Indonesia’s Coal Mining Sector: A Silver Lining Behind Dark Clouds

After being highly sought-after and becoming a leading foreign exchange earner through the early 2000s, Indonesia's coal sector has been hit hard in recent years following the fall in commodity prices. There are many factors contributing to the decline of the national coal industry; from over dependence on export markets and the lack of market diversification, to concerns over climate change that have prompted some countries to cut back their coal consumption.

Nevertheless, Indonesia's coal industry is far from over yet. Many expect to see the revival of this commodity in the near future. The Indonesian government’s 35 gigawatts (GW) electricity project, for example, will still rely on coal to increase the nation’s electrification ratio (See Investment in Indonesia’s Electricity Sector; Sparks of Life). This megaproject is expected to sustain demand for coal for decades to come and should play a key role in shoring up demand for domestic coal.

The Joko Widodo administration is currently working hard to improve the investment climate in the coal mining sector by facilitating permits, postponing the increase in royalties, limiting exports and increasing domestic market demand

Once a leading commodity, now struggling to survive

Indonesia’s coal industry underwent rapid expansion from the 1990s as the government sought out alternative sources of energy as their oil resources approached depletion. To encourage investment in coal mining and coal-fired power plants, the Indonesian government reformed the sector to invite both local and international investors through the issuance of coal contract of work (CCOC) and mining business permits (IUPs; See Applying for a Mining License in Indonesia). This set off a coal rush as companies quickly took up the opportunity for quick returns given Indonesia’s advantages as a coal producer, proximity to China, and easily accessible coal in coastal areas thus resulting in lower operational and transportation costs. Indonesian coal’s high calorific content as well as low sulphur content also made it a highly attractive option.

Indonesia swiftly became the fourth largest coal producing country and among the largest coal exporters in the world. The stock prices of the country’s coal companies such as Indika Energy, Bumi Resources and Bukit Asam soared. Coal became a leading commodity and a top foreign exchange earner. Indonesian coal production grew rapidly from 10.7 million tonnes in 1990 to 474 million tonnes in 2013. The country’s coal exports also rose significantly from 4.3 million tonnes or 42.5% in 1990 to 402 million tonnes or 85% in 2013. The majority of Indonesian coal was exported to China, India, Japan, and South Korea. During its heyday, coal accounted for nearly 85% of state revenue derived from the mining sector which reached 24.4 trillion IDR in 2014.
The coal rush came to an abrupt halt; in 2012, after the price of coal peaked at $118.4 USD per tonne in the previous year, the coal price quickly descended. In 2015, coal was sold at $60.1 USD per tonne or shrank nearly 50% from that in 2011. This downward trend continued into the first quarter of 2016 when the price of coal dropped to below $50 USD per tonne. This has led to a decline in production from 96.77 million tonnes in the first quarter of 2015 to 86.63 million tonnes in the same period in 2016. Coal exports also weakened from 79.44 million tonnes to 68.09 million tonnes or down by 14.29%.

The slump in coal price has been attributed to the slowdown of China’s economy (See What China’s Slowdown Means for Indonesia: A Trade Perspective) which forced the country to cut back its energy consumption, particularly coal. Furthermore, the campaign for environmental conservation and global climate change that focused on coal as a key culprit in environmental degradation, air pollution and global warming has prompted many countries to shift towards cleaner energy such as natural gas, wind, solar, and geothermal (See Renewable Energy in Indonesia – A Sleeping Giants). The shale gas and oil revolution has also contributed to a weak coal price as cheap oil has made coal less attractive and led to a flooding of the global market with cheap, underutilised coal from the US market.

**Mismanagement and poor governance**

The crisis experienced by the coal industry in Indonesia in recent years is a result of a decade-long mismanagement and poor corporate governance. This cheap and abundant energy resource which was originally set up to substitute oil in meeting domestic energy needs was intentionally turned into a commodity charged with high royalties and taxes to boost state revenue and economic growth.

Consequently, many private companies opened mines and extracted coal without taking into account the environmental impact. They focused on short-term revenue and failed to develop downstream industries and conduct exploration activities to discover new reserves as well as create new demand; especially in the domestic Indonesian market. Moreover, the industry relied too much on export markets which are limited to a few countries only, namely China, India, Japan, and South Korea. This has made Indonesia more susceptible to the global economic slowdown in coal demand.

As a result, based on estimates from the Indonesian Coal Mining Association (APBI), Indonesia only has 7.3 – 8.3 billion tonnes of coal reserves left as of 2015. These reserves will be expended by 2033 – 2036.

**There is a silver lining behind dark clouds**

The decline in the Indonesian coal industry does not mean that the sector is still not interesting for investment. The Joko Widodo administration is currently working hard to improve the investment climate in the coal mining sector by facilitating permits, postponing the increase in royalties, limiting exports and increasing domestic market demand through the 35 GW power plant project; among others.

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Indonesia continues to present several challenges for companies involved in power generation; not least the need for better coordination and cooperation across the different sectors that play a role in the successful completion of a power plant project.

The 35 GW power project should breathe new life into the struggling coal industry. As the state-owned electricity firm (PLN) allocates 60% or 20 GW to coal-fired power plants, this will in turn create demand for some 166 million tonnes of coal per year starting in 2019. Overall, the Indonesian government will still rely on coal for its energy needs because the ‘black gold’ will still account for 30% of the country’s energy mix by 2025.

Many large-scale coal companies have already taken advantage of this opportunity by constructing mine-mouth steam power plants and becoming Independent Power Producers (IPPs). As well as gaining profits from the sale of electricity, the move will sustain the demand for their coal products for the next 30 years or so.