S. RAJARATNAM SCHOOL
OF INTERNATIONAL STUDIES
A Graduate School of Nanyang Technological University

RSIS COMMENTARIES

No. 014/2014 dated 22 January 2014

Indonesia's Ores Export Ban: A Knotty Conundrum

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Synopsis

Indonesia has implemented a new law banning the export of mineral ores. From this month, all mining companies must refine their ores before they can be exported. Infrastructure weaknesses, however, render such restriction highly unviable for many companies.

Commentary

INDONESIAN MINING companies have been in a curious quandary since the start of the new year as the government implements a ban on the export of unprocessed mineral ores. Mining companies are required to refine their minerals before they can be exported or sold in the international market.

The ban was originally designed to encourage local mining companies to process raw mineral ores so as to increase their value-add, thus yielding higher export revenue. However, it is becoming evident that this law would instead have a downside effect due to the lack of funds to build smelters as well as deficiencies in supporting infrastructure within the industry.

Strong resistance

Unsurprisingly, the regulation met with strong resistance from several domestic mining companies. They argued that the ban essentially penalises mining companies without smelting facilities. Selling their mining products to other mining companies with the requisite refining facilities will also not be a preferred option as revenues would have been substantially marked down.

The Indonesian Mining Entrepreneur Association (*Asosiasi Pengusaha Mineral Indonesia* or APEMINDO) stressed that the ban would badly hit the industry as many local mining companies do not have the financial capacities to construct refining or smelting facilities.

State revenue would in turn be adversely affected, as exports in minerals, royalties and dividends would decrease in response to the regulation. The projected loss incurred is estimated between US$5 billion to US$7 billion in 2014. The impact of the regulation will likely also extend to the political sphere. Support from mining companies to the current administration may diminish significantly – not to mention the spike in unemployment generated by a suspension in mining activities.

Processing ore domestically to increase its value is important not only for greater revenue generation, but also to increase Indonesia's overall industrial capabilities in the long term. The state will benefit from the increase in revenues through taxes and exports, while mining companies will gain more revenue from their value-added goods. In addition, the injection of workforce into the industry will drive up the economy from its current state of stagnation. Nonetheless, a smelting or refining plant requires uninterrupted supply of power to operate – something which Indonesia currently lacks.

Killing the goose that lays the golden egg

Regardless of the debate over regulations, the lack of good infrastructure remains the single underlying hurdle that impedes the prospect of processing raw mineral ore domestically. It appears that the ministry merely aims to achieve a short-term objective without taking the overall, holistic interest of the industry and its development. The fundamental issue of infrastructure deficiency is often overlooked as government officials focus their debates over regulation and cost-benefit calculations.

The Chamber of Commerce and Industry (KADIN) projected that Indonesia would need one to 1.5 GW of additional power to satisfy power demand from smelting facilities all across the archipelago. Though power plants in Java and Bali have the capacity to support smelting plants, they are plagued with operational and supply problems that have resulted in disastrous blackouts, not to mention the additional cost of transporting the ore from remote parts of the archipelago to Java. In addition, the designated power plant would have to undergo several modifications before they can be industrially compatible with its smelters.

The option of directly transmitting power to the proposed smelter plant within the proximity of mining areas is also questionable as most mining operations are located in remote areas where transmission infrastructure is rare or non-existent. There is neither power nor adequate transmission infrastructure available to sustain a viable mineral refinement process.

The underlying challenge that has plagued Indonesia's mining sector is not the lack of finance, determination or interested investors. It is rather the lack of power supply and proper power transmission infrastructure to sustain mineral refinement and smelter operations. Improving the power infrastructure would not only provide better opportunities for mining companies to expand their businesses into the mineral refining sector. It will also attract investors who were previously hesitant in placing their bets on the mineral refining sector due to the deficiencies in the power infrastructure.

A self-imposed Catch-22

In sum, implementing the ban would ultimately result in more harm than good in the short term. However, allowing companies to skirt the ban altogether reflects a lack of resolve by the government in enforcing regulations. This does not bode well for the legitimacy of the government. A compromise to benefit all stakeholders is the solution to prevent the potential outbreak of major mining disruptions while vouching the government's credibility.

Extending the deadline, applying a partial ban, or scaling down the refinement of specific high-valued minerals may serve as a possible short term solution. It is envisaged that several companies will seek to skirt the ban. Such a solution will not bring about a long-term resolution. The government will ultimately have to come to terms with the underlying hurdles that it now chooses to ignore. Ideally, the government will have to function as a bridge for interested investors and mining companies to come together rather than creating roadblocks. The first thing the government has to do is to ensure that the power infrastructure problems will not become an impediment in the future.

While mining companies suffer from infrastructure deficiencies, investors are also concerned with the lack of commitment from mining companies in processing their products domestically. This trust deficit amongst the two parties can be bridged by the government committing to uphold the law consistently. The government should also look into the long-term development of the industry rather than on short-sighted objectives.

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