ASEAN MINING LAW REFORM - IS INDONESIA LEADING THE WAY OR JUST PLAYING CATCH UP?[1][2][3][4][5]

INTRODUCTION

Indonesia introduced numerous reforms of its mining and related laws during 2020 in an endeavor to spur greater investment generally, including from foreign investors.

This reform program was long overdue and undoubtedly received a major "boost" from the economic downturn triggered by the Covid-19 pandemic and the severe impact of the same on Indonesia.

Other ASEAN countries, with mining industries, have also suffered from the economic downturn triggered by the Covid-19 pandemic. Accordingly, it might seem probable that Indonesia's ASEAN "neighbors" will, likewise, be eventually forced to pursue wide-ranging mining and related law reform programs in order to not lose out to Indonesia as a preferred destination for mining industry investment. This, however, depends on whether other ASEAN countries, with mining industries, have as great a need as Indonesia clearly does to make themselves more attractive investment destinations, particularly for foreign investment in their mining industries.

In this article, the writer will consider the issue of whether Indonesia's 2020 mining and related law reform program is really a case of Indonesia leading the way for the rest of ASEAN to follow or is it, instead, just a case of Indonesia belatedly trying to catch up with the rest of ASEAN in terms of what is required, from a government policy perspective, for its mining industry to attract sufficient investment?

BACKGROUND

The attractiveness or otherwise of any country's mining industry, as a destination for investment generally (and, more particularly, foreign investment), is a reflection of various different factors including (i) underlying geological potential, (ii) mineral commodity prices, (iii) security of tenure, (iv) regulatory predictability, (v) data availability and (vi) infrastructure availability (together, "**Critical MI Factors**").

The relative importance of the individual Critical MI Factors is an issue that is the subject of different views. Useful guidance on this issue, however, can be obtained the Fraser Institute of North America's yearly survey of the relative investment attractiveness of different mining

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[1] Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to Stephenson Harwood LLP.
[2] Bill Sullivan is the author of "*Mining Law & Regulatory Practice in Indonesia – A Primary Reference Source*" (Wiley, New York & Singapore 2013), the first internationally published, comprehensive book on Indonesia's 2009 Mining Law and its implementing regulations.
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[5] An earlier version of this article appeared in the January – February 2021 edition of Coal Asia Magazine.

jurisdictions. The survey results are, ultimately, reflected in an Investment Attractiveness Index ("**IAI**"). The IAI is, in turn, a combination of 2 other sub-indexes being the Best Practices Mineral Potential Index ("**BPMPI**") and the Policy Perception Index ("**PPI**").

The BPMPI rates different mining jurisdictions on their geological attractiveness/mineral potential which, broadly speaking, measures the Critical MI Factors of (i) underlying geological potential and (ii) mineral commodity prices while the PPI, broadly speaking, measures the Critical MI Factors of (iii) security of tenure, (iv) regulatory predictability, (v) data availability and (vi) infrastructure availability.

The PPI is described in the 2019 Fraser Institute Survey (which is the most recent Fraser Institute Survey available) as being a composite index that measures the overall policy attractiveness of 76 mining jurisdictions based on survey responses to policy factors that affect investment decisions including (i) uncertainty concerning the administration of current regulations, (ii) environmental regulations, (iii) regulatory duplication, (iv) the legal system and taxation regime, (v) uncertainty concerning protected areas and disputed land claims, (vi) infrastructure, socioeconomic and community development conditions, (vii) trade barriers, (viii) political stability, (ix) labor regulations, (x) quality of the geological database, (xi) security and (xi) labor and skills availability.

It is important to explicitly recognize that the PPI (i) takes into account factors other than security of tenure and regulatory predictability and (ii) is focused on how government policy/public policy affects exploration investment only rather than on how government policy/public policy affects investment in mining industry activities generally including downstream processing and refining of minerals and coal.

The Fraser Institute Survey has, over many years, found that geological attractiveness/mineral potential accounts for about 60% of an individual country's IAI ranking while government policy/public policy accounts for the remaining 40% of an individual country's IAI ranking. According to the 2019 Fraser Institute Survey, the 2019 IAI split was 57.55% for geological attractiveness/mineral potential and 42.45% for government policy/public policy.

Self-evidently, no country can do anything about its underlying mineral potential or lack thereof as this is a "given" determined by evolutionary forces or, somewhat more prosaically, by God. As there can clearly be no traditional mining industry in a country that has no or very little mineral potential, it may be readily acknowledged that mineral potential is the single most important determinant of the attractiveness or otherwise of a particular country's mining industry, something that is borne out by the Fraser Institute's survey results.

There is, likewise, relatively little most countries can do about mineral commodity prices as mineral commodity prices are determined by the global market for mineral commodities – the only exception being where a particular country is the primary source of a certain mineral commodity with no close substitutes.

Security of tenure, regulatory predictability, data availability and infrastructure availability are then left as the only factors that most countries are in a position to materially influence if they want to change investors' attitudes to the local industry.

Data availability and infrastructure availability mean little if potential investors in a country's mining industry are not assured of security of tenure and regulatory predictability. The capital intensive and long-term nature of most mining industry investments are generally understood as being the reasons that potential investors traditionally attach such importance to security of tenure and regulatory predictability when determining whether or not to invest in a particular country's mining industry.

Security of tenure and regulatory predictability are, uniquely, a function of government policy in respect of the mining industry.

Indonesia is something of a paradox when it comes to investors' perceptions of the attractiveness or otherwise of its mining industry as an investment destination. Indonesia has long been recognized as one of the most geologically prospective countries in the world, with a high BPMI ranking in successive Fraser Institute Surveys. At the same time, however, government policy with respect to the Indonesian mining industry has been identified, in numerous studies, as a factor that actively and materially discourages investment (particularly foreign investment) in the Indonesian mining industry, something which is evidenced by its low IAI ranking in successive Fraser Institute Surveys. Issues with lack of security of tenure and chronic regulatory unpredictability are, invariably, sighted as the pre-eminent examples of what is wrong with government policy in respect of the Indonesian mining industry.

Governments, in post 1998 Indonesia, have largely shown little interest in even understanding, far less addressing, investor concerns about government policy with respect to the Indonesian mining industry. This has been particularly the case with regard to foreign investor concerns about government policy with respect to the Indonesian mining industry. The Government attitude and the mind-set has long been "*This is the way we do things here. If you don't like it, don't come*."

We, however, witnessed an important change in the Government's attitude and mind-set, in 2020, towards investor concerns about policies impacting the attractiveness of Indonesia as an investment destination generally, including with respect to the local mining industry. Law No. 3 of 2020 re Amendments to the 2009 Minerals and Coal Mining Law ("**New Mining Law**") and Law No. 11 of 2020 re Job Creation ("**Omnibus Law**") evidence a serious attempt to make Indonesia, including the local mining industry, a more attractive place to invest.

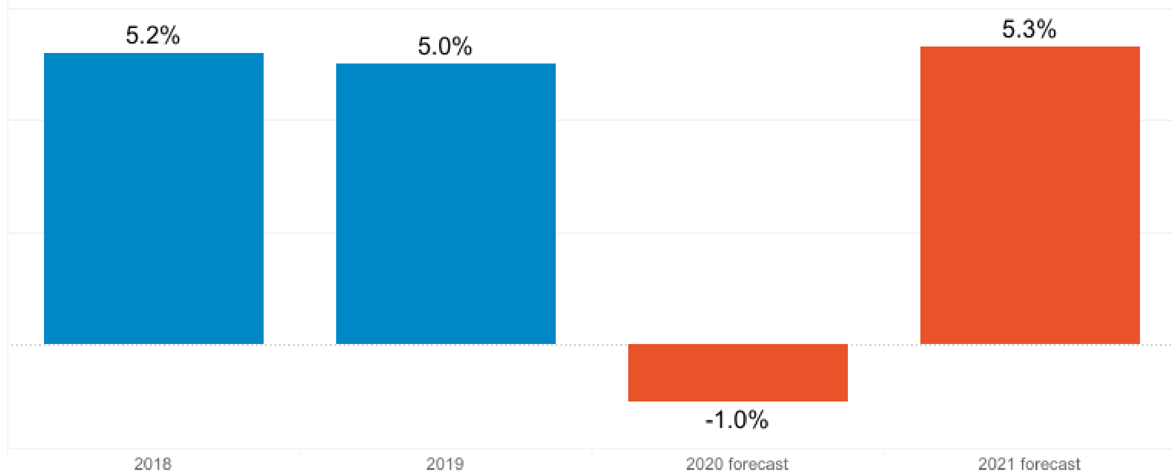
ANALYSIS AND DISCUSSION

1. Impact of Recession on Indonesia

The need for sweeping regulatory reform, not only in respect of Indonesia's mining industry but also in respect of the Indonesian economy as a whole, has long been recognized by international financial institutions and foreign investors, as well as by many policy analysts in Indonesia. It would seem, however, that it has taken the worst economic recession that Indonesia has experienced since the Asian Financial Crisis of the late 1990s to finally compel the Government to "jump-start" the process of making the necessary reforms in a major way and even if hesitant reform moves have actually been feature of the Jokowi administration since 2014.

The following chart, prepared by the Asia Development Bank, shows the economic impact on Indonesia of the recession triggered by the Covid-19 pandemic:

GDP Growth Rate: Indonesia (% per year)



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

The economic impact on Indonesia has been unquestionably severe, with Indonesia's GDP growth rate falling from 5% in 2019 to a projected -1% in 2020. For a country that needs annual GDP growth of 7% or better in order for the economy just to be able to absorb the number of young workers entering the labour market every year, a projected -1% GDP growth rate in 2020 has very serious implications for Indonesia in terms of the number of people living in poverty and the potential for social unrest.

Indonesia's projected 2020 GDP growth rate of -1%, in fact, disguises just how badly the local mining industry was affected, in 2020, by the Covid-19 triggered recession and other factors including, very likely, factors relevant to the Fraser Institute's PPI. The Ministry of Energy & Mineral Resources recently published data showing that Indonesian energy and mining investment declined to its lowest level in 5 years during 2020, shrinking 26.6% year on year to US$24.4 billion. When this data is analysed further, it shows that the drop in mining investment was actually 40% in 2020 while the drop in investment in (i) electricity generation was 42.15%, (ii) renewables was 17.7% and (iii) oil & gas was 6.21%. The likely relevance of PPI factors to these hugely concerning 2020 declines in Indonesian energy and mining investment was alluded to by the Executive Director of the Institute for Essential Services Reform when, as quoted in the 13 January edition of The Jakarta Post, he said in response to the recently released investment realization data:

> "*Investments falling below target due to the pandemic is understandable.* ***But I also see that low investments arose from unresolved issues not related to the pandemic***."

A projected return to GDP growth of 5.3% in 2021 is still going to be far short of what Indonesia actually needs.

Given the above, it is entirely understandable that the Government felt it could not wait any longer to introduce major reforms, in mining and related areas, even if this risked exacerbating existing political divisions among members of the ruling coalition.

2. Overview of Recent Reforms Relevant to Mining Industry Investment

Some only of the more important reforms introduced by the New Mining Law and the Omnibus Law have been:

(a) Increased Central Government control of the mining industry through:

(i) elimination of residual authority of Provincial Governments to issue Mining Business Licenses ("**IUPs**"); and

(ii) integration of IUP issuance with the Online Single Submission System ("**OSS System**") for general business licensing.

(b) Greater legal certainty for major coal producers and major metal mineral producers through:

(i) promised extension of Contracts of Work and Coal Contracts of Work (A) in the form of Special Mining Business Licenses ("**IUPKs**"), (B) valid for up to 20 years, (C) without having to participate in a public auction process and (D) taking into account the need to "*increase State revenue*";

(ii) removing the previous 15,000 Ha limitation on the maximum size of special mining business license areas for coal; and

(iii) making possible, through successive 10 year IUP/IUPK extensions, so-called "*life of mine*" operating rights for IUP/IUPK holders that carry on "*integrated*" mining/coal getting and mineral processing & refining/coal getting & utilization activities.

(c) Encouragement of coal development & utilization activities (so-called "*downstreaming*") by way of offering various incentives including:

(i) potential 0% Production Royalty in respect of the sale/delivery of coal used for coal development & utilization;

(ii) special coal pricing formula; and

(iii) VAT and other tax exemptions/holidays.

(d) Extension of the divestment period for foreign owned IUP/IUPK holders, at the production operation stage, from 5 to 10 years after commercial production commences to become:

(i) 10 to 14 years in the case non-integrated open pit mining;

(ii) 15 to 19 years in the case of integrated open pit mining;

(iii) 13 to 17 years in the case of non-integrated underground mining; and

(iv) 18 to 20 years in the case of integrated underground mining.

(e) Provision for mandatory exploration activity by IUP/IUPK holders (i) every year and (ii) with a minimum annual budget set aside for exploration.

(f) More "streamlined" environmental impact assessment requirements in the form of:

(i) only requiring environmental impact assessments ("**UKL-UPL/AMDAL**") to be undertaken in the case of (A) recognized "*medium risk/high risk*" business activities/operations and (B) having a "*significant impact*" on the environment;

(ii) in the case of companies proposing to carry out business activities/operations that are considered to be "*low risk*", only requiring the submission, as part of the business licensing process, of a statement letter confirming their willingness to carry out environmental management and monitoring;

(iii) UKL-UPL/AMDAL review/approval will now only be carried out by the Central Government while still involving certified experts and representatives from the relevant Regional Government as necessary;

(iv) reduced community involvement in UKL-UPL/AMDAL review/approval process with only "*directly impacted*" communities to be involved; and

(v) Environment Permits will be replaced by seemingly less difficult to obtain Environmental Approvals to be issued through the OSS System and as part of the business licensing process (including IUPs/IUPKs).

(g) Simplification of licensing of access to and use of designated forestry areas for activities such as mining, with the result that:

(i) Rent Use Permits will no longer (A) be issued by the Ministry of Forestry or (B) require approval of the Indonesian Parliament in the case of proposed designated forestry area use with (C) "*significant impact*", (D) "*wide scope*" or (E) "*strategic value*";

(ii) permission to use designated forestry areas will now form part of business licenses (including IUPs/IUPKs) issued through the OSS System; and

(iii) former requirement that a minimum of 30% of designated forestry areas in river basins and on islands must be maintained has been dropped.

(h) Reform of manpower requirements including:

(i) greater permitted flexibility for employment arrangements in the form of removing the previous (i) maximum permitted time limit for so-called

"*defined period/fixed term*" employment contracts and (ii) restrictions on outsourcing of manpower needs; and

(ii) reduced severance package entitlements of terminated workers by way of eliminating the previous (i) 2 X severance payment loading in the case of termination due to efficiency and certain other reasons and (ii) 15% severance payment loading for housing and other benefits.

Readers interested in knowing more about the details of some of the changes mentioned above are referred to the writer's earlier articles on the New Mining Law and the Omnibus Law being (i) "*Omnibus Bill – Likely Big Changes Ahead for Mining Industry*", Coal Asia Magazine, March – April 2020, Petromindo; (ii) "*Proposed Manpower Law Changes – Important Implications for Industry*", Coal Asia Magazine, April – May 2020, Petromindo; (iii) "*Mining Law Changes – Moving in the Right Direction At Last*", Coal Asia Magazine, June – July 2020, Petromindo and (iv) "*Coal Downstreaming – Inconsistencies and Questionable Policy Choices*", Coal Asia Magazine, November – December 2020, Petromindo.

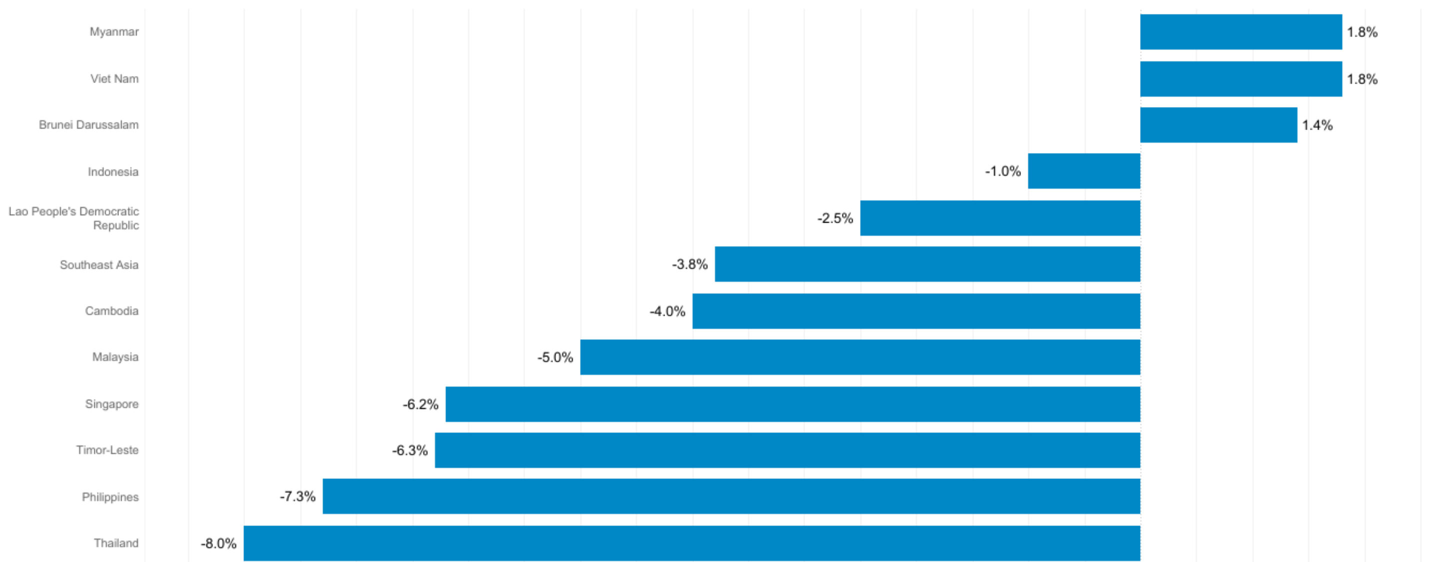
While undeniably comprehensive and broad based, it remains to be seen whether or not the reforms introduced by the New Mining Law and the Omnibus Law are sufficient to attract material new investment for the Indonesian mining industry. Much will depend upon the reform details to be set out in a large number of implementing regulations for the New Mining Law and the Omnibus Law, which implementing regulations are already in advanced draft form and are expected to be finalized and issued during the first quarter of 2021.

3. Economic Incentive for Rest of ASEAN to Pursue Mining and Related Reforms

3.1 **Overview**: Whether or not other countries in ASEAN will feel compelled to follow Indonesia's 2020 lead in pursuing a wide ranging mining law reform agenda, in the aftermath of the economic recession triggered by the Covid-19 pandemic, depends on various considerations including (i) how seriously they have been impacted by the economic recession, (ii) how significant or otherwise, in economic terms, are their local mining industries compared to Indonesia's mining industry and (iii) whether the existing government policy environment for their local mining industries is better or worse than that of Indonesia.

3.2 **Impact of Recession on Other ASEAN Countries**: What is important, for the purposes of this section, is how the economic impact on Indonesia of the recession triggered by the Covid-19 pandemic compares with the economic impact of this recession on other ASEAN countries rather than how serious that impact has been on an ASEAN country specific basis. The following chart, from the Asia Development Bank, provides a useful "snapshot" of how the economies of different ASEAN countries have been affected, in 2020, by the recent recession:

GDP Growth Rate, 2020 forecast (% per year)



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

What is immediately apparent from the above chart is that, with the exception of Myanmar, Vietnam and Brunei (which are all projected to have positive GDP growth rates in 2020), Indonesia's projected 2020 GDP growth rate of -1% is actually considerably better than the projected 2020 GDP growth rates of other ASEAN countries which have projected 2020 GDP growth rates of between -2.5% (Lao) and -8% (Thailand).

To the extent it was the economic impact on Indonesia of the Covid-19 triggered recession that was the immediate "catalyst" for why the 2020 reform agenda pursued by the Government has been so comprehensive and broad based, it might be thought the fact that most other ASEAN countries have been more severely impacted by the recession than has been Indonesia means that they have at least as great an economic incentive as Indonesia to pursue far reaching reform including reform of policies related to the mining industry. Whether or not this is true, however, depends on the **other 2 considerations** identified in 3.1 (ii) and (iii) above.

3.3 **Relative Economic Importance of Mining Industry in Indonesia and other ASEAN Countries**: The following chart shows the relative importance, expressed as rankings in a so-called "Mining Contribution Index" ("**MCI**"), of the local mining industry in different ASEAN countries including Indonesia.

5th Edition Mining Contribution Index (MCI): ASEAN member states (based on 2016 to 2018 data)

Country	**5th edition MCI Rank** (out of 183 countries)	**5th edition MCI Score** (out of 100)	**Metallic, mineral, metals & coal export contribution 2018** (% of exports)	**Increase/decrease in mineral and metal export contribution between 2013-2018 (perc. points)**	**Metallic mineral & coal production value 2018** (% of GDP)	**Mineral rent 2018** (% of GDP)
Myanmar	24	73.8%	11.0%	2.7 pp	2.03%	1.26%
Indonesia	**34**	**69.8%**	**21.3%**	**-0.1 pp**	**5.68%**	**1.12%**
Philippines	42	65.7%	7.3%	0.1 pp	2.10%	0.99%
Lao P.D.R	49	62.4%	22.6%	-15.3 pp	6.56%	5.25%
Thailand	68	52.4%	4.6%	0.7 pp	0.43%	0.02%
Malaysia	74	51.2%	4.7%	1.2 pp	0.06%	0.04%
Vietnam	99	41.4%	1.4%	-0.2 pp	0.16%	0.28%
Singapore	120	34.4%	4.0%	0.3 pp	-	0.00%
Brunei Darussalam	153	20.8%	0.4%	0.1 pp	-	0.00%
Cambodia	170	15.8%	1.8%	-0.4 pp	0.00%	0.00%

Source: International Council on Mining and Minerals. The role of mining in national economies: mining contribution index, 5th ed., supplement

As explained by the International Council of Mining & Metals, in the 5th (and most recent) edition of "Ro*le of Mining in National Economies*", the MCI synthesises into a single number (and an associated ranking) the significance of the local mining industry of 183 different countries to the national economy of the relevant country. The MCI is intended to provide an indication, according to various different metrics, of the relative importance of mining to the economic life of a country. The metrics used are:

(a) mineral and metal export contribution 2018 (a measure of the scale of mining in relation to other production activities);

(b) increase/decrease in mineral and metal export contribution between 2013 – 2018 (an indication of whether the importance of mining as an economic activity is rising or falling over a 5 year period);

(c) mineral production value expressed as a percentage of GDP in 2018 (a measure of the scale of production relative to the size of the economy); and

(d) mineral rents as a percentage of GDP in 2018 (this is production values minus "normal" costs, which is said to provide a clearer indication of tax and profit above "normal" profits from mining).

Indonesia's 5th ed. MCI ranking of 34 out of 183 countries and its 5th ed. MCI score of 69.8 means the Indonesian mining industry is significantly more important, overall and in terms of the contribution it makes to the national economy, than is the mining industry of any other ASEAN country with the exception of Myanmar which has a 5th ed. MCI ranking of 24 out of 183 countries and a 5th ed. MCI score of 73.8.

3.4 **Relative Need for Government Policy Reform in respect of Mining Industry**: Indonesia's score of 47.74 (out of a possible maximum score of 100) in the Fraser Institute's 2019 PPI puts it in 64th place or 12th from the bottom out of the 76 mining jurisdictions surveyed. Although Indonesia's PPI ranking showed some improvement in 2019, 2018 and 2017, after an all time low score of 29.93 or 99th place out of 104 countries in 2016, Indonesia's PPI score for 2019 still means that international mining company perception, of Indonesian government policy with respect to the local mining industry, remains hugely unfavourable. To put this in context, Indonesia only ranked ahead, in the 2019 PPI, of Mali, Nicaragua, La Roja, Guinea, Zambia, Democratic Republic of Congo, Bolivia, Mendoza, Chubut, Tanzania, Zimbabwe and Venezuela. Self-evidently, these are hardly mining jurisdictions that the Government is likely to be pleased (far less proud!!) to see Indonesia compared with. At the risk of stating the obvious, 12th from the bottom of the 2019 PPI is most definitely **not** where Indonesia needs or wants to be if it is serious about encouraging more foreign investment in its mining industry.

The 2019 Fraser Institute Survey is particularly relevant as this was the year immediately before the Government introduced its ambitious 2020 reform program with the passage of the New Mining Law and the Omnibus Law.

No ASEAN country, other than Indonesia, was included in the 2019 Fraser Institute Survey. Accordingly, it is not possible to directly compare Indonesia's 2019 PPI ranking with that of other ASEAN countries. The writer would, though, suggest it is unlikely that, with the possible exception of Myanmar (the 1994 Mines Law of which jurisdiction the writer has previously done extensive work on), any other ASEAN country would have had a lower 2019 PPI ranking than Indonesia even if it had had been included in the2019 Fraser Institute Survey.

3.5 **Assessment**: Indonesia's (i) high 5th ed. MCI ranking, compared to other ASEAN countries (with the exception of Myanmar), and (ii) low 2019 PPI ranking goes a long way to explaining why the Government devoted so much time and effort, in 2020, to mining law and related reform. The (i) importance of the contribution the local mining industry makes to the Indonesian economy and (ii) the perceived very serious government policy-related problems affecting the local mining industry mean that the Government simply could not afford, any longer, to ignore the need for regulatory reform in respect of the local mining industry and the wider economy.

While Indonesia is suffering relatively less from the Covid-19 triggered economic recession than many other ASEAN countries, disastrous economic performance alone is not likely to be sufficient, by itself, to cause other ASEAN countries to focus as much attention, as Indonesia has done, on mining and related law reform.

Other ASEAN countries may well need to pursue reforms in order to address the consequences of the Covid-19 triggered recession. However, with the possible exception of Myanmar, mining law reform is likely to be much less of a priority for them because (i) the mining industries of these other ASEAN countries make significantly smaller contributions to national economic performance than is the case in Indonesia and (ii) government policy towards the local mining industries in these other ASEAN countries has not been so widely perceived, by foreign investors, as

wholly inadequate and deficient. Logically, any reforms initiated by other ASEAN countries will be focused on the industry sectors that are most important to their individual economies. Mining is not one of those industry sectors for other ASEAN countries apart from Myanmar.

SUMMARY & CONCLUSIONS

Indonesia's 2020 mining law and related reforms are undeniably significant and, in some respects, praiseworthy.

Indonesia, however, has a much greater economic need and investment incentive, than do its fellow ASEAN members (with the possible exception of Myanmar), to overhaul its mining regulatory regime in order to address long standing problems. It would, accordingly, be a mistake to assume that the ambitious and wide-ranging mining and related law reform agenda that Indonesia pursued in 2020 will necessarily be followed, any time soon, by other ASEAN countries.

Put in their proper perspective, the 2020 mining law and related reforms are probably less an indication of Indonesia leading the reform agenda in ASEAN than they are of Indonesia having to "play catch up" with the rest of ASEAN when it comes to protecting one of its most important industries and ensuring that it does not fall even further behind other ASEAN countries as a desirable investment destination for investment, particularly foreign investment in mining.

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This article was written by Bill Sullivan, Senior Foreign Counsel with Christian Teo & Partners and Senior Adviser to Stephenson Harwood LLP. Christian Teo & Partners is a Jakarta based, Indonesian law firm and a leader in Indonesian energy, infrastructure and mining law and regulatory practice. Christian Teo & Partners operates in close association with international law firm Stephenson Harwood LLP which has ten offices across Asia, Europe and the Middle East: Beijing, Dubai, Hong Kong, London, Paris, Piraeus, Seoul, Shanghai, Singapore and Yangon.

Get in touch

Bill Sullivan

T: +62 21 5020 2789
M: +62 815 8506 0978
E: bsullivan@cteolaw.com

Christian Teo

T: +62 21 5020 2789
M: +62 818 124 747
E: cteo@cteolaw.com

Claudius Novabianto

T: +62 21 5020 2789
M: +62 818 0858 9235
E: cnbianto@cteolaw.com