DISCUSSION PAPER

Subject: **ON THE ISSUE OF HIGHER DOMESTIC SHIPPING FREIGHT RATES COMPARED WITH FOREIGN/ OCEANGOING FREIGHT RATES**

In the President's speech, "**10 Point Action Program for the First Hundred Days of an ERAP Presidency**", the subject issue was cited in connection with the Action Points enumerated under Infrastructure, to wit;

"... It is unacceptable to me that our domestic shipping costs today are twice the equivalent cost for international shipping over comparable distances..."

This issue has likewise been raised in the past, precipitated by an earlier contention that it is cheaper to ship corn from Bangkok or Taiwan to Manila, than from General Santos to Manila. Although papers have been written on the matter, the issue has nevertheless persisted. The issue had in fact been similarly raised lately by the country's exporters/importers, with the contention that freight rates for containerized cargoes charged by domestic vessels is much higher than those charged by foreign shipping lines in the transport of their commodities.

This paper is primarily intended to provide some contribution towards a better understanding of the subject issue, specifically in terms of:

- putting in proper perspective certain aspects and components of cargo transport and the freight rates charged;
- presenting comparative tabulations of available data on freight rates charged by domestic vessels and oceangoing vessels; and
- contextualizing the results obtained from the freight rates comparison.

I. BASIC FACTS AND CLARIFICATIONS ON FREIGHT RATES COMPARABILITY

In order to render any comparison tenable and accurate (and derive meaningful and rational conclusions therefrom), it is essential to ensure that the things being compared are indeed comparable. As often admonished, apples must be compared with apples, not apples with oranges.

A. Freight Rates of Grains – Domestic vs. Foreign: A Case of Non-Comparability

This principle is very relevant in the attempt to compare the freight rate of grains transported from abroad (U.S., Bangkok, etc.) to Manila, with that of rice or corn shipments from General Santos to Manila. The freight rates charged in each situation are not really comparable considering the following essential differences;

1. Difference in the Manner of Carriage

Grains from abroad shipped into the country are always transported in bulk while grains transported between the country's domestic ports are always in sacks and often unitized or placed in container vans. In the case of foreign shipments, a big vessel is loaded entirely with grains and would necessarily have

the advantage of economy of scale in terms of transport cost. This is not however, the case for domestic grains shipment where the manner of carriage is in sacks and containers and would accordingly entail a much different basis for transport charges.

2. Difference in the Coverage of Rates Quoted

While the rates quoted for domestic grains transport would cover: **(1)** loading into the vessel at the port of origin; **(2)** the sea transport; and **(3)** unloading of the cargo at the port of destination, the *overseas freight rate quoted is only up to the anchorage* at the port of destination (Manila) and does not include the conveyance of the grains shipment from the vessel to the port/storage area which would entail: **(1)** unloading into barges; **(2)** the barge transport from shipside to shoreside; and **(3)** unloading from the barge into the storage area. Quite obviously therefore, the overseas freight rate quoted is understated/ incomplete as compared to the domestic freight rate, for purposes meaningful comparison.

3. Difference in Cargo Handling Cost

Even despite the difference in volume involved, loading and unloading of grains in bulk is faster/ more efficient and less time-consuming, and therefore costs less, as compared to the cargo handling entailed by domestic grains shipment.

The aforecited differences would therefore render inadvisable any effort to make a reasonable comparison between overseas freight rates and domestic freight rates of grains.

B. Non-Comparability of Liner vs. Tramping Vessels

Another common error is the tendency to compare the freight rate charged by liner vessels vis-à-vis that of tramping vessels. Liner vessels are those which call regularly on specific ports under fixed schedules, and cater to the transport requirements of the public at large without discrimination (known as *common carriers*), charging fares/ freights which are already fixed and specified for the reference/ guidance of the public. Tramping vessels on the other hand, operate without any regular ports of call nor schedules, providing transport services only on the basis of negotiations.

Liner vessels would therefore entail greater overhead and operational expenses by virtue of the required administrative machinery in their ports of call to handle marketing and other concerns. Moreover, liner vessels cannot always benefit from economies of scale, especially during the lean seasons, as they are obliged to undertake their scheduled voyages even despite less-than-economic loads.

Thus, it would be clearly unfair to compare the freight rates charged by liner vessels with that of tramping vessels.

II. THE TRANSPORT OF CONTAINERIZED CARGOES

Basic differences likewise exist in the transport of containerized cargoes from overseas, and those carried between domestic ports. In the case of the domestic carriage of containerized cargoes, there are three basic categories of carriages that would need to be properly contextualized.

A. Domestic Carriage of Containerized Cargo for Export

Briefly presented hereunder would be the typical components/ aspects of the transport involved for this category;

- A handicraft manufacturer in Iloilo for example, having negotiated the export of his products to Taiwan, will make arrangements with a foreign shipping line for the transport of the export cargoes.
- No domestic carriage would be involved if the foreign shipping line has a vessel calling at Iloilo which could then pick up the export cargoes and proceed directly to Taiwan. In most cases however, foreign shipping lines would have vessels having Manila, (South Harbor or MICT) as their port of departure. Accordingly, the contracted foreign shipping line will make arrangements with a domestic vessel for the transport of the export cargoes from Iloilo to Manila. Such arrangement would typically involve the following;

  - Empty containers of the foreign shipping line will be transported from Manila to Iloilo, (referred to as "*repositioning of empty containers*"), and upon arrival are subsequently filled up with the export cargoes.
  - The containers filled with the export cargoes will then be transported from Iloilo back to Manila by a domestic vessel and unloaded at the North Harbor where domestic vessels are limited to.
  - The containerized cargoes are then loaded into trucks at the North Harbor and brought into the South Harbor for eventual loading into the foreign vessel bound for Taiwan.

(Please refer to **Illustration 1** for an overview of the entire process)

B. Domestic Carriage for Imported Containerized Cargoes

The process involved in this category is somewhat similar to that of export cargo carriage, except that the sequence is reversed. Under a situation where a businessman, say in Davao, imports materials from Singapore, the Singaporean exporter will make arrangements with a foreign shipping line for the transport of the containerized cargoes from Singapore to the Philippines. Again, if the foreign vessel contracted calls at Davao, the process will not involve any domestic carriage of the imported cargoes . However if the foreign vessel has only Manila (South Harbor/MICT) as port of destination, the following arrangements will necessarily be included in the transport process.

- The foreign shipping line will make arrangements with a domestic vessel for the transport of the imported cargoes from Manila to Davao, which will in turn cover the following aspects;

- Trucking of the foreign containerized cargoes from South Harbor/MICT to North Harbor;
- Domestic sea transport of the imported cargoes from Manila to Davao;
- Once the containers are emptied of their contents in Davao, the empty containers are transported back to Manila and redelivered to the foreign shipping line.

(Please refer to **Illustration 2** for an overview of the entire process.)

C. Domestic Carriage of Containerized Cargoes Confined to Local Destinations / Origins

Compared to the previous two (2) categories, this category does not include in its process any repositioning of empty containers and trucking between North Harbor and South Harbor/MICT. What is basically involved is the loading at the local port of origin, the domestic carriage, and unloading at the port of destination, and would thus be more comparable to the attendant proces for overseas carriage.

III. FREIGHT RATES COMPARISON OF CONTAINERIZED CARGOES

With the foregoing overview of containerized cargo categories, available freight rates data could now be better analyzed. Presented hereunder are three (3) groups of freight rates data.

The first group would be the freight rates of containerized cargoes carried by foreign vessels between Manila and selected Asian ports.

The second group would be the freight rates charged by domestic vessels on containerized cargoes for export covering their domestic transport leg between Manila and selected domestic ports, and after separating the cost components involved and only using the sea transport charge for comparison. The freight rates for domestic transport of imported containerized cargoes was deemed no longer necessary for presentation as the figures involved would not vary much from those for export cargoes, except for some minor differences.

The third group would be the freight rates currently charged by domestic vessels for containerized cargoes confined to local destinations/origins.

In order to achieve meaningful comparisons, the freight rates data used would apply to full container load (FCL) of 20-foot containers and freight all kinds (FAK) for overseas carriage and Class A commodities for domestic carriage. Moreover, the differences in distances involved were addressed by further translating the freight rates into per distance units (nautical miles in this case).

It is also significant to invite attention to the fact that the rates for transhipment cargoes and containerized cargoes have been deregulated since 25 October 1990 through MARINA Memorandum Circular No. 57.

A. The Freight Rates of Oceangoing Vessels

1. Freight Rates of Oceangoing Vessels

Route	Distance (n.m.)	Freight (US$) *		Rate/n.m.	
• Manila - Kaoshiong	547	300.00		0.55	
• Manila - Hongkong	633	250.00		0.39	
• Manila - Singapore	1,308	350.00		0.27	
• Singapore - Manila			530.00		0.40
• Manila - Bangkok	1,485	600.00		0.40	
• Manila - Jakarta	1,571	650.00		0.41	
• Jakarta - Manila			850.00		0.54

Source : Philippine Shippers' Bureau

* Excludes Terminal Handling Fee of P 1,800.00 And Documentation Fee of US$ 15.00

2. Freight Rates of Domestic Vessels for Export Cargoes

Route	Distance (n.m.)	TotalCharges (US $)	Breakdown of Total Charges			
			Auxillary Charges [1]	Charges from Repositioning [2]	Sea Transport Freight	$ Sea Transport Freight/n.m.
• Manila - Cebu	392	356.31	30.12	144.23	212	0.54
• Manila - Cagayan de Oro	504	507.47	30.91	166.61	310	0.61
• Manila - Zamboanga	512	507.47	30.91	166.61	310	0.61
• Manila - Gen. Santos	723	507.47	30.91	166.61	310	0.43
• Manila - Davao	829	507.47	30.91	166.61	310	0.37

Source : Domestic Shipowners Association

[1] Includes local arrastre at ports of origin and destination, wharfage & doc. stamps.

[2] Freight of empty containers

3. Freight Rates for Containerized Cargoes of Local Origin/ Destination

Route	Distance (n.m.)	Freight Rate [1]		$ Rate/ n.m.
		P	US $ [2]	
• Manila - Cebu	392	12,545.96	317.62	0.81
• Manila - Cagayan de Oro City	504	15,408.96	390.10	0.77
• Manila - Zamboanga	512	15,614.48	395.30	0.77
• Manila - Gen. Santos	723	21,006.72	531.82	0.73
• Manila - Davao	892	23,716.28	600.41	0.72

Source : Domestic Shipowners Association

[1] Excluding 10% VAT

[2] Exchange Rate : 1 US$ = P39.50

B. Summary of Freight Rate Comparison

On the basis of the foregoing data presented, it may be concluded that;

1. The **domestic freight rates of containerized cargoes for export**, on a per nautical mile basis (*range: $0.37 - $0.61*) **is relatively higher than overseas freight rates** (*range: $0.27- $0.55*) **by 11% to 37%. The gap however, would possibly be smaller if the foreign freight rates considered are the forward haul**

(i.e., Singapore – Manila and Jakarta – Manila) rather than the backhaul, as it would appear that the freight for forward hauls charged by foreign vessels is much higher than the backhaul freight.

(**N.B.** *What may be essential to invite attention to is the contention made by domestic shipowners/ operators that the freight rate that they charge to foreign shipping lines for the domestic carriage of transhipment cargoes is lower by 8% to 22% than the amount that the foreign shipping lines charge to the exporter/ importer for such carriage , commonly referred to as* "**arbitrary rates**".)

2. The above-noted difference becomes even more pronounced when one compares the **freight rates charged for local containerized cargoes** (*range:$0.72 - $0.81*) to that of overseas freight rates, with the former being **higher by 47.3% up to 166.6%.**

IV. FREIGHT RATES COMPARISON OF BREAK-BULK CARGOES

Another category of cargo transport involves non-containerized breakbulk cargoes. Tabulated below are the attendant freight rates for selected routes:

Route	Distance	Freight (per cbm or ton)	Rate/n.m.
• Manila - Hongkong	633	US$ 5	$ 0.0079
• Manila – Keelung, Taiwan	732	US$ 15	$ 0.02
• Manila - Singapore	1,308	US$ 12	$ 0.009
• Manila – Cagayan de Oro	504	P 358-550* = US$ 9.1- 13.9	$ 0.018- 0.027
• Manila – Gen. Santos	723	P 488-750* = US$12.3- 18.9	$ 0.017- 0.026
• Manila - Davao	829	P 551–847* = US$13.9- 21.4	$ 0.016- 0.025

Source: Philippine Shippers' Bureau for the oceangoing rates and Maritime Industry Authority for the domestic rates.

* Covers the range of freight rates for Class C to Class A commodities which are now deregulated

On the basis of the above comparative figures, our **domestic freight rates for breakbulk cargoes** are **higher than oceangoing freight rates** from **35% to 100%.**

V. CONTEXTUALIZING THE DIFFERENCES IN FREIGHT RATES

With the foregoing data serving to indicate that domestic freight rates are higher than overseas freight rates, under comparable assumptions, the essential questions to be asked is **WHY?**

In comparing the operating conditions between overseas vessels and domestic vessels, there are several factors/conditions deemed relevant to explain the resulting disparity in freight rates.

A. Factors Influencing Disparities in Freight Rates á 7 Obstacles To Domestic Shipping Competitiveness

1. High Fuel Cost (Local vs. Foreign)

Vessels consume largely Diesel and Special Fuel Oil for their operations. Comparing the cost of such fuels in the Asian region, our domestic ship owners

obviously suffer a disadvantage in terms of higher fuel cost in the Philippines compared to other Asian countries as shown in the table below;

Table 1: COMPARATIVE BUNKER PRICES AMONG ASIAN COUNTRIES

Country	Fuel Oil Price (US$/m.t.)	Diesel Oil Price (US$/m.t.)	Regular Gasoline (US$/m.t.)
Philippines	112	188	249
Hongkong	89	134	148
Taiwan	92	152	182
Singapore	74	125	118
Malaysia	103	153	160
Japan	94	195	n.a.
Korea	76	150	160

Source : ERB for Philippine prices (as of 12 March 1998) and Shell Gas Eastern Inc. for prices of other countries (as of 18-22 May 1998)

It would clearly appear from the above price comparisons that **domestic vessels pay 8.7% to 51.3% more for Fuel Oil**, and **23.7% to 40.2% more for Diesel Oil**, than their foreign vessel counterparts. (Underscoring this difference is the fact that in Indonesia, the price of 1 liter Diesel Oil is only P 1.80 compared to the current price in the Philippines of P 8.24)

If one one adds to this the fact that the big liner operators, members of the Domestic Shipowners Association (DSA) spends 25.7% of their 1996 Total Operating Expenses for Fuel, the disadvantage becomes quite evident.

2. High Interest Rates (Local vs. Foreign)

Another major expense in vessel operations revolves around the interest rates shouldered by ship owners/ operators arising from needed capitalization. Our domestic ship owners would again suffer at a disadvantage in this regard, as shown by the following table;

Table 2: **COMPARATIVE INTEREST RATES AMONG ASIAN COUNTRIES**

	Interest Rates (%)			
Country	20 March 1998	1997	1996	1995
Philippines	15.81	13.13	13.80	15.75
Hongkong	7.53	9.63	6.60	8.75
Taiwan	7.85	8.66	6.60	7.25
Singapore	5.78	8.06	3.30	6.00
Malaysia	11.02	9.07	7.30	7.70

Source : Far Eastern Economical Review

As of March 20, 1998, **Philippine shipowners/ operators pay 43.5% to 173.5% *more* in terms of interest rates compared to their Asian counterparts**, which would further make them less competitive, despite on-going efforts to increase Total Assets, which stands at P 27.718 B as of 1996 for the DSA members. Significantly, interest expenses of the DSA member-operators account for 6.08% of their 1996 Total Operating Expenses of about P 8.971 B.

3. High Insurance Premium (Local vs. Foreign)

Another major expense in shipping operations are the payments for Insurance Premium relative to Protection & Indemnity (**P&I**) and Hull & Machinery Insurance of

vessels. In the case of DSA member-operators, this accounts for about 3.37% of their Total Operating Expenses in 1996.

Although there are no readily available statistics as to variations in insurance premium among Asian countries, it is generally acceded that the country's domestic vessel pay higher cost of insurance premium, (particularly for Hull & Machinery coverage) compared to their foreign counterparts.

4. Higher Taxes for Domestic Shipping Operations

Domestic shipping companies are subject to the **3% common carrier's tax**, the **10% value added tax** (VAT), and **34% income tax**. On the other hand , foreign shipping lines are only subjected to 2.5% tax on gross income. Additionally, domestic shipping lines also shoulder **administrative expenses** to maintain offices/personnel at their ports of call and handle marketing concerns, and the payments of **fees attendant to franchises and licenses** required for their operations, among others.

5. Higher Cost of Domestic Shipping Operations To Subsidize Passenger Carriage Operations & Services in Less Profitable Routes

The typical **revenue profile** of domestic liner vessels is such that **65% of total revenue** is accounted for by **freight revenues,** while the remaining **35% comes from passenger revenues**. Considering that passenger- carrying vessels are required to allocate 50% of their passenger capacity to 3rd class accommodations (except for those accredited by the Department of Tourism), the rate of which is regulated/ prescribed by government, freight rates of domestic vessels are designed not only to recover cargo carriage cost but likewise provide subsidization to passenger carriage operations. Aggravating matters for the country's domestic shipping operators is the fact that the current passage rates for 1st and 2nd class accommodations, although deregulated, could only be increased by so much in view of the low air fares now being offered by airline companies who could afford to do so due to some form of fuel tax subsidy that they can avail of, which is not being enjoyed by domestic shipping operators.

6. Less Port Efficiency & Productivity (Local vs. Foreign)

Cargo handling efficiency greatly influence a vessel's productivity which, in turn, is translated into the level of freight rates to be charged. The lower cargo handling productivity to which our domestic vessels are confronted with likewise place them at a disadvantage compared to their foreign vessel counterparts. Productivity in our domestic ports approximates only about one-half of the efficiency in other foreign ports.

7. Lack of Comparable Government Support Programs for Domestic Shipping

Foreign shipping lines likewise enjoy better subsidies than their Philippine counterparts which enable them to make better rates offerings. In the case of American shipping companies for example, they enjoy such government support as the Jones Act, the PL 480, the Merchant Marine Act of 1984, and last November 1997, the law requiring Alaskan crude oil to be carried exclusively by American vessels.

From the foregoing, it becomes relevant to consider whether foreign vessels, if made to operate under the same conditions as our domestic vessels, would still be able to charge the same lower freight rates as they are currently charging, compared to existing domestic freight rates.

B. Disparity In Domestic Freight Rates

It will be noted that the domestic freight rates charged for containerized cargoes of local origin/ destination is even higher than those charged for containerized cargoes for export/ import. Such disparity manifests a discrepancy in pricing, considering that the local carriage which does not involve repositioning of empty containers and trucking between North Harbor to South Harbor/ MICT is expected to entail lower freight rates.

A key factor in the above consideration is the fact that the freight rates for containerized cargoes have been deregulated by government, thus granting domestic shipowners/ operators flexibility in their pricing scheme. The lower freight rates charged to cargoes for export/ import is apparently designed to respond to the clamor of exporters/ importers for lower domestic transport cost, especially in view of the fact that such categories of containerized cargoes account for a significant share of the total volume being transported, involving a freight revenue of P 100 M in 1997. *This would however, be rendered meaningless if it is indeed true that the arbitrary rates paid by exporters/ importers to the foreign shipping lines (for the domestic carriage of their cargoes) is higher than what the foreign shipping lines are actually paying to the domestic vessels for such domestic carriage. Thus, the support intended to be extended by domestic shipowners/ operators to the country's export competitiveness and lower production costs, would turn out to be not really benefitting our exporters/ importers.*

C. Recommended Areas of Government Support for the Domestic Shipping Industry to Enhance the Sector's Global Competitiveness

1. Re-filing and certification as an urgent Administration Bill of the "**Philippine Domestic Shipping Development Act**".
2. Grant of **fuel tax exemption / subsidy** for domestic shipping operators, similar to that of the airline industry.
3. Grant of **special interest rates** to domestic shipping operators.
4. **Privatization of ports** (e.g. North Harbor) and **cargo-handling activities**.

EML / DSO