

COMPETITION POLICY AND REGULATION IN PORTS AND SHIPPING

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LIST OF ABBREVIATIONS

AO	Administrative Order
APPOOP	Association of Private Port Owners and Operators of the Philippines
ARMM	Autonomous Region of Muslim Mindanao
ATI	Asian Terminals, Inc.
BCDA	Bases Conversion Development Authority
CCPSP	Coordinating Council for Private Sector Participation
CEZA	Cagayan Economic Zone Authority
CPA	Cebu Port Authority
DENR	Department of Environment and Natural Resources
DMAP	Distribution Management Association of the Philippines
DOF	Department of Finance
DOTC	Department of Transportation and Communication
DPWH	Department of Public Works and Highways
DTI	Department of Trade and Industry
EO	Executive Order
FPI	Federation of Philippine Industries
FSA	Filipino Shipowners Association
GOCC	Government-owned and controlled corporation
HCPTI	Harbour Centre Port Terminal, Inc.
IPA	Independent Port Authority
JICA	Japan International Cooperation Agency
LGU	Local Government Unit
LOLO	Load-on, Load-off
MARINA	Maritime Industry Authority
MCPT	Mindanao Container Port Terminal
MECP	Maritime Equity Corporation of the Philippines
MICT	Manila International Container Terminal
MO/MC	Memorandum Order / Memorandum Circular
NEDA	National Economic Development Authority
PCASO	Philippine Chamber of Arrastre and Stevedoring Operators
PCCI	Philippine Chamber of Commerce and Industry
PCG	Philippine Coast Guard
PD	Presidential Decree
PIA	Phividec Industrial Authority
PISA	Philippine Inter-Island Shipping Association
PPA	Philippine Ports Authority
RA	Republic Act
RORO	Roll-on, Roll-off
RRTS	Road-RORO Terminal System
SBMA	Subic Bay Metropolitan Authority
SLDP	Sustainable Logistics Development Program
USAID	United States Agency for International

UTAP
VAFCSO

Development
United Trampers Association of the Philippines
Visayan Association of Fastcraft Shipping
Operators

COMPETITION POLICY AND REGULATION IN PORTS AND SHIPPING

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I. INTRODUCTION

This paper examines competition policy and the regulatory framework of the port and shipping sectors. It assesses the policies and programs of the government in promoting competition in these sectors and recommends areas for policy and regulatory reform. After a brief introduction, Section II describes the analytical underpinnings of competition policy and regulation that provides a framework for the succeeding discussion in Section III of the present state of competition and regulation in Philippine ports. Meanwhile, Section IV discusses inter-island shipping. Section V gives concluding remarks and provides specific recommendations for policy and regulatory reform.

The Philippines is an archipelago of 7,107 islands. It has a long coastline that extends to 235,973 square kilometers, longer than that of the United States (UNESCAP 2002b). The country's archipelagic configuration requires an efficient maritime transport infrastructure composed of ports and shipping for growth and socio-economic integration. The integration of peripheral islands to the urban economic nodes such as Metro Manila, Cebu, Davao and General Santos and the diffusion of investments and economic activities fundamentally count on an efficient road and maritime transport network.

Maritime transport is the major means by which the islands are connected, and the movement of commodities and people facilitated. The Philippines is likewise primarily linked to the international trade system via maritime transport. Almost 98 percent of materials and products imported and exported by the country are facilitated through maritime exchanges (Innovation Norway 2004). By the 1990s many countries had adopted a development strategy that emphasizes integration with the global economy (Clark, David and Dollar 2004). Because the Philippines seeks to integrate itself into the global trading system, an efficient maritime transport, composed of ports and shipping, is a necessary condition for successful integration.

However, the country's inefficient maritime transport has effectively acted as a barrier to domestic and international trade integration. It has stymied countryside development because of the high cost of transporting people and goods and has stunted efforts to improve productivity and the competitiveness of exports and tourism. Inefficiencies in maritime transport intensify transaction cost, resulting in higher goods prices and the erosion of the competitiveness of exports. Research shows that as much as 40 percent of predicted transport costs for coastal countries like the Philippines may be explained by the quality of onshore infrastructure accounts (Limao and Venables (2000). The inefficiencies stem from (a) inadequate port and vessel capacities; (b) ineffective ports management and administration

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and (c) constraints arising from anti-competitive policies and regulation. Port efficiency, a major determinant of shipping costs, is affected by government regulation in a non-linear way, that is, increasing at some level of intervention and decreasing in excess of regulation (Clark, David and Dollar 2004). The lack of competition in the shipping industry undermines incentives to minimize costs which could be simply passed on to the consumers of the service.

Because the Philippines aspires to become a major maritime hub in the Asia-Pacific region, that is, as an alternative to Singapore and Hong Kong, modernization and restructuring in the shipping and ports industries need to be seriously considered. There is an urgent need to address the inadequacy in ports and vessels capacities, and to have efficient ports management and administration. Competition policy and market-enhancing regulation would motivate the private sector investments in better-equipped vessels and ports that support value-added logistics services. Modernization efforts need to be supported by a competition policy and changes in the regulatory framework to ensure efficiency and the protection of consumers from the exercise of market power.

II. COMPETITION AND REGULATION: SOME REMARKS

Ports have traditionally been provided by the government while ports services and inter-island shipping and cargo handling have been usually provided by a highly regulated and sometimes protected private market. This has given way to the present Philippine policy stance of building up more competitive markets in infrastructure including maritime transport, mainly through an overall shift in paradigm from government provision of infrastructure to greater private sector participation with government providing a competitive environment.

Competition policy and efficient regulation have a central role in certain infrastructure and transport networks because of significant economies of scale that these entail. Because of economies of scale, total costs will be lower if service will be delivered by a single firm rather than by a large number of firms. In addition, large infrastructure and transport networks are capital-intensive and involve long-lived assets. Duplication of operations may raise the overall costs significantly. The number of service providers rests on the capacity of the industry to support them, for instance, where an area or a route could support only one surviving firm. These conditions call for regulatory intervention to avoid possible exploitative firm behavior. In the extreme case, public ownership of the infrastructure or public provision of the service has been employed by governments to address such market failure. Alternatively, the state allows private monopoly to operate but under regulation of the government to prevent the exercise of market power.

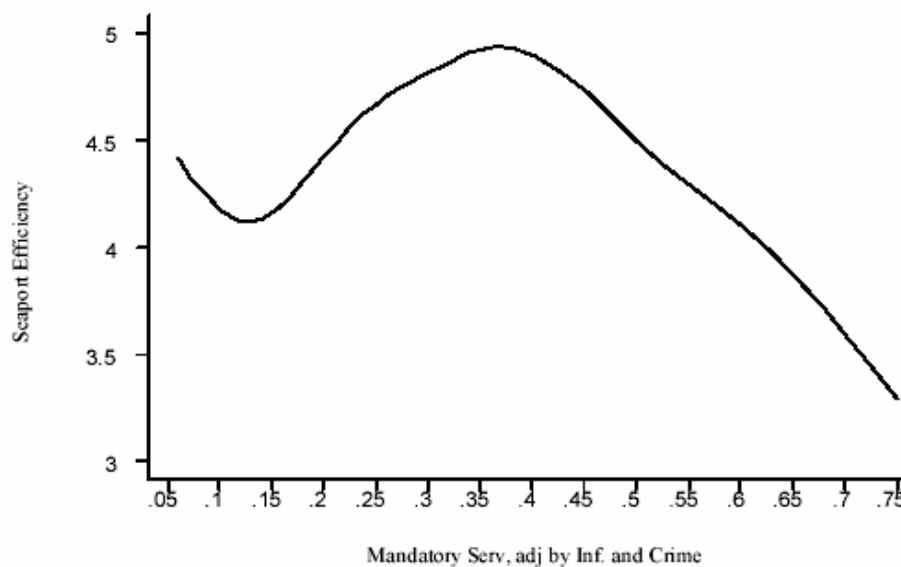
Because of severe fiscal constraints, the Philippine government has failed to satisfy the growing demand for better and lower-priced infrastructure services and greater access by the population. In particular, the development of ports in the Philippines has lagged behind that in other ASEAN countries because the government has not been able to finance the needed infrastructure. Thus, the government has turned to greater private sector participation, not only in the provision of funds for infrastructure, but also for expertise in

ports administration and management. The very limited financial capacity of the state has spurred the privatization of infrastructure provision.

The government regulates inter-island shipping and cargo-handling services which have been traditional private sector areas of operation. However, efficient regulation generally is often difficult to install and is susceptible to capture. Newbery (1999) argues that regulation is inevitably inefficient and thus, the concern about the damage brought about by over-regulation. Regulation is not an easy task. Oftentimes, problems of information asymmetry between the regulator and the firm arise. The regulator is often disadvantaged because it cannot entirely know the financial structure and actual conduct of the firm. On the other hand, regulation done in pursuit of social objectives could sometimes over-restrict private enterprise and endanger the financial viability of the business.

Regulation may enhance port efficiency while excess regulation may negate gains. Clark, David and Dollar (2004) found a non-linear relationship between regulation and port efficiency (**Figure 1**). Not only does port development require efficient infrastructure, it also calls for efficiency in industry design and regulatory structures.

Figure 1 Port Efficiency and Level of Regulation of Mandatory Port Services, 1998



Source: Clark, David and Dollar (2004)

Competition, on the other hand, confers benefits to the ports and shipping sector. It encourages the entry of other firms and opens the industry to better and lower-priced service. Under a competitive environment, rival firms try to outdo each other by offering lower-priced and better-quality service in a bid to capture a greater market share; in effect introducing discipline in the market. Consequently, this situation would call for less intrusive regulation of the industry because competition provides incentives to firms to reduce costs and to innovate for increased profits. It tends to limit collusive behavior in the industry and makes possible the transfer of rents to consumers.

However, it is naïve to expect pure competition and zero regulation in the area of infrastructure and transport networks due to the economies of scale needed to operate in the industry. It is also difficult to find unfettered competition because market competition needs to occur within a framework of rules, rights and obligations (Banks 2002). Privatization could simply result in a transfer of power to private monopolies from bureaucratic monopoly (Tornell 1999). Industry liberalization, which is expected to introduce more competition in an industry, does not necessarily bring about the intended effect. Thus, there is a need for an explicit competition policy and efficient regulation that balance investor interest and consumer welfare.

The real challenge is how to have a degree of regulatory restraint on private providers that would not unnecessarily stifle investments and innovations. The policy challenge is to find the right combination of regulation and openness to potential competition in an industry such as infrastructure that needs lumpy investments in long-lived assets. While in principle, competition is preferred to regulation, it may be necessary to unbundle industries into competitive and non-competitive components. The policy may be to leave the competitive sector to market forces and contain regulation to component or components where competition is not feasible. For instance, ownership of ports could be monopolistic but other port services such as cargo handling could be competitively provided by more than one operator. Where the scope for competition is substantial, there may be little need for regulation as, for example, in the provision of shipping services.

Nevertheless, vertical integration of competitive and non-competitive components complicates the regulatory framework. Undue regulatory intervention in the potentially competitive sector gives rise to inefficiencies and lower level of welfare. Thus, a careful diagnosis of the industry structure is imperative before any regulation is laid out and implemented.

The scope and form of regulation depend on the kind of competition that is created in a particular sector. The form of competition that is created in a particular sector, in turn, depends on the scale of operation and level of development in the sector (UNESCAP 2001). For instance, a route that is initially not being served by any shipping line could be opened to the market by inviting bids from firms to operate for a specific period of time. This creates competition for market. After the contract for the operation in the route had been awarded, some regulation that makes the market contestable is needed in order to regulate the monopoly behavior of the winning firm or (few) firms. Alternatively, when demand for shipping services increases to a certain high level and the agreed upon period of exclusive operation has been completed, the route could now allow more than one operator. The entry of other operators would facilitate competitive behavior in the market and hence, regulation would need to take a different form.

In summary, competition policy and regulation are not mutually exclusive or contradictory. They can actually be mutually re-enforcing. The next section presents the current status and issues of competition and regulation in the ports and shipping sectors

III. STATE OF COMPETITION AND REGULATION OF PORTS

Significance of Port Efficiency

Ports, being nodes that connect land and maritime transport, are a vital component of the maritime industry. Port efficiency reduces logistical costs and results in greater passenger convenience and thus, is an important determinant of maritime transport costs. On the other hand, inefficient port infrastructure explains around 40 percent of predicted maritime transport costs for coastal countries while cargo handling accounts for 46 percent of sea transport costs in the Philippines (Limao and Venables 2000; Clark, David and Dollar 2004)). **Table 1** compares the efficiency of Philippine ports handling foreign trade with those of the leading Asian ports.

Table 1 Indicators of Port Efficiency

Country	Port Efficiency Index (1-7)	Median Clearance Time (Days)
Hong Kong	6.38	na
Malaysia	4.95	7
Philippines	2.79	7
Singapore	6.76	2
Taiwan	5.18	na

Notes: Port efficiency index is from the Global Competitiveness Report, 7 being the best score; Median Clearance time is the median number of days to clear customs; Data for year 2000

Physical infrastructure, industry structure, and regulation affect port performance. The structure of the industry and regulatory restrictions, e.g. cargo handling tariff and certain procedures, could induce inefficiencies and anti-competitive behavior of firms involved in the port industry.

Direction of Reforms in the Port Industry

The maritime transport industry has been undergoing rapid changes, especially in the past decade. Ports, like most forms of infrastructures, have been traditionally provided by the state. The government identifies the area, builds the infrastructure, maintains superstructures including buildings within the ports, operates cargo handling, and provides other port services. However, in a number of countries, the structure of the port industry has changed because of the unsatisfactory performance of publicly-owned and managed ports. Inefficient

bureaucratic planning and management brought both huge financial losses to the state and burden to business and consumers. Tight fiscal constraints and the need for greater competitiveness of businesses induced governments to turn to privatization to meet the mounting demand for better port services. Governments have not been able or were not willing to invest on expensive port development projects or equipment. Thus, starting in the 1980s, some countries began to reconsider the organization and management of national port systems. These countries started seeking ways to increase private sector participation in the provision of port infrastructure and services. In Southeast Asia, Malaysia was the first country to involve the private sector to manage port facilities by leasing the container terminal in Port Kelang to a private consortium in 1986. From then on, private sector participation expanded and by 1995, port productivity was reported to have increased by 15 to 20 percent (Peters 1995).

There are varying degrees of private sector participation according to the structure of ports system. The following are the main models of mixture of public and private sectors involvement (WB 2002; UNESCAP 2001):

Services port: Services ports are mainly public in character. The port authority is responsible for the port as a whole. It owns, maintains and operates the infrastructure and superstructures, and cargo-handling services are executed by labor hired by the port authority itself. Many ports in developing countries are still structured according to this model.

Tool port: Port infrastructure and superstructure are owned and managed by the port authority. Private cargo handling companies use these facilities through concessions or licenses.

Landlord port: In this model, port infrastructure is owned by the port authority but is leased to private operating companies and/or industries. The private port operators provide and maintain their own superstructure, including buildings, cranes, vans and forklifts. The port authority acts largely as a regulator and as a landlord, while port operations are carried out by the private sector. This model is increasingly becoming popular in large and medium-sized ports worldwide.

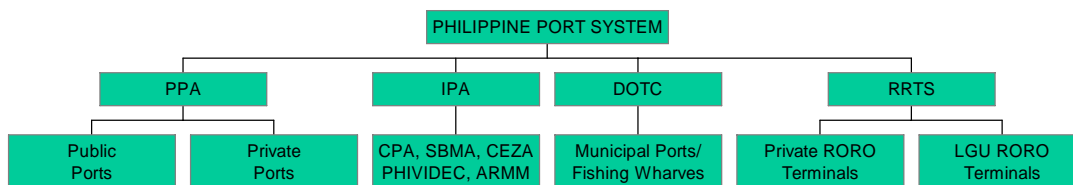
Fully privatized port: In this model, the state basically has no meaningful participation. Ownership of port land is transferred to the private sector. Regulatory functions are also passed on to the private successor. Therefore, privatized ports are essentially self-regulating.

Except in the case of fully privatized ports, some basic responsibilities remain with the public sector regardless of the degree of private sector participation. These include the provision of port land and infrastructure, port planning and coordination, regulation of safety within the port area, and environmental protection. Some advocates of competition argue that the involvement of the government should be limited to these functions (UNESCAP 2001). The amount of regulation that will be required largely depends on the structure of the ports system. The government has some latitude in managing the degree of competition except in the case of fully privatized ports. However, in the latter case the government can regulate tariff setting of port and cargo handling operators.

The Philippine Port System

The Philippine Port Authority (PPA) dominates the Philippine port system as the main developer, operator and regulator of ports in the country (**Figure 2**). The Philippine port system has four categories: (a) the PPA ports system consisting of public and private ports; (b) ports under the jurisdiction of independent port authorities (IPA); (c) municipal ports devolved to the local government units (LGUs) and the recently established Road RORO terminal system (RRTS).

Figure 2. The Philippine Port System



The PPA Port System

The PPA, established in 1974, is the main government agency concerned with the planning and development of seaports in the country. It was also originally mandated to plan and coordinate port development in the entire Philippines.

The PPA port system is the most important and extensive network of ports in the country². It consists of 115 PPA-owned ports and over 500 private (commercial and non-commercial/industrial) ports under the direct supervision of the PPA. The PPA-owned ports were developed and are being maintained by the PPA. The biggest common-user ports in the Philippines are all in Manila, namely the Manila International Container Terminal (MICT), and the South and North Harbors. Although these are under the supervision of the PPA, they are under long-term concessions (except for North Harbor) with the private sector. In almost all cases, cargo handling services are provided by private cargo handling companies³.

Private ports are mostly for industrial use; there are, however, those which operate for commercial purposes. The most important private commercial port is the Harbor Center Port Terminal (HCPTI) in Manila which operates both as a domestic and a foreign port. HCPTI competes with PPA-owned ports: South Harbor, which is privately operated under a long term concession, and North Harbor, the largest domestic cargo in the Philippines which is also undergoing privatization.

² PPA established in 1974 is a government corporation mainly concerned with the planning and development of seaports in the country. Most ports especially the large ones are under the control of PPA.

³ These cargo handling companies formed themselves into the Philippine Chamber of Arrastre and Stevedoring Operators (PCASO).

The PPA has no investment in the private ports but receives a share of port dues (i.e., 50 percent share from usage/berthing fees and wharfage dues). There are around 30 private commercial ports, e.g., Allen Port in Samar, San Lorenzo Port in Guimaras, Tefasco port in Davao, Bredco in Bacolod⁴. The latest addition to this family is HCPT in Manila established in 1996. Private commercial ports rarely provide competition to PPA ports with the possible exception of HCPT which operates in the same area in Manila where PPA ports operate.

The PPA is financially autonomous from the government⁵. It earns revenues from (a) concession fees from the lease of South Harbor and MICT; (b) port charges such as wharfage, berthing, pilotage, etc.; and (c) a share of cargo handling revenues from private cargo handling operators and from port charges of privately operated ports. A 1992 law mandates it to remit 50 percent of its net income as dividends to the national government. Its ports handle domestic and foreign cargo (containerized and bulk) and passengers. Some PPA-owned ports allow for Ro-Ro operations.

Independent Port Authorities

There are six independent port authorities (IPAs) outside the purview of the PPA, namely:-

- Subic Bay Metropolitan Authority (SBMA), which operates and manages the Subic Bay Freeport in Zambales
- Cebu Port Authority (CPA), which is in-charge of all ports in the province of Cebu
- Cagayan Economic Zone Authority (CEZA), which oversees the operation of the Port Irene
- Phividec Industrial Authority (PIA), which is in-charge of the newly-constructed Mindanao Container Port Terminal (MCPT) located within the Phividec Industrial Estate in Cagayan de Oro
- Autonomous Region of Muslim Mindanao (ARRM), which manages the devolved PPA ports in Polloc, Jolo and Bongao
- Bases Conversion Development Authority (BCDA), which supervises the port in San Fernando, La Union and manages the former US facility in Clark Field, Pampanga

With the exception of the Subic Bay Freeport and the Mindanao Container Port Terminal, all other ports were spun-off from the PPA port system. As IPAs, the port authorities can set their own rates but normally take a cue from the PPA. The IPAs were created to decentralize control of the PPA, to create more competition with its ports, and to allow an LGU to have greater control of its ports.

DOTC-developed feeder ports

The DOTC also develops and funds the construction of small landing stages and feeder ports which eventually are handed over to the LGUs. At present, there are about 427 fishing ports,

⁴ The organization of private port operators is called the Association of Private Port Owners and Operators of the Philippines (APPOOP).

⁵ The PPA board has 9 members (8 representatives from various government agencies: DOTC, NEDA, DENR, DPWH, MARINA, PPA, DTI and DOF) and only one representative from the private sector. The government agencies dominate the board and this weakens the participation of the private sector in policy and decision-making.

landing stages and municipal feeder ports in the country. Ports under the jurisdiction of LGUs include ports that were built by the national government but later on transferred to municipal governments and those which were built by LGUs themselves. Fishing ports are basically used for fishing but nevertheless handle some commercial cargo transfer under the agreement of the PPA and the Philippine Fisheries and Development Authority (PFDA).

Road-RORO Terminal System (RRTS)

The most recent addition to the Philippine port system is the Road-RORO Terminal System (RRTS) which was established in 2003 to be an integral part of the national highway network and aims to parallel the PPA port system.⁶ It is meant to provide greater access to island provinces and better integration among the different regions. It is a response to the clamor for greater efficiency and lower cost in transporting passengers and goods from Mindanao to Luzon. Executive Order (EO) 170 calls for private sector and LGU collaboration in the establishment of RORO links as part of the national highway network.

Aside from new RORO ports, EO170 also mandates the privatization and/or devolution of existing public RORO ports under the PPA or CPA⁷. Existing private port operators are encouraged to convert their operations to RRTS. To bank roll its development, the state-owned Development Bank of the Philippines (DBP) has opened a lending window called Sustainable Logistics Development Program (SLDP) in support of this thrust. Eligible projects for funding are: RORO vessel acquisition, RORO port construction, investment in bulk-handling of agricultural commodities and cold chain facilities. A Memorandum of Understanding (MOU) was signed recently by interested LGU and private investors seeking to establish a RORO network that would connect the Visayan islands and Mindanao, as follows.

- Cebu (Cordova) – Getafe (Bohol)
- Guadalupe (Southern Leyte) – Ubay (Bohol)
- Loay (Bohol) – Mambajao (Camiguin)
- Camiguin – Misamis Oriental
- Jasaan (Misamis Oriental) – Loay (Bohol)

⁶ What distinguishes the RRTS from the regular (LoLo) ports are the following:

- No cargo handling charges since the cargo is “rolling,”
- No wharfage dues (Specified under EO No.170),
- Toll fee consisting of 4 unbundled cost items: i) a terminal fee charged on the self-powered vehicle and passengers for the use of the terminal; (ii) berthing fee levied on the RoRo vessel by the terminal operator for mooring and berthing; (iii) freight or rolling cargo fee, based on the lane meter or the actual space occupied by the vehicle, charged to the rolling cargo by the carrier vessel operator; (iv) a passage fee levied to the passengers by the RoRo vessel operator
- Simplified documentary requirements, and
- Waiver of port authorities’ share in revenues, with PPA and MARINA receiving a fixed annual administrative supervision fee.

⁷ Unfortunately, almost two years after the EO 170 was issued, the PPA has yet to finalize the guidelines for the development of private ports under the RRTS.

Recent Developments

Competition, privatization, transparency, and greater private sector participation are stated policy objectives of the government. The government has implemented these objectives in the development and operation of public ports with mixed results.

The privatization of MICT and South Harbor

The first major pro-competition initiative by government in the port system was the privatization of the terminal operation of the MICT in 1987. A 25-year contract was awarded to the International Container Terminal Services, Inc. (ICTSI), a private terminal operator. This is the first successful case of the implementation of a “landlord” port model in the country. This model was replicated almost a decade later with the awarding of the terminal operation of the South Harbor to a private company, the Asian Terminals, Inc. (ATI).

The development of a private commercial port in Manila

The second initiative started in 1992 with government’s Memorandum Order No. 415 directing the National Housing Authority (NHA) to implement the “Smokey Mountain Development Plan” and undertake the reclamation of the area across Road 10. The PPA was directed to assist in the evaluation of the port-related land issues in the reclaimed area. In 1993, Memorandum Circular No. 45 directed all concerned government agencies to liberalize and provide an environment conducive for increased competition in the support service sector, particularly land, air and sea transportation, communication, energy, insurance and port services.

In 1996, the PPA issued a permit to R-II Builders, as part of the Smokey Mountain Development Plan, to construct a 15-hectare private port facility in the reclaimed area. The port facility, named Harbour Centre Port Terminal (HCPT) was envisaged to be operated as a private commercial port and to directly compete with the ports in Manila.

The de-monopolization and privatization program

The government issued Executive Order (EO) 212 “accelerating the de-monopolization and privatization program for government ports in the country.” However, the labor unions succeeded in opposing its implementation, citing as reason the possible displacement of port workers in the process and arguing that port privatization would result in the inability of some cargo handling companies to shoulder the retirement benefits of the displaced port workers. In 1997, on Labor Day, the government issued EO 410⁸ rescinding EO 212.

Policy reversal

In 1998, the government issued Executive Order (EO) No. 59 directing PPA “to adopt and implement a program for further rationalization, modernization, and improvement of port

⁸ Executive Order 410 “Repealing EO 212 s. 1994 In Recognition of the Power of the PPA under P.D. No. 857 to Implement the Policy of Accelerating the De-monopolization and Privatization of Government Ports in the Country”.

services and facilities in government ports.” The existing Charter of the PPA (PD 857) mandates it to develop seaport terminals, other facilities and ancillary services in the port areas. However, the EO argued that the government does not have sufficient funds to finance the modernization of those publicly-owned ports. To address this constraint, EO 59 was issued for the purpose of promoting and encouraging the “participation of the private sector by requiring all existing facility operators and service providers such as cargo handling operators, shipping companies and port workers and labor to unify into one corporation by merger, consolidation, buyout, joint venture, or by any other similar means to manage, operate and develop the entire government port without need of a public bidding.” While the objectives of port modernization and greater private sector participation are laudable, what was highly questionable in EO 59 is the manner by which port privatization and modernization will be carried out, to wit:

- a. *Creation of a nationwide private monopoly.* The contract was supposed to be awarded to a “consortium” organized two months before the issuance of EO 59. The consortium is to be composed of terminal operators, cargo handling companies and big shipping lines.
- b. *Bundling of port services.* This means that all port services, including ancillary services will have to be provided by the private port monopolist.
- c. *Negotiated Contract.* The operation and development of the ports will be awarded to the port monopolist without the benefit of a public bidding, contrary to the principle of transparency and competition being promoted by the government.
- d. *Nationwide coverage.* This is not only a monopoly of one port but of the entire port system.

However, the business community and the public vigorously objected to the implementation of EO 59. Because of mounting public pressure, government revoked EO 59 on October 30, 2000.⁹ The government issued EO 308 on October 31, formally rescinding EO 59 and directing the PPA to subject the privatization of the Manila North Harbor to competition by dividing it into two terminals and subjecting it to public bidding.

Seeking greater private sector participation

The government’s Memorandum Order No. 47 (s. 2001) directed the PPA to assist in the technical evaluation of port-related land use in the reclaimed areas and expeditiously process applications for the permits for private commercial ports. Thus, the PPA issued HCPT a permanent commercial permit to operate and handle (a) all types of domestic vessels and cargoes and (b) foreign vessels and cargoes chartered by the locators at Harbour Centre. In 2003, the PPA expanded HCPT’s permit to handle foreign break-bulk traffic not limited to its locators.

⁹ “There is a perception that EO 59 will create a monopoly in port services. Thus EO 59 which involves the further rationalization of port services and facilities in government ports is hereby revoked” (President Estrada, *Towards a Common Ground, October 30, 2000*).

The government also issued EO 170 and 170-A s. 2003 promoting Private Sector Investment in the Road RO-RO Ferry Terminal System (RRTS). This system, once fully operational, will be a parallel and competitor port system to the PPA utilizing the RORO technology. The EOs call for private sector and LGU collaboration in the establishment of RORO links as part of the national highway network. Under this policy, the PPA and CPA (Cebu Port Authority) are mandated to privatize their RORO ports to the private sector or devolve the same to the local government units (LGUs).

Emerging Issues

Several issues arise from the policy, regulatory and institutional framework of the ports sector that has constrained competition and provided burdensome regulation (**Table 2**). That framework has affected the existing structure and performance of Philippine ports. Overall port efficiency in the Philippines lags behind rival Asian ports as indicated above in **Table 1**).

Table 2. Institutional and Regulatory Framework for PPA Ports

Port System	Port Authority & Legal Framework	Regulation
PPA Port System LOLO and RORO operations; containerized and non-containerized cargoes	The PPA serves as the main authority in the national port system, per Presidential Decree No.505 (1974), as amended by PD 857. PPA is a government owned and controlled corporation (GOCC); an attached agency to DOTC. As a GOCC, PPA (a) raises its revenues, (b) does not receive funding from the national government, and (c) declares dividends to the government.	Public ports <ul style="list-style-type: none"> • PPA develops, owns, maintains, and regulates its ports • Sets and collects port charges such as wharfage dues, berthing/ usage fees, and terminal handling costs • Approves increases in cargo handling rates and receives 10 percent and 20 percent from cargo handling revenues on domestic and foreign cargo respectively. • Awards contracts to private terminal operators (e.g., 25-year management contract with ICTSI for the operation of MICT, 10-year contract with ATI for South Harbor), and cargo handling operators (2-year probationary contract/10-year contract without public bidding.) Under such concessions, port charges and cargo handling rates are set by the PPA. Private ports <ul style="list-style-type: none"> • PPA also regulates private ports. The regulation comes in the form of (a) issuance of permit to construct and operate the port, and (b) approval of increases in cargo handling rates and port charges such as berthing/usage fees and wharfage dues. It also collects shares from port charges (50 percent).

Source: World Bank “Meeting Infrastructure Needs”, Philippine Transportation Sector Review (2004); Interviews

Conflicting roles of the PPA

The Philippine port system gravitates around the PPA port system and government-owned IPAs. In this system, the PPA has multiple roles as a developer, operator, maintainer and regulator. It regulates private ports, awards contracts for cargo handling services to the private sector in ports owned by it, and regulates the entry of the private sector through the issuance of permits to construct and operate ports. This highly-centralized port ownership and administration system leads to conflict of functions and interest problems.

Limited competition

This setup disadvantages non-PPA ports and leads to limited competition in the industry. The PPA, which is also a port owner, issues permits to private companies to construct and operate ports. This set up creates the wrong incentive for the PPA which may not approve the private sector's application for construction or expansion if this threatens its port ownership and revenues. In 1997, the PPA issued a regulation liberalizing the construction and operation of private industrial ports but not its operation for commercial purposes.

Prior to the entry of Harbour Centre Port Terminal in 1996, the PPA was the only operator of the ports (MICT, South and North Harbors) in Manila. Initially, the North Harbor handled domestic cargoes while MICT and South Harbor handled foreign cargoes. In 2003, Pier 15 of South Harbor was converted into a domestic port (Eva Macapagal Terminal).

The PPA owns these ports but the terminal operations of MICT and South Harbor have been awarded to ICTSI and ATI, respectively, as part of the government's privatization program. In the case of the North Harbor, cargo handling companies operate in specific piers. **Tables 3 and 4** provide a comparison of the capacities and performance (in terms of an indicator of productivity and market share) of PPA-owned ports operated by private concessionaires and a private port owned and operated by a private investor (Harbor Center).

Table 3. Comparative Analysis of North Harbor, South Harbor, and Harbor Center

Indicators	North Harbor	MICT	South Harbor	Harbor Center
Area	430,000 sqm	606,740 sqm	200,000 sqm	150,000 sqm
Draft	6.0 meters	10-11.5 meters	12 meters	11.5-12 meters
Berths	15 berths	5 berths	3 berth	12 berth
Quay length	-	1,000 Meters	600 meter	1,100 meters
Container Yard	-	322,584 sqm	-	45,000 sqm
Equipment	-	10 Gantry Cranes 25 Rubber Tyre Gantries 10 Reach Stackers	8 Gantry Cranes 9 Reach Stackers	1 Mobile Harbor Crane 4 Rubber Tyre gantries 25 Forklifts 2 Reach Stackers
2002 Cargo Throughput	16.8 million MT	12.2 million MT	7.3 million MT	1.1 million MT (10 percent capacity utilization)

Productivity of unloading steel @ 40,000 MT/vessel	- -	- -	6,000 MT/hr 8-10 days	7,200 MT/hr 5.5 days
Market Share (2003)	Break bulk – 12 percent Containerized – 49 percent	Foreign Containerized – 80 percent	Foreign Containerized – 20 percent Foreign break-bulk – 30 percent	FOREIGN – break bulk Steel – 90 percent Logs / Lumber- 100 percent Wheat / Grain – 50 percent DOMESTIC – break bulk Bottled Cargo – 100 percent Gypsum – 100 percent
Modernization Cost	P 3.5 billion	Php30 billion (proposed)	Php15 billion (as per contract)	P4.8 billion (actual) Php1.5 billion (additional equipment and facilities)
Price	PPA prescribed	PPA prescribed	PPA prescribed	PPA prescribed (but has the flexibility to price itself lower being a private port; lower cost since no double handling at pier side)
2002 Net Income	Not available	P2.8 Billion	P641 Million	P1.3 Million

Source: Strategic Implications of Competition. R. Romero (UA&P Masteral Thesis, 2004)

Table 4 Port Operation in Manila

Port	Terminal Operator	Coverage
Manila International Container Terminal (MICT)	International Container Terminal Services, Inc. (ICTSI)	<ul style="list-style-type: none"> • Foreign cargoes – mainly containerized
South Harbor	Asian Terminals, Inc. (ATI)	<ul style="list-style-type: none"> • Foreign cargoes – both containerized and break-bulk • In 2003, the Eva Macapagal Terminal was inaugurated to handle domestic cargoes and passengers
North Harbor Pier 2 Pier 4	Cargo Handlers Northstar Northstar	<ul style="list-style-type: none"> • Domestic cargoes – containerized, break-bulk and RORO • Domestic passengers

Pier 6	United Dockhandlers, Inc. (UDI)	
Pier 8	Pier 8 Arrastre and Stevedoring	
Pier 10	Northstar	
Pier 12	UDI	
Pier 14	UDI	
Pier 16	UDI	
Marine Slipway (MSW)	Vetyard*	
IPB	Isla Putting Bato	

* former cargo handling operator

In 1995, the PPA Board approved the proposal of R-II Builders Inc. to develop and operate a private commercial port at the Manila North Harbor.¹⁰ A year later, the PPA gave R-II a permit to construct a 15-hectare port facility (HCPT). However, it was only in June 2002 that the PPA issued HCPT a commercial permit to operate and handle:

- a. all types of domestic vessels and cargoes
- b. limit to its locators, the operations of foreign vessels and cargoes, provided such vessels are chartered to carry only cargoes of such authorized locators.

Limited competition started when HCPT was issued the permit by PPA in 2003 to handle foreign break-bulk cargoes. As a result, HCPTI claims that 80 percent of the foreign break-bulk traffic (normally handled at the South Harbor) transferred to Harbour Centre due to better service and lower cost (rate at HCPTI is 50 percent lower than PPA rates). The need for barges disappeared because foreign vessels can unload docked at the Harbour Centre (the draft is deep enough to accommodate foreign vessels). In the case of South Harbor, barges are needed because foreign vessels cannot dock at the port. Of the 50 barges that were utilized prior to the operation of HCPTI, only 5 are still being used at the South Harbor at present. **Table 5** summarizes the status of competition among Manila ports.

Table 5. Services Provided at the Manila Ports

Type of Cargo Handled	North Harbor	South Harbor	MICT	HCPT	REMARKS
DOMESTIC Break-bulk	With permit	With permit		With permit	Competitive
DOMESTIC Containerized	With permit	With permit		With permit	Competitive
FOREIGN Break-bulk		With permit	With permit	With permit	While MICT has a permit to handle foreign

¹⁰ PPA Board Resolution No. 1473

					break-bulk cargoes, it focuses on handling foreign container traffic; HCPT provides intense competition to South Harbor
FOREIGN Containerized		With permit	With permit	No permit yet	Competition exists between MICT and South Harbor on foreign containerized cargoes. However, the entry of HCPT into the market is expected to intensify the level of competition

North Harbor, South Harbor and HCPT compete for domestic cargoes, whether break-bulk or containerized. South Harbor and HCPT compete for foreign break-bulk cargoes. ICTSI has the permit but is not actively competing in this market. Instead, it concentrates on the foreign containerized cargo market. Only MICT and South Harbor compete for foreign containerized cargoes despite the capacity of HCPT to compete in this market. The PPA has not issued HCPT the permit to handle foreign containerized cargoes to date in spite of HCPT's satisfaction of the PPA's requirements for the issuance of the permit.

Table 6 illustrates the positive benefits of competition in the port sector.

Table 6. Benefits of Competition

Indicators	South Harbor	HCPT
Productivity/Efficiency Level	Steel – 6,000 MT/hr Cement/Rice – 4,000 bags per gang/ship	Steel – 7,200 MT/hr Cement/Rice – 6,000 to 8,000 bags per gang/ship
Unloading Time	8-10 days	5.5 days
Rates	PPA prescribed	30-50 percent lower

Source: Strategic Implications of Competition. R. Romero (Masteral Thesis, 2004)

Several factors create a disincentive for more competition in the port sector, namely:

- The PPA’s bias against full competition in the foreign containerized market which might undermine the income potential of MICT and South Harbor. HCPT’s handling of foreign break-bulk cargoes led to an erosion of the income potential of South Harbor. A lower income generated from MICT and South Harbor operations means lower rents paid to the PPA which receives both fixed and variable fees from port operations (**Table 7**). The PPA gets a 10 percent and 20 percent share from domestic and foreign cargo handling revenues, respectively. Table 7 shows the PPA-approved cargo handling rate increases in recent years.

Table 7. Increasing Cargo Handling Rates

YEAR	DOMESTIC		FOREIGN	
	Arrastre	Stevedoring	Arrastre	Stevedoring
1998	12%	40%	8%	40%
1999			20%	
2000	10%	10%	8%	8%
2001	10%	10%	15%	15%
2002			10% /a	10% /a
2005	38% /b		12%	
2006			8-10%	

/a Rate increase applicable only to MICT and South Harbor

/b Petition filed by cargo handling companies operating in domestic ports

- A reduction of the PPA’s income will affect its capacity to declare more dividends to the national government.

Table 8. PPA Revenues and Net Income (2001-2002) In Million Pesos

	2001	2002/a
Port Revenues	4,720	3,640
Fixed Fee from ICTSI	1,400	1,230
Revenue from Cargo Handling Share	837	430/b
Net Income	1,640	2,120

a/ January to September b/ ATI only

Sources of Basic Data: PPA Financial Reports, News article written by Teresa Visita of Malaya.

- Lower income will also affect the PPA’s port development and maintenance activities.
- Lower volumes handled by PPA terminal operators (ICTSI and ATI) have implications on their income, profitability, and investment commitments (e.g., ATI is committed to invest \$300 million within the contract period).

In sum, the PPA may have a weak incentive to promote competition to protect its own interest. This highlights the “conflict of interest” situation that the PPA faces because it is vested with proprietary, developmental and regulatory functions.

With a few exceptions and despite policy pronouncements that favour multiple operators, the PPA has chosen to limit a port to one cargo handling company (except in North Harbor). Bidding is a stated PPA policy but the award or renewal of cargo-handling contracts is mainly by negotiations¹¹. Thus, the PPA can simply renew a contract without the benefit of public bidding or without a thorough assessment of performance. This grants tremendous rents to the fortunate company.

The centralization of port administration leaves very little room, if at all, to inter-port competition. It has been claimed that the PPA regulates against competition by not granting Harbour Centre (a private commercial port) a permit that will allow the handling of foreign containerized cargoes because it will compete against PPA-owned ports (i.e., MICT and South Harbor).

The PPA's Charter (Presidential Decree 857) allows it a share of at least 10 percent from cargo handling revenues. It regulates and approves tariffs and rate increases in port charges and cargo handling rates for both public and private ports. This puts it in a potential conflict of interest situation because higher cargo handling rates given to private port operators result in a higher share of the revenues to it that regulates rate setting. This is a case of a regulator benefiting from its own regulation.¹² Non-PPA ports, including private ports, have to give 10 percent of cargo handling revenues to the PPA which uses it mainly for the development of its own ports. It seems that the 'tax' paid by the private ports leads to their own disfavor because of the competition presented by PPA ports supported by that 'tax'.

On the other hand, it is claimed that present port charges, including tariffs for domestic ship berthing and cargo handling, are set extremely lower than what is required for financial viability of operations (JICA 2003). Philippine port charges are among the lowest in the Asian region (UNESCAP 2002a). Since a port that handles only domestic cargo has limited sources of revenue, a number of ports are not financially independent, especially those operated by LGUs.

Undue restrictions on setting cost-based tariffs may jeopardize port operations and may reduce the attractiveness of port development to private investors. This prevents

¹¹ PPA AO 01-2001 "Renewal of Expired and Expiring Cargo Handling Contracts seeks to grant the renewal of expired and expiring cargo-handling contracts without public bidding, contrary to what the law dictates. Executive Order 40 s. 2001 and Executive Order 109 s. 2002 issued by President Arroyo mandate government agencies to subject to public bidding all procurement, including cargo handling, and contract award. PPA requested the Office of Government Corporate Counsel (OGCC) for an opinion on the matter. OGCC in its opinion (No. 234) affirmed that indeed cargo handling is covered by EOs 40 and 109. Instead of implementing the advice, however, PPA requested the OGCC to reconsider its opinion. OGCC did reconsider its opinion (No. 282). Early this year, Congress passed into law RA 9184 (Government Procurement Reform Act) which defines as a matter of policy, in all cases, the following principles: transparency and competition through public bidding, monitoring, accountability, etc. When the issue was brought up by the private sector at the NPAC for the purpose of making sure that PPA policies are consistent with the law, PPA said they will seek another legal opinion from the OGCC.

¹² In the past, the PPA had as much as a 33 percent share from cargo handling revenue. Thus, approval of petitions for rate increase invariably benefits the regulator itself. In August 2002, President Arroyo directed the PPA to adopt a universal rate for collecting the government share from the revenues of cargo handlers, that is, 10 percent for domestic ports and 20 percent for international ports. The PPA announced that it has revised its rules on the bidding of cargo handling contracts to comply with the presidential directive. Instead of using "the highest share to the PPA" rule as basis for winning a contract, the PPA will now use "the lowest service rate" as basis since its share from cargo handling revenues is already fixed. However, the PPA has to withdraw AO-O1-2001 which allows the renewal of expired and expiring cargo handling contracts without public bidding.

potential entry of more cost efficient operators who could offer lower port charges. Thus, there is a case for more transparent procedures on how cargo handling tariffs are set for different ports.

Another conflict of interest is a potential bias for multiple cargo handling instead of Roll on-Roll off (RORO) shipping¹³ because RORO shipping does not entail cargo handling.¹⁴ Lesser cargo handling implies a lesser revenue share for the PPA from cargo handling fees. In 2001, the share from cargo handling fees accounted for 18 percent of the total revenues generated by the PPA from port operations¹⁵. In addition, the huge revenues from multiple cargo handling may motivate the (traditional) large shipping companies to ignore RORO shipping which can bring shippers positive benefits such as reduction in breakage and deterioration of cargoes, increased security of cargoes and reduction in pilferage.

What about IPA ports? It is doubtful whether these IPAs are providing inter-port competition to PPA ports. For instance, MICT and Subic Bay Freeport are operated by the same terminal operator. On the other hand, the terminal operator at the South Harbor is also the cargo handling operator at the Port of Batangas. The newly constructed MCPT in Misamis Oriental is supposed to provide competition to PPA's port in Cagayan de Oro. However, even before it could operate, a lower court issued an injunction to operate on the basis of a case filed by the cargo handling operator at the PPA Cagayan de Oro port, arguing that the MCPT provides unfair competition.

In conclusion, despite the objective of creating more competition, there is actually very limited competition, if not at all, in the Philippine ports system under the current policy, institutional and regulatory framework.

Necessary Reforms

The inefficiencies in port operations and administration are a due to the flaws in the port policy and regulatory design. These flaws have led to very limited competition and little private sector participation.

Reforming the PPA

¹³ In the early 1990s various studies (JICA, SHIPDECO) recommended the extensive use of Roll-on/Roll-off (RORO) shipping as the most appropriate mode of sea transport for an archipelagic country like the Philippines.

¹⁴ PPA implemented RORO in some ports. Special ports, or terminals in existing ports designed for inter-modal transport were constructed more than 20 years ago. The earlier versions were the water links in the Pan-Philippine Highways (implemented by DPWH) – from Sorsogon to Samar, thence to Leyte and Surigao (in Mindanao). These were subsequently called the Eastern Seaboard. PPA also introduced ferry ports and services on the Batangas-Mindoro sea corridor, thence to Panay, Guimaras and Negros; these were subsequently labelled the Eastern seaboard. The Manila-Cebu Corridor Intermodal Transport Plan (MCCITP) envisaged in 1994 RoRo ports in Pagbilao, Quezon and Balamban, Cebu. The Central Visayas East-West Intermodal transport Project came up with the east-west land-sea links from Ormoc-to Cebu, thence to Panay and Mindoro. A less ambitious network was finally made operational in 2003 by DOTC. Together with the Eastern seaboard links, these inter-modal links were dubbed the “Strong Republic Nautical Highway” (World Bank, 2004). Unfortunately, cargo handling fees are being collected in these PPA RORO ports even if no commensurate service is provided.

¹⁵ This figure still does not reflect the share of PPA from cargo handling in the international Ports, MICT and South Harbor.

Because of the intrinsic flaws in the structure of the regulatory framework for the port industry, a restructuring is indispensable. The PPA's charter has to be amended to separate the PPA's regulatory responsibilities from its development and operation functions. The development of ports and operation functions are the domain of the private sector while the formulation of broad policies is the responsibility of the DOTC.

There is a need to provide transparent rules or guidelines for the grant or extension of cargo handling contracts. In theory, the PPA awards cargo handling contracts on the basis of the lowest fee charged to shippers. However, the lack of transparency in the grant or extension of cargo handling contracts, including possible extension without the benefit of a thorough assessment of performance creates inefficiency problems. According to the World Bank (2003), "there is a general lack of transparency as to how cargo handling rates are set for the different ports, how rates are increased, and what constitutes cargo handling and what constitutes shipping or terminal charges given that some companies offer both cargo handling and shipping services."¹⁶

With regard to port charges, the PPA should stop collecting a percentage of revenues and instead lease port facilities to port operators. It should allow competition in cargo handling operation by allowing more than one operator. Tariff setting should be deregulated and port operators and cargo handlers should be allowed to establish cost-recovery tariffs subject to the regulatory guidelines protecting consumer welfare against the exercise of market power. It can draw useful lessons from international experience in port administration (**Box 1**).

Box 1. Port Administration Lessons Applicable to the Philippines

- None of the successful ports and well-managed ports is administered by a "centralized" system of port administration;
- The ports are run by independent boards (of directors) and professional managers carefully appointed to represent and serve the interests and aspirations of the local community and industry;
- The consistent practice of utilizing competition, whether intra-port or inter-port rivalry, is no accident. Competition is regarded as the primary market force in regulating the operator's business behavior, motivating them to produce higher levels of service quality, disciplining them to reduce costs;
- A decentralized system of local port authorities each operating independently is predicated on the fact that a local port authority can respond to market conditions more quickly than a centralized authority can;
- It is no coincidence that a dynamic and responsive board makes a considerable difference in the performance of a port. Although the constitution of a port authority in the international scene offers a diversity of practice, there is invariably a strong commonality among them such as a strong community and industry representation with a degree of government participation in the board; and

¹⁶ MARINA attempted to resolve the issue on shipping services and cargo handling by developing a new chart of accounts for the unbundling of shipping and cargo handling costs and by requiring shipping companies to use them (World Bank 2003).

- The utilization of the private sector (or privatization) in port functions has been carefully predicated on the strategy of generating competition among the operators within the port.

Source: Peter Yee

The recent port reform experiences of Argentina and Mexico highlight these lessons. Prior to the reform in the 1990s, Argentina's port operations were characterized as highly centralized, inefficient and costly. The fact that its ports were open rather than terminal-based led to inefficient practices and unnecessary costs for storage and cargo handling. These problems therefore resulted in the ports' loss of market share to the road sector and to more efficient neighboring ports such as the Chilean ports.

The Argentinian reform process sought to achieve the objectives of reduced cost and increased productivity. The strategy focused on privatization, decentralization and competition. As a result of the implementation of this strategy, there was a sharp decline in port charges and tariffs, and an increase in labor productivity and cargo volumes. The decentralization of port administration, on the other hand, led to government savings from the devolution and privatization of small ports and/or closure of unprofitable ports. In sum, the positive externalities of the reform process produced a positive impact on Argentina's external trade, a considerable reduction in freight rates, and savings to the national government.

The case of Mexico is similar to the Argentinian experience. The same strategies were adopted - decentralization of port administration to promote inter-port competition, privatization and liberalization. The first phase of the reform process focused on the decentralization of port administration, which was achieved by creating independent port administrations with the national government only having supervisory functions over the system. Similar to Argentina, the independent port administrations were made up of representatives from the local government and the private sector. The independent port administrations performed the functions of planning, building infrastructures and promoting the port, and safety.

The second phase of the reform process centered on the privatization of the port industry to private investors, both domestic and foreign. The private sector was initially allowed to operate the terminals and facilities. Private entities interested in bidding for concessions submitted bids to be evaluated by the competition agency in order to avoid market power after privatization. Likewise, port tariffs were liberalized and cross subsidies and entry barriers eliminated. Only in cases where there is not enough competition would regulation surface. Eventually, private sector participation expanded to port ownership and administration.

Promotion of the Road-RORO system

The first best scenario is to privatize the PPA ports and to encourage the development of a road-RORO system by the private sector. However, given the political and vested interests supporting the PPA, the second best approach is the development of a road-RORO terminal system (RRTS) that parallels or complements the existing PPA port system. The RRTS will introduce the needed ports competition to improve efficiency and reduce cost, and give shippers the flexibility to determine the most efficient and cost-effective way of shipping

their cargoes. In addition, the government should allow the conversion of private non-commercial ports into commercial ports under the RRTS. This will instantly expand the existing port network with no or minimal cost.

IV. STATE OF COMPETITION AND REGULATION OF INTER-ISLAND SHIPPING

Structure of the Philippine Shipping Industry

The shipping industry plays a crucial role in the development of the country. It enables the movement of goods and passengers in the Philippine archipelago and to other countries. Efficient shipping services encourage economic growth and development and are vital for regional integration (**Table 9**).

The shipping industry is divided into 3 main sectors: (a) the shipping sector, (b) shipbuilding, ship repair and drydocking sector, and (c) the manning/seafaring sector (**Figure 3**). The shipping sector is further divided into domestic inter-island shipping and ocean-going (international) shipping. Domestic inter-island shipping consists of liner shipping operations, tramping, tanker services, ferry/fast craft operations, RORO shipping, and barging operations. This section of the paper discusses inter-island shipping.

Figure 3. The Philippine Shipping Industry

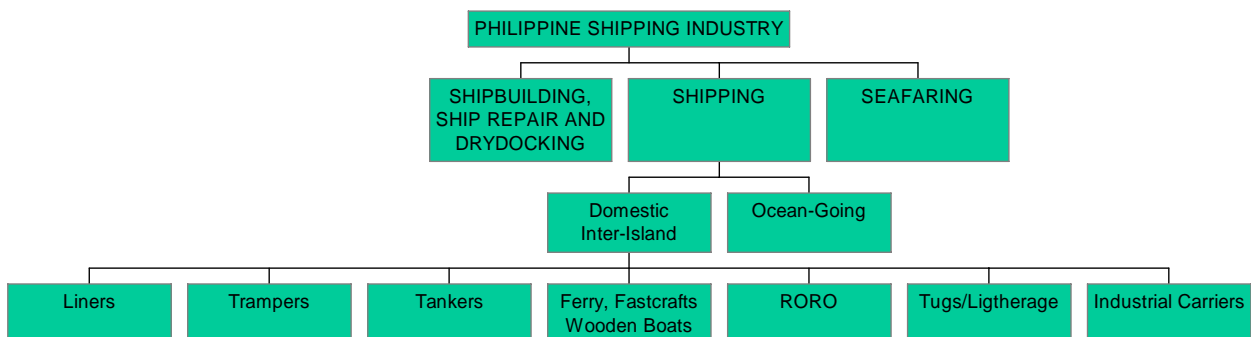


Table 9. Services Provided by the Domestic Inter-Island Shipping Industry

Domestic Shipping	Description
Liner	Liner shipping is involved in the transport of both passengers and cargoes although some liners carry only cargoes, e.g. Solid Shipping. It follows fixed sailing schedules, regular ports of call (routes) and frequency of travel. Liner routes are classified as primary (major ports with developed markets), secondary, tertiary and developmental (also referred to as “missionary”). Companies in the liner shipping business are WG&A (now ATS), Negros Navigation, Solid Lines, Lorenzo and Sulpicio. These corporations already take 90 percent of the market (Austria, 2002).
Tramper	These are freight vessels that do not follow a regular route and schedule. They are contracted (chartered) by shippers to deliver cargoes from port to port. They only handle cargoes.
Tanker	These are specialized vessels that transport oil, chemicals and LPG.
Fastcraft, Ferry and Wooden Boat	These vessels travel short distances. They cater mainly to passengers. The service has a fixed schedule and a regular route.
RORO	Vessels used for short distance travel. Can accommodate passengers and vehicles (as cargo). The service has a fixed schedule and a regular route. No cargo handling involved since the cargoes are “moving” (self-propelled) cargoes.
Industrial Carrier	Vessels owned and used by companies to transport their cargoes (in many cases using their own ports)
Tugs, barges	Used in ship-to-shore loading and unloading of cargoes.

Liner Shipping Industry Performance

Number of passengers and cargo volume

The sheer number of passengers and volume of cargoes that utilize this mode of transportation manifests the importance of the shipping industry in the economy. Sea transport is the dominant mode for passenger travel and cargo. In 2001, around 75 percent of travelers used the sea transport mode (**Table 10**).

Table 10. Share of Passenger Traffic by Mode (Unit in Person)

Mode	Sector	Indicator	1991	Share	2001	Share
Land	Rail	Passenger	10,326,800		10,211,400	
	Long Distance bus	Passenger	762,727		1,513,590	
Sea	Domestic	Passenger	31,715,783		55,797,795	
Air	Domestic	Passenger	7,687,468		12,017,417	
	Total		50,492,778	100.0 percent	79,540,202	100.0 percent

Source: Department of Transportation and Communication (DOTC), "The Study on the Master Plan for the Strategic Development of The National Port System in the Republic of the Philippines," (December 2003)

From 1991 to 2001, passenger traffic via sea grew by 175.93 percent. This translates to an annual growth rate of 5.81 percent. In terms of the share of cargo traffic, almost all (99.7 percent) cargoes are shipped via sea transport (Table 10). Cargo traffic grew by 149.32 percent in the period 1991-2001, or an average annual growth of 4.09 percent.

Table 11. Share of Cargo Traffic by Mode (in Metric Tons)

Mode	Sector	Indicator	1991	Share	2001	Share
Land	Rail	Cargo	43,800	0.07 %	3,400	0.00 %
Sea	Domestic	Cargo	58,630,134	99.67 %	87,544,738	99.72 %
Air	Domestic	Cargo	151,098	0.26 %	246,289	0.28 %
	Total		28,825,032	100.00 %	87,794,427	100.00 %

Source: DOTC Master Plan (2003)

Table 12 provides a dis-aggregation of cargo movements by major port of origin.

Table 12. Sea Borne Cargo Volume in 2001 (in Metric Tons)

Region	Port	Import	Export	Inbound	Outbound	Total Cargo
NCR	North Harbor (Manila)	1,540,943	0	7,726,750	8,589,744	17,857,437
	South Harbor (Manila)	6,348,106	474,980	6,203,211	64,487	13,090,784
	M.I.C.T.	6,914,717	3,989,829	3,750	6,090	10,914,386
CAR						
1	San Fernando, BCDA	3,483,174	31,729	303,670	13,920	3,832,493
2	San Fernando, CEZA	5	55,500	408	0	55,913
3	SBMA					1,384,325
	Limay	9,812,702	794,990	394,043	5,794,105	16,795,840
4A	Batangas	15,037,310	644,009	3,019,643	5,248,072	23,949,034
4B	Calapan	0	0	368,371	328,719	697,090
4B	P. Princesa	8,349	483,402	478,346	210,302	1,180,399
5	Legazpi	216,315	135,784	1,849,468	1,151,849	3,353,416
6	Iloilo	385,577	176	2,379,118	890,839	3,655,710
	Pulupandan	201,936	148,539	2,112,468	1,331,007	3,793,950
7	Dumaguete	32,698	472,357	700,175	388,256	1,593,486
	Cebu	1,811,998	1,599,130	5,250,167	6,143,334	14,804,629
	Tagbilaran	40,648	387,999	827,309	903,973	2,159,929
8	Tacloban	1,909,948	827,665	2,345,464	2,928,709	8,011,786
9	Zamboanga	177,977	249,158	1,241,149	659,151	2,327,435
10	Cagayan de Oro	4,982,114	5,308,801	2,632,046	2,417,630	15,340,591
	Ozamiz	35,758	165,423	1,363,754	1,082,785	2,647,720
11	Davao	1,168,845	2,836,733	2,192,399	1,210,780	7,408,757
	General Santos	251,303	443,110	878,092	876,893	2,449,398
12	Iligan	436,349	488,750	1,250,807	1,298,185	3,474,091
	Cotabato	0	0	38,917	69,968	108,885

13	Surigao	64,491	990,092	405,754	650,292	2,110,629
	Nasipit	93,876	415	561,389	442,073	1,097,753
ARMM	Polloc*	0	0	0	0	757948*
	Jolo*	0	0	0	0	240362*
	TOTAL	54,955,139	20,528,571	44,526,668	42,701,163	162,711,540

Source: DOTC Master Plan (2003)

Note: Cargo volume of Polloc and Jolo were 1998 figures and as such, were not included in the total.

Maritime safety

The performance of Philippine shipping in terms of safety is lamentable. From 1995 to 2002, the Philippines has averaged 162 maritime accidents and 215 fatalities per annum. A study¹⁷ of maritime accidents from 1991-2000 revealed the four most frequent causes of maritime accidents: (a) capsizing (30 percent), (b) sinking (25 percent), (c) grounding (21 percent), and (d) engine trouble (12 percent). Motorized bancas were found to be most vulnerable to capsizing, grounding and sinking. Capsizing happened mostly during typhoon seasons. The casualty figures were also very high – averaging 118 fatalities and 152 missing persons per annum.

Service quality and cost

The export of manufactured goods by ocean transport is at a disadvantage because Main Line Container Operators do not make direct calls to Manila, but rather use common carrier feeders to transport cargo to and from their regional hubs such as Hong Kong and Singapore. **Table 13** shows the feeder shipping services serving Philippine international ports.

Table 13. Feeder Shipping Services

Feeder	Route	Frequency	Vessel Size
OOCL Feeder	Hongkong-Kaoshiung-Manila-Hongkong	Weekly	1,500 TEUs
APL Feeder (mnx express)	Kaoshiung-Manila-Cebu-Kaoshiung	Weekly	1,500 TEUs
APL Feeder (bugo feeder)	Kaoshiung-Subic-Manila-Bugo-Davao-GenSan-Manila-Kaoshiung	Weekly	1,000 TEUs
RCL	Singapore-Manila-Cebu-Singapore	Weekly	750 TEUs

Note: The main feeder service route going to the USA is via Kaoshiung. For Europe and Middle East trade, the Philippines uses Singapore as transshipment port. The majority of the feeders operate a weekly service, either offering short-haul feeder vessels or multiple vessels calling on several ports in rotation.

Source: Direct Container Line Phils.

Exports also face the problem of inefficient inter-island container handling facilities and shipping services. The export of perishables is hampered by the lack of a cold chain in moving goods from the farmer/producer to the point of export. The export of bulk cargoes is

¹⁷ Sigua, R and Aguilar, G. "Maritime Incident Analysis Using GIS", 5th EASTS Conference, Oct 2003.

at a competitive disadvantage because there are few port facilities that provide efficient bulk cargo handling and storage. Thus, freight rates tend to be higher and this increases shipping and transaction costs (**Table 14**).

Table 14. Comparative Freight Rates*

	Manila-Davao	Hongkong-Manila	Bangkok-Manila	Klang-Manila
Freight	6	250	600	675
Distance (in nautical miles)	519	619	1,189	1,343
Sailing Time (number of days)	1.5	1.5	8	8
Freight/nautical mile	1.20	0.40	0.50	0.50

*20 Foot Container in US\$

The domestic shipping fleet operates smaller cargo vessels compared with the feeder vessels used for regional trans-shipment. Philippine container vessels average about 20 years old and are only about 2000 GRT or less than 250 TEU in capacity. The general cargo vessels, many of which carry containers, are younger but average less than 500 GRT. The small size of Philippine cargo vessels means limited capacity and more turnaround times in domestic ports which themselves are inefficient. Thus, inter-island shipping costs are extremely high.

On the other hand, the quality of passenger service has recently shown dramatic improvements in the primary and secondary routes. New facilities and amenities were introduced on board while passenger accommodation and ticketing and booking facilities were upgraded. Fast craft ferries became popular on the secondary routes in the Visayan seas, due to its shorter travel time, but these soon declined due to oversupply and the high cost of operations. Not unlike the cargo service, the quality in the tertiary route is still considered poor – with about 78 percent of the routes still served by a single (and small) operator. (WB PTSR 2004).

Institutional and Regulatory Framework for the Shipping Industry

The government agency for shipping is the Maritime Industry Authority (MARINA), which has both developmental and regulatory functions. It is under the supervision of DOTC. Unlike the PPA, it has not faced conflict-of-interest situation because it is not involved in ship operating activities. It regulates all carriers and shipping companies, including those in logistics. DOTC, meanwhile, is responsible for the provision of navigation and maritime communication facilities. The Philippine Coast Guard is responsible for security and safety enforcement along coastal areas. **Table 15** shows the key stakeholders of the domestic shipping industry as well as the major associations and organizations representing these stakeholders.

Table 15. Domestic Shipping Stakeholders

Institutions	Description / Function
Maritime Industry Authority (MARINA)	Government agency tasked to oversee the development and promotion of the shipping industry. Vested with economic regulatory powers. Acts as the “flag state administrator” of IMO in the Philippines. Certification of Filipino seafarers.
Philippine Coast Guard	Together with PPA and MARINA, tasked to implement safety shipping-related marine pollution rules and standards, maintains and operates aids to navigation, and enforces maritime laws and regulations. Implements IMO’s MARPOL 73-78 but enforcement is weak due to lack of resources.
Department of Environmental and Natural Resources (DENR)	Regulates all kinds of environmental pollution, including marine (e.g. oil spillage, garbage dumping).
Commission on Higher Education (CHED), Maritime Training Council (MTC), TESDA, other private and public maritime schools	CHED regulates all specialized schools, including those that offer maritime education and training of various types of seamen
National Telecommunications Commission (NTC)	Regulates all forms of telecommunication, including grant of radio frequencies for vessels whether ship-to-ship, ship to shore, or ship to INMARSAT & GMDSS
Professional Regulatory Commission	Licensure (marine engineering / marine transport)
Ship classification	Applies ship inspection rules for vessels 500GRT and above, in accordance with International Association of Classification Societies (IACS). Seven classification societies exist in Philippines.
Shipping companies	Domestic and foreign shipping companies calling at Philippine ports. Main Organization: PISA.. Member Organizations of PISA: Liners – DSA; Trampers –UTAP; Ferry Operators – VAFCSO; Tankers – Philippine Tanker Operators; Ocean-going – FSA.
Pilotage service companies	Offers pilot services at major ports. Association: United Harbor Pilot Association of the Philippines.
Shippers	Private cargo owners; port users (exporters/importers, domestic manufacturers, traders,). Organizations: DMAP, PHILEXPORT; Federation of Mindanao Shippers; PCCI, FPI
Seafarers	Ship officers and crew. Organization: Association of Maritime Officers and Seafarers Union of the Philippines (AMOSUP)
Forwarding Companies	Provides cargo consolidation and freight forwarding services.
Trucking companies	Inland trucking service providers. Organization: CTAP
Forwarding companies, Customs brokers, and 4 th Party Logistic providers	Provide services to shippers, by addressing all requirements at every stage of the logistic chain, including tracking, documentation and customs clearance

Consumers/Passengers	The general public whose interest the MARINA is supposed to protect. Organizations: Consumer Watch, Consumer Complaints Center. Etc.
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MARINA exercises its regulatory functions through the issuance of a Certificate of Public Conveyance defining route and safety regulation and fixing rates of passenger fares and cargo freight. At present, there are 694 cargo routes being served by the domestic inter-island shipping industry. To operate on any given route, a shipping company has to secure a permit from MARINA. For a long time, MARINA has subscribed to the ‘prior operator’ rule which has raised the hurdle on the entry of a second operator to a given route. It required proof of presence of sufficient traffic to warrant the operation of another carrier without resulting in “destructive competition”.

In 1994, reforms liberalized the entry into routes¹⁸. Presumption of need is deemed in favor of the prospective entrant while the existing operator has the burden of proof that a proposed service is not needed. Routes were opened to at least two shipping operators. To encourage entry in developmental or new routes, the pioneering operator was given protection for a period of 5 years. This was re-iterated under Memorandum Circular 106 (1995) that opened all monopoly routes with 5-year history to a second operator, and allowed rates different from the fork rates to be imposed by vessels with new technological features.

With the exception of third class passenger fares and specific non-containerized basic commodities whose rates are set by MARINA, all other passenger fares and cargo rates have been deregulated. Cargo rates are set through negotiation between the shipping company and the cargo owner. Theoretically, shipping companies are not supposed to exceed 12 percent rate of return on operating assets under the Public Service Act¹⁹.

Republic Act 9295 (“An Act Promoting the development of Philippine Domestic Shipping, Shipbuilding, and Ship Repair/Breaking, ordaining reforms in government policies towards shipping in the Philippines, and for other purposes”) further deregulated the shipping industry by allowing shipping companies to fix their own rates. The following were included in the Implementing Rules and Regulations (IRR) to protect public interest:

- development of routes to promote competition
- MARINA intervention in rate setting under certain conditions
- right of shippers to question/challenge the rate increase

MARINA issued Memorandum Circular 153²⁰ removing the Consultative Council (DOSCON) which provided the venue for discussing proposed rate increases. The only requirement now is the publication of proposed rate increases in newspapers of general circulation. As a result, freight rates have increased annually over the last 3 years as shown in **Table 16**.

¹⁸ See Annex A for a brief history of regulation of shipping services.

¹⁹ Commonwealth Act No. 146 of 1936 classified shipping services as public service and thus, subject to regulation.

²⁰ It revised the IRR of EO 213.

Table 16. Annual Changes in Shipping Rates

Year	General Rate Increases + Automatic Fuel Rate Adjustments (AFRA)
November 2000	20 percent
November 2002	6 percent
March 2003	5.98 percent
October 2003	7.5 percent
October 2004	9 percent
January 2005	5.5 percent
May 2005	6.99 percent

Source: DMAP

The 5-year period for protecting pioneer operators in developmental routes was revised to include certain conditions. New entrants can ply these routes as long as the entry was not detrimental to existing operators. Entry was not allowed when existing operators only have break even load and when their financial statements manifest that they are losing from the operation.

The newly enacted Domestic Shipping Development Act (RA 9295) provided the industry with tax and other incentives to encourage the modernization of the industry. It requires the “retirement of old vessels, including wooden-hulled ships.” The law also has provisions on ship safety standards, move towards ship classification and compulsory insurance coverage of passengers and cargoes.

The investment incentives provided are the following:

- VAT exemption on the importation of vessels, spare parts, materials for the construction and repair of ships, life-saving, safety, fire-fighting, cargo handling, communication, navigation equipment, etc.
- restrictions on vessel importation to promote local ship building
- net loss carry over
- accelerated depreciation.

The law also defined MARINA’s mandate which was simply a reiteration of MARINA’s existing regulatory and quasi-judicial functions and created the MARINA Trust Fund. The Trust Fund was meant to augment the budgetary allocation that MARINA receives from Congress. A MARINA Trust Fund Management Committee will be organized to manage the Fund. Aside from representatives from the MARINA, two private sector representatives will be included in the Committee, coming from the shipping industry and shipper association. It is hoped that the Trust Fund will be utilized to achieve the objective of developing the shipping industry.

Emerging Issues

The deregulation that began in 1992 led to the growth in the number of shipping companies from 223 in 1975 to 585 in 2001. However, the domestic shipping industry has remained very concentrated, with five shipping companies accounting for 90 percent of passenger and cargo markets and almost all of the primary and secondary shipping routes.

Austria (2002) commented that “10 years after the de-monopolization of shipping routes, 50 percent and 70 percent of primary and secondary/tertiary routes, respectively, remain a monopoly”²¹. **Table 17** and **Table 18** show respectively the state of competition in cargo service and passenger travel. There is a need for transparency in the awarding of routes to ensure competition.

Table 17. State of Competition in Cargo Service, 1998

Route Classification	Primary		Secondary		Tertiary	
	No.	%	No.	%	No.	%
Routes with only 1 operator	25	36.2	16	34.8	444	76.7
Routes with at least 2 operators	44	63.8	30	65.2	135	23.3
- Routes with effectively 1 operator	7	10.1	9	19.6	39	6.7
- Routes with substantial competition	10	14.5	6	13.0	38	6.5
- Routes with mild competition	27	39.1	15	32.6	58	10.0
Total Number of Routes	69		46		579	

Source: M. Austria. Philippine Domestic Shipping Industry (2002)

Table 18. State of Competition in Passenger Travel, 1998

Route Classification	Primary		Secondary		Tertiary	
	No.	%	No.	%	No.	%
Routes with only 1 operator	26	50.0	27	58.7	166	77.6
Routes with at least 2 operators	26	50.0	19	41.3	48	22.4
- Routes with effectively 1 operator	5	9.6	7	15.2	10	4.7
- Routes with substantial competition	7	13.5	6	13.0	18	8.4
- Routes with mild competition	14	26.9	6	13.0	20	9.3
Total Number of Routes	52		46		214	

Source: M. Austria. Philippine Domestic Shipping Industry (2002)

The deregulation of passenger fares and cargo freight rate, except for third class passenger fares and specific non-containerized basic cargo, has introduced flexibility in fare setting. Shipping companies and cargo owners negotiate, with the Public Service Act capping the rates of return of shipping companies at 12 percent. There is thus a need for MARINA to establish transparent accounting and reporting standards to ensure that the agreed upon fare rate complies with the Public Service Act.

Maritime accidents exact a heavy toll on lives and property. Old vessels that are not seaworthy have to be replaced. There is therefore a need for MARINA to establish and enforce strictly rules on vehicle safety and procedures for vessel inspection in order to reduce the high rate of maritime accidents.

²¹ DMAP claims that the liners operate in a cartel-like fashion

V. CONCLUSION AND RECOMMENDATIONS

Port Sector

Various inefficiencies saddle the port sector and these have resulted in the high cost of shipping which, in turn, negatively impacts on the country's competitiveness and growth. There is absence of effective intra-port and inter-port competition among the country's ports. Port administration is highly centralized with the PPA as the central authority. Independent port authorities theoretically provide some (very limited) competition to the PPA's stranglehold of ports and there is some semblance of support to competition through the concessions awarded to selected private sector participants but the port sector remains dominated by the PPA which has been tasked by Presidential Decree 857 to regulate, develop and own ports in the country. The PPA's charter has given rise to conflict of interest situations for the PPA and has only allowed token private sector participation. The PPA regulates and approves tariffs, a share of which is given to it as mandated by law. It has used its regulatory power to bar direct competition between Harbour Centre (a private commercial port) and the PPA-owned ports in Manila, MICT and South Harbor.

To government's credit are past efforts to modernize and privatize public ports. In 1987, PPA awarded the terminal operation of MICT to ICTSI under the "landlord" port model. A decade later, the government used this approach in awarding a concession to another private company to operate South Harbor. Efforts to privatize the Manila North Harbor have failed. Executive Order (EO) 212 tried to accelerate the de-monopolization and privatization program for government ports in 1994. However, vigorous opposition by port workers made the government to revoke EO 212.

The provision of cargo handling services in a port is not competitive. The six cargo handlers at North Harbor are allowed to operate only in specific piers dedicated to specific shipping lines. Cargo handling rates increased annually during the period 1998-2002. In 2001, the PPA issued the new guidelines for the renewal of expired and expiring cargo handling contracts (PPA AO 01-2001). These guidelines grant a 2-year probationary contract that can be converted into a long-term contract (8-10 years) without the benefit of public bidding. However, current government policy under EOs 40 and 109 and RA 9184 mandate as a matter of national policy transparency and competition through public bidding in government procurement.

A positive development seems to be the establishment of the Road-RORO Terminal System (RRTS) under EOs 170 and 170-A. These EOs also promote private sector investment and participation in the RRTS. Designed to be a parallel system to the PPA port system, the RRTS forms an integral part of the national highway system.

In view of the foregoing, the following are recommended:

- Amend the charter of the PPA to remove conflict of interest provisions and to separate the regulatory function from the development function.
- Require the PPA to have transparent and competitive bidding procedures on granting or extending cargo handling contracts.

- Revoke the PPA's Administrative Order 01-2001.
- Require transparent accounting and reporting standards for the enforcement of port charges and shipping rates.
- Replace the present practice of the PPA sharing in port fees and other charges with a (regulatory) fee for services rendered.
- Promote the development of RRTS as a parallel system to PPA ports and remove the cargo handling fees on RORO cargo when no corresponding service is offered.
- Continue the privatization of operations in PPA ports and terminals and the designation of private non-commercial ports into private commercial ports.

Shipping Sector

In 1994, the government issued executive orders that aimed to deregulate the shipping industry. Executive Order 185 de-monopolized shipping routes while Executive Order 213 deregulated passenger fares and freight rates. Republic Act 9295 further deregulated the shipping industry by allowing shipping companies to fix the rates subject only to a negotiation between themselves and cargo owners and a publication of the proposed increase in rates in newspapers of general circulation.

However, despite the deregulation and liberalization that took place since the nineties, which resulted in the growth in the number of shipping companies, the domestic shipping industry has remained dominated by five shipping companies. These five account for 90 percent of total passenger and cargoes and almost all of the primary and secondary shipping routes. There is a need for MARINA, the regulator, to carefully review its policies and regulations and the conduct and performance of the industry to uphold competition and the protection of consumers from the exercise of market power. MARINA has to have clear and transparent procedures for route licensing.

There is also a need to enforce transparent accounting and reporting standards for the monitoring of the rate-setting exercise conducted by shipping companies and cargo owners. DMAP, for instance, claims that shipping liners operate in a cartel-like fashion.

There is also a need to improve the enforcement of maritime safety rules and regulations to reduce the severity and frequency of maritime accidents. The high maritime accidents and fatalities have negative impact on growth and particularly on the poor that rely on sea transport for mobility and cargo transport.

In view of the foregoing, the following are recommended:

- Require MARINA to review its policies and regulations to uphold competition and the protection of consumers from the exercise of market power.
- Require MARINA to have clear and transparent procedures for route licensing.
- Strictly enforce maritime safety regulations and inspection of vessels to check seaworthiness and provide effective training programs on maritime safety.

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Annex A

A. The Beginnings of Regulation (1920-1970)

In 1936, Commonwealth Act No. 146 (also known as the Public Service Act) was enacted into law. In this act, shipping services were considered public service and therefore should be regulated. Fixed rates for passenger fares and cargo freight were instituted as well as a cap of 12 percent on ROI (return on investments) of shipping companies.

Cargoes were classified into 3 types of commodities: Class A (processed products), B (semi-processed) and C (unprocessed or agricultural commodities). Passengers, on the other hand, are categorized as first, second and third class. Each class offers a different type of service and accommodation.

In 1972, the issuance of Certificate of Public Convenience (CPC) was instituted. The CPC authorizes shipping companies to operate and offer shipping services for commercial purposes. The objective of the CPC is to curb the excessive use of major routes and to shift the operation of some ships to less utilized routes. CPCs are issued on a per vessel, trip and schedule basis. This was established to serve as an entry barrier. To get hold of the certificate, a first come first serve policy is instituted. For developmental routes, the new entrant that has been issued a certificate is protected from competition (until such time that the investment of the operator has already been recovered). However, the period for recovering investments for the development route operator was not stated. As such, almost all routes were monopolized.

B. Changes in Rates and Low Compliance Levels (1980s)

The classification of passengers and commodities in the early 1920s for fixed rates underwent changes. In 1983, distance was factored in. The rates varied as distance increased. The distances are classified in these following ranges: 0-100 miles, 101-300 miles and over 300 miles. Moreover, rates also taken into account the cargo classification. Class A commodities were charged higher rates than B and C.

Memorandum Circular No. 26 was introduced requiring all operators to stick to their routes, sailing frequency and schedules. Sanctions were given to violators. Rerouting of vessels required an amendment of the CPC. Acquisition of new vessels was also regulated.

C. Deregulation Era (1990-Present)

In 1994, President Ramos issued a series of EOs aimed at deregulating the shipping industry –

- EO 185 – de-monopolization of shipping routes
- EO 213 – deregulation of passenger fares and freight rates