

ATTRACTING MORE INVESTMENT IN INDONESIAN MINING INDUSTRY

COVID-19 ECONOMIC CRISIS SPURS SIGNIFICANT REGULATORY REFORM

Presented by:

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OUTLINE OF SESSION

1. Introduction
2. Background
3. Economic Imperative
4. Recent Regulatory Reform Overview
5. More Important Regulatory Changes
6. Residual Strategic Problems
7. Indonesia as a Case Study for SEA?
8. Summary & Conclusions

INTRODUCTION – PART I

1. Indonesia has for a long time been a paradox when it comes to mining and foreign investment
2. Indonesia is simultaneously ranked as
 - (a) one of the most geologically prospective countries in the world and
 - (b) one of the least desirable countries in the world in which to carry on a mining project
3. Major western multinational mining companies have increasingly looked elsewhere for promising investment opportunities

INTRODUCTION – PART II

4. Many of the long standing legal policy and regulatory problems facing the Indonesian mining industry and foreign investors are the product of the last mineral commodities boom
5. There are some indications that GoI finally understands it needs to do more to encourage foreign investment including in the mining industry
6. Current economic and fiscal crises in Indonesia may be forcing rethink of (i) long standing ambivalence towards foreign investment and (ii) possibly merits of resource nationalism

INTRODUCTION – PART III

7. The favoured economist of Indonesia's first President Sukarno was fond of saying

“you should never miss a good economic crisis and the opportunities it presents for reform”

8. Good economic times often produce bad policies while bad economic times often lead to good policies

9. Will recent changes in Indonesia be followed elsewhere in South East Asia given other countries face similar Covid19-related economic/fiscal problems to Indonesia?

BACKGROUND – PART I

1. Indonesia traditionally
 - (a) refused to be “*benchmarked*” against other SEA countries
 - (b) took the view that “*this is the way we do things here so just accept it or don’t come*”
2. Indonesia has unquestionably fallen behind Vietnam, Thailand, Philippines, Malaysia in attracting new foreign investment

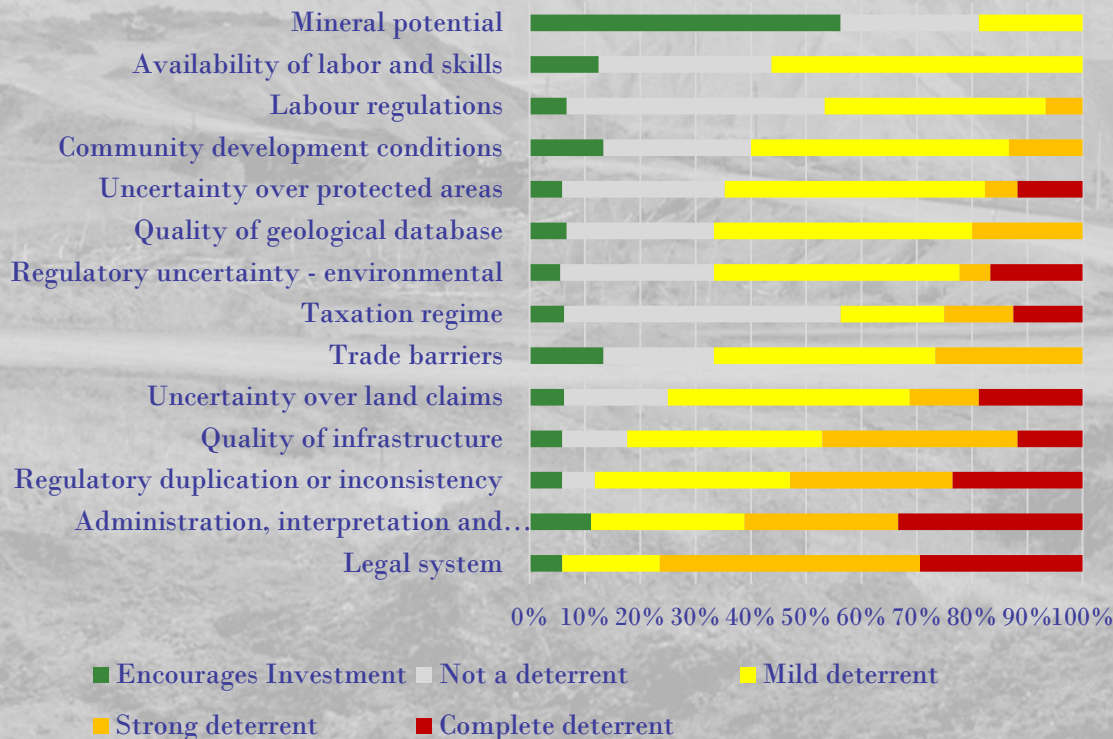
BACKGROUND – PART II

3. Foreign investment in Indonesian mining industry has been discouraged by
- (a) regional autonomy
 - (b) failure to recognize that exploration and mining are not the same
 - (c) 51% divestiture requirement applicable to foreign owned mining companies
 - (d) growing domination of SOEs
 - (e) difficulty of obtaining permission to work in Forest Areas
 - (f) chronic regulatory inconsistency

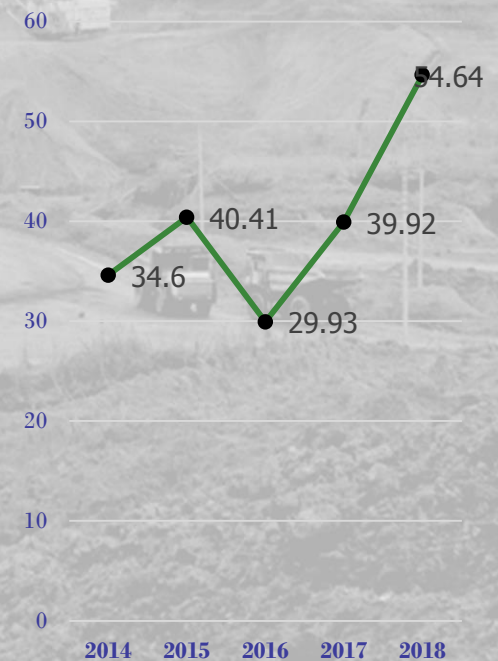
BACKGROUND – PART III

...and global investor sentiment continues to reflect perceived risks in Indonesia – but this is improving

Fraser Institute Annual Survey of Mining Companies 2018 – Indonesia



2018 Policy Perception Index - Indonesia

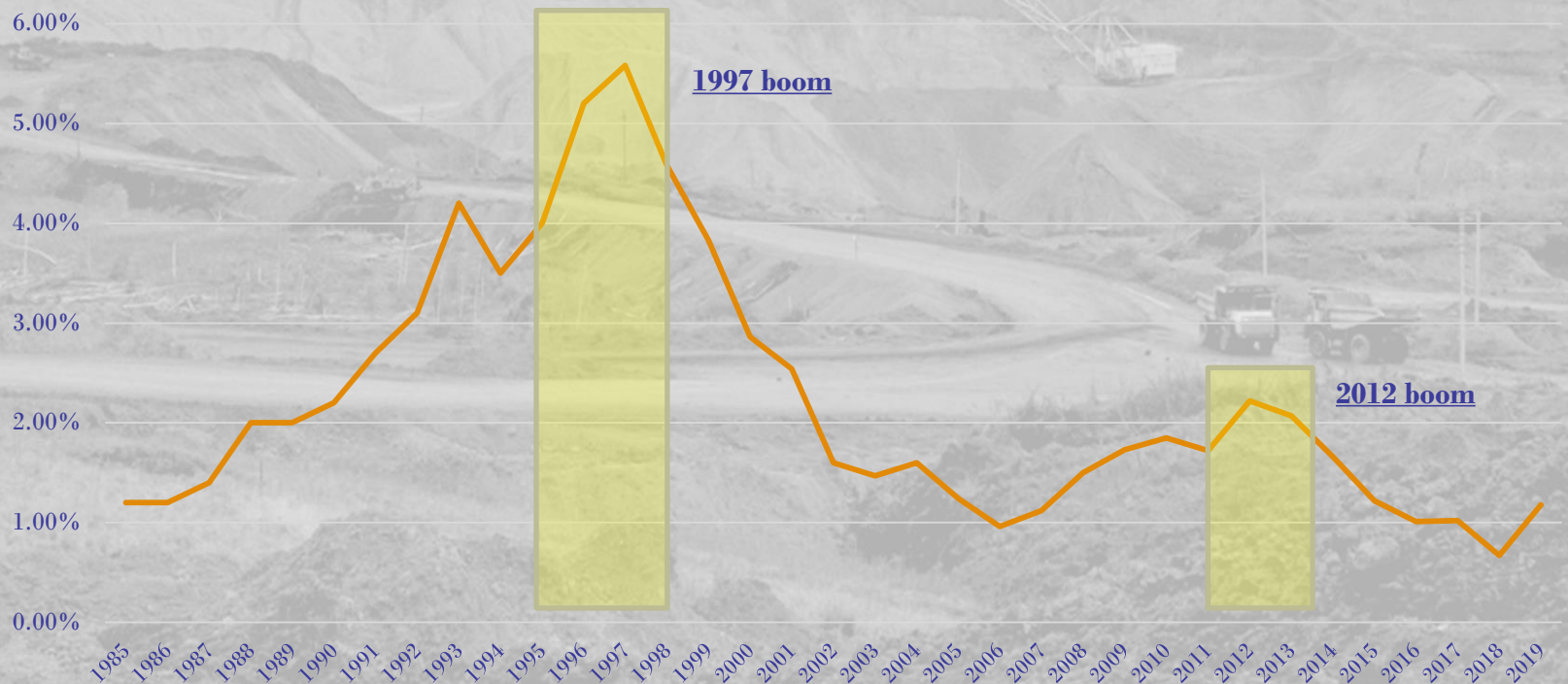


Source: Fraser Institute 2019

BACKGROUND – PART IV

...as well as a significant decrease in Indonesia's share of global exploration spending.

Indonesia's share of global exploration budget, 1985-2018



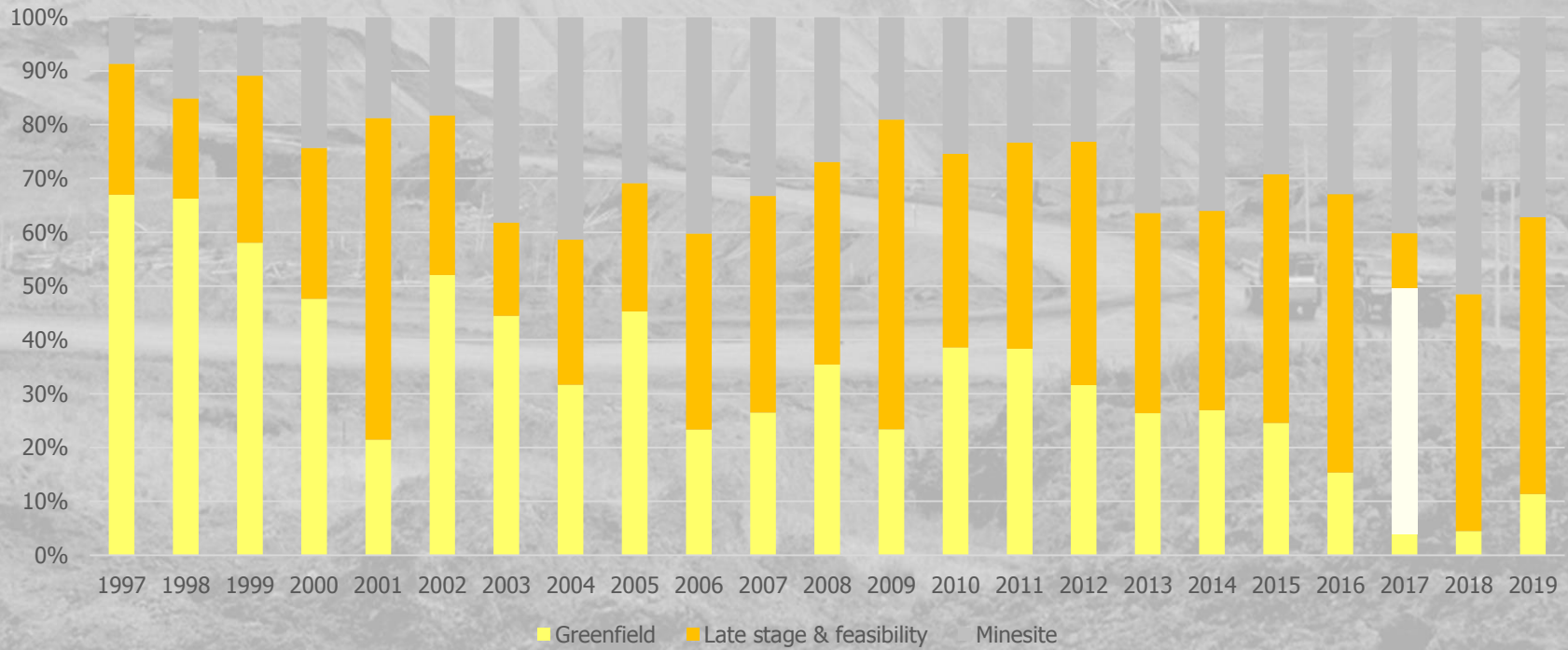
Excludes expenditures on bauxite, coal and iron ore

Source: S&P Global Market Intelligence & MineX Consulting

BACKGROUND – PART V

... greenfield exploration has decreased steadily across two price cycles ...

Exploration spending by stage (%), 1997 - 2019



Source: S&P Global Market Intelligence Excludes coal and iron ore

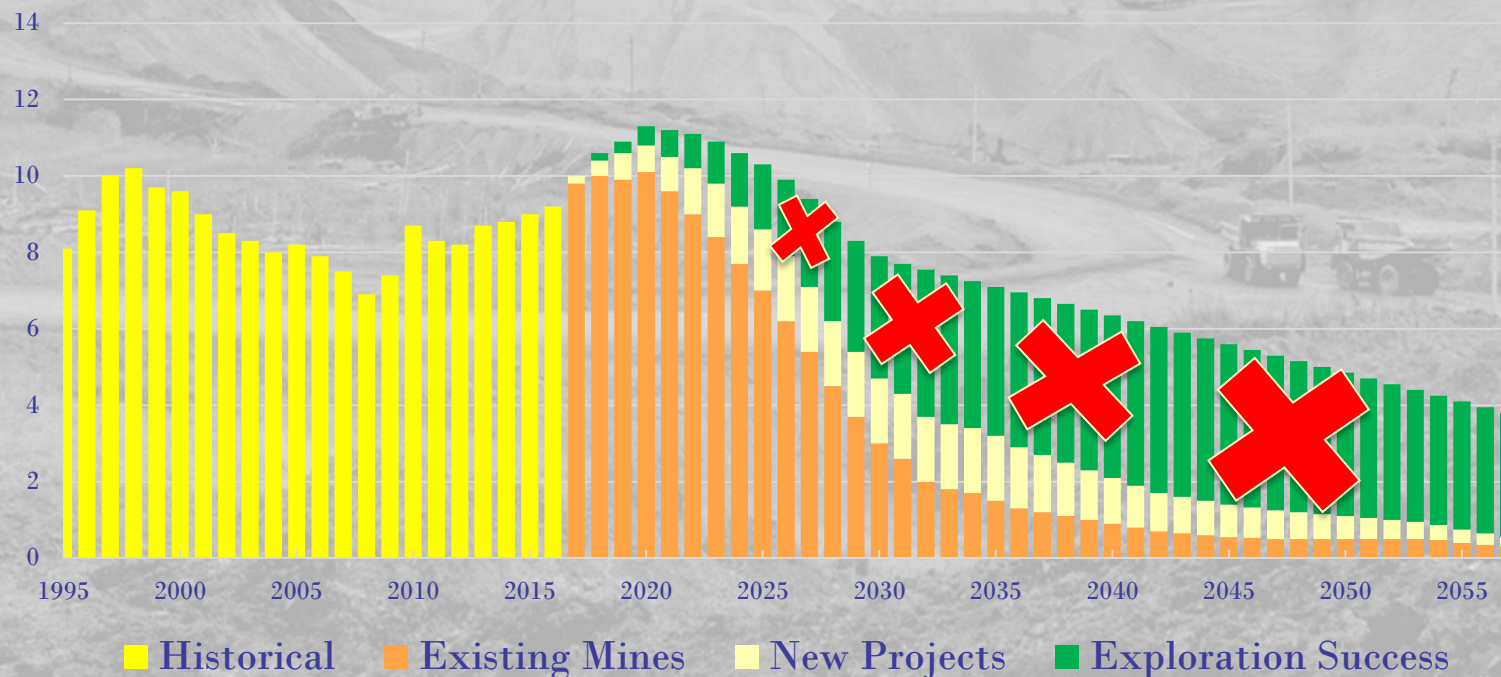
BACKGROUND – PART VI

Q: What happens if exploration investment does not materialize?

A: The Indonesian mining sector will slowly grind to a halt.

Detailed forecasting is subject to inherent uncertainties around price, economics of current mines, brownfield exploration success, etc., and is beyond the scope of this presentation.

Conceptual model: Historical & future production



Source: adapted from R. Schodde, Minex Consulting 2016

ECONOMIC IMPERATIVE – PART I

1. GoI has belatedly recognized that Indonesia
 - (a) must do more to attract foreign investment
 - (b) does compete with other SEA countries for foreign investment
 - (c) is very much over-regulated in a way that discourages both domestic and foreign investment

2. Covid-19 economic and fiscal crises have made sweeping regulatory reform for Indonesia
 - (a) essential
 - (b) urgent

ECONOMIC IMPERATIVE – PART II

September 2020

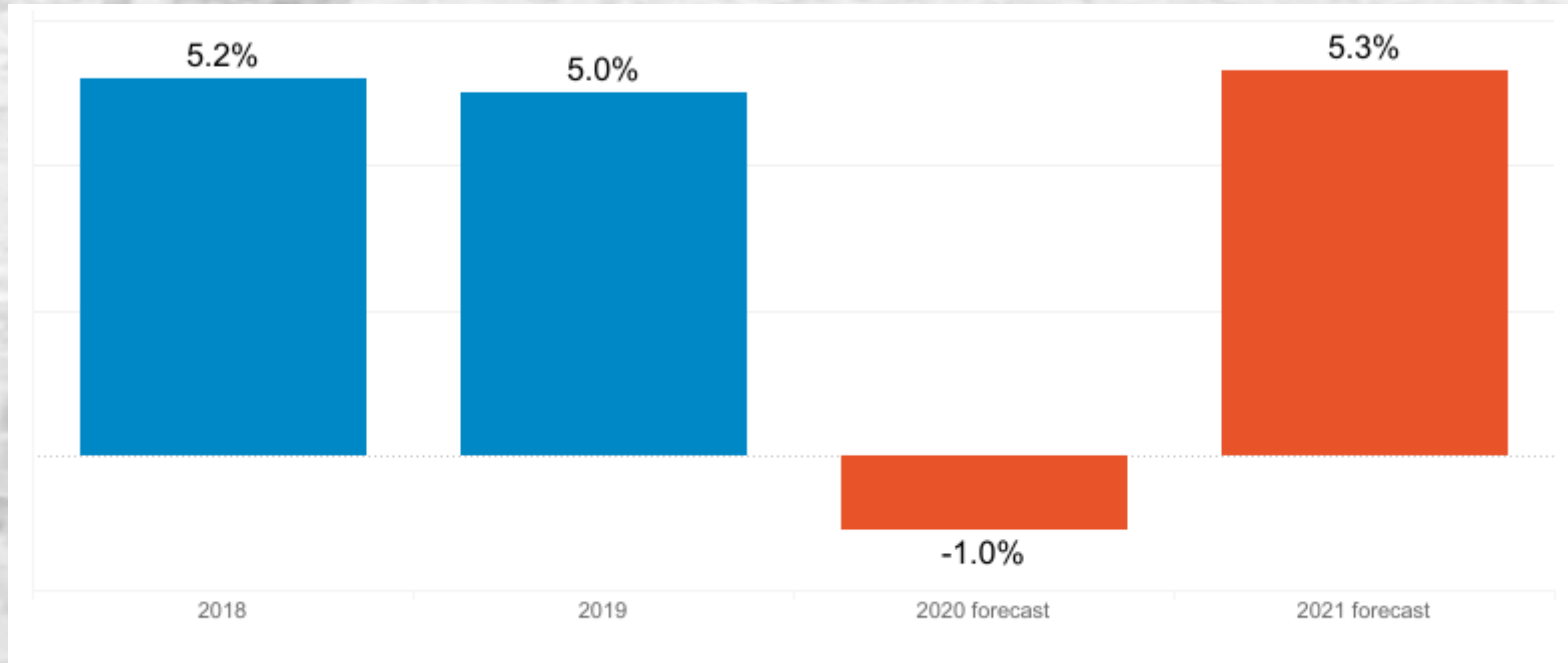
Indonesian GDP Growth down sharply but not as badly hit as most Asian neighbors in Q2 2020

- China +3.2% (Q1 -6.6%)
- Vietnam +0.36%
- Indonesia -5.32% (Q1 +2.97%; Govt predicts 1-3% Q3 contraction)
- Thailand -12.2%
- Singapore -13.2%
- Philippines -16.5%
- Malaysia -17.1%
- India -19.9% (-23.9% Q1 FY2021)

Source: Indonesia Forecast Webinar, 2020

ECONOMIC IMPERATIVE – PART III

GDP Growth Rate: Indonesia (% per year)



Source: Asian Development Bank. Asian Development Outlook (ADO) 2020 Update (September 2020)

ECONOMIC IMPERATIVE – PART IV

Trend of Investment Realization 2015 – June 2020 : Quarterly



Source: Indonesia Investment Coordinating Board, 2020

RECENT REGULATORY REFORM OVERVIEW – PART I

1. Exploration/mining investment is highly sensitive to non-geological factors...

Exploration/mining is speculative, costly and risky. Commercial rationale depends heavily on long-term policy/regulatory environment.



Source: adapted from N. Adams, EMD Indonesia

RECENT REGULATORY REFORM OVERVIEW – PART II

2. New Mining Law and Omnibus Law are intended to make Indonesia and local mining industry more attractive to both domestic investors and foreign investors
3. Poor Government handling of “*rollout*” of New Mining Law and Omnibus Law have resulted in widespread public protests and opposition to individual reforms
4. Investors are waiting for Implementing Regulations before making significant new investments
5. Government may be disappointed in short term impact of New Mining Law and Omnibus Law

RECENT REGULATORY REFORM OVERVIEW – PART III

6. Most important regulatory changes for local mining industry
 - (a) increased Central Government control of licensing
 - (b) greater legal certainty for major producers
 - (c) limiting SOE domination of coal industry
 - (d) incentives for DP&R and CD&U
 - (e) better divestment terms
 - (f) focus on exploration
 - (g) less onerous environmental requirements
 - (h) easier access to Forest Areas
 - (i) relaxation of manpower restrictions

RESIDUAL STRATEGIC PROBLEMS FOR INDONESIAN MINING INDUSTRY – PART I

A. Declining Quality of Foreign Investment

1. GoI

- (a) treats all foreign investment as being equal
- (b) does not distinguish between good foreign investment and bad foreign investment

2. Risk that Indonesia

- (a) has already lost many world class multi-nationals which are not coming back anytime soon
- (b) is attracting “*replacement*” foreign investors which are
 - (i) attracted to/comfortable with Indonesia’s opaque/poorly enforced/unclear regulatory environment
 - (ii) have no intention of doing the right thing

RESIDUAL STRATEGIC PROBLEMS FOR INDONESIAN MINING INDUSTRY – PART II

B. Resource Nationalism has Not Gone Away

1. Resource nationalism is so strongly entrenched in Indonesia that it is not going away anytime soon
2. More favourable attitude to foreign investment may well be temporary only
3. Once good economic times return foreign investment could quickly become “*out of favour*” again
4. Resource nationalism will increase in run-up to 2024 Presidential Election

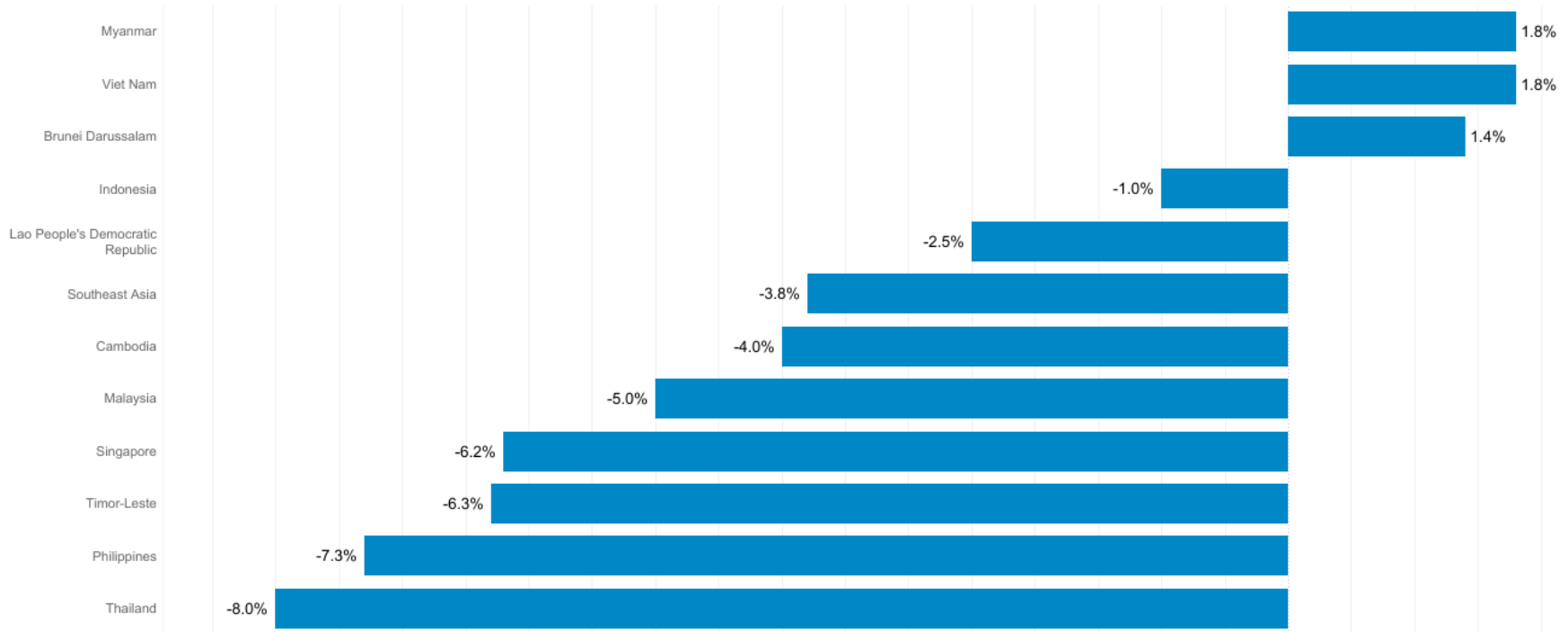
RESIDUAL STRATEGIC PROBLEMS FOR INDONESIAN MINING INDUSTRY – PART III

C. Weak Legal and Court Systems

1. Indonesia's inherently weak legal and court systems mean foreign investors
 - (a) have no assurance of adequate legal protection for their investment
 - (b) are always at a serious disadvantage in disputes with local parties
 - (c) underestimate the non-operating risks they face
2. GoI shows no interest in serious reform of legal and court systems

INDONESIA AS A CASE STUDY FOR SEA? – PART I

GDP Growth Rate, 2020 forecast
(% per year)



Source: Asian Development Bank. Asian Development Outlook (ADO) 2020 Update (September 2020)

INDONESIA AS A CASE STUDY FOR SEA? – PART II

Mining Contribution Index (MCI): ASEAN member states (2018)

Source: International Council on Mining and Minerals. The role of mining in national economies: mining contribution index, 4th ed., supplement

Country	2018 MCI Rank (out of 182)	Metallic , mineral, metals & coal export contribution (% of exports)	Metallic mineral & coal production value 2016 (% of GDP)	Mineral rent 2016 (% of GDP)
Brunei Darussalam	24	0.5	-	0.00
Lao P.D.R.	46	27.1	7.27	5.63
Indonesia	50	16.8	5.09	0.72
Philippines	61	5.8	2.81	0.94
Malaysia	67	4.2	0.44	0.18
Thailand	73	6.0	0.46	0.04
Myanmar	77	6.1	3.66	0.54
Vietnam	96	1.1	2.69	0.21
Cambodia	108	9.3	0.0	0.00
Singapore	128	2.5	-	0.00

Note: The MCI provides an indication of the relative importance of mining in the economic life of a given country. Ranking is out of 182 economies. Metallic mineral and coal production value is based on a dataset that includes metals, coal, feldspar, phosphate rock, salt, and sulphur. Mineral rent as percentage of GDP represents loosely aggregated potential tax and profit flows from mining

INDONESIA AS A CASE STUDY FOR SEA? – PART III

1. Indonesia's mining industry

- (a) is the largest in SEA
- (b) makes the greatest contribution to SEA host country GDP after Lao
- (c) arguably has the least favourable foreign investment climate

2. Legal/policy/regulatory problems facing Indonesia's mining industry are probably no worse than the problems facing mining industries of

- (a) Myanmar
- (b) Philippines

3. Indonesia may still have biggest incentive to improve investment environment for local mining industry compared to other SEA countries

INDONESIA AS A CASE STUDY FOR SEA? – PART IV

4. Other SEA countries

- (a) have suffered significantly greater GDP declines as a result of Covid19 than Indonesia but
- (b) with the exception of Lao and Brunei are much less dependent upon the mining industry than is Indonesia and
- (c) have more favourable foreign investment climates than does Indonesia

5. Unclear whether other SEA countries will pursue wide ranging regulatory reform like Indonesia

6. It may rather be a case of Indonesia needing to “*catch up*” with the rest of SEA

SUMMARY & CONCLUSIONS – PART I

1. New Mining Law and Omnibus Law are “*net*” positives for foreign investment and mining industry
2. Ongoing economic and fiscal crises have forced Government to rethink its priorities at least temporarily
3. New Mining Law and Omnibus Law are good examples of difficult economic times producing better Government policies than in robust economic times

SUMMARY & CONCLUSIONS – PART II

4. Reforms may still not be sufficient to be a “*game changer*”
5. Important residual strategic problems remain unaddressed in Indonesia
6. Probably more a case of Indonesia “*catching up*” with rest of SE Asia than it is of Indonesia being a “*case study*” for how the rest of SE Asia may develop

A grayscale photograph of an industrial facility, likely a water treatment plant. In the background, there are three large vertical storage tanks. The leftmost tank is labeled 'T.101' and 'ISIMAX-VIRM'. The middle tank is labeled 'T.102' and 'ESIMAX-3200'. The rightmost tank is labeled 'T.103' and 'MAN-110 DI'. In the foreground, there is a complex network of white pipes and machinery, including a large horizontal cylindrical tank with a circular logo. The sky is overcast.

Thank You