

## Reforms in Ports and Shipping

*Most of the necessary reforms in the ports and shipping sectors were already part of the 1999-2004 MTDP but progress has been slow. The role the PPA, as developer, operator, and regulator of ports, creates conflict of interest and stifles competition. Immediate measures to increase competition in the port sector includes deregulating private sector investment in ports and more competitions for cargo handling. Over the medium term, PPA reform is imperative. The regulatory framework for the shipping industry has to be revised to ensure that there is competition within routes or contestability for them. The financial liability resulting from labor retrenchment due to privatization should be estimated and payment alternatives considered. Enforcement of regulations to increase maritime safety has to be given priority.*

### Background

- Since the deregulation of shipping and the privatization of operations through concessions in South Harbor in the early nineties, there has been little progress on policy and institutional reforms for the ports and shipping industries. While the institutional framework of the Philippines Port Authority (PPA) as developer, operator, maintainer and regulator clearly remains a problem due to the fact that the PPA regulates itself, there have been attempts to introduce efficiency in the port sector by privatizing the operations of the main ports in Manila using the “landlord” model and by introducing some form of competition among ports. However, certain weaknesses in the policy and institutional frameworks remain. These result in an increase in the cost of inter-island shipping and overall logistics as well as reduce the quality of services offered.
- The reported high cost of shipping not only has negative implications for the overall efficiency, competitiveness and growth of the Philippines, but it also makes it more difficult for the Government to achieve its poverty reduction objectives. Inefficient port and shipping services can make foreign imports, particularly of agricultural commodities, more financially attractive, and in the case of exports, they would reduce the potential income of farmers and producers in Mindanao and other islands.
- The fact that domestic cargo throughput accounts for more than half of the total

cargo throughput in the Philippines further demonstrates the imperativeness of an efficient and integrated shipping system for trade-led growth and higher living standards.

- There are roughly 950 ports and landing stages all over the country. These make up the Philippine Port System which is divided into four major categories:
  - (a) the PPA port system consisting of public and private ports;
  - (b) ports under the jurisdiction of independent port authorities (IPA’s);
  - (c) municipal public ports devolved to the LGU’s, including fishing ports/wharves; and,
  - (d) the recently-established Road RORO Terminal System (RRTS)
- *PPA Port System:* More than half of ports in the country (about 115 public ports and 400 private ports) are under the purview of the PPA, a government-owned and controlled corporation. Around 25 of the PPA’s public ports are Base Ports and the balance are secondary ports. The PPA has a Port Management Office (PMO) in every Base Port. Within their respective geographical territories, each PMO covers both public and private ports that fall under the purview of the PPA.
- *IPA’s:* There are a handful of independent port authorities (IPA) that were created either as part of special economic zones to decentralize the PPA’s control and create more competition with its ports, or to provide direct control to some LGU’s over

their ports. IPA's are government agencies, the most notable of which are the Cebu Port Authority (CPA) and the Subic Bay Metropolitan Authority (SBMA) that manages Subic Freeport. They have provided limited competition at best.

- *Municipal Ports, Landing Stages and Fishing Wharves*: There are over 420 of them fishing ports. The biggest well-equipped ones were developed by the Department of Transportation and Communications (DOTC) and turned over to the Philippines Fisheries Development Authority and to LGU's.

- *Road-RORO Terminal System (RRTS)*: This system, established by an Executive Order in 2003 is envisaged to be an integral part of the national highway network and to serve as a "parallel" system to the PPA port network. It is intended to provide wider and alternative access to provinces. Under RRTS, vessel use and terminal use fees would be applied instead of the significantly higher cargo handling fees and port charges. The DOTC is the lead agency mandated to oversee the implementation of the RRTS. Like any new program, RRTS is facing teething problems that need to be tended to but it is too early to judge its success.

- The biggest common-user ports in the Philippines are in Manila (MICT, South and North Harbors). Under the purview of the PPA, these are publicly owned, but privately operated under long-term concessions.

- Private ports are mostly for industrial use. There are, also, private ports that operate commercially – the most important and largest of which is the Harbor Center Port Terminal (HCPTI) in Manila. It operates both as a domestic and foreign port with grains handling facility. HCPTI competes against the PPA's publicly-owned ports in Manila: South Harbor which is privately operated under a long term concession, and North Harbor, the largest domestic cargo port in Manila (and the Philippines) which is also undergoing privatization of its operations through concessions. HCPTI has not been able yet

to compete with the PPA's third large port in Manila (MICT) as it has not been awarded the permit to handle foreign containerized cargo.

- The PPA runs a surplus every year and remits dividends to the government (Pesos 845 million in 2003). It raises its revenues from three main sources: a) concession fees paid by the two concessionaires in South Harbor and MICT, b) port charges (wharfage, berthing, pilotage, etc.), c) a percentage of cargo handling revenues.

## **Main Issues**

### **A. The Institutional Framework of the PPA**

The PPA model of a centralized port authority responsible for the operation, development and regulation of all public ports in the country as well as the regulation of private ports is *a model that leads to conflict of interest and has been replaced by other systems in all but a few countries. This model has resulted in limited competition in the sector and low quality of services offered.* While it is clear that PPA's role needs to be redefined, any future actions must take into account the Authority's role in financing the development and operations of some unprofitable regional ports on social grounds.

### **Impeding competition and adversely impacting quality of services**

- PPA regulates entry by the private sector through the issuance of permits to construct and operate ports, on the premise of avoiding wasteful duplication of resources. As a grantor of these permits, PPA can control, or insulate its ports from, competition.

- PPA sets the port dues that private ports charge for handling non-own cargo and collects 50% of these dues in taxes. The low port charges in the Philippines (among the lowest in the region), is likely to discourage investment by the private sector in ports. Even when private ports do exist and compete, they might not be able to offer

high quality services due to the low-set tariffs and the high tax rate. It is not evident that the 50% tax is in return for any services rendered by the PPA.

### **Cargo handling rates**

#### Conflict of interest and lack of transparency in rate setting

- The main criterion for awarding a contract to a private cargo handling operator used to be the share of cargo handling revenues that the PPA receives. The conflict of interest arose from the fact that as part of its regulatory powers, the PPA approves and sets rate increases in cargo handling rates for both public and private ports, a decision it would directly benefit from.
- Despite a recent shift by PPA to award cargo handling contracts on the basis of the lowest fee charged to shippers (cargo owners), shippers remain largely skeptical. This is due to the fact that 1) many cargo handling contracts are simply renewed to the incumbents on the existing terms and without any assessment of performance; 2) the PPA would stand to benefit from its own regulation by approving tariff increases and 3) the lack of transparency in awarding contracts.
- 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. MARINA, attempting to resolve the last issue, has developed a new chart of accounts for the unbundling of shipping and cargo handling costs, and has required the shipping companies to use them.

#### Lack of competition among cargo handling companies

- With few exceptions, and despite policy pronouncements favoring multiple operators, the PPA designates only one cargo handling company in every port. While this is justified when the throughput is low, there

still should be competition/contestability for the port.

### **B. The Policy and Regulatory Framework for the Shipping Industry**

- Route Licensing: Despite the deregulation that took place in 1992 in the shipping industry which brought a dramatic growth in the number of shipping companies-- from 223 in 1997 to 585 in 2001, *the domestic shipping industry remains highly concentrated with five shipping lines accounting for 90% of passenger and cargo markets and almost all of the primary and secondary shipping routes.* Licenses to operate on any given route are granted by MARINA on the basis of traffic volumes.
- Rate Determination: 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 are determined by the shipping lines. Whether there is one or multiple operators on any route, MARINA does not set the rates. Shipping rates are set by negotiation between the shipping company and the cargo owner. The rates of return of shipping companies, in theory, are capped by the Public Service Act at 12% but in practice this does not seem to be a binding constraint.

### **C. Labor Opposition to Privatization**

- Labor opposition has been a key factor to reform process, or to any changes in the status quo. Past efforts at reforms, such as replacing an inefficient cargo handling operator, have been resisted. In one instance, the PPA was required by Executive Order to establish a Port Labor Trust Fund to cover retrenchment compensation of cargo handling personnel to pave the way for privatization. The PPA financed such a Fund by approving an increase in cargo handling rates. For the reform of North Harbor in Metro Manila, the PPA paid an estimated P250 million to the workers in 2000.

## **D. High Rate of Maritime Accidents**

The Philippines has a high rate of maritime accidents and fatalities relative to other countries despite initiatives by the Government and the shipping industry to reduce their occurrence and severity. A major contributor to these accidents is the frequency of typhoons (19-21 a year).

### **Recommendations**

Many of the institutional and policy reforms in the ports and shipping sectors proposed by the World Bank and the ADB in collaboration with the government were included in the 1999-2004 government MTDP. The question raised in the World Bank's transport sector strategy note at the time was *whether*, and *how*, these reforms were going to be carried out. As of today, very few of the targets have been met and many of the reforms were altogether abandoned.

#### **A. The Port Sector**

##### Short Term

- Remove the restrictions enabling PPA or other port authorities (such as Cebu Port Authority) to block the establishment of ports by the private sector
- Remove the tax imposed by the PPA on private ports—charges should be in return for services rendered. If this requires legislative action, consider reducing the rate in the interim.
- Provide explicit and transparent guidelines for the provision/extension of cargo handling contracts
- Follow rules regarding competitive bidding for cargo handling contracts
- End practice of charging cargo handling fees on RoRo cargo when no commensurate services are offered.
- Invite private sector participation to PPA board meetings as a precursor to changing legislation to include the private sector in the board.

##### Medium - Long Term

- Continue privatization of operations in PPA ports and terminals using the “landlord” model.
- Amend the charter of the PPA to separate the different functions. PPA can retain the development function, while MARINA can assume the regulatory responsibility.
- Develop and implement a plan to strengthen competition by Independent Port Authorities.

#### **B. The Shipping Sector**

##### Short Term

- Increase the transparency in the route awarding process.
- Set clear accounting and reporting standards for the enforcement of the agreed upon rate of return

##### Medium - Long Term

- Revise the existing regulatory framework to provide for competition among shipping lines both for, and within, routes.
- Introduce antitrust legislation

#### **C. Labor Fund**

##### Short Term

- Estimate the potential liability that may arise from a labor payoff by PPA.
- Formulate different alternatives for meeting the liabilities and analyze the competitiveness, equity and fiscal dimensions of each alternative.
- Prepare training plans for retrenched labor

##### Medium - Long Term

- Set up a retirement/separation benefit fund via monthly contributions, to be administered by a Trustee Bank. Representatives of the beneficiaries should be included on the board of the fund.

## **D. Maritime Safety**

### Short Term

- Tighten procedures for the inspection of vessels, especially in enforcement.
- Develop a plan for the replacement of outmoded/ageing vessels, particularly wooden-hulled vessels.

### Medium - Long Term

- Create a National Transport Safety Commission

Create a fund financed by users dedicated to financing maritime safety measures and programs.