US Embassy Jakarta
ECONOMIC SECTION

INDONESIA'S COAL OUTPUT INCREASES IN 2004

Summary

Indonesia's coal production increased 16 percent in 2004, despite continued uncertainty in the mining industry over legal and tax issues. China's decision to halt coal exports, coupled with rising Japanese and Korean coal imports, caused the production increase by raising international coal prices. High tax rates, divestment concerns and the lack of a new mining law contribute to uncertainty in the coal sector, although Chinese and regional companies continue to show interest. Indonesia has abundant resources and potential, but a comprehensive new mining law, clear regulations and investment-friendly policies are needed in order to maintain production, coal reserves and Indonesia's strong position in the global market.

Coal Output Jumps 16 Percent

Coal production reached 132 million metric tons (MT) in 2004, an increase of nearly 16 percent over the year before. Rising coal demand and high coal prices, averaging more than $50/MT in 2004, drove the production increase. Most major coal producers enjoyed higher output, except for state-owned PT Bukit Asam (PTBA), the production of which dropped over thirteen percent due to railway transportation disruptions from its South Sumatra mine.

Coal Production Statistics (in thousands MT)

Company	2002	2003	2004	% Change
Bukit Asam (PTBA)	9,482	10,027	8,707	-13.2
Adaro Indonesia	20,819	22,523	24,331	8.0
Kaltim Prima Coal	17,577	16,203	21,280	31.3
Kideco Jaya Agung	11,500	14,056	16,927	20.4
Arutmin Indonesia	10,557	13,615	15,019	10.3
Berau Coal	7,123	7,360	9,103	23.7
Indominco Mandiri	5,335	6,327	7,103	12.3
Other CCOWs	14,168	16,217	19,409	19.7
Local cooperatives	6,811	7,951	10,474	31.7
TOTAL	**103,372**	**114,278**	**132,352**	**15.8**

Note: CCOW refers to companies with coal contracts of work. Local cooperatives are small coal mining firms that obtain concessions at the regional level.

Source: Directorate of Mineral and Coal Enterprises

Coal Exports Up 9 Percent

Coal exports also increased by 8 million metric tons in 2004 and account for 70% of production. The country's largest coal exporter, PT Bumi Resources (shareholder of KPC and Arutmin) experienced a surge in exports to 36.2 MT, an increase of 39% from 2003. Regional exports within Asia reached 69.9 MT, almost 75% of total exports. Japan and Taiwan remain the largest consumers of Indonesian coal and bought over 38% of exports, followed by South Korea, Hong Kong and Malaysia. Exports to Japan and South Korea increased over 2.5 million MT last year, as both countries reportedly aim to reduce their reliance on coal imports from China. Coal exports to China doubled between 2003 and 2004 in response to China's growing energy demand. (The U.S. receives about 2.3 percent of Indonesian coal exports).

Coal Export Statistics (in thousands MT)

Company	2002	2003	2004	% Change
Bukit Asam (PTBA)	1,855	2,239	2,712	21.2
Adaro Indonesia	12,688	15,178	15,099	-0.5
Kaltim Prima Coal	16,629	16,034	22,404	39.7
Kideco Jaya Agung	6,750	8,942	10,966	22.6
Arutmin Indonesia	9,825	13,772	13,798	0.2
Berau Coal	5,072	5,349	6,160	15.2
Indominco Mandiri	5,334	4,887	6,854	40.2
Other CCOWs	10,204	12,225	11,681	-4.5
Local cooperatives	5,822	7,055	4,084	-42.1
TOTAL	**74,178**	**85,681**	**93,759**	**9.4**

Source: Directorate of Mineral and Coal Enterprises

Coal-Fired Power Drives Domestic Demand

Domestic coal demand rose five percent to 36.1 million MT in 2004. Coal-fired power plants were the single largest consumers, accounting for 22.9 million MT or 63 percent of total demand. Cement plants were the second largest consumers, comprising 15 percent of domestic demand. Coal traders also comprise a larger portion of the demand pie. Taking advantage of high prices, coal sold and distributed by coal traders jumped last year to 6.3 million MT, up from 0.9 million MT in 2003.

Additional demand for coal will come from planned coal-fired power projects in West and Central Java. Tanjung Jati B (1,600 MW), Cilegon (740 MW) and Cilacap (600MW) are all scheduled to begin operations during 2005-2006. This is part of a larger government strategy to increase the proportion of coal and natural gas in the country's energy mix. The GOI hopes to raise the share of coal for power generation from 18% to 38% by 2020. To help accomplish this, it would create disincentives for coal exporters by imposing export duties and obliging new industries to use coal.

Westerners Out, Regional Investors Chipping In?

Last year saw an increasing trend toward local and regional investors in Indonesia's coal industry. Australia's New Hope Corporation Ltd. plans to divest its 49% stake in PT Adaro Indonesia to the Alam Tri Abadi consortium, the members of which include Edwin Soerjadjaya (owner of PT Dianlia Setyamukti, majority shareholder of Adaro). The divestment is set to continue despite ongoing dispute over ownerships between Dianlia and previous shareholders. Adaro currently is the largest coal producer in Indonesia, representing 18% of total production. It is the country's second largest exporter after Kaltim Prima Coal (KPC).

Local firm PT Indika Inti Corpindo, backed by China's Huadian Group, completed its 41 percent stake acquisition in Kideco Jaya Agung for $145 million. However, Indika failed to acquire United Tractors' 60 percent stake in Berau Coal when Armadian Tritunggal, an existing shareholder of Berau, exercised its pre-emptive rights. Armadian is now the majority shareholder in Berau after purchasing United Tractors' stake for approximately $70 million. Huadian, PTBA and Indika Inti Energy (a joint venture between state-owned power company PLN and Indika) also plan to build a $1.6 billion coal-fired power plant in South Sumatra. Thai Banpu also plans to invest over $117 million in the next five years on its Indonesia mines. Banpu owns five coal companies in Indonesia and combined is Indonesia's fifth largest coal exporter.

Systemic Problems Threaten Long-Term Health

Systemic problems continue to threaten the growth of the coal mining industry. According to the Fraser Institute, Indonesia ranks next to last among major mining countries for its investment climate and last for political stability, regulatory uncertainty and regulatory duplication. Experts have cited the government's tax policy on coal as a major disincentive for investment in the sector. High corporate tax rates, royalty payments and value added taxes (VAT) are among the most onerous in the world. According to an industry survey, first generation contract coal companies pay a combined royalty and income tax rate (excluding other taxes) of 58%. This is 65% higher than China, 69% higher than Australia, and 80% higher than South Africa.

The net effect of these policies, as well as continued delays in producing a new mining law, has been a steady drop in investment in the coal sector. Industry analysts estimate that Indonesia's mineral reserve recovery cost (the exploration amount necessary to maintain production and reserve levels) reached $52 million annually for coal in 2004 and $173 million for the mining industry in general. Due to a steady investment decline since 1998 (now under $19 million annually), experts say Indonesia now needs exploration investments of $750 million in order to restore its reserve levels.

A Good New Mining Law is Needed

Mining industry sources say Indonesia needs a new mining law to stimulate new exploration and development in the sector. Since the current mining law's enactment in 1967, Indonesia's population has nearly doubled. Over 110 nations have changed their mining investment laws. They note that standard practices in the current law, such as "ring fencing", are outdated and hinder new investment. (Note: Ring fencing requires investors to create separate mining companies for each new exploration project. This single company, single exploration and single mine concept traps cash and equity in a company that could instead be used to fund or be leveraged to fund exploration in other areas. Companies can take their money offshore and then bring it back to Indonesia to reinvest in other projects, but this practice can be uneconomic and inefficient.)

A recent PriceWaterhouseCoopers survey offered seven recommendations to improving investment conditions in the mining industry:

- Restore long-term certainty for contracts of work, such as tax stabilization.
- Improve the competitiveness of the tax and royalty system, including restoring VAT refunds for coal producers.
- Ensure contract sanctity by resolving conflicts between mining contracts and forestry regulations without imposing new burdens on mining companies.
- Minimize over-regulation and regulatory duplication between central and regional governments.
- Ensure fairness in divestment of foreign interests and mine closures.
- Reduce illegal mining.
- Improve certainty of the legal interpretation of mining contracts and regulations.