PHILIPPINE INTER-ISLAND SHIPPING ASSOCIATION

Presentation: Maritime Week Celebration

September 25, 2020 Via Zoom

INITIATIVES, INNOVATIONS AND INVESTMENTS IN THE DOMESTIC SHIPPING INDUSTRY

- some new vessels scheduled for delivery in the short term as shipping lines complete their previous orders
- importation of younger ships in compliance with relevant MARINA circulars for the importation of vessels ie passenger, cargo, among others
- electronic transactions ie bookings, submission of relevant delivery documents for cargo shipments, among others

CURRENT SITUATION of the DOMESTIC SHIPPING INDUSTRY

- High Cost of Doing Business
- Lack of Economies of Scale
- Lack of Connectivity, Network Planning, and Consolidation
- Poor Port Infrastructure
- Conflict of Interest of Port Regulator

“(I)t is more expensive to transport goods between 2 domestic points than 2 domestic points via an international point. For example, transporting goods in a 40-foot container from Manila to Cagayan de Oro costs some USD 1,860 but transporting between Manila and Cagayan de Oro via Kaohsiung would reduce the tariff by USD 716 to only USD 1,144.”

CURRENT SITUATION

High Cost of Doing Business

- High cost of vessel acquisition
- High fuel cost
- High cost of drydocking

CURRENT SITUATION

High Cost of Fuel –

- Domestic shipping companies pay more for fuel compared to their counterpart in other countries.
- Fuel is the largest cost item at 27 percent of total revenues, and at 41 percent of total operating expenditures. In contrast, comparator companies, such as Maersk Group, OOCL Hong Kong, and NOL Singapore, registered lower share of fuel cost at around 20 percent of revenues. Industry insiders explain that Philippine fuel is more expensive since it is not subsidized and a 12 percent VAT is imposed on top of excise tax and import tariff, while fuel in Singapore, Malaysia, and Indonesia are subsidized and are levied lower tax rates. (Taken from draft World Bank-IFC study entitled POLICY OPTIONS FOR LIBERALIZING PHILIPPINE MARITIME CABOTAGE RESTRICTIONS)

CURRENT SITUATION

High Cost of Drydocking —

- Same World Bank-IFC study reveals that “dry docking, repairs, and maintenance can reach as high as 26 percent of revenues. In contrast, the average dry docking cost in the region was 50 percent cheaper and up to 3.5 times cheaper in the case of China. The high share of dry docking, repair, and maintenance to total cost reflects government regulations that mandate domestic ships to dry dock in the Philippines. This has resulted in higher repair and maintenance cost and slower repair time.” (Presidential Decree No. 1221)

CURRENT SITUATION

Lack of Economies of Scale –

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

CURRENT SITUATION

Lack of Economies of Scale –

- “Within the Philippines, domestic cargo trade is also relatively small.- In 2011, domestic cargo throughput in the Philippines amounted to 102 million metric tons or equivalent to 35 percent of Indonesia’s 291 million metric tons. Ironically, compared to Vietnam, a non-archipelagic country, Philippine throughput is only slightly higher than Vietnam’s 80 million metric tons.”
- “Philippine commodity flow data reveal that most of domestic sea trade is concentrated in just a few shipping routes.- Routes servicing the Port of Manila, the largest port in the Philippines, account for around 47 percent of total Philippine domestic sea trade. Eight other routes, out of a total of 137 routes, account for another 10 percent of total domestic sea trade.”

CURRENT SITUATION

Lack of Economies of Scale –

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

CURRENT SITUATION

Lack of Economies of Scale –

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

CURRENT SITUATION

Lack of Connectivity, Network Planning, and Consolidation

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

CURRENT SITUATION

Poor Port Infrastructure

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

CURRENT SITUATION

Conflict of Interest of Port Regulator

- “The PPA is both a regulator and an operator of ports. It sets cargo handling rates for all its ports but also receives at least 10 percent of all cargo handling fees. This not only raises the cost of shipping, but also gives rise to real or perceived conflict of interest. This conflict of interest could be removed by shifting away from its port operations mandate so that it can focus exclusively on its regulatory mandate.”

- “(I)t is more expensive to transport goods between 2 domestic points than 2 domestic points via an international point. For example, transporting goods in a 40-foot container from Manila to Cagayan de Oro costs some USD 1,860 but transporting between Manila and Cagayan de Oro via Kaohsiung would reduce the tariff by USD 716 to only USD 1,144.”
- True? Maybe, maybe not!

Maybe because —

- “International shipping lines benefit from economies of scale as they tend to have larger container vessels carrying at least 800 twenty-foot equivalent unit (TEU) compared to local cargo vessels with 150 – 200 TEU capacity and significantly less for passenger,break bulk, and container combination vessels.”
- “Vessels utilized in domestic shipping are geared vessels (i.e., with cranes), which are more expensive to acquire and operate, given the limited supply of geared vessels. Most ports in the Philippines do not have specialized cargo handling equipment needed to service gearless container vessels. Container vessels on international routes are normally gearless (i.e., without cranes) since the ports they serve have complete cargo handling equipment.”

- “International liner shipping operates under a different regulatory and market environment and is not subject to the same rules as domestic shipping in the Philippines. Vessels are often registered under so-called “flags of convenience,” which bring certain cost advantages.”

- “Freight rates are strongly influenced by the direction of trade. If trade is significantly imbalanced, rates in the higher volume direction will be much higher than in the reverse direction.”

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

Comparative Analysis of Factors Influencing Operating Costs of Foreign and Domestic Vessels Plying Philippine Waters –

	Foreign Shipping Lines	Domestic Shipping Lines
Fuel Prices	No tax	Duties and VAT of 12%
Philippine Income & Freight Taxes		
VAT on Gross Freight	0%	12%
Corporate Income Tax	0%	32%
Common Carrier's Tax	3%	0%
Tax on Gross Philippine Billings (Outgoing)	2.50%	0%
Operating Costs		
Steel Plates, Spare Parts & other supplies		
Duties	0%	10%
VAT	0%	12%
Dry-docking VAT	0%	12%
Vessel Acquisition		
Vessel Cost (in Pesos)	288,000,000.00	288,000,000.00
12% VAT and 3% duties	0%	43,200,000.00
Drydocking	No restrictions on where to dry dock	Must dry dock in the Philippines

- “(I)t is more expensive to transport goods between 2 domestic points than 2 domestic points via an international point. For example, transporting goods in a 40-foot container from Manila to Cagayan de Oro costs some USD 1,860 but transporting between Manila and Cagayan de Oro via Kaohsiung would reduce the tariff by USD 716 to only USD 1,144.”
- **Maybe not!** No proof presented that actual shipment was made from Manila to CDO via Kaohsiumg
- Domestic cargo loaded on a foreign vessel is treated as imported subject to import duties and taxes
- Co-Loading Law (R.A. No. 10668) prohibits foreign ships to load domestic cargo

Current Challenges

- High Cost of Doing Business

  - ✓ Expiration of Incentive under RA 9295
  - ✓ BOI Incentives under 2017 IPP only to New Ships (High Cost of Vessel Acquisition)
  - ✓ Excise Tax on Fuel (Fuel accounts to 40-50% of Vessel Operation; Drydocking – cost of power component in drydocking to increase)
  - ✓ Upgrading of some ports – increase in port charges

Current Challenges

- Clamor to Lift Cabotage
- Amendment to the Public Service Act (Transportation no longer a Public Utility, hence, shipping may now be 100% foreign-owned)
- Magna Carta of Seafarers (House of Representatives' version) – Mandatory provision of allowance to Cadets equivalent to 50% of applicable minimum wage

Current Challenges

- Restriction on vessels during ECQ, GCQ
- DOTr DO 2020-007 with subject, “Directive for all Shipping Lines to Provide Cargo Space Allocation for Agricultural and Food Products and Providing for Preferential Rates Therefor”
- PPA AO 01-2020 entitled, “Prescribed Waste Reception Fees in all Ports”
- PPA AO 12-2019 entitled, “Policy on the Centralized Ticketing System (CTS) Relative to an Online Application Integrating the Booking and Payment processes for the Use of Ship and Passenger Terminal in a Single Platform”

Challenges/Strategies

- Greater engagement with policy-makers on shipping's role in trade.
- Long Term
  - Government clear strategy on manufacturing and agricultural focus so shipping knows where and what to invest in.
  - Creation of production clusters around hub ports to develop economies of scale, the greatest contributor to lowering shipping and logistics costs. Clusters and hub ports will dictate roads and housing to support domestic and import/export trade.
  - **Allow domestic ships to enjoy the same tax regime as foreign ships**

Challenges/Strategies

- Short Term
  - Government clear strategy on addressing the port and logistics needs of domestic trade not only import and export trade. (includes dry and wet bulk, LOLO and RORO)
  - Selected high traffic domestic hub ports should be improved and modernized.
  - All domestic hub ports should be provided with state of the art and well-maintained navigational aids eventually covered by VTMS. There should be an efficient system for the swift broadcasting of navigational threats.
  - Modern and Well-Maintained Weather Forecasting Equipment: This is a necessary complement of safe shipping. Funding for these should be prioritized by government. Brain drain at PAG-ASA should be addressed. Salaries of weather staff improved.

Challenges/Strategies

Structural Change for modern and efficient ships

- Phase out plan for old, substandard and unclassed ships
- Develop shipbuilding capacity
  - Strategically support the development of the shipbuilding industry including for smaller ships including LOLO and RORO to serve both domestic and regional markets.
  - Strategically develop a shipbuilding cluster (Subic?) to attract investment by subcontractors and industry so the sector can be competitive.
- Modernize ports so gearless ships can trade in coastal waters

Challenges/Strategies

Structural Change for Safe Operations

- Classification of Ships
  - All domestic vessels should be classed either by a single local classification society or by an IACS member.
  - There should only be one local classification society (not 8) . The local classification society can be a Philippine Government classification society (similar to JG) and its board of trustees should be men and women of unquestionable competence, experience and integrity.
  - Training programs strategies leveraging on manning and training companies expertise and strengths.

- Strict implementation and governance/audits of ISM/NSM.

Challenges/Strategies

Excellent Crew as part of overall supply pipeline

- Career Promotions
  - Promote a career in shipping with domestic shipping as part of the path to a career abroad. Strategy and coordination between domestic and overseas sectors.
- Cadetships and post overseas opportunities
  - Strategy and coordination between domestic and overseas sectors with domestic cadetships as part of the overall capacity to place students and post sea careers in ship management.
- Educational System
  - Joint promotion of culture of excellence in schools.

Challenges/Strategies

Excellent Crew as part of overall supply pipeline

- Change in Minimum Manning Regulations
  - Number of minimum manning reduced so higher wages can be paid.
- Taxation of Seafarers
  - Special taxation regime for seafarers serving in domestic trade aligned to those serving in foreign ships.

Challenges/Strategies

- On Safe Ships and Competent Crew
  - Classification of Ships: There are too many local classification societies.
  - Taxation of Seafarers: Exempting domestic seafarers from income tax may not be viable as other group of workers may clamor for the same privilege.
  - Maritime Education: Maritime schools lack training ships. Small ships and/or high cost of cadets' boarding and lodging are disincentives for ship owners to take in cadets.

Challenges/Strategies

- On Port Infrastructure
  - PPA should be regulatory. Ports are public service infrastructure- the highest quality for the lowest cost.
  - Difficulty to implement hub port strategy. Pressure from local politicians to create ports often times not economically viable.
  - Ports are not regularly dredged.
  - Some ports are designed without consideration of the draft requirements of ships.

Challenges/Strategies

- On Port Operation
  - Some ports have only one cargo handling operator that practically dictate port charges.
  - Lack of focus and strategy to address berth congestion in Manila and major growth ports of Cebu, Zamboanga, Iloilo, Gensan, Dumaguete and Davao.

Laws Needed to Address Current Situation

- For Safe Ships
  - Restoration and upgrading of the incentives under R.A. 9295 to enable ship owners to invest in younger, if not new ships
  - Amendment of P.D. 1221 to allow certain tonnage of Philippine registered ships to undergo dry dock abroad.
  - Passage of a law mandating a single classification society.

- For Port Infrastructure
  - A law that would make PPA a regulatory agency.
  - The formation of a government owned corporation with highly qualified management that would access ODA funds to develop key port and road infrastructure at the lowest cost with the highest quality. (follow Singapore model and privatize through an IPO)

Laws Needed to Address Current Situation

- Laws that would lower the cost of domestic shipping
  - Repeal of Executive Order No. 1088, and passage of a law mandating open pilotage and optional pilotage for domestic ships unless a port is declared compulsory by the proper port authority.
  - Tonnage Tax system instead of Income Tax Laws, or even executive issuances, that would streamline procedures and requirements of various government agencies
  - Creation of a Department of Maritime Affairs that would integrate the various agencies regulating the shipping industry.
  - Philippine domestic ships to engage in international trade without need of obtaining permits from the maritime authority.

Strategic Directions

- Co-Loading/Cargo Consolidation
- Merger and Consolidation (Japan/China Experience: Nippon Yusen KK-Mitsui Osk Lines-Kawasaki Kisen Kaisha merger; China Ocean Shipping Group & China Shipping Group forming China Cosco Shipping Corp.

End of Presentation

Thank You