

## Our View: The First Rat Jumps from the IMO 2020 Ship

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July 29, 2019

Indonesia announced last week that it would not enforce the upcoming IMO 2020 rule requiring marine vessels to burn bunker fuels containing no more than 0.5 percent sulfur on its domestic shipping fleet.<sup>1</sup> The country thereby became the first “rat” to jump from the IMO ship.

Indonesia’s actions may have a noticeable impact on at least the Asian bunker fuel market. According to Reuters, the country made its decision in reaction to the high cost of new, cleaner fuels. Instead of complying with the IMO mandate, Indonesian-flagged vessels can keep burning high-sulfur fuels within Indonesian markets. Reuters added that this policy would continue until the domestic supply of low-sulfur fuel increases. As one official stated, “We always put forward national interest as consideration [sic] in making the decision.”

An article in *Manifold Times*, which claims to be Singapore’s first local bunker publication, provided further details on Indonesia’s decision.<sup>2</sup> According to an *MT* interview with shipbroker Albert Susilo, the decision makes sense given the following operational and commercial factors affecting Indonesia:

First, Indonesian ships are probably not ready to shift to low-sulfur fuels. Most are between fifteen and thirty years old. In many cases, the engines and other equipment were manufactured by firms now out of business, which makes it difficult to get information on the upgrades needed to switch to low-sulfur fuel.

Second, Indonesian shipowners have already experienced difficulties with a 2019 Indonesian rule requiring ships to use a diesel blend that contains twenty-percent biodiesel (FAME). The switch to FAME provides a market for renewable fuel produced in Indonesia.

Third, the country’s shipping industry is self-contained. Most vessels in the local fleet do not leave Indonesian waters. Susilo noted that there are five hundred sixty active oil tankers moving product around the country.

Also, Indonesia’s energy policy is focused on energy independence. The country does not import high-sulfur fuel oil. It plans to use products from its refineries: “The Pertamina Cilacap refinery traditionally produces an excess of HSFO 180 CST which used to be exported to Singapore.” These exports have stopped. Instead, local dealers and former importers will need to buy the product from Pertamina.

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<sup>1</sup> See Bernadette Christina and Roslan Khasawneh, “Indonesia will not enforce IMO low-sulfur rules on its domestic fleet,” Reuters, July 26, 2019 [<https://tinyurl.com/yyxozko2>].

<sup>2</sup> See “Indonesia: Decision to allow domestic consumption of 3.5% marine fuel ‘makes sense,’” *Manifold Times*, July 24, 2019 [<https://tinyurl.com/y3hbdcq7>].

At the same time, Indonesia seems to have large supplies of low-sulfur fuel oil that would comply with the IMO 2020 regulation. However, Pertamina and the government seem bent on exporting the fuel and thereby capitalizing on high prices while using high-sulfur fuel at home.

A lawyer interviewed in a separate *Manifold Times* article explained that Indonesia's action was made possible by a legal loophole: "Indonesia cannot opt out as such from the IMO 2020 limits but they may choose not to enforce any penalties in relation to Indonesian flagged vessels operating in Indonesian waters."<sup>3</sup> The lawyer noted that the penalties for noncompliance are to be established by each IMO member state. Thus, Indonesia can elect not to penalize an Indonesian ship burning high-sulfur fuel while operating in Indonesian waters.

Indonesia's decision may relieve some of the coming pressure expected for the oil market. The country consumes 1.8 million barrels per day of oil, according to the *BP Statistical Review of World Energy*. The nation comprises more than eighteen thousand islands and has a very large shipping industry that developed to serve its inter-island shipping needs. The nation's gasoil and fuel oil consumption totaled six hundred thousand barrels per day in January, according to the JODI database. Much of that product was likely burned by its maritime industry.

In its March 2019 forecast, the International Energy Agency indicated that as much as one million barrels per day might have to be moved from the world distillate pool to the marine bunker supply pool to facilitate the IMO 2020 transition. Indonesia choosing to export low-sulfur fuel that meets the IMO standard, possibly importing some very low-cost high-sulfur product, and permitting its domestic shipping industry to continue using high-sulfur fuel could relieve much of that pressure.

The impact of this decision on refining margins will not be good. Refiners are already feeling the effect of increased exports from new Chinese refiners reacting to slumping domestic consumption. Now they must adjust to a major shipping nation "jumping ship" from the IMO mandate and worry that more "rats" will follow suit.

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<sup>3</sup> See "Indonesia: Domestic use of 3.5% sulphur marine fuel possible through legal loophole," *Manifold Times*, July 26, 2019 [<https://tinyurl.com/y35ge5ex>].