

Cabotage Principle as the Realization of National Freight Protection in Free Trade

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Abstract

Realizing independence in national freight is a must because independence can be a maritime sovereignty milestone. While, Indonesia' overseas freight is still approximately 90% dominated by foreign freight, for domestic freight already using Indonesian ships, although there are still foreign ship leases and crew salaries. This research uses a legal research that is normative and empirical. The research was conducted in Makassar with consideration as a port-city and the gateway of Eastern Indonesia. The results show that the principle of cabotage has not been fully harmonized with other laws and regulations because for the regulation of oil and gas (offshore) is still given an easy, especially the deadline for foreign use permits in Indonesian waters. Similarly, for overseas freight, most of them still use foreign ships rather than Indonesian ships. Provisions that regulate the principle of cabotage in various fields are basically well, but for the oil and gas sector, it is expected that the government can be more consistent and consequently regulate the deadline of the use of Indonesian-flagged ships. Uphold the law, sanctioning to ship owners or foreign ship operators and government apparatuses who grant permission to use foreign ships whereas Indonesian ships are available. The function of law as a means of community renewal is expected to maximum, both in terms of substance and its implementation.

Keywords: Cabotage Principle, Free Trade, Marine, National Freight

1. Introduction

Indonesia is an archipelago country, hence the sea and its fleet is an absolute requirement that must be owned and an integrative factor that unified the entire archipelago with all its citizens into an integral whole. Sea transportation is one of facilities in creating unitary and unity of the nation. Sea can be used as a means of facilitating the distribution, equity of development and population mobility.

In principle, sea transport activities within the country can only be done by national sea transport by Indonesian-flagged ships and manned by Indonesian citizenship crew. Foreign ships are prohibited from transporting passengers and/or goods commercially or between ports in the territorial waters of Indonesia. This is known as 'cabotage principle'.

The principle of *cabotage* (read: *kabotaj*) is a prerogative right of a country to transport passengers and/or goods commercially from place to place within a sovereign state. The right is granted to a national transport company, not to any foreign transport company except in consideration for the national interest of the country concerned.

In reality, being an imbalance to see the national freight industry when reflecting from a country with an ocean area of 5.8 million km² and have about 17.500 islands inside but a foreign country controls national transportation services.¹ If we look back, when Indonesia became independent, Indonesia controlled the headquarters of Dutch' KPM in Gambir but the *Koninklijke Paakketvaart Maatschappij* (KPM) ships or Kingdom Freight Company with the Dutch-flagged success to escape and the Dutch sold them abroad so that Indonesia did not have a strong fleet to serve the whole country.²

In 2005, the President of Indonesia issued Presidential Instruction No. 5 of 2005 on Strengthening of the National Freight Industry which instructed to 13 Ministers and Governors/Mayors/Regents to apply cabotage principles.³ Consequently and formulate policies and take the necessary steps in accordance with their respective authorities to empower or strengthen the national freight industry. Furthermore, in 2008, the birth of Act No. 17 of 2008 on Freight (amended Act No. 21 of 1992 on Freight) that foreign ships are prohibited from transporting passengers and/or inter-island goods/inter ports in Indonesia.⁴

In period between 2005 (since the issuance of the Presidential Instruction 2005 - December 2016) there was a significant change in which the number of national fleet capacity increased sharply. On 31 May 2005, the number of commercial ships was 6.041 ship units and in December 2016 increased to 21.866 units or increased

¹ Maritime' Weekly, *Apa Kabar Industri Pelayaran Nasional?* 28 November 2005, page.12

² Emil Salim in Kompas, "Cabotage" Untuk Merah Putih, 4 October 2012, page. 6

³ The principle of *cabotage* underlies that freight from 1 (one) port to another port in Indonesia must be done by Indonesian-flagged ships. The giving of permit to use foreign ship is issued if there is a shortage of Indonesian-flagged ship so it is a dispensation cost that require Dispensasi Syarat Bendera (DSB) permit.

⁴ Huda, M.K. (2007). Problematika Implementasi Asas Cabotage dalam Industri Pelayaran Nasional, *Jurnal Prespektif Hukum* Vol. 7, No. 1.

361%.¹ This is derived from the shift of foreign flags into red and white flags, the construction of new ships and the procurement of former ships from abroad.²

As seen on data above, red and white-flagged ships fleet have the ability to carry domestic cargo even excess. It can be said that for domestic cargo, 100% transported by national ships but for national freight engaged in the offshore sector. The application of cabotage principle is still a big job because the government keeps updating the regulations and makes the use of foreign ships in the offshore sector, which in 11 years (2005-2016) has been issued 8 (eight) times the regulation of Minister of Transportation (Permenhub) which permits the use of foreign ships under certain terms and conditions.

If refers to article 8 and 341 of Act No. 17 of 2008 concerning Freight, the provisions on the use of foreign-flagged ships are no longer valid because foreign-flagged ships still operating within the country can still perform their activities within a maximum period of 3 (three) years since enactment of this regulation so that after 7 May 2011, the use of foreign ships is not allowed anymore. Whereas, article 11 paragraph (1) of Act No. 17 of 2008 on Freight indicates that sea transport activities from and to abroad are conducted by national and foreign transport companies by using Indonesian and/or foreign-flagged ships.

This reflects a direct link between the ship and the flag of the ship. It means the process of growth and development of Indonesian trading fleet relies on the investment capability of Indonesian Citizens. Foreign ships are not allowed to register their ships in Indonesia but how foreign ships are leased by Indonesian citizens or Indonesian legal entities? Should not the ship have been registered by the owner in his home country? This is a question given the number of Indonesian-flagged ships that are in fact leased from foreign freight companies, as well as Indonesian ships that are agents of foreign freight companies.

It is a positive thing that the government requires payment of export activities by exporters and importers by using *cost, insurance and freight* (CIF) which started on 1 March 2014, where the CIF will stimulate the insurance industry, banking and domestic transportation services. Free trade is an economic concept that refers to *Harmonized Description and Coding System* (HS) where the sale of inter-state products without import-export taxes or other trade barriers. Free trade can also be interpreted as there are no artificial barriers imposed by the government on the trade between individuals and companies residing in different countries.

The world is experiencing globalization so that Indonesia must be able to adapt. Indonesian entrepreneurs should be able to compete with foreign entrepreneurs without barriers including in the field of freight in the fight for available market share, especially transporting passengers and or goods in the domestic. Realizing independence in national freight is a must because independence can be a maritime sovereignty milestone. However, in view of the facts above, Indonesia' overseas freight is still approximately 90% dominated by foreign freight, for domestic freight already using Indonesian ships (except offshore sector) although there are still foreign ship leases and crew salaries. This is feared Indonesia is not ready in the face of free trade so that it will only be a spectator in their own country. As described above, there is a trend not yet operating the maximum cabotage principle in national freight practices so not ready to face free trade. This requires further study and research.

2. Method of the Research

This research uses a legal research that is normative and empirical. Normative research is done by using legislation approach related to the principle of cabotage. While, empirical research to examine whether the legal rules related to the implementation of cabotage principle can solve the problem of the national freight industry protection so can realize the implementation of cabotage principle in the Indonesian sea freight system that is ready to face free trade.

The research was conducted in Makassar with consideration as a port-city and the gateway of Eastern Indonesia. The populations in this research are all parties involved in the implementation of cabotage principle in Indonesia, both decision makers and also supervising the freight activities in Indonesia and the parties who run their business activities in the scope of sea transport. The sample in this research will be taken through *purposive-sampling* and based on certain criteria and considerations, in this case representativeness and capability.

3. Legal Substance of Cabotage Principles in Supporting Indonesia as an Archipelago Country

Literally, Indonesia is an archipelago and developing country that has a legal relationship with the international community. In national law, have interrelated interests so that the development of national law in the international world cannot be separated from the influence of international law.

Sea Law Convention in 1982, Section 91 which regulates the Nationality of ships states in paragraph (1) that

¹ Speech of Ministry of Transportation on Consolidation Forum of National Shipping Industry, 9 November 2016, Jakarta. Related to the Transportation Statistics, Ministry of Transportation, 2012-2016.

² Umar Hadi in Kompas, Sejuta Kapal Rakyat, 18 September 2014, page. 7

each country shall establish requirements for the granting of its nationality on board, for registration of ships within the territory and for the right to fly its flag. The ship has the nationality of the country whose flag can legitimately be flown by it. There must be a valid connection between the state and the ship. Subsequently, each State shall grant to the ship by which it has been granted the right to fly its flag of the necessary documents to it, requiring a connection between the ship and its owner so that between the nationality of the owner and the ship shall be appropriate.

Related to the registration of Indonesian ships internationally, in 1979 in Manila it was agreed to seek international uniformity in ship registration requirements, especially in creating genuine links between flag countries and ship using the flag. Also, The International Labor Organization (ILO) has issued the Maritime Labor Center (MLC) 2006 which is the International Labor Standards that have been adopted at international labor meetings in February 2006 and updated 37 ILO's conventions in the field of maritime labor.

Indonesia has approved the draft of Act on the ratification of 2006 Maritime Labor Convention (MLC) to become law at the plenary session of the House of Representatives on 8 September 2016, with Act No. 15 of 2016 on the ratification of Maritime Labor Convention 2006. It is intended the Indonesian seafarers can compete internationally, and for ship industry and ship owners to be able to face competition in the global freight industry. In addition to the national legal, the freight company must also be prepared with the provisions in MLC which are its responsibilities, for example the provision of crew accommodation and the fulfillment of crew' welfare and their families.

In the context of national law, initially the implementation of cabotage principle was opposed by domestic freight companies because almost all freight companies have had a lease contract with foreign ship companies so that the birth of Presidential Instruction No. 5 of 2005 that "forced" to use Indonesian-flagged ships, making them have to re-negotiate.

National freight companies more rent foreign ships because they cost less than investing in a ship. To buy a new ship, it takes up to tens of billions rupiah so it burdens the national freight company. Also, the procurement of these ships is imports considering the limitations of the shipyard industry in meeting the demand of ship fleet to support cabotage principle. In addition, ships of national freight companies tend to be less good because most are old ships or used. The amount is not much so it cannot meet the needs of the national ship.

Then, it was issued Presidential Instruction No. 5 of 2005 which regulates the principle of cabotage, with the government supervision that is stronger so that the number of Indonesian-flagged ships increased but it should be noted the increase is whether from the purchase of new ships or used, ships obtained by leasing or becoming a foreign company agent. For offshore fields, national freight companies still use foreign ships due to different types of ships, higher prices than ships, and also the technology is more sophisticated so that the implementation is not maximized.

One obstacle in applying the principle of cabotage is that national freight companies do not fully own ships but only rely on their business to ship agents. This can happen because the burden of costs to be borne by foreign freight companies are given various facilities in the country, both in terms of capital and regulation so that competition between Indonesian ships with foreign ships become unfair. Table 1 listed the number of ship by ownership, whether owned by national companies, foreign charter or foreign agency.

Table 1. Data of ships by ownership in 2012-2016

No	Item	Units	2012	2013	2014	2015	2016	Amount
1	National	Unit	11.791	13.120	14.156	16.142	26.048	81.257
2	Foreign Charter	Unit	435	354	295	182	199	1.465
3	Foreign agent	Unit	4.694	4.364	4.320	4.282	9.191	26.851
	Total		16.920	17.838	18.771	20.608	33.396	109.573

Source: The Ministry of Transportation, Indonesia, January 2017

As data above, national commercial freight is able to maintain the availability of inter-island ships/ports. It can be seen from the value of investment spent for ship' procurement, if the estimated price of 1 (one) ship approximately US \$ 3 million then the value of investment spent by national freight companies to reach US\$ 4 billion for 2015. This is due to the policy of *cabotage* principle which requires domestic sea transport activities using red and white flag ship. This is shown also by decrease use of foreign charter vessels and foreign agency.

4. Legal Function as a Community Renewal Mean in Realizing Marine Development

Law serves to encourage the current development to be directed to the sea, not to land to harmonize the geographical state of Indonesia which is an archipelagic state so that the sea should be utilized as well as possible. Mochtar Kusumaatmaja's theory which states that law is the main foundation in the community renewal mean, not as a community renewal tool.¹ In this sense, the law is not passive but is expected to change a certain circumstances and conditions into the desired direction of communities. The law is not only regulates the

¹ Kusumaatmadja, M. (1990). *Pengantar Hukum Internasional (Buku I-Bagian Umum)*, Binacipta, Bandung

existing state but is able to create new conditions and situation.¹ Based on this theory, the regulation on *cabotage* principle is expected to make the Indonesia development towards the sea.

So far, domestic and foreign trade that occurred can be used as a benchmark or picture of how big the function of law in advancing national freight. Domestic and foreign trades flows can be well organized, require a good transportation system as well. Transportation means required to connect different regions or countries may be aircraft, ships and land transportation. The parties who need a large space/place because held agreements in large numbers also tend to use ships because it is able to transport commodities in large quantities, inexpensive cost when compared to air and land transportation.

National trading system expects import-export entrepreneurs to change the items of trade of goods shipping from domestic and abroad. So far, the mechanism of export-import of goods from Indonesia through sea freight only benefits foreign freight because it uses Free On Board (FOB) trading system which is more profitable to the buyer (importer) than the owner of goods so few Indonesian ships are utilized by buyers. This system benefits the buyer because it can determine the ship to be leased in accordance with the wishes and interests of his home country even though the Indonesian-flagged vessel is available. Using FOBs term is easy for the owner of goods because it does not need to look for export ships and spend freight costs or bear insurance risk because everything is taken care by the buyer (importer).

Incoterms or International Commercial Terms is a collection of terms created to embed understanding between sellers and buyers in international trade.² Incoterms explains the rights and obligations of buyers and sellers related to the purchase of goods. Issued by the International's Chamber of Commerce (ICC) on 1 January 2011, called Incoterms 2010 (formerly Incoterms 2000). Matters described in Incoterms include the process of goods shipping, guarantor of the export-import process, the guarantor of costs incurred and the risk bearer in case of changes in the condition of goods that occur due to the delivery process.

There are several terms in Incoterms 2010 divided into 2 (two) categories based on the method of delivery, 7 (seven) terms generally applicable and 4 (four) terms that apply exclusively for delivery via water transport. The following 4 (four) terms applicable in sea freight:

- a. *Free Alongside Ship* (FAS). The seller is responsible until the goods are at the port of departure and ready alongside ship to be loaded. Costs to the cargo alongside ship become the sellers' expense.
- b. *Free On Board* (FOB). The seller is responsible from taking care of the export license to load the goods on board ready to depart. Until the goods on the ship becomes the seller's responsibility.
- c. *Cost, Insurance and Freight* (CIF). The seller shall bear the charge until the ship containing the goods docked at the port of destination but the responsibility is only until the ship departs from the port of departure. The insurance fee for the shipped goods is the seller's responsibility.
- d. *Cost and Freight* (CF / CFR / C & F). The seller shall bear the cost until the ship containing the goods docked at the port of destination but the responsibility is only until the ship departs from the port of departure. When it arrives at the port, there will be other additional costs such as insurance of goods, taxes and other costs to be borne by the buyer to be able to remove his goods from the port.

Related to the principle of cabotage, it often occurs in export transactions from Indonesia to other countries where payment terms are FOB while in import transactions to Indonesia, the terms of payment are CIF or C & F. Under such conditions, Indonesian entrepreneurs are in a weak position (especially in foreign exchange earnings) where under FOB requirements for export activities, the opportunity to obtain foreign exchange from export proceeds only until the goods arrive on board while freight costs are paid by foreign entrepreneur in abroad did not choose the Indonesian ship as their transportation but chose a ship from his country. In contrast, in import activities, the price of goods to be paid by the seller is up to the goods unloaded from the ship at the port of destination in Indonesia including the cost of insurance if the requirement is CIF. The choosing of ship was determined by the seller.

It should be reversed, in export activities the requirements are CIF or C & F while the requirements on import activities are FOB to be more beneficial to the Indonesian side, including the choosing of Indonesian ships as transportation means. Its problems are; *first*, the availability of Indonesian ships. As known, the fleet of Indonesian ships serving overseas routes is only 10%, the rest is controlled by foreign fleet. This makes it difficult for Indonesian entrepreneurs to request FOB conditions as they relate to the certainty of the availability of ships; *Second*, bargaining power of Indonesian entrepreneur with their counterparts from abroad. Goods from Indonesia exported to abroad, such as tea, coffee, crude palm oil (CPO), textiles are goods that are also produced and exported by other countries. Negotiations will be hard if competitors from other countries offer cheaper price than the price offered by Indonesian entrepreneurs, especially when it is added by asking for CIF or C & F terms. The Indonesian Ship-owners Association (INSA) is trying to smooth out all efforts needed to improve the

¹ Nugraha, R. (2016). Improving Aviation Safety in Indonesia: How Many More Accidents?. *Hasanuddin Law Review*, 2(3), 328-348. doi: <http://dx.doi.org/10.20956/halrev.v2i3.321>

² Mansell, J.K. (2009). *Flag State Responsibility (Historical Development and Contemporary Issue)*, Springer, Berlin.

bargaining power of Indonesian exporters and importers.

5. Conclusion

Legal substance that regulates the principle of cabotage has not been fully harmonized with other laws and regulations because for the regulation of oil and gas (offshore) is still given an easy, especially the deadline for foreign use permits in Indonesian waters. In associate to the link with international agreements, Indonesian laws and regulations have adapted to international treaties, for example the 1982 Maritime Law Conference (KHL 1982) and the Maritime Labor Center. The function of law as a means of community renewal to realize sea development has been running well, it can be seen from the law regulating the principle of cabotage has encouraged the application of cabotage principle in the domestic maximally than ever before. Similarly, for overseas freight, most of them still use foreign ships rather than Indonesian ships.

Provisions that regulate the principle of cabotage in various fields are basically well, but for the oil and gas sector, it is expected that the government can be more consistent and consequently regulate the deadline of the use of Indonesian-flagged ships. Uphold the law, sanctioning to ship owners or foreign ship operators and government apparatuses who grant permission to use foreign ships whereas Indonesian ships are available. The function of law as a means of community renewal is expected to maximum, both in terms of substance and its implementation.

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