce tax measures, such as a tonnage tax, that would treat domestic and foreign shipping companies on equal footing.
Amend current legislations	Amend the Domestic Shipping Development Act to define aspects of shipping that can be considered as a non-public utility.

	Amend the Tariff and Customs Code to allow the domestic transshipment of import and export cargo on foreign vessels.
Amend the constitution	Remove the foreign ownership restriction on all public utilities - not just shipping - and relegate the decision to impose restrictions to Congress or to the President via the bi-annual Foreign Investment Negative List.
Enact a new shipping law	A new shipping law could be enacted to gradually liberalize cabotage restrictions over a specified period of time. The new legislation could: i. Gradually increase the allowable foreign equity share from 40 to 100 percent. ii. Allow foreign vessels to carry ancillary and adjunct cargo between 2 domestic ports iii. Expand the list of exemptions over time to explicitly include specific activities that have high economic value.

Introduction

19. **The purpose of this policy note is to present reform options on cabotage liberalization.** The goal of cabotage liberalization is to help i) foster more competition in the domestic shipping industry, ii) reduce shipping cost, and iii) improve efficiency, maritime services, and safety standards. These, together with complementary reforms in domestic shipping and ports, can help enhance consumer and producer welfare through lower consumer prices, higher household real income, timely delivery of goods, and ultimately, job creation and poverty reduction through greater market access.

20. **Cognizant of the problems besetting the Philippine maritime sector, the President has given priority to the reform of the cabotage provisions.** In his July 2013 State of the Nation Address, President Aquino identified cabotage liberalization as a priority reform and asked congress to amend the cabotage provisions "in order to foster greater competition and to lower the cost of transportation for agricultural sector and other industries."[9]

21. **The National Economic and Development Authority (NEDA) has been tasked to lead the reform.** Aside from lifting cabotage restrictions, NEDA is also looking to enhance competition among domestic shipping firms and improve the efficiency of the ports system. The Secretary of NEDA has turned to the World Bank for advice on how to carry out this reform package.

22. **This policy note is part of a series of studies on improving the efficiency of the country's maritime sector.** Cabotage liberalization only addresses part of the overall challenge. While it can help lower shipping costs of export and import goods and domestic container cargo, it is unlikely to lower the cost of transporting agricultural products, which are often carried in bulk. Complementary and more fundamental reforms in domestic shipping and ports are also needed to address these concerns. In this regard, 2 other notes were prepared together with the cabotage note. One policy note looks at how domestic competition in the shipping industry can be enhanced. The other note looks at how the efficiency of the ports system can be enhanced especially when cabotage is liberalized. All 3 notes are to be presented to the Cabinet Economic Cluster in the third quarter of 2014.

23. **This policy note on cabotage is organized as follows.** Part I provides an overview of the domestic shipping industry and discusses the key issues that it faces. Part II discusses the underlying reasons for the industry's inefficiency. Part III discusses the concept of cabotage, the

[9] The technical report of the 2013 State of the Nation Address explains that amendments to the cabotage provisions are needed to "remove from local shipping operators the exclusive privilege of conducting coastwise trade and allow foreign shippers to engage in the same, thereby enabling the country to benefit from lower prices and greater efficiency brought about by open competition. The proposed legislation will also include provisions rationalizing sea transport costs."

cost and benefit of cabotage liberalization, and the cabotage regimes of the Philippines and of selected countries. Part IV closes with a discussion of reform options.

Inefficiencies in the Philippine shipping industry

Significance of the industry

24. **The Philippine ports and shipping sectors account for a very small share of GDP and employment**. Between 2008 and 2013, the 2 sectors account for only 0.2 percent of gross value-added. Average growth was slower at 3.9 percent compared to the economy-wide growth of 4.8 percent (Table 3). In 2010, employment in these sectors was estimated at around 54,000 (57,000 in 2013), of which around 18,000 were formally employed (Table 4).[10]

Table 3. GDP and sector performance

	2008	2009	2010	2011	2012	2013	Average
Share to total real GDP (%)							
GDP	100	100	100	100	100	100	100
Services	55	56	56	56	57	57	56
Transportation, Storage and Communication	8.1	8.0	7.5	7.5	7.6	7.5	7.7
Water Transport	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Growth rate (%)							
GDP		1.1	7.6	3.6	6.8	7.2	5.3
Services		3.4	7.2	4.9	7.6	6.9	6.0
Transportation, Storage and Communication		-0.1	1.0	4.3	8.1	5.6	3.8
Transportation		-1.9	-0.6	4.8	7.8	5.8	3.2
Water Transport		-20.0	11.6	11.7	12.1	-0.9	2.9

Source: Philippine Statistics Authority

Table 4. Employment

	LFS						ASPBI
	2008	2009	2010	2011	2012	2013	2010
Employment (in thousands)							
Services	17,196	18,111	18,873	19,722	19,740	20,141	2,609
Transportation, Storage and Communication	2,595	2,685	2,726	2,779	2,805	2,875	255
Transport	2,171	2,234	2,276	2,326	2,529	2,637	138
Water Transport	52	51	54	56	55	57	18
Total	**34,088**	**35,062**	**36,034**	**37,191**	**37,558**	**38,050**	**3,966**
Share to total employment (%)							
Services	50.4	51.7	52.4	53.0	52.6	52.9	65.8
Transportation, Storage and Communication	7.6	7.7	7.6	7.5	7.5	7.6	6.4
Transport	6.4	6.4	6.3	6.3	6.7	6.9	3.5
Water Transport	0.2	0.1	0.2	0.2	0.1	0.1	0.4

Source: Labor Force Survey, Annual Survey of Philippine Business and Industry

[10] Total employment is based on the 2010 Labor Force Survey while formal employment is based on the 2010 Annual Survey of Philippine Business and Industry.

25. **Yet, the efficiency of ports and shipping operations has a significant impact on prices and jobs, given the archipelagic geography of the country.** For instance, around 15 million agriculture workers in the Philippines depend on these 2 industries to connect to markets and sell their produce. In the Visayas, 18 million people rely on shipping to access the majority of their goods, including food. In Mindanao, 22 million people rely on shipping for most manufactured goods given its weak manufacturing sector. Its farmers also rely on shipping to bring their produce to Manila and to the rest of the world.

26. **Currently, the domestic maritime industry is beset with a number of inefficiencies.** These include the high cost of shipping, the low quality of service, and a poor safety record that manifests in frequent maritime accidents. These issues strongly suggest that the liberalization of the industry, which started in 1989, has yet to result in more efficiency and greater innovation. Box 1 discusses the liberalization of the domestic shipping industry.

Box 1. Liberalization of the domestic shipping industry

Pre-reform regulatory framework

Regulation of the domestic shipping industry was first introduced during the American colonial period and was patterned after the US Jones Act and the Passenger Vessels Services Act. This sought to balance 2 objectives: protect the public from exorbitant tariffs and prevent "ruinous" competition among shipping operators. The Board of Transportation (BOT) was initially charged with regulating the industry, which covers route entry and tariff determination, until the creation of the Maritime Industry Authority (MARINA) in 1985.[11]

Between 1928 and 1985, the basic structure of tariffs remained largely unchanged.[12] Tariffs were adjusted periodically and across-the-board for inflation. Upward adjustments were also made using the revenue deficiency method, which determined the tariff needed to provide a rate of return[13] (ROI) consistent with the Public Service Act of 1936 (Commonwealth Act No. 146).

The shipping industry was initially exempted from a government regulation requiring operators of all public services to obtain a certificate of public convenience (CPC).[14] Route

[11] MARINA was created under Presidential Decree No. 474 and mandated to provide effective supervision, regulation, and rationalization of the organizational management, ownership, and operations of all water transport utilities and other maritime enterprises.

[12] See Renardet Sauti Consulting Engineers (1986) for a more detailed discussion.

[13] The maximum allowable ROI for public utilities has always been 12 percent.

[14] The Public Service Act stipulates in Section 13 (a) that "the Public Service Commission shall have no authority to require steamboats, motor ships and steamship lines, whether privately-owned, or owned or operated by any Government controlled corporation or instrumentality, to obtain certificate of public convenience or to prescribe their definite routes or lines of service."

licensing was introduced in 1972. It restricted competition to prevent "*overtonnage"* on major routes and ensure the availability of service for the smaller and less lucrative routes.[15]

Liberalization

Beset with large-scale inefficiencies in the industry and frequent maritime accidents, the government embarked on a gradual liberalization of the industry beginning in 1989. The setting of both passenger and freight tariffs, as well as routes, was gradually and partially liberalized.

The liberalization of tariffs began with the removal of ad valorem charges on passenger tariffs. In 1990, the 30 percent valuation surcharge for insurance premiums was abolished and freight tariffs for refrigerated cargoes, transit cargoes, and livestock were liberalized. In 1992, freight tariffs for Class A and Class B cargoes were liberalized.[16] Through Executive Order 213 of 1994, all freight tariffs were liberalized except for non-containerized basic commodities. Full tariff liberalization was achieved in 1999 with the abolition of the Domestic Shipping Consultative Councils (DOSCONs), allowing shipping operators to fully set their own tariffs.[17]

In 1992, route liberalization was introduced through Memorandum Circular Nos. 71 and 80, which opened routes to at least 2 operators. Protection for developmental routes (i.e., low volume routes) was limited to a maximum of 5 years after which the route was opened to other operators.[18] Executive Order 185 of 1994 further strengthened liberalization efforts by allowing operators to charge market-accepted freight and passage rates different from the fork rates (i.e., indicative or reference rates provided by MARINA) upon their provision of pioneering technological innovation of shipping service in a developmental route.

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[15] See Nathan Associates (1991) for a more detailed discussion.

[16] Class A cargo includes processed goods or high value manufactured goods. Class B cargo includes semi-processed goods or low value manufactured goods.

[17] Prior to 1999, shipping operators were not allowed to determine their own tariffs. Instead, tariffs were negotiated through the Domestic Shipping Consultative Councils (DOSCONs), which was composed of shippers/consumers, operators, and government representatives.

[18] Before deregulation, protection was granted for an indefinite period (i.e., until the initial investment is recovered).

High cost of shipping

27. **Domestic shipping costs per mile are high.** On average, Philippine shipping cost is significantly more expensive than Indonesia's and slightly more expensive than Malaysia's. The average port-to-port cost per nautical mile in the Philippines is USD 1.47, higher than Indonesia's USD 0.77 and slightly higher than Malaysia's USD 1.36 (Table 5).[19]

Table 5. Domestic shipping cost in the Philippines, Indonesia, and Malaysia

		Cost						Freight cost per NM		
Origin	**Destination**	**Door to door (local currency)**	**Door to door (USD)**	**Port to port (local currency)**	**Port to port (USD)**	**Destination port domestic throughput (MT)**	**Distance (NM)**	**Door to door**	**Port to port**	**Number of operators**
Malaysia										
Kuala Lumpur	Kuching	5,126	1,589	3,626	1,124	9,188,635	653	2.43	1.72	NA
Kuala Lumpur	Kota Kinabalu	5,756	1,784	3,976	1,233		1005	1.78	1.23	NA
Kuala Lumpur	Sandakan	6,176	1,915	4,576	1,419		1250	1.53	1.13	NA
								1.91	**1.36**	NA
Philippines										
Manila	Cebu	36,000	827	26,150	600	18,169,471	404	2.05	1.49	4
Manila	Cagayan do Oro	38,000	873	28,495	654	6,171,957	504	1.73	1.30	5
Manila	Davao	44,000	1,010	33,320	765	4,081,487	829	1.22	0.92	5
Manila	Iloilo	42,000	964	33,320	765	3,516,048	355	2.72	2.15	4
Average								**1.93**	**1.47**	
Indonesia										
Jakarta	Pontianak	12,250,000	1,065	5,000,000	435	46,546,000	420	2.54	1.04	NA
Jakarta	Makassar	9,500,000	826	5,300,000	461	11,335,000	762	1.08	0.60	NA
Jakarta	Banjarmasin	10,500,000	913	6,300,000	548	7,642,000	579	1.58	0.95	NA
Jakarta	Medan	9,500,000	826	6,000,000	522	7,303,000	861	0.96	0.61	NA
Jakarta	Balikpapan	12,250,000	1,065	5,800,000	504	2,841,000	765	1.39	0.66	NA
Average								**1.51**	**0.77**	NA

Source: World Bank Group staff inquiries of various shipping firms.

28. **Ironically, it is more expensive to transport goods between 2 domestic points than 2 domestic points via an international point.** For example, transporting goods in a 40-foot container from Manila to Cagayan de Oro costs some USD 1,860 but transporting between Manila and Cagayan de Oro via Kaohsiung would reduce the tariff by USD 716 to only USD 1,144 (Table 6). Moreover, a comparison of shipping costs in selected domestic and international routes indicates that domestic routes are more expensive than international routes on a per mile basis. For instance, the shorter Manila-Davao route is more expensive than the longer Hong Kong, Bangkok, and Port Klang to Manila routes (Table 7).

[19] These estimates are based on the average values of available data. One issue with these estimates is that they do not compare the same products. A better approach would be to acquire the shipping costs of multinational companies (such as Nestlé or Unilever) that are present in the Philippines, Malaysia, and Indonesia, for the same product. This could form part of future analysis.

Table 6. Cost of shipping between 2 domestic points and 2 domestic points via an international point

Cost (in USD) of domestic shipping vs. Foreign transhipment			
Type of shipping container	**Manila-Cagayan de Oro**	**Manila-Hong Kong-Cagayan de Oro**	**Difference**
20 Footer	1120	644	476
40 Footer	1860	1144	716
	Manila-Cagayan de Oro	**Manila-Kaohsiung-Cagayan de Oro**	**Difference**
20 Footer	1120	519	601
40 Footer	1860	1044	816

Source: Data gathered by Royal Cargo as of October 2010 as cited in the Joint Foreign Chambers of the Philippines

Note: 1. The difference is equal to cost savings from using foreign transhipment routes instead of a single domestic ship carrying a good from Manila to Cagayan de Oro.

Table 7. Comparative shipping costs in selected domestic and international shipping routes

Indicators	MNL-DVO	HKG-MNL	BKK-MNL	KLANG-MNL
Distance (in nautical miles)	519	619	1,189	1,343
Sailing time (no. of days)	1.5	1.5	8	8
Freight/nautical miles (in USD)	1.2	0.4	0.5	0.5

Source: G. L. Lanto & E. Basilio, 2005

Note: MNL – Manila; DVO – Davao; HKG – Hong Kong; BKK – Bangkok; Klang – Port Klang, Malaysia

29. **As a result, domestic shipping costs are a substantial part of logistics costs in the Philippines.** Logistics costs account for 24 to 53 percent of wholesale price in the Philippines compared to less than 20 percent in other countries in the East Asia region.[20] Shipping and port handling costs account for an average of 35 percent of logistics cost, 8 percent (to as high as 30 percent) of wholesale price depending on the goods and routes, and an average of 5 percent of retail price (Tables 8 and 9).[21]

[20] Part of the high cost of logistics in the Philippines is driven by its archipelagic geography. However, Indonesia, another archipelago, has lower unit shipping cost (Table 4). This indicates that geography alone does not fully explain why the Philippines has high logistics cost.

[21] These figures are based on data from Japan Bank for International Cooperation [JBIC] (2002) and University of Asia and the Pacific Industry Monitor (2002) as cited in Japan International Cooperation Agency and Maritime Industry Authority (2005). JBIC (2002) was cited by Hussein S. Lidasan and Jun T. Castro in their PowerPoint presentation titled "Philippine Intermodal Logistics System and Policies," delivered in a logistics conference held in Dusit Hotel, Makati, Metro Manila, on February 5, 2009.

Table 8. Shares to total logistics cost (%)

	Average
Shipping	27.2
Ports (cargo handling)	6.9
Trucking	39.5
Storage	17.9
Handling	32.8
Others	30.3

Sources: Arnold and Villareal (2002), JBIC (2002), JICA and MARINA (2005), BAS (2011a), BAS (2011b), and University of the Philippines Mindanao (2013)

Table 9. Average shares to total logistic costs and Philippine prices… (%)

	Logistics cost	Wholesale price	Retail price
Shipping	27.2	6	2.8
Ports	6.9	2.4	2.1
Shipping and ports	34.1	8.4	4.9

Sources: Arnold and Villareal (2002), JBIC (2002), JICA and MARINA (2005), BAS (2011a), BAS (2011b), and University of the Philippines Mindanao (2013)

30. **However, such comparisons should be treated with extreme caution.** There are several factors that may generate differences in tariff rates which should be taken into account:

- International shipping lines benefit from economies of scale as they tend to have larger container vessels carrying at least 800 twenty-foot equivalent unit (TEU) compared to local cargo vessels with 150 – 200 TEU capacity and significantly less for passenger, break bulk, and container combination vessels.
- Vessels utilized in domestic shipping are geared vessels (i.e., with cranes),[22] which are more expensive to acquire and operate, given the limited supply of geared vessels. Most ports in the Philippines do not have specialized cargo handling equipment needed to service gearless container vessels. Container vessels on international routes are normally gearless (i.e., without cranes) since the ports they serve have complete cargo handling equipment.
- International liner shipping operates under a different regulatory and market environment and is not subject to the same rules as domestic shipping in the Philippines. Vessels are often registered under so-called “flags of convenience,” which bring certain cost advantages.
- The international feeder routes, which feed into mega-container vessels with capacities of 12,500 TEUs at hub ports. Feeder tariffs do not necessarily reflect the stand-alone costs of the feeder ship operation.
- Freight rates are strongly influenced by the direction of trade. If trade is significantly imbalanced, rates in the higher volume direction will be much higher than in the reverse direction.

[22] Geared vessels or vessels with onboard cranes are slowly being phased out as major international ports already provide their own gantry cranes to load/unload containers. Refrigerated vessels or reefer vessels are specialized vessels used in the transportation of cargo requiring refrigeration such as pineapples, mangoes, etc. With the widespread use of refrigerated containers by international cargo liners and their increasing allocation of slots on vessels for reefer containers, the need for reefer vessels has also diminished significantly.

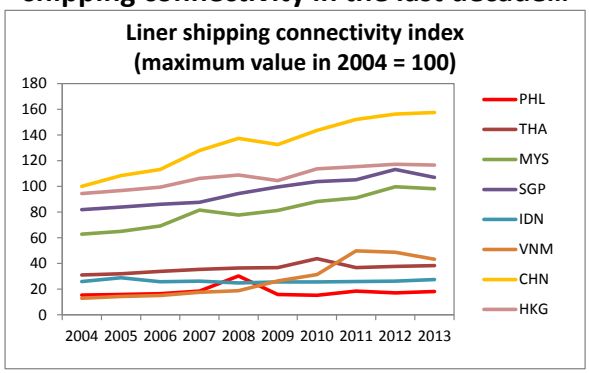
- Quoted freight rate may or may not include terminal handling charges at either end of the journey. These costs may comprise a significant percentage of total shipping cost (typically one-third, but can be more than 50 percent under some circumstances).

For these reasons, comparison between international and domestic freight rates cannot be regarded as firm evidence that domestic freight rates reflect excessive costs, or that domestic shipping operators are making excess profit.

Low quality of service

31. **Domestic shipping is characterized by low quality of service.** In the East Asia region, the Philippines trails behind its neighbors in various logistics performance and connectivity indices. For instance, in liner shipping connectivity,[23] the Philippines ranked 66th out of 157 countries in 2013, and performs the worst among a group of East Asian comparators.[24] It is at the bottom in terms of frequency with which shipments are delivered within expected time and is third to the bottom in terms of arranging competitively priced shipments (Figure 1 and Table 10). Moreover, the Philippines has shown minimal improvements in the last 10 years.

Figure 1. Deterioration in Philippine shipping connectivity in the last decade…



Source: WDI

Table 10. …as well as in other logistics performance indicators.

Logistics performance index (1=low to 5=high), average for 2007-12

	Frequency with which shipments are delivered within expected time	Ease of arranging competitively priced shipments	Quality of trade and transport-related
Singapore	4.35	3.90	4.23
Hong Kong	4.18	3.80	4.04
Malaysia	3.90	3.48	3.45
China	3.81	3.40	3.50
Thailand	3.81	3.25	3.20
Indonesia	3.47	2.93	2.71
Vietnam	3.45	3.10	2.71
Philippines	3.34	3.12	2.56

Source: WDI

32. **Low quality of service is also pronounced in cargo handling.** The lack of high quality shore-based handling equipment is reflected in poor cargo handling productivity and delays in many ports. Interviews with various stakeholders reveal that cargo handling performance, especially in the loading and unloading of break bulk cargo, is poor. This results in significant

[23] The liner shipping connectivity index captures how well countries are connected to global shipping networks. It is computed by the United Nations Conference on Trade and Development (UNCTAD) based on five components of the maritime transport sector: number of ships, their container-carrying capacity, maximum vessel size, number of services, and number of companies that deploy container ships in a country's ports.

[24] It can be argued that Philippine ships serving domestic routes are less efficient than Philippine ships serving international routes, given the high rate of maritime accidents and complaints from businesses. In this case, the liner shipping connectivity score for the Philippines provides an upper bound for the performance of domestic ships.

delays in shipping, higher shipping costs, poor cargo handling productivity, and decreasing service reliability (IFC 2013b).

Poor safety record and high frequency of maritime accidents

33. **The industry's low quality of service and poor safety standards are most evident in the high number of maritime accidents.** A comparative analysis from the ASEAN-Japan Transport Partnership database shows that in the East Asia Region, the Philippines has the highest casualty rate. This is 40 percent higher than the second ranked country, Indonesia (Table 11).[25] On average, there were 228 ships involved in accidents and 303 casualties per year in the Philippines from 2004 to 2012. Philippine Coast Guard (PCG) data also show a similar trend. From 1995 to 2006, there were 1,982 maritime accidents, or an average of 167 accidents per year. Casualties (both in terms of lives lost and missing people) numbered 2,482, or an average of 207 per year (Figure 2). Of the cases documented by the PCG, around 80 percent had the potential to compromise safety of cargo, and more importantly, of the passengers and crew. The most frequent type of maritime accident was capsizing (30 percent), followed by ship grounding (18 percent), and sinking (17 percent) (Figure 3). Box 2 discusses some of the country's major maritime accidents.

Table 11. Casualties and ships involved (2004-2012)

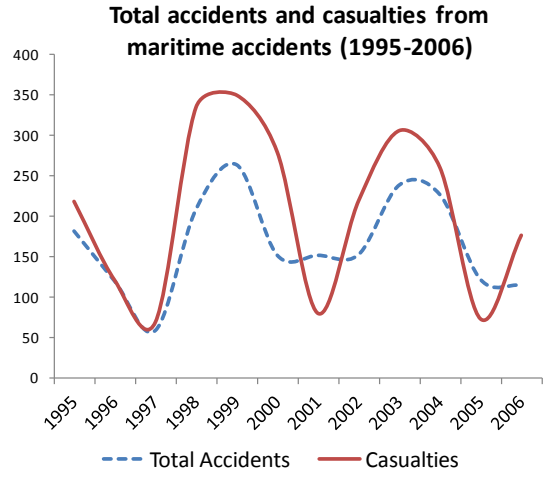
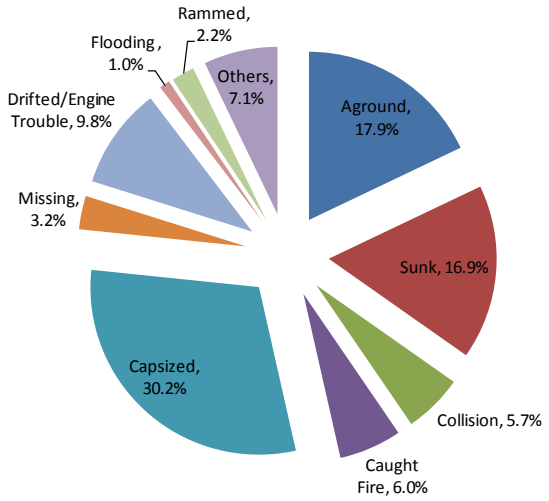
	Casualties	Number of ships involved	Casualties/Total fleet size
Singapore	0	2	0
Myanmar	13	13	0.046
Thailand	31	34	0.002
Vietnam	44	95	0.003
Indonesia	215	20	0.033
Philippines	303	228	0.118
Hong Kong	NA	NA	NA
China	NA	NA	NA
Malaysia	NA	NA	NA

Source: ASEAN-Japan Transport Partnership

Notes:

1. Total size of fleet is the sum of domestic cargo fleet, domestic passenger fleet, passenger river fleet, and cargo river fleet
2. There is no record of a domestic shipping fleet for Singapore. As a proxy, international merchant fleet was used

[25] The Philippines also has the highest relative casualty rate, surpassing Myanmar. This is measured by the ratio of total casualties to total fleet size.

Figure 2. Maritime accidents are frequent in the Philippines.	**Figure 3. Capsizing, grounding, and sinking account for over two-thirds of all maritime accidents.**
	
Source: Philippine Coast Guard.	Source: Philippine Coast Guard.

Box 2. Worst maritime accidents in the world

The Philippines is home to some of the worst peace-time maritime accidents in the world. In December 1987, MV Doña Paz, a passenger ferry owned by Sulpicio Lines with a capacity of 1,518 passengers, collided with MT Vector, a small tanker carrying 8,800 barrels of gasoline. The collision sparked a massive fire and resulted in the death of around 4,000 people, a clear indication that MV Doña Paz was severely overloaded. Only 26 survivors were reported. Preliminary investigations showed that the incident was a result of negligence and inability to follow proper safety regulations.[26] Despite ongoing investigation, Sulpicio Lines was allowed to continue operating.[27]

In June 2008, MV Princess of the Stars, also owned by Sulpicio Lines, sailed during a strong typhoon. Strong winds pushed it against the rocks. The ship capsized and resulted in over 1,000 casualties. Despite poor weather conditions, the ship's captain took the risk of continuing the trip, resulting in the country's worst maritime accident in 20 years. The Board of Maritime Inquiry concluded that human error led to the accident.

In August 2013, MV St. Thomas Aquinas, a passenger ferry owned by 2GO Shipping Lines, and Sulpicio Express Siete, a cargo ship owned by Philippine Span Asia Carrier (formerly Sulpicio Lines), collided in fair weather just 2 kilometers from the shore of Talisay City in Cebu

[26] An investigation by the Board of Marine Inquiry claimed that both owners and operators showed gross negligence and complete lack of care. The board found that the Vector Shipping Corporation did not possess a license to operate the vessel and that the crew of MT Vector was not qualified to run the tanker.

[27] In the absence of a final ruling, shipping companies can insist that they be allowed to continue operation.

Province. Over 116 lives were lost. As in the past, human error was determined to be the cause of the accident. According to preliminary investigations of the Board of Maritime Inquiry, the accident occurred because of a failure of the 2 ships to communicate. Sulpicio Express Siete, the outgoing vessel from Cebu, used the inbound lane leading to the collision with the inbound MV St. Thomas Aquinas.[28] The captains of both ships claimed that they tried to contact each other by radio in order to avoid crossing each other's path, but without success. Both the ferry and cargo ship also reportedly failed to comply with labor standards and safety regulations.[29] One of the safety regulations violated by both ships was the lack of the required safety committee members or safety officers to ensure the health and safety of the passengers and crew.

Source: Board of Maritime Inquiry and various news articles, notably
http://www.philstar.com/opinion/2013/08/19/1107101/editorial-dangerous-waters,
http://www.rappler.com/nation/37161-sulpicio-express-siete-wrong-lane-cebu,
http://www.gmanetwork.com/news/story/116375/news/nation/sulpicio-bucks-bmi-findings-on-princess-tragedy
http://newsinfo.inquirer.net/327123/dona-paz-victims-waiting-for-justice-25-years-after

Underlying reasons for the industry's inefficiency

34. **High shipping cost, low quality of service, and poor safety standards are caused by a number of factors.** In shipping, the oligopolistic market structure and low profitability leading to lack of investments in new ships are the main reasons for the industry's inefficiencies. Other sources of inefficiencies are the lack of market scale, which is exacerbated by the lack of connectivity, network planning, and consolidation, weak port infrastructure, and conflict of interest in the Philippine Ports Authority.

Oligopolistic market structure

35. **There are many companies offering commercial shipping services in the Philippines,[30] but scheduled operations (i.e., liners) are dominated by a few firms.[31] The bulk of sea freight**

[28] This suggests that, apart from human error, standard operating procedures and safety protocols were also violated. The investigation revealed that it was common practice for outbound ships to take the inbound lane to avoid shallow waters.

[29] This finding is based on the Department of Labor and Employment's initial investigation. The extent of non-compliance has not been finalized.

[30] Between 1996 and 2008, there was an average of 37 shipping firms in the Securities and Exchange Commission's (SEC) list of top 5,000 corporations. According to MARINA, there were 2,802 shipping operators in 2012, of which 555 are partnerships/corporations.

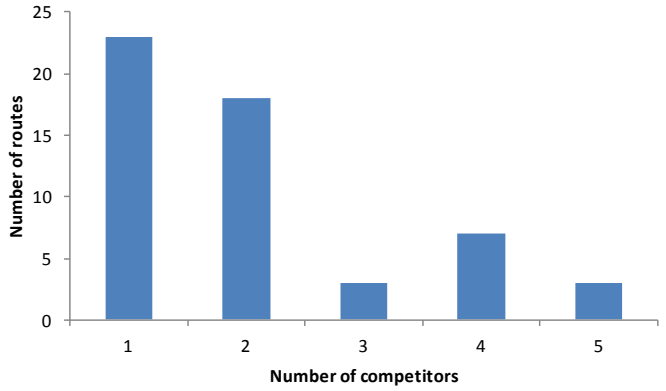
[31] The small number of dominant players in scheduled operations is the result of several mergers. For instance, in 2010, Negros Navigation acquired Aboitiz Transport System Corporation (ATSC) and all its subsidiaries to form 2GO Group. This new company also acquired several other major players such as Supercat Fast Ferry, Philippine Fast Ferry Corporation, and Cebu Ferries Corporation. Philippine Fast Ferry, in turn, is the result of the merger between

is provided by tramp services. Tramp operators provide an alternative to scheduled operations, mostly for bulk or break bulk cargo on a contract basis. Their ports of call cover those that are not served by liners. Their rates are not reported to MARINA. While required to have a certificate of public convenience (CPC) as a tramp operator, their operations are seldom monitored and no statistics are available on the volume of cargo carried.

36. **Scheduled operations are dominated by a few companies.** In 2011, the three biggest shipping companies, 2GO Group, Philippine Span Asia Container (formerly Sulpicio Lines), and Solid Shipping, accounted for some 38 percent of the freight market.[32] The next 2 largest companies, NMC Container Lines and Asian Shipping, accounted for around 7 percent of the market. Many of these liners are long time players.

37. **Most routes are served by 1 or 2 shipping companies.** Of around 54 primary routes, over 40 percent are served by a single operator. A third of the routes are served by two operators. Less than one quarter of routes are served by three or more operators (Figure 4). In general, high volume routes which are financially more attractive (e.g. Manila-Cebu, Cebu-Cagayan de Oro, and Manila-Davao) attract many players - as many as 5 - while *de facto* monopolies exist on routes with low demand (e.g., Bacolod City – General Santos City, Iloilo to Davao, and Cebu City – Zamboanga) (Figure 5).

Figure 4. Most routes have only 1 or 2 operators.



Source: IFC (2013b)

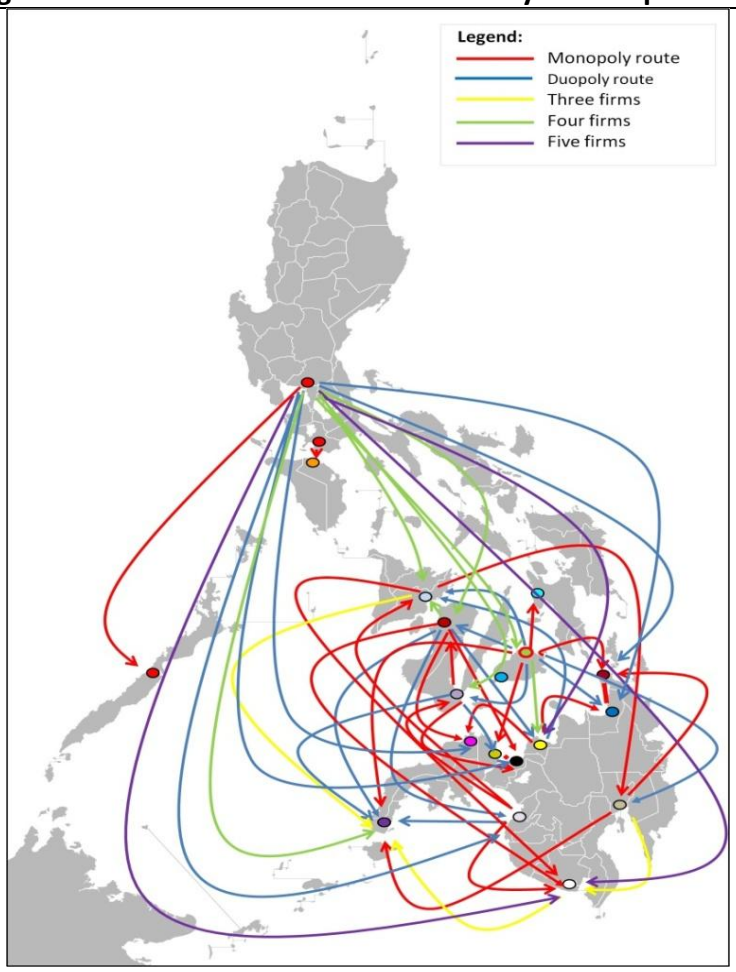
Universal Aboitiz and Sea Angels Ferry Corporation (a subsidiary of Negros Navigation) in 1998. Cebu Ferries was established in 1996 as a subsidiary of WG&A. ATSC emerged from Aboitiz Equity Ventures, the holding company of Aboitiz Shipping Corporation, and WGA. The latter was formed in 1995 when William Lines, Gothong Lines, and Aboitiz Shipping Corporation merged. Magsaysay Lines was formed when Lorenzo Shipping Lines and NMC Container Lines merged.

[32] Market share is computed as the share of the top 5 firms' revenues to the total revenues of shipping companies included in the SEC list of top 5,000 firms. Shipping companies are identified with PSIC codes 61102, 61103, and 61104 for ocean freight transport, inter-island water passenger transport, and inter-island water freight transport, respectively. This includes RORO and tramp.

38. **Significant barriers to market entry exist.** Current regulations favor incumbents and make it hard for new firms to enter the industry. Incumbents are allowed by law to object to the granting of a CPC, which authorizes the operation of a ship to new entrants. Cumbersome and costly procedures and the lack of transparency surrounding the CPC process also deter entry of new firms. In response to these inefficiencies, MARINA has begun to simplify procedures in early 2014 by streamlining the steps needed to register a ship.

39. **Several other regulations also contribute to the inefficient operation of the industry.** Currently, CPCs do not give priority to quality standards, which manifests in frequent maritime accidents. Each new ship and/or new route requires shipping companies to apply for a new CPC, which can be opposed by incumbents. The high cost of shipping is exacerbated by the requirement to dry dock in the Philippines,[33] which is generally more expensive (e.g., Chinese dry docks are reportedly up to 3.5 times cheaper than Philippine dry docks), and high tax rates associated with leasing vessels.

Figure 5. Low volume routes are served by 1 or 2 operators.



Source: MARINA.

[33] Presidential Decree 1221 requires locally flagged ships, even those engaged in international trade, to dry dock in the Philippines, unless they get a permit to do so otherwise.

Increased competition yet low profitability

40. **There are indications of increased competition in the domestic shipping industry over the last 15 years following liberalization.** The share of revenues of the top 5 shipping companies fell from 69 percent in 1996 to around 45 percent in 2011 (Table 12). The reduction in market share was most evident in the 2 biggest companies, 2GO Group and Sulpicio Lines, while the 2 smallest players in the top 5 saw their market shares more than double.

41. **However, profitability in the shipping industry remains very low.** The often claimed assertion that shipping companies earn monopoly profits is not supported by available data. Financial statements of shipping companies from the Securities and Exchange Commission (SEC) reveal that shipping firms in the SEC Top 5,000 List of Corporations have very low return on assets (ROA), return on equity (ROE), and profit margins (PM). The average ROA, ROE, and PM between 1996 and 2008 were 0.6, 1, and 0.7 percent, respectively (Table 13).[34] These ratios were slightly higher at 2.6, 5.3, and 3.2 percent, respectively, between 2005 and 2008 when shipping rates were liberalized compared to the pre-rate liberalization period, suggesting that competitive pressures have contributed somewhat to improved efficiency, though still below international benchmarks. A breakdown of these ratios by firm size reveals that the top 2 firms were less profitable than the other firms.

Table 12. Estimated market shares of top Philippine shipping companies (1996-2011)

	1996*	2001	2006	2011
2GO Group	40	32	28	27
Sulpicio Lines	21	20	14	6
Solid Shipping	5	6	4	5
NMC Container Lines*	1	2	3	4
Asian Shipping	2	1	2	3
CR5	69	61	50	45

*NMC Container Lines started operations in 1997.

[34] As a comparison, the average ROA, ROE, and PM of non-shipping firms in the SEC Top 5,000 are higher at 3, 10, and 6 percent, respectively for the same period.

Table 13. Profitability indicators

	Overall average	Average 1996-2004	Average 2005-2008
All shipping firms in the SEC Top 5000			
Revenue growth	10.3	14.2	2.4
Cost growth	11.2	15.7	2.2
Profit growth	8.2	-5.3	35.3
ROA (percent)	0.6	-0.7	2.6
ROE (percent)	1.0	-2.3	5.3
Profit-cost ratio	0.7	-1.1	3.2
Top 5 shipping firms			
Revenue growth	10.1	16.3	-2.4
Cost growth	11.5	18.5	-2.4
Profit growth	-75.6	24.6	-276.0
ROA (percent)	0.4	-0.5	1.2
ROE (percent)	0.8	-1.5	2.3
Profit-cost ratio	0.5	-0.9	1.6
Top 2 shipping firms			
Revenue growth	11.6	19.1	-3.4
Cost growth	12.4	19.9	-2.6
Profit growth	-194.0	-146.0	-290.0
ROA (percent)	1.0	1.4	-0.8
ROE (percent)	0.5	-0.2	-1.7
Profit-cost ratio	2.4	3.2	-1.0

Source: Securities and Exchange Commission (SEC)
Notes: Domestic shipping rates were deregulated in 2004. Data after 2008 is not available in usable format.

42. **Low profitability reflects competition from unscheduled and opportunistically operating trampers, and from air and land transport.** Trampers typically compete on flexibility and price, with some of them operating sub-standard ships. Another major source of competition comes from alternative modes of transportation, such as the roll-on roll-off (RORO) services and air transport. Improved arterial roads and strong support for RORO services since 2003 are making bus transport increasingly popular. Air transport liberalization since 1993 has brought down average air fares by more than 50 percent in real terms, resulting in a five-fold increase in domestic air passengers (see World Bank 2013 for more discussion). Finally, the high incidence of maritime accidents has also drawn passengers away from liners.

43. **High input costs also pull down profitability.** The overall cost structure of the Philippine domestic shipping industry is broadly similar to that of shipping companies in the East Asia region. Between 2008 and 2012, operating expenditures[35] of Philippine domestic shipping companies averaged around 70 percent of total revenues compared to an average of 80 percent among a group of comparators (Table 14). However, Philippine shipping firms pay more for fuel and repairs compared to firms in other countries. Fuel is the largest cost item at 27 percent of total revenues, and at 41 percent of total operating expenditures (Tables 14 and 15). In contrast, comparator companies, such as Maersk Group, OOCL Hong Kong, and NOL

[35] Operating expenditures exclude general and administrative expenses, finance costs, interest expense, and other non-operating expenses.

Singapore, registered lower share of fuel cost at around 20 percent of revenues.[36] Industry insiders explain that Philippine fuel is more expensive since it is not subsidized and a 12 percent VAT is imposed on top of excise tax and import tariff, while fuel in Singapore, Malaysia, and Indonesia are subsidized and are levied lower tax rates.

44. **Dry docking, repair, and maintenance are also major expenditure items, accounting for an average of 11 percent of total operating cost** (Table 15)**.** Firm level data, however, show that dry docking, repairs, and maintenance can reach as high as 26 percent of revenues. In contrast, the average dry docking cost in the region was 50 percent cheaper and up to 3.5 times cheaper in the case of China (IFC 2013a). The high share of dry docking, repair, and maintenance to total cost reflects government regulations that mandate domestic ships to dry dock in the Philippines.[37] This has resulted in higher repair and maintenance cost and slower repair time.

[36] MISC Berhad of Malaysia (whose cost breakdown was not available) can also be assumed to have access to cheaper fuel as it is a subsidiary of Petronas, Malaysia's national oil company.
[37] The market is typically dominated by a single shipyard for certain types of ships.

Table 14. Operating expenditure and fuel cost as percent of total revenues (2011-12)

	ROA	ROE	PM	Fuel cost	Opex
Philippine companies (2011-12)					
Sulpicio Lines	3.1	14.3	5.1	33.2	61.3
2GO Group	-1.2	-4.6	-1.0	28.3	69.4
Solid Shipping	16.0	17.9	15.5	29.3	80.0
NMC Container	3.0	9.5	2.6	14.6	87.8
Asian Shipping	18.0	32.3	15.3	26.6	84.9
Industry average (2008[1])					
Shipping companies in the top 25,000 corporations	**3.5**	**11.7**	**4.4**	**n.a.**	**n.a.**
International benchmarks (2012)[2]					
Maersk Group	10.1	19.1	12.4	11.7	79.5
MISC Berhad[3] (Malaysia)	4.3	7.1	16.9	n.a.	77.5
Orient Overseas Limited (HK)	3.8	6.9	4.8	18.8	89.9
Neptune Orient Lines (Singapore)	-4.4	-15.9	-3.8	19.9	94.5
Evergreen Taiwan	0.0	0.1	0.2	23.2	93.0
Yang Ming Marine (Taiwan)	-0.1	-0.2	-0.1	25.5	98.8
China COSCO	-4.5	-17.7	-8.4	14.0	102.5
China Shipping Container Lines	0.3	0.6	0.5	31.5	100.7

1/ Latest available SEC data
2/ Companies included here are some of the largest international shipping companies with ship capacity of more than 100,000 TEU
3/ Malaysia International Shipping Corporation
Notes: Operating expenditures (opex) include cost of services and cost of goods sold and exlcude general and administrative expenses, finance costs and other non-operating expenses. Return on assets (ROA) = income before tax / total assets, return on equity (ROE) = income before tax / total equity, profit margin (PM) = income before tax / total revenues.
Sources: SEC Top 25,000 Corporations and company annual reports

Table 15. Breakdown of operating expenditure of the top 5 Philippine shipping firms

Percent of total operating cost	2008	2009	2010	2011	2012	Average
Operating expense						
Fuel, oil and lubricants	**49**	**34**	**38**	**41**	**43**	**41**
Depreciation	8	10	12	9	7	9
Personnel cost	6	7	6	7	6	6
Dry docking, repairs and maintenance (vessel)	**12**	**14**	**13**	**11**	**3**	**11**
Stevedore, wharf labor	4	4	3	4	2	4
Others	22	30	28	29	38	29

Lack of investment in ships

45. **Low profitability has resulted in low rates of investment.** The domestic shipping industry lags behind its ASEAN counterparts in new ship acquisition. The average age of the country's domestic passenger, general cargo, and container ships is around 30 years old,

compared to 8 years old among top Asian shipping companies (Table 16).[38] Aging ships are one reason for the high incidence of maritime accidents in the Philippines. They also contribute to the high cost structure and inefficiencies in operation. The overall result of this vicious cycle is the stagnation of the industry, which adversely impacts the economy through high logistics costs, high food prices, and weak job creation.

Table 16. Comparative Asian shipping fleet age

	Average fleet age (years)
Philippine companies (2011-12)	
Sulpicio Lines	32.1
2GO Group	29.9
Solid Shipping	26.2
NMC Container	23.8
Asian Shipping	18.9
International benchmarks (2012)	
MISC Berhad (Malaysia)	12.1
Orient Overseas Limited (HK)	5.0
Neptune Orient Lines (Singapore)	6.5
Yang Ming Marine (Taiwan)	6.5
China COSCO	10.2

Source: SEC, Company annual reports

Lack of market scale

46. **One of the key reasons for high shipping costs is small trade volumes that do not justify big ships that can benefit from economies of scale.**[39] Economies of scale in shipping are derived not from operating cost, as the difference in operating cost between a small vessel and a large vessel is not substantial, but on the carrying capacity of the vessel. In the international picture, the Philippines is a feeder destination, not a hub or main destination. According to industry insiders, feeder vessels are generally a fourth of the size of mother ships that serve hubs, and feeder ships add around USD 200 in additional unit freight cost.[40]

[38] Source: MARINA list of operating vessels as of December 2012 and various ASEAN shipping company websites.

[39] The analysis of lack of scale leading to high shipping cost needs to be tempered by the possibility that these 2 variables are endogenous. Shipping cost can be high due to lack of scale, but lack of scale can also be caused by high shipping cost. For instance, businessmen and farmers may decide against expanding their businesses/planting more because of the high cost of shipping. A reduction in shipping cost can therefore induce an increase in scale.

[40] See Philippine Inter-Island Shipping Association (2013) for a more detailed discussion. According to industry insiders, the size of feeder vessels is typically around 2,000 to 3,000 TEUs while mother ships are typically around 6,000 to 18,000 TEUs.

47. **Within the Philippines, domestic cargo trade is also relatively small**. In 2011, domestic cargo throughput in the Philippines amounted to 102 million metric tons or equivalent to 35 percent of Indonesia's 291 million metric tons.[41] Ironically, compared to Vietnam, a non-archipelagic country, Philippine throughput is only slightly higher than Vietnam's 80 million metric tons (Table 17).

Table 17. Throughput in selected countries

	Year	Domestic	International	Total
Philippines	2013	101,700	147,300	249,000
Indonesia	2011	290,542	526,964	741,629
Malaysia	2012	179,105	169,859	316,574
Vietnam	2011	79,779	140,501	199,835
Australia	2012			1,034,406
New Zealand	2012	6,075	31,156	37,232

Source: Various country statistics offices and port authorities

48. **Philippine commodity flow data reveal that most of domestic sea trade is concentrated in just a few shipping routes.** Routes servicing the Port of Manila, the largest port in the Philippines, account for around 47 percent of total Philippine domestic sea trade. Eight other routes, out of a total of 137 routes, account for another 10 percent of total domestic sea trade.

49. **The majority of domestic shipping routes have very small volumes.** Table 18, which shows commodity flows between major ports, reveals that majority of routes account for less than 1 percent of total domestic sea trade.[42] Small volumes do not warrant a further increase in capacity or size of ships. An analysis of the Register of Ships maintained by MARINA shows that a large number of ships are very small craft, many of them wooden-hulled, that operate very localized service. Some 1,582 vessels or roughly 42 percent of total vessels have sizes that are less than 50 gross register tonnage (GRT). For passenger and passenger/cargo vessels, this proportion is much higher at over 80 percent (1,556 out of a total of 1,943 vessels). This in turn adds to high cost of shipping.

50. **Moreover, many routes have predominantly one-direction traffic.** For example, ships plying the Manila to Cebu route are often filled to capacity, but the reverse route is filled way below capacity. In terms of price, the Manila-Cebu leg amounts to around PHP 36,000 per 20-foot container from pier to pier but the Cebu-Manila route amounts to only PHP 14,000, reflecting weak demand. Moreover, most domestic shippers do not consolidate cargo, contributing to unfilled capacity.

[41] Indonesia's large domestic trade volume is partly attributed to its much larger economy and the presence of natural resource commodities.

[42] Commodity flow data from the National Statistics Office are given only at the regional level. Commodity flows between ports are not available. To arrive at port level data, the largest port (or 2 largest ports) per region is given the entire region's value.

51. **This lack of market scale is ultimately traced to the country's weak agriculture and manufacturing sectors, which are unable to produce more goods at low prices.** Moreover, variances in the quality of agricultural produce such as corn mean that farmers and agribusinesses prefer to ship in sacks rather than co-mingle them in bulk, thereby increasing the per unit cost of packaging and shipping.

Table 18. Eight routes make up almost 60 percent of total domestic sea trade

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1	North Harbor	0.1%															
2	Port of San Fernando	0.0%	0.0%														
3	Port of Irene/Port of Aparri	0.1%	0.0%	0.0%													
4	Port of Limay/ Subic	5.5%	0.4%	0.1%	0.1%												
5	Port of Batangas	0.1%	0.0%	0.0%	0.6%	0.0%											
6	Port of Puerto Princesa	1.3%	0.0%	0.0%	0.2%	1.2%	0.6%										
7	Port of Tabaco/Legazpi	0.1%	0.0%	0.0%	0.0%	0.1%	0.2%	0.6%									
8	Port of Iloilo	11.6%	0.1%	0.0%	0.4%	0.7%	0.3%	0.7%	3.2%								
9	Port of Cebu	8.4%	0.0%	0.0%	0.4%	0.0%	0.1%	0.8%	1.7%	4.6%							
10	Ports of Maasin and Liloan	0.7%	0.0%	0.0%	0.2%	0.1%	0.0%	0.3%	0.2%	6.1%	0.1%						
11	Port of Zamboanga	2.2%	0.0%	0.0%	0.3%	0.0%	0.0%	0.0%	0.3%	1.6%	0.0%	0.0%					
12	Port of Cagayan de Oro/Iligan	7.0%	0.0%	0.0%	0.4%	0.1%	0.1%	0.4%	1.7%	5.5%	0.8%	0.2%	1.7%				
13	Port of Davao	5.1%	0.0%	0.0%	0.3%	0.0%	0.0%	0.0%	0.1%	0.9%	0.0%	0.2%	0.3%	0.2%			
14	Port of General Santos	2.8%	0.0%	0.0%	0.3%	0.0%	0.0%	0.0%	0.2%	0.5%	0.0%	0.2%	0.3%	0.5%	0%		
15	Port of Surigao	1.2%	0.0%	0.0%	0.2%	0.0%	0.0%	0.0%	0.1%	1.8%	8.1%	0.1%	0.8%	0.0%	0%	0.4%	
16	Ports of Cotabato, Lamitan	0.1%	0.0%	0.0%	0.2%	0.0%	0.0%	0.0%	0.0%	0.1%	0.2%	0.4%	0.0%	0.0%	0%	0.0%	0.2%

Source: National Statistics Office

Exacerbated by the lack of connectivity, network planning, and consolidation

52. **The lack of market scale is exacerbated by the lack of connectivity, network planning, and consolidation.** In general, national and regional transport planning is weak, resulting in significant infrastructure gaps, such as missing regional arterial roads and farm to market roads to connect farms to ports and ultimately to markets. These infrastructure gaps have, in turn, contributed to the proliferation of public and private ports that spread the market too thinly and therefore reduce scale. For example, Northern Mindanao from Ozamis to Surigao, with a total coastline of around 497 kilometers, has 7 public ports: Cagayan de Oro (CDO), Mindanao Container Terminal (MCT), Iligan, Nasipit in Butuan, Surigao, Bislig, and Ozamis, alongside 29 private ports. Consolidating commercial traffic in the largest port in Cagayan de Oro (MCT) can help increase scale and reduce cost, while allowing private ports to deal with private cargo.

Lack of port and road infrastructure

53. **Port infrastructure deficiencies also contribute to the high cost of shipping.** According to the Global Competitiveness Report 2013-14, the Philippines ranks 98th out of 148 countries in the quality of overall infrastructure. Road infrastructure is ranked higher at 87th, but it still trails behind its neighbors. In terms of port infrastructure, it ranks 116th and, ironically, was better only compared to Lao PDR (which is a landlocked country) (Table 19). The consequences

of these infrastructure deficiencies are severe congestion, long wait time for ships, delays in shipment, and consequently, higher cost of shipping.

Table 19. Port infrastructure scores in the region

Country	Overall ranking	Quality of infrastructure	Quality of roads	Quality of port infrastructure
Singapore	2	5	7	2
Hong Kong	7	2	5	3
Japan	9	14	12	30
Taiwan, China	12	26	14	29
Malaysia	24	25	23	24
Korea, Rep.	25	23	15	21
Brunei Darussalam	26	39	35	49
China	29	74	54	59
Thailand	37	61	42	56
Indonesia	38	82	78	89
Philippines	**59**	**98**	**87**	**116**
Sri Lanka	65	54	49	73
Vietnam	70	110	102	98
Lao PDR	81	65	65	137
Cambodia	88	86	80	81
Mongolia	107	133	141	140
Bangladesh	110	134	118	104
Timor-Leste	138	131	146	145
Myanmar	139	146	138	136

Source: The Global Competitiveness Report 2013-14

54. **The majority of the country's major domestic ports are not equipped with modern port facilities to handle today's larger and more advanced vessels.** In many of the country's ports, cargo handlers cannot deploy modern cargo handling equipment such as quay cranes and other heavy equipment due to the poor condition of ports and weight limitations. In these ports, vessels must rely on on-board cranes. As a result, the shipping industry is constrained to use geared vessels (i.e., vessels with on-board cranes) to handle port cargo. These vessels are more costly to construct and are increasingly short in supply, and consequently more expensive to buy or charter, leading to higher cost of operations and inefficiencies in both port and shipping operations (IFC 2013b).

55. **Maritime access is limited by shallow berths in most Philippine ports.** An important factor determining access of ships to ports is the berth depth of both the origin and destination ports. In the Philippines, 60 percent of berths at major public ports have depths that are less

than 8 meters.[43] This means that mid-sized vessels would have to wait for high tide before they can dock while large vessels cannot be accommodated even if demand increases. The resulting reliance on smaller vessels means that shipping companies cannot take advantage of economies of scale to reduce shipping cost even if the market expands.

56. **Apart from port infrastructure, the country's weak state of road infrastructure also contributes to high logistics costs.** The World Development Indicator (WDI) database shows that the Philippines has only about 40,000 kilometers of paved roads out of 200,036 kilometers in 2003 (20 percent paved),[44] compared to an average of 198,184 kilometers of paved roads (out of 455,702 kilometers or 43 percent paved) among East Asian countries. More importantly, the country lacks adequate farm-to-market roads, which are important conduits to connect farmers to markets. For instance, farmers in Benguet Province face up to 8 hours when bringing their vegetables to Manila (a distance of about 280 kms or 40 km/h), when a more efficient road network can bring this down to at most 4 hours. Inadequate road infrastructure also results in congestion and limits the efficiency of shipping services. For instance, congestion around the Port of Manila decreases truck turnaround time and the amount of cargo/containers that can be carried in a day, and thus adversely impacts the efficiency of shipping services in the country. Port congestion, in turn, results in significant road congestion. Overall, JICA (2013) estimates the total annual cost of congestion at around PHP 876 billion (around 8 percent of GDP) or PHP 2.4 billion daily.

Conflict of interest in the Philippine Ports Authority

57. **Finally, conflict of interest in the Philippine Ports Authority (PPA) also contributes to higher cost of shipping.** The PPA is both a regulator and an operator of ports. It sets cargo handling rates for all its ports but also receives at least 10 percent of all cargo handling fees.[45] This not only raises the cost of shipping, but also gives rise to real or perceived conflict of interest. This conflict of interest could be removed by shifting away from its port operations mandate so that it can focus exclusively on its regulatory mandate.

Cabotage liberalization

58. **Cabotage restrictions refer to policies that reserve the carriage of domestic cargo and passengers to citizens. Cabotage liberalization refers to opening up the domestic shipping industry to non-citizens.** Cabotage liberalization can result in more innovation, improved services, and lower prices. Allowing more efficient foreign shipping firms to operate in domestic routes has the potential of lowering cargo rates and improving the quality of transport services.

[43] See JICA-MARINA (2005) for more discussion.
[44] This is based on latest available data from the World Development Indicators.
[45] This is prescribed by Letter of Instruction 1005-A signed by President Marcos in 1980.

More competition from foreign shipping firms can also serve as a disciplining force or an incentive for domestic shipping firms to be more efficient.

59. **Bringing down shipping costs and raising the quality of service and safety standards require a comprehensive reform to address all the factors discussed above.** Cabotage liberalization is only one means of addressing these issues. It can help lower shipping costs of export and import goods and domestic container cargo, but it is unlikely to lower the cost of transporting agricultural products, which are often carried in bulk. Complementary and more fundamental reforms in domestic shipping and ports are also needed to address these concerns. This part of the note discusses cabotage liberalization while Annex 1 summarizes related recommendations in domestic shipping, ports, and road infrastructure.

Cabotage regime in the Philippines

60. **The legal basis for Philippine cabotage is found in the 1987 Constitution and in several legislations and jurisprudences.** Article XII Section 11 of the 1987 Constitution restricts the ownership and operation of public utilities to citizens of the Philippines or to corporations with at least 60 percent Filipino equity. The term "public utility" is defined in the deliberations of the Constitutional Commission,[46] which can be used in legal proceedings, and in a number of jurisprudences (i.e., decisions of the Supreme Court, which have the same effect of a statute).[47] A number of legislations govern cabotage: these include i) the Public Service Act[48] (Commonwealth Act 146 of 1936 as amended by Republic Act [RA] 2677), ii) the Tariff and Customs Code of the Philippines (RA 1937 of 1957), and iii) the Domestic Shipping Development Act (RA 9295 of 2004). Annex 2 provides the text of the relevant sections of these laws and jurisprudences.

61. **The Public Service Act (PSA) is the earliest of the cabotage provisions.** Enacted in 1936, it defines "public service" to include the sea transport of passenger and freight, as well as ship repair and the operation of wharfs and docks (i.e., port operation). The PSA also restricts the issuance of a certificate of public convenience, which authorizes the operation of a ship, to only citizens of the Philippines or to corporations with at least 60 percent Filipino equity. The original purpose of this protectionist policy was to facilitate the development of the local shipping industry. It was also argued that domestic operators were more familiar with maritime, geographic, and weather conditions in the Philippines, and thus could provide safer sea travel.

62. **The Tariff and Customs Code of the Philippines (TCCP) reiterates the nationality restriction as applied to the shipping industry.** Section 902 of the TCCP states that "the right to engage in the Philippine coastwise trade is limited to vessels carrying a certificate of Philippine

[46] See Vol. III, RCC No. 64, 23 August 1986 for more details.

[47] See for instance Albano vs. Reyes (G.R. No. 83551, 11 July 1989) and Iloilo Ice and Cold Storage Co. vs. Public Utility Board (G.R. No. L-19857, 2 March 1923)

[48] This law is based on the US Jones Act and the Passenger Vessels Services Act.

registry." Section 1009 limits foreign vessels carrying import or export cargo to at most 2 stops in Philippine ports.

63. **The Domestic Shipping Development Act (DSDA), which superseded the TCCP in 2004, is the present basis for Philippine cabotage restrictions.** Section 6 of the DSDA states that "no foreign vessel shall be allowed to transport passengers or cargo between ports or places within the Philippine territorial water except upon the grant of a special permit by MARINA when no domestic vessel is available or suitable to provide the needed shipping service and public interests warrants the same."

64. **Currently, foreigners are allowed to engage in domestic shipping activities under 2 conditions:** i) through equity infusion of at most 40 percent in a Filipino shipping company, or ii) via a special permit as provided by Section 6 of the DSDA. Special Permits are primarily granted to domestic companies that want to charter specialized foreign vessels that are not available in the country. These include vessels used for oil exploration, cable-laying, and marine science studies, among others. Special Permits for specialized foreign ships can be extended for only up to 2 years. Domestic companies can also request to charter a foreign cargo or passenger vessel, if there are no domestic counterparts available for the time requested (i.e., time charter). The special permits for cargo and passenger vessels can run for a maximum of 1 year. Box 3 describes the grant of a special permit in recent years.

Box 3. MCC-Aboitiz joint venture

In 2007, MCC Transport Philippines was created out of a joint venture between MCC Transport (a subsidiary of the the Danish A.P. Moller – Maersk Group), a Singapore-based company, and Aboitiz Transport Systems, a Filipino company. Due to foreign ownership restrictions, Aboitiz held 60 percent of the equity while MCC held the remaining 40 percent. The company was set up primarily to engage in domestic shipping within the Philippines.

In May 2007, while waiting for the delivery of a permanent ship to be used in its operations, MCC Transport Philippines requested MARINA to grant it a special permit to operate the Dutch-flagged Mekong Cayenne for 6 months. This vessel was used in the Manila-Cebu-Cagayan de Oro route.

In its application, MCC Transport Philippines explained that its sister company, Aboitiz, had recently sold 4 Superferry vessels, thereby creating a shortage in cargo handling capacity in the country. The Dutch-flagged vessel would temporarily close the shortage created by the exit of the Superferries until the arrival of its replacement.

MARINA granted the special permit, which commenced on June 15, 2007. Three subsequent extensions were also granted. The final extension allowed the Dutch-flagged vessel to operate until January 31, 2008, which went beyond the original 6 month request because of the delay in the arrival of the replacement ship, the MV Medbay, to the country.

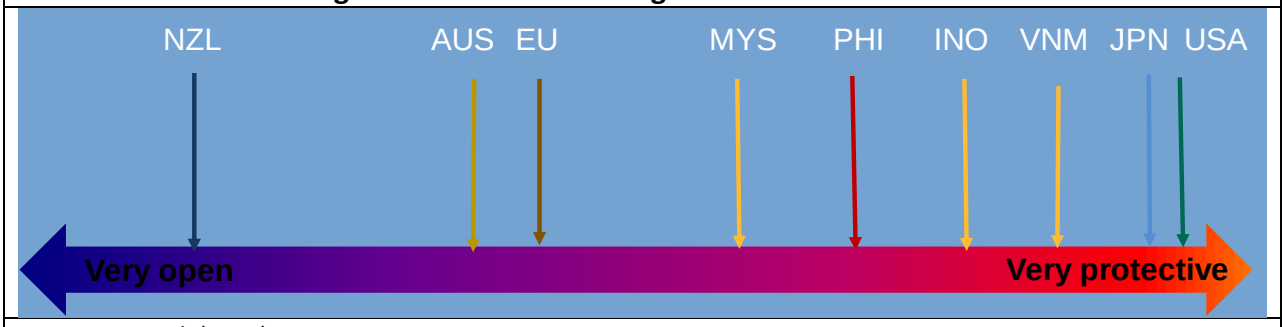
Source: MARINA.

Cabotage regimes in other countries

65. **Most countries impose nationality restrictions on the carriage of domestic passengers and cargo and the degree varies by country**. Nationality criteria can be defined with respect to i) provenance (i.e., where the ship was built), ii) ownership, iii) dry docking, iv) registration, and v) crewing. In the region, Thailand has a 30 percent cap on foreign ownership while Indonesia has a 49 percent cap. In New Zealand, the corporation need only be registered in the country, while in the US, foreign ownership is capped at 25 percent. A number of countries also require that the ship be registered locally, fly the flag of the country, and be crewed by local citizens. Some countries impose restrictions on vessel importation and dry docking. Annex 3 discusses in detail the cabotage regimes of selected countries. Table 20 presents these various nationality criteria.

66. **Exemptions from cabotage also vary across countries, ranging from non-availability of ship to full liberalization.** Exemptions can be given for i) non-availability of ships, ii) ancillary cargo (i.e., export and import cargo), iii) adjunct cargo (i.e., domestic cargo on the domestic leg of foreign-flagged ships with spare capacity), and iv) specific activities. Among the countries studied, the US is by far the most restrictive (Figure 6 and Annex 3). It strictly implements all 5 nationality criteria and gives exemptions only for extraordinary cases, such as emergency clean-up of oil spill. The most liberal countries include UK and New Zealand (Annex 4 discusses cabotage liberalization in New Zealand), which have basically lifted all restrictions on cabotage. Indonesia moved from a restrictive regime to cabotage liberalization in the 1980s but moved back to strict cabotage in 2000s (Annex 5). Most countries grant exemptions for non-availability of ships. Malaysia and India have provided limited exemptions for ancillary cargo. Australia *de facto* allows international container ships traveling between the west and east coast to carry domestic cargo. Under the Labor Party, some degree of cabotage was re-established but the new Liberal Party announced its intention to re-liberalize cabotage. The liberalization of cabotage in the EU was characterized by a progressive relaxation of restrictions on specific maritime trade components. Table 21 presents the various scope for exemptions and give some country examples. Annex 3 discusses in detail the cabotage regimes of selected countries.

Figure 6. Extent of cabotage in selected countries.



Source: Meyrick (2013)

Scope for liberalizing cabotage in the Philippines

67. **There are some potential benefits to liberalizing cabotage.** While the Philippines' cabotage regime is not exceptionally restrictive relative to those of other countries in the region, its archipelagic geography puts a premium on an efficient water transport system. The liberalization of cabotage, which can increase competition and improve efficiency, can help lower shipping costs and improved service quality and safety standards, with potentially positive impact on jobs and poverty reduction.

Arguments for liberalization of cabotage restrictions

Increased efficiency and lower shipping costs

68. **Opening up the domestic shipping industry to international competition may help increase efficiency.** Under a more liberalized regime, the threat of competition from more efficient foreign shipping companies has the potential to serve as a disciplining force or an incentive to be more efficient, thereby lowering shipping costs. The use of larger and more advanced foreign-flagged vessels reduces cost by taking advantage of economies of scale and cargo consolidation. For instance, allowing the shipment of domestic cargo in the domestic leg of an international vessel is more efficient than shipping them on several smaller domestic ships. Similarly export and import cargo may benefit from economies of scale, as well as savings from port charges (by around 7 percent) by avoiding unnecessary cargo transfer from a domestic vessel to an international vessel.[49] Moreover, allowing the shipment of domestic cargo in international vessels with excess return capacity could also bring down shipping cost. With complementary reforms in the ports sector, efficiency can be improved further. The experience of other countries points to some benefits from cabotage liberalization.

69. **In most cases, increased competition, and hence marginal costing by international ship operators, resulted in a significant drop in shipping rates**. In the case of New Zealand,

[49] See REID (2013) for more discussion.

Cavana (2004) estimates that since 1995, freight rates declined steadily (the year where the liberalization of the shipping sector was implemented) between 25 and 50 percent depending on coastal routes and type of goods transported (e.g., containers, bulk). In contrast, the cabotage restrictions imposed by the US have resulted in notably higher shipping costs. A US International Trade Commission report estimated that the elimination of the Merchant Marine Act of 1920[50] would result in a 22 percent reduction in shipping prices (USITC 1999). This would translate to a USD 1.32 billion welfare gain to the US economy.

Improved service and safety standards

70. **Cabotage liberalization may also improve the services and safety standards in the maritime sector.** World-class foreign technology and international good practices come with cabotage liberalization. These may help the domestic maritime industry raise its services and safety standards. The end results could be an improvement in the efficiency of sea travel and freight delivery, and fewer maritime accidents.

71. **There are also environmental benefits to cabotage liberalization.** A relatively recent stem of the literature has started to examine and quantify the environmental impact of cabotage restrictions. Such impact predominantly focuses on CO2 emissions of ships that carry empty containers as a result of regulatory maritime restrictions including cabotage. In an empirical case study on Canada, Kosior et al (2009) conclude that amending cabotage provisions, through allowing a free circulation for foreign containers along coastal lines, would increase the transport system capacity and reduce fuel consumption.

Development of a world class maritime industry

72. **Liberalization may also help the Philippines strengthen its global position as a major provider of world class maritime manpower.** The Philippines has already proven that it is a major source of world-class maritime talent. It has more than 1 million seamen around the world (equivalent to about 25 percent of global seafarers), including key leadership and technical positions in major shipping companies (e.g., tankers, container ships, cruise ships). By leveraging on world-class technology, it could also enhance its capacity to become a world-class center of ship building and repair, and maritime studies given its comparative advantage in the maritime sector as evidenced by its globally competitive seafarers.

Preparation for a future open ASEAN market

73. **Relaxing cabotage may also help the Philippines prepare for more intense competition in a future open ASEAN market.** One goal of the ASEAN Economic Community (AEC) 2015 is to promote freer flow of investment in services. This includes maritime services. However, as

[50] The Merchant Marine Act of 1920, also known as the Jones Act, is a US law that regulates maritime commerce. The law tackles cabotage and requires that all goods transported between US ports be carried by US-flagged ships, and constructed, owned, and crewed by US citizens.

discussed above, the Philippines is one of the worst performing countries in the region. An early head start, by liberalizing cabotage, could hasten the entry of technology and processes that can help the country more quickly modernize its inefficient maritime sector.

Improvement in welfare

74. **Ultimately, cabotage liberalization has the potential to help raise real income, create more and better jobs, and reduce poverty.** Cabotage liberalization, together with complementary reforms in domestic shipping and ports, could reduce logistics cost significantly. With improved service and safety standards, goods arrive on time and the risk of maritime accidents is lower, thereby reducing business volatility and the need for costly insurance. These may also contribute to lowering consumer prices and increasing business profitability. Finally, these reforms could help the country develop its exports sector and create many jobs in manufacturing.

75. **For instance, in countries that have liberalized its cabotage restrictions, farmers and consequently consumers are or could be the major beneficiaries of lower freight rates.** In New Zealand, freight rates of grains from the South Island to the North Island dropped from USD 90 to USD 40 per ton (Cavana 2004) as foreign companies charged lower rates and New Zealand shipping companies adjusted their rates downward. Using a trade gravity model, Vido (2004) calculates that a 5 percent reduction in freight rates, arising from liberalizing the cabotage market in Canada, could lead to a 10 percent increase in lentil exports, or USD 10 million in improved export sales.

Arguments against cabotage liberalization and remedies

76. **On the other hand, there are concerns about the negative impact of cabotage liberalization.** The major concerns are i) the demise of the local shipping industry and the loss of jobs, ii) uneven playing field, iii) lower tax revenues, iv) responsibility for liability, and v) national security issues. Fortunately, many of these concerns can be addressed even if cabotage is liberalized. Moreover, if a package of reforms is considered, which includes cabotage liberalization, ports enhancement, and domestic shipping reforms, the short-term cost to the industry is likely to be more than offset by the benefits accruing to the bigger economy and even to the industry in the long-term, as other structural reforms in the country had shown.

Negative impact on the industry

77. **Foremost, there are concerns that relaxing cabotage will lead to the demise of the local shipping industry.** This concern is valid as foreign liners are likely to have modern technologies and stronger financial position to charge lower rates. The ability of international firms to reduce their marginal costs and cross-subsidize their Philippine operations from their earnings elsewhere could put pressure on the profitability of domestic firms, forcing them to cut on costs or to cease operation. The current low margins and inefficiencies of most domestic

shipping firms make the industry highly vulnerable to foreign competition. In addition, domestic firms are subject to the regulatory uncertainties prevalent in the Philippine maritime sector, including extensive bureaucratic practices, disputes in the awarding of fiscal incentives, and changing interpretations on the taxation of bareboat chartered ships, among others. Given these, some argue that the country needs to first streamline its internal regulatory procedures and develop its domestic shipping industry before cabotage is liberalized.[51]

78. **Cost cutting could lead to significant job destruction.** Employment considerations are a major concern for policymakers and cabotage restrictions are often set to protect domestic jobs. As indicated earlier, the industry has about 18,000 formal sector jobs and it is likely that a significant number who are working for highly inefficient shipping firms will lose their jobs.

79. **However, these negative effects need to be put in the context of the gains accruing to the bigger economy.** While it is true that domestic firms will be affected, it is also true that the threat of competition will force them to improve their services. In this regard, a gradual and time-bound liberalization would give domestic firms ample time to adjust. Moreover, the loss of direct employment in the short-term needs to be compared with job creation due to forward and backward linkages created by a more liberal maritime sector. These include direct jobs in international shipping firms, indirect jobs in the maritime supply chain, and indirect jobs among users of shipping services as a result of lower shipping costs and wider market access.

Uneven playing field

80. **The possible demise of the domestic shipping industry is related to concerns about an uneven playing field.** These include preferential tax rates and cheaper access to fuel and dry docks. In taxation, foreign liners are subjected to the 3 percent common carrier tax (CCT) in lieu of all other taxes,[52] while domestic liners are subject to a 12 percent VAT and a 30 percent corporate income tax. Foreign vessels also have a cost advantage such as cheaper fuel from abroad (which are generally subsidized or taxed lower), and access to foreign dry docks, which are cheaper by some 50 percent and up to 3.5 times cheaper in the case of Chinese dry docks (IFC 2013a).

81. **Concerns about tax differential can be addressed by enacting a tonnage tax, which could be an improved version of the CCT.** Brooks (2009) defines a tonnage tax as a method of calculating corporate income tax based on the net tonnage of the ship. The tax is charged only on the income from the particular shipping operation as opposed to all operations of the shipping company, which is captured by the income tax. Since international carriers are not

[51] Some would contend that the country has had enough time to do so since the deregulation of the shipping industry in 2004. One logistics specialist commented that "If shipping companies have not developed, then it is time to replace them with more productive foreign vessels."

[52] Revenue Regulation 15-2013 of the BIR states that international air and shipping carriers doing business in the Philippines shall pay a common carrier's tax (i.e., a percentage tax) equivalent to 3 percent of their quarterly gross receipts derived from the transport of cargo from the Philippines to another country.

subject to national profit taxes, the tonnage tax allows for more equal competition as the difference in the cost of conducting operations between domestic and international sectors of the industry is reduced. The tonnage tax rate can be set at a level that boosts the domestic industry competitiveness. The tonnage tax has been used for a long time in Greece and the Netherlands before being adopted as an EU-wide policy. It has also been adopted by Australia and New Zealand instead of re-introducing cabotage. Other countries that have adopted the system successfully are Panama and Liberia.

82. **Concerns about additional expenses caused by regulatory issues in the Philippine maritime sector, such as high dry docking expense, can be addressed by streamlining laws and regulations that indirectly increase the expenses for domestic ship owners.** Laws can be passed removing the requirement that domestic ships dry dock in the Philippines, giving domestic ships access to cheaper dry docking facilities abroad much like their counterparts. Clarification in the respective positions of the Bureau of Customs, Bureau of Internal Revenue, Maritime Industry Authority, Department of Finance, and the Department of Trade and Industry with respect to fiscal incentives and taxes on chartered vessels can facilitate access of domestic firms to better vessels for domestic operations. Finally, streamlining the ship registration and CPC issuance processes could provide domestic firms with greater flexibility to compete against foreign companies.

Tax erosion

83. **Concerns that cabotage relaxation would erode tax collections have a limited horizon.** In the short-term, tax revenues are likely to fall as some firms close down or report losses, and as some firms source cheaper inputs (e.g., fuel, repairs) from abroad. In addition, Filipino firms can choose to re-domicile their headquarters in lower tax jurisdictions and take advantage of differentials in tax rates and government subsidies. But even if these were to happen on a large scale, the impact on revenues is expected to be minimal since the industry contributes little to tax revenues in the first place. Currently, the domestic shipping industry contributes only 2 percent of total excise tax revenues for its fuel consumption, around 1 percent of total VAT revenues (and declining), and only 0.3 percent of total corporate income tax revenues.[53] Moreover, the negative effect of firms closing down or re-domiciling can be offset by setting the tonnage tax to achieve revenue neutrality.

84. **In the long-term, tax revenues could be higher.** If potential revenues are included from the tonnage tax and higher GDP due to lower shipping costs and a bigger market, then net incremental tax revenues from cabotage liberalization could turn out to be positive.

Responsibility for liabilities and national security

[53] The effective tax rate for the industry is estimated at 20 percent of earnings as some companies, which incurred losses benefited from net operating loss carryover (NOLCO) and minimum corporate income tax (MCIT).

85. **Finally, there are concerns about evading responsibility for liabilities and about national security.** Some argue that since foreign ships procure foreign insurance, it would be difficult for Philippine authorities to run after the ship/insurance company for any liability within Philippine waters (e.g., accidents, pollution). There are also concerns that national security can be compromised if domestic ships are outnumbered by foreign ships, especially Chinese vessels given current tensions with China.

Remedies for concerns

86. **Concerns about evading responsibility for liability should be manageable.** The license for foreign ships plying domestic routes or the cabotage relaxation law itself could spell out clear provisions for insurance claims and compliance with all local regulations even if a ship sails under a foreign flag. Moreover, local insurance can be mandated to ensure adequacy of insurance coverage. At any rate, foreign vessels engaged in international trade and operating in Philippine waters are subject to Philippine laws and thus strict implementation should address this concern.

87. **Concerns about national security can be mitigated by prudent issuance of licenses to avoid domination by foreign firms.** For example, licensing can limit the market share of a certain foreign nationality to, say, at most 30 percent. Prudent issuance of licenses can also address concerns around cherry-picking of routes.

88. **Finally, concerns about lack of ships during national emergencies have already been discounted.** During Typhoon Yolanda, domestic cargo ships were the first to respond to the disaster areas, even before military and navy vessels. These shipping lines provided tremendous support in ferrying goods and relief personnel to Leyte and other affected provinces throughout the months of November and December 2013. The worldwide outpouring of support to the Philippines strongly suggests that foreign vessels operating in the Philippines would be equally likely to provide a similar level of support to any local relief operations. As a case in point, the disappearance of the Malaysian Airline jet in March 2014 saw 26 countries offering their ships to search for signs of wreckage.[54] The same can be expected in the Philippines during times of national emergency.

[54] Source: http://www.thestar.com.my/News/Nation/2014/03/18/Number-of-countries-in-SAR-operations-increases-to-26/

Options for reform

Approach to liberalization

89. **There are 2 possible modes when liberalizing cabotage: unilateral and bilateral/multilateral.** Although the ultimate objective of both modes is to increase economic efficiency, they differ in the way the reform is conceptualized and in the immediate policy objectives. Under a unilateral mode, liberalization is regarded as a primarily domestic economic reform initiative where the policy objective is to intensify competition. Examples of this mode are those taken by New Zealand and Indonesia in the 1990s. Under a bilateral/multilateral mode, liberalization is regarded as a component of trade policy where the policy objective includes market integration. The European Union (EU) and MERCOSUR are examples of this mode. In the EU, cabotage liberalization took the form of reciprocal recognition of cabotage rights between EU nations. This could serve as a model for liberalization under the ASEAN Economic Community (AEC) 2015.

90. **The Philippine government has decided to take the unilateral mode when relaxing cabotage.** The advantage of this mode is that it can attain the stated objectives faster. The disadvantage is that prior unilateral action may reduce the Philippine's leverage in future trade negotiations that may include relaxing cabotage restrictions. The rest of this policy note discusses options under a unilateral mode.

91. **Within a unilateral mode, cabotage liberalization can be implemented either through a swift and radical, or a gradual approach. Each has its own pros and cons.** A swift and radical approach implements various components of a reform simultaneously and often quickly, building political momentum and rallying key supporters who will make implementation easier. While this approach requires considerable political capital, the main premise is that the speedier and more comprehensive the reform, the larger the returns. On the other hand, a gradual approach implements the reform over a longer period of time. It may work best when there are many uncertainties around the prospects of reforms and when incumbent stakeholders' opposition is so strong that a more radical approach is not feasible. It is also used when important lessons can be learned from the implementation of earlier components. The pace and phasing of the implementation of cabotage liberalization is dependent on the strength of political ownership and on the stakeholders' reciprocity. Annexes 6 to 8 discuss the liberalization of the banking, retail trade, and the aviation sectors, respectively, and how the gradual approach worked to their advantage. The following sections discuss what each of these approaches entails.

A swift and radical approach to reforms

Amend the 1987 Constitution

92. **A swift and radical approach goes directly to amending the 1987 Constitution.** Being the fundamental source of cabotage, an amendment to the constitution would remove the fundamental barrier to cabotage liberalization, making the reform swifter and more decisive. Moreover, amending the constitution would provide a stronger legal basis for liberalizing cabotage, as other methods, such as legislation and executive orders, without an accompanying constitutional amendment, may not be sustainable and can be questioned before the courts. Annex 9 investigates the constitutionality of cabotage liberalization.

Scope of the amendment

93. **The amendment involves removing the foreign ownership restriction on all public utilities.** This restriction is provided under Article XII Section 11 of the 1987 Constitution, which limits the ownership and operation of public utilities to Filipino citizens and corporations with at least 60 percent Filipino equity. The decision to impose a foreign equity limit can be relegated to congress or to the president via the bi-annual Foreign Investment Negative List. Removing the nationality restriction on all public utilities not only addresses cabotage per se, but it also addresses in a more holistic manner one of the primary reasons for doing the reform in the first place—reducing shipping cost. As the total cost of shipping includes inputs from other related public utilities, such as port operation and ship repair, opening up all public utilities to foreign competition has the potential of reducing shipping cost further than if the reform were to focus solely on cabotage.

Actions following the constitutional amendment

94. **Following constitutional amendment, the reform can focus on enacting a new shipping law that gradually relaxes cabotage over a specified period of time.** This legislation should i) allow foreign vessels to carry ancillary and adjunct cargo between 2 domestic ports, ii) expand exemptions over time to explicitly include specific activities that have high economic value (see Table 20 for a proposed list of these activities), and iii) gradually increase allowable foreign equity from 40 to 100 percent. Concerns about a single nationality dominating the domestic shipping industry can be alleviated by including provisions that bar a certain nationality from having more than, say 30 percent, of the market. This would allay any fear of threat to national security (e.g., fear of domination by Chinese vessels).

Gradual approach

95. **A gradual approach implements the reforms in phases over a longer period of time.** This could begin with steps that only require executive action, such as simplifying procedures and maximizing the use of special permits, before moving to steps that require legislation, such

as amending the Domestic Shipping Development Act (DSDA), and finally amending the constitution and enacting a new shipping law that would gradually phase out cabotage. It is important that the phasing in of reforms is time-bound, so as to avoid distortions arising from lengthy processes.

Three-stage approach to liberalization

Maximize the use of special permits in the short-term

96. **In the short-term, cabotage can be liberalized by maximizing the use of special permits.** Section 6 of the DSDA allows the Maritime Industry Authority (MARINA), the regulator of the shipping industry, to grant a temporary special permit when no domestic vessel is available or suitable to provide the needed shipping service, and if public interest warrants the same. Recent maritime accidents (e.g., the collision of MV St. Thomas Aquinas and Sulpicio Express Siete in August 2013), the grounding of several ships pending MARINA investigation of the accident, and concerns about the safety of domestic ships provide scope for granting special permits to allow safer and possibly cheaper foreign ships to temporarily serve domestic routes. In addition, the use of special permits can be further maximized by expanding the notion of public interest to include lower shipping costs, especially for ships that will transport critical goods following natural calamities (e.g., in the aftermath of Typhoon Yolanda).

Promote leasing, chartering, and other modes of local-foreign partnerships to facilitate access of domestic shipping companies to better ships

97. **In the short-term, time and bareboat charters[55] can be promoted to facilitate the access of domestic firms to better ships, and more innovative maritime technologies and practices from abroad.** Chartering lowers the upfront investment cost for deploying better and more efficient ships, particularly ships that comply with international safety standards. In addition, the government can facilitate the licensing of combined international-domestic routes (e.g., Hong Kong-Manila-Cebu) for domestic shipping lines. Currently, the licensing for such routes requires special permits for each conversion from a local to an overseas route and vice-versa. Such practice would enable local shipping companies to partner with foreign companies, giving them access to better prices for purchasing or leasing of new ships, a larger market, and state-of-the-art shipping management and information systems. Because of the stricter enforcement of safety standards on international routes, this would result in an upgrading of the domestic fleet and less maritime accidents. Most importantly, it would allow them to maximize the cargo load of ships, with an optimum mix of domestic and export cargo.

Pursue reforms in domestic shipping in the short-term

[55] Time charter refers to leasing a vessel with its own crew. Bareboat charter refers to leasing only the vessel. The Philippines allows time charters up to a maximum of 1 year while bareboat charter is allowed for a minimum of 1 year.

98. **Pending cabotage reform, laws and regulations that govern the domestic shipping industry could be streamlined to ensure that domestic firms are not hampered in their ability to compete with foreign players.** In order to ensure a level playing field between foreign and domestic players, laws that needlessly increase the cost of domestic shipping operations need to be amended or repealed in advance. For the benefits of liberalization to be more widespread, domestic firms should be allowed to access auxiliary shipping resources that foreign firms are able to obtain, such as the chartering of vessels and ship repair facilities abroad. For other regulatory domestic costs that cannot be easily altered, such as income tax differentials or VAT payments on fuel, a compensating tonnage tax could be calculated and imposed on foreign vessels.

Amend current shipping laws in the medium-term

99. **In the medium-term, cabotage can be liberalized by amending the Domestic Shipping Development Act (DSDA).** The DSDA can be amended to define what aspects of shipping can be considered non-public utilities. For instance, the amended DSDA could distinguish between shipping companies, which may not always be public utilities, and freight forwarders, which are necessary public utilities since they deal with the general public. The difference is that the former functions as the backend provider of service, which does not need to interface with the general public, and hence can be considered a non-public utility, while the latter must deal with the public indiscriminately. Legal precedence from similar cases lends support to this approach (e.g., the Supreme Court recently ruled that a train system, except its ticketing system, which interfaces with the public, is not a public utility; similarly, power generation is not a public utility as opposed to power distribution, which is a public utility).

100. **Moreover, the Tariff and Customs Code of the Philippines (TCCP) can be amended to allow foreign ships multiple stops.** Currently, Section 1009 of the TCCP limits foreign vessels carrying import or export cargo to at most 2 stops in Philippine ports. This could be amended to allow unlimited stops.

Amend the 1987 Constitution and enact a new shipping law in the long-term

101. **In the long-term, cabotage can be liberalized by amending the 1987 Constitution and enacting a new shipping law.** This phase basically implements the swift and radical approach, which calls for removing the foreign ownership restriction on all public utilities and relegating the decision to impose a foreign equity limit to congress or to the president. After the constitutional amendment, a new shipping law that gradually relaxes cabotage can be enacted. As discussed above, amending the constitution would provide a stronger legal basis for liberalizing cabotage, as other methods, such as using special permits and amending the DSDA only, without an accompanying constitutional amendment, may not be sustainable and can be questioned before the courts.

Possible provisions of the new shipping law

102. **The new shipping law can identify a gradual phase-out of cabotage by making the nationality criteria more inclusive and by relaxing the scope of exemption**. Except for the use of special permits, and the restriction on dry docking, all other forms require legislation and could be included in the new shipping law.

Gradual liberalization of the nationality criteria

103. **The nationality criteria can be made more inclusive by gradually allowing foreign ownership, management and crewing, ship importation, and dry docking outside the country.** Like the banking sector reform, foreign ownership restrictions can be gradually relaxed from the current 40 percent cap to no cap over a period of say 10 years. Moreover, management and crewing at highly technical positions can also be liberalized if no Filipino qualifies for the job. This would help Filipino shipping companies improve the quality of service and become globally competitive. Facilitating the entry of leased vessels and other forms of vessel importation, and allowing dry docking abroad are also needed. Finally, simplifying the process of acquiring bareboat charters would also contribute to cabotage liberalization. Table 20 provides the various criteria and how these could be applied to the Philippines.

104. **The impact of cabotage liberalization on the competitiveness of the domestic shipping industry depends on the nationality criteria imposed by the country.** If a country imposes restrictions on the access of firms to foreign-built ships or foreign shipyards, cabotage liberalization could translate to the greater introduction of new shipping technologies from abroad. If a regime prohibits the use of foreign manpower, cabotage liberalization may allow for improved ship management and safety techniques. Eliminating restrictions to allowing firms to ply both domestic and foreign routes could help shipping firms lower fuel costs by allowing access to fuel from different jurisdictions. On the other hand, if cabotage restrictions pertain only to ownership, the impact of liberalization on access to technology or fuel may not be as significant.

Table 20. Cabotage restrictions: nationality criteria

Criterion	Description	Country example	Current situation in the Philippines	Options for the Philippines
Provenance	Requires that the ship is built in the country.	United States	Ship importation allowed with some restrictions.[56]	Eliminate all restrictions on ship importation.

[56] Section 20 of RA 9295 states the following: "In the first year of evaluation, the MARINA shall determine the capability of MARINA-registered shipyards to build new vessels below 500 GRT. If, upon evaluation, the capability of MARINA-registered shipyards to build classed vessels below 500 GRT in quantities sufficient to meet domestic

Ownership	The strict version requires that the owner is a national of the country if a natural person, or is majority owned by citizens for a corporation. A broader version requires only that the corporation is registered in the country.	Foreign equity ceiling: Thailand: 30 percent Indonesia: 49 percent United States: shipping company must be 75 percent owned by US citizens.	Foreign equity limited to 40 percent. Foreign management is not allowed.	Increase foreign equity from 40 to 100 percent over 10 years. Allow foreigners a stake in managing domestic shipping companies if there is no qualified Filipino.
Dry docking	Requires domestic ships to dry dock in local facilities.		Dry docking is not allowed outside the Philippines except with special permit.	Allow the option to dry dock outside the Philippines to reduce dry docking cost.
Registration	Requires that the ship be registered in the country and hence fly the flag of the country.	United States	"Dual flag" allowed for bareboat charter in the sense that one flag is dormant when the other flag is active.	Simplify process on the flagging of bareboat charters.
Crewing	The strict version requires that the vessel be crewed by nationals of the country.	United States	Must be crewed by Filipinos.	Allow a limited number of foreign crew in highly technical positions if no

demand is proven, then all domestic ship operators shall be discouraged from importing new or previously owned vessels that are less than 500 GRT for the domestic trade and vessels built in MARINA-registered shipyards shall be given priority for entry in the Philippines Registry and allowed to operate in the domestic trade."

	The broader version requires only that the employment conditions of the crew conform to the labor laws of the country.			Filipino qualifies.

Gradual liberalization of the scope of exemption

105. **Expanding the scope of exemption can be achieved in several ways.** The easiest way involves the use of special permits, which requires no legislation. As discussed earlier, exemptions can be given to ancillary cargo (i.e., import or export cargo) and adjunct cargo (i.e., domestic cargo on the domestic leg of an international vessel when there is spare capacity). It can also be given to specific high impact activities. The most liberal form is to remove all restrictions, which the Philippines can target after several years of gradual cabotage liberalization. Table 21 explains the various forms of exemptions and how this could be applied to the Philippines.

106. **Special permits are allowed by law and could be used more frequently.** Section 6 of the DSDA could be interpreted more liberally to include "cheaper alternatives" and "public safety" as allowable reasons for granting exemptions. The new shipping law could make these reasons for granting exemptions more explicit.

107. **Exemptions to ancillary (i.e., export and import) cargo have the strongest basis and should be automatically included in the new shipping law for immediate implementation.** Export and import cargo are sensitive to price and will benefit significantly from lower freight cost. This would make Philippine exports more competitive and reduce the cost of imported goods. This form of liberalization could be achieved by allowing transshipment of export or import cargoes. Box 4 illustrates this in the case of exports. The MARINA draft bill on cabotage liberalization proposes to allow the transshipment of ancillary cargo (see Sections 4 and 5 of the bill).[57] The bill also repeals the TCCP provisions on cabotage exemptions to simplify the law (Section 9).

[57] This draft bill is essentially similar to the bill drafted by Congressmen Rufus Rodriguez and Maximo Rodriguez (HB 2562) in the 15th Congress. According to the cover page of the MARINA sponsored bill: "Cabotage limits competition and encourages inefficiency among local vessel operators since foreign vessels are not allowed to call at more than one port for every entry within the Philippine territory. This prevents foreign vessels from calling at multiple ports for the purpose of either loading export cargoes or discharging import cargoes. This often translates to additional cost for shippers who need to transship their foreign cargoes through one of only a few major ports. Local vessel operators are not forced to compete in terms of freight cost and service quality with international vessel operators. This barrier in foreign trade must be eliminated. Foreign vessels must be allowed to engage in

108. **As a next step, exemptions can be granted to adjunct cargo when there is spare capacity on foreign-flagged vessels.** Adjunct cargo refers to domestic cargo that can be loaded on foreign-flagged ships traversing between 2 or more domestic ports that have spare capacity. This would help reduce prices of domestic goods especially in routes that have volume imbalance.

109. **Finally, specific exemptions can be gradually issued for high impact activities. Exemptions could cover i) ships traversing major exporting or importing ports (e.g., Manila,** Batangas, Subic, Cagayan de Oro, Davao, and Cebu), ii) key export or import products (e.g., oil, electronics, bananas, mangos, pineapple, and furniture), iii) selected ships (e.g., large enough ships to address scale issues), iv) selected players (e.g., foreign firms with joint ventures with local firms), and v) a fixed share of the cargo space of a foreign-flagged vessel calling on several domestic ports (e.g., up to 30 percent of cargo space). The decision for exempting specific activities should be discussed with stakeholders to minimize distortions and ensure maximum impact. Final decision on the scope of exemption should be included in the roadmap for easy implementation and monitoring.

Box 4. Transshipment of export cargo

Currently, foreign-flagged ships can carry import or export cargo between 2 domestic ports but are barred from unloading the cargo and loading them to other foreign-flagged ships. Figure 7 gives an example. Four ships are carrying export cargo from Cebu, Davao, and CDO destined for Hong Kong via Manila. Current cabotage provisions state that the cargo cannot be unloaded in Manila. Each ship must carry the cargo to Hong Kong, even if it is not economical.

With a relaxation of cabotage to allow for transshipment (i.e., consolidation of cargo), foreign-flagged ships can transfer export or import cargo to another foreign-flagged ship. Figure 9 gives an example. The same Ships 2, 3 and 4 carrying export cargo can transfer their cargo in Manila to Ship 1 for consolidation. Only Ship 1 will make the trip to Hong Kong. This way, shipping cost fall as ships take advantage of economies of scale.

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transshipment of export and import cargoes." The relevant provisions are found in Sections 4, 5, and 9 (with emphasis in italics). Section 4 states that "Cabotage liberalization – the right to engage in the carriage of cargoes *shall not be limited to vessels carrying a certificate of Philippine registry, provided that said cargoes fall within the purview of import or export cargoes…*articles arriving from abroad on a foreign vessel may be carried by the same vessel through any port of entry to the port of destination in the Philippines. Section 5 states that *"…foreign ship owners or operators may be issued the certificate of carriage of import-export cargoes.* Finally, Section 9 repeals Sections 810, 902, 903, and 1009 of the TCCP, and Sections 5, 6, and 7 of the DSDA.

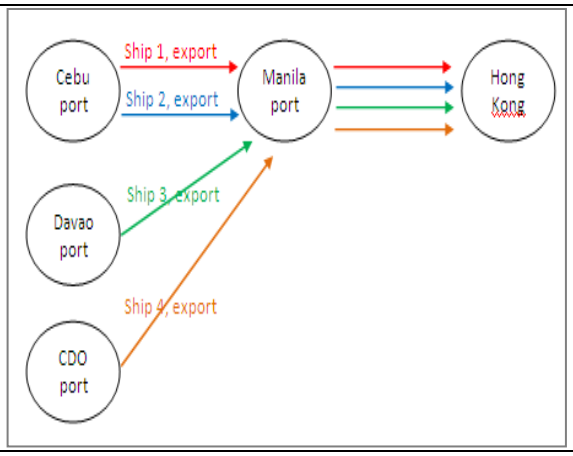
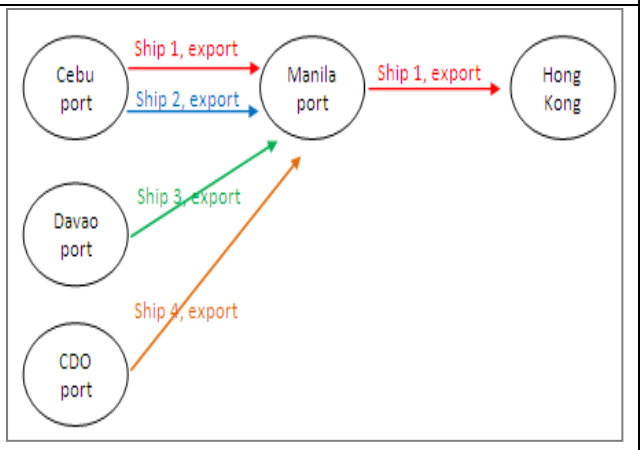
Figure 7. Current laws prohibit consolidation of cargo from 2 or more foreign-flagged ships.	Figure 8. Cabotage can be relaxed by allowing consolidation of cargo from 2 or more foreign-flagged ships.
	

Table 21. Cabotage restrictions: scope of exemption

Scope	Description	Country example	Current situation in the Philippines	Options for the Philippines
None	There is no provision for exemption.	US regime approximates this.	Not applicable in the Philippines.	Gradually remove all restrictions.
Non-availability	Provision is made for exemption when suitable domestic vessels are not available.	Most countries make some provision of this type.	Section 6 of RA 9295 allows the grant of special permits by MARINA when no domestic vessel is available or suitable to provide the needed shipping service and public interest warrants the same.	This can be expanded through a liberal interpretation of Section 6 to include "cheaper alternatives" and "public safety" as allowable reasons for granting exemption. The new shipping law can make these reasons for exemption more explicit.
Ancillary to international	Provisions are made for	Malaysia and India have provided	Currently not allowed except	Introduce legislation to allow

	exemption of the domestic movement of international cargoes to a hub port for transhipment to international vessels (e.g., foreign consortium shipping [similar to airline code-sharing], domestic transhipment of export or import cargo).	limited exemptions of this type.	possibly through special permit.	transshipment of export or import products.
Adjunct	Provisions are made to allow international vessels that call at several domestic ports as part of an international service to carry domestic cargoes between those ports (i.e., domestic cargo on international vessels that have spare capacity, since it is economically efficient).	Australia *de facto* allows international container ships travelling between west and east coasts to carry domestic cargoes.	Currently not allowed except possibly through special permit.	Introduce legislation to allow carriage of adjunct cargo.

Specific activities	Provisions are made to exempt specified commodities or maritime activities from the application of cabotage restrictions.	Liberalization of the EU regime proceeded through the progressive relaxation of restriction on specific maritime trade components.	Currently not allowed except possibly through special permit.	Special permits can be issued for high impact activities such as: i) ships traversing major exporting or importing ports, ii) key export or import products, iii) selected ships, iv) selected players, and v) a share of the cargo space of an international ship calling on several ports.
No restrictions	All cabotage restrictions are eliminated subject to minimal restrictions	UK approximates this.	Currently not allowed.	This could be the target after several years of gradual cabotage liberalization.

Managing resistance

110. **Undoubtedly, the reform of cabotage will meet some resistance. To improve the chances of success, good preparation is essential.** The preparation could include the quantification of the cost and benefit of the reform in terms of income, price, jobs, and implications on public finances. These inputs can help build a stronger case for the reform during the legislative debates. The preparation could also include the conduct of a stakeholder analysis to understand the position of different stakeholders, their ability to influence or resist reform, and how they will be impacted by the reform. The stakeholder analysis for the Philippines can be patterned after the methodology used in New Zealand (Box 5), which is considered best practice as it involved a rigorous consultation process that was seen as independent and scientific by stakeholders, and had wide ownership from government and policymakers at various levels.

Box 5. Stakeholder analysis for cabotage in New Zealand

Faced with a shrinking shipping industry, the New Zealand government decided in 2000 to evaluate a decision to re-introduce cabotage following the full liberalization of the sector in 1995. To do so, a Shipping Industry Review Committee was formed. The committee was tasked to evaluate this policy decision and propose measures to increase the participation of the domestic shipping industry. The quantitative analysis was limited due to an absence of sufficient maritime statistics. This prompted the committee to conduct a thorough qualitative assessment using the stakeholder analysis methodology.

As part of the exercise, a rigorous survey of stakeholders was conducted. The stakeholders include: domestic ship owners, international shipping firms, port authorities, other transport operators, worker associations, industry associations, manufacturing industries, other producers, and special interest groups. The survey focused on a unified set of questions that evaluated a set of indicators. Political economy considerations were used to determine the weights used for each indicator. A stakeholder impact matrix (Table 22) was constructed to help policymakers with their decision.[58]

Source: Cavana (2004) and Brooks (2009).

[58] The methodology is discussed in Cavana (2004). While some indicators can be quantified (e.g., changes in cost structure, market size, freight rates and employment creation), the net effects from cabotage regime changes are not always determined in terms of monetary values or contribution to GDP. The literature (e.g., Cavana 2004) points to using force-fields analysis, or evaluating the magnitude of forces for and against change.

Table 22. Stakeholder impact matrix of "reintroducing cabotage" in New Zealand.

	Employment on NZ coastal ships	*Employment in maritime ancillary jobs*	*Future supply maritime staff*	*Number of NZ coastal ships*	*Competition in transport services*	*Choice — transport services*	*Frequency and quality of transport services*	*Costs and efficiency*	*Domestic freight rates*	*Domestic cargo by NZ ships*	*Domestic cargo by rail/road*	*Domestic cargo by international ships*	*International freight rates*	*Balanced regional growth*	*Other jobs*	*Export volumes*	*Environmental and pollution*	*National strategic implications*	***Overall net effect on NZ***
NZ ship owners																			
Strait Shipping				+	–	–													
Tranz Rail	+			+		+	+		+	+	+			+	+		–		+
Sea-Tow Ltd.																			
Pacifica Shipping	+	+	+	+		+	+		+	+	+	–		+			+		+
Coastal Tankers Ltd.																			
International ship operators					–	–	–		–			–	–		–	–	–		–
Other transport ops/serv.																			
Transport Operators	+		+				+		+	+	+								+
Freight & Distr. Services						–	–		–					–	–				–
Ports	+				–	–		–	–						–				–
Workers associations	+	+	+	+		+	+					–		+	+		+	+	+
Government																			
Industry associations																			
Transport industry ass'ns	+	+	+	+															+
Other industry ass'ns					–	–	–	–	–				–	–	–	–	–		–
Other primary producers/boards					–	–	–	–	–				–	–	–	–	–		–
Manufacturing industries					–	–	–	–	–				–	–	–	–	–		–
Special interest groups																			

Note: + and – are, respectively, positive and negative impact from the perspective of the stakeholder.

Annex 1. Summary of issues and proposed recommendations outside cabotage

Issue	Proposed recommendations
Shipping factors	
Lack of level playing field	Remove opportunity for incumbents to object to granting of certificate of public convenience (CPC). Focus CPC conditions on quality standard. Streamline the CPC process. Use a single form of CPC for both tramp and liner operators. Allow greater flexibility within a CPC so that operators can adjust easily to changing market conditions. Simplify approval for special permits for foreign vessels to temporarily operate in domestic trade. Freely disseminate information to actual and potential market participants.
Low profitability	This can be indirectly addressed by liberalizing cabotage and enhancing competition in the domestic shipping industry, which can both provide incentives to be more efficient.
High tax rate	This can be addressed by a comprehensive reform to broaden the tax base and lower the rate.
High cost of fuel	With cabotage liberalization, foreign operators engaged in genuine domestic operations will be in the same boat as Philippine operators.
High cost of dry docking	Remove requirements for dry-docking of domestic vessels in local shipyards.
Lack of investment in new ships	This can be indirectly addressed by liberalizing cabotage and enhancing competition in the domestic shipping industry, which can both provide incentives to be more efficient.
Other factors	
Lack of scale/domestic market	In the short to medium-term, there is a need for consolidation and network planning: i) consolidate around 1 port per island group and build infrastructure (e.g., arterial roads and farm-to-market roads) to connect

	farms (for agriculture) and cities (for manufacturing and agribusiness) to the chosen port. For Mindanao, this means consolidating around Cagayan de Oro (CDO) port/Mindanao Container Terminal (MCT). This requires building farm-to-market roads linking farms to CDO/MCT port, and other roads linking major cities and towns to CDO port. For Southern Luzon, this means consolidating around Batangas Port or Subic Port. This would reduce congestion in Manila. For Visayas, this means enhancing RORO operations and allowing consortium shipping and the transportation of ancillary and adjunct cargo on board international vessels (see cabotage discussion for more details). In the long term, faster GDP growth will automatically lead to faster increase in scale.
Lack of consolidation and network planning	See above.
Lack of port infrastructure	Privatize the ownership, management, and/or operation of PPA-owned ports to increase port investment and improve the quality of ports services.
Conflict of interest in the PPA	Rationalize the mandate of PPA by gradually reducing its port operations mandate so that it can focus exclusively on its regulatory mandate. Remove the nexus between PPA revenue and cargo handling charges by changing port tariff from a fixed percentage of cargo handling fee to a fixed rate.
Other related issues	
Congestion in Manila ports	Rebalance port traffic from Manila to Subic Port and/or Batangas Port.
High cost of port charges	To further reduce logistics cost, promote roll-on roll-off (RORO), in particular allowing Chassis-RORO model (CHARO). This requires amending EO 170 (series of 2003) to include chassis as allowable RORO mode.[59]

[59] This would allow shippers to save around 7 percent of the total pier-to-pier cost of shipping by removing handling fees at port of origin and destination and wharfage fees at port of origin and destination. Moreover, since under the CHARO model, the prime mover (truck) is not required to go with the chassis-mounted container on

Customs delays	Modernize customs procedures.
Issues in trucking	Address cartel-like behavior. Industries complain about cartel-like behavior when using truck services in Subic and Batangas Port. Improve road infrastructure.

board the RORO ship, it reduces opportunity cost as it can be used as opposed to being idle on the RORO ship during transit. Another benefit is faster transit from warehouse to the cargo's end destination since there is less waiting time at the port. See REID presentation on Chassis-RORO policy for more discussion.

Annex 2. Legal basis for Philippine cabotage restrictions

Law	**Provision** (emphasis in bold)	Remarks
Philippine Constitution Article XII Section 10 (national economy and patrimony)	The **Congress** shall, upon recommendation of the economic and planning agency, when the national interest dictates, reserve to citizens of the Philippines or to corporations or associations at least **sixty *per centum*** of whose capital is owned by such citizens, **or such higher percentage as Congress may prescribe**, certain areas of investments. The Congress shall enact measures that will encourage the formation and operation of enterprises whose capital is wholly owned by Filipinos. In the grant of rights, privileges, and concessions covering the national economy and patrimony, the State shall give preference to qualified Filipinos. The State shall regulate and exercise authority over foreign investments within its national jurisdiction and in accordance with its national goals and priorities.	
Philippine Constitution Article XII Section 11 (national economy and patrimony)	**No** franchise, certificate, or any other form of authorization for the operation of a **public utility** shall be granted except to **citizens of the Philippines** or to corporations or associations organized under the laws of the Philippines, **at least sixty *per centum*** of whose capital is owned by such citizens; nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than fifty years. Neither shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the common good so requires. The State shall encourage equity participation in public utilities by the general public. The participation of foreign investors in the **governing body** of any public utility enterprise shall be limited to their **proportionate share** in its capital, **and all the executive and managing officers of such corporation or association must be citizens of the Philippines.**	
Public Service Act [PSA] (CA	The term "**public service**" includes every person that now or hereafter may own, operate, manage, or	

146 as amended by RA 2677) Section 13b	control in the Philippines, for hire or compensation, with general or limited clientele, whether permanent, occasional or accidental, and done for general business purposes, any **common carrier**, railroad, street railway, traction railway, sub-way motor vehicle, **either for freight or passenger**, or both with or without fixed route and whether may be its classification, freight or carrier service of any class, express service, **steamboat or steamship line, pontines, ferries, and water craft**, **engaged in the transportation of passengers or freight or both, shipyard, marine railways, marine repair shop, [warehouse] wharf or dock,** ice plant, ice-refrigeration plant, canal, irrigation system, gas, electric light, heat and power water supply and power, petroleum, sewerage system, wire or wireless communications system, wire or wireless broadcasting stations and other similar public services: Provided, however, that a person engaged in agriculture, not otherwise a public service, who owns a motor vehicle and uses it personally and/or enters into a special contract whereby said motor vehicle is offered for hire or compensation to a third party or third parties engaged in agriculture, not itself or themselves a public service, for operation by the latter for a limited time and for a specific purpose directly connected with the cultivation of his or their farm, the transportation, processing, and marketing of agricultural products of such third party or third parties shall not be considered as operating a public service for the purposes of this Act.	
PSA Section 16	Proceedings of the Commission, upon notice and hearing - The Commission shall have power, upon proper notice and hearing in accordance with the rules and provisions of this Act, subject to the limitations and exceptions mentioned and saving provisions to the contrary: (a) **To issue certificates which shall be known as certificates of public convenience**, authorizing the operation of public service within the Philippines whenever the Commission finds that the operation of the public service proposed and the authorization to	

	do business will promote the public interest in a proper and suitable manner. Provided, That thereafter, certificates of public convenience and certificates of public convenience and necessity will be **granted only to citizens of the Philippines** or of the United States or to corporations, co-partnerships, associations or joint-stock companies constituted and organized under the laws of the Philippines; Provided, **That sixty per centum of the stock or paid-up capital of any such corporations, co-partnership, association or joint-stock company must belong entirely to citizens of the Philippines** or of the United States: Provided, further, That no such certificates shall be issued for a period of more than fifty years.	
Supreme Court jurisprudence (GR 124293 [2003])		Shipyard is not a public utility and hence not subject to the 60-40 equity rule.
Tariff and Customs Code of the Philippines [TCCP) (RA 1937) Sections 810, 902, and 903	**A certificate of Philippine registry** confers upon the vessel the right to engage, consistent with law, in the Philippine coastwise trade. Vessels Eligible for Coastwise Trade — The right to engage in the Philippine coastwise trade is limited to vessels carrying a **certificate of Philippine registry**. All vessels engaging in coastwise trade must be duly **licensed annually**.	
TCCP Section 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 embarked 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 the coastwise trade.	
TCCP Section 1009	Clearance of Foreign Vessels To and From Coastwise Ports — Passengers or articles arriving from abroad	The first paragraph allows

	upon a foreign vessel may be carried by the **same vessel** through any port of entry to the port of destination in the Philippines; and passengers departing from 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 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.	transshipment of foreign cargo originating from outside the Philippines or destined outside the Philippines through domestic ports.
Domestic Shipping Development Act [DSDA] of 2004 (RA 9295) Section 5	Authority to Operate - **No** franchise, certificate or any other form authorization for the carriage of cargo or passenger, or both in the domestic trade, shall be granted **except for domestic ship owners or operators**.	
DSDA Section 6	Foreign Vessels Engaged in Trade and Commerce in the Philippines Territorial Waters - **No foreign vessel** shall be allowed to transport passengers or cargo between ports or place 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.	Special permit may be issued but this cannot have the nature of CPC. Otherwise, there is circumvention of the law
DSDA Section 7	Issuance of Authority to operate - The MARINA shall have the power and authority to issue certificates of public convenience to **qualified domestic ship operators**, taking into consideration the economic and beneficial effect which the proposed services shall have to the port province or region which it proposes to serve, and the financial capacity of the domestic ship operator to provide and sustain safe, reliable, adequate, efficient and economic service in accordance with the standards set by the government regulation. Every domestic ship operator shall state in its	

	application the route it proposes to serve, and the service it proposes to offer. Domestic ship operators who do not intend to operate in a fixed route shall nevertheless state in its application the service it proposes to offer.	
Foreign Investment Act (RA 7042, RA 8179)		Restricts foreign equity to a maximum of 40 percent in areas mandated by the constitution and specific laws.
Foreign Investment Negative list (EO 362) and 9th Negative List (EO 98 series of 2012)		Up to 40 percent foreign equity is allowed in the operation and management of public utilities.
EO 170 (2003) Section 1.2	Roll-on/roll-off or RO-RO operations shall refer to the method of loading and discharging of vehicles between vessel and shore via a ramp, whether a.1 self-powered (such as cars, trucks, containers on chassis attached to a prime mover, buses, motorcycles)	Amend to include: a.2 containers on chassis loaded by a prime mover (or tractor) on one end (origin) and by a different prime mover (tractor) on the other end.

Annex 3. Cabotage regimes in selected countries

Country	Overall	Scope: special exemptions	Scope: exemptions for ancillary or adjunct cargo	Nationality criteria
Overall	Recent MARAD survey of 56 countries identified 40 countries as having strong cabotage regimes, with 7 others imposing some restrictions on commercial operation of foreign vessels on the coast.	NA	NA	NA
Indonesia	Indonesia moved from an extremely restrictive regime in the early 1980s to become among the most open regimes in the 1990s. However, this has been reversed by a series of measures since 1999, culminating in the Shipping Law of 2008, which provides re-imposition of strict cabotage applied to different commodity groups over a three-year transitional period. The law imposes criminal	Specialized vessels serving the oil and gas industry as long as there are insufficient Indonesian flag vessels.	NA	NA

	sanction on use of foreign vessels in Indonesia beyond this transitional period.			
Malaysia	Only Malaysian vessels are allowed to engage in domestic trade. It has a formal cabotage regime that reserves coastal trade to national flag vessels, but has a comparatively liberal system of exemption.	Foreign carriers may acquire a temporary license if there is insufficient domestic capacity.	Exemptions allowed for export cargo. Exemptions are made for feeder ships to Malaysian hub ports.	NA
Thailand	NA	NA	There is provision for special circumstance exemptions.	Foreign equity limited to 30 percent.
Vietnam	Vietnam prohibits the carriage of coastal cargo by foreign operators.	NA	Vietnam suspended limited exemptions to allow some foreign registered ships to operate domestically.[60]	NA
Singapore	No domestic shipping activity to protect, and	NA	NA	NA

[60] In January 2013, the Vietnamese government suspended cabotage licenses for international relay containers following pressure from owners of Vietnamese -flagged containerships that want to return to the domestic trade after other markets declined. Source: http://www.jura.lt/lt/naujienos/7588-davos-protectionist-cabotage-rules-add-costs-threatens-environment

	thus imposes no cabotage restrictions.			
India	NA	NA	Exemptions allowed for export cargo.	NA
China	Only Chinese nationals are allowed to own vessels that trade domestically.	NA	NA	NA
Japan	Only Japanese ships shall be allowed to call at any port that is not open to foreign commerce or navigation.	NA	NA	NA
US	NA	Very few exceptions: only during times of emergency like cleanup of oil spill in Gulf of Mexico, relief for hurricane.	NA	Ship must be US built, crewed, owned, and flagged (Jones Act).
Canada	No foreign ship shall engage in coasting trade except in accordance with the license issued to it.	NA	NA	NA
New Zealand	New Zealand adopted a 'big bang' approach to cabotage liberalization (Maritime Transport Act 1994 and Immigration Act).	NA	Coastal cargoes may be carried by a foreign ship i) on demise charter to a New Zealand national, or ii) travelling between New Zealand ports as part of an	For the purposes of the administration of the Maritime Transport Act 1994, a New Zealand national is defined as:

			international journey.	A New Zealand citizen A corporate body registered under the law of New Zealand The Executive Government of New Zealand
Australia	Only Australian flagged vessels manned by Australian nationals. Australia never formally limited participation in coastal shipping to national operators or national flag vessels but achieved this *de facto* through licensing provisions in the Navigation Act 1912. In recent years, under the Labor Party, some degree of cabotage was re-established but the new Liberal Party announced its intention to re-liberalize cabotage.	Navigation Act 1912 also allowed for permits to be issued to non-licensed vessels for a single voyage or continuous periods of operation on the coast when a suitable licensed vessel was not available. From the mid-1990s to the late 2000s, progressive liberalization of "non availability" led to a substantial increase in the share of coastal cargo carried by foreign vessels under permits. As of 2012, the Coastal Shipping Act replaced the licence/permit system by a system of stratified	Exemptions allow for international vessels serving domestic ports as part of an international service to carry domestic cargo. Temporary licences can be granted to vessels on Australian International Register or foreign registered vessels which are not subject to Australian crewing requirements.	General licences issued only to vessels on the Australia general register, which must be owned by Australian residents and crewed by Australians. As in New Zealand, a company registered in Australia qualifies as a resident, irrespective of the beneficial ownership of the company.

		licences: general, temporary and emergency licences. A simplified “non availability” test applies to the issue of a temporary licence.		
EU	NA	NA	Gradual exemption for specific commodities or maritime activities	NA
UK	No restrictions	NA	NA	NA

Source: Meyrick (2013).

Country	Cabotage	Fleet Subsidies	Crewing Requirements	Ownership Restrictions	Domestic Construction	Reflagging Restrictions	Cabotage and Related Laws
United States	X		X	X	X	X	Title 46 USC App 883 (Jones Act) and Sec. 289
Algeria	X	1	X	X		1	Ordinance 68-83 (4/16/68) and Ordinance 76-80 (10/23/76)
Argentina	X	4	X	X		5	Decree 19492 (1944) ratified by law 12980
Australia	X	4	X				Navigation Act of 1912
Bahamas	X	X	X	X		1	Boat Registration Act and Merchant Shipping Act
Belgium		X	X				
Brazil	X	X	X	X	X	X	Shipping Law of 1967
Bulgaria	X	4	X	X			Code for Commercial Navigation, Issue 55
Canada	X		X	3		5	Canadian Shipping Act, Part X
Chile	X	4	X	X		X	Maritimie Transportation Laws; Decree Law 600
China	X	4	X	X		X	Water Transportation Management and Registration Regulation
Colombia	X		X	X		5	Decree 2451, July, 1986, Articles 55-62
Cyprus						1	
Denmark	2	4	X	X		5	Danish Merchant Marine Act, Part I, Section I
Ecuador	X	4	X	X		1	Cargo Reserve Law
Egypt	X		X	X	3	5	Law Number 63 (1961) and Egyptian Company Law 158 (1981)
Finland	X		X	X		1	Section 4 of the Right to Pursue Business Legislation
France	X	X	X	3		1	Customs Code, Articles 257 and 258
Germany	X	X	3			5	Coastal Shipping Act (7/26/57)
Greece	X		X	X		1	Legislative Decree 187/33, Articles 164 to 180
Honduras	X		X	X		1	Commercial Code (1948) and Merchant Fleet Law (195)
Hungary	X	X	X	X		5	Belgrade Agreement of 1946
India	X		X	X		1	Merchant Shipping Act
Indonesia	X	4	X	X	X	X	Regulation PP 17 (1988)
Israel						1	
Italy	X	4				5	
Ivory Coast	2	4	X	X			National Shipping Policy
Japan	X	X	X	X		5	Japan Ship Law, Articles 1,3,4,5 (1988)
Kenya						1	
Malysia	X	4	X	X		1	Merchant Shipping Ordinance of 1952
Malta	X		3			5	Merchant Shipping Act; Code of Police Law, Port and Berthing Regulations
Mexico	X	X	X	X		1	General Law of Means of Communication

Country	Cabotage	Fleet Subsidies	Crewing Requirements	Ownership Restrictions	Domestic Construction	Reflagging Restrictions	Cabotage and Related Laws
Netherlands	2	X	3	X		1	Law of Commerce, Article 311
New Zealand	X		X	X			Shipping and Seaman Act
Nigeria	2	X	X	X		1	Shipping Policy Decrees (1967)
Norway	2	X		X		1	
Panama	2						Law 56 (1979) and Law 2 (1980)
Peru	X	X	X	X	X	5	
Philippines	X		X	X		1	
Poland	X			X		5	Polish Maritime Code, Article 13
Romania	X	X	X	X		5	Decree 443 of 1972
Saudi Arabia	X			X		1	Governed by cargo and passenger regulations
Singapore						1	
South Africa						1	
South Korea	X	X		X		X	Korea Maritime and Port Administration Guidelines
Spain	X	4	X	1	X	1	National Maritime Act (5/12/56)
Sweden	X		3	X			Ordinances dated November 10, 1724 and February 28, 1726
Taiwan	X	1	X	1	1	1	Maritime Transportation Law, Article 4 and 18
Thailand	X		X	X		5	Thai Vessels Act (1988), Sec. 33
United Kingdom	2	4	X				Merchant Shipping Act of 1988, Sec. 33
Uruguay	X		X			1	Law 12091 (1954)
USSR	X	X	X	X	1	1	Merchant Shipping Code
Venezuela	X	X	X	X		5	Organic Customs Law; Law for the Protection and Development of the National Merchant Marine, Articl 7
Yugoslavia	X	X	X			5	Article 27 of the Law on Maritime and Inland Navigation

X/ Yes, (blank) No

1/ No information provided

2/ Countries that do not exclude foreign vessels but do have certain restrictions

3/ No formal requirement, but some minor restrictions

4/ Indirect benefits provided

5/ Reflagging allowable but controlled.

Source: By the Capes Around the World: A summary of world cabotage practices (MARAD)

Annex 4. Cabotage liberalization in New Zealand

New Zealand is an open economy that is geographically distant from its major markets. The country consists of 2 main islands separated by the Cook Strait. One third of the population (total population is estimated at slightly more than 4 million) is located in Auckland in the North Island while the rest of the population is scattered mainly around manufacturing centers.

Due to its geographical remoteness, the transportation supply chain, in particular international and coastal shipping is emphasized in the country's economic policies. To maintain New Zealand's trade competitiveness, competitive shipping services with lower pricing, reliable services, and speedy operations across the islands is crucial. Exports are a concrete example. New Zealand's exports of goods are dominated by agricultural, horticultural, and forestry products, and therefore price competitiveness and success in maintaining its exports market share are largely dependent on shipping costs. From this perspective, reform of cabotage came into place.

Like most other countries, New Zealand had a restrictive cabotage regime. Despite considerable restructuring of its shipping industry prior to 1994, foreign vessels could still not load and unload cargo and passengers at domestic ports, except in narrow cases where no local vessels exist. Exemptions required special permits from the Ministry of Transport. Such cabotage restrictions were considered as an impediment to the country's open economy policies.

The liberalization of the coastal shipping market in New Zealand came into effect in February 1995. It was envisaged to form part of the creation of a trans-Tasman free market with Australia, one of the country's major trading partners. The liberalization of this market had taken place as part of a comprehensive economic reform program tackling most sectors, including international trade along with industrial, transport, labor, monetary, and fiscal policies. This reform effort, pushed by a new governance and public management drive that started in 1984, transformed the country from a highly regulated economy to one of the most liberal in the world.

Cabotage liberalization encountered a number of challenges. Legislation introduced in 1993 initially included the full opening of coastal transport, allowing foreign vessels to operate freely on all ports. However, this had to be modified following pressures from the domestic shipping industry. The modified Maritime Transport Act of 1994 was passed as a compromise. It allowed international vessels to load and upload domestic cargo along New Zealand's coast provided that they originally enter the country to deliver imports or upload exports. While there was no restriction on the nationality of the operator, permanent coastal operation must be New Zealand-based. The chartering of foreign-flagged vessels was also liberalized.

Liberalization has led to a significant reduction in freight rates and consequently reduced transportation costs. This came primarily as a result of improved carrier utilization capacity

through the open access regime, and as clients had more operator choices. However, this meant that domestic operators saw their profit margins cut down. Despite increases in trade volumes as the economy grew, domestic shipping was not reaping the revenues as it faced fierce competition from international operators. In 2000, 21 vessels operated by 9 companies provided coastal shipping services compared to 19 vessels operated by 10 companies in 1994. Domestic industry participation seemed to not have achieved its expansionary objective.

Faced with this issue, the New Zealand government decided in 2000 to evaluate a decision to re-introduce cabotage. A Shipping Industry Review Committee was formed for this purpose. The committee was tasked to evaluate this policy decision and propose measures to increase the participation of the domestic shipping industry. The quantitative analysis was limited due to an absence of sufficient maritime statistics. This prompted the committee to conduct a thorough qualitative assessment using a stakeholder analysis methodology. The review highlighted that New Zealand ship owners, workers, and maritime industry associations were supportive of re-introducing cabotage, arguing that it would provide more jobs for the locals and make the domestic industry more sustainable over the long term. However other stakeholders, including international ship operators, ports, freight and distribution services, manufacturers, and primary goods producers were against the re-introduction of cabotage, claiming that it would lead to higher domestic and international freight rates, loss of jobs, businesses, and exports, higher fuel usage, negative environmental effects, and a decline in regional economic activity.

The overall conclusion reached was against the re-introduction of cabotage as an option for enhancing the domestic economy as this was estimated to lead to negative net returns for the economy. Instead, recognizing the strong support and subsidies provided by many countries to their respective shipping industries, the committee recommended leveling the playing field between international and domestic sectors of the industry to ensure fair competition. Concrete measures were proposed to achieve this objective and boost New Zealand's shipping industry participation. These included the introduction of a tonnage tax and a second vessels register.[61]

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[61] A second register is a concept introduced in 1987 by Norway and the Netherlands in response to the proliferation of "convenience flags," in which ships carry the flag of countries such as Panama or Liberia that have little regulation. The second register allows vessels of home countries to operate with less restrictions (e.g., on hiring foreign labor and paying taxes). For more discussion, see Carlisle (2009).

Annex 5. Liberalization and de-liberalization in the Indonesian shipping industry

The Indonesian shipping industry has gone through several regulatory changes. From a highly regulated and centralized industry following its independence in 1945, it underwent a period of liberalization between the mid-1980s and mid-1990s. However, with the fall of the Suharto regime in 1998, the industry was de-liberalized, which continues to be in effect today.

From colonial times to the mid-1980s, the Indonesian shipping industry was highly centralized and regulated on all aspects of the industry, including cabotage. Before attaining independence, the country's inter-island shipping industry was a virtual monopoly controlled by the Dutch company Koninkljke Paketvaart Maatschappij (KPM or Royal Packet Company). After independence, the Indonesian government decided to nationalize the industry and reduce the role of KPM in inter-island shipping. The government encouraged private operators to enter the market, established a state-owned inter-island shipping corporation, and implemented regulatory controls on tariffs and operating conditions. The result was chaotic as local firms were largely inexperienced. To restore order, the government created the Ministry of Shipping to oversee the industry in terms of routes, vessel allocation, rates, and capacity. At the same time, as part of its economic nationalism policy, the government ordered the strict implementation of cabotage in the mid-1970s.

Despite these measures, the industry continued to underperform. The "mass of inconsistent and unworkable regulations" led to severe noncompliance and/or bribery to circumvent these regulations. The bureaucracy was inefficient and corruption was the norm. These contributed to a serious erosion of maritime safety. With a weak regulatory environment, the Indonesia National Shipowners Association (INSA) established itself as a strong lobby group. Their influence culminated in the re-establishment of cabotage three decades later.

Beginning in the mid-80s, the industry was gradually liberalized, culminating in 1988 with the issuance of PP 17/1988. The collapse of oil prices from their 1981 peak threatened the country's fiscal and external stability. The government, led by strong technocrats, responded by pursuing an export-driven growth strategy geared towards the promotion of non-oil exports. Central to the success of this policy was the removal of regulatory obstacles that hindered the growth of trade. These included regulations that protected the shipping industry. The government also began to rebalance policy objectives from protecting the needs of shipping firms to protecting the needs of the users. Liberalization under 2 presidential directives, Inpres 4/1985 and PP 17/1988, allowed domestic shipping companies to own or charter foreign-flagged vessels for domestic trade at their discretion.[62] It also allowed foreign-flagged ships to

[62] Inpres is short for Instruksi Presiden, which translates to "presidential instruction". PP is short for Peraturan Pemerintah, which translates to "government regulation".

trade between foreign ports and Indonesian ports, provided that they appointed a local agent, which no longer needed to be a domestic shipping company.[63]

Available studies suggest that liberalization led to a number of positive outcomes. The shipping industry grew significantly as old firms expanded and new firms entered the industry (Dick 2008).[64] The industry also modernized with the accelerated conversion of break bulk cargo to container cargo. However, the share of domestic cargo carried on Indonesian-flagged vessels declined from over 90 to just 50 percent (Dick 2008). However, a number of foreign firms appeared to be intrinsically Indonesian firms which decided to register in Singapore to avoid the regulatory costs imposed by the Indonesian bureaucracy (Dick 2008). The relaxation of cabotage put pressure on the better-performing Indonesian shipping firms to meet international service standards in order to remain in business (Dick 2008). Shipping costs reportedly declined and service quality improved (Dick 2008). A few Indonesian shipping companies also grew to become regional players (Dick 2008). These facilitated regional integration, and contributed to the strong growth of trade and labor intensive manufacturing (Hill 2000 and Thee 2003).

However, liberalization was short-lived as the country began to protect its domestic shipping industry in 1999. The fall of the Suharto regime in May 1998 saw a number of policy reversals. In shipping, opponents of liberalization were successful in pushing for the return of cabotage. The Asian Financial Crisis, which crippled the domestic shipping industry, was used as a pretext for bringing back cabotage. Under the term of President Habibie, PP 82/1999, which repealed PP 17/1988, re-regulated the shipping industry.[65] It required Indonesian flagged-ships to be built by Indonesian shipbuilders and declared in principle the return of cabotage. However, cabotage only took effect after Inpres 5/2005 was enacted.

In 2008, the initial steps taken to re-regulate the shipping industry were strengthened by legislation. Law 17/2008, which restated PP 82/1999 and Inpres 5/2005, contained a stronger and clearer statement on cabotage.[66] The law restricted domestic sea transport to Indonesian shipping companies using only Indonesian-flagged vessels and crewed by Indonesians. Foreign-flagged vessels which were operating at the time of the law's enactment were given 2 options: cease operation by May 2011 or form a joint venture with an Indonesian company with majority of the shares held by the Indonesian company. Violations are treated as a criminal offense. Government Regulation No. 22 of 2011 exempted from cabotage vessels that do not

[63] Other provisions of Inpres 4/1985 and PP 17/1988 were as follows: i) customs clearance was transferred from the government to the Swiss firm, Societe Generale de Surveillance (SGS), ii) licensing was simplified, and iii) routes were liberalized, subject to safety requirements and reporting.

[64] For example, between 1980 and 1999, merchant fleet capacity grew by 130 percent, while total number of Indonesia's merchant fleet doubled in size (source: Lloyd's Register of Shipping: Statistical Tables).

[65] The return of cabotage under the Habibie regime was no surprise, as the president, during his term as minister of research and technology in the 1980s, had identified ship building as one of the strategic industries of Indonesia and called for the protection and strengthening of the industry.

[66] Law 17/2008 was enacted by parliament, making it stronger than Inpres 5/2005, which was a presidential directive. Apart from reinforcing PP 82/1999 and Inpres 5/2005, Law 17/2008 tackled other pertinent issues such as the simplification of licensing and the separation of the port authority's regulatory and operational functions.

transport goods or people, which includes vessels in the oil and gas industry as a result of the unavailability of domestic ships. Foreign vessels can apply for special permits valid for three months.

The same studies claimed that the return of cabotage contributed to the growth of the domestic shipping industry. From 2005 to 2010, the number of domestic vessels increased by 63 percent from 6,041 in 2005 to 9,835 in 2010 (Asrofi 2011). The share of domestic freight held by the domestic shipping industry increased from 55 percent in 2005 to 95 percent in the first quarter of 2010 (Asrofi 2011). This, however, does not automatically reflect new demand as the high growth could reflect the reflagging of Indonesian-owned ships from Singaporean flag to Indonesian flag.

At the macro level, cabotage de-liberalization allegedly came at the expense of the wider economy. Increased bureaucratic regulation reportedly contributed to higher compliance and shipping costs (Dick 2008). The lack of competition as a result of cabotage led to artificially high inter-island shipping cost and lower shipping efficiency, thereby discouraging trade (Dick 2008).

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Annex 6. Gradual liberalization of the Philippine banking industry[67]

Until fairly recently, the Philippines restricted foreign participation in the country's domestic banking industry. The General Banking Act of 1948 (Republic Act 337) set a 40 percent cap on foreign ownership in any domestic banking institution. It also limited the entry of foreign banks as stated in Section 14 of the same act.[68] The law, however, exempted 4 foreign banks that were already operational in the Philippines prior to RA 337. These banks were subjected to strict conditions such as limits on investments made using deposits within the territorial limits of the Republic of the Philippines. The rural banking industry was protected the most. In 1992, the Rural Bank Act (RA 7353) mandated that rural banks should be fully-owned by Filipinos (Section 4).

The Philippine banking industry was gradually liberalized in the last two decades. In 1994, the Foreign Bank Liberalization Act (RA 7221) was signed into law. It aimed to create a more competitive environment for the banking industry and encourage more foreign participation. RA 7221 provides 3 modes of entry for foreign banks: i) by acquiring, purchasing, or owning up to 60 percent of the voting stock of an existing bank, ii) by investing in up to 60 percent of the voting stock of a new banking subsidiary incorporated under the laws of the Philippines, or iii) by establishing up to three branches with full banking authority. However, entry was limited to only 10 new foreign banks, and was subject to the Bangko Sentral ng Pilipinas' strict guidelines for approval.[69]

Liberalization progressed with the enactment of the General Banking Law (RA 8791) of 2000. RA 8791 allowed foreign banks to acquire up to 100 percent of voting stock in only one domestic bank within a 7-year period from the effectiveness of the law. In 2013, RA 10574, amended the Rural Bank Act of 1992. It allowed foreigners to acquire up to 60 percent of the voting stock in rural banks. Finally, in June 2014, a law was passed allowing foreign banks 100 percent participation in the domestic banking industry.

The impact on FDI inflow into the banking sector was astonishing. Within 3 years of the 1994 liberalization, 10 foreign banks entered the Philippines, bringing a total FDI inflow of USD 4 billion from an average of USD 233 million in the preceding 12 years. The same was also true for the insurance sector, which followed a similar liberalization schedule.

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[67] Source: Bautista (1999).

[68] Section 14 of RA 337 states that 'no foreign bank or banking corporation formed, organized or existing under the laws other than those of the Republic of the Philippines shall be permitted to transact business in the Philippines…'

[69] Section 3 of RA 7721 lists the guidelines of approval for foreign bank entry. Among some of the stricter guidelines of entry are: i) Only those among the top 150 foreign banks in the world or top 5 banks in their country of origin as of the date of application shall be allowed entry in accordance with Section 2, ii) In order to qualify to establish a branch or a subsidiary, the foreign bank applicant must be widely-owned and publicly-listed in its country of origin, unless the foreign bank applicant is owned by the government of its country of origin.

Annex 7. Gradual liberalization of the Philippine retail trade industry

The Philippines moved from a liberal retail trade regime to a protected regime in the 1950s, and then to partial liberalization in 2000. In 1954, the Retail Trade Nationalization Act Republic Act [RA 1180] gave the sole right to participate in the country's retail trade industry to Filipino citizens or corporations wholly-owned by Filipinos (Section 1). The law was originally intended to protect Filipino retailers from immigrant Chinese retailers, who at the time controlled around 60 percent of the retail trade industry.[70] It, however, provided a transitory provision which allowed non-Filipinos, who at the time of the enactment of RA 1180, were engaged in retail trade to continue operation until death or voluntary retirement from the business. In the case of corporations or partnerships not wholly-owned by Filipino citizens, these entities were given a maximum of 10 years to cease operation.

The retail trade sector was partially liberalized in 2000 in a bid to promote consumer welfare and improve competition. The Retail Trade Liberalization Act (RA 8762) amended RA 1180, allowing foreigners to engage in retail trade subject to certain restrictions. Under the law, foreigners can own retail establishments that have a minimum paid-up capital of USD 2,500,000. For establishments engaged in high-end or luxury products, the minimum paid-up capital is lower at USD 250,000. Other restrictions are:

- All retail trade enterprises under Categories B and C,[71] where foreign ownership exceeds 80 percent of equity, shall offer a minimum of 30 percent of their equity to the public through the Philippine Stock Exchange within eight years from commencing operations (Section 7).

- Foreign retailers must have a minimum net worth of USD 200,000,000 in an enterprise's parent corporation for Categories B and C, and USD 50,000,000 in an enterprise's parent corporation for Category D (Section 8).

- After 10 years from the approval of RA 8762, at least 30 percent of the aggregate cost of the stock inventory for Categories B and C, and 10 percent for category D shall be made in the Philippines (Section 9).

- Qualified foreign retailers are prohibited from using sales representatives and door-to-door selling, and establishing restaurants and other similar retailing activities as determined by the Department of Trade and Industry (Section 10).

[70] See Agpalo (1962) for more discussion.

[71] Section 5 of RA 8762 defines Category B enterprises as firms with a minimum paid-up capital of USD 2,500,000, but less than USD 7,500,000, while Category C enterprises have a minimum paid-up capital of USD 7,500,000.

Annex 8. Gradual liberalization of the Philippine aviation industry[72]

Between 1972 and 1995, the Philippines had a one-airline policy. The monopoly was operated by Philippine Airlines (PAL).[73] The 1987 Constitution declared that the state shall regulate or prohibit monopolies when the public interest so requires. However, it was only in 1995 when the country's one-airline policy was abolished with the enactment of Executive Order (EO) 219.

The liberalization of the Philippine aviation industry began in 1995 when the domestic sector was opened up to competition. This reform was part of a broader civil aviation reform to address 3 main issues: i) airport congestion in Manila, ii) poor performance of international tourism, and iii) inefficiencies in the domestic aviation market. In the domestic sector, in which the reform was most successful, EO 219 allowed new domestic airlines to operate freely and to complement or establish new routes. In the international sector, EO 219 allowed the designation of a second flag carrier.[74] All other areas, such as foreign ownership and control, tariff setting, freedom of the air rights,[75,76,77] and participation in the domestic market (i.e., cabotage having been in effect), remained closed to competition.

The second phase of the liberalization happened in the 2000s with the partial liberalization of the international sector. In 2001, EO 500, as amended by EO 500-A, allowed unlimited third[78] and fourth[79] freedoms of the air rights to foreign carriers serving the Clark International Airport and the Subic Bay International Airport. The Civil Aeronautics Board (CAB) was tasked to evaluate and approve applications for these rights.

Liberalization in the international sector was further expanded in 2011. EO 29 gave the Philippine Air Panels[80] the authority to grant third, fourth, and fifth[81] freedom of air rights,

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[72] Source: Austria (2000).

[73] The monopoly was very inefficient. Flights were limited and largely flew out from Manila and, to a lesser extent, from Cebu. Service was characterized by frequent flight delays, cancellations, and high passenger ticket prices and freight costs (World Bank 2013).

[74] However, implementation of EO 219 was partly delayed as the implementing rules and regulations were not passed until 2001.

[75] EO 219 allowed only the first 2 freedoms of the air. The third and fourth freedoms were determined based on reciprocity and value for the Philippines.

[76] The International Civil Aviation Organization (ICAO) defines the first freedom of the air as "the right or privilege, in respect of scheduled international air services, granted by one State to another State or States, to fly across its territory without landing."

[77] The ICAO defines the second freedom of the air as "the right or privilege, in respect of scheduled international air services, granted by one State to another State or States, to land in its territory for non-traffic purposes."

[78] The ICAO defines the third freedom of the air as "the right of an airline of one country to carry traffic from its country of registration to another country."

[79] The ICAO defines the fourth freedom of the air as "the right of an airline of one country to carry traffic from another country to its own country of registration."

[80] Executive Order 28 series of 2011 reconstituted and reorganized the single negotiating Philippine Air Panel (established by EO 32 series of 2001) into the Philippine Air Negotiating Panel and the Philippine Air Consultation

subject to conditions of national interest, to all foreign carriers flying into all Philippine airports except the Ninoy Aquino International Airport. However, Section 5 of EO 29 explicitly states that "in no case shall the CAB grant to any foreign air carrier cabotage traffic rights of any kind."

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Panel, collectively known as the Philippine Air Panels, which are responsible for the initial and succeeding negotiations of air service agreements.

[81] The International Civil Aviation Organization defines the fifth freedom of the air as "the right of an airline of one country to carry traffic between two countries outside its own country of registration as long as the flight originates or terminates in its own country of registration."

Annex 9. Constitutionality of cabotage liberalization

Under Article XII, Section 11 of the Constitution, no franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to Philippine corporations whose capital is at least 60 percent owned by Filipinos. Simply stated, if an activity is deemed to be a public utility, then the citizenship requirement applies. Any form of legal liberalization allowing foreign firms to enter the market could be termed as unconstitutional. Broadly defined, the transport of goods by shipping vessels has been generally understood to be a public utility.

Despite this Constitutional provision, the term "public utility" is defined neither by the Constitution nor by Philippine laws, but only by jurisprudence; only the term "public service" has been defined by law. Through the Public Service Act of 1936, "public service" has been defined as firms that own, operate, manage or control in the Philippines, for hire or compensation, with general or limited clientele, whether permanent, occasional or accidental and done for general business purposes, in a pre-defined set of industries, including common carriers, railroads, water transport, public warehouses, telephone, electric light, shipyards, and ice plants, among others.

The term "public utility" implies not only service to the public but also public use. Legally, this means that not all public services are interpreted to be public utilities and the term "public service" has a broader scope as compared to a public utility. It is not always necessary, in order to be a public service, that an organization be dedicated to public use; it is only necessary that it must in some way be impressed with public interest. Thus, a business may be affected by public interest and regulated for public good, although not be under any duty to serve the public.

The previous statutory definition of a public utility was abandoned because the concept of public service did not exactly fit the concept of public utility. The lack of statutory definition may be due to several reasons: i) "public utility" is difficult to define, ii) it is a judicial question, or iii) the legislative determination may either be upheld or struck down by the Court.

Since there is no statutory declaration yet, the definition of the term "public utility" is judicially determined. Supreme Court decisions provide judicial pronouncements as to what defines a public utility. These include businesses or services engaged in regularly supplying the public with some commodity or service of public consequence such as electricity, gas, water, transportation, telephone or telegraph service. The principal determinative characteristic of a public utility is that of service to, or readiness to serve, an indefinite public or portion of the public as such, which has a legal right to demand and receive its services or commodities.

On the one hand, legislative enactments may declare whether or not a business or activity is a "public utility." Some laws have declared that a particular activity within a public service industry is **not** a public utility, including power generation (RA 9136 Electric Power Industry Reform Act of 2001) and ship building and ship repair (PD 666). These laws have been cited by the Courts in later jurisprudence. Laws may also declare that certain activities or businesses are

public utilities, such as transportation of passengers (Act 2307), ice plants (Act 2694), and petroleum operation (RA 387). However, there are certain cases wherein the legislative declarations were overturned by the Courts.

Such laws may be subject to judicial review to determine whether they contravene the Constitution. The Supreme Court has made previous declarations that the "legislature cannot, by its mere declaration, make something a public utility which is not in fact such; and a private business operated under private contracts with selected customers and not devoted to public use cannot, by legislative fiat or by order of a public service commission, be declared a public utility, since that would be taking private property for public use without just compensation." Firms such as Tan Piaco (trucking of passengers and freight), Iloilo Ice and Cold Storage (cold storage) and Petron (oil refining) were previously declared to be outside the scope of public utilities. They all operated businesses categorized by law as Public Services, but primarily engaged in activities under strictly private contracts and were never devoted by its owners for public use.

In terms of cabotage liberalization, certain activities involving domestic shipping could be declared by legislation as not being public utilities, so long as they can clearly be argued to not involve public use or not regularly supply the public with commodities or services of public consequence. For example, a law could be passed allowing the transshipment of import and export cargo in international ports through a redefinition of "coastwise trade". Additionally, separate legal arguments could be made that yachts-for-hire, specialized cargo transport, or scientific exploration, among other examples, are not deemed to be public utilities by indicating that a limited public could use these services.

By extension, it could potentially be argued that cargo vessels for limited hire, such as those that deal solely with a limited set of third party consolidators or freight forwarding companies, do not deal with the general public and are therefore not public utilities. This form of shipping activity is different from cargo handling operators who enter into direct contracts with shippers and consignees. Since the contract of transportation will be entered by the foreign ship owner and freight forwarders, it may be considered that the use of vessels for transporting cargo within the Philippines involves particular persons (freight forwarders) under strictly private contracts. As such, the vessels are never devoted by their owners to public use. It should also be noted that these types of ship owners may not be legally obligated to render their services indiscriminately to the public.

Therefore, there may be other activities involving shipping which may be classified as "public service" yet do not fall under the definition of public utilities. The citizenship requirement under the Constitution applies to the operation of public utilities. The Deliberations of the Constitutional Commission states that shipping is a "public utility," which was defined as "services which are **vital** for the delivery of services for the public". It may be implied that some services are not vital for the delivery of services to the public. Therefore, not all forms of shipping may be classified as public utilities. If the ship owners are not under any duty to serve

the public, legislation may declare that these are considered as providing “public service” only, wherein the nationality requirement does not apply.

However, it must be restated that such laws stating which modes of shipping will not be defined as public utilities (and therefore open to foreign companies) will be subject to judicial review to determine whether these laws are constitutional. The extent to which these shipping activities can be legally defined as not having the characteristics of public service and public use will determine the shipping activities subject to cabotage reform without a constitutional amendment. Given the lack of clarity in the legal definitions of the “public utility” concept, such a law would still have a significant risk of being declared unconstitutional. As such, great care must be taken in drafting legislation that specifies the particular modes of shipping that operate outside the definition of a “public utility.”

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