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Cabotage the key to maritime trade, if we have political will

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Indonesia's ancient kingdoms of Sriwijaya (7th century) and Majapahit (13th century) were known for their naval strength. They enjoyed flourishing maritime trade. But in the centuries since, the focus of national development has shifted to agriculture and less attention has been given to the maritime economy.

That situation is about to change now the second Shipping Law has been passed by the House of Representatives.

The long-awaited revision to the 1992 Shipping Law addresses more issues than its predecessor. It is better integrated with related regulations (such as the labor, investment, regional autonomy and taxation regulations) and is markedly more comprehensive.

The new law also reinforces the cabotage principle introduced in Presidential Decree No. 5/2005.

The word cabotage is taken from the Spanish word "cabotaje" and refers to "sailing from cape to cape". In the context of maritime law, the cabotage principle grants rights to a country to trade and navigate within its own coastal territories, and to operate and regulate the traffic inside its territorial waters.

Imitating the cabotage laws of industrial nations (such as the Jones Act in the United States and cabotage laws in Japan and Australia), the Shipping Law will limit domestic trade to vessels flying the Indonesian flag. It also covers matters such as vessel registration and ownership as well as the crew complement.

Under the new law, by 2010, all domestic shipments of 13 specified commodities (including rice, crude palm oil (CPO), coal, oil, wood products, fresh produce, fertilizer and cement) will have to be conducted by national vessels.

However, as of the end of 2007, the 7,463 domestic vessels in operation carried only 65.3 percent of the total domestic cargo, or about 148.7 million tons, according to the Transportation Ministry.

It is then estimated an additional 654 vessels will be needed to augment the national armada before the new cabotage law takes effect. A huge sum of money will obviously be needed to fund the purchases of the new vessels. The additional investment is expected to reach US$4.6 billion, of which $3.7 billion will come from the banking industry.

According to Bank Indonesia, bank loans extended to the shipping sector amounted to Rp 9.8 trillion in 2007, or less than 1 percent of the total loans disbursed. The reluctance of banks to lend reflects the high-risk, low-yield and long-term repayment characteristics of the shipping sector.

The new Shipping Law, however, does at least provide better legal assurances over a ship's status as collateral. This should go some way to ameliorating concerns.

Difficulties in securing capital investment for the shipping industry will result in a shortage of dry bulk cargo and tanker vessels for transporting coal, oil and possibly CPO by 2010. As the law comes into effect, transportation tariffs will increase because demand for domestic marine transportation will outstrip supply.

All of this will lead to heightening inflationary pressures in various industries. The government might be tempted to issue a temporary waiver in regard to some aspects of the law in a bid to control inflation.

However, such a waiver would undermine government efforts to empower the domestic shipping industry.

The shipping sector is capital intensive and highly leveraged. As such, the freight rate becomes a key factor in determining the return on invested capital. In this regard, cabotage will tip the balance in favor of the domestic shipping industry.

There are some threats. As well as the risk of a temporary waiver, vessel prices and operational costs are both rising. This will put pressures on margins for some time to come.

The International Maritime Organization, through the Marpol Convention of 1978, is requiring its member countries to gradually phase out older tankers by 2015 and replace them with double-hull vessels. This will result in greater demand for tankers.

With high demand for vessels and shipping services due to increased global demand for commodities, the prices for secondhand vessels have been also steadily rising.

With shipyards operating at full capacity, maintenance costs for existing vessels will likely rise as the fully utilized shipyards will need more time to undertake repairs. Thus, the capacity to raise freight rates is a crucial factor in ensuring adequate returns on invested capital.

Given the new law comes into effect in less than two years, and it takes between one and three years to build a new vessel, it is clear that time is of the essence. The government will have to come up with appropriate policies to encourage investment in the industry.

Such polices might include streamlined ship registration, tax incentives for lenders, legal assurance in the event of asset execution and the setting of floor freight rates.

The government might also decide to offer temporary subsidies -- either directly to the shipping industry or to other industries affected by the higher transportation costs.

All things considered, the new Shipping Law is an essential step in the right direction, but it remains to be seen if there will be the political commitment to realize the dream of having a great maritime economy to equal those of Sriwijaya and Majapahit.

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