11-3-2020

Pushing the borders on cabotage : Indonesia's Beyond Cabotage regime

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RES 420 FINAL PUBLISHING

by Kristi Dwi Anita

Submission date: 04-Nov-2020 07:55AM (UTC+0100)
Submission ID: 135384836
File name: 1755_Kristi_Dwi_Anita_RES_420_FINAL_PUBLISHING_11057_1122241173.doc (1.01M)
Word count: 18310
Character count: 102330

WORLD MARITIME UNIVERSITY

Malmö, Sweden

PUSHING THE BORDERS ON CABOTAGE: INDONESIA'S *BEYOND CABOTAGE* REGIME

by

KRISTI DWI ANITA

Indonesia

A dissertation submitted to the World Maritime University in partial fulfilment of the requirements for the award of the degree of

MASTER OF SCIENCE

in

Maritime Affairs

(MARITIME LAW AND POLICY)

2020

Declaration

I certify that all the material in this dissertation that is not my own work has been identified, and that no material is included for which a degree has previously been conferred on me.

The contents of this dissertation reflect my own personal views, and are not necessarily endorsed by the University.

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Acknowledgement

All praises and thanks are due to God alone, for the countless blessings and for granting me the strength and ability to undergo my studies in WMU and to conclude my dissertation. I would also like to express my heartfelt gratitude to the Government of Germany for the scholarship that enables me to have this life-changing experience.

I would like to thank my supervisor, Dr. Maximo Q. Mejia, for your guidance, patience, and support throughout the writing process of my dissertation and also to all Professors of the Maritime Law and Policy specialization for the valuable knowledge during my studies as well as the WMU Faculty and staff who have been giving us great assistance. My gratitude also goes to my superiors and colleagues in the Ministry of Transportation (MOT) of the Republic of Indonesia for the continuous emotional and technical support.

Having my time being away from home and family might have been very difficult for me to get through, especially in the midst of Covid 19 pandemic, but with the support of my Indonesian friends of WMU S19, WMU S20, WMU S21, the MLP Students, and all WMU S20 friends. You, you, you, yes you, also you, of course you, hmm.., okay you too, and you laah! I forever be indebted to your sincere friendship and support. I would also like to say thank you to the Indonesian community in Malmo who has been making this place more like a home.

Lastly, I owe this dissertation and studies to my husband, my parents, my siblings, my families in laws, and all the family members for their unconditional love, prayer and support. And to myfuture children, you are welcome anytime.

Abstract

Title of Dissertation: Pushing the Borders on Cabotage: Indonesia's *Beyond Cabotage* Regime

Degree: Master of Science

The aim of this dissertation is a comprehensive inquiry and analysis of the legal framework for cabotage as well as the status of its implementation, with particular regard to potential tensions between national regulations and international commitments.

This research focusses on finding data by reviewing national and international regulations on cabotage regimes and its current updates in the maritime sector. The analysis finds the challenges faced by the Indonesian government in implementing cabotage and *beyond cabotage*. Indonesia can not be fully satisfied because of the mixed results of its cabotage regime because there are sectors that still need foreign participation. Furthermore, there is no significant improvement in shipbuilding industry. The increasing number of vessels is not newly built ships and shipping companies focus their business as shipping agency. The high tariff of sea freight impact to deficit of state revenues in balance of trade in services. The contribution of maritime sector to the GDP is still low considering the fact that Indonesia is an archipelagic country. There are many challenges that hindering the implementation of *beyond cabotage*, such as lack of availability of ships, the use of INCOTERM in the shipment contract preferably FOB than CIF, the international pressure, and the indications of breaching commitment in maritime trade in services under WTO and IJEPA, also the Covid-19 pandemic.

This research is concluded with some recommendations, and it is expected to make a positive contribution to the process of policymaking in Indonesia on the sea transport sector and maritime industry in order to support the Indonesian Government in empowering sea transport role in the maritime/shipping industry by implementing a new policy in the national and international level without worry to benefiting the Indonesian economy.

KEYWORDS : Indonesia, cabotage, *beyond cabotage*, shipping industry, shipbuilding industry, Incoterms, breaching, international commitment.

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List of Abbreviations

BPS	Badan Pusat Statistik (Statistic Centre)
CSD	cutter suction dredger
CPO	crude palm oil
DGST	Directorate General of Sea Transportation
DP	dynamic position
DSV	diving support vessel
DWT	deadweight tonnage
EEZ	exclusive economic zone
EPP	economic policy package
GAPKI	Gabungan Pengusaha Kelapa Sawit Indonesia (Indonesian Palm Oil Association (IPOA))
GATS	General Agreement on Trade in Service
GDP	gross domestic product
GT	gross tonnage
ICS	International Chamber of Shipping
IJEPA	Indonesia Japan Economic Partnership Agreement
INSA	Indonesia National Shipowners' Association
IMO	International Maritime Organization
ISAA APBI – ICMA	Indonesia Shipping Agencies Association, Asosiasi Pertambangan Batubara Indonesia – Indonesia Coal Mining Association
LDCs	least developed countries
MOT	Ministry of Transportation
TSHD	trailing suction hopper dredger
TZMKO	Territorale Zeeen en Maritieme Kringen Ordonantie
UNCLOS	United Nations Convention on the Law of the Sea, 1982

SEDU	self-elevating drilling unit
SIDS	small island developing states
SWL	safety working load
SURF	subsea umbilical riser flexible
USA	United States of America
WTO	World Trade Organization

CHAPTER 1
INTRODUCTION

1.1 Background and problem statement

Being the world's largest archipelagic country, Indonesia depends on sea transport to connect its many islands; connectivity is an essential factor for economic growth. Sea transport plays a vital role in facilitating economic activities and daily activities on the islands. Indonesia, which has more than 17,000 islands, considers sea transportation as the vein of the Indonesian economy, for transporting people (passengers) or delivering goods (cargo).

Despite having an important role, the existing domestic sea transport and national shipping companies cannot compete with foreign shipping companies and ships dominating Indonesian waters. It is predicted that the share of export cargo in Indonesia is dominated by international sea transport by more than 90% (Leung, 2016). To address this issue, since 2005, the Indonesian Government issued a public policy on how to maximize the maritime industry potential by empowering domestic shipping through Presidential Instruction Number 5 the Year 2005. All domestic shipping activities between ports in Indonesian waters must use Indonesian flagships owned by national shipping companies and operated by crews of Indonesian citizens. In this context, the cabotage regime is a tool used to reserve different maritime transport services, such as domestic, intra-regional maritime transport services, and transshipment, for domestic shipping companies.

The urgency in exercising the cabotage regime is based on the consideration that domestic maritime transport has a strategic and significant role in national development in every aspect like law, economy, social, cultural, or security. Furthermore, the cabotage regime also elevates Indonesian people's economy by giving as much opportunity as possible to carry out business to local and national business players. It is believed that this regime can help increase domestic

shipbuilding where only Indonesian ships are allowed to sail through Indonesian waters from one port to another port. Also, the cabotage regime is a form of the government authority to practice its sovereignty to protect the region as a maritime country.

In 2018, after more than ten years of implementation, cabotage was considered successful, bringing changes to Indonesia's maritime industry. The number of national ships increased by 356% from 6041 units in 2005 to 23,887 units at the end of October 2018, while the number of shipping companies increased by 25% from 1,601 to 3,606 shipping (MOT, 2018).

Although Indonesia's positive impact on the cabotage regime can be felt, Indonesia can not be fully satisfied because of the mixed results. The increasing number of vessels is not newly built ships but used and old ships, 70% of Indonesian flagships are between 25-30 age ships and need to be replaced by newer ships (Sunaryo, 2015). The changing of flag vessels from foreign to national flagships also caused an increased number of vessels. The cabotage regime's implementation is not merely to increase the national vessels through the mechanism of changing the flags from foreign flag vessels but through the construction of new ships in the domestic shipyard (Rumi, 2017). In fact, in 2016, the Directorate General of Sea Transportation (DGST), suspended many shipping companies because they failed to carry their obligation as required in the Shipping Law 2008.

In 2017, The Government officially launched the XV Economic Policy Package (EPP) to accelerate business development and strengthen the competitiveness of national logistics service providers. It aims to provide opportunities to improve business role and scale, ease of doing business, and reduce the cost for a national logistic service provider (Coordinating Ministry of Economic Affairs, 2017). By issuing this policy, it is expected to stimulate the growth of the maritime industry.

In implementing this economic policy, the Government issued new provision on utilizing Indonesian ships for transporting coal and Crude Palm Oil (CPO) products by regulation Number 82 the Year 2017. The regulations required exporter and

importer of the products (CPO, coal, rice, and governmental procurement goods) to use Indonesian vessels and covered by national insurance.

This new policy is in line with the MOT agenda, under a program known as "*beyond cabotage*". *Beyond cabotage* for Indonesia is an extension of the cabotage regime to international waters. Where the cabotage regime applies in domestic shipping, *beyond cabotage* requires Indonesian flagship to transport export-import commodities to and from other countries. The stakeholders in the maritime industry welcome this policy, however many countries and international organizations raised their concerns on how Indonesia could implement it.

After two years since it came into force, the policy has yet to be implemented due to its challenges; a technical challenge is one of them. By issuing the policy, it can be assumed that Indonesia ready for the implementation; however, there is no sufficient ship availability to offer the service to replace foreign-flag ships potentially. For example, for transporting coal to China, India, Japan, Malaysia, and Singapore, usually, it is carried by foreign shippers (INSA, 2018). According to MOT Indonesia (2018), there are only 68 ships available for coal and CPO export activities. Currently, only 5% of the export volume of coal is transported using national vessels. As an illustration, national coal production ranges from 400 million to 500 million tons per year or an average of 30 million tons per month.

A policy is made to be implemented. When drafting the policy it should be imagined how the policy will be implemented. However, this policy has received many challenges since its formulation, many pros and cons. According to Indonesia National Shipowners' Association (INSA), the policy will bring more opportunities for shipping companies to carry the commodities; however, the policy will interrupt the coal market for the seller. After some considerations, the Government committed that the policy will be ready to be implemented in May 2020 and gave stakeholders some time to prepare the necessary needed. However, in the current Covid-19 pandemic, the Government suspended *beyond cabotage* regime temporarily. The policy is considered hindering economic activity affected by the pandemic.

1.2 Objectives, expected results, and research questions

1.2.1 Objectives and expected results

The aim of this research is a comprehensive inquiry and analysis of the legal framework for cabotage as well as the status of its implementation, with particular regard to potential tensions between national regulations and international commitments.

The objectives of this research are:

a. Analyze the implementation of the cabotage regime in Indonesian shipping.

b. Examine the particular challenges faced by the Indonesian Government in implementing its latest policy on cabotage.

c. Examine the impact of the cabotage regime on Indonesia's international trade commitments.

d. Describe the future of the cabotage regime in Indonesia.

e. Put forward some recommendations for the improvement of policy and implementation.

This research is expected to make a positive contribution to the process of policymaking in Indonesia on the sea transport sector and maritime industry in order to support the Indonesian Government in empowering sea transport role in the maritime/shipping industry by implementing a new policy in the national and international level without worry to benefiting the Indonesian economy.

1.2.2 Research question

To achieve the objectives, this research will address several questions, as follows:

a. How is the implementation of the cabotage regime in Indonesia shipping policy?

b. What are the challenges that the Indonesian Government faces to implement Indonesian flagships for export and import of certain products?

c. How is the current cabotage regime impacting the shipping sector outside of the cargo segment?

d. What significant changes in Indonesian cabotage regime have been introduced through the latest policies such as Ministry of Trade Regulation Number 40/2020

e. How does the current cabotage regime impact Indonesia's commitments on General Agreement on Trade in Services (GATS) and Indonesia Japan Economic Partnership Agreement (IJEPA)?

f. How is the future of cabotage regime in Indonesia in relation to connectivity?

1.3 Research methodology

This research will focus on finding data by reviewing national and international regulations on cabotage regimes and services in the maritime sector. Primary sources of data are based on interviews with the competent authorities. Other primary sources consulted are the United Nations Convention on the Law of The Sea (UNCLOS), IMO conventions, IMO regulations, GATS – WTO, and Indonesia shipping laws and its implementing regulations. Secondary sources include academic writings, journals, reports, and fact sheets. This research will also study existing sources of official records and public documents from various international meetings or domestic consultations among government ministries and agencies in Indonesia on maritime transport and industry. Other secondary sources include data, information, and facts from related stakeholders to cabotage regime and the policy on the use of Indonesian

flagship for export and import of certain products, including Ministry of Trade, MOT, and related stakeholders (INSA, ISAA, APBI, et cetera).

1.4 Structure of the dissertation

This dissertation is divided into five chapters. The first chapter provides an introduction of the research, which also include objectives, expected results, and research questions. Chapter two is the literature review; it gives an overview of the EPP, coal and CPO market, and cabotage in international law, particularly with UNCLOS. It also contains types of cabotage law, and implementation in some countries.

Chapter three provides an analysis of cabotage implementation in Indonesia. It begins with the history and legal framework of cabotage, then continues with the development of current cabotage. The changes in the shipping industry include the exemption or waiver in some sectors and the connection between cabotage and other policies.

Chapter four presents the result of the analysis of the challenges face by the stakeholders in drafting or implementing the policy, such as less availability of national ships, Incoterms use in the transportation contract, international pressure, indication of breaching international commitment on maritime trade in services under GATS and IJEPA.

Chapter five presents the conclusions and recommendations of this research.

CHAPTER 2
LITERATURE REVIEW

2.1 Overview of the economy package policy

When Jokowi was elected as Indonesia's President in 2014; his election was seen as a fresh start for clean governance. Jokowi has pledged to eliminate thousands of regional government regulations that were identified to hamper the operation of businesses (Hayden, 2016). He intended to stimulate and create a conducive economy to respond to global economic problems that affected slowed economic growth and stagnant achievements in investment and exports during his presidency. He made stabilization efforts, both from the fiscal side as well as the monetary side, which contained in the economic policy packages released from 2015 to 2018, one year after he officially took over the presidential office in 2014.

The policy packages consisted of sixteen series serving as evidence of the efforts from the Government to overcome current economic problems and create sustainable economic growth in the future. These policies focused on improving industrial competitiveness by reducing the red tape, the reforming package removed 89 business investment regulations and eased the acquisition of licenses, land, and bank accounts. Jokowi is gradually making an effort to make it easier to do business in Indonesia.

In 2016, the World Bank ranked Indonesia 109th for ease of doing business, behind regional neighbors in ASEAN such as Singapore (1st), Malaysia (18th), Thailand (49th), Brunei Darussalam (84th), Vietnam (90th), and the Philippines (103rd). Table 1 shows the improvement of ease of doing business in Indonesia in 2020. According to the World Bank, Indonesia moved up from rank 109th in 2016 to rank 73th in 2020; among ASEAN countries, Indonesia ranks 6th behind Singapore, Malaysia, Thailand, Brunei Darussalam, and Vietnam.

Table 1 Ease of doing business ranking

Rank 2020	Rank 2016	Economy	DB Score 2020	DB Score 2016
2	1	Singapore	86.2	87.34
12	18	Malaysia	81.5	79.13
21	49	Thailand	80.1	71.42
66	84	Brunei Darussalam	70.1	62.93
70	90	Vietnam	69.8	62.10
73	**109**	**Indonesia**	**69.6**	**58.12**
95	103	Philippines	62.8	60.07
144	127	Cambodia	53.8	55.22
154	134	Lao PDR	50.8	53.77
165	167	Myanmar	46.8	45.27

Source: World Bank, 2020

The Government issued the 15th Economic Policy Package to focus on business development and sea freight service providers' competitiveness to reduce the sea freight cost. Sea freight is the main contributor to the deficit in services balance in the amount of 65%, including international liner shipping, leasing and chartering foreign vessels, container leasing (Ridhwan, Paundralingga, Pratama, & Fridayanti, 2016). Other sectors that also contribute to the deficit are the shipbuilding industry (22%), financial insurance (11%), and ports (2%).

According to Darmin Nasution, the Minister of Coordinating Ministry of Economic Affairs (2017) cited from the Ministry of Finance website:

> "*15th EPP is focused on improving the national logistics system to accelerate business development and the competitiveness of national logistics service providers with the rate of logistics costs for around 40% of the retail price of goods, where 72% of the largest component of logistics is transportation costs.*"

a. Freight Cost

   Domestic shipping companies dominate domestic ships due to the implementation of cabotage; however, the shipment of international seaborne

cargo for export and import transactions is still being dominated by foreign shipping companies. Though, domestic shipping is dominating in domestic share; however, the ship used is built in other countries or charter foreign vessels. The national shipping companies cannot compete with international companies, where they have bigger size ships with more advanced technology to ensure shipping safety and have more capacity.

b. Shipbuilding industry

The domestic shipyard capability to build more ships to replace the domination of foreign vessels in the international market contributes to the deficit in services balance. It supports the purchase of foreign ships, were purchased used ships are cheaper than building new ones. The limited space for ship repairs and dry docking also encourages the shipping owners to repair their ships when they need urgent repairs though it will cause higher costs (Haristianto, 2014).

c. Financial insurance

For export and import transactions in the shipping industry, the cargo must be covered by insurance. The shipper or the cargo owner usually choose international insurance due to less cost of insurance but with more coverage (Azranda, 2019).

To minimize the impact of these sectors to national GDP, the Government released the Ministry of Trade Regulations No. 82/2017. This regulation requires the use of national flagships for export-import shipment of coal, CPO, rice, and government cargo. The shipment is not only in Indonesian waters but also in international water. These commodities also have to be covered by national insurance.

2.2 Indonesian coal and CPO industry

2.2.1 Coal industry

Coal plays a vital role in providing global needs in energy for electricity, steel production, cement manufacturing, and liquid fuel. In 2018, coal was produced as much as 7813,3 MT worldwide to support 38% of the world's electricity and 71% of the world's steel (World Coal Association, n.d.). China produced most of coal production in 2018, and since 2000, coal production by China has increased by 161.8%. Top coal producers countries in the world are China, India, the USA, Indonesia, and Australia (Table 2).

Table 2 Top five coal producers in 2018

No.	Country	Total Production (MT)
1.	PR China	3550
2.	India	771
3.	USA	685
4.	Indonesia	549
5.	Australia	483

Source: IEA Coal Information, 2019

Indonesia is also known as the top exporter of coal with a total value of export approximately USD 180 billion, and the total volume of coal export was 343 MT from 610 MT in 2018 (BPS, 2019). According to APBI-ICMA (2020), Indonesia is the World's biggest thermal coal exporter (in terms of volume). In 2018 and 2019, the country's thermal coal exports were more than 450 M/T. Figure 1 shows Indonesia's coal production and export from 2016 to 2019.

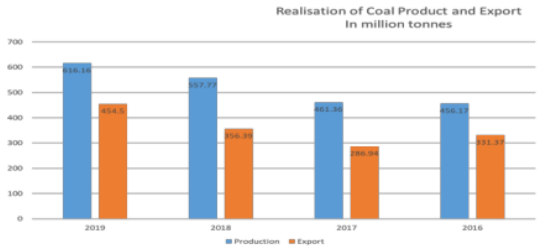


Figure 1 Coal production and export
Source: MODI, 2020

China and India are the two most prominent Indonesian coal export destinations. Export to China and India accounts for 24-25% and 20-21%, respectively, of the total Indonesian thermal coal exports in terms of volume (APBI-ICMA, 2020). Table 3 shows the top 5 countries as exporter and importer, as Indonesia is the top exporter, and China is the top importer.

Table 3 Top 5 exporter and importer countries in 2018

No.	Country Exporter	Total MT	Country Importer	Total MT
1	Indonesia	439	PR China	295
2	Australia	382	India	249
3	Russia	210	Japan	185
4	United States	105	South Korea	142
5	Colombia	82	Chinese Taipei	66

Source: IEA Coal Information, 2019

Other major export destinations are countries in the Far East, such as South Korea, Japan, and Taiwan, and Southeast Asia, such as Malaysia and the Philippines. Since 2017, Vietnam has emerged as one of the most potential markets for Indonesian coal exports, though the number is not too significant yet (APBI-ICMA, 2020). Table 4 shows export destination countries from Indonesia to India, China, Japan, South Korea, Taiwan, and Malaysia in 2015 to 2019 with total coal export was 1,676.8 MT and value of USD 150.84 billion (BPS, 2020).

Table 4 Top 10 coal export destination countries

Destination Country	2015	2016	2017	2018	2019
	Net Weight : 000 ton				
India	123 841.9	95 110.5	98 553.5	110 378.2	121 692.5
China	36 684.5	50 961.1	48 167.4	48 135.7	65 670.5
Japan	32 503.5	33 037.8	31 421.4	28 722.9	28 436.4
South Korea	33 037.3	34 943.2	38 075.1	37 150.9	29 550.0
Taiwan	24 088.1	20 289.5	18 187.7	17 935.1	19 061.2
Malaysia	16 567.5	17 272.4	21 189.9	22 045.4	25 323.5
The Philippines	15 811.3	17 503.4	18 977.9	22 595.0	27 450.8
Thailand	17 729.5	16 439.0	16 374.7	19 964.1	17 600.4
Hong Kong	9 414.7	9 423.9	8 449.8	9 028.4	7 876.8
Spain	4 826.5	4 944.0	3 232.2	2 463.9	684.6
Others	13 882.6	11 405.0	16 468.8	24 704.7	31 589.1
Total	**328 387.4**	**311 329.8**	**319 098.4**	**343 124.3**	**374 935.8**

Source: BPS, 2020

Coal is transported to meet the global demand by truck, conveyor, sea transport, or railway; however, it depends on the distance to reach the market. To cover long distances, coal is transported by trains and ships. Figure 2 shows that ships are commonly used for international transportation (World Coal Association, n.d).

Figure 2 Ships that used for international transportation
Source: World Coal Association, n.d.

Generally, because of geographical reasons in Indonesia for export transshipment is carried by bulk carrier or barge. Table 5 shows the type of vessel that used to carry coal based on size, as follow:

Table 5 Type of vessels used to ship coal

No.	Vessels type	Dwt (Tons)	Length (M)	Load (M)	%
1	Mini Bulk Carrier	3 – 23.999	100 – 130	< 10	3%
2	Handysize	24 – 35,000	130 – 150	10	5%
3	Handymax	35 – 50,000	150 – 200	± 11-12	7%
4	Supramax	50 – 61,000	200 – 210	13	31%
5	Panamax	61 – 80,000	210 – 230	13	29%
6	Capesize	80 – 199,000	230 – 270	< 17	22%
7	Very Large Bulk Carrier	> 180,000	> 270	> 17	2%

Source: MOT, 2019

For export activities in 2019, the coal shipment was dominated by bigger size ships. Most of the coal production is carried by foreign vessels reached 93.7%, while the Indonesian vessels carried only 6.3% (Haryana, 2017). There were 4090 calls from 2044 of bulk carrier ships or barge that shipped coal for export activities. Table 5 shows that supramax, panama, and capsize were most frequently used. Those vessels are considered to give more benefits for long-distance shipment and a bigger capacity that will affect cheaper transportation per unit cost. From 2.044 ships for

export transportation in 2019, all the vessels were used is foreign vessels, 23% Panama, 16% Marshall Island, 12% Hong Kong, 11% Liberia, 7% China, 6% Singapore, 5% Malta, 3% Cyprus, and 17% others countries (MOT, 2019). Coal transshipment is essential to support the national development as a revenue stream to increase trade revenue and support counterbalancing deficit from the maritime industry as the transshipment of coal mostly carried by foreign ships.

According to INSA, dry bulk carrier is the most suitable type of ships to carry Indonesian coal export; however, Indonesia only has 68 units (supramax 55 units and panama 13 units). Furthermore, barge with 1032 units is dominating the coal transshipment and is mainly used for short-distance transshipment between domestic and small port, as a feeder to mother vessels, and transshipment to Singapore and Malaysia. However, according to World Bank (2016), Indonesia needs 270 units of dry bulk carrier (16.25 million dwt) to dominantly serve the export coal transshipment. With no sufficient availability of national vessels, there is no option to keep using foreign ships.

2.2.2 Crude palm oil industry

Palm oil is one of the most consumed and produced oils in the world. This easy to produce, and very stable oil is used for a wide variety of foods, cosmetics, hygiene products, and nearly 50% of all consumer products sold daily. Palm oil can also be used as a source of biofuel or biodiesel (Mekhilef, Siga, & Saidur, 2011).

Most palm oil is produced in Asia, Africa, and South America, where warm temperatures, sunshine, and high rainfall are needed to maximize the production of palm oil. Asia is also the largest consumer of palm oil with India, China, and Indonesia accounting for 40% of all palm oil used for the food industry.

Figure 3 shows Indonesia and Malaysia as the top producers that contribute to more than 80% of global production. Thailand, Colombia, and Nigeria are also considered with major producers but with a smaller contribution (ICCT, 2019).

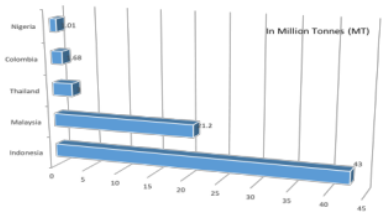


Table Major oil producers countries
Source: ICCT, 2019

Indonesia and Malaysia are also recognized as the largest exporting countries of CPO, together with Guatemala, Papua New Guinea, and Colombia. Figure 4 shows Indonesia's production of CPO for export and domestic use from 2015 to 2018.

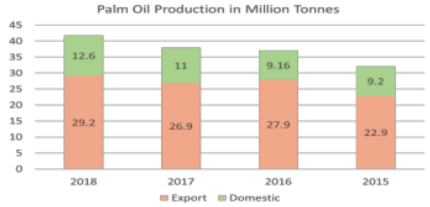


Figure 3 Palm oil production for export and domestic use
Source: Azranda, 2019

In 2018, Indonesia exported CPO, and its fractions (whether or not refined) was USD 3.57 billion, while Malaysia was USD 1.95 billion, Guatemala was USD 0.39 billion, Papua New Guinea, and Colombia were the same USD 0.38 billion (Azranda, 2019) (Figure 5).

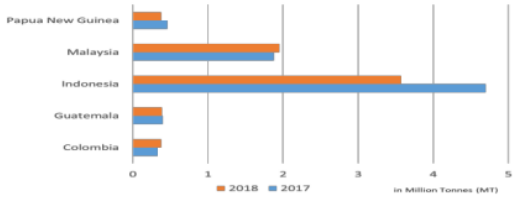


Figure 4 Major CPO exporter countries
Azranda, 2019

According to IISD, ITC, and Fibl (2020), the largest importing countries in the same year were India (USD 6.5 billion), China (USD 3 billion), and Pakistan (USD 2.2 billion). Figure 6 shows major market for export destination. In 2018, Indonesia exported its CPO to India (USD 2.17 billion), Netherlands USD 350 million), Singapore (USD 240 million), Italy (USD 220 million), and Malaysia (USD 210 million) with total CPO export was 50% of the world's CPO import (ITC, 2019).

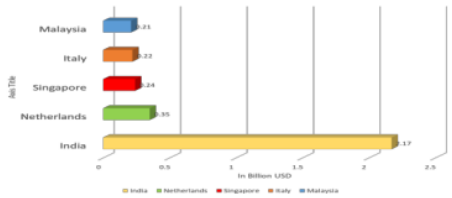


Figure 5 Major CPO import destination from Indonesia

For export activities, CPO is carried by tanker with bigger capacity than container. In 2018, there were 2335 calls of CPO export shipment from Indonesia using tankers. Table 6 shows the type of tanker vessels that generally carried CPO for export transshipment, are:

Table 6 Tanker size for CPO export

No.	Tanker	Dwt (Tons)	%
1	Handysize	< 10,000	30%
2	General Purpose	10 – 25,000	46.5%
3	Medium Range	25 – 45,000	15.2%
4	Large Range 1	45 – 80,000	7.1%
5	Large Range 2	80 – 160,000	1%
6	VLCC	160 – 320,000	0.1%
7	ULCC	> 320,000	0.1%

Sumber : MOT, 2018

A general-purpose tanker carried most of the CPO by 46.5% (1085 call); this is due to bigger capacity and maintains the quality of CPO. Approximately 700 calls, or 30%, were used handysize tanker, and 15,2%, or 355 calls were used medium range tanker. According to INSA (2018), Indonesia has 572 Indonesian tanker flagships;

however, most of them are designed for oil products transshipment but not suitable for CPO, and only 24 vessels are suitable. World Bank in 2016 estimated that Indonesia should have the least 32 vessels of chemical tanker (536,000 dwt) to dominate CPO shipment for export.

2.2.3 The importance of coal and CPO for Indonesia

Coal and CPO are significant to Indonesia as one of the primary income sources for the state budget to support national development. In 2019, the non-oil and gas sector for the export commodity contributed USD 155 billion, while the coal sector contributed USD 18.9 billion to state revenues (BPS, 2019). In the agriculture sector, the palm oil industry contributes between 1.5 - 2.5 % of total GDP (GAPKI, 2019), while the mining industry contributes 5-8% of total GDP, 80% of it comes from the coal industry (IESR, 2019).

As mentioned above that Indonesia is considered as one of the major producer and exporter of coal and CPO to India, China, Japan, and others countries, and their contribution to national income is significant. However, the transportation (sea freight) of coal and CPO as export commodities is considered as the primary contributor to the deficit of state revenues from the maritime industry (Ridhwan, Paundralingga, Pratama, & Fridayanti, 2016). It is because coal and CPO are carried by foreign ships. According to APBI-ICMA (2020), national-owned vessels only served roughly 2% of the total coal exports in 2018 with mostly carried by barges (average 7,000 MT coal capacity) for shorter voyages, mainly to ASEAN region.

2.3 Cabotage law

The origin of cabotage is still in doubt; however, the word cabotage is came from France “caboter”. It means coasting trade or navigating and trading between ports along French coast coasts was restricted to French vessels. This policy was later extended to apply to navigation between a metropolitan country and its overseas colonies (Oyedemi, 2012). There is another view that cabotage was first introduced

in Portugal in the 15th century to protect its sea trade and prevent other countries from dominating shipping along the coast. In England, its Navigation Acts between the 1650s and 1770s reserved all commerce the colonies and Europe to British citizens (Seafarers' Rights International, 2018).

Many coastal States have set of laws on sea transportation of passengers or cargo between two ports in its waters to restrict trade to national vessels in order to protect its economy as well as to maintain its resources for security purposes. This restriction is called cabotage that limits sea transportation along the inland and coastal waters in a country. The definition of cabotage is accepted differently and diverse in each country; generally, cabotage is the policy that conducted by a country to preserve its maritime and shipping trades, services, and activities for its citizens and may be encouraged and supported in other relating laws on companies, employment or composition of the crew, taxation, ship registration and ownership, subsidies for the shipbuilding and operation, or requirement for permission to be granted as an exemption and foreign direct investment.

Cabotage regime contains a set of laws regulating the maritime and shipping activities within domestic waters of a country that include which vessels may operate in sea trade. The Jones Act 1920 of the US is known as the first known formal enactment on cabotage that provides promotion and maintenance of the US merchant vessels by regulating maritime commerce its waters and between ports.

According to Black's Law Dictionary 8th edition, cabotage is

> *"1. The carrying on of trade along a country's coast; the transport of goods or passengers from one port or place to another in the same country. The privilege to carry on this trade usually limited to vessels flying the flag of that country.*
>
> *2. The privilege of carrying traffic between two ports in the same country."*

Cabotage is a form of protection from a country in its national coastal territory or inter-island shipping services and widely extends to the scope of requirements or activities. In some countries, the form of protections require the following:

a. The vessels should be registered as national vessels of the country;
b. The vessels should be owned by a citizen of the country;
c. The vessels should be crewed by a group of people from the country;
d. The vessels should be built or repaired in the country.

Such protection impacts domestic markets on the business and trade potential because it creates a high cost of freight cost and old and inefficient fleet (Murkherjee, 2013), due to it excludes foreign vessels from the domestic market. Foreign vessels are not allowed to move in transit between two ports nor compete in the market, making this protection considered as barrier and discrimination to trade. Nevertheless, this is an acceptable practice internationally as a measure to achieve national economics, if the domestic market is considered unfair and dominated by foreigners.

The significant impact of cabotage restriction on connectivity relates to restraining competition, which leads to high costs and less efficient transport operations. Maritime transport connectivity is an essential determinant of trade costs in developing countries, including Small Island Developing State (SIDS) and Least Developed Countries (LDCs). They encourage higher transport costs, given fewer access, less frequent, less reliable and more costly transport connections (Rodriguez & Youssef, 2017).

Cabotage regime is not only relates and interacts with other policies but is part of the policy framework that is integrated and mutually benefited other sectors to reach national goals, such as developing the maritime and shipping industry, national security and defense, and investment. Cabotage contributes to national economic growth by protecting, improving, and maintaining domestic resources from foreign competition. However, cabotage should be separated from international trade and

liberalization commitments. It takes many requirements that apply to foreign participation in the domestic market.

2.3.1 Types of cabotage

There are many different types of cabotage practiced by countries. Different countries enact and apply any of cabotage types depending on their circumstances of the national interest, domestic situations, or objectives in economy or security to promote national economic development.

In a broad sense, cabotage system can be defined by:

a. Strict cabotage regime

   Strict cabotage means that a country's domestic maritime industry is fully protected and does not allow the presence of foreign vessels, personnel, nor any participation because such is prohibited by the applicable law. The domestic trade is limited to ships owned, manned and operated, and built by national entities of the country. However, when they open to foreign entities, these are usually under strict terms and conditions apply. Strict cabotage is meant to promote national flagships by protecting the country's maritime industry from foreign participation, domination, or control for the benefit of its shipping industry. Strict cabotage is also meant for security purposes, for instance the US implements strict cabotage where foreign vessels and personnel in its coastal trading might can increase terrorism cases in the country (Agama & Alisigwe, 2018).

   In some countries, the cabotage regime extends to cover maritime activities up to 200 miles, includes the Exclusive Economic Zone (EEZ) and the Continental Shelf. This restriction includes carriage of goods and passengers and other maritime activities such as seismic activities, towage, hydrographic surveys, oil spills, and sometimes salvage services (Akpan, 2015).

b. Relaxed cabotage regime

Relaxed cabotage, also called liberalized cabotage, has few reservations or restrictions compared to strict cabotage on conducting maritime or shipping activities in domestic waters of a country. Vessels, regardless of its registration, ownership, country of build, or crew nationality, are free to do activities or engaged in maritime or shipping trade in domestic waters of a country. Foreign participation is allowed to a certain measure of ownership or shipbuilding and ship operation in the country's sea trade or maritime industry in order to accommodate liberalization.

In strict cabotage, foreign participation is limited to avoid foreign domination and is treated as a threat to the sea trade of a country. In relaxed cabotage, foreign participation is considered an advantage to prevent national shipowners from the opportunity to charge high freight rates and also to create fair competition. According to Bryng and The Jonessen (Agama & Alisigwe, 2018), China is known to have conducted strict cabotage, that China did not allow foreign vessels to engage in maritime activities in its domestic waters. However, in 2003, China decided to relax its restrictions and allowed foreign shipping companies to ship empty containers between its domestic ports though limited to shipping companies of countries that have an agreement with China (Anderson & Monteiro, 2010).

2.3.2 Cabotage in selected countries

Cabotage is a common practice and widely spread but there are different levels of application in developed or developing countries. However, sometimes a country enters into agreements with other countries to relax their restriction to open domestic shipping (Ezeoke, 2017). One developed country that practices strict cabotage is United States (US) with its The Jones Act since 1920, which requires goods shipped between its domestic ports to be transported on vessels that are built, owned, and operated by US citizens or long term residents. One developing country that still actively practices cabotage is Indonesia, which will be discussed in the next chapter.

a. The USA

In the USA, its cabotage regulation lies in section 27 of The Jones Act that requires vessels transporting cargo from one US coastwise to another USA coastwise shall be built, registered, owned, and crewed by US citizens or permanent residents. In paragraph 861 outlines the national goals that it is addressing:

> *"it is necessary for the national defense and for the proper growth of its foreign and domestic commerce that the United States shall have a merchant marine of the best equipped and most suitable types of vessels of sufficient to carry the greater portion of its commerce and serve as a naval or military auxiliary in time of war or national emergency, ultimately to be owned and operated privately by citizens of the United States; and it is declared to be the policy of the United States to do whatever may be necessary to develop and encourage the maintenance of such merchant marine, and in so far as may not be inconsistent with the express provisions of this Act, the Secretary of the Transportation shall, in the disposition of vessels and shipping property as hereinafter provided, in the making of rule and regulations, and in administration of the shipping laws keep always in view this purpose and object as the primary end to attained."*

The Jones Act protects its national shipyards, domestic vessels, and crew vessels from foreign competition, at the same time addressing potential national security concerns (Frittelli, 2019). The Jones Act addresses the policy goals by reserving domestic sea trade with crewing requirement means the master, all of the officers, and 75% of the remaining crew must be citizens of the US, furthermore ship owners must be owned at least 75% of the corporation's stock is a citizen of the US (Cole, 2010)

According to Oyedemi (2012), there have been many attempts to repeal and sustain The Jones Act. The reasons to sustain the cabotage regime are because it encourages to have a good, trained and ready marine and shipbuilding base that able to protect national defense and economic interests, also to boost domestic commerce through the protection of shipping,

shipbuilding, and maritime industry. However, it is considered there is no reasonable economic benefit to sustain The Jones Act because the cost of building, rebuilding, or repairing vessels in the USA is high compared to other countries (Japan or Korea) that leads to a decline of less demand in shipbuilding. The Jones Act is also impacting the uncompetitive shipyard in the global competition that competition could lead to lower prices and improve shipyard and human resources ability to compete.

b. Japan

Japanese cabotage is reserved for its national ship include transporting cargo and passengers; foreign participation is limited to access as part of a bilateral agreement. Japanese cabotage regime protects domestic markets, provides maritime safety, optimizes shipping volumes, and manages the competition. The cabotage regime is integrated with other national laws support for shipbuilding, taxation, or direct subsidies. The integration to improve its maritime capacity by the highly regulated and closed system to encourage small business in Shipping Associations, to which smaller operators belonged, ensure employment levels, orderly market, and seafarer and passenger safety.

Since 1966, Japan continues to address the issue of controlling shipping volumes (tonnage) by focusing on scrap and build policy through Japanese Coastal Shipping Law. Japan strengthened the operators' business foundation and control market entry, set tonnage limit, and adjusted shipping capacity under Shipping Associations, establish and improve transaction terms.

For Japan, cabotage plays a significant role in supplying goods and foods to populated islands and providing adequate inter-island connectivity. However, demand for cargo and passengers is declining due to decreased population in the rural area that has resulted in a struggle to maintain shipping business to remote service islands. This has led the Government to support ship operators financially to keep operating to remote service islands. Cabotage also

supports the shipping and shipbuilding industry. Japan is best known as a shipbuilder, and provides many programs and laws that support the shipbuilding industry and modernization on merchant's vessels through tax incentive up to 60% for ship operated by national companies (Cole, 2010).

c. China

According to Casaca & Lyridis (2018), Chinese cabotage is provided under the 1992 Maritime Code rules that maritime transport and towage services between the ports to be performed by vessels registered in China. Foreign vessels were allowed to enter cabotage market after granted permission from the competent authorities after they satisfied the requirement for investment on Chinese-foreign equity joint ventures limited to 49%.

Since 2003, the Chinese Government decided to gradually relax its cabotage restriction by allowing foreign container vessels to carry containers on the trade routes between Shanghai Free Trade Zone and other coastal Chinese ports as a solution of port congestion and addressing port infrastructure growth. This exemption only applies to countries that signed a bilateral agreement with China. China has signed bilateral agreements with more than 50 countries and European Community that include agreement on cargo sharing. For instance, China and US agreed for parity in liner cargo with a minimum of one-third of cargo is reserved for to national tonnage (Cole, 2010).

2.4 Conclusion

One year after he officially took over the presidential office in 2014, Jokowi made stabilization efforts, both from the fiscal side as well as the monetary side, which contained in the economic policy packages released from 2015 to 2018. Indonesia believes that the cabotage regime brings improvement in its maritime industry, however the freight cost is considered still high. Under the leadership of Jokowi, Indonesia commits to improving its cabotage by drafting new policy as an

extension to its cabotage, particularly in the coal and CPO market. As mentioned above that Indonesia is considered as one of the major producer and exporter of coal and CPO to India, China, Japan, and others countries, and their contribution to national income is significant. In 2019, the non-oil and gas sector for the export commodity contributed USD 155 billion, while the coal sector contributed USD 18.9 billion to state revenues (BPS, 2019).

There are many different types of cabotage practiced by countries. Different countries enact and apply any of cabotage types depending on their circumstances of the national interest, domestic situations, or objectives in economy or security to promote national economic development. The next chapter will discuss cabotage implementation in Indonesia, and whether it achieves its goals. It also examines the impact of cabotage on the Indonesian maritime, and its current updates.

CHAPTER 3
CABOTAGE IN INDONESIA

3.1 Overview of the Indonesian cabotage regime

Before Independence Day, Indonesia's territory is referred to the 1939 Dutch East Indies Ordinance, Territoriale Zeeën en Maritieme Kringen Ordonantie (TZMKO). According to TZMKO, foreign vessels were free to sail in the Java Sea, Banda Sea and Makassar Sea (Kurniasari, 2011). After Indonesia independence from of Japanese colonialism, the President at that time, Soekarno, on his speech stated a country could be stable if it can rule the sea. To rule the ocean, it must have sufficient number of vessels (Febiyansah, 2016).

To reach the commitment, trough Juanda Declaration 1960, Indonesia reiterated its jurisdiction on its internal waters. The territory became 2.5 times more significant (exclude Irian Jaya at that time) with more than 17,000 islands, and the Indonesian marine sector's total economic potential reached USD 800 million per year (Dajlal, 2018). However, the shipping industry at that time did not quite satisfy the economic growth as more foreign vessels were sailing in internal waters than national vessels.

In the 1960s, the Government introduced a policy on the exemptions terms to limit foreign vessels in maritime or shipping activities in domestic waters. The Government strategy was the view that restricting foreign vessels would encourage and offer national shipping companies opportunities to have and run at least one national ship (Siswoyo, 1995). However, the Government still permitted using foreign vessels for certain activities, such as the offshore industry, with more restrictions to get permission.

The policy was followed by prohibiting vessels over the age of 25 years from operating in domestic waters. Therefore, many vessels at the time could not be operated and dumped by the owner. Shipping companies or shipowners had difficulties building vessels because there was no help from the Government on ease

to build vessels, including tax relief and lack of raw materials for the steel industry (Umar, 2001). This situation brought no certainty in the shipping industry for national vessels; many shipping companies were collapsed and worsened with Presidential Decree Number 4, the Year 1985, which opened 144 ports to international trade and vessels. Deregulation allowing foreign vessels running in domestic waters also worsen the condition where foreign vessels began dominating the internal waters again.

Furthermore, under the Government Regulation 17/1988, the cabotage regime was unevenly applied and ineffectual in serving domestic cargo for national vessels where foreign investment in shipping companies was allowed in the form joint ventures with participation up to 95% (Cole, 2010). The new regulation also provided that the vessels constructed in the local shipyard were provided subsidies to serve domestic trade and specific inter-island shipping. According to the MOT (2020), the total national vessels in 1988 were only 5,050 vessels, while foreign vessels were 6,397 vessels. The Government also allowed the vessels above age 25 to sail and operate in domestic waters once more under the condition they met the requirements for seaworthiness.

In the early 1990s, Indonesian waters were dominated by foreign vessels and national vessels above 25 ages. The Government issued a new regulation on shipping in 1992 called Shipping Law Number 21/1992, where the cabotage regime was introduced officially. However, it was still not firm and strict because there were still opportunities for an exemption in certain circumstances and conditions (Umar, 2001). The Government permitted the use of foreign vessels when the national flagship was not available and caused foreign vessels dominating domestic shipping.

This situation continued until 2005 when the Government under Susilo Bambang Yudhoyono issued cabotage regulations for strengthening the shipping industry through Presidential Instruction Number 5, the Year 2005. The regulation provided a stricter cabotage regime. Domestic shipping have to be carried by national

flagship owned by an Indonesian citizen or Indonesian legal entity and crewed by Indonesian personnel.

3.2 The implementation of cabotage

The cabotage may not fully implement; however, its objective is clear that the national vessels should dominate the domestic shipping. As mentioned before, there were difficulties in the implementation process. However, due to the Government's strong commitment, it brought ethical impacts to the growing number of national vessels and shipping companies, as follows:

3.2.1 Vessels growth

After more than ten years of Indonesian cabotage implementation, the number of Indonesian flagships from year to year increased gradually. According to the MOT (2020), in May 2005, Indonesian vessels were 6,041 units with 5,67 million GT, while in 2019, it was 32,587 vessels with a total of 45 million GT. It means an increasing number of total vessels registered in the Indonesian registry is 26,546 units or 45 million GT.

Table 7 Comparison of vessels during the cabotage regime

vessels type	Ships		percentage	
	Mar 2005	Dec 2019	Mar 2005	Dec 2019
General Cargo	1,388	4,298	22.98	13.19
Container	107	551	1.77	1.69
Ro Ro	60	409	0.99	1.26
Ferry/ Penyeberangan	-	733	0.00	2.25
Bulk Carrier	22	440	0.36	1.35
Tanker	224	1,091	3.71	3.35
Barge	1,236	9,818	20.46	30.13
Passenger	229	960	3.79	2.95
Tug Boat	1,188	9,801	19.67	30.08
Landing Craft	205	1,028	3.39	3.15
Fishing Vessel	874	1,256	14.47	3.85
Tug Boat	169	724	2.80	2.22
Yacht, Cruise	57	148	0.94	0.45
Bulk Carrier	24	83	0.40	0.25
Tanker	9	100	0.15	0.31
Landing Craft	9	76	0.15	0.23
Barge	212	798	3.51	2.45
Others (Kpl Keruk, Motor Boat, Cargo, Suplly Vessel)	28	273	0.46	0.84
Total	6,041	32,587	100	100

Source: MOT, 2019

Table 7 shows that the cabotage regime as stimulated national shipping business actors to invest in the marine transportation sector. Cabotage has proven to play a role in encouraging the growth of the national economy that has encouraged investment in the maritime transportation sector. This significant increase is also because the shipping companies improved the ability to buy vessels (Aprilianto, 2014).

The implication of the cabotage affected some sectors as follows:

a. Domination over domestic market share.

   With a reasonably large fleet strength, national shipping has also served all domestic cargo distribution. In 2017, the delivery of domestic cargo had been served by national vessels from a total cargo of around 965 million tons for all parts of Indonesia (INSA, 2018). According to the MOT, before cabotage in 2005, national vessels could only carry 114.5 million tons of cargo, out of a total share of 206.3 million tons, or control 55.5% of the domestic cargo share. At the end of 2016, the control of national shipping was 359.7 million tons or 99.65% of the total 360.9 million tons of domestic cargo share.

b. Some business clusters related to the national shipping industry that have been positively affected by the growth and development of the domestic shipping fleet, such as shipbuilding, ship insurance, education, and training for seafarers (Halim, 2018).

c. The significant increase number of vessels was not followed by an increasing number of vessels for offshore activities. According to INSA (2014), during 2011-2015 for offshore operations because Indonesia needed 253 vessels, the country needed to delay the full implementation of cabotage in 2011. Furthermore, in 2019 Indonesia still needs foreign vessels in the offshore industry, including drilling, offshore construction, oil, and gas survey, dredging, salvage, and under waterworks, as well as in

the cruise tourism industry. These two sectors are excluded from the implementation of cabotage.

d. Domestic market share is fully controlled by national vessels; however, it is in contrast with the development of the international market share carried by national vessels, which is not subject to the obligation to apply the cabotage regime. International cargo carried by national vessels is currently only 7.1% or an increase of 2.1% compared to 2005, which was at 5.0%. In 2016, out of 1.04 billion tons of total international cargo, only 6.4% or 67.23 million tons of cargo were carried by Indonesian vessels, while the remaining 93.7% or 976.20 million tons were carried by foreign vessels. For the Government, when national shipping companies can dominate international cargo, it will undoubtedly have a positive impact because the domestic revenue from taxes will increase. Also, it will open up employment opportunities because the cabotage regime requires Indonesian citizens should operate its vessels.

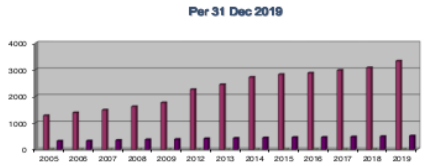
With the increase of national vessels, it is expected that the shipbuilding industry is also increasing; however, the increased number has not been as high as expected. The main activities of the ship building industry are dry docking and repairing. According to the Ministry of Industry (2020), that level of utilization of shipbuilding production capacity is still low, ranging from 35–40 percent. In terms of utilization of ship repair capacity, its performance is still high, which is above 70 percent (Nurcaya, 2020).

Most vessels owned by shipping companies change flag from a foreign flag to an Indonesian flag because to purchase of used foreign vessels is cheaper than new built ship. Most newly built vessels are connected with Government projects. The number of governmental shipbuilding projects includes the construction of 20 traditional are multi-year contracts in 2018-2019 with size 35 GT belonging to the DGST. There was also the construction of 562 fishing boats donated to groups of

fishermen with the size of 3-10 GT, from the Directorate General of Fishing, the Ministry of Marine Affairs and Fisheries in 2018-2019.

3.2.2 National shipping companies growth

The increase in the number of vessels owned by national shipping companies is a positive signal of the cabotage regime. The ship's increasing number is directly related to the increasing number of Indonesian shipping companies. Article 29 of Shipping Law states that national business entities are required to have an Indonesian flagship with a minimum size of 175 GT, for joint venture companies, it is necessary to have a minimum of 5000 GT.



Company Type	2005	2006	2007	2008	2009	2012	2013	2014	2015	2016	2017	2018	2019
Shipping Lines	1,274	1,382	1,485	1,612	1,758	2,256	2,442	2,718	2,821	2,875	2,980	3,077	3,327
	9.5%	7.8%	6.9%	7.9%	8.3%	6.6%	7.6%	30.6%	25.3%	34.4%	29.3%	38.7%	36.7%
Dedicated Shipppping Line	317	322	346	370	382	408	424	439	455	498	475	488	511
	5.4%	1.6%	6.9%	6.9%	3.1%	2.5%	3.8%	11.6%	12.9%	15.3%	16.2%	20.5%	22.1%
TOTAL	1,591	1,704	1,831	1,982	2,140	2,664	2,866	3,157	3,276	3,333	3,455	3,565	3,838

Figure 6 Shipping companies growth from 2005 to 2019
Source: DGST, 2019

Figure 7 shows the growth of shipping companies from the year 2005 to 2019. It shows figures for both “shipping companies” and “dedicated shipping lines”. Dedicated shipping lines are those that are allowed to operate only as an adjunction to another primary business activity, such as coal mining. The number of shipping companies is increasing, making the competition among the companies becomes more significant with more frequent competition between shipping companies as they vie for long-term contracts from the shippers. To attract the shipper, they compete to give lower prices and shorter contract periods. However, long-term contracts are essential as a long-term contract is a business certainty for domestic shipping companies (Aprilianto, 2014), also for banking as guarantee for giving loan to build a new ship.

To create and foster fair competition and business environment in the shipping industry to support a growing economy and support national maritime development programs to realize the world's maritime axis, the Government evaluates business licenses owned by the shipping companies. From the evaluation, it was found that 1,489 companies did not fulfill their obligations in fulfilling the administrative and technical requirements as required in Article 69 of the Regulation of the Minister of Transportation Number PM 93 of 2013 (MOT, 2016). The administrative requirements are deed of incorporation, authorized capital, tax ID number, and physical office, a board of directors, an expert in shipping affairs, and a business plan. The technical requirements are one ship with minimum size GT 175 or tugboat with the lowest engine 150 hp and barge with the lowest 175 GT. Those companies which cannot complete the requirements were not allowed to run the business activities, either in the form of ship operating or ship agency.

Some shipping companies that have middle to lower capital are generally only run as ship agents to take care of routine tasks or general interests such as handling shipments or cargoes of foreign vessels while they are in Indonesian water. Because many foreign vessels operate in Indonesian waters, ship agency is quite promising than ship operation because they do not have adequate funds for operating vessels. To run a ship costs not only in management skill but much capital because of multi-layered and high taxes in the shipping industry.

To encourage fair competition between the shipping companies and shipping agency, the Government revised the capital requirements. To have a business shipping license, capital is not required but one ship with a minimum size 175 GT for domestic investment and 5000 GT for joint ventures. However, to have a permit in shipping agency, there is no requirement capital or vessels. It is following the Minister of Transportation regulation PM 24 the Year 2017.

3.2.3 Promote shipyard industry

As mentioned in the Shipping law, cabotage is not only to promote shipping and maritime industry, but also shipbuilding industry. The shipyard is expected to produce many type of vessels to support the cabotage. However, the effect to shipbuilding is not significant. Though there is increasing request of new vessels, but most of them are Government projects to support Jokowi's program, Tol Laut[1].

The shipyards are more active for vessels repair and dry docking than building new vessels. Based on data from the Ministry of Industry (2014), of the 250 registered shipyard, about 40% are considered active. Most of the shipyard ability of about 35% of the need for new buildings for vessels and 85% for ship repair. Moreover, shipyard capacity is limited, and when the demand to build new ship is high, the shipyard is not ready, and the companies also afraid to make investment to have bigger shipyard. Also, when the ship repair is urgent the shipowners have to wait in a long queue or they will repair at the nearest country, such as Malaysia or Singapore, though they have to pay more expensive services.

The limited capacity of shipyard to build vessels may encourage shipping companies to buy vessels from other countries. Furthermore, 70% of vessels component are also import components. According to Ridhwan, Paundralingga, Pratama, & Fridayanti (2016), transaction fees to build or repair ship in other country and imported components contribute to deficit of balance of trade.

However, to promote the shipbuilding industry cannot solely come from cabotage. Support from banks or financial institution close related to shipbuilding because the risk of the industry is still high so that the interest rate is also high. Investor hesitates to invest in shipbuilding industry, so the growth of national shipyard is low. Furthermore, policies related to the purchase of new or used vessels

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[1] Jokowi introduced Tol Laut in 2017 to reduce price disparities of the commodity sold in Java Island and other islands in western or easternmost of Indonesia by taking over domestic cargo ship route of essential commodities, cutting of delivery time by sea toll ship route, prices can be reduced.

from abroad should be limited gradually while fully supervising the needs of national vessels for global seaborne trade.

Without support from the shipbuilding industry, domestic shipping will depend on foreign ships, the industry needs to be supported by public policy such as ship standard for domestic shipping, tax and finance policy, shipyard revitalization and modernization, shipyard clustering, and development of ship component industry (Ma'ruf, 2014).

3.3 Exemption in cabotage

There are two sectors excluded from cabotage. These are offshore and cruise tourism. Cabotage is intended to protect its sovereignty on its internal waters and to give business opportunities for shipping companies to dominate market share by using national vessels. These goals are written in the explanation text of Article 8 of Shipping Law 2008; however, due to challenges that can impact the economy, the Government decided to relax cabotage for those sectors.

The underlying reason for the exemption is the national shipping companies have not been able to provide certain types of vessels to support offshore exploration and exploitation activities due to the high cost of providing vessels for these activities (Hidayanto, 2011). About the cruise tourism industry, the cabotage regime prevents tourists to travel on international cruises from Indonesia and start and end the journey from Singapore, Malaysia, Thailand, Hong Kong, or Australia. By exempting from cabotage, international cruise vessels allowed to board and embark on foreign and local tourists to travel inside and outside Indonesian territorial waters (Yahya, 2017).

3.3.1 Foreign vessels for offshore industry

As mentioned in the previous part, the offshore industry needs significant investment and technology. Building a new ship requires a lot of money and time to produce a ship with good quality; the price is estimated at IDR 20 billion or USD 1,5

million (Hidayanto, 2011). With the enormous investment costs required, it is quite tricky for national shipping companies to buy vessels for their own companies.

According to the MOT (2020), the beginning of the cabotage regime implementation, there was pro and contra between the oil and gas sector stakeholders and INSA. The oil and gas sector hoped implementation could be postponed, and the Shipping Law of 2008 should be revised. In 2011, when the cabotage was supposed to be fully implemented, there was not a single Indonesian flagship used for exploration and exploitation in offshore oil and gas activities. Vessels used for surveying, seismic vessels, drilling vessels, and offshore construction vessels and support vessels were still under foreign flags. Therefore, if the cabotage regime is applied soon, that oil and gas activities will stop operating is inevitable and will cause potential loss production reach to USD 13 billion or IDR 120,25 trillion (IPA, 2011). However, INSA said that cabotage is the right moment as a turning point for empowering the national shipping industry and wished the Government fins solution of this matter, as to build or buy new or used vessels were very expensive (INSA, 2011).

From the beginning of implementation, the Government understood that the offshore industry is an important sector that impacts the national economy, and it decided to apply the cabotage in the offshore industry gradually. In 2011, the Minister of Transportation issued a new policy as a follow up to the Shipping Law and Government Regulations for the use of the foreign vessels for offshore activities, which was Permenhub 48/2011. This Minister decree provided a limitation of time for operating foreign vessels engaged in offshore activities in Indonesian waters and certain types of vessels within a specific time. This Decree also mandated that the national shipping companies operated the foreign vessels that engaged in offshore activities.

The MOT evaluates the policy every three months evaluate by including the stakeholders to assess the availability of national vessels for offshore activities. Permenhub 48/2011 has been amended and revoke several times from 2011 to 2019

to gradually implement full cabotage and give time to the maritime industry to provide the necessary vessels to engage in these activities.

The Decree regulates six activities, including oil and gas survey, drilling, offshore construction, supporting offshore operations, dredging, salvage, and under waterworks, according to the timeline in the table 8 below.

Table 8 Activities, vessels, and timeline

No.	Activities and vessels	timeline
1.	oil and gas survey (seismic, geophysical, geotechnical)	Until the end of Dec 2014
2.	Drilling Jack up rig, semi-submersible rig, deepwater drill rip, tender assist rig, swamp barge rig	Until the end of Dec 2015
3.	offshore construction a. Derrick/crane, pipe/cable/subsea umbilical riser flexible (SURF) laying barge/vessel b. Diving support vessel (DSV)	 Until the end of Dec 2013 Until the end of Dec 2012
4.	Supporting offshore operations Anchor handling tug supply vessel bigger than 5000 BHP with Dynamic Position (DP2/DP3), platform supply vessels, diving support vessel (DSV)	Until the end of Dec 2012
5.	Dredging Drag-head suction hopper dredger, trailing suction hopper dredger	Until the end of Dec 2013
6.	Salvage and under waterworks Heavy floating crane, massive crane barge, survey salvage.	Until the end of Dec 2013

Source : MOT, 2013

The latest update of the Minister of Transportation Regulation is in 2019 by PM 46/2019. This decree provides exemption limited in five activities including drilling, offshore construction, oil and gas survey, dredging, and salvage and underwater works. It excludes supporting offshore operations that have been using national flagship since 2013. It is also mentioned details type of foreign ships that can be used for each activities until the end of December 2020 (see table 9). According to MOT, evaluation for exemption of those activities in the year 2021 is still undergoing to see if the provisions are still relevant with the current situation in the country.

Table 9 Type of activities, vessels, and time period

No.	Activity	ship
1.	Drilling	a. Jack up rig/jack up barge/self-elevating drilling unit (SEDU) b. Semi-Submersible rig c. Deep Water Drill Ship

		d. Tender Assist Rig
2.	Offshore Construction	a. Derrick/ Crane, Pipe Laying/Lifting Ship/Vessel with min DP 1, and min crane capacity 200 ton safety working load (SWL) b. Pilling Barge with Hydraulic impact hammer min carrying power 200 ton c. Diving Support Vessel (DSV), with DP 2/DP3 d. Semi-Submersible Accommodation Barge min DP I with capacity accommodation bigger than 120 rooms and min crane capacity 100 ton
3	Oil and Gas Survey	a. Survey Seismic with electromagnetic bigger than DP 1 b. Survey Geophysical bigger than DP 1 c. Survey Geotechnical bigger than DP 1
4	Dredging	a. Cutter Suction Dredger (CSD) vessel, with min Cutter Head 30 inch b. Trailing Suction Hopper Dredger (TSHD) with min Hopper capacity Hopper paling 3700 M^3
5	Salvage and under water works	a. Floating Crane with capacity of 300 ton b. Cable ship min DP 2 for deployment work c. Cable Barge min DP 1 for repairing and deployment work

Source : MOT, 2019

3.3.2 Support marine tourism

The cabotage regime limited foreign-flag cruise in boarding and disembarking passengers or carry out other commercial activities in Indonesian ports. Resulted in local tourists who want to try international cruise ship tours must embark from Singapore, as well as foreign tourists on foreign cruise vessels who wish to visit Indonesia. It also causes international cruise ship tourist routes to pass through Indonesia rarely.

In 2015, the Minister of Transportation issued a new regulation related to promoting cruise tourism by giving foreign cruise vessels permission to sail in Indonesia waters through Minister Regulation 121/2015. It allows international cruise to load and unload passengers at five ports[2] in Indonesia territory, including Belawan Port (Medan), Tanjung Priok Port (Jakarta), Tanjung Perak (Surabaya),

[2] Article 6 of the Minister of Transportation Regulation 121/2015

Soekarno-Hatta Port (Makassar), Benoa Port (Bali) to enjoy cruise tourism in Indonesian tour destination and back to its port origin as part of tour package then sailing to exit Indonesian territorial waters[3].

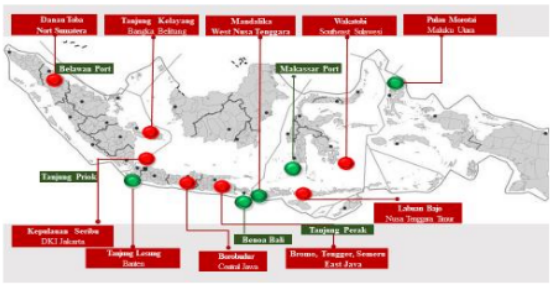

Figure 7 Map of domestic cruise port
Source: Ministry of Tourism, 2016

Figure 8 shows the location of the ports. The ports are located to be integrated with the ten priority tourism destination. The ports are exempt from cabotage to support President Joko Widodo's commitment to prioritize the tourism sector as a leading sector. The tourism location are Danau Toba, Tanjung Kelayang, Tanjung Lesung, Kepulauan Seribu, Borobudur, Bromo Tengger Semeru, Mandalika, Labuan Bajo, Wakatobi, dan Morotai. The existence of this relaxation has a positive impact on increasing cruise visits. In 2016 the cruise visit was 357 calls and 259, 940 passengers; while in 2015 the cruise visit was 361 and 228,716 passengers (Ministry of Tourism, 2016). An increase is also recorded in 2019, with total of cruise visit of 593 and 387,783 passengers.

3.4 From cabotage to *beyond cabotage*

The Ministry of Trade and the MOT are working together on the policy to promote the cabotage regime beyond domestic shipping by supporting export and import commodities carried by national vessels to provide business opportunities for

[3] Article 3 of the Minister of Transportation Regulation 121/2015

national shipping companies. In 2017, the Minister of Trade issued regulation 82/2017, which provided provisions on the use of sea transportation and national insurance for the export import of certain goods, including coal, CPO, and government cargo.

The Ministry Regulation is supported by Ministry of Finance to change the term of delivery used for export from Free on Board (FOB) to Cost, Insurance, and Freight (CIF). CIF means that the seller delivers when the goods pass the ship' rail in the port of shipment and pays the costs, freight, and insurance; while in FOB, the buyers have to pay all costs and risks of loss and damage (ICC, 1999). Encouraging the seller to change the term of delivery will increase the Indonesian vessels participation to in shipment, as the seller is responsible to choose the ship and the insurance. In this case, the Government expects the seller to choose Indonesian ships and insurance. In this sector, the maritime sector gets benefit from the coal market.

Beyond cabotage is intended to increase the competitiveness of shipping companies and investment in the shipbuilding industry. However, it never materialized and even slightly hindered the coals export in 2017 (Coordinating Minister of Investment and Maritime Affairs, 2020). In 2018, the regulation was amended twice by Minister of Trade Regulations number 48/2018 and 80/2018. Implementation of the policy was delayed as follows:

- The requirement for national insurance to cover coal, CPO, rice, and Government cargoes is postponed until August 1, 2018;
- The requirement to use Indonesian vessels to carry coal, CPO, rice, and Government for export and import is postponed until 1 Mei 2020.

The delay in implementing the policy was to gradually create change for the maritime industry to prepare the infrastructure and the shippers to renegotiate their contract with the foreign shipowners. However, because of the Covid-19 pandemic's impacts in early 2020 on the global economy, the Government decided to suspend the policy temporarily to protect the coal and CPO market from a further downfall.

The Government then formulating new policy with new provisions, which is the Minister of Trade Regulation 40/2020. The new regulation applies to the use of national vessels to carry coal, CPO, rice, and Government cargo with a maximum ship capacity of 15000 dwt. In July 2020, the Government revised the policy to ships with maximum capacity of 10,000 dwt and will conduct an evaluation on the impact of this policy to the maritime industry and coal market (Hidranto, 2020).

3.5 Conclusion

Before Independence Day foreign vessels were free to sail in the Java Sea, Banda Sea and Makassar Sea. In 1960, the Government restricted foreign vessels to engage in domestic shipping activities with exemption in oil and gas industry. In the early 1990s, Indonesian waters were dominated by foreign vessels. This situation continued until 2005 when the Government under Susilo Bambang Yudhoyono issued cabotage regulations for strengthening the shipping industry through Presidential Instruction Number 5/2005. The regulation provided a stricter cabotage regime. There is a significant increase of ship registered in national registry and shipping companies and also domination in the domestic shipping market. However, the cabotage is not fully implemented because there are sectors need foreign participation, and that the contribution of maritime sector to the GDP is still low considered Indonesia is archipelagic country.

The exemption in offshore industry started in 2011 in six activities, including oil and gas survey, drilling, offshore construction, supporting offshore operations, dredging, and salvage and under waterworks. The MOT evaluates this exemption to assess the availability of national vessels for offshore activities. The latest update of the Minister of Transportation Regulation is in 2019 by PM 46/2019. This decree provides exemption limited in five activities including drilling, offshore construction, oil and gas survey, dredging, and salvage and underwater works. It excludes supporting offshore operations that have been using national flagship since 2013. It is also mentioned details type of foreign ships that can be used for each activities until the end of December 2020

To improve the situation and increase national participation in international shipping, the Government issued new policy to require the shipment of export-import cargoes, such as coal, CPO, and government cargo to be carried by Indonesian ships. This new policy is in line with the MOT agenda, under a program known as *beyond cabotage*. In the next chapter it will discuss and analyze the challenges to implement *beyond cabotage* faced by Indonesia.

CHAPTER 4
CHALLENGES TO THE POLICY

According to MOT, discussions of the *beyond cabotage* have been started since 2012 between MOT, the Ministry of Trade, and related Ministries. However, the policy faced some challenges such as lack of ships availability and the INCOTERM used in international sea borne trade. In 2016, it was found that the maritime industry through sea freight contributed to a deficit of balance of trade services. Under the leadership President of Jokowi, the related Ministries were encouraged to finalize *beyond cabotage*.

In 2017 the Government issued *beyond cabotage* in export import of coal, CPO, and government cargo through the Minister Regulation 82/2017 and entered into force since six months after signed, May 2018. Due to some issues raised, the implementation of *beyond cabotage* was postponed to May 2020.

4.1 Lack of availability of ships

As explained in the previous discussion, bigger size is preferable for transporting coal and CPO for export commodities. Coal is mostly carried by dry bulk carrier with type of supramax by 31%, panama by 29%, and capsize by 22%. In comparison, CPO is mostly carried by chemical tanker with type of general purpose tanker by 46.5%, and handysize by 30%.

Vessels availability to carry coal and CPO remains mostly in foreign vessels due to the lack of Indonesian flagships. Indonesia has 68 units of bulk carrier to carry coal and 24 units of chemical tanker to carry CPO for transporting to other countries. The World Bank estimates in order for Indonesia to dominate the export shipment of coal and CPO, it needs 270 units of dry bulk carrier (16.25 M dwt) and 32 units of chemical tanker (536,000 dwt) (World Bank, 2016). This means, Indonesia needs an additional of 202 dry bulk carriers and 8 chemical tankers.

To implement *beyond cabotage*, INSA needs an additional 42 ships, consisting of 4 barges, 3 units handysize, 5 handymax, 10 supramax, 16 panamax, 3 post panamax, and 1 capesize (INSA, 2020). Large capital investment and time are needed to meet the need for new ships. It was mentioned before that the policy is postponed to apply from 1 May 2018 to 1 May 2020, however it is unlikely that 42 new ships gave been built during those two years.

INCAFO reported that there are worries from coal companies on the readiness of Indonesian flagships to serve the export transshipment, however it also reported that there are 15 shipping companies in process of negotiation with other countries to own dry bulk carrier through time charter or joint venture to operate the vessels (Pelindo 1, 2020). Related to this matter, cabotage and *beyond cabotage* were expected to raise productivity of the shipbuilding industry.

APBI also raised its concern on the implementation of *beyond cabotage*. The implementation closely relates to the availability of national flagships. Suppose the Government requires the coal and CPO shipment by national flagships. It has to provide a sufficient number of vessels in line with the productivity of coal and CPO. Otherwise, there will be a long queue in transportation, damaging the coal and CPO market.

4.2 Incoterms used in transporting coal and CPO for export

Two incoterms generally use in the contract between shipowner and cargo owner are CIF and FOB. Roughly more than 90% of Indonesian coal exports are done using FOB. With FOB, the responsibility to bear the cost of insurance freight is in the buyer's hands. The buyer will choose the ship to carry the products and insurance to cover the products during the delivery until it reaches the destination's port. The seller's responsibility is only until the cargo is delivered on board at the port of origin.

The Government encourages the exporter to use the CIF term. This term requires the seller to choose the insurance and the ship to carry the cargo. It is expected that

the seller will likely choose its national insurance and ships. This term will support the use of Indonesian flagships to carry the export products. According to APBI-ICMA (2020), because Indonesia has smaller ships capacity, the coal exporters prefer the FOB scheme. They do not need to find a suitable ship capacity. Furthermore, changing the export scheme from FOB to CIF will put coal exporters in unfavorable circumstances. It requires them to renegotiate the contract.

As one of the largest producers and exporter of coal and CPO globally, Indonesia should have more bargaining power to choose the contract term. However, the Indonesian producer will let the buyer to choose the delivery term. The Government encourages coal and CPO producers to compete with the international traders bravely. According to MOT (2020), CIF term is commonly practiced in Malaysia, where Malaysian ships must be used to ship palm oil products.

Beyond cabotage is expected to align with the Government program promoting the CIF term for export shipment. Since 2014, through the Ministry of Trade, the Government requires the export shipment to use the CIF term. However, the said program is launched without support by the related sector and is considered a domestic trader barrier. According to APBI-ICMA, this Government program is not running smoothly and does not affect trade revenue. Moreover, the program caused Indonesian producers to pay a royalty to the State based on the FOB price when they do not use the CIF term.

Domestic shipping's current condition is dominated with smaller size ships, which is considered unsuitable for coal and CPO export capacity. Furthermore, the ships is not classify in international standard. The national insurance and sea freight costs more than in others countries. Understandably, the seller will let the buyer choose the ships that considered more benefits for both sides. The national shipowners cannot compete with the lower cost that foreign shipowners offer.

The high cost of sea freight is caused by imbalance trade or empty backhaul. Indonesian flagships ship will be full capacity with cargo only for export shipment, but it is usually empty when the ship comes back to the original port. The foreign

cargo owners usually used the CIF term when sending cargo to Indonesia. They preferred to use their ships than Indonesian flagships, where bigger ships are generally preferred for international trade. On average, Indonesian ships owned by the national shipowners are 1,700 - 3,000 teus that are more suitable for domestic shipping (Ridhwan, Paundralingga, Pratama, & Fridayanti, 2016).

4.3 International pressures

During the preparation to implement beyond cabotage, Indonesia received many requests from other countries to review it. According to MOT (2020), Japan officially asked to explain how Indonesia will implement the policy. As one of Indonesia's major coal export market, Japan thought it might affect Indonesia and Japan's coal trade because Japan mostly uses its ships to carry coal from Indonesia. The lack of Indonesian ships' availability to cover coal production will cause queue in demand to use the Indonesian ships. The possible situation will likely make Japan rethink to buy coal from Indonesia. Japan also considered *beyond cabotage* to breach Indonesia's commitment to maritime trade in services sector under the IJEPA.

International Chamber of Shipping (ICS) (2018) also raised its concern on beyond cabotage. ICS thought it would appear to be a form of discriminatory cargo reservation, contrary to accepted international practice and maritime free trade principles. According to ICS, cargo reservation is contrary to Indonesia's commitment under the World Trade Organization (WTO) on the Maritime Schedule.

In 2018, Indonesia provided the exemption to use insurance and foreign ships for transporting coal and CPO to and from Indonesian territorial waters. In the situation where the Indonesian flagships or insurance referred to above is not available or is still limited in availability, then the use of foreign ships operated by national shipping companies is allowed. Indonesian flagship shipment is still the priority. When there is no ship availability, the sellers are allowed to charter ships (Indonesian flagships or foreign) from national shipping companies. It is a very significant revision of the policy, which very much a U-turn policy. However, Japan and other

countries or international organizations considered the exemption would cause an additional cost for chartering the ships from Indonesian shipping companies (MOT, 2020). When buyers have a ship to carry the coal or CPO but they cannot use it and have to charter a ship through Indonesian shipping companies.

4.4 Indication of breaching commitment on maritime trade in services

Indonesia agreed on commitment under GATS WTO in 1994 before *beyond cabotage* was introduced. In the commitment under GATS WTO for international freight transport (CPC 7212), Indonesia does not mention any limitation on market access in cross-border supply[4], but mentioned restrictions on limitation on national treatmen. The reservations are the foreign shipping company obliged to appoint an Indonesian shipping company as its general agent and government cargo must be carry by national ships. These reservations are of discrimination or restriction between the domestic and foreign shipping service providers, however they have been agreed in the Schedule.

Table 10 Indonesia's commitment on GATS WTO 1994 Schedule

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons		
Sector or subsector	Limitation on Market Access	Limitation on National Treatment
International Freight Transport (CPC 7212)	1) None 2) None 3) Foreign Shipping Company may establish Owner's Representative 4) a) Joint Venture: As specified in the Horizontal Measures b) Owner's Representative	1) a) Foreign Shipping Company is obliged to appoint Indonesian shipping company as its general agent***) b) Government's cargo****) 2) None 3) As Specified in the Horizontal Measures 4) As Specified in the Horizontal Measures

[4] The GATS covers services supplied in 4 modes. Modes 2 (Cross border trade) from the territory of one Member into the territory of any other Member; Mode 2 (Consumption abroad) in the territory of one Member to the service consumer of any other Member; Mode 3 (commercial presence) by a service supplier of one Member, through commercial presence, in the territory of any other Member; Mode 4 (Presence of natural persons) by a service supplier of one Member, through the presence of natural persons of a Member in the territory of any other Member

Notes (Maritime)

***) : The tasks of General Agent in Indonesia inter alia are as follows:
a) to make arrangement in order to get all necessary port services as required by the foreign vessel concerned during their stay in Indonesia ports;
b) to appoint stevedoring company for cargo loading and unloading on behalf of its principal;
c) to arrange cargo booking and canvassing;
d) to collect freight on behalf of the principal;
e) to issue Bill of Lading on behalf of the principal;
f) to settle the disbursement and claim (if any);
g) to give information as required by its principal.

****) Government's Cargo is cargo originated from the other countries (import cargoes) purchased by the Government Agencies or based on loan/credit agreement with the other countries.

Source: WTO, 1994

With beyond cabotage has been introduced after the GATS WTO Agreement, there is potential breach on Indonesia's commitment. Indonesia restricts foreign participation to access coal and CPO market (Article XVI GATS on Market Access). Table 10 shows Indonesia's commitment under the GATS WTO 1994 is "None" on Limitation on market access in mode 1. It means Indonesia has to allow any ships from other countries to enter Indonesia's market. Foreign shipping service providers are allowed to enter Indonesia market without being subject to any restriction (Parameswaran, 2004). Prioritizing the national flagships and national shipping companies to carry coal and CPO to and from Indonesian waters can limit foreign ships' access to enter the Indonesian market. This would constitute a contradiction of the Indonesian commitment.

Furthermore, *beyond cabotage* provision can also be considered in potential breach of Indonesia's commitment on national treatment (Article XVII GATS on National Treatment). National treatment is defined as treatment no less favorable or non-discrimination treatment between national and foreign shipping service providers (Parameswaran, 2004). However, on its schedule of commitment, Indonesia mentioned its reservation on national treatment in mode 1 are "Foreign Shipping Company is obliged to appoint Indonesian shipping company as its general agent" and "government cargo". *Beyond cabotage* is not include in the reservation. *Beyond cabotage* is favorable treatment on national flagship and shipping companies

that only Indonesian flagships or any ships chartered from national shipping companies are allowed to carry coal and CPO to and from Indonesian waters.

IJEPA is bilateral agreement between Indonesia and Japan in economic that agreed in 2007, before *beyond cabotage* is introduced. Table 11 shows Indonesia's commitment under the IJEPA in maritime services. Under IJEPA, Indonesia's commitment to market access and national treatment is "none" which means that the Japanese shipping service providers are not subject to any restrictions on Indonesia's market. Japan is free to do shipping activities and free from favorable treatment in Indonesian market. With the restriction for its ships to carry coal and CPO to and from Indonesian waters, and requirement for chartering ships through Indonesian shipping companies shows potential breach of commitment on Article 78 on Market Access under the IJEPA.

Table 11 Indonesia's commitment on IJEPA Schedule

Modes of supply: 1) Cross-border supply 2) Consumption abroad 3) Commercial presence 4) Presence of natural persons		
Sector or subsector	Limitation on Market Access	Limitation on National Treatment
Freight Transportation (CPC 7212) Excluding Cabotage	1) None 2) None 3) The commercial presence must be established only through joint venture enterprise, with foreign equity share allowable up to maximum 49%. 4) As specified in the Horizontal Section	1) None 2) None 3) Foreign shipping company is obliged to appoint Indonesian shipping company as its General Agent. 4) As specified in the Horizontal Section

Source: mofa.go.jp

Beyond cabotage may be in breach Indonesia's commitment of the Maritime schedule under the WTO. It was also already a concern for the Government before ICS mentioned it. The Government understands that cabotage is Indonesia's sovereignty over water within its jurisdiction. Prioritizing the national flagships over foreign vessels to carry coal and CPO for export-import may restrict or protect cargo reservations. However, with the exemption in *beyond cabotage* that allows foreign participation means that there is no more restriction or protection cargo reservations

(Ministry of Trade, 2018). The exemption should free Indonesia from the indication of breaching commitment on maritime trade in services.

4.5 Covid-19 pandemic

The Covid-19 outbreak hit globally in the early year of 2020 has caused damage in almost all the economic sectors, including the maritime industry and coal and CPO industry. Even before the outbreak of Covid-19, coal demand had begun to fall because of slowing down because of economic activities. In early 2020, coal demand fell by 8% compared to the early year of 2019 (IEA, 2020). The global demand for coal is mostly impacted by China and India, where coal is used dominantly in the electricity sector in both countries. The industrial use of coal has also declined because of a decrease in economic activity in China. In India, the economy is not yet recovered from the pandemic of Covid-19, though China is rising but slowly.

Indonesia's trade balance recorded a deficit of US$350 million in April 2020, as exports fell around 7% (MODI, 2020), on the back of falling commodity prices and plummeting global demand due to the pandemic. As a major coal exporter, Indonesia is not immune to the crisis in the Covid-19 pandemic. Particularly in the Indonesian coal market, April 2020 is the lowest level of coal export for Indonesia since October 2010 (IEA, 2020). Figure 9 shows export levels from 2015 to 2020; exports already dropped below average in February and March 2020 to decline further in April 2020.

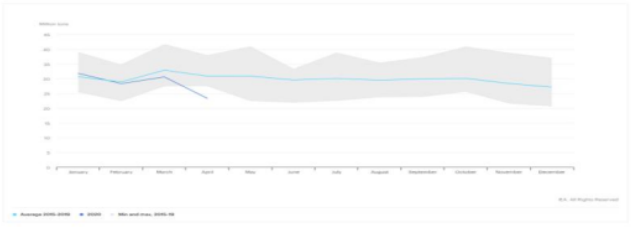

Figure 8 Indonesia coal exports, January-April 2020 vs. 2015-2019
Source: IEA, 2020

The impact of Covid-19 in the wider maritime industry has also hit Indonesia. The shipping activity continues to decrease though the Government commits to encouraging running business as usual. Because of the economic slowdown's impact on the economy, the Government decided to suspend the implementation of *beyond cabotage* (Firman, 2020). The unpreparedness of the Indonesian flagships cannot be allowed to hamper the flow of exports amidst the difficulties caused by Covid-19. During the Covid-19 pandemic, the Government decide to revoke the Minister Regulation 82/2017 and its revisions.

In April 2020, the Government issued Minister Regulation 40/2020 on the implementation of *beyond cabotage* with a specific provision on the limitation of ship capacity that can carry the coal and CPO to or from Indonesian waters. According to the Ministry of Trade (2020), the new regulation is completing the previous Minister regulations and addressing the impact of Covid-19 from further fall of coal and CPO industry and to gradually implement to *beyond cabotage*.

For the first phase, the policy applies to Indonesian flagships with a maximum capacity of 15,000 dwt. For export activities that use ships with a capacity below 15,000 dwt are required to use Indonesian flagships; however, for ships capacity above 15,000 dwt are allowed to use foreign ships. It means that with average coal and CPO are carried by foreign ships with a capacity above 15,000 dwt, *beyond cabotage* is unlikely to work as intended. The current update, with the Covid-19 pandemic still going into the unknown future, the Government decided to lower the limit of ship capacity to a maximum of 10,000 dwt through the Ministry of Trade Regulation 65/2020.

4.6 Analysis on the challenges

Implementation is one of the most critical parts of a policy; without implementation, it stays as nothing more than an item on the agenda (Mejia, 2020). According to Mazmanian and Sabatier (Cerna, 2013), implementation is the carrying out of a fundamental policy decision that policy decisions should be carried out as

planned (Cairney, 2012); if a policy is not balanced with proper implementation, it will not work well.

At the beginning of the cabotage regime's implementation, many national shipping companies opposed it because they already had contracts with foreign ship owners, and wanted to avoid having to renegotiate their contracts (Aprilianto, 2014). At that time, the national shipping companies prefer to charter foreign vessels than own because investment in the shipping industry requires a lot of money to buy new vessels and vessels operation; this condition was considered an insurmountable hurdle for domestic shipping companies.

Another situation that made the cabotage regime's implementation difficult at that time was the small number of Indonesian vessels could not meet the needs of domestic shipping. The ships' performance was not best compared to new built vessels condition. The ships needed high maintenance and operational because almost all the Indonesian flagships were over used and lack of maintenance. The shipowners preferred to buy cheaper ships disregards the condition. However, routine maintenance costs can be a burden for the company and used vessels affects the ship's life and maintenance costs (Luo & Fan, 2010). The actual service life of a ship will be longer or shorter depending on the ship's operation and maintenance during the life cycle of the vessel (Gratsos & Zachariadis, 2009).

Having understood the condition of its maritime industry, the Government was committed to strictly implementing cabotage. The measures were being taken such as simplification in the licensing requirement and certification, tax incentive in shipbuilding, building many ships to promote the trade. These measures to support the implementation of cabotage and trigger activities in shipping. The Government annually evaluates the implementation with the stakeholders. The shipping industry grows gradually, number of ships and shipping companies are increasing every year since the cabotage regime applied. Shipbuilding also shows increasing productivity.

According to Cairney (2012), there are seven elements of perfect implementation, they are:

a. The policy's objectives are clear, consistent, and well communicated and understood.
b. The policy will work as intended when implemented.
c. The required resources are committed to the program.
d. Skillful and compliant officials implement the policy.
e. Dependency relation are minimal.
f. Support from influential groups is maintained.
g. Conditions beyond the control of policymakers do not significantly undermine the process.

Depending on how contentious they are, policies and their intentions will often be changed or even distorted; its execution delayed or even blocked altogether (Mejia, 2020). This could very well happen to *beyond cabotage*. *Beyond cabotage* is controversial because it relates to many sectors, including coal and CPO, shipping industry, shipbuilding industry, and many others. Shipowners and shipbuilding are support the policy. *Beyond cabotage* will push the use of national flagship, force the shipyard to produce new ships. However, the coal and CPO market requested the Government to review the policy. The new policy requires the involvement of many national flagships to carry coal and CPO; however, the ships' availability is limited to cover all production of coal and CPO.

The Government also faces much concern from other countries and international organizations, such as Japan and ICS. Japan and ICS strongly raise their concern about how Indonesia will implement the cabotage regime. Many of their ships are used to carry Indonesia coal and CPO, it means the policy will affect their business. Furthermore, according to them, Indonesia will likely to breach its commitment under WTO and IJEPA. Both Japan and ICS asked the Government to review the policy.

The coal and CPO market also are not welcome with the policy because it will damage their business. GAPKI and APBI-ICMA support the Government as long the program does not hamper the smooth flow of export-import of coal and CPO, not

cause additional cost and no indication of breaching the international commitment. Due to all challenges are still no guarantee from the Government, they asked the Government to postpone the implementation.

The policy is meant to improve the maritime industry and increase its GDP by contributing positively to the national balance of trade. However, if the policy is implemented without the preparation of national flagships, it will boomerang against coal and CPO exports. As explained in the previous chapter, coal and CPO contributes an average of 20% to national GDP. It is estimated that GDP will take a dive after the policy is forced to be implemented. INSA welcomes the policy because it will force the use of national flagship and the demand for new ships will increase and push the shipbuilding industry to build new ships.

All these challenges force the Government to rethink its actions and satisfy all sectors. From 2017 to 2020, the regulations have been changed four times. The Government delayed the first implementation from 1 May 2018 to 1 May 2020 to give stakeholders some time to prepare for the implementation. However, the time provided is not enough to fill the shortage number of national ships. Those two years were also considered not enough for the sellers to end and renegotiate the contract. When the year 2020 is approaching, Indonesia received more international pressure to review its *beyond cabotage*. More countries questioned how Indonesian would implement it without endangering its coal and CPO market and international commitments.

The last amendment of the regulations has re-opened doors for foreign ships to engage their business as usual as the implementation of beyond cabotage is delayed and blocked. The obligation to use Indonesian flagships apply for ships with a maximum capacity of 10,000 dwt. When the buyers ship their coal or CPO by a ship with size last than 10,000 dwt, the regulation requires them to use Indonesian ships. However, if they ship the products by a ship with a capacity of more than 10,000 dwt there is no obligation for them to use Indonesian ships.

Most coal and CPO shipment is carried by ships with a capacity above 10,000 dwt (supramax, panama, capasize). However, the policy applies to the ship with a capacity below 10,000 dwt. The national shipowners questions the objectives of the policy. For INSA, the last amendment is a big hit for shipowners if there is no obligation to use Indonesian flagships, the seller and buyer will likely choose foreign ships. National ships cannot compete with foreign ships because foreign ships have bigger capacity and better quality than Indonesian ships. The Government regulates something that has less impact on the intended objectives. In practice, the policy may not affect foreign ships. However, provision of limiting foreign participation and prioritising national participation still exist and written officially under Permendag 65/2020, meaning the indication to breach international commitment technically still exists.

With the rapid changes of regulation that regulated *beyond cabotage*, the Government has confused the business sectors as they create legal uncertainty and result in great distrust of the Government. When formulating the policy, the Government should have developed a plan, method to mitigate some risk. The Government should have researched all sectors' preparedness and coordination among stakeholders to share information on issues or disadvantages and advantages. The Government should have learned from the cabotage regime where lack of sufficient ships is still a significant issue. With proper preparation, all the challenges that were raised were not beyond the control of the policymakers. In the end, the policy has not only changed; it has become distorted and a boomerang against the Government.

4.7 Conclusion

The analysis found that they are 5 major challenges faced by the Government to implement *beyond cabotage*, they are lack of availability of ships, the use of INCOTERM in the shipment contract preferably FOB than CIF, the international pressure, and the indications of breaching commitment in maritime trade in services under WTO and IJEPA, also the Covid-19 pandemic. Most of the challenges are not

beyond control (Covid-19 is force majeure) of the Government if it has well preparation in formulating the policy. Prioritizing the national flagships as carriage of coal and CPO may restrict market access and unfavorable treatment for other countries. It may technically breach Indonesian commitments that have been agreed in international framework before *beyond cabotage* exist. *Beyond cabotage* has been modify many times. The Government relaxed the restriction by giving chance for the foreign ship to participate in the market. However the exemption is likely to prevent the policy from being implemented, and may even considered a full reversal.

CHAPTER 5
CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

Cabotage is a tool used by a country to protect its national interest in its marine environment. There are many types of cabotage, such as strict or relaxed cabotage. It is a country's sovereign prerogative on how to implement the cabotage regime under its jurisdiction. Indonesia sees cabotage as bringing improvement in its maritime industry. There has been a significant increase in shipping companies and ships registered in the national registry, and also domination in domestic shipping market.

The cabotage regime may not be fully implemented because there are sectors that still need foreign participation. Furthermore, there is no significant improvement in shipbuilding industry. The increasing number of vessels is not newly built ships and shipping companies focus their business as shipping agency. The high tariff of sea freight impact to deficit of state revenues in balance of trade in services. The contribution of maritime sector to the GDP is still low considering the fact that Indonesia is an archipelagic country.

After cabotage, Indonesia extend it to *beyond cabotage*. *Beyond cabotage* requires Indonesian flagship to transport export-import commodities to and from other countries. There are many challenges that hindering the implementation of *beyond cabotage*, such as lack of availability of ships, the use of Incoterms in the shipment contract preferably FOB than CIF, the international pressure, and the indications of breaching commitment in maritime trade in services under WTO and IJEPA, also the Covid-19 pandemic.

Prioritizing the national flagships as carriage of coal and CPO may restrict market access and unfavorable treatment for other countries. It may technically breach Indonesian commitments that have been agreed in international framework before *beyond cabotage* exist. *Beyond cabotage* has been modified many times. The

Government relaxed the restriction by giving a chance for the foreign ship to participate in the market. However, the exemption is likely to prevent the policy from being implemented and may even considered a full reversal. *Beyond cabotage* is meant to support the maritime industry through coal and CPO market. However, without proper preparation, it will endanger the coal and CPO market.

5.2 Recommendations

The Indonesian government should rethink its cabotage. Although Indonesia's positive impact on the cabotage regime can be felt, Indonesia can not be fully satisfied because of the mixed results. Stricter cabotage might help to achieve the objective as intended. If Indonesia adds requirements in its cabotage regime, such as ships for domestic shipping must be built domestically, it can force the shipyard to increase its productivity. Cabotage regime relates shipping industry to ship building industry. Without support from shipbuilding industry, the shipping industry will depend on foreign ships.

Indonesian government should also consider to have one roadmap of maritime policy, where clear direction of policy should be communicated to related sectors. Each Government agency has agenda or strategic plan, and one have to integrate with the other. Maritime industry does not consist of shipping only but also shipbuilding industry, finance institution, ship components, ship engine and machinery. All of these should work toward the objective of cabotage and *beyond cabotage*.

With the rapid changes of regulation that regulated *beyond cabotage*, they have confused the business sectors as the changes create legal uncertainty, and resulted in great distrust of Government. Indonesian government should show full commitment and constant effort to implement the policy. In policy the formulation phase, the Government should have considered the preparedness of all sectors related, coordination among stakeholders to share information of issues, or disadvantage and advantages.

The government should consider on having a roadmap on the implementation of *beyond cabotage* before introducing the policy to the public. The roadmap should contain a step by step guide to help prepare the public to understand and accept the policy. The Government could also consider to follow Malaysia steps by encourage the coal and CPO producers to require the seller to use Indonesian flagship carries the coal or CPO to port destination. If the requirement comes from the private sector, there is possibility Indonesia prevent breaching its commitment under GATS and IJEPA.

The cabotage regime is a useful tool for national economic progress, particularly in term of the shipping industry. However, extending the regime beyond national waters has proven a much more challenging policy. Perhaps a thorough review of different policy instruments and implementation procedure will have the country achieve its objectives.

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