

The Urgency of Building Competitiveness to Attract Oil and Gas Investment in Indonesia

An Industry Survey on Investment Issues and
Opportunities to Enhance Upstream Investment*

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PRICEWATERHOUSECOOPERS 

Presentation Outline

Survey Background and Coverage

Trends in the Indonesia Upstream Oil and Gas Industry

**Major Issues Preventing the Upstream Oil and Gas Industry
from Attracting Needed Investment**

Actions which may spur increased investment

Conclusion

Survey Background

The purpose of the survey is to inform the public and private sectors in Indonesia and abroad about Indonesia's upstream petroleum industry and the contributions made by the industry to the economic and social fabric of Indonesia. In addition, the report attempts to highlight some of the challenges facing the Indonesia upstream oil and gas industry from attracting optimal investment and achieving its full potential.

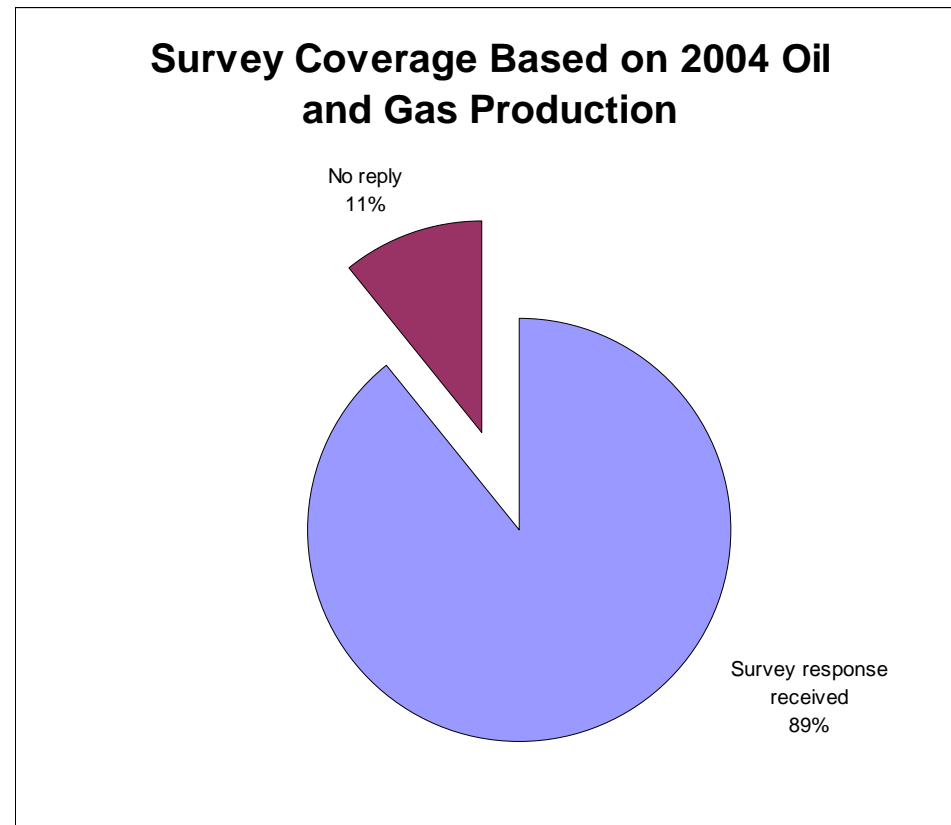
Survey Coverage

This report is based on the results of a confidential, comprehensive survey questionnaire circulated by PricewaterhouseCoopers to 25 producing and exploration companies active in Indonesia's petroleum industry in 2004.

The survey results cover 15 producing and exploration petroleum companies with activities in Indonesia during 2004.

Virtually all geographic areas of Indonesia are presented in the survey

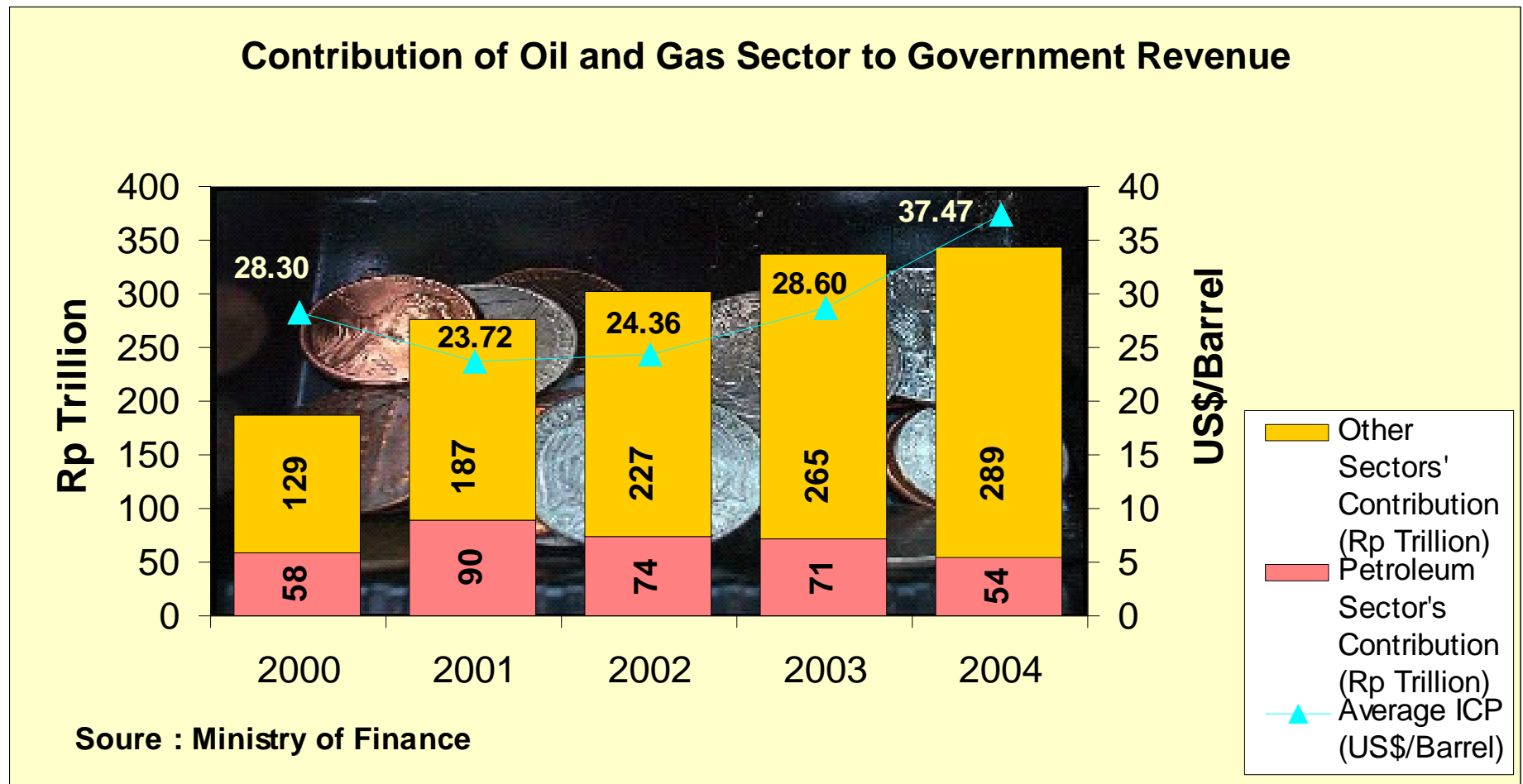
Survey participants produced approximately 89% of Indonesia's petroleum in 2004



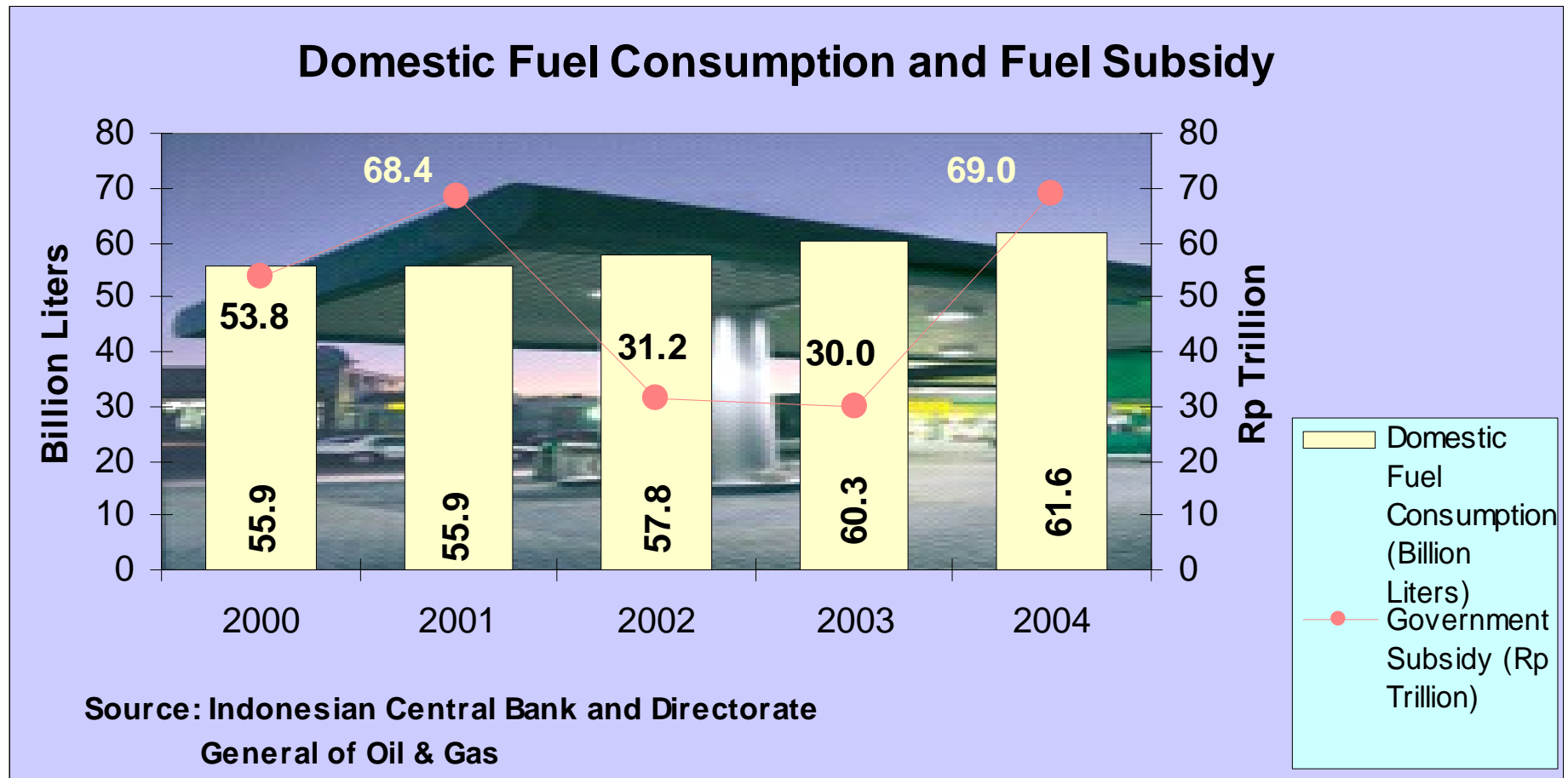
Trends in the Indonesia Upstream Oil and Gas Industry

- Declining contributions from oil and gas sector to GOI revenues
- Domestic fuel consumption on upward trend and related fuel subsidy continues to be drain on GOI budget
- Oil imports growing significantly, Indonesia became net oil importer in 2004
- Gas exports are stagnant or declining but pipeline gas sales are on a upward trend
- Oil production downward trend/Gas production stagnant
- Total industry spend is on a upward trend but primarily driven by development and production costs rather than by exploration
- Minimal exploration spending over last 5 years, declining share of estimated worldwide share of exploration spend

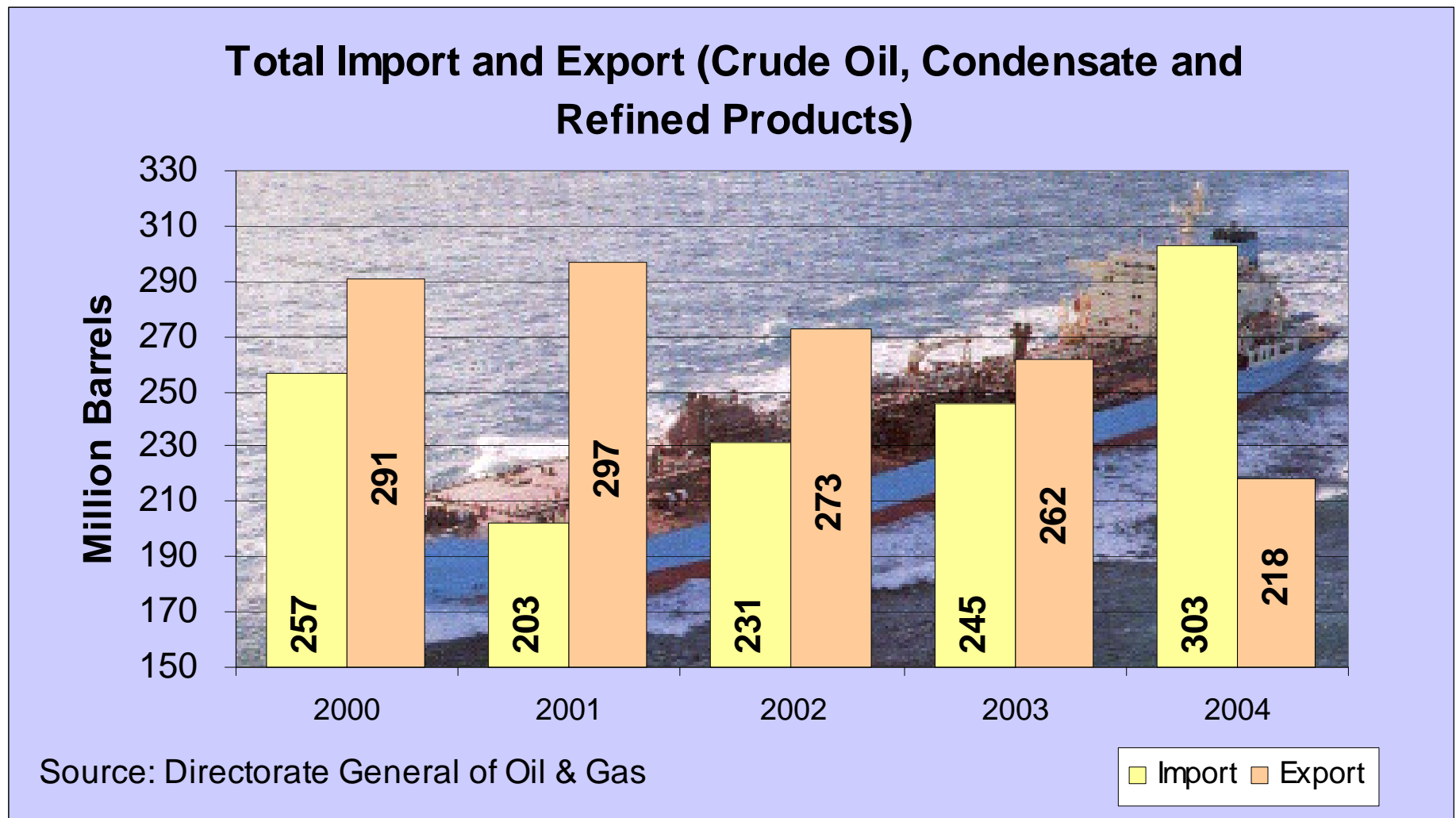
Contribution of the Oil & Gas Sector to Total GOI Revenue/Exports



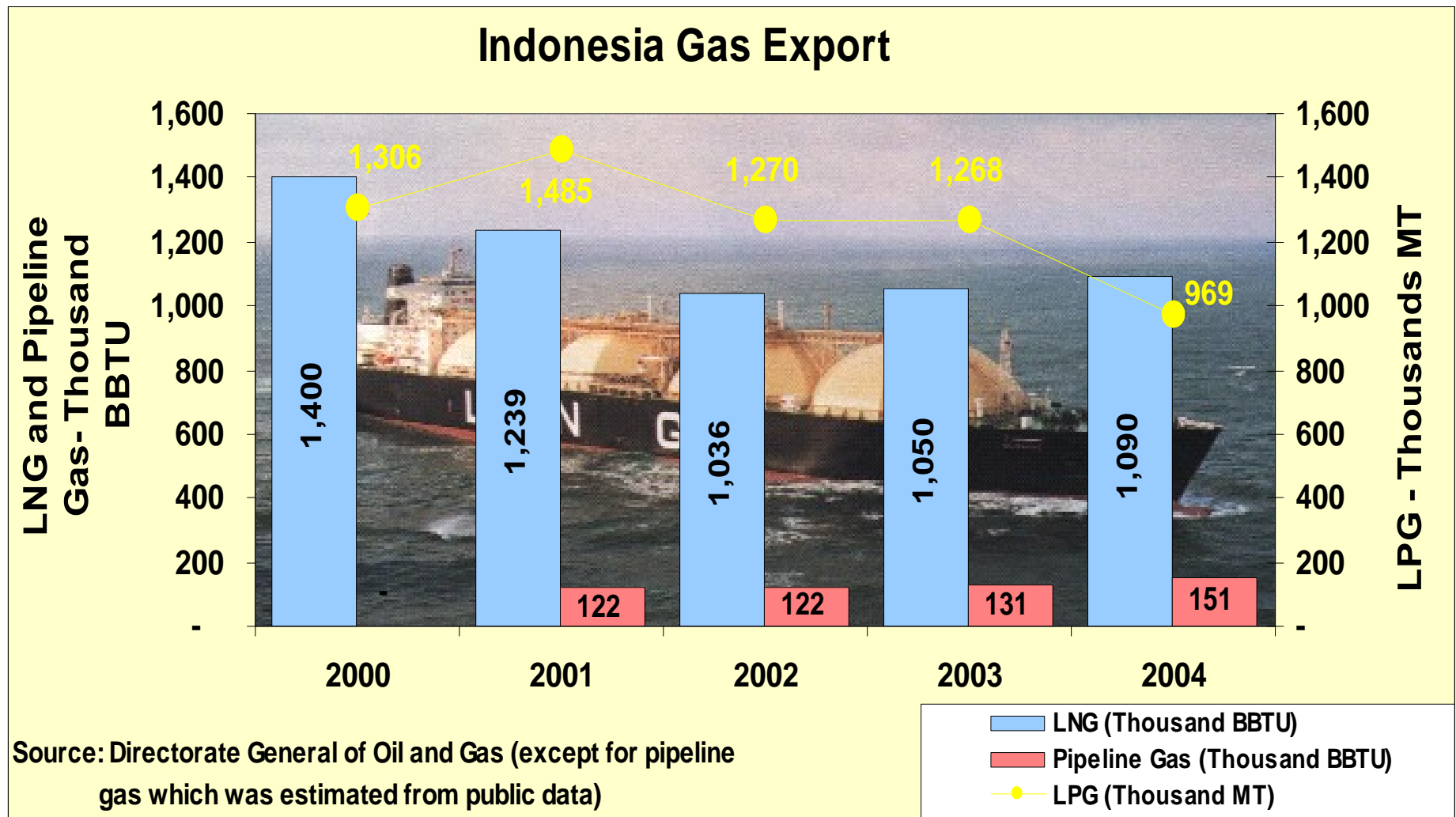
Domestic Fuel Consumption and Subsidy



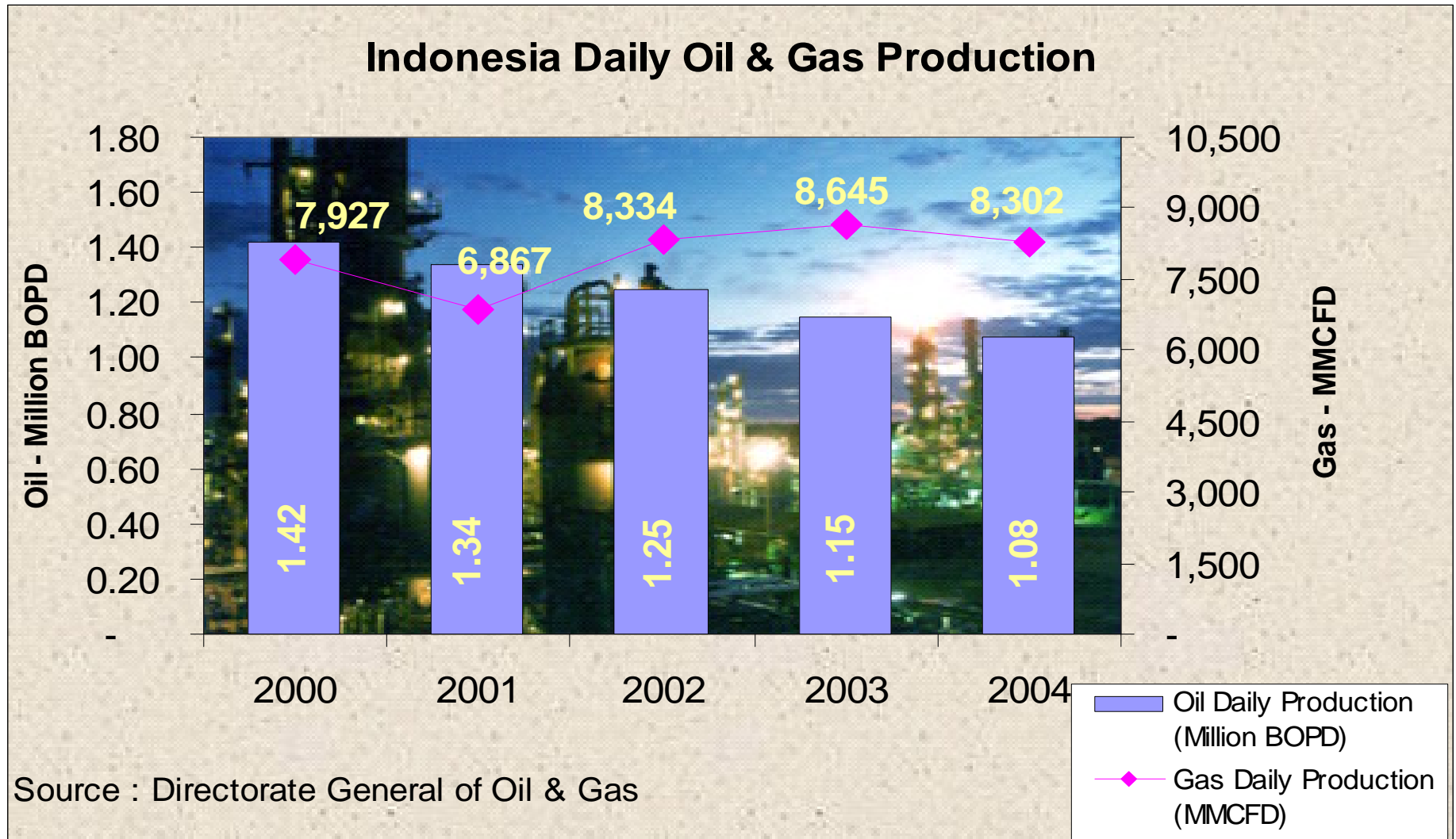
Export and Import of Oil



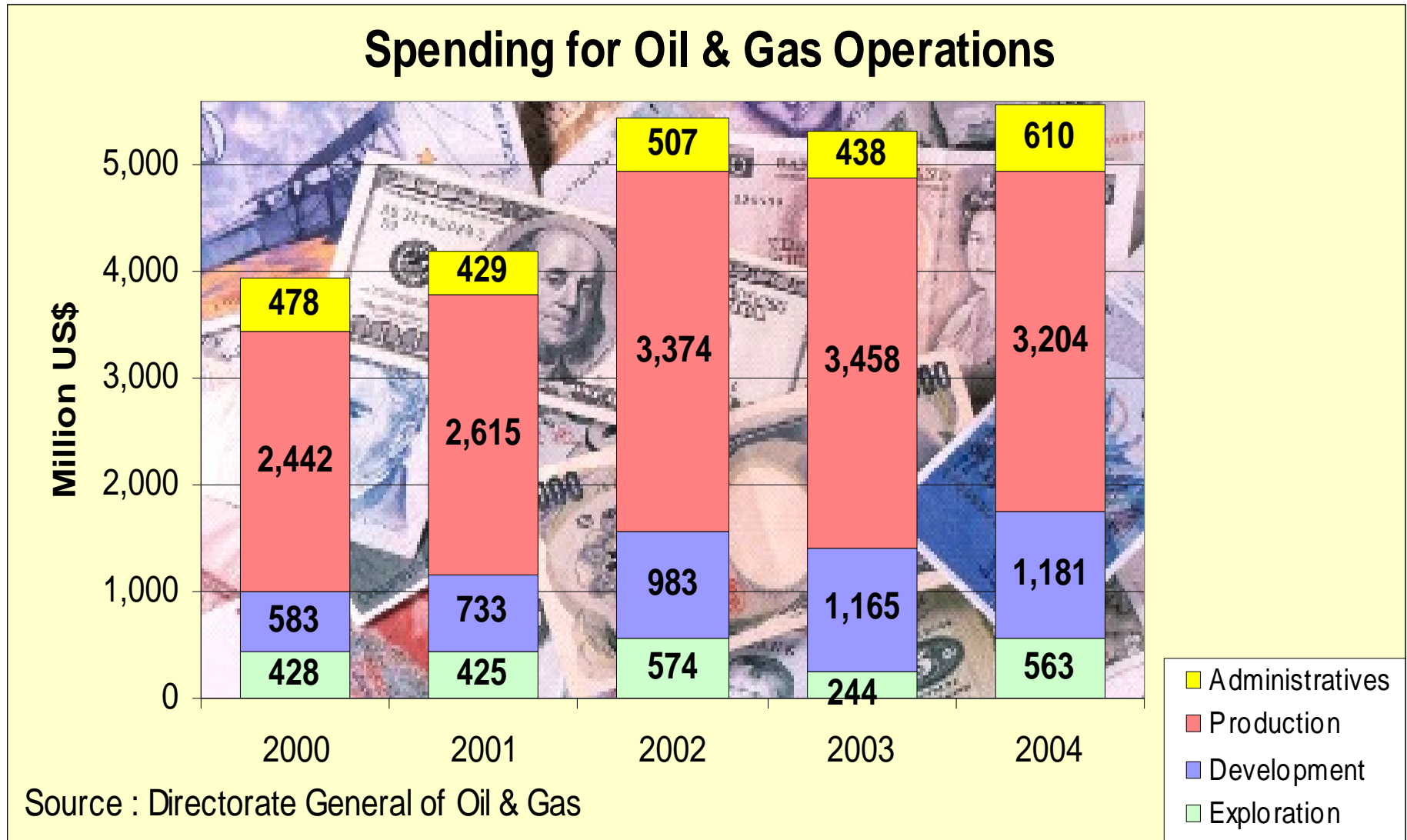
Export of Gas



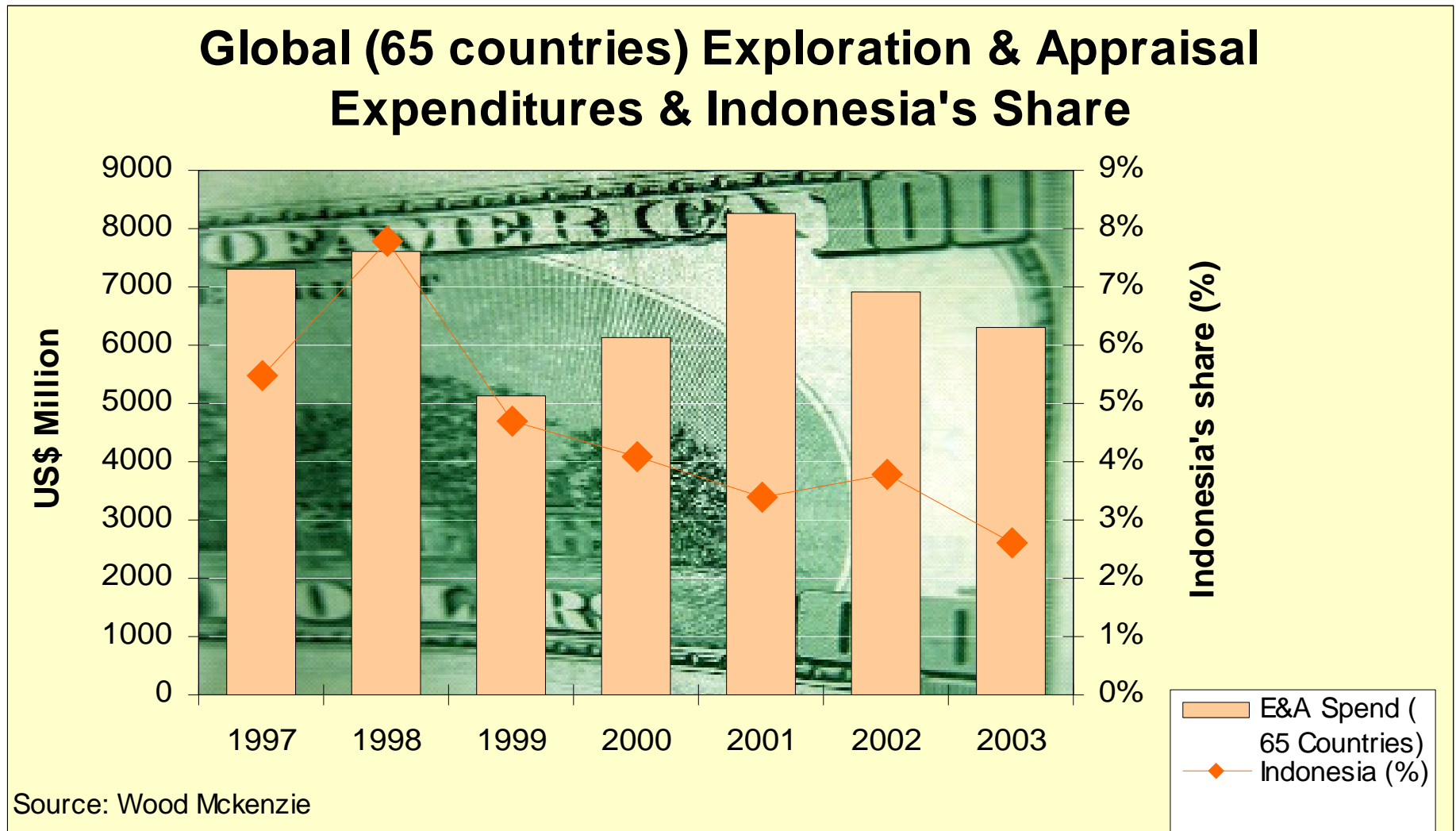
Oil and Gas Production - Daily



Investment in Oil and Gas Exploration Activities



Investment in Oil and Gas Exploration Activities



Major Issues Preventing Industry from Attracting Needed Investment

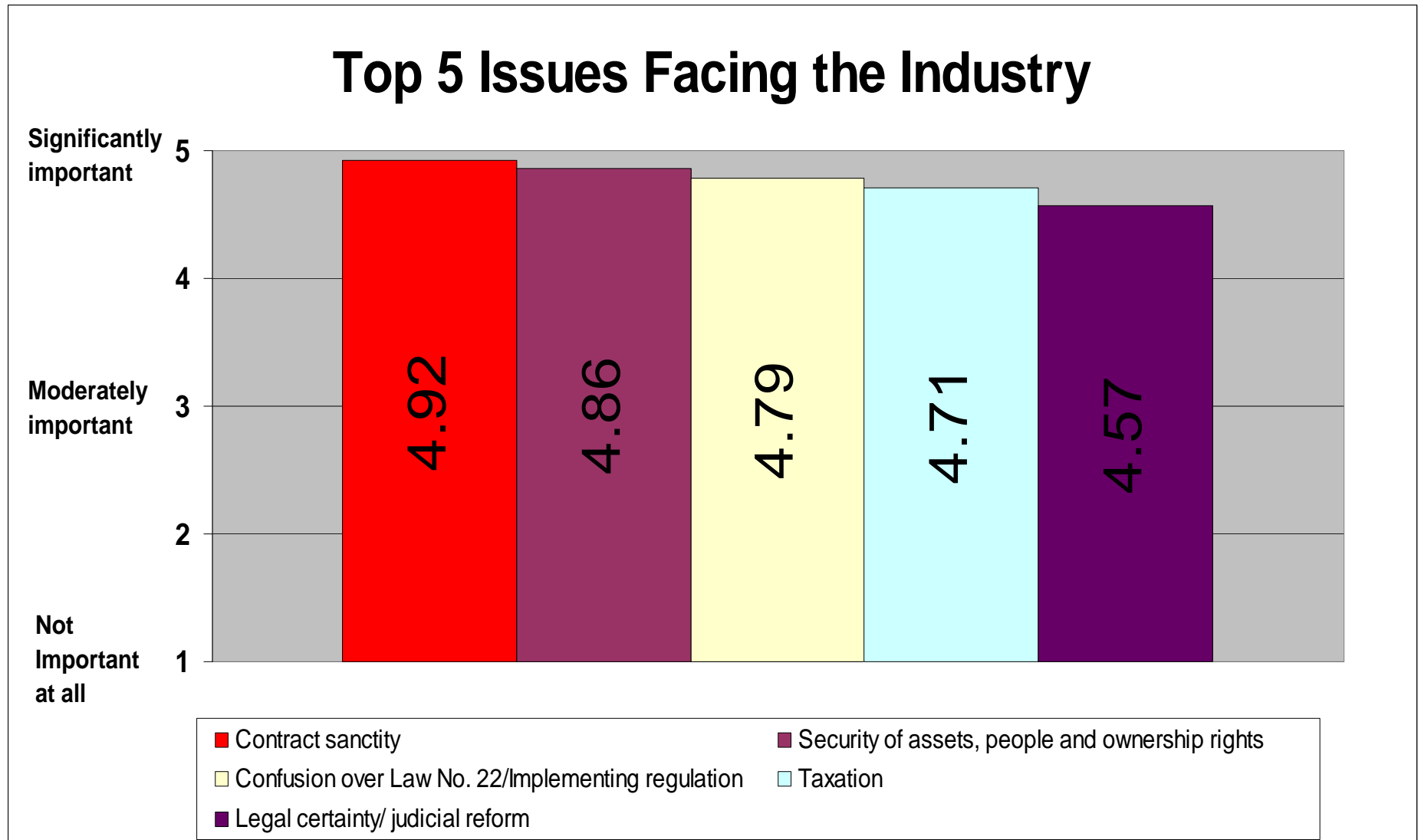
Critical Industry Issues

Contract sanctity	Security of assets, people and ownership rights	Confusion over Law No. 22/Implementing regulations
Taxation	Legal certainty/judicial reform	Interference from other governmental agencies, such as the tax authorities
Confusion as to the roles of the central, provincial and regional governments	Confusion over BP Migas regulations / “grand fathering” of prior Pertamina rulings	Political risk
Local government relations	Corruption, collusion, and nepotism	Community relations
Clarification of import/master list facilities	Confusion over energy policy and supporting blueprints (gas utilization, etc)	Impact of constitutional court decisions
Confusion as to the role of Pertamina/BP Migas and the Ministry of Energy and Mineral Resources	Transparency in block bidding/evaluation process (eg. Gazetal)	Timely reimbursement of VAT
Labor regulations and relations	Clarity and consistency of message from GOI ministries involved in oil and gas	Other participants were allowed to write-in issues not named. Some responses were: a) domestic gas pricing, b) domestic market obligation for gas, c) credit risks for domestic gas producers

Revolutionary and Evolutionary Change

- In the past 5-6 years Indonesia and the Oil and Gas Industry has experienced major change:
 - a new Oil and Gas Law;
 - a new Regional Autonomy Law;
 - a new Manpower Law;
 - a new Tax Law;
 - a new Environmental Law;
 - numerous implementing regulations related to these new laws;
 - establishment of BP MIGAS and BPH MIGAS;
 - numerous changes in Indonesia's political system and leadership;
 - judicial reform;

The Top 5 Issues Confronting the Industry



Contract Sanctity/Confusion over Law No. 22/2001 and Implementing Regulations

- *“Sanctity of ALL PSC’s, existing and new, is highly questionable. The current PSC scheme is NOT truly a PSC, having been greatly modified/eroded over the years with VAT, DMO, FTP, regional taxes/imposts, import duties and is NO longer competitive or attractive compared to other countries (especially Asian) contracts. It is time to get back to the true PSC and review the PSC production splits and other factors mentioned”. – Survey participant comment*

Security of assets, people and ownership rights

- *“The regional governments efforts to protest and block contract extensions and their demand to takeover PSC’s will destroy the nation’s efforts to efficiently maximize the productive yield of Indonesia’s resources”.*
– **Survey participant comment**

Taxation

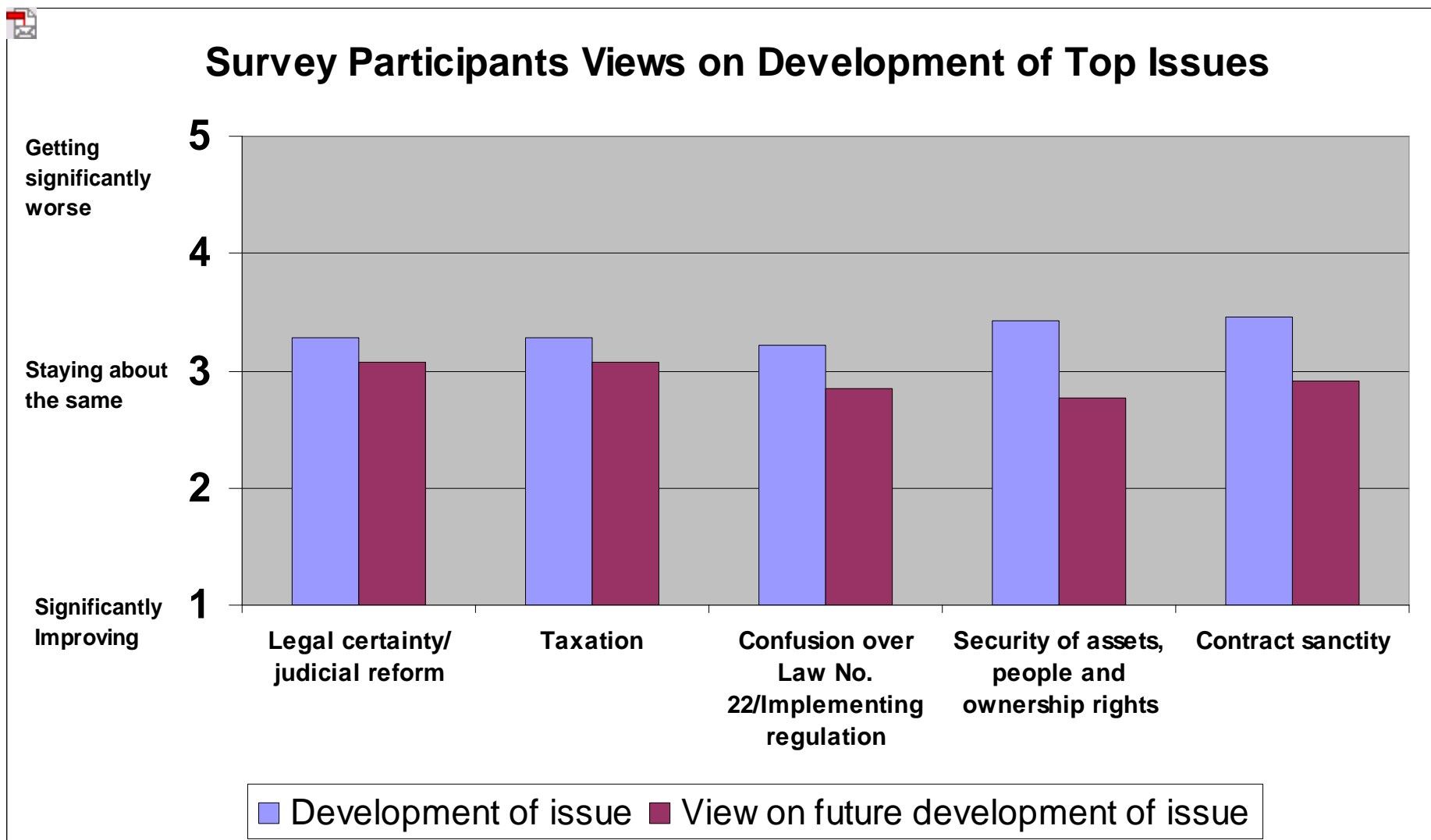
- *“The Directorate General of Tax and Ministry of Finance are only looking at short-term budgeting issues and are not considering the long-term benefit to the country”.* – **Survey participant comment**
- *“There are many conflicting tax regulations between the Ministry of Finance, Directorate General of Tax and Minister of Energy and Mineral Resources.....”.*
– **Survey participant comment**

Legal Certainty/Judicial reform

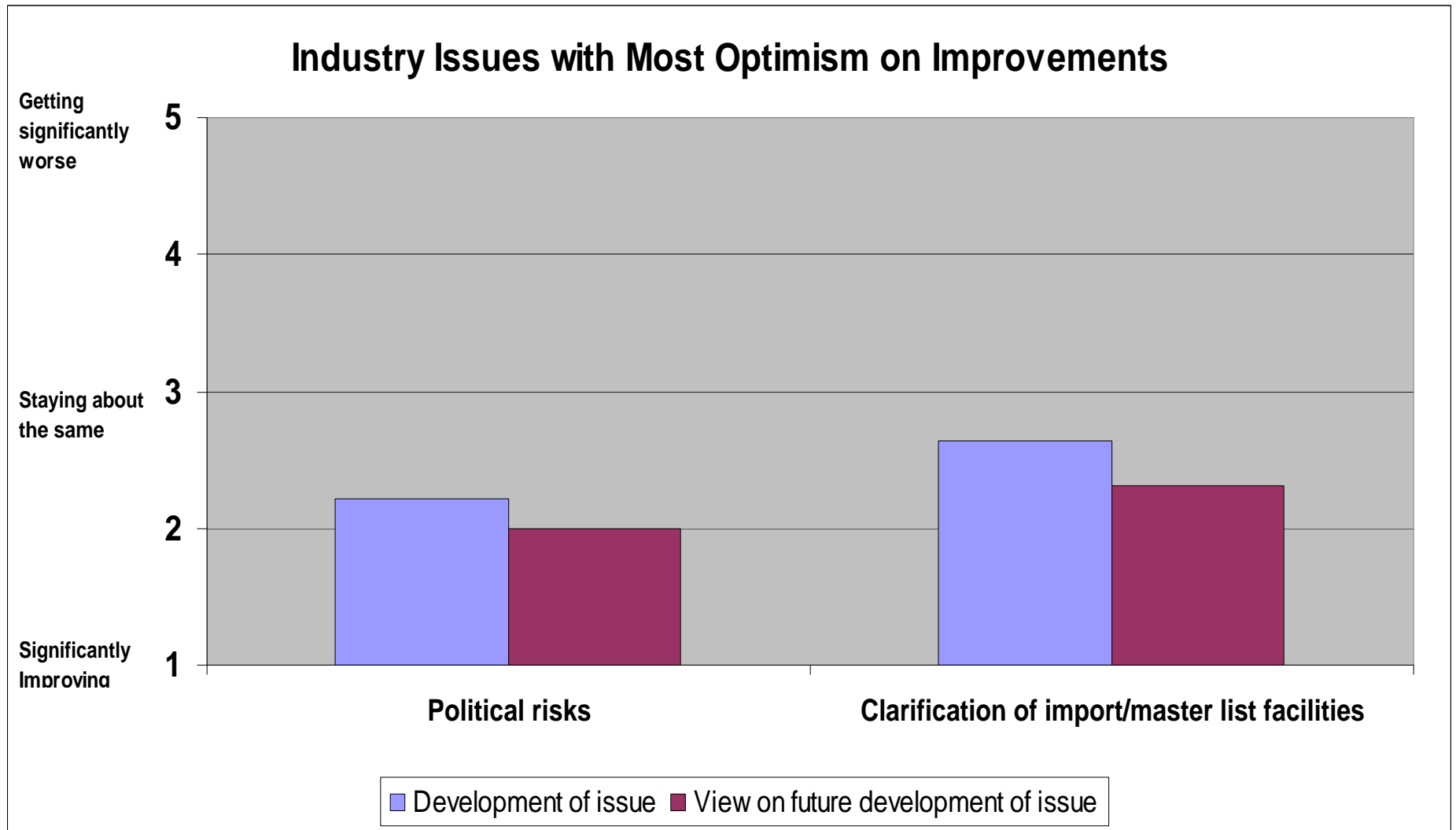
Examples of concerns due to enactment of new laws and regulations:

- Regional government regulations which may be in conflict with central government regulations;
- Potential impacts of any relevant rulings by the constitutional court;
- Potential impacts of new investment law;
- Potential impact of bankruptcy law (as an example an international oil company was sued for bankruptcy due to contract dispute)

Some Cautious Industry Optimism Towards The Future



Industry Issues with Most Optimism on Improvements



Relationships between key industry stakeholders

- **We believe effective relationships and teamwork amongst the key industry stakeholders is necessary to address the issues facing the industry**
- **We asked survey participants to rate their current relationship amongst various governmental stakeholders**
 - Survey participants were generally neutral to slightly negative towards their existing relationships with the various government stakeholders;
 - When asked to rate the future development of these relationships survey participants generally thought the relationships would stay about the same or slightly improve;
 - Relationships with the MoF and DGT were viewed the least favorably

Indonesia's Competitiveness

- **What are the most competitive features for investing in Indonesia?**
 - Geological prospective
 - Export gas market opportunities
 - Trained workforce

- **What are the less competitive features for investing in Indonesia?**
 - Regulatory framework
 - Contract/project approval and audit processes
 - The existing PSC framework
 - Infrastructure
 - Domestic gas market opportunities

Major Issues Preventing Industry from Attracting Needed Investment

Prioritizing Actions and Ease of Implementation to Increase Investment

- We asked survey participants to prioritize actions and rate ease of implementing actions to spur investment
 - Over 15 critical actions were considered by the survey participants
 - No one single action or silver bullet could be adopted or undertaken to dramatically increase levels of investment
 - Survey participants believed that the Government needs to address all 15 critical issues in parallel and not piecemeal

Indonesian oil and gas industry is at a critical juncture

Positive Trends

- Gas reserves have increased slightly over the past several years.
- Within the last few years the country commenced gas exports via pipeline with upside for future exports
- The GOI has recently announced increased fiscal incentives (e.g. investment credits on marginal fields. Lower FTP, higher equity splits)
- 9 new PSC's were recently awarded
- Clear vision and target for oil production of 1.3 BOPD by 2009
- A National Energy Policy and developing domestic gas blueprint
- High oil prices driving a global swing back to exploration
- Significant recent settlement of VAT reimbursements

Negative Trends

- Oil and gas production is in a downward trend, the country became a net importer in late 2004
- Despite high commodity prices and favorable geological prospectivity Indonesia's "share of the pie" of global exploration expenditures is declining to very low levels
- The industry's contribution to GOI revenue is in a downward trend
- The fuel subsidy continues to be a strain on the GOI's budget
- Operating costs per barrel are on an upward trend
- Oil reserves are declining
- Deterioration in certainty of contract sanctity
- Regional government and local community actions and demands are negatively impacting investment

Suggested Actions – Keep Doing

- Continue to assess fiscal terms and provide incentives to encourage increased investment;
- Continue to develop and promote infrastructure development;
- Continue to work with all industry stakeholders to improve the investment climate/business environment;
- Continue to maintain political and macroeconomic stability and momentum;
- Continue to develop and implement a National Energy Policy and detail blueprints;
- Continue initiatives on KKN.

Suggested Actions - Needed To Be Accelerated or Given More Attention

- Harmonizing conflicting laws and regulations, including timely implementation of regulations
- Improved teamwork, coordination and cooperation amongst GOI entities
- Implementing judicial reform
- Changing the regulatory paradigm to a “shared economic interest” model
- Continue phasing out fuel subsidies and implement effective gas regulatory environment

Conclusion

Existing Conditions

- Positive global and macro upstream industry trends
- Recognition and understanding of the issues amongst all stakeholders
- A willingness to seek solutions to regulatory and legal issues through stakeholder engagement
- Positive view on geological prospectively by investors
- Political and macro economic stability and momentum
- A National Energy Policy and developing blueprints

Actions

- Harmonization of regulations and laws
- Continue phasing out fuel subsidies
- Change in BPMIGAS paradigm

Actions

- Better intergovernmental teamwork and coordination
- Attention to detail execution of initiatives, plans etc.
- Continue to develop domestic infrastructure

Outcomes

- Increased investor confidence
- Industry Growth
- Increased Gol revenues