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Indonesia heavies its coal producers with new regulations

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INDONESIA only began selling thermal coal abroad 21 years ago, but by 2006 it had overtaken Australia as the world's biggest exporter; now its government apparently wants to curb a business earning it more than \$6 billion a year.

And by doing so hand back the advantage to Australian-based miners, by means of a technically dubious obligation on Indonesian producers to upgrade energy content of low-grade coal or be banned from shipping it.

In the face of mounting opposition from the coal industry and trade bureaucrats, the Energy and Mineral Resources Ministry's draft regulation has been revised and weakened for the third time, leading some analysts to predict the measure will not be realised by the due date of January 2014.

Investment bank UBS dismissed the export ban recently as a "non-event", because the necessary technology is not yet workable at mining scale and if enforced the restriction would only cost revenue from a trade worth about \$US22bn (\$22.3bn).

The regulation, when it first came to light, proposed to ban coal exports of calorific (energy) value below 5700kcal/kilo, intending to force producers to upgrade such output by removing moisture. That would have affected about 170 million tonnes, 64 per cent of last year's total exports (including metallurgical grades for steelmaking), Indonesian Coal Mining Association (APBI) chairman Bob Kamandanu says.

The most recent draft however specifies coal at or below 5100kcal/kg, affecting no more than 30 million tonnes of exports, so could the miners live with that?

Kamandanu says it is the wrong question because the concept is so flawed and risky to Indonesia's key role as an exporter.

"Just don't do it," he advises.

But resources law expert Bill Sullivan warns that some mild version of the regulation is almost certain and, when on the books, be available for upward adjustment.

Sullivan, at the Jakarta legal firm Christian Teo Purwono and Partners, says it is instructive to note which export producers are preparing to toe the ministry's line, even while most of the industry remains firmly opposed.

Bumi Resources subsidiary Arutmin Coal is building one beneficiation plant in South Kalimantan, partnered by Kobe Steel of Japan, and plans another for South Sumatra.

Bumi, controlled by the Bakrie family group, is the most politically connected of the big coalminers, and while Nirwan Bakrie runs the business side, elder brother and Golkar party chairman Aburizal prepares for the 2014 presidential race.

"One would have to ask, given what astute business people and politicians Bumi Resources are, would they have invested all that money in coal upgrading if they weren't very sure (the regulation) was going to come in and probably become more onerous over time," Sullivan says.

Bumi has an Indian partner (Tata Group owns 30 per cent of Arutmin and Kaltim Prima Coal) as do a growing number of Indonesian miners.

Indian power utilities imported about 42 million tonnes of Indonesian thermal coal last year, surpassing China as the Indonesian trade's most important customers.

But they are far from sanguine about recent Indonesian developments, particularly the escalation of government export price benchmarks, which raises Indian buyers average Indonesian coal cost by \$US30/tonne and, they say, threatens the viability of planned power stations.

The new benchmarks also chop into Indonesia's substantial shipping cost advantage over Australia, being closer to all the major East Asian coal customers.

That is a further spur to Indian and Chinese buyers to seek alternatives further afield.

Even South African generators complain that Indian competition for their domestic supplies risks driving retail electricity prices to politically sensitive levels.

Indonesia's state-owned power generator, PLN, is feeling that squeeze and although a coal production quota is reserved for PLN, price is dictated by the market.

But PLN is hobbled by the government's insistence on power price caps and extensive subsidisation of supply to households and strategic businesses.

That is why Kamandanu, Sullivan and others suspect one background motive for the government applying its minerals value-adding policy to coal is to trap enough low-grade coal at home to drive down prices and with them PLN's input costs.

Australian export production, now with heavy Indian and Chinese participation, is a beneficiary of Indonesia's approach.

Neither China nor India is exactly coal poor. China is the world's largest producer and user of thermal coal, and India mined as much of its own last year as Indonesia produced for export, but its consumption still exceeded domestic output by 28 per cent.

Driven mainly by the two rapidly industrialising giants with their frantic need of cheap electrification, thermal coal accounted for 29.6 per cent of the global energy mix last year, according to BP's Statistical Review of World Energy. That is the highest level in 40 years and Indonesia's cheap steaming coal has made perhaps the largest single contribution.

"The leverage point here is that Indonesia has been the biggest and fastest responder to the expansion of demand in the export coal industry," ANZ Bank's head of global commodity and industry research Mark Pervan says.

A decade ago, Indonesia had fewer than 50 mines in operation; now there are more than 400.

Pervan says Indonesia's coal industry owes its nimbleness not just to export logistics but the riverine and coastal geography of Kalimantan and Sumatran coal provinces. Miners and shippers have been able to use barges and floating loaders, avoiding much of the port and railway development needed by Australian fields.

But sooner or later, Indonesia will need to divert much more of its energy coal from exports into servicing domestic growth.

Imposing export restrictions today is plainly unrealistic, Pervan says. "But this is not a 12-month story but a five to 10-year story," he says.

And it implies a major shift in international supply and demand patterns. Indonesia, with 238 million people and more than 6 per cent annual growth, expects to follow a similar development trajectory as India and China.

With petroleum reserves dwindling and nuclear power more an aspiration than a plan, Indonesia must turn increasingly to cheap coal to satisfy its energy thirst.

Domestic coal demand is budgeted to grow almost 32 per cent to 79 million tonnes this year, but the country will still be exporting a record 291 million tonnes.

The government now seems uncomfortable with that rate of export growth, even though it does not have an up-to-date assessment of coal reserves and the national electrification program is running way behind schedule.

Kamandanu says the government should first correct the data, "because wrong data creates wrong decisions".

But rather than resource conservation, Energy and Minerals Minister Darwin Zahedi Saleh focuses the argument on enforced domestic processing of minerals.

Darwin is working to Law No 4 of 2009 on Minerals and Coal Mining which bans export of unprocessed minerals from January 2014. But critics say: why start on coal? It comes from the mine virtually as finished product, gets washed, crushed and graded on site, then shipped for burning. According to APBI, the industry paid 55 trillion rupiah (\$6.07bn) in royalties, taxes and fees in 2009.

"Close to 60 per cent of what we earn is going back to government," Kamandanu says.

So why risk government revenues on enforced standards that foreign buyers don't appear to want and many Indonesian producers will cheat?

Kamandanu sniffs nationalist politicking, which worries him.

"When it comes to nationalism, it's a matter of 'whatever it takes'," he says. "Even if the country is going to lose a lot of money because of it, they will do it."

Sullivan agrees, noting that keeping Indonesian resources from greedy foreigners is a popular cause here. He says no consideration of mineral upgrading should ignore that the 2009 law was passed a few months before that year's parliamentary and presidential elections, or that the implementation deadline falls just ahead of the 2014 elections.

In terms of planning and implementation, the deadline is beginning to loom large for miners and APBI is demanding the government settles the question by the end of next month.

But the bureaucrats and politicians are still prevaricating.

The Australian tried for more than three days for responses from the Energy and Mineral Resources & Trade ministries after strong rumours that the the regulation was final and would be declared this month.

A trade official, who declined to be identified, said for the time being, the regulation would not be declared and was still under discussion between the ministries. There were continuing problems identifying mining operations which would fall under the ruling.

"According to the 2009 law, it should be implanted by 2014," the official said. "So we are only following the law."
