

Indonesia has substantial [unexplored basins predicted to hold 43.7 billion barrels of crude oil](#) , according to data from the country's Upstream Oil and Gas Taskforce (SKK Migas).

But companies are reluctant to fund expensive explorations of new oil fields, which in Indonesia's case are mostly offshore. The problem: Indonesia does not have a dedicated law for oil and gas management. The lack of clear regulation creates legal uncertainty for the industry.

It was not always like this. Indonesia [had a dedicated oil and gas law](#) . In 2002, the parliament passed a law that ended the state oil company's three-decade monopoly over oil and gas management in Indonesia. But a decade later the [Constitutional Court ruled](#) in favour of nationalist groups and declared the 2002 oil and gas law unconstitutional.

The country's lawmakers for the past two years have been deliberating a new oil and gas bill without much progress. Nationalist groups are pushing to return monopoly rights over the country's oil and gas reserves to the state oil company, Pertamina.

### Learn from past failures

Lawmakers should learn from past failures and avoid this option. Throughout the 1970s to the early 2000s, the concentration of power in the hands of Pertamina created systemic corruption. It also created complacency within the company, resulting in inefficiency and a lack of competitiveness.

The Pertamina monopoly used a model called the [production sharing contract](#) . It was introduced in Indonesia in the 1960s and is now used for oil and gas contracts by around 40 developing countries in Africa, Central Asia and Southeast Asia.

Under this model, a state, represented by a state oil company, hires private contractors to explore and produce oil and gas. The contracted company will bear all the risks, including the financial costs of exploration and production. If oil is discovered, the company receives

“payments” for the oil produced after covering production costs. If the exploration fails, the company receives nothing.

Pertamina held both supervisory and commercial roles under the production sharing contract model. There was no independent agency to monitor Pertamina’s commercial activities. Since private contractors did all of the hard work, Pertamina’s own capacity in oil production regressed.

This model created a middleman mentality within the state oil company. Pertamina is supposed to be an oil producer because it’s essentially an oil company owned by the government, but under this model it mainly served as a distributing agent. [Data shows that Pertamina’s own production in those years was only 5.3 % of national production](#) ; private contractors produced the other 94.7%.

The bill being debated at the moment seems to maintain the status quo in terms of Pertamina’s monopoly model. The draft bill still delegates full concessionary power to a state company. This means the company holds both supervisory and commercial roles.

### Independent regulatory agency

When the 2002 law ended Pertamina’s monopoly, it led to the setting up of BP Migas, an independent body in charge of oil and gas regulatory affairs.

[Nationalist groups objected to BP Migas](#) as an imposition of foreign Western powers. Following the devastating Asian financial crisis in 1997, Indonesia sought a loan from the International Monetary Fund. BP Migas was established as part of the conditions set by the IMF.

But, apart from that, BP Migas was also part of a national effort to reform the oil and gas legal framework. Its role was to produce accountable, transparent and predictable policies that would foster competition and efficiency in the oil and gas sector.

Modelled on [independent regulatory agencies](#) – which are popular in OECD countries – BP

Migas was filled by non-elected technocrats and independent from the power struggles of national politics.

The 2012 Constitutional Court ruling [effectively abolished BP Migas](#) . The then president, Susilo Bambang Yudhoyono, swiftly established the Upstream Oil and Gas Taskforce (SKK Migas) to replace BP Migas under a presidential regulation, posting it within the Ministry of Energy and Mineral Resource.

However, from a legal perspective, a presidential regulation doesn't provide strong legal certainty as it can easily be changed by the president.

### What works

In [Indonesia's experience](#) , the production sharing contract (PSC) model is prone to corrupt practices. Indonesia's audit agency recently found a [mark-up of cost production of around Rp 4 trillion](#) (AUD\$406 million) from oil companies, including Pertamina.

There are other models that work in managing the oil and gas sector. Looking at the experiences of Norway, which like Indonesia has oil deposits in offshore basins, we can determine three important features of a successful framework.

First, the government should be willing to assume risks in oil and gas projects. This will increase the state oil company's professionalism. Second, the design should guarantee openness and transparency in the oil and gas industry. Finally, the framework needs to separate the supervisory/regulatory function from the business/commercial function.

In the 2012 BP Migas decision, based on [Article 33 of the Indonesian Constitution](#) that requires natural resources to be under "state control", the court ruled that the legal framework should clearly stipulate the government's role in the direct management of the oil and gas industry through a state-owned company.

The court argued that the BP Migas design did not fit this framework because it prevented government from holding direct management roles.

### Participation Model

I argue that it's possible to separate regulatory and commercial functions while keeping in line with the ruling.

Lawmakers should change the contractual model from a production sharing contract to a participation contract. In this model the government, represented by an independent regulatory agency, maintains its concessionary power. In each step of the oil and gas block bidding process, the regulatory agency will stipulate the amount of Pertamina's participating interest. Under this model, the power to control the project comes from Pertamina's contribution to the projects.

In the participation model, all of Article 33's element of state control is still assumed by government. In this context, a regulatory agency can still assume the regulatory function, whereas the commercial interest of the government is assumed by Pertamina.

Having said that, the separation of regulatory function from business/commercial activities is not a panacea for the industry. From Norway's experience, transparency and accountability play crucial roles in ensuring successful oil and gas management for the benefit of the people.

*Giri Ahmad Taufik does not work for, consult, own shares in or receive funding from any company or organisation that would benefit from this article, and has disclosed no relevant affiliations beyond the academic appointment above.*

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