INDONESIA'S BAN ON EXPORTING UNPROCESSED MINERALS BEGINS TO BITE

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Legal Briefings – By **Shane Kyriakou** and **Bryce Paterson**

In January 2014 the Indonesian Government introduced a prohibition on the exportation of unprocessed minerals. This prohibition was the next step in mineral law reform in Indonesia, which began with the 2009 Mining Law (**Mining Law**).

The Mining Law and its implementing regulations set quite an aggressive divestment regime, requiring foreign companies holding an operating mining licence (*Izin Usaha Pertambangan Operasi Produksi* (**IUP-OP**)) to reduce their interests in the corporate entity holding the IPU-OP to 49% by the 10th year of operation. The stated intention of this approach was to increase participation by domestic companies in the mining sector.

Similarly, the prohibition on exporting unprocessed minerals was aimed at stimulating domestic industry. Upon its introduction the Coordinating Economic Minister Hatta Rajasa stated that its intention was to "add value to mineral exports by having them processed in Indonesia and create more jobs." This would be achieved by compelling upstream producers to refine minerals before export and therefore growing domestic processing businesses.

However, the Indonesian government recognised that the lead-in time for the export ban would not provide sufficient time for mining operators to build the necessary infrastructure to process and refine minerals for export. A transition period was therefore granted from 12 January 2014 until 11 January 2017. Companies seeking to take advantage of this transition period must obtain:

- a recommendation from the Director General of Mineral and Coal, which will only be granted if the mining company has provided sufficient demonstration of its commitment to build a refining facility (including, amongst other things, feasibility study, approved environmental documents and construction schedule), and

- a Mining Products Export Approval from the Minister of Trade.

In addition, exporters of unprocessed and unrefined minerals must pay a progressive export levy during the transition period which increased from ~20% in 2014 to 60% commencing on 1 July 2016.

KEY ISSUES

One year out from the end of the transition period there has been a negligible increase in Indonesia's mineral processing capacity. Whether as a result of low commodity prices, a redirecting of foreign investment to other emerging markets or a combination with other factors, the lack of investment in domestic processing has begun to have an adverse effect on the export of a number of key commodities.

Low historical investment

For example, only one bauxite smelter has been completed since the introduction of the export ban. Historically, relatively little bauxite was processed in Indonesia and this low base of existing infrastructure coupled with the slow pace of new processing plant development has led to production cuts at bauxite mines across Indonesia. BMI Research has downgraded Indonesian bauxite production growth estimate for 2016 from 58% to -4.0% and for 2017 from 20% to -4.0% due to the shortage of domestic processing infrastructure. The nickel sector has faced similar issues, as reflected in our comments below.

Slow pace of approval

Indonesia's challenging planning approval system has also played a part. Duplication of provincial and national regulatory requirements and some inconsistent application of policies have contributed to a slow pace of approval for foreign companies wanting to establish or increase in-country processing. In February 2016 U.S. copper giant Freeport McMoRan Inc.'s subsidiary PT Freeport Indonesia (**Freeport**) had its export permit for copper concentrate suspended amid a deadlock over a guarantee for the construction of a local smelter. The smelter was required to enable Freeport to comply with the export prohibition. On 10 February 2016 President Joko Widodo stated publicly that before consideration could be made for an extension to the export permit "Freeport Indonesia must talk about royalties, local content, smelter and development in Papua." On the same day Indonesia's Energy and Resources Ministry belatedly issued a recommendation that an interim export permit be granted for 6 months. Freeport operates the world's third largest copper mine in Grasberg, Papua province and the two-week suspension and public stoush with the Indonesian Government had a considerable impact on the global copper market and Indonesia's reputation as a commodity exporter.

Increased foreign competition

Adding to the difficulty in achieving its domestic processing ambitions has been the viability of competing markets which threatened to displace Indonesia's exports across a number of key commodities. After the introduction of the export ban the Philippines, a major competitor with Indonesia in the nickel export market, replaced Indonesia as the world's largest exporter of the nickel to China. The ban on exporting unprocessed minerals hit Indonesia's nickel sector particularly hard as its in-country processing infrastructure was embryonic compared to its long established thermal coal and gold industries. As producers struggled to finalise plans for the development of in-country processing, Filipino producers increased capacity and have gained a greater foothold in the Chinese nickel market.

WHERE TO NEXT?

The Indonesian government has faced considerable disquiet for the export prohibition measures from IUP-OP holders and from the wider business community. As is common with Indonesian mining law there has been a number of supplementary government regulations (*Peraturan Pemerintah*) which augment and adjust the parameters of the Mining Law and export prohibition. For example, IUP-OP holders who conduct processing and/or refining activities have been given relief from the Mining Law's divestment regime with the reduced requirement of 60% foreign ownership by the 10th year of production. To date requirements such as these have only added to the complexity of the prohibition and greater uncertainty for investors. Furthermore, the government has publicly remained committed to the ban and the timetable for full implementation in January 2017.

We will update you on any developments on Indonesian mining law as they arise.

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