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BUSINESS Indonesian coal threat

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INDONESIA has quietly become the world's second-largest exporter of coal used to generate electricity and could potentially challenge Australia for the top spot this year, analysts and industry officials say.

But growing domestic demand for energy in Indonesia and stagnating foreign investment have cast doubt on the country's ability to take advantage of expanding demand for coal in its export markets, they say.

Draft laws that could give foreign investors more control over their local ventures are key 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 said in a recent report.

Thermal coal is used mainly in power stations to produce high pressure steam, which then drives turbines to generate electricity.

Indonesian coal is exported around the globe, including to the European Union, the US, 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 per cent of which is exported, Citibank said.

Between January and October coal exports totalled around \$US5.1 billion (\$A6.5 billion) about 32 per cent higher than a year earlier. In that period, its overall exports rose 15 per cent to \$US58.5 billion .

Coal has long been an unfashionable energy source because it is a highly polluting fuel and a major contributor to greenhouse gasses. But improved technology for coal-fired power plants has significantly reduced carbon dioxide output.

And global demand for electricity, driven in part by economic growth in developing countries such as India, are underpinning a strong outlook for global coal demand and pricing, said Professor **George Haley**, director of the Centre 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 capitalise on that strong market.

But restrictive laws and perceived political risk have halted new investments and exploration by major foreign mining and energy firms in Indonesia, analysts say.

Furthermore, President Susilo Bambang Yudhoyono wants to reduce Indonesia's reliance on oil, and increase the role of coal, which could lead to a cap on exports, experts 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 grow to 170 million tons by 2009, but could drop to 160 million tons in 2010, said Indonesian Coal Association Chairman Jeffrey Mulyono.

To counter the projected drop, 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.

But 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 mining companies have limited direct control over investments in Indonesia because they can now invest only in partnership with a domestic company holding mining authorisation from a regional government.

Draft changes to replace the contract system with mining licences are currently before Parliament.

Though the exact nature of the changes is unclear, the government says they will give more control to foreign investors.

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 lawyer at US firm Vinson & Elkins LLP.

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