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Hydrocarbon & Governance Challenges in Indonesia

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HYDROCARBON FISCAL REGIME IN INDONESIA
Hydrocarbon Legal Arrangements

Oil & Gas Legal Arrangements

Concessionary

Production Sharing Agreement/Contract (PSA/PSC)

Contractual

Service Contracts

Risk Service Contract

Technical Service Agreements

Main Differences Concessionary & PSCs

<table>
<thead>
<tr>
<th>Features</th>
<th>Concessionary</th>
<th>PSCs</th>
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</thead>
<tbody>
<tr>
<td>Ownership of resources</td>
<td>Held by sovereign state</td>
<td>Held by sovereign state</td>
</tr>
<tr>
<td>Title transfer point</td>
<td>At the well head</td>
<td>At the export point</td>
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<tr>
<td>Company entitlement</td>
<td>Gross production less royalty</td>
<td>Cost oil &amp; gas + profit oil &amp; gas</td>
</tr>
<tr>
<td>Entitlement percentage</td>
<td>Typically 90%</td>
<td>Typically 50-60%</td>
</tr>
<tr>
<td>Ownership facilities</td>
<td>Held by the company</td>
<td>Held by the state</td>
</tr>
<tr>
<td>Management &amp; control</td>
<td>Typically less government control</td>
<td>More direct government control and participation</td>
</tr>
<tr>
<td>Government participation</td>
<td>Less likely</td>
<td>More likely</td>
</tr>
<tr>
<td>Ring fencing</td>
<td>Less likely</td>
<td>More likely</td>
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PSC Characteristic

- Started in the 60s, in Indonesia
- Work commitment
- Bonus payment
- Royalties
- Recovery of production cost
- Profit oil split between company (contractor) and host country
- Overall share of host country depends on the bargaining
- Most of developing countries now prefer PSC

PSC Advantage & Disadvantage for Host Countries

ADVANTAGE

- All financial and operational risk rests with the company;
- Government shares potential profit without making a direct investment;
- PSA can be enacted into law to provide legal security.

DISADVANTAGE

- Requires highly negotiation skills;
- Requires excellent data & information of the oil & gas reserves in the particular field;
- Requires high degree of supervision on cost of exploration, development and operation;
- Requires excellent regulatory management;
- Difficulty to enforce of social & environment standard, beyond the contract terms.
Indonesia Hydrocarbon Fiscal Regime

- Indonesia oil & gas applies Production Sharing Contract (PSC) regime:
  - Contractor is working on specific Working Area (or Block).
  - Contractor is responsible to all risk.
  - Exploration, development and operation costs are held by the contractor and will be recovered by the government from the commercial production.
  - Production minus cost recovery will be split between government and contractor based on certain percentage.

- Working Area or block given to the contractor is ring fence.
- Contractor must pays taxes (e.g. Income tax).
- All equipments of the contractor are owned by government.
- Contract period is 30 years, including 6 to 10 years for exploration, and can be extended.
- Contractor must supply petroleum & gas for Domestic Market Obligation (25% of contractor’s share).
Indonesia PSC Fiscal Terms

- O/G Production
- LIFTING (GR)
  - FTP
  - Profit Oil
    - Equity to be Split, ETS
  + Cost Recovery:
    - Investment Credit
    - Incentive
    - Sunk Cost
    - Capital Cost
    - Operating Cost
  - Contractor Share (Split(1-Tax))ETS
  + DMO
  + DMO FEE
  + Taxable Income
  - Indonesia Share (1-Contractor Share) ETS
  - Indonesia Take
  + Tax
  - Contractor Take
Total revenues from O&G is about $30 bn annually.

Revenue sharing of Central Government and Local Government where oil and gas produced:

- Typical: 15.5% for petroleum and 30.5% for natural gas
- Special Region of Aceh Province: 70% for Aceh, and 30% for Central Government
List of ASEAN countries GDP (nominal), CIA World Factbook 2008 estimates

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>GDP (millions of USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>—</td>
<td>World</td>
<td>78,360,000</td>
</tr>
<tr>
<td>—</td>
<td>European Union</td>
<td>18,930,000</td>
</tr>
<tr>
<td>—</td>
<td>United States</td>
<td>14,330,000</td>
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<tr>
<td>—</td>
<td>ASEAN</td>
<td>1,486,467</td>
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<tr>
<td>1</td>
<td>Indonesia</td>
<td>496,800</td>
</tr>
<tr>
<td>2</td>
<td>Thailand</td>
<td>272,100</td>
</tr>
<tr>
<td>3</td>
<td>Malaysia</td>
<td>214,700</td>
</tr>
<tr>
<td>4</td>
<td>Singapore</td>
<td>192,800</td>
</tr>
<tr>
<td>5</td>
<td>Philippines</td>
<td>186,000</td>
</tr>
<tr>
<td>6</td>
<td>Vietnam</td>
<td>90,880</td>
</tr>
<tr>
<td>7</td>
<td>Brunei</td>
<td>17,180</td>
</tr>
<tr>
<td>8</td>
<td>Myanmar</td>
<td>13,700</td>
</tr>
<tr>
<td>9</td>
<td>Cambodia</td>
<td>10,820</td>
</tr>
<tr>
<td>10</td>
<td>Laos</td>
<td>5,187</td>
</tr>
</tbody>
</table>

The Big Six: Revenues vs GDP (2008)

**OIL AND GAS COMPANIES:**
- Exxon: $404,5 billion
- RD Shell: $355,8 Billion
- BP: 274,3 Billion
- Chevron: $204,9 billion
- Conoco Phillips: $188,5 billion
- Total SA: $153,8 billion

**ASEAN COUNTRIES:**
- Indonesia: $496,8 Million
- Thailand: $272,1 million
- Malaysia: $214,7 million
- Singapore: $192,8 million
- Philippine: $186 million
- Vietnam: $90,880 million
- Brunei: $17,180 million
- Myanmar: $13,700 million
- Cambodia: $10,820 million
- Laos: $5,187 million
Global Norms and Standards of EI

- Required companies to report payment to host government:
  - USA’s Dodd – Frank Act (Cardin – Lugar provision)
  - EU transparency legislation
- Guidelines for Companies
  - OECD Guidelines for Multinational Enterprises
  - UN Global Compact
- Human Rights Standard
  - Voluntary Principle on Security and Human Rights
  - UN’s Guiding Principles on Business and Human Rights
- Environmental & Social Standard:
  - IFC’s Policy and Performance Standard on Social and Environmental Sustainability
- Financial Transparency
  - Equator Principles
- Revenue Collection:
  - Extractive Industries Transparency Initiative (EITI)
- Public Revenue & Expenditure Transparency
  - IMF’s Code of Good Practice on Fiscal Transparency
  - World Bank’s Public Expenditure and Financial Accountability (PEFA)

Extractive Industries Transparency Initiative (EITI)

- Established in 2003;
- The EITI is a global standard, a voluntary, multi-stakeholder initiative intended to promote accountability and good governance in resource-rich states through the generation and publication of credible data on payments made by EI sector companies to host state governments;
- By 2012: 14 compliant countries, 22 candidate countries, 123 reports.
Prudent use of natural resource wealth as an engine for sustainable economic growth
Effective management of resource wealth by sovereign governments;
Regular, easily accessible publication of payments made and revenues received;
Recognition of the fluctuation of benefits of resource revenue streams due to price volatility and the need to governments to manage such;
Transparency of government and corporate financial management and accounting of EI revenues, including credible audit of payments and revenues;
Accountability of the government to all citizens for resource revenue management;
Disclosure of all EI payments to a host country; Greater transparency in the context of both contracts and laws;
Engagement of civil society and all stakeholders in seeking solutions to problems stemming from EI sector projects;
For a complete principle and criteria go to: [http://eiti.org/eiti/principles](http://eiti.org/eiti/principles)

Host country publicly signs up to EITI.
National Multi-stakeholder Implementation Group (MSWG) is formed.
Time-bound work plan is drawn up by MSWG.
MSWG determines sector & boundaries for EITI reporting and templates developed based on that.
Reporting-reconciliation process is executed.
Results made public, supported by a communications program.
Process begins again.
Implementing country undergoes validation every two years.
Extractive firms in Indonesia that support EITI

**Oil and gas:** BP, ChevronTexaco, ConocoPhilips, Eni, ExxonMobil, Hess, Marathon, Santos, Shell, StatoilHydro, Talisman, Total, Woodside.

**Minerals and coal:** BHP Billiton, Eramet, Freeport, INCO, Newmont, OZ Minerals, Rio Tinto, Sumitomo

However, all firms within an implementing country, not just those which support EITI as a matter of corporate policy, must report.

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Indonesia AND EITI (1)

- First in the South East Asia
- Why did Indonesia decided to implement EITI?
  - The raise of decentralization in Indonesia context
  - Local governments demand central government to be transparent on revenue sharing mechanism
  - The need to increase investment in oil and gas sector
  - Improving overall investment climate
- Indonesia kicked of the process to implement EITI in 2010
Indonesia AND EITI (2)

- EITI implementation in Indonesia is required by Presidential Regulation, enacted in 2010
- EITI secretariat and implementation team is hosted by Coordinating Ministry of Economics Affairs
- Stakeholders: Central Government's Ministries and Agencies, Local Governments, Companies and Civil Society.
- Sector covered: oil, natural gas, and mineral industries
- Revenues Reporting: project by project basis
- First report due to late 2012/early 2013, based on 2009 audited report

EITI Implementation

Source of Industries:
- Oil and Natural Gas Projects
- Coal
- Mineral Extraction (Gold, Copper, Tin, Bauxite, etc)

Revenue sharing (under PSCs)
Royalties (from License contract)
Bonuses
Taxes
CSRs/ComDev
Etc
EITI Process (1)

Companies publish what they pay and governments publish what they receive in an EITI Report.

- **COMPAINES** disclose payments
- **EITI REPORT** where the tax and royalty payments are independently verified and reconciled
- **GOVERNMENTS** disclose receipt of payments

EITI Process (2)

This process is overseen by a multi-stakeholder group of governments, companies and civil society.

- **Association of O&G association**
- **Association of Mineral companies**
- **SOE on O&G**
- **Publish What You Pay Indonesia – a coalition of more than 30 NGOs**
- **Ministries and Government Agencies, Local government**
EITI might prevent corruption but does not necessarily effective in addressing corruption in the entire extractive industries' value chain.

- ...however it helps to detect corruption practices and serve as evaluation tool to improve entire EI governance (transparency, accountability, public participation) along the value chain.
- EITI report can be excellent source of information to be used by civil society to advocate broader transparency and accountability.
- Other standard/norms/framework is required to strengthen effectiveness of EITI.
- Required genuine participation of three parties for an effective and sustained result
  - Government must open to engage with CSOs & Companies
  - Strong civil society institutions is a must
Effectiveness of EITI as transparency and accountability tool determine by several infrastructure & material:
- Data and information of oil, gas, and mineral productions
- Availability of Extractive Industries contract
- Clear and transparent revenue flows in the country (companies payment to the government)
- Government (central and local/state) revenue and expenditure reporting mechanism
- Government accounting standard and budget transparency
- Public Accounting Rules and Stock Exchange Regulation
- Etc...

Effective EITI should be supported by the capacity of Government to manage revenues, and plan the development to ensure the resource rich country to escape from resource curse.

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