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A STUDY OF THE RELATIONSHIPS
BETWEEN THE GOVERNMENT AND THE
PETROLEUM INDUSTRY IN SELECTED
FOREIGN COUNTRIES

INDONESIA

PREPARED BY THE
CONGRESSIONAL RESEARCH SERVICE

AT THE REQUEST OF

HENRY M. JACKSON, Chairman
COMMITTEE ON INTERIOR AND
INSULAR AFFAIRS
UNITED STATES SENATE

PURSUANT TO

S. Res. 45
THE NATIONAL FUELS AND ENERGY
POLICY STUDY

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SENATE RESOLUTION 45

NATIONAL FUELS AND ENERGY POLICY STUDY

This publication is printed for the use of Senators participating in the National Fuels and Energy Policy Study, authorized by Senate Resolution 45 of the 92d Congress.

Senate Resolution 45, introduced by Senators Jennings Randolph and Henry M. Jackson, was amended and agreed to by the Senate on May 3, 1971. The resolution authorized the Senate Committee on Interior and Insular Affairs and ex-officio members of the Committees on Commerce and Public Works and the Joint Committee on Atomic Energy to make a comprehensive study of programs and policies required to meet national energy needs.

Subsequently, the Senate approved the addition of ex-officio members from the Committees on Aeronautical and Space Sciences, on Finance, on Foreign Relations, on Government Operations, and on Labor and Public Welfare.

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MEMORANDUM OF THE CHAIRMAN

To Members and Ex Officio Members of the National Fuels and Energy Policy Study (S. Res. 45, 92d Congress), Committee on Interior and Insular Affairs:

The advent of the energy crisis has brought a vastly expanded Federal role in energy policy. The creation of the Federal Energy Administration and the Energy Research and Development Administration by the 93d Congress symbolize this fact. The close relationship between energy, economic and foreign policy and the predominant Federal ownership of energy resources are among the factors which assure a greater Federal role in energy matters in the future.

As a new Federal role emerges it is inevitable that the traditional role of private industry must also change in response to new requirements and objectives of national energy policy. Dissatisfaction with the past performance of both industry and government in meeting national energy needs has led to a number of proposals that would change the relationship between public and private sectors on energy matters. These include Federal chartering of energy corporations and the creation of a Federal Oil and Gas Corporation to develop federally owned energy resources.

As Congress considers these and other proposals, it should be useful to consider the experience of other countries. With this in mind, the Congressional Research Service of the Library of Congress was asked to examine the relationships between Government and the petroleum industry in selected foreign countries. In each case, these studies will attempt to describe the extent to which Government has assumed traditional industry functions; the degree of regulation when such functions are still performed by the industry; the institutional mechanisms used by Government to regulate or control industry operations and the statutory basis for Government action.

I have directed that the seventh study in the series, dealing with Indonesia, be published as a committee print for the use of Senators participating in the National Fuels and Energy Policy Study.* The study was prepared by Larry A. Niksch, Analyst in Asian Affairs of the Congressional Research Service.

HENRY M. JACKSON, *Chairman.*

* The other reports in the series are: United Kingdom, Italy, The Netherlands, Japan, Germany, and France.

PREFACE

This study on Indonesia is the seventh in a projected series of country monographs intended to provide a brief narrative account of the relationships between Government and the petroleum industry in several industrialized oil consuming countries.

While there are, of course, wide variations in the practices and experiences of the various countries, each study will cover the following general topics:

Overall energy position.—As the framework for the more specific relationships with the petroleum industry, there is a brief summary of the country's energy posture, including a description of overall energy policy, energy use patterns, and the degree of dependence on petroleum, particularly on imports.

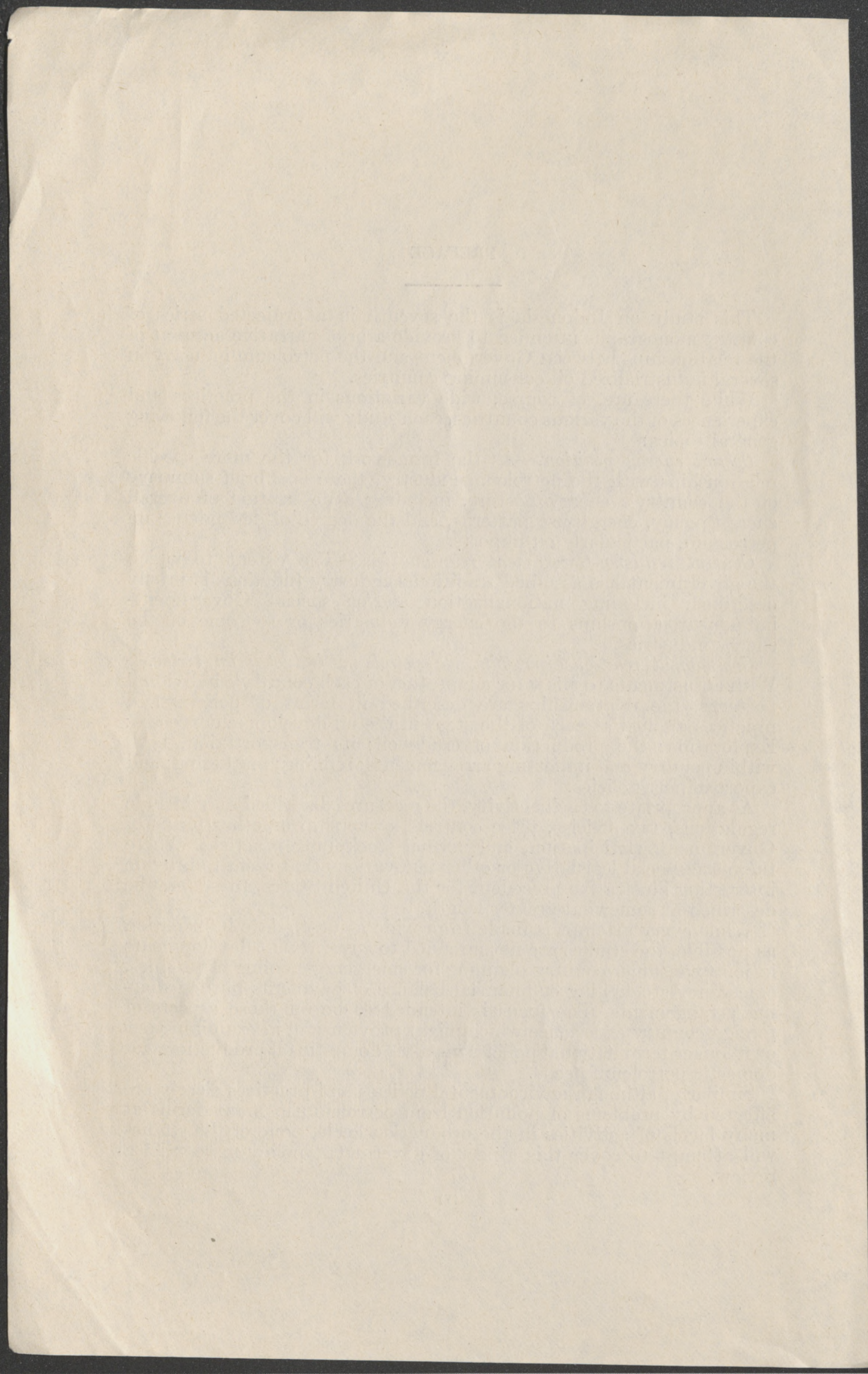
General industry-Government relationships.—The extent to which the government has assumed traditional industry functions is briefly described, including nationalization and/or special Government-industry relationships to the energy industries or to some of the energy industries.

Government relationships with the petroleum industry by sector.—With adjustments to allow for adaptation of each country's individual patterns, the relationships are described in terms of policies and practices applied at each of the steps in the oil development process: Exploration; the production of crude oil; its transportation, both within country and importing arrangements; refining; marketing; and export-import policies.

As appropriate to each activity, the measures described may include regulations, tax policies, price controls, ownership or other forms of Government participation, and normal stockpiling practices. Where there are special legislative or other innovations that seem to provide interesting illustrative precedent for the United States, these may be described at somewhat greater length.

While every attempt is made to provide as up-to-date information as possible, the studies are not intended to cover recent developments in joint consumer country planning for emergency pooling of supplies, emergency stockpiling or financial balance of payments burden sharing arrangements. The focus is intended to be on those aspects of foreign country experience which might prove useful in examining our own longer term national policies vis-a-vis domestic oil production and domestic petroleum needs.

Similarly, although environmental policies and practices clearly are affected by problems of pollution from petroleum in many forms at many levels of activities in the production cycle, none of the studies will attempt to cover this aspect of government policy in so brief a review.



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INDONESIA AND PETROLEUM—GOVERNMENT-INDUSTRY RELATIONS

(By Larry A. Niksch, Analyst in Asian Affairs, Congressional Research Service)

I. ECONOMIC BACKGROUND

Indonesia occupies an unusual position among oil producing nations. Unlike smaller, less populated producing countries that have accumulated huge revenue surpluses, Indonesia's monumental economic problems will require extensive oil revenues for their solution, if, in fact, they can be solved. Indonesia is one of the poorest, most overpopulated nations in the world. The population is approximately 130 million, ranking it fifth in the world. Nearly two-thirds of the people live on the island of Java, which constitutes less than 7 percent of the total land area. The population density of Java is 565 people per square kilometer, one of the highest in Asia and the world. Moreover, about 54 percent of the population is under the age of 20; this makes probable a high rate of population growth in the future. The present population growth rate is estimated at over 2.5 percent per annum, compared to 0.8 percent per annum for the United States. The population is expected to reach 183 million by 1985 and 260 million by the end of the century.

Over 84 percent of the Indonesian people live in rural areas. About 62 percent of the labor force (estimated at 40 million in 1971) is employed in agriculture, mainly subsistence farming. Unemployment and underemployment is over 30 percent. The literacy rate is about 40 percent.

The U.S. Agency for International Development states in its fiscal year 1976 program submission to Congress that "health and nutrition conditions are primitive at best." Infant mortality was estimated in 1971 at 135 per 1,000 live births compared to 18.5 per 1,000 for the United States. Disease is widespread. Life expectancy is only 48 years compared to 71 years for Americans.

Indonesia's Gross National Product (GNP) was estimated at \$11.4 billion in 1973, and per capita GNP is presently estimated at less than \$120. This latter figure can be compared with \$560 for Taiwan, \$400 for South Korea, \$474 for Malaysia, \$252 for the Philippines, and \$234 for Thailand.¹

Since the collapse of the Sukarno regime in the mid-1960's, the Government of Indonesia has given high priority to economic problems. The Government's initial goals were to control inflation (where it achieved considerable success), sharply increase rice production (where it also made major gains by the 1975-76 crop), and renew overall economic growth. The First Five Year Plan (1969-73) emphasized these priorities. The Second Five Year Plan (1974-79) also sets these as major objectives, but it gives increased emphasis to satisfaction of economic needs such as adequate food and clothing, housing construction, improved social welfare, employment, and education.

¹ U.S. Agency for International Development. Gross National Product: Growth Rates and Trend Data by Region and Country. May 1, 1974: 7. U.S. Agency for International Development. Fiscal Year 1976 Submission to the Congress: East Asia Programs. May 1975: 11.

II. OVERALL ENERGY POSITION

The role of oil in Indonesia is set against this economic background. The Government of Indonesia will rely increasingly on earnings from petroleum sales to finance its programs under the Second Five Year Plan, rather than on foreign economic assistance.² For example, the percentage of foreign exchange earnings from oil increased from 36 percent of the total in Indonesian fiscal year 1969-70 to 70 percent in fiscal year 1974-75. Gross foreign exchange earnings from petroleum amounted to nearly \$5 billion in fiscal year 1974-75 as compared to \$384 million in fiscal year 1969-70. For the Second Plan, oil is expected to provide about 70 percent of foreign exchange revenues which will reach an estimated level of \$7.3 billion by fiscal year 1978-79.³ Indonesia's Minister of Mines, Mohammed Sadli, summarized the role of oil and other natural resources in the country's development plans when in 1974 he told the Australian Petroleum Exploration Association that "in Indonesia we are confident that our current interests and those of future generations are best served not so much by safeguarding future production as providing the country now with the resources we need to undertake the reconstruction and development of our economy."⁴

Indonesia's known oil reserves are put at 15 billion barrels, an increase from the 10.5 billion barrels estimated in 1974. This is 2.1 percent of the world's known oil reserves.⁵ It is likely that Indonesia's known reserves will rise again in the future. Ninety percent of the prospective oil and gas area inside the country and offshore remain to be explored and tested.⁶ Spokesmen for Pertamina, Indonesia's national oil company, have stated that foreign oil companies working under production sharing contracts have located about 100 structures and that in Pertamina's five working areas, there are 128 known structures (geological formations where the existence of oil is likely). In mid-1974, only 26 of these had been tested by drilling. Pertamina also expects testing of the area between the Sunda shelf in the west and the Sahul shelf in eastern Indonesia in the next 5 to 10 years.⁷

Indonesia's current output of crude oil is nearly 1.4 million barrels daily (b/d) or about 2.4 percent of the world's production. Chart I shows the growth in production since 1960:

CHART I

Indonesia's Crude Oil Production, 1960-74

Year:	Production (thousands of b/d)
1960	419
1965	501
1970	855
1971	904
1972	1,056
1973	1,339
1974	1,360

Source: International Economic Report of the President, p. 153.

² The Inter-Government Group on Indonesia, composed of the United States and other Western aid donors, provided almost \$5.0 billion in economic aid from 1967 through 1974. See U.S. Agency for International Development, Fiscal Year 1976 Submission to Congress: East Asia Programs, p. 12.

³ Kennedy, John L. Indonesia Plans Based on Record, Prospects. Oil and Gas Journal, v. 73, March 3, 1975: 74. Grenville, Stephen. Indonesia: the Second Five Year Plan. Intereconomics, January 1975: 24.

⁴ Indonesia '74 Focus. Far Eastern Economic Review, v. 86, November 15, 1974: 11-12.

⁵ U.S. President. International Economic Report of the President, March 1975. Washington, Government Printing Office: 152. Indonesia. Petroleum Economist, v. 42, April 1975: 154.

⁶ The Role of Oil in the Indonesian National Economy. New York Times, August 15, 1975.

⁷ Kennedy, Indonesia Plans Based on Record, Prospects, pp. 76-77.

Pertamina forecasts an output of 3 million b/d by 1980 and 4 million b/d by 1984.⁸ Targets set under the Second Five Year Plan are not as ambitious. The plan calls for an annual increase in production of 8 percent, bringing it at the end of fiscal year 1978-79 to about 2 million b/d, or 720 million barrels for the year.⁹

The bulk of crude oil production is exported, and this situation will continue throughout the Second Five Year Plan despite some increase in domestic refining capacity and consumption. Chart II shows the plan's targets for crude oil production and exports, refining capacity, and domestic fuel demand:

CHART II.—SECOND 5-YEAR PLAN TARGETS

[Millions of barrels]

Fuel year	Crude production	Crude export	Crude refining capacity	Domestic fuel demand
1974-75.....	529	423	118.6	69.01
1976-76.....	550	444	125.7	78.75
1976-77.....	620	514	162.1	89.08
1977-78.....	660	550	174.5	99.72
1978-79.....	720	610	185.0	113.17

Source: Oil and Gas Journal, Mar. 3, 1975, p. 76.

Japan by far is the leading purchaser of Indonesia's oil exports, but since 1970 the United States also has become a major customer. Both countries find Indonesia's oil particularly attractive because of its low sulfur content, which reduces the potential for air pollution. Crude from Indonesia's Minas field (Sumatra), has a sulfur content of 0.1 percent.¹⁰ Charts III and IV show the growth of oil exports to Japan and the United States, according to Pertamina statistics:

CHART III.—INDONESIA'S OIL EXPORTS TO JAPAN

[Thousands of barrels]

Year	Crude Oil	Refined Products
1971.....	176,353	27,153
1972.....	207,045	40,676
1973.....	264,087	51,582

Source: Petroleum Economist, July 1974 p. 259.

CHART IV.—INDONESIA'S OIL EXPORTS TO THE UNITED STATES

[Thousands of barrels]

Year	Crude Oil	Refined Products
1971.....	36,653	¹ N.A
1972.....	49,082	¹ NA
1973.....	67,932	¹ NA

¹ Not available.

Source: Petroleum Economist, July 1974, p. 259.

⁸ Interview with General Ibnu Sutowo, President-Director of Pertamina. Oil and Gas Journal, v. 73, March 3, 1975: 73. Indonesia's Pertamina. Petroleum Economist, v. 42, March 1975: 99.

⁹ Kennedy, Indonesia Plans Based on Record, Prospects, p. 74-76.

¹⁰ Indonesia: Revenue this Year. Petroleum Economist, v. 41, February 1974: 68.

The importance of Japan and the United States is illustrated by the fact that Indonesia's total crude oil exports for 1973 was 369.5 million barrels of which Japan and the United States combined received 331.9 million barrels.

Since the late 1960's, Indonesia has been one of the most active areas for foreign oil companies. In 1965, only four oil firms were operating in the country. By the end of 1974, more than 45 companies were exploring for petroleum.¹¹ Some 35 companies, most of them American, held production sharing contracts with Pertamina.¹² Between 1968 and April 1975, there were 209 oil and natural gas discoveries in Indonesia, scattered from Sumatra in the west to Irian Jaya (West New Guinea) in the east.¹³ Oil industry expenditures for exploration and production have grown from \$400 million in 1973 to \$807 million in 1974 and are expected to reach \$1,200 million in 1975.¹⁴ Chase Manhattan Bank has predicted that petroleum industry expenditures in Asia between 1970 and 1985 could total \$55 billion as compared to \$23 billion in the Middle East,¹⁵ and the companies likely will spend a large portion of these funds in Indonesia.

American companies account for about 80 percent of the foreign investment in Indonesian oil.¹⁶ P. T. Caltex Pacific Indonesia (CPI), jointly owned by Standard Oil of California and Texaco, is the biggest foreign producer. CPI production, all onshore and mostly on Sumatra, was 965,000 b/d in 1973. Nearly 410,000 b/d came from CPI's Minas field, the largest single producing field in the country. Other major U.S. companies are Union Oil (off eastern Borneo); Atlantic Richfield (Java Sea); Natomas Company (Java Sea and on Java); Mobil Oil (north Sumatra); and P. T. Stanvac, a consortium of Mobil Oil and Esso (mainly onshore Sumatra). In addition, numerous American "independent" oil companies operate in Indonesia. Among the more important independents are Carver-Dodge Oil Company, Getty Oil Company, Genard Oil and Gas, Mapco Inc., North Central Oil, Southern Cross Ltd., and South Pacific Oil Company.¹⁷ Mapco, North Central, Southern Cross, and Trend Exploration (U.S.) are partners in drilling in Irian Jaya in a major new venture.¹⁸

III. GOVERNMENT RELATIONSHIP WITH THE PETROLEUM INDUSTRY

A. PERTAMINA: INDONESIAN NATIONAL OIL

Pertamina, or the National Oil Mining and Natural Gas Company, is Indonesia's state oil company. Its origins lay in several pieces of legislation passed since independence. Indonesia's first constitution of 1945 decreed that natural resources on land and in the sea "shall be controlled by the State. . . ." Law No. 44 of 1960 provided that petroleum operations were to be "exclusively carried out" by state enterprises, but it authorized the Minister of Mines to "appoint

¹¹ Fabrikant, Robert. Production Sharing Contracts in the Indonesian Petroleum Industry. *Harvard International Law Journal*, v. 16, Spring 1975: 303.

¹² *International Petroleum Encyclopedia*, 1974: 90.

¹³ The Role of Oil in the Indonesian National Economy.

¹⁴ *Ibid.*

¹⁵ *Ibid.*

¹⁶ Goldstone, Anthony, Pertamina's Risky Strategy. *Far Eastern Economic Review*, v. 82, December 24, 1973: 26.

¹⁷ *International Petroleum Encyclopedia*, 1974, p. 90-91.

¹⁸ Kennedy, John L. Development of West Irian's Watio Field Gets Priority. *Oil and Gas Journal*, v. 73, March 3, 1975: 100.

parties as contractors of the State Enterprises, if required, for execution of operations."¹⁹

After the passage of Law No. 44, the Government set up several state oil companies. By 1968, these had been merged into one company, Pertamina.

Law No. 8 of September 1971 governs the operations and organization of Pertamina and its relationship, especially financial relationship, with the rest of the Government. It provides for a board of commissioners, composed of Cabinet ministers, to oversee Pertamina's activities. The board, itself, is responsible to the President of Indonesia. In reality, President Suharto has allowed Pertamina to operate independently, and major policy decisions are made by Lt. Gen. Ibnu Sutowo, the President-Director of Pertamina.

Pertamina has been described as a "state within a state," and Sutowo generally is recognized as one of the two or three most powerful men in the country. Based on 1972 figures, Pertamina ranked 184th in the list of the 300 largest corporations outside the United States, and its current rating probably is higher.²⁰ The organization reportedly has assets of over \$2 billion,²¹ nearly 18 percent of Indonesia's GNP. In 1974, the Minister of Mines disclosed that its operating budget was \$1.9 billion, which would be about 40 percent of the entire Government's budget. The number of employees are estimated at between 36,000 and 60,000.²² As such, Pertamina dwarfs other economic enterprises in Indonesia.

Pertamina's functions are in four broad areas. First and foremost, it negotiates production sharing contracts with the foreign oil companies under which the foreign firms operate in Indonesia. Pertamina also administers the contracts (See section III.B. The Production Sharing Contract). Secondly, Pertamina sets the official selling price of Indonesian crude (See section III.C. Pricing Policies and Profits). Third, Pertamina engages in its own exploration and production of oil and natural gas. Fourth, it has embarked on a host of other economic activities, some related to oil and natural gas but others in nonrelated fields.

Pertamina's own exploration and production operations have yielded a current production of more than 150,000 b/d of oil, still a small amount of the total nationwide output of nearly 1.4 million b/d. The Government's view has been that Pertamina should undertake exploration and production where the risk is not high, leaving higher risk operations to the foreign companies.²³ Therefore, Pertamina's activities are essentially onshore in accessible places like the Jatibarang field on the north coast of West Java (45,000 b/d).

Under Law No. 8, the President of Indonesia shall authorize diversification of Pertamina's activities. In practice, President Suharto has authorized Pertamina to engage in wide-ranging projects. Sutowo now describes his organization as a "national development company" that will help develop other forms of energy, establish other industries, and participate in "other community development projects."²⁴

¹⁹ Fabrikant, *Production Sharing Contracts in the Indonesian Petroleum Industry*, p. 306, 308.

²⁰ Pertamina: *Roll Me Over in the Clover*. *Far Eastern Economic Review*, v. 86, November 15, 1974: 14.

²¹ *International Petroleum Encyclopedia*, 1974, p. 90.

²² *Indonesia's Pertamina*, p. 101.

²³ *Foreign Area Studies*, American University. *Area Handbook for Indonesia*. DA Pam 550-39. Washington, Government Printing Office (1975) p. 352-353.

²⁴ Interview with General Ibnu Sutowo, President-Director of Pertamina, p. 73. Pertamina: *Roll Me Over in the Clover*, p. 14.

Pertamina owns and operates all of Indonesia's commercial refineries (seven refineries with a capacity of 422,000 b/d).²⁵ It also markets all domestic consumption of petroleum products. In connection with marketing, it maintains a fleet of more than 200 cargo vessels, tug boats, oil barges, and tankers and has contracted for the construction of additional tankers. Pertamina has established numerous facilities to service its own personnel and foreign oil company personnel. These include a \$6 million telex communications center in Jakarta; an aviation service of over 60 helicopters and a fleet of fixed wing aircraft for transportation; an eight story Oil Center Office in Jakarta; a 300 bed hospital; and rental housing for foreign oil personnel.²⁶

Pertamina has primary responsibility for the maintenance and operation of several ports connected with the transportation of oil and natural gas. In addition, it has constructed several submarine pipelines to load larger tankers offshore. To meet the needs of offshore oil exploration, production, and transshipment, Pertamina has constructed four oil service and supply bases that offer services previously provided from Singapore. The largest of these is on Batam Island, 12 miles south of Singapore, where a joint venture group involving Pertamina, the Bechtel Corporation, and Nisso Iwai of Japan is building an industrial estate. It will contain one or more refineries, two deep water ports, a variety of oil-related industries and fabrication plants, a tourist-resort complex, a steel plate processing plant, and cattle ranches. The Government envisages Batam as the future logistics center for Southeast Asian oil development.²⁷

Pertamina's first petrochemical plant was completed in 1973 in South Sumatra and produces 20,000 tons of polypropylene annually. Also, in South Sumatra, Pertamina and Commonwealth Oil Refining Company have begun the construction of a large Aromatics plant, which will produce materials for synthetic fibers and plastics for use in domestic factories and for export. Also under construction are two liquified natural gas plants, which will have the capacity to produce 10.9 million tons annually representing a Btu equivalent of about 260,000 barrels of oil per day. Natural gas will also supply an offshore fertilizer plant which Pertamina is building to help meet Indonesia's requirement of 2 million tons of fertilizer annually (current production is 100,000 tons annually).²⁸

In fields more unrelated to oil and natural gas, Pertamina and the Ministry of Industry joined to develop an integrated steel mill on the site of the abandoned Soviet steel project at Citegon in West Java. When completed, it will have an output of 2 million tons of steel annually. Pertamina was also involved in a \$150 million rice growing and milling operation on South Sumatra, and it promotes tourism by building motels in various parts of Indonesia.

After 1972, the demands of these many projects on Pertamina's financial resources caused it to borrow heavily from overseas financial institutions. By mid-1975, its debt was over \$2 billion, including \$1.5 billion in short term debts.²⁹ In March 1975, Pertamina was

²⁵ Indonesia's Pertamina, p. 100. The Role of Oil in the Indonesian National Economy.

²⁶ The Role of Oil in the Indonesian National Economy.

²⁷ Ibid.

²⁸ Ibid.

²⁹ Pertamina: Roll Me Over in the Clover, p. 15. Pertamina Runs into Financial Problems Due to Overextension, Slight Sales Drop. Wall Street Journal, March 26, 1975. Indonesia. Petroleum Economist, v. 42, August 1975: 309.

unable to pay some short term obligations on time. The Government directed the Bank of Indonesia to guarantee repayment of short term debts. This has led the Government to tighten the formerly loose controls on the organization. The Finance Ministry and the Bank of Indonesia will handle all future borrowing for Pertamina. Senior officials of the Ministry of Mining and the Ministry of Finance have assumed high positions in Pertamina dealing with budget and finances.³⁰ The Government also has placed certain Pertamina projects under the authority of other agencies, including the Java steel complex and two fertilizer plants in Java. The Batam Island refinery has been postponed, and Pertamina's planned rice estate in South Sumatra has been reduced in scale.³¹ In short, it appears that the Government will scrutinize more closely Pertamina's activities, especially those not directly related to oil and natural gas development. Pertamina's expansion into such endeavors may slow or cease. However, its commanding position in energy development seems secure.

B. THE PRODUCTION SHARING CONTRACT

The production sharing contract is the basic contractual instrument of Government-oil industry relations. It is a unique innovation of the Government of Indonesia. The first production sharing contract was signed in 1966. At present about 45 foreign oil or oil related companies operate in Indonesia under production sharing contracts.³² Many other energy producing countries or potential energy producers either have adopted the production sharing contract or have shown interest in it.

The production sharing contract has replaced the older "contract of work," of the early 1960's. The contract of work provided the company with terms no less favorable than were then available in the Middle East in terms of control over management and operations.³³

The production sharing contract is signed by Pertamina as the representative of the Government. The standard contract has a duration of 30 years. The company, or contractor, is obligated to bear all expenses and financial risks of the operation. It is responsible for furnishing all foreign exchange, materials, equipment, supplies, and foreign personnel necessary for the operation. The contractor receives unrestricted access rights to and from the contract area and facilities.

The contractor is allowed to recover as operating expenses up to 40 percent of the gross income from each barrel of crude oil.³⁴ The remaining 60 percent of gross income is divided between Pertamina and the company. Until 1973, the standard division was 65 percent to Pertamina and 35 percent to the contractor. With the increase in world oil prices, Pertamina has renegotiated old production sharing contracts and has written into new ones a greater percentage share to it. Under the new or renegotiated contracts, the 65-35 split now applies only to the first \$5 of gross income per barrel of oil. From gross income above \$5 per barrel, the division is 85-15 percent in Pertamina's

³⁰ Indonesia: Pertamina Debts Guaranteed. *Petroleum Economist*, v. 42, April 1975: 138. Coggin, Dan. *Oil Empire: Tethering the Corporate Tiger*. *Far Eastern Economic Review*, v. 90, November 7, 1975: 9-11.

³¹ Coggin, *Oil Empire: Tethering the Corporate Tiger*, pp. 10-11.

³² Indonesia's Pertamina, p. 99.

³³ Fabrikant, *Production Sharing Contracts in the Indonesian Petroleum Industry*, p. 310.

³⁴ Operating costs include rental payments to Pertamina for equipment, depreciation of such equipment, personnel expenses, administrative expenses, buildings, rental of equipment from third parties, transportation, contract services, insurance claims, technical services, and other expenditures incurred to fulfill the contractor's obligations. Interest on money borrowed is not included in operating costs.

favor. Thus, under Indonesia's current selling price of \$12.80 per barrel, the contractor would retain up to \$5.12 as operating expenses. Since this is already above the \$5 limit, the remaining \$7.68 would be split on the 85-15 percentage basis.

In at least one or two cases, the standard contract has been modified to increase Pertamina's share of the gross income per barrel as production rises. Caltex and Pertamina settled on contract terms at the beginning of 1975 which set a base of \$5.83 and a 60-40 split in Pertamina's favor up to the base, minus the 40 percent in operating costs to the company. For the remainder of gross income per barrel above \$5.83, the 85-15 division applies to the first 150,000 b/d. The split is 90-10 on the next 100,000 b/d and 95-5 for the remainder. Caltex's present production is about 850,000 b/d.³⁵ In July 1975, Pertamina signed a production sharing contract with a British West Indies private corporation with significant U.S. investment participation; the contract also reportedly contained a sliding scale for the division of gross income per barrel at various levels of production.³⁶

Besides the income sharing provisions, the production sharing contract contains other unique features:

(1) *The Management and Submission of Information Clauses.*—All contracts provide that "Pertamina shall have and be responsible for the management of the operations contemplated." The contractor "is responsible to Pertamina for the execution of such operations," and Pertamina is obligated to assist the company. The contractor is required to submit annually to Pertamina a budget and program of operations for the contract year, and Pertamina may propose revisions to the budget and program of operations. The parties are "to agree on the revisions proposed by Pertamina."³⁷ Moreover, Pertamina has title to "all original data" resulting from the operation; the contractor is obliged to submit to Pertamina all original data and reports compiled during the term of the contract.³⁸

The management clause represented a major change from the older concession arrangements under which the companies retained full managerial control. To date, Pertamina generally has not interjected itself into the day to day affairs of company management and operations, even though the companies are required to consult with and submit various reports to Pertamina.³⁹ For now, Pertamina lacks the technical and managerial skills for this type of supervision, and it also does not wish to discourage future investment by the oil companies. On at least one occasion, however, Pertamina has required the contractor to revise its program of operation and begin production despite the contractor's view that the discovery was not significant enough for commercial production.⁴⁰

The Management Clause has served company interests in that Pertamina has acted as a liaison between the companies and other government agencies to expedite petroleum operations by keeping the companies from becoming entangled in the Indonesian bureaucracy.

³⁵ Indonesia. *Petroleum Economist*, v. 42, March 1975: 114-115. U.S. Federal Energy Administration. *The Relationship of Oil Companies and Foreign Governments*. Washington, June 1975: 68.

³⁶ Indonesia Gives INCA Rights in 2 Oil Tracts in South China Sea. *Wall Street Journal*, July 15, 1975.

³⁷ Fabrikant, *Production Sharing Contracts in the Indonesian Petroleum Industry*, p. 312-313.

³⁸ *Ibid.*

³⁹ The contracts state that information submitted to Pertamina shall not be disclosed to a third party without informing the contractor and giving the contractor "the opportunity to discuss" the disclosure.

⁴⁰ Fabrikant, *Production Sharing Contracts in the Indonesian Petroleum Industry*, p. 316.

Pertamina has enhanced its generally good working relations with the companies by acting as a buffer between them and the rest of the Indonesian Government, especially in the areas of permits and taxation.

(2) *The Marketing Clauses.*—Most production sharing contracts require the contractor to bear marketing responsibility for all crude oil produced in the contract area. The standard contract also requires the contractor to supply a portion of its commercial production to Indonesia's domestic market. Indonesia pays the contractor 20 cents per barrel of oil received under the domestic supply requirement.

The contracts also specify that if Pertamina can obtain a higher price for "cost" oil (oil sold to meet the company's operating costs), the contractor must match Pertamina's price or permit Pertamina to market the oil. If Pertamina markets the oil, it must reimburse the contractor, and the entire amount is applied to the contractor's operating costs account. Pertamina's right to sell "cost" oil at a higher price accelerates the reimbursement to the companies for operating costs and increases Pertamina's percentage of total sales revenue. Most contracts also specify that the contractor must refine in Indonesia a stipulated percentage of crude oil when production reaches a certain level. If no refining facility is available, the contractor must build one, providing the parties consider it economical. As an alternative, the contractor may make an equivalent investment in another project related to petroleum or petrochemical industries.

(3) *Financial Clauses.*—All production sharing contracts specify annual minimum financial expenditures to be made by the contractor during the initial years of the contract. They also require the contractor to make a cash payment (production bonus) to Pertamina after crude oil production reaches a stipulated level. Contracts also require the contractor to pay Pertamina a stipulated sum (compensation bonus) for information regarding the contract area. Reportedly, the compensation bonus is a bidding device, with the company offering the highest compensation bonus usually receiving the contract.⁴¹

(4) *Tax Clauses.*—Most production sharing contracts provide that Pertamina will pay the contractor's Indonesian income tax out of Pertamina's share of oil sales revenue ("profit" oil). By tying the contractor's tax obligations to the value of Pertamina's "profit" oil, the contractor theoretically could be liable for payment of a portion of its Indonesian income tax if the tax exceeds the value of Pertamina's "profit" oil. In actual practice, however, the large revenues from "profit" oil held by Pertamina have given it ample funds to pay the contractor's tax.

(5) *Participation Clauses.*—A minority of production sharing contracts require the contractor to offer a stipulated percentage (usually 5 or 10 percent) of its contractual rights and obligations to an "Indonesian participant" either upon the discovery of commercial petroleum or the commencement of commercial sales.

(6) *Ownership of Equipment.*—A unique feature of production sharing contracts states that all equipment purchased by the contractor pursuant to its operations becomes the property of Pertamina when landed at an Indonesian port. When commercial production begins, the con-

⁴¹ Ibid., p. 323.

tractor must make rental payments to Pertamina for use of the equipment not to exceed annually ten percent of the value of the equipment. The contractor may include rental payments as part of its operating costs. The contractor does not have to pay rent for leased equipment belonging to subcontractors, and many companies reportedly have leased equipment in order to avoid transferring ownership to Pertamina.⁴²

(7) "*Indonesianization*" *Clause*.—Production sharing contracts generally require the contractor to train and educate Indonesian nationals for all job classifications involved in the operation. When commercial production begins, the contractor is obligated to train and employ Indonesian personnel for all positions including administrative and executive management positions. Most contracts also state that the contractor "shall also consider" a program of assistance for training Pertamina personnel.

C. PRICING POLICIES AND PROFITS

Indonesia has been a member of the Organization of Petroleum Exporting Countries (OPEC) since 1962; and like other OPEC countries, it has in the last five years assumed control of oil pricing decisions from the oil companies. Indonesia has not been a driving force (in public at least) in OPEC decisions in the 1970's to raise the price of export oil; Iran and Venezuela have taken the lead in this respect. However, Indonesia has supported higher prices.⁴³ Indonesia took a strong stand against either price cuts or production cutbacks during the September 1974 meeting of the OPEC Planning Commission, when these measures were discussed. However, one obstacle to increased prices is the competition for the Japanese market Indonesia will likely have in the future with China, which is now emerging as a major oil producing country. Before October 1, 1975, Chinese crude was priced 37 cents per barrel less (c.i.f.) than comparable Indonesian Minas crude.⁴⁴ As a result of Chinese competition, Indonesia increased the price of Minas crude effective October 1, 1975, from \$12.60 (f.o.b.) to \$12.80 per barrel—far less than the 10 percent increase decided upon by OPEC at its September 1975 meeting.⁴⁵

Indonesia bases its policy of maximizing production and earnings on its need for substantial foreign exchange funds to finance its development programs and import foods, fertilizer and other essential items. Indonesia undoubtedly can absorb into its economy all of the oil revenues it obtains.⁴⁶ It is unlikely to accumulate major surpluses of oil revenues as some of the other OPEC countries have done.

Indonesia's policy also makes it unlikely that it could support an Arab oil embargo against the United States, Japan and Western Europe in the event of another Arab-Israeli war, even though the Suharto Government strongly supports the Arab cause. During the first embargo in late 1973, Indonesia allowed exports to the United States to increase, and General Sutowo stated in New York City that

⁴² Ibid., p. 332.

⁴³ Embassy of Indonesia (Washington). Indonesia News and Views. July/August/September 1974.

⁴⁴ Ibid.

⁴⁵ Indonesia Raises Oil Far Less than 10 Pct. Washington Star, October 12, 1975.

⁴⁶ U.S. Federal Energy Administration. The Relationship of Oil Companies and Foreign Governments, p. 68.

Indonesia was willing to increase petroleum production and exports to the United States.⁴⁷

Pertamina is responsible for setting the price of Indonesian oil, including exports, although President Suharto and other high government officials undoubtedly exercise authority here to. Chart V shows the dramatic rise in Indonesian oil prices since 1970:

CHART V

F.O.B. price of Minas crude oil, 1970-75

<i>Date</i>	<i>Price per barrel</i>
1970: January 31	\$1. 70
1971: April 1	2. 21
October 1	2. 60
1972: April 1	2. 96
1973: April 1	3. 73
October 1	4. 75
November 1	6. 00
1974: January 1	10. 80
April 1	11. 70
July 1	12. 60
1975: October 1	12. 80

Source: Petroleum Economist (formerly Petroleum Press Service), 1970-1975. The F.O.B. (Freight on Board) price is the price at the Indonesian point of departure for oil and does not include overseas transportation costs.

The sharp rise in oil prices has resulted in increased oil revenues for the Government of Indonesia and apparently higher profits for the foreign oil companies operating in Indonesia. Chart VI shows the rise in the Indonesian Government's oil revenues since 1970:

CHART VI

Estimated oil revenues of the Government of Indonesia, 1970-1974

<i>Year:</i>	<i>Amount (millions of U.S. dollars)</i>
1970	\$185
1971	284
1972	429
1973	900
1974	3, 000

Source: Petroleum Economist, March 1975.

Observers of the oil industry in Indonesia generally believe that the price increases decreed by Pertamina since 1970 have allowed the foreign oil companies to realize a substantially higher profit per barrel than in previous years. The decision of the Indonesian Government to increase its share of the gross income above \$5 per barrel was designed partly to limit these escalating profits. The cost of bringing oil out of the ground in Indonesia is much higher than in the Middle

⁴⁷ Smith, Gene. Potential to Double Oil Output Seen by Indonesians. New York Times, November 7, 1973. The Indonesians are set for a Killing. Far Eastern Economic Review, v. 82, November 12, 1973: 38.

East: an average cost of 60 cents per barrel onshore and \$1.75 offshore in Indonesia against approximately 12 cents for the Persian Gulf.⁴⁸ Nevertheless, it has been reported that the company profit on the total price of \$12.60 per barrel was over \$2.50—one source has put it at \$2.73 per barrel as compared to \$1.05 per barrel in profit when the total price was \$5.⁴⁹ Reportedly, the new limitations on the company's share of the gross income over \$5 per barrel will reduce the company's profit by 35–60 cents from the level of \$2.50–\$2.75.⁵⁰

IV. FUTURE POLICY

Barring a radical change in the international energy situation, especially in the supply/demand relationship. Indonesia can be expected to continue its policy of maximizing oil production for some years to come. It is also likely that Indonesia will raise the price of its oil whenever possible and will argue for higher prices in OPEC. One factor that might cause Indonesia to act more cautiously on price is the emergence of China as a major petroleum producer and exporter. China and Indonesia already are beginning to compete for the lucrative Japanese market, and China's future relationship with OPEC is uncertain at this point.

Indonesia's formidable economic needs will require a policy of maximizing production and profits. Moreover, the prospect of heightened Communist insurgencies in Thailand and Malaysia in the late 1970's probably will induce Indonesia to modernize its armed forces.⁵¹ The armed forces (currently 270,000) now possess mainly old Soviet weapons and equipment supplied in the late 1950's and early 1960's. Modernization will necessitate substantial purchases of weapons and equipment from abroad. In short, economic objectives and the growing Communist threat in Southeast Asia will levy heavy financial burdens on the Government of Indonesia over the next decade and perhaps longer. The Government undoubtedly will look to oil to finance both economic development and military modernization.

In accordance with this situation, the Government likely will favor more investment by the foreign oil companies in exploration and extraction, particularly offshore. Pertamina's role will increase but only gradually. It will continue to acquire technological and managerial skills through constant exposure to the operations of the foreign companies; but this is a long educational process. While Pertamina may increasingly interject itself in the foreign companies' operations, the basic position of the companies appears secure at least for the next decade, barring an unforeseen political upheaval. The companies apparently have accepted the production sharing contract as a suitable instrument of Government-industry relations, and the production sharing contract satisfies Indonesia's national aspiration for control of its natural resources.

⁴⁸ International Economic Report of the President, p. 158. Federal Energy Administration, *The Relationship of Oil Companies and Foreign Governments*, p. 67.

⁴⁹ Fabrikant, *Production Sharing Contracts in the Indonesian Petroleum Industry*, p. 346 Indonesia: Some Price Cuts. *Petroleum Economist*, February 1975: 58.

⁵⁰ Indonesia: Some Price Cuts, p. 58.

⁵¹ The Government reportedly has begun to consider military modernization as a result of the Communist victories in Indochina. President Suharto reportedly discussed this with President Ford when the two leaders met in Washington, in July 1975.