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Laws Jeopardize Indonesia's Coal Profits

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JAKARTA, Indonesia -- Indonesia has become the world's second-largest exporter of thermal coal, but growing domestic demand and stagnated foreign investment could hurt the country's profits in the global market.

Draft laws that could give foreign investors more control over their local ventures are crucial to whether Indonesian growth can keep pace with that of other big exporters, such as Colombia, experts say.

"Indonesia has come from nowhere to challenge Australia as the world's largest exporter of thermal coal," Citibank wrote in a recent report.

Indonesian coal is exported around the globe, including to the European Union, the U.S., Japan, India and China, which itself is a major coal producer but imports coal to feed domestic industries.

Indonesia's coal production has risen 20-fold since 1990 to an estimated 167 million tons in 2006 -- 73% of which is exported, Citibank said. From January through October last year, Indonesia's coal exports totaled around $5.1 billion, about 32% higher than a year earlier. In that period, its overall exports rose 15% to $58.5 billion.

Coal was long an unfashionable energy source. But global demand for electricity, and economic growth led by industry in developing countries such as India, lend a strong outlook to global coal demand and pricing, said **George Haley**, director of the Center for International Industry Competitiveness, based at Connecticut's University of New Haven.

With large potential coal reserves and growing domestic and export demand, Indonesia has the potential to capitalize on that strong market. But restrictive laws and perceived political risk have halted new investment and exploration by big foreign mining and energy businesses in Indonesia, analysts say.

Furthermore, Indonesian President Susilo Bambang Yudhoyono wants to reduce his country's reliance on oil and increase the role of coal, which could lead to a cap on exports, analysts say. "The government may, before too long, prefer to reserve [some] production for the domestic market," Mr. Haley said.

At current levels of known mineable reserves, Indonesia's coal exports may rise to 170 million tons by 2009, but could fall to 160 million tons in 2010, said Indonesian Coal Association Chairman Jeffrey Mulyono.

To counter that forecast decline, Indonesia's government needs to accelerate changes to mining and energy regulations designed to give more direct control to foreign investors, in order to rekindle investor confidence and bring the exploration resources of major international coal companies into Indonesia, Mr. Mulyono said.

Greater national unity under the Suharto dictatorship saw steady economic growth and concurrent higher rates of exploration in energy and minerals in Indonesia, though critics say those economic benefits often came at the expense of human rights. A policy shift over the past eight years to strengthen regional autonomy has led Jakarta to hold off granting concessions directly to foreign miners.

Foreign coal miners have limited direct control over investments in Indonesia, because they can now invest only in partnership with a domestic company holding mining authorization from a regional government.

Big foreign players in Indonesia's coal sector -- such as Australia's Straits Resources Ltd. and Thailand's Banpu PLC -- are surviving on existing supply chains entrenched under Suharto-era contracts, while two other big foreign companies, BHP Billiton Ltd. and Rio Tinto PLC, divested themselves of their Indonesian coal assets rather than assume minority ownership under local partners.

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Draft changes to replace the contract system with mining licenses are before Parliament. Though the exact nature of the changes is unclear, the government says they will give more control to foreign investors.

Once the proposed changes are passed, Indonesia could attract exploration from foreign mining companies that could potentially double or triple its seven billion metric tons of known mineable coal reserves, heading off a decline in the growth of coal exports, Mr. Mulyono said.

He said Parliament might approve the long-delayed draft laws in March or April, but analysts are skeptical that the laws will be passed that quickly.

Conflicts between Indonesia's central government and provincial administrations, and the restrictive mining-investment laws, mean Indonesia "remains a place where uncertainty exists in a number of areas; therefore the rest of the economic factors have to be that much better," said Stephen Davis, energy attorney at U.S. firm Vinson & Elkins LLP. While political risk is a factor that will take longer to improve, accelerating changes to investment regulation could bring big investors, he said.

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