THE INSTITUTIONAL FRAMEWORK

"All natural resources in the soil and the waters of the country are under the jurisdiction of the State and shall be used for the greatest benefit and welfare of the People."
-Article 33, Indonesian Constitution

The Indonesian Parliament (Dewan Perwakilan Rakyat – DPR) passed the oil and gas bill into law on October 23, 2001. The new law replaces Oil and Gas Law No. 44/1960 and Law for Pertamina No. 8/1971. It will reduce the government's power over the petroleum sector and allow for open competition in the downstream oil and gas distributing and marketing area. The new law authorizes the establishment of an implementation agency ("badan pelaksana") and regulatory agency ("badan peraturan") to assume state oil and gas company Pertamina's roles. The implementation agency will replace Pertamina in managing Production Sharing Contract (PSCs) with private oil and gas companies, thus eliminating the conflict-of-interest inherent in upstream producer Pertamina regulating the activity of its competitors. The law also removes Pertamina's monopoly in the downstream sector with the regulatory agency assuming the responsibility for managing domestic fuel distribution and supply.

The law stipulates that the two new agencies must be established within one year of the law's enactment while Pertamina must establish itself as a limited liability company ("persero") within two years. Pertamina, nevertheless, must maintain its overall responsibility for domestic fuel supply and distribution for four years after the law's enactment. Existing PSC's will be grandfathered and in effect until expiration of the contract. The GOI must still prepare five separate implementing regulations for the upstream sector, the downstream sector, Pertamina's transition to a limited liability company, and for the establishment of the implementing and regulatory agencies.

Article 33 of the Constitution still requires the government to continue its key role in the management of Indonesia's energy sector. All energy activities dealing with petroleum and gas fall under the Ministry of Energy and Mineral Resources, which is charged with creating and implementing Indonesia's energy policy. The Ministry of Energy and Mineral Resources is divided into several directorates, with the Directorate General of Oil and Gas (MIGAS) responsible for all aspects of the petroleum industry, including its development, employee training, and promulgating regulations.

Pertamina

Under current government regulation, Pertamina is responsible for the production of oil and gas and is in charge of all petroleum ventures for Indonesia. A legal requirement to supply the nation with adequate petroleum products is in force until the new oil and gas law is implemented. Pertamina carries out its responsibilities principally through Production Sharing Contracts in cooperation with joint venture partners. Five regional offices regulate exploration and development activities. With nine refineries and ownership or franchising of gasoline stations, Pertamina is responsible for downstream oil activities as well.

Pertamina's top leadership was supportive of the oil and gas bill, and took several steps to move the company proactively forward toward a newly deregulated era. Pertamina President Baihaki Hakim, appointed on February 28, 2000, survived several changes of cabinet and the transition from President Abdurrahman Wahid to President Megawati. Baihaki announced on December 11, 2000 that the Indonesian government had issued presidential decree 169/2000, which authorized the restructuring of the state-owned petroleum company.

Among other changes, the decree simplified Pertamina's organizational structure from five directorates and one semi-independent body to five directorates only. Before the change, Pertamina was organized into directorates for:

- exploration and production;
- processing;
- supply and marketing;
- shipping, harbors, and communication;
- general affairs; and
- financial affairs.

In addition, its Foreign Contractors Management Body (BPPKA -- Badan Pembinaan Pengusahaan Kontraktor Asing) had primary responsibility for managing foreign investors and approved contractors' budgets, work programs and future contracts.

After restructuring, Pertamina had five major elements with corresponding directors (vice-president equivalent):

- upstream sector (formerly the exploration and production directorate);
- downstream sector (merging processing; shipping, harbors, and communication; and supply and marketing);
- development;
- financial affairs; and
- oil and gas contractors.

The development directorate has responsibility for, among others, human resources management, information technology, strategic planning, environmental issues, and business development. If the oil and gas bill is enacted and an independent Implementation Agency is established, then the new oil and gas contractors' directorate will be dissolved.

Pertamina also plans to reduce staffing by as much as 30-40 percent over a five-year period beginning in 2001. The objective would be to reduce to a staffing level of 18,000 employees from the current 26,000. The goal would be reached largely through attrition and early retirement, according to Baihaki.

While ranking 9th in crude oil production, Pertamina was Indonesia's 5th largest producer of natural gas in 2000 so that, on a barrels-of-oil-equivalent basis, Pertamina is a significant contributor to Indonesia's petroleum output. On various occasions, Pertamina executives have expressed their resolve to enhance Pertamina's position in the upstream sector to position the company for petroleum sector deregulation. On

December 8, 2000, then Director for Exploration and Production Gatot K. Wiroyudo said Pertamina would increase its exploration and production spending from 2000's Rp 1 trillion (US $119 million) to Rp 1.8 trillion (US $214 million) in 2001. The increase in spending is part of an ambitious plan to spend a total of some Rp 9 trillion (US $1.07 billion) over a five-year period to boost Pertamina's output from 210,000 barrels of oil equivalent per day (BOE/D) to 425,000 BOE/D by 2005. In a February interview, Baihaki expressed the target slightly differently in terms of tripling Pertamina's current crude oil production of 46,000 barrels per day (B/D) to 150,000 B/D by 2004.

In other developments, BP transferred its X-Ray field offshore West Java on July 26, 2001 to Pertamina following the expiration of its contract. The field, Pertamina's first offshore operation, has 34 wells and two platforms and produces 500 barrels of crude and three million cubic feet of gas per day. Also in July, Pertamina decided to allocate US $10 million to expand its operations to other countries, concentrating first on Vietnam, Burma, Iraq, and Libya. The money would be used for activities such as field studies, feasibility studies, and seismic and geological surveys.

Other Agencies

Other government agencies responsible for Indonesia's petroleum sector include:

- <u>National Energy Policy Coordinating Board</u> (BAKOREN) – chaired by the Minister of Energy and Mineral Resources; shapes Indonesia's energy policy;
- <u>The Energy Resources Technical Committee</u> (PTE) – performs research on technical sites to better inform BAKOREN;
- <u>The Electric Power Generation Development Team</u> – oversees the generation of power for the country;
- <u>Indonesian Parliament</u> – through Commission VIII, works on issues related to Indonesia's energy sector.

Production Sharing Contracts

In 1966, the government set up a type of agreement between Pertamina and its foreign partners known as the Production Sharing Contract (PSC).

Under the terms of the PSCs:

- Pertamina manages the operations of the contractor;
- Contractors pay a bonus when the PSC is signed (not cost-recoverable);
- Contractors provide all funds to conduct operations;
- Contractors recover start-up costs only after commercial production begins;
- Contractors pay Indonesian income taxes, and Pertamina reimburses the contractors for other taxes paid in conducting operations;
- PSCs allow for 6 to 10 years exploration and 30 years total terms;
- For most PSCs, the profit-sharing split is on a net income basis of 85/15 (government/contractor) for oil, and 70/30 for gas.

Additional Contracts

Pertamina uses various other contractual arrangements to deal with petroleum contractors.

Technical Evaluation Agreements (TEA) give oil companies access to Pertamina data on seismic or other petroleum- related information for possible exploration use.

Technical Assistance Contracts (TAC), Joint Operating Agreements (JOA) and Enhanced Oil Recovery (EOR) contracts are used for Pertamina's own oil fields. Pertamina may hire a contractor to produce oil in a field on its behalf, with a specified amount of petroleum going directly to Pertamina.

Joint Operating Bodies (JOB), which are applicable only in JOAs, are designed to pair Pertamina with a contractor in an area that has previously been worked. This limits exploration costs. Under the deal, the company matches previous expenditures or pays the first three years of work, whichever is greater. Then the field is split 50/50 (government/ contractor).

Fiscal Decentralization Law

With implementation of a new fiscal decentralization law in January 2001, revenue-sharing formulas came into effect that split 15 percent of the Indonesian Government's net oil revenues and 30 percent of its net natural gas revenues with provincial and district governments. Provinces and districts with both resources will receive both revenue shares. Of the 15 percent of the oil revenue flowing to the regions, 6 percentage points will go to the district of origin (where the PSC is located), 6 percentage points will be shared among the other districts in the province, and 3 percentage points will go to the provincial government. The same relative shares apply to gas revenues. These distributions had not taken place as of this report's publication.

OPEC

Indonesia joined the Organization of Petroleum Exporting Countries (OPEC) in 1962. Currently an active member, Indonesia has hosted important OPEC conferences in 1964, 1976, 1980 and 1997.

In an effort to control oil price volatility and to counter what they saw as softening crude oil prices, OPEC oil ministers agreed to production cuts of 1 million barrels per day (b/d) at a mid-March 2001 meeting and to a second 1 million b/d in early July. On each occasion, Indonesia received a 52,000-b/d quota reduction, effective first on April 1, 2001, then again on September 1. Indonesia's new OPEC production quota on September 1, 2001 was 1,203,000 b/d, or probably slightly less than its actual crude output.

OPEC Quota (Million B/D)

Source: MIGAS

Other Professional Bodies

IPA

The Indonesian Petroleum Association (IPA) was established in 1971 in response to growing foreign interest in the Indonesian oil sector. Contractors and the government meet frequently to discuss matters such as production ventures and energy economics. The objective of the IPA is to utilize public information to promote the exploration, production and refining aspects of the petroleum industry in Indonesia.

IGA

The Indonesian Gas Association (IGA) was established in 1980 under the sponsorship of Pertamina and key gas producers, Mobil and Huffco. The main objective of IGA is to provide a forum to discuss matters relating to natural gas and to advance knowledge, research and development in the areas of gas technology. IGA also aims to promote the development of infrastructure and cooperation among producing, transporting, consuming and regulatory segments of the gas industry.

The IGA and the IPA sponsored Indonesia's membership on the Permanent Council of the World Petroleum Congress (WPC).

ACE

The multilateral ASEAN Center for Energy (ACE) is a regional energy center established under ASEAN. Founded effective January 1, 1999, with its head office in Jakarta, ACE grew out of the former ASEAN-European Commission (EC) Management Training and Research Center (AEMTRC). AEMTRC had an objective of strengthening cooperation among the ASEAN member countries and between ASEAN and the European Union in the field of energy. ACE now opens the door to cooperation with other dialogue partners while still maintaining a partnership with the European Commission. ACE works toward: providing a comprehensive assessment of the energy situation in ASEAN; developing a regional framework for national energy programs and policies; and formulating policy recommendations for stronger regional cooperation on energy.