Once Pioneer Status is granted to a ship operator in its authorized route, entry and expansion becomes more difficult for potential entrants and incumbent players. The provisions of EO 909 act as regulatory barriers that i.) impose bans on entry and expansion activities, ii.) allow participation of incumbent players on entry decisions, and iii.) increase compliance costs.

These regulatory barriers reduce attractiveness of the industry to potential entrants and need to be reconsidered in order to widen the range of services that shipping customers are able to choose from. In oligopolistic environments such as the domestic shipping industry, threat of entry is expected to be a major disciplining force to incumbent players. Participation of new and efficient competitors would correct the behavior of existing operators by introducing competitive pressure to provide higher quality and lower priced services.

Does the policy limit the ability of suppliers to compete?

As mentioned above, the use of IACS quality standards reduces the ability of potential entrants and incumbent players to enter a route and expand operations in routes where Pioneer Status grantees already ply. This quality standard creates a distinction between Pioneer Status and non-Pioneer Status vessels. This may potentially result in an unequal playing field between ship operators plying the same route, given that there are some incentives in EO 909 that make certain operational costs cheaper for Pioneer Status grantees.

Aside from the moratorium on vessel deployment and right of first refusal that deter entry and expansion, Pioneer Status grantees are also given priority issuances of permits and special berthing facilities that may affect the ability of incumbent players to compete effectively.

Under Article VI of the Circular, shipowners or operators of Pioneer Status vessels only need to pay 50 percent of regular fees in the application and renewal of ship documents, licenses, certificates, and permits. These incentives reduce the cost of operations of Pioneer Status grantees, thereby giving them an advantage not otherwise available to their competitors.

Under the Circular, special ramps or berthing facilities shall likewise be made available to vessels granted Pioneer Status, subject to existing policies of port authorities. Allowing Pioneer Status grantees to build and use tailor-fit ramps physically prevents incumbent players from accessing port facilities that should be available to all shipping lines that operate in the same route. Further, providing a special ramp for one specific vessel would prevent other vessels from using that space for docking. This could potentially worsen congestion and increase turnaround time for vessels in ports.

These provisions, specifically limiting the access of incumbent players to a common berthing space, artificially raises operating costs. Such government intervention affects competition dynamics by giving advantage to certain kinds of market players. Competition in the industry should be promoted such that no single player or group of market players is given undue and distinct set of rights and privileges over the rest. Doing so may potentially disadvantage other market players and affect their ability to compete effectively.

Recommendations

Based on the above discussion, it appears that the Policy has a clear purpose–promoting modernization in an industry beset by market failures. However, having this purpose does not discount the fact that there are several incentives under the Circular that pose additional regulatory restrictions that hinder entry and expansion activities.

We recognize the importance of vessel modernization in order to guarantee safety and improve quality of service in the domestic shipping industry. There are, however, improvements that need to be made to the Circular to ensure that market competition is not negatively affected as a consequence of attaining these policy objectives.

1. Review requirements for granting Pioneer Status

We note that the Policy is hinged on the requirement of introducing brand new and IACS-classed vessels. Several industry stakeholders have pointed out that the cost of acquiring and operating these vessels is significantly higher that non-IACS vessels. However, it is unclear whether the stringent standards set by IACS classification societies are necessary in the context of ships licensed to ply domestic waters only.

There is a need to evaluate and determine whether there are other measures that MARINA can impose to guarantee quality and safety of domestic shipping services without requiring shipping lines to make investments that significantly raise their operating costs and thus affect their ability to compete effectively.

2. Review implementation of the protection of investment incentive

MARINA does not impose an absolute moratorium on the deployment of additional vessels in Pioneer Status routes such that new entrants and incumbent players are still allowed to enter or expand operations subject to certain conditions. These conditions, however, give rise to other competition concerns such as the participation of a market player in entry decisions and increased entry and expansion costs for non-Pioneer Status grantees.

The same stringent quality standards apply to non-Pioneer Status grantees who wish to enter or expand operations in Pioneer Status routes. However, similar to the discussion above, there may be alternative means of ensuring quality and safety without imposing restrictive conditions on entry activities. Thus, when evaluating the requirements for granting Pioneer Status, specifically the use of IACS classification societies, it should also be determined whether these requirements significantly increase the cost of entry and expansion for non-Pioneer Status shipping lines.

3. Review implementation of the provision of special ramp and berthing facilities

Based on market investigation, the special ramp or berthing facility provided to certain Pioneer Status players gives an advantage to these operators because the facilities cannot be accessed by any other competitor. Access to port facilities should be available for all shipping lines operating in the same route. As such, there is a need to re-evaluate whether this specific provision or incentive is necessary. The provision may only be benefiting a certain group of shipping lines and putting other competitors at a disadvantage.

4. Sustain inter-agency dialogue and stakeholder consultation

MARINA should continue its existing efforts with various government agencies to periodically review and, if needed, amend specific provisions of the Policy. The Philippine Competition Commission, which is mandated to promote fair market competition, should continue coordinating closely with MARINA to perform its advisory functions and flag any potential competition concerns in the planned policies and programs for the Philippine shipping industry. Further, industry stakeholders' proactive participation in public consultations will help ensure a fair policy design. ■

PHILIPPINE COMPETITION COMMISSION

POLICY NOTE

No. 1, Series of 2020

On Potential Competition Concerns in the Granting of Pioneer Status in the Philippine Shipping Industry

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The Philippine domestic shipping industry encompasses a wide range of activities in relation to the movement of goods and passengers within the Philippines, an archipelagic country composed of over 7,000 islands. The industry plays a key role in linking producers to consumers and ferrying passengers. In 2016, 95.3 million metric tons of cargo were shipped domestically, and a total of 68.8 million passenger traffic was recorded. Despite its recognized importance to the economy, the domestic shipping industry is observed to have several inefficiencies including high shipping costs, low quality of service, and poor safety records.

This Policy Note examines the impact on competition of Executive Order No. 909 (EO 909) entitled "Encouraging Investments in Newly Constructed Ships or Brand New Vessels in the Domestic Shipping Industry by Providing Incentives Therefor", as well as its implementing rules and regulations, and Maritime Industry Authority (MARINA) Circular 2015-04 (MC 2015-04), collectively called the "Policy". The Policy promotes modernization of domestic fleet through the introduction of new vessels. However, it introduces incentives that distort the market and pose additional regulatory restrictions that hinder entry and expansion activities. We provide recommendations on how the Policy can achieve its specific objectives while maintaining or improving the current levels of market competition.

Domestic shipping industry

Within the region, the Philippines ranks relatively low in terms of safety as it had recorded the worst and highest number of maritime accidents in East Asia. According to the 2014 World Bank study on the domestic shipping industry, casualty rates in the Philippines are 40 percent higher than that of Indonesia, which recorded the second highest number of maritime accident casualties from 2004 to 2012.[2]

Inefficiencies in the domestic shipping industry can be attributed to the oligopolistic structure of the market. In 2013, while there are 2,497 entities operating domestic fleet, only four shipping companies serve primary routes. Market concentration is an even bigger issue when evaluated on a per route basis. More than 70 percent of primary routes lack meaningful competition and are serviced by one or two operators only. Higher volume routes such as Manila-Cebu and Cebu-Cagayan De Oro usually have more than three players, but for routes with smaller demand, de facto monopolies exist.

In the absence of competitors, shipping lines do not have an incentive to lower the price and improve the quality of service, nor innovate and adapt to new technologies in maritime transport. Through competition, shipping companies become more efficient and productive in offering better quality service at lower costs.

The domestic shipping industry continues to be highly concentrated and especially problematic in liner operations. There are around 2,802 commercial shipping operators as of 2012[3] but liner operations continue to be dominated by few large firms. The three biggest shipping companies, 2GO Group, Philippine Span Asia Container, and Solid Shipping, accounted for 38 percent of the entire freight market in 2011.[4] There have been several mergers and acquisitions of shipping companies in the past that resulted to fewer dominant players in scheduled operations.

Policy background

Given the importance of and the problems that beset the Philippine shipping industry, several efforts have been made by the government to improve the market conditions therein. On 29 June 2010, then President Gloria Macapagal-Arroyo signed EO 909 to encourage investments and provide incentives for newly constructed ships or brand new vessels in the Philippine shipping industry. Five years later, on 07 September 2015, MARINA issued MC 2015-04 to implement the provisions of EO 909. It was only upon the promulgation of this Circular that domestic shipowners or operators were able to avail of the incentives provided under EO 909.

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[2] *World Bank (2014). Enhancing Competition Conditions and Competitiveness of Philippine Domestic Shipping,.*

[3] *Ibid.*

[4] *Ibid.*

The primary objective of the Policy is the modernization of domestic fleet through the introduction of new vessels. As stated in the introductory paragraphs of EO 909, the grant of incentives to shipowners and operators of brand new vessels was prompted by the inefficiencies plaguing the domestic shipping industry. EO 909 was accordingly issued in response to the need to modernize the water transport industry to safely ferry passengers and cargo in various seaports of the country.

EO 909 provides that new and existing domestic shipowners or operators who will introduce International Association of Classification Societies (IACS)-classed brand new or newly constructed ships in their respective authorized or applied routes may be granted "Pioneer Status". The Pioneer Status entitles them to a set of benefits and privileges to ensure that their investments on brand new vessels are recovered. To avail themselves of the Pioneer Status incentives pursuant to EO 909 and MC 2015-04, shipowners must meet a set of criteria required by MARINA. The requirements for applying for Pioneer Status and the corresponding incentives granted to ship operators are listed in **Table 1**.

As of December 2018, there are six companies that have benefitted from the Pioneer Status Program. **Table 2** lists these companies as well as their respective routes.

Table 1. Eligibility Requirements and Incentives under the Policy

Eligibility Requirements *(all must be met)*	Incentives (MC 2015-04)
• Classed by an IACS member; • Brand new or newly constructed either abroad or built locally by a MARINA-licensed shipyard; • Appropriate and suitable to the weather and sea conditions of the area where it will operate; • Covered by a Certificate of Philippine Registry (CPR) and Certificate of Ownership (CO) under MARINA Circular No. 2013-02; and • Owned and operated by a domestic shipowner/operator and fully manned by qualified Filipino officers and crew.	• Protection of investment and/or route protection for liner companies for a period of six years by imposing a moratorium on the deployment of additional vessels or not allowing other vessels to ply in the applied link or route; • Priority in the issuance of Certificate of Public Convenience (CPC) by MARINA in the route it proposes to operate whether said route has an existing ship operator or not; • Reduction of 50 percent of the regular fees in all applications and renewals of ship documents, licenses, certificates and permits; • Drydocking of classed vessels according to drydocking schedule required by the authority; and • Provision of special ramp or berthing facility in any port subject to existing policies of the port authorities.

Table 2. List of Pioneer Status Program Grantees as of December 2018

Company/Operator	Vessel/Ship Name	Routes to be served	Date of Approval
Solid Shipping Corporation	MV Solid Harbor	Manila – Davao Manila – Cagayan De Oro Manila – General Santos City	23 November 2015
	MV Solid Gem		19 April 2016
	MV Solid Marine		
	MV Solid Unity		13 June 2018
Archipelago Philippine Ferries Corporation	MV Fast Cat M3	Iloilo River Wharf- Banago Port, Bacolod	26 November 2015; amended the routes to be served on 03 February 2016
	MV Fast Cat M5	Batangas City – Calapan, Oriental Mindoro	
	MV Fast Cat M6	Dumaguete City – Pulauan, Dapitan	
	MV Fast Cat M7	Liloan, Southern Leyte – Lipata, Surigao	
	MV Fast Cat M8	Bulalacao, Oriental Mindoro – Caticlan, Aklan	
	MV Fast Cat M9	Matnog, Sorsogon – San Isidro, Northern Samar	
	MV Fast Cat M10	San Carlos City, Negros Oriental – Toledo City, Cebu	03 February 2016
	MV Fast Cat M11	Pier 3, Cebu City – Tubigon, Bohol	12 December 2016
Starlite Ferries, Inc.	MV Starlite Pioneer	Roxas, Oriental Mindoro- Caticlan, Malay, Aklan	Approved on 12 January 2016 but was revoked on 29 March 2016
	MV Starlite Eagle	Roxas, Oriental Mindoro- Caticlan, Malay, Aklan	08 May 2017
	MV Starlite Reliance	Dangay, Roxas Oriental Mindoro – Poctoy, Odiongan, Romblon	03 August 2016
	MV SWM Salve Regina	Batangas – Caticlan	13 November 2018

Table 2. *continued*

Company/Operator	Vessel/Ship Name	Routes to be served	Date of Approval
Mabuhay Maritime Express Transport Inc.	MV Malambing Express (fastcraft)	Kalibo, Aklan – Boracay, Caticlan, Aklan	04 July 2018
VS Grand Ferries Corporation	MV Sea Cat One (fastcraft)	Cebu City – Calbayog City, Samar	16 July 2018
Lite Shipping Corporation	MV Lite Ferry Five	Dipolog City, Zamboanga del Norte – Oslob, Cebu	21 September 2018

Source: MARINA

As mentioned, domestic shipping is known to be an oligopolistic market where few large ship operators exist in each route. Having a high degree of concentration is often a result of the market's infrastructure and transport networks. However, anti-competitive outcomes may occur when inherent market features and structural constraints are aggravated by government interventions that create more obstacles to competition. Industry policies and regulations intended to address industry inefficiencies may sometimes not account for plausible effects that may distort markets and result in anti-competitive outcomes.

Under the Policy, incentives are introduced to address pressing issues on safety and quality of service. To achieve this, the Policy limits the grant of Pioneer Status to brand new or newly constructed IACS-classed vessels. While the main objective of EO 909 is to resolve industry inefficiencies related to safety, it might have certain effects on market dynamics that need to be examined to determine whether competition is harmed as a consequence of the intervention.

Does the Policy limit the number and range of suppliers?

Under the Policy, Pioneer Status grantees are given the opportunity to impede entry through the right of first refusal. In case additional vessels need to be deployed, Pioneer Status grantees are given first priority to add new vessels and/or schedules. Thus, in routes where there are existing players, expansion activities of incumbents are curtailed as they will only be allowed to add trip frequencies or vessels if the Pioneer Status grantee is unable to do so. This limits the incumbent players' ability to provide a wider range of services to passengers or cargo customers. Meanwhile, in routes where there are no Pioneer Status grantees and incumbents cannot add IACS-classed vessels, an entity may enter a route even without having a brand new and IACS-classed vessel but the new entrant would not have access to the incentives under EO 909. Thus, if there is unmet demand in a route without Pioneer Status, the EO 909 and the Circular do not apply.

What is IACS?

IACS is a non-governmental international organization with twelve member marine classification societies. More than 90 percent of the world's cargo carrying tonnage is covered by the classification design, construction, and through-life compliance rules and standards set by IACS members. IACS provides technical support and guidance to and has a consultative status with the International Maritime Organization (IMO).

Source: IACS website, www.iacs.org.uk

Pioneer status applicants as well as incumbent players who wish to expand operations in a Pioneer Status route are required to invest in brand new or newly constructed IACS-classed vessels. Based on information gathered, IACS-classed vessels are notably more expensive than non-IACS classed brand new or secondhand vessels, not only in purchase price but also in maintenance costs.

Industry stakeholders note that having a vessel classed by an IACS member costs approximately twice as compared to having it classed by a non-IACS member. In the Philippines, there are six accredited classification societies[5] as of June 2019, none of which is an IACS member. Industry stakeholders attest to the strong competition among these local classification societies who compete on the basis of price.

Industry stakeholders also mentioned that IACS classification standards are mostly applied to vessels that ply international waters and may be unnecessary for ships intended for coastwise voyages only. Additionally, a number of shipowners posit that neither the provision of brand new vessels nor international classification does not automatically guarantee safety. Rather than age, vessel maintenance is argued to be the more critical factor. The condition of introducing IACS-classed vessels may therefore be unnecessary and only limit the ability of ship operators to effectively service routes where there are existing Pioneer Status operators.

If shipowners want to avail of the incentives provided under the Policy, they must invest in brand new or newly constructed IACS-classed vessels. The cost of entry of a Pioneer Status vessel is broken down in **Table 3**:

Table 3. Cost of entry estimates for pioneer status

Expenditure	Percentage Share
Vessel	95.58
Ramp	1.71
Government fees (ports, permits, clearance)	0.64
Conduction expenses	0.33
Insurance fees	1.33
Ticketing office	0.02
Launching expense	0.03
Advertisement	0.06
Personnel and crew expenses	0.31

Source: Information provided by a pioneer status grantee.

Vessel cost is the most significant expense for a shipowner who wants to obtain a Pioneer Status. Industry players claim that IACS-classed shipbuilding materials and equipment are approximately 30-50 percent more expensive than non-IACS classed alternatives. The cost breakdown above does not include regular maintenance, inspection, and other operational expenses which are more costly for IACS-classed vessels.

The high costs associated with investing in a brand new and IACS-classed vessel make it harder for potential competitors to enter the market and for incumbents to expand in their own routes. The high amount of capital required is not easily accessible to just any interested market participant.

[5] *The six classification societies accredited by MARINA are: Filipino Vessels Classification System Assn., Inc.; Ocean Register of Shipping, Inc.; Orient Register of Shipping, Inc.; Philippine Classification Register, Inc.; Philippine Register of Shipping, Inc.; Shipping Classification Standards of the Philippines, Inc.*