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### THE EXPORT BAN AS FINALLY INTRODUCED – A GRAND COMPROMISE WITH MUCH RESIDUAL UNCERTAINTY<sup>12345</sup>

#### INTRODUCTION

With just a few hours to go, the Government finally made its decision on how the long proposed export ban on unprocessed mineral products (“**Export Ban**”) would be applied and enforced as of 12 January.

Following a late night “huddle” at the private residence of the President, a “**Grand Compromise**” was reached which seeks to avoid the worst of the likely economic consequences of a full and immediate imposition of the Export Ban over all metal mineral classes while still providing sufficient incentives for the promoters of more promising smelter projects to proceed with their plans.

Only time will tell whether or not the Grand Compromise delivers the intended result.

It would be hard to overstate in what a “poor light” the handling of the introduction of the Export Ban has shown the process of Government policy making (or, perhaps more accurately, the lack thereof) with regard to the local mineral and resources sector.

The terms of the Grand Compromise are set out in (i) a press release from MoEMR on 13 January at 1 PM (“**13 January Press Release**”), (ii) Government Regulation No. 1 of 2014 re Increase of Mineral Value Added Through Domestic Processing & Refining (“**GR 1/2014**”) and (iii) MoF Regulation No. 6 of 2014 re Determination of Export Goods that are subject to Export Duty and the Export Duty Tariff (“**MoFR 6/2014**”). GR 1/2014 and the MoFR 6/2014 have just become available as of the deadline for submission of this article to the publisher.

Notwithstanding the lack of any time to study GR 1/2014 and MoFR 6/2014 in great depth, the writer will endeavor to explain his understanding of the Grand Compromise and likely implications of the same. This explanation may need to be reviewed and augmented once a more detailed study of GR 1/2014 and MoFR 6/2014 is possible.

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## COMMENTARY

### 1. Overview of the Grand Compromise

- 1.1 **Different Treatment for Different Minerals**: The Government has sought to distinguish between (i) those metal minerals which it is not realistic to currently expect any greater level of domestic processing and refining than is already taking place (“**Category 1 Minerals**”) and (ii) those metal minerals which it is realistic (at least in the mind of the Government) to currently expect a greater level of domestic processing and refining than is already taking place (“**Category 2 Minerals**”).

Category 1 Minerals will be allowed to be exported, after 12 January, in “concentrate form”; that is, so long as a specified minimum level of processing and refining has been carried out and which minimum level of processing and refining is substantially less than that originally mandated by the Government in 2012 as part of MoEMR Regulation No. 7 of 2012 re Local Processing & Refining of Minerals (“**MoEMRR 7/2012**”).

Category 2 Minerals will only be allowed to be exported, after 12 January, if the full minimum level of processing and refining originally mandated by the Government in 2012 is carried out.

Substantially, the Government has compromised on the level of processing and refining required for Category 1 Minerals but has offered no compromise in the case of Category 2 Minerals.

- 1.2 **Category 1 Minerals**: The Category 1 Minerals are primarily copper but also include iron ore, manganese, lead, zinc, ilmenite and titanium.

GR 1/2014 specifies new and much reduced minimum required levels of processing and refining for Category 1 Minerals as follows:

<b><u>Mineral</u></b>	<b><u>2012 Requirement</u></b>	<b><u>2014 – 2017 Requirement</u></b>
Copper	99%	15%
Iron Ore	80/88%	62%
Manganese	60/98/99%	49%
Lead	99.85%	57%
Zinc	90%	52%
Ilmenite	98%	56%
Titanium	94%	58%/56%

The reduced minimum required level of processing and refining for copper is particularly significant as it will enable Indonesia’s 2 largest copper producers, Freeport and Newmont, to continue exporting copper concentrate without having to undertake any further domestic processing and refining as, so the writer understands, they already meet the new 15% requirement.

It is probably the case that the reduced minimum required level of processing and refining for Category 1 Minerals is only temporary and that, by January 2017, the much higher, 2012 specified levels of processing and refining for Category 1 Minerals will have to be met. This is strongly indicated in Point 7 of the 13 January Press Release and Article 12(5), (15) and (16) of GR 1/2014.

It also may be the case that the right to export Category 1 Minerals, in concentrate form, for the next 3 years is not absolute but, rather, is dependent upon the relevant Category 1 Mineral producer obtaining a recommendation from the Director General of Minerals & Coal which recommendation will only be issued if the relevant Category 1 Mineral producer can show, among other things, development plans which will eventually ensure full domestic processing and refining. Article 12(6) to (14) of GR 1/2014 appear to contemplate a continuation of the pre-12 January approval and recommendation procedures for export of unprocessed mineral products in the case of partially processed Category 1 Minerals albeit with some modifications.

- 1.3 **Category 2 Minerals:** The Category 2 Minerals are primarily nickel, bauxite, tin, gold, silver and chromium as well as, most probably, all the remaining 65 mineral products originally specified by the Government in MoEMRR 7/2012 as being subject to the Export Ban and which are not otherwise Category 1 Minerals.

Of the Category 2 Minerals, nickel and bauxite will be most affected by GR 1/2014 as there are a large number of small and medium size nickel and bauxite producers which, currently, carry out little or no domestic processing and refining. Nickel and bauxite producers actively lobbied the Government for much reduced minimum required levels of processing and refining, along the lines of those reduced levels allowed for Category 1 Minerals, but this was not accepted by the Government.

In the run up to the 12 January start date for the Export Ban, it was widely reported that producers of Category 2 Minerals would be allowed to continue exporting unprocessed mineral products until 2017 so long as they could show a “firm commitment” to carrying out full domestic processing and refining by not later than January 2017. The Government finally decided, however, that there will be no 3 year extension of the start date for full domestic processing and refining for Category 2 Minerals. Accordingly, all exports of unprocessed Category 2 Minerals should have stopped as at 12 January, thereby obliging producers of Category 2 Minerals to immediately begin carrying out full domestic processing and refining of their mineral products if they want to maintain their export business.

- 1.4 **Continuation of Export Tax:** The Government intends to continue to impose an “Export Tax” on Category 1 Minerals until such time as producers of the same meet the minimum required levels of processing and refining specified in 2012, something which, at this stage, must happen before January 2017.

MoFR 6/2014 indicates that the Export Tax on Category 1 Minerals will now be a “progressive” tax in the sense that the applicable rate of the Export Tax will be increased every 6 months, starting in 2015, until it reaches 60% in the second half of 2016. The applicable rates of Export Tax payable in respect of the different Category 1 Minerals are as follows:

No.	Category 1 Mineral	Export Tax Rate (% total sales one-time export)					
		2014		2015		2016	
		H1	H2	H1	H2	H1	H2
1.	Copper concentrate ( $\geq 15\%$ Cu)	25%	25%	35%	40%	50%	60%
2.	Iron concentrate ( $\geq 62\%$ Fe)	20%	20%	30%	40%	50%	60%
	Iron concentrate ( $\geq 51\%$ Fe & $\geq 10\%$ Al <sub>2</sub> O <sub>3</sub> +SiO <sub>2</sub> )	20%	20%	30%	40%	50%	60%
3.	Manganese concentrate ( $\geq 49\%$ Mn)	20%	20%	30%	40%	50%	60%
4.	Lead concentrate ( $\geq 57\%$ Pb)	20%	20%	30%	40%	50%	60%
5.	Zinc concentrate ( $\geq 52\%$ Zn)	20%	20%	30%	40%	50%	60%
6.	Ilmenite concentrate ( $\geq 58\%$ sand iron & $56\%$ pellet)	20%	20%	30%	40%	50%	60%
	Titanium concentrate ( $\geq 58\%$ sand iron & $\geq 56\%$ pellet)	20%	20%	30%	40%	50%	60%

Source: Finance Ministry

MoF has been quoted as saying that the progressive nature of the Export Tax is “a form of punishment for companies that do not have mineral-processing smelters in the archipelago” (Wednesday 15 January edition of The Jakarta Post). Perhaps less controversially, MoFR 6/2014 is also said to be intended to provide an incentive for Category 1 Mineral producers to build local smelters and otherwise carry out full domestic processing and refining as soon as possible before January 2017, being the new deadline for meeting the minimum required levels of processing and refining specified in 2012.

It seems reasonably certain that producers of Category 2 Minerals cannot continue to export unprocessed Category 2 Minerals after 12 January even if they are otherwise prepared to pay the Export Tax in accordance with MoFR 6/2014.

- 1.5 **No Distinction between CoW Producers and IUP Producers:** The 13 January Press Release indicates that the Government does not see any distinction between CoW producers of metal minerals and IUP producers of metal minerals. Point 8 of the 13 January Press Release unequivocally states that both CoW producers of metal minerals and IUP producers of metal minerals are prohibited from exporting unprocessed mineral products after 12 January.
- 1.6 **Lack of Clarity:** Even a cursory reading of GR 1/2014 causes the writer to be very concerned that a number of provisions of GR 1/2014 are hard to understand and, possibly, contradictory having regard to the apparent intention of the Grand Compromise. This is, perhaps, not surprising given the circumstances in which the Grand Compromise was arrived at and GR 1/2014 was finalized. The writer will address these apparent textual problems with GR 1/2014 in a later article if the same are ultimately determined to be material.
2. **Assessment of the Grand Compromise**
- 2.1 **Special Treatment for Category 1 Mineral Producers:** Reports in the popular press have tended to see the reduced minimum required level of processing and refining for Category 1 Minerals and, more particularly, for copper as reflecting a “cave-in” to the demands of the major CoW producers and, especially, of Freeport and Newmont. The spokesman for the Association of Indonesian Mining Professionals was quoted in the 10 January edition of The

Jakarta Post as saying “the purity level adjustment shows the Government’s weakness”. Strident nationalist sentiment is, apparently, never far away in Indonesia when Freeport and Newmont take a public position on any issue. In the writer’s view, however, this is a mistaken interpretation of the Grand Compromise.

It is important to bear in mind that the objective of the domestic processing and refining obligation and, hence, of the Export Ban was always said to be to ensure that Indonesia and Indonesians, as a whole, derived more benefit from the local mining industry than has supposedly been the case in the past. To the extent the Government has now belatedly come to recognize the overwhelmingly negative economic consequences, in terms of lost jobs in the mining sector, of the full application of the Export Ban to Category 1 Minerals, the Government is merely acting in the best interests of the country in providing special treatment for Category 1 Mineral Producers. Accordingly, seen from this perspective, the Grand Compromise simply ensures that, as far as it relates to Category 1 Minerals, Indonesia and Indonesians, as a whole, do not derive even less benefit from the local mining industry than has supposedly been the case in the past.

While Category 1 Mineral producers may be concerned about the new 2017 deadline for the enforcement of the 2012 domestic processing and refining requirements for Category 1 Minerals and a progressively increasing Export Tax in the interim, both these events are still, in political and real world terms, a long way off and much can happen in the meantime. With a new Government to be installed in October this year, it is impossible to predict what will happen, in terms of mining industry policy and regulation, in 2015 far less in 2016 or 2017. In this regard, Category 1 Mineral producers may well be inclined see the new 2017 deadline for the enforcement of the 2012 processing and refining requirements for Category 1 Minerals as being equivalent to a substantial extension of the time to expiry of an option in terms of the right to continue or not continue producing Category 1 Minerals after 2017. The further in the future the expiry date, the more valuable the option.

- 2.2 **No Special Treatment for Category 2 Mineral Producers:** It is probable that the Government rejected the requests of nickel and bauxite producers for a reduction in the minimum required levels of processing and refining for nickel and bauxite on the basis that these are the 2 metal minerals in respect of which there has, apparently, been the greatest interest, from international companies, in building local smelters. Any reduction in the minimum required levels of processing and refining for nickel and bauxite could well have changed the economics of the proposed smelting facilities and, arguably, made it less likely the same would proceed.

The writer assumes that it was also concern over the likely adverse reaction of international companies, which have expressed interest in building local nickel and bauxite smelters, which caused the Government to “backtrack”, at the last minute, on its previously announced plan to allow Category 2 Mineral producers to keep exporting unprocessed mineral products, until 2017, so long as they could shown a “firm commitment” to carrying out full domestic processing and refining by not later than 2017. Would these international companies have had any or sufficient confidence in the Government’s ability and willingness to actually deliver on a revised 2017 deadline for domestic processing and refining in the case of Category 2 Minerals

if it was not able and willing to do so in 2014? In the absence of that sufficient level of confidence, construction of domestic smelters for nickel and bauxite would almost certainly not proceed.

Insisting upon a “firm commitment” to carry out full domestic processing and refining, by not later than 2017, was always going to be an exercise fraught with problems. After all, producers of both Category 1 Minerals and Category 2 Minerals were not meant to be able to export unprocessed mineral products after May 2012 unless they could establish, among other things, that they had “definite plans” in place which would enable them to commence domestic processing and refining come January 2014. Clearly, these “definite plans” have proved to be wholly illusory in most cases. As such, it is hard to see how a “firm commitment” would have made it any more likely that Category 2 Mineral producers would have actually commenced domestic processing and refining by a revised deadline of January 2017.

2.3 **Rationalizing the Different Treatment of Category 1 Mineral Producers and Category 2 Mineral Producers:** Looked at in somewhat cynical terms, the Grand Compromise of providing special treatment for Category 1 Mineral producers but not for Category 2 Mineral producers is simply how the Government has chosen to finally resolve the policy dilemma which the writer discussed at length in his December 2013 – January 2014 article. The early construction of new domestic smelters for Category 1 Minerals and, more particularly, for copper is unlikely under any scenario and, therefore, not allowing the continued export of only partially processed and refined Category 1 Minerals is counter-productive such that Category 1 Mineral producers might as well be allowed to keep exporting only partially processed and refined Category 1 Minerals. On the other hand, the construction of new domestic smelters for Category 2 Minerals and, more particularly, for nickel and bauxite is far more likely given the right incentives and, therefore, allowing the continued export of unprocessed or only partially processed and refined Category 2 Minerals is counter-productive such that Category 2 Mineral producers should not be allowed to keep exporting unprocessed or only partially processed and refined Category 2 Minerals if this will discourage new smelter construction. Although this means that, at least in the short to medium term, Category 2 Mineral producers bear the brunt of the domestic processing and refining burden for the mining industry as a whole, while Category 1 Mineral producers largely escape the domestic processing and refining burden altogether, the Grand Compromise makes some sense, at least from the Government’s perspective, in terms of maximizing the chances of some overall increase in domestic processing and refining taking place with minimum adverse economic consequences for the country. A similar analysis was surely employed by the Government, in 2010, when it decided not to impose any domestic processing and refining obligation at all on coal despite such an obligation being clearly provided for in Article 102 of the 2009 Mining Law.

Notwithstanding the foregoing rationale for the differential treatment of Category 1 Mineral producers and Category 2 Mineral producers as part of the Grand Compromise, Category 2 Mineral producers undoubtedly have considerable grounds for complaint as to how they have been treated. First, it is clearly impossible for any Category 2 Mineral producer, which was not already carrying out full domestic processing and refining as of 12 January, to immediately start carrying out full domestic processing and refining so as to save its export business. Second, in the case of small and medium size Category 2 Mineral producers, which never

intended to carry out their own domestic processing and refining but, rather, were always going to rely on third party service providers to handle domestic processing and refining of their production (as is clearly allowed for by Articles 12 to 14 of MoEMRR 7/2012 and by Article 6 of GR 1/2014), why should they be penalized merely because the contemplated third party service providers have not materialized? Third, although the Category 2 Mineral producers are still free to sell their unprocessed mineral products in the local market, domestic demand is small or non-existent for most Category 2 Minerals thereby effectively putting all the Category 2 Mineral producers out of business overnight except in the case of those Category 2 Mineral producers, if any, which have already built smelters. It would, perhaps, not be surprising then to see small and medium size Category 2 Mineral producers challenging in the courts the validity of all or part of GR 1/2014 and the Grand Compromise.

- 2.4 **CoW Producers and IUP Producers as One:** As the writer pointed out in his December 2013 – January 2014 article, it is by no means clear that, notwithstanding the wording of Article 170 of the 2009 Mining Law, CoW holders are automatically subject to the same domestic processing and refining requirements applicable to IUP producers given the special legal status of CoWs and the as yet uncompleted CoW renegotiations. Presumably, if the Government was confident that the domestic processing and refining obligation already automatically applied to CoW holders, by virtue of the operation of the 2009 Mining Law, it would not have made inclusion of the domestic processing and refining obligation 1 of the 6 key amendments which it is currently seeking to make to every CoW. The reluctance of many CoW holders to accept the inclusion of an express domestic processing and refining obligation in their amended CoWs has, supposedly, been 1 of the main reasons for the delay in concluding the long running CoW renegotiations.

During the period immediately prior to 12 January, the major CoW producers, very noticeably, refrained from publicly denying the applicability to them of the Export Ban on the basis that the special legal status of their CoWs meant that the underlying domestic processing and refining obligation only applied to IUP holders. Instead, the major CoW producers preferred to simply highlight the potentially disastrous employment consequences of the Export Ban. This was, most likely, because Government and public concern over the claimed potential loss of employment, for tens of thousands of workers in the local mining industry, was seen as a much more effective way to challenge the Export Ban, in the “court” of public opinion, than relying on arcane arguments as to “lex specialis”. Of course, it is also possible that the major CoW producers have simply decided that, at the end of the day, they are not going to be able to avoid domestic processing and refining regardless of the legal merits of their arguments that the 2009 Mining Law imposed domestic processing and refining obligation cannot and should not automatically apply to CoW holders. This alternative explanation, however, seems inherently improbable to the writer given the CoW renegotiations are still ongoing and the CoW holders would, presumably, not want to give up, in advance and without getting “something” in return, any “bargaining chip” in those renegotiations. Perhaps, though, that “something” may be the much reduced minimum required levels of processing and refining that now apply to Category 1 Minerals until 2017.

2.5 **The Progressive Nature of the Export Tax:** Describing the “progressive” Export Tax as “punishment” would seem to reflect a most unfortunate mindset on the part of MoF and the Government with regard to the position of the Category 1 Mineral producers. The Category 1 Mineral producers have not built local smelters because it makes no economic sense to do so. As profit focused commercial ventures, the Category 1 Mineral producers can hardly be expected to ignore the economic consequences of their investments as they have a duty to maximize the return to their shareholders.

It also seems inherently unlikely to the writer that the progressive Export Tax will have the desired effect of providing an incentive to the Category 1 Mineral producers to quickly build local smelters. If local smelters for Category 1 Minerals made no economic sense prior to 12 January, local smelters for Category 1 Minerals are still not going to make any economic sense after 12 January and in the face of a punitive, progressive Export Tax. The only impact of MoFR 6/2014 is likely to be to make the continuation of operations by Category 1 Mineral producers increasingly unattractive and, accordingly, discourage further investment generally by Category 1 Mineral producers.

Rather than seeking to “punish” Category 1 Mineral producers with a punitive, progressive Export Tax, the focus of MoF should, arguably, have been on providing tax relief and other forms of subsidies to Category 1 Mineral producers so as to help overcome the negative economic profile of local smelters for Category 1 Minerals.

2.6 **The Export Tax and CoW Holders:** It will be interesting to see whether or not those Category 1 Mineral producers, which are CoW holders, challenge their Government assumed liability to pay the progressive Export Tax. CoW holders have long maintained that they are only liable for those taxes specifically mentioned in their CoWs. The writer is not aware of any CoW generation which specifically mentions an Export Tax. Although MoF has simply chosen to ignore this issue in the drafting of MoFR 6/2014, the Government is clearly aware of its significance as indicated by the fact that 1 of the 6 key CoW amendments which the Government is currently trying to negotiate is acceptance by CoW holders of submission to the Indonesian tax regime which applies from time to time. Unless and until this proposed amendment is accepted by CoW holders, the punitive, progressive Export Tax may well be simply irrelevant to all those Category 1 Mineral producers which are CoW holders.

2.7 **The Failure of Government Policy Making:** While the Grand Compromise may be seen, to some extent, in a fairly positive light (unless, of course, one happens to be a Category 2 Mineral producer!!), the way in which the Government has handled the whole issue of the Export Ban and the underlying domestic processing and refining obligation, is a serious indictment of the current approach to government policy making in Indonesia. Leaving it until late evening, on the day immediately before the Export Ban was to take effect, to decide what to do about the future of the Export Ban and the underlying domestic processing and refining obligation is almost impossible to justify when the domestic processing and refining obligation was introduced 5 years ago and the Export Ban was introduced 2 years ago. It really was almost “1 minute to midnight” before the Grand Compromise materialized and GR 1/2014 was finalized.

The economic rationale for domestic processing and refining, in respect of each of the different minerals produced by Indonesia, should have been carefully studied before the domestic processing and refining policy became law in 2009. Such a pre-2009 study would have, presumably, shown that full domestic processing and refining of most Category 1 Minerals cannot be justified from an economic perspective and, yet, such economic viability was just blithely assumed to be the case by the DPR and the Government. Indeed, it was not until 2013 that USAID carried out the first comprehensive economic analysis of domestic processing and refining which, as the writer has reported at length on in a previous article, highlighted the inherent fallacy of insisting upon domestic processing and refining for most of Indonesia's main metal mineral products as a way of ensuring that Indonesia and Indonesians, as a whole, derived more benefit from the local mining industry than they have supposedly done in the past. Similarly, the likely economic consequences of the Export Ban should have been fully and thoroughly assessed before the Export Ban was announced in 2012. Finally, the minimum needs, in terms of legal certainty as to the Export Ban being imposed and enforced, of international companies, willing and able to build local smelter facilities, should have been determined long before 12 January.

It would be good to think that the Government and the DPR might have learnt a valuable lesson from the Export Ban fiasco in terms of the need for a more thorough and careful approach to policy making in future. Unfortunately, as similar policy debacles are, at present, all too common an occurrence in many different sectors of the Indonesian economy, any "valuable lesson learnt" assessment seems inherently unjustified.

## **SUMMARY AND CONCLUSIONS**

In the course of 5 years, domestic processing and refining has gone from being an obligation of general applicability to all mineral and coal producers in Indonesia to being an obligation which, at least in the medium term, only applies to Category 2 Mineral producers and, for all intents and purposes, just to nickel and bauxite. Essentially, Category 2 Mineral producers are now "carrying the burden" of domestic processing and refining for the Indonesian mining industry as a whole and even though exports of Category 2 Minerals amount to substantially less than 10%, by value, of Indonesia's total mineral exports.

The Grand Compromise was patched together by the Government, at the last minute, to save the country from the, potentially, very serious economic consequences of insisting upon full domestic processing refining now as contemplated by MoEMRR 7/2012. At the same time, the Grand Compromise ensures that the Export Ban does not become a total non-event and the substantial "roll back" of domestic processing and refining is not too obvious.

Notwithstanding the wholly deficient policy making process evidenced by the overall handling of the Export Ban, the Government's last minute Grand Compromise does make some kind of sense in terms of its implicit acknowledgment that the construction of smelters for Category 1 Minerals is not realistic in the short to medium term while, at the same time, preserving the incentive for international companies to proceed with the supposedly much more promising smelter projects for Category 2 Minerals.

Although some aspects of the Grand Compromise make sense, the punitive, progressive Export Tax seems to be totally misconceived and counter-productive. Rather than providing the necessary incentive for Category 1 Mineral producers to build local smelters, the more likely outcome is to discourage all further investment by Category 1 Mineral producers as their operations become increasingly less profitable as the Export Tax rate increases. MoFR 6/2014 may be seen as an attempt by the Government to convince the electorate, in the run up to this year's parliamentary and presidential elections, that Indonesia will still extract maximum benefit from Category 1 Mineral producers even if the Government has backed away from insisting upon full domestic processing and refining for Category 1 Minerals by 12 January. In fact, unless and until the ongoing CoW renegotiations are concluded in the Government's favor, the Export Tax will, arguably, not apply at all to those Category 1 Mineral producers which are CoW holders.

With a new Government to be installed in October and the new deadline for full domestic processing and refining of Category 1 Minerals 3 years away, the writer would not be placing any large bets on full domestic processing and refining of Category 1 Minerals ever becoming a reality. A lot can change in 3 years and under a new Government.

As far as the Government is concerned, the Category 2 Mineral producers are really just "collateral damage" and the overnight cessation of their export business a "reasonable price" to pay for the Government being able to maintain some semblance of its domestic processing and refining policy so close to parliamentary and presidential elections.

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