Indonesia – Seeking Production Growth

By Vishnu Pillai

Indonesia has been Southeast Asia's sole representative in OPEC since it joined in 1962. However, recently it lost that status by pulling out of the international association. What is certain is that Indonesia has become a net importer of oil since 2004, no thanks to its flagging reserves and its low refining capabilities.

Indonesia's oil reserves have been observed to be declining steadily, as there have been insufficient new discoveries to compensate for the declining production rates and reserves of its aging fields. The larger fields in Indonesia are mature with a pattern of declining production. Discoveries of new fields have been few, and to compound matters, realization of the potential of the new discoveries has been hampered by various pitfalls.

Administrative Changes

In 2001, PERTAMINA was made to relinquish its role in granting new oil development licenses and limited the company's monopoly in upstream activities. PERTAMINA's regulatory and administrative functions were transferred to BP Migas. PERTAMINA was formed into the limited liability company PT PERTAMINA (Persero), although it remains a state-owned entity. PT PERTAMINA has since been laying the groundwork for full privatization to take place at some point in the future.

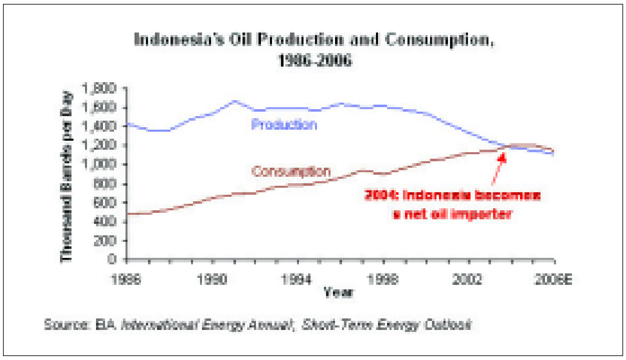
BP Migas and the Indonesian government have introduced policies aimed at increasing investment in the country's upstream sector. BP Migas set up various incentive programs for firms to develop marginal oil resources throughout the country that would not otherwise be attractive to international oil companies. In October 2006, the government waived import taxes on capital goods for oil and natural gas exploration and production. BP Migas has also held several competitive bidding rounds for new upstream projects throughout Indonesia. During 2006, BP

Migas concluded its fifth round of acreage offerings in which it awarded dozens of new exploration and production licenses to companies. During the fifth bidding round, a handful of exploration blocks were awarded to international oil majors, such as ExxonMobil and ConocoPhillips, although the majority of tenders were won by smaller Indonesian firms.

These changes were made with the aim of attracting foreign investment and to a point the changes have served their purpose. It is thus puzzling that the decline in the production has not been arrested. In order to determine the cause of the failure to arrest the slide other factors have to be considered.

Production versus Consumption

One factor could be the duration of the contract terms offered to the oil companies. A good example would be the Cepu block, located in East and Central Java. ExxonMobil's local subsidiary discovered 250 million barrels of proven oil reserves in the Cepu Contract Area in 2001, and in 2007 the company estimated that the area could hold up to 600 million barrels of recoverable oil reserves. ExxonMobil hesitated to develop the promising oil resource, however, because the company's contract for the area was set to expire in 2010. After several years of negotiations, in



March 2006 ExxonMobil and PT Pertamina signed a joint operation agreement (JOA) for the Cepu field. Each company will have a 45 percent stake in the project, with the remaining 10 percent held by provincial governments in East and Central Java. The project moved into its production phase in December 2008.

However, blocks with reserves as high as Cepu are not easy to come by. To put the discovery in context there is a need to weigh the production gained from the start-up of the Cepu block against the loss in production in the other fields.

Chevron have stated that their Duri and Minas concessions in Sumatra, two of Indonesia's largest fields, might only produce 405,000 bpd in 2008, which is a drop from the 425,000 bpd in 2007.

ConocoPhillips announced that production to drop to 45,000 bpd 2009 from 2008's 80,000 bpd. Medco's production is expected to fall from 2008's by 7% to reach 30,000 bpd in 2009.

The only company to buck the trend is PERTAMINA, who expect their production to rise to 125,000 bpd from 2008's 118,221 bpd.

The governing body's level of expectation was clear when they dropped their estimated oil output to 950,000 bpd this from 2008's 977,000 bpd. Once the burgeoning oil consumption of Indonesia is taken into account the energy deficit is plain to see.

Indonesia needed 364.8 million barrels of oil in 2007 and 369.2 million in 2008 so the country needs just over a million barrels a day. It supplied 62% of its own crude oil needs in 2007 and 61.5% in 2008. The only way to arrest the widening deficit is to increase production as it is next to impossible to reduce the consumption significantly without creating a host of fresh problems. That seems to be the direction Indonesia, and indeed, PERTAMINA are taking.

Indonesia Seeks Control

One of the first steps that Indonesia has taken in ensuring the replacement of declining resources is in seeking greater control over its energy resources. The Indonesian government, aiming to play a greater role in managing its own energy resources, plans to step up the participation of domestic firms in developing the country's oil and gas industry.

"The Indonesian government has the right to manage its energy resources…" said Vice-President Jusuf Kalla during a state visit to the Netherlands."No single country in the world allows foreign entities to manage its energy resources," former Vice-President Kalla commented, citing the fact that most of his country's major energy projects are operated by international oil companies.

His statements are given credence when one considers the fact that Chevron produces approximately 45% of Indonesia's oil output, almost three times the oil output of state-owned PERTAMINA.

He was quick to alleviate the fears of foreign investors, however, and assured them that boosting the roles of domestic companies does not necessarily mean rejecting international oil companies as partners, especially as the country still needs their financing and internationally recognized expertise.

After years of under-investment the country is trying to turn the tide. Indonesia's oil production was targeted to reach 960,000 b/d of oil in 2009 based on some US$13.15b of investment, according to upstream oil and gas regulator BPMigas.

It said about US$12.95b of the planned investment would be spent on production activities: US$3.73b for drilling activities in 1,237 wells, US$2.85b for production facilities, US$4.72b for operational production, and US$1.64b on administration.

Going Deep

Indonesia has also been quick to realize that the days of easy oil are fast-departing and have looked to deepwater E&P as a savior. In October 2009 Jakarta released 31 offshore blocks for bidding. A majority of the new releases are in deepwater basins.

Late 2008 a BP Migas official confirmed Indonesia's aim to attract more investment to explore and develop its deepwater oil and gas fields. As part of the move to encourage the uptake of deepwater blocks in Indonesia, the government recently passed a ministerial decree allowing the production sharing contracts (PSCs) for deepwater blocks to be extended to four or five years. Under the terms of the standard PSC, operators are given up to three years to fulfill the required work commitments on the offshore blocks.

The move allows operators more time to conduct the necessary activities leading up to exploration drilling in the deepwater blocks, according to Department of Energy and Mineral Resources' Director Edy Hermantoro, who made the comment the OSEA 2008 conference in Singapore.

The Foreign Factor

The foreign players have an integral role in the development of Indonesia's oil and gas industry is undeniable. Hence their continued commitment and involvement is critical at this juncture. Fortunately for Indonesia, the foreign oil companies have been resolute and have come forward to pledge their allegiance.

Chevron, for example, confirmed in early 2009 that it remains committed to developing natural gas fields offshore from East Kalimantan in the Kutei Basin although it was reviewing its business strategy for Indonesia.

Kangean Energy, a joint-venture with foreign investment, announced at the end of 2008 that it expects production from the Pagerungan Utara field to kickoff by June 2009. They finalized details to install an FPSO to this end. They also planned to deploy an FPU in the TSB project, which is off East Java; in the first half of 2010.The drilling campaign was scheduled to take place then.

Pearl Energy has committed to spend US$30m over the course of the next three years to explore two offshore blocks. Pearl was awarded the East Muriah and Kerapu blocks late 2008.

These are but a few projects where the foreign companies have declared their commitment, and this bodes well for the near future. That is not to say that everything is rosy. One particular project which is facing problems is the Natuna project.

ExxonMobil was the operator of the giant field, but ongoing contractual disputes between ExxonMobil and BP Migas have resulted in a cloud of uncertainty looming overhead. The Indonesian government does not seem overly concerned as they are extremely confident of securing a new partner. However, certain factions believe that although the project might not suffer greatly, the image of Indonesia might be adulterated in the eyes of foreign investors. This is an issue that Indonesia has to consider and circumvent successfully.

The Importance of Pertamina as a Business Unit

As important as the foreign players are, the role of the NOC PERTAMINA is critical, especially so in the wake of Indonesia's declaration of wanting more control over its resources. The route that PERTAMINA chose to take, therefore, has to run parallel with that of Indonesia.

It has been a criticism that PERTAMINA was being run based on a civil service model as opposed to a business model. The old fashioned management in state owned enterprise had to be eradicated. Although PERTAMINA contributes to the state revenues more than any other state owned enterprise, to evolve into a global first-rank oil company PERTAMINA must operate as a business and not as an organization based on the tenet of political patron client relationships.

Steps have been taken to change this outlook. In February 2009 Karen Agustiawan (above), who had previously held positions at Mobil Oil Indonesia, CGG Petrosystems and Halliburton, was appointed the President Director of PERTAMINA. She was promoted from the position of Upstream Director, PERTAMINA. The new President is known as a technocrat in the oil and gas industry, and her appointment will no doubt serve notice to the old-boy-network.

By itself the appointment may not seem monumental but when taken in context with the appointment of Omar Sjawaldy Anwar, CEO of Rio Tinto Indonesia, as PERTAMINA's Vice-President Director, a forceful message is perceived. Mr. Omar is reputed to be extremely astute in financial matters.

According to Indonesia's minister of state for state enterprises, Sofyan Djalil, the appointments represented "a combination of business and technical" expertise. "Bu Karen has expertise in technical aspects of the oil and gas industry, while Pak Omar has experience in business and finance," said Djalil. "I believe they are going to make a good combination for PERTAMINA."

Without casting any aspersions on the performance of former PERTAMINA President Ari Soemarno, it seems that a shake-up was what the doctor ordered at Pertamina. Being a state-owned enterprise PERTAMINA could not function as a purely business driven unit, as it had to consider the country's state of affairs. However, the time has come for PERTAMINA to evolve, or risk a more drastic energy deficit.

The new President Director Karen Agustiawan has already made assurances that the government-set targets would be met by boosting both upstream and downstream production and delivery. She also highlighted the importance of the firm's upstream activities when she commented that she would "… also closely monitor PERTAMINA's upstream business because it is a profit-maker for the company". Agustiawan noted that PERTAMINA has targeted to produce 171,000 b/d of oil in 2009, up from 156,000 b/d in 2008, as well as 1,266 MMscfd of gas in 2009, up from 1,178 MMscfd in 2008.

In terms of focus on E&P, PERTAMINA could not mirror Indonesia's stance any more closely. The company has made assurances that it will continue with its plans to upgrade upstream facilities and acquire stakes in blocks despite the recent financial turmoil and plunge in oil prices. In December 2008, Karen Agustiawan went on to state that PERTAMINA intends to spend US$1b to upgrade its production facilities, with particular allocation of funds to the Lima fields(oil) and the Tambun fields (gas). Furthermore, PERTAMINA is also interested in procuring stakes in the West Madura block, the Mahakam block and Chevron's deepwater fields off East Kalimantan.

Convergence of Strategies

It is clear that the Indonesian government's strategy to invigorate its energy production is centered on four main factors:

1. Increasing Production
2. Deepwater Exploration
3. Increasing Local Participation
4. Increased Capital Investment

The blueprint outlined by the government officials thus far seems to be concise, uncomplicated, logical and, most importantly, achievable. What is left now is the execution of the strategy. Although these four factors appear to be the most vital, it does not mean that there are no other factors involved. As mentioned earlier in this article, the involvement of foreign companies is an important factor in the development of Indonesia's oil and gas industry. These four factors build the platform for energy independence, but, in order for the campaign to be successful, it is critical that the government also takes the other factors into account when implementing its strategy.

PERTAMINA's aim is to operate more as a business unit to facilitate its long-term goal of full privatization. That being so PERTAMINA has to be more profit-oriented. There have already been steps taken to alter the way the organization is run with new appointments at the top of the hierarchy. That is a crucial first step.

PERTAMINA has also expressed its desire to make capital investments to upgrade its upstream facilities despite the current low prices. It also intends to acquire stakes in more projects. Through these actions PERTAMINA is already supporting two of the four factors enumerated above. There is increased local participation and increased local capital investment.

With the declaration of interest in the Chevron's deepwater fields, as well as a number of upcoming deepwater projects, PERTAMINA has signaled its intent to delve into deepwater E&P. Once again, this is in line with the Indonesia's strategy.

Last, but not least, is Indonesia's aim to increase production? Despite the majority of operators going on record to state that output would fall from the levels achieved in 2008, PERTAMINA has come out and stated that they expect the output in 2010 to outstrip that of 2008. With this bold stroke the fourth factor enumerated above has been accounted for.

No doubt, being a state-owned enterprise one would expect a convergence of strategies between Indonesia and PERTAMINA. However, as the numerous examples scattered around the globe prove, this is not always the case. Indeed, in some instances in the past, it has not been the case with PERTAMINA itself.

With the two strategies now working in tandem, it is highly likely that Indonesia will go some way in addressing and arresting its widening energy deficit. Indonesia's presence in OPEC will not play a major role in determining the production or consumption levels of oil and gas in the country, but the prestige factor of being Southeast Asia's sole representative at OPEC cannot be discounted. Only time will tell if Indonesia will be a member of OPEC in the future, but the blueprint of Indonesia, and PERTAMINA, bodes well for the country's goal of energy independence. PP

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