Client Alert | Project Development and Finance

Indonesian Presidential Elections

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The incumbent, Joko Widodo, declared victory in Indonesia's presidential elections over his challenger and former general Prabowo Subianto. The election commission said Mr. Widodo, widely known as Jokowi, won 55.5 percent of the vote with his rival, Prabowo, on 44.5 percent. Here we put the spotlight on what can be expected of a Jokowi government with respect to energy and infrastructure policy over the next five years.

In summary, the expectation is business as usual for the President's second and final term in office.[1] What this means is a continuation of a mixed model economic policy underlined by inward-looking economic policies for resources such as oil, gas and mining, and outward-looking strategies in pushing for greater FDI in oil & gas and infrastructure.

Resource Nationalism

Protectionist economic policy characterised Jokowi's tenure over his first term in office where he embarked on a nationalisation project with respect to mineral resources and oil and gas. With this nationalistic drive, BUMN (*Badan Usaha Milik Negara*) (the local term for state-owned enterprises) have taken the opportunity to secure majority interests in projects in the Indonesian resource sector. In the past four years of Jokowi's tenure, BUMNs have secured majority interests in the Grasberg mine from Freeport-McMoran, the Rokan oil block from Chevron Corp and the Mahakam gas field from Total SA and Inpex Corp. The expectation is for the same trend of the nationalisation of mineral resources to continue over the next five years.

Oil & Gas

Jokowi has called upon the Ministry of Energy and Mineral Resources to reduce regulation in the oil and gas sector in order to encourage private investment and boost oil production.

Indonesia's crude oil production has been declining since 2000. A major driver of the decline has been the lack of exploration and the maturity of the oil fields leading to a decline in production rates.

Incentives to investment: the Gross Split PSC

In an attempt to kickstart investment, the Indonesian government introduced a new Gross-Split PSC – a large step toward eradicating the former Cost Recovery PSC model. The Gross-Split PSC model introduced by the Gross-Split PSC Regulation presents a more upfront approach to PSC based on the working area and the gross production. Under the new Gross-Split PSC, the contractor covers all operation spending, while the government will receive its profit sharing on a monthly basis. This is in contrast to the Cost Recovery PSC where profit sharing was calculated after contractors deduct production and exploration costs.

Interest in government tenders since the introduction of the Gross Split PSC, however, has been tepid. Commentators argue that the economics of the Gross Split PSC may not be well suited to Indonesia's oil and gas industry where projects are high-cost, capital-intensive with low-margins located in deep water areas.

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1 Article 7 of the Indonesian Constitution only allows a president to serve two five-year terms.

Additionally, it is not yet clear whether the Gross Split PSC will, in fact, significantly reduce bureaucratic oversight by SKK MIGAS, the Indonesian regulatory authority managing oil & gas activities.

With current contracts set to expire and a lukewarm response to the Gross Split PSC by investors, commentators suggest that investors should expect the takeover of more oil & gas assets by BUMNs as current contracts expire. News reports indicate that major oil & gas market players have started to withdraw. In 2016, Chevron announced that it would not be extending its contract in the East Kalimantan oil and gas block beyond Oct 2018. Chevron also announced that sale of its interest in South Natuna Sea Block B, and that it would no longer be extending its contract in the Makassar Strait gas block beyond 2020. Other major companies to withdraw include ConocoPhillips, which also sold its interest in South Natuna Sea Block B, and ExxonMobil, who have exited the East Natuna gas block.

The Increasing role of BUMN in Oil & Gas

In line with this withdrawal, in April 2018, the government awarded Pertamina, an Indonesian state-owned oil & gas corporation exploration rights via eight expiring licences that had previously been held by Chevron, China National Offshore Oil Corporation and Inpex over the Rockan Block despite Chevron's request for an extension. In September 2018, Pertamina submitted a proposal to take over the Corridor oil and gas field from ConocoPhillips when the company's contract comes to an end in 2023.

Oil & gas contracts due to expire beyond 2021 are:

Energy Assets	Operator	Expiry Date
Coastal Plains & Pekanbaru (CPP) Block	BOB Pertamina – Bumi Siak Pusako	Aug 8, 2022
Tarakan Block	PT Medco E&P Tarakan	Jan 13, 2022
Tungkal	Montd'or Oil Tungkal Ltd.	Aug 25, 2022
Sengkang Block	Energy Equity (Sengkang) Pty. Ltd.	Oct 23, 2022
Jabung Block	Petrochina International Jabung Ltd.	Feb 26, 2023
Rimau Block	PT Medco E&P Rimau	Apr 22, 2023
Corridor Block	ConocoPhillips (Grissik) Ltd.	Dec 19, 2023
Bangko Block	Petrochina International Bangko Ltd.	Feb 16, 2025
Pangkah	Saka Indonesia Pangkah Ltd.	May 7, 2026
Muriah	Petronas Carigali Muriah Ltd.	Dec 31, 2026

Source: Energy and Mineral Resources Ministry; Bloomberg

Commentators have suggested that the Government's decision to award these expiring exploration and development rights to Pertamina represents compensation for its losses on government-set retail fuel prices due to the Government's slashing of fuel subsidies. Jokowi has cut government fuel spending by 90 percent to fund infrastructure development across the archipelago. According to the Supreme Audit Agency ("**BPK**"), which reviewed the government's financial report in 2016, the state owes Pertamina about Rp 22 trillion (US$1.57 billion) for subsidized fuel.

Sights for a simpler regulatory framework

In sum, the oil & gas sector in Indonesia is a relatively high cost environment for project companies compared to other jurisdictions and a transition to a lower cost operating environment is unlikely to occur overnight. Foreign investors should keep a look out for changes to regulations in the oil & gas sector aimed at simplifying regulations to encourage investment.

Mining

Jokowi's government has taken steps to ensure that mineral resources remain at home through the regulation of mineral exports. This was done through a moratorium on coal and metal-ore exports so as to encourage domestic smelter production (which has been lifted in the interim) and the introduction of a new Mining Law of 2009 which made changes to the legislative framework for mining contracts in Indonesia and introduced new foreign ownership divestment rules.

Moratorium on exports

A ban on unprocessed ore exports was imposed in 2014 to encourage the development of higher value smelting industries. However, after a 3-year moratorium, the government adopted a sweeping policy shift in 2017 which allowed for the export of nickel ore and bauxite and concentrates of other minerals under certain conditions.

Shift from Contract of Work ("CoW") to a Mining Business License regime

Under the new Mining Law of 2009, Indonesia's long-standing CoW framework for foreign investment was replaced with a new area-based licencing system (*Izin Usaha Pertambangan,* or "**IUPs**") that is applicable to both foreign and domestic investors, incorporates tendering procedures for granting licences and requires the involvement of central and provincial governments.

While the Mining Law of 2009 was heralded as the beginning of an era of greater certainty for investors in the mining industry in Indonesia, this has not been the case in practice. Reports indicate the same challenges that applied under the CoW regime still apply. These challenges include but are not limited to conflicts between mining and forestry regulations, difficulties in dealing with downstream in-country processing requirements and the lack of coordination between central, provincial and regional governments.

New foreign divestment rules

Reports have also indicated of investor concerns due to the numerous changes in foreign ownership divestment rules since the enactment of the Mining Law of 2009. In their current form, foreign ownership is capped at 49 percent. Divestment of a foreign shareholder's interest is done in stages, commencing from the fifth year of production, so that foreign shareholders have a maximum shareholding of 49 percent by the tenth year of production.

For investors, many view Indonesia as having significant geological potential, in terms of its coal and mineral resources, but the regulatory uncertainties and the rising sentiment of resource nationalism have become key deterrents to investment.

Infrastructure Boom

Infrastructure is at the heart of Jokowi's presidency and his re-election campaign. Specifically, Jokowi's *Nawacita* (nine priority programmes) prioritizes accelerating infrastructure development to connect the geographic peripheries with urban growth centres and, promoting connectivity between islands in the archipelago. In his current term, Jokowi has already embarked on a US$350 billion infrastructure drive, the biggest in Indonesia's history.

Over Jokowi's five-year term, infrastructure has accounted for an average 17 per cent of total state spending and the spending is set to continue. In terms of economic focus, the "hard" approach of focusing on building infrastructure and the "soft" approach of streamlining regulations is still very much part of Jokowi's economic strategy.

Reports indicate however, that Jokowi's infrastructure development has not progressed as smoothly as expected. While some projects such as the Jakarta MRT and Java Toll Road have seen positive developments, others such as the Jakarta-Bandung High-Speed Rail have witnessed poor progress.

A State-led approach to Infrastructure

To implement massive infrastructure projects all over the country, the government has injected large portions of budgetary funds to BUMNs. Commentators have expressed concern that such a policy approach could hinder the market access of more effective providers from the private sector. This concern has been conveyed by KADIN and GAPENSI, Indonesia's Chamber of Commerce and National Construction Services Association, who opined that such an approach may allow for BUMN dominance and push the private sector to the side-lines of the domestic construction industry, leaving what would be a smaller number of BUMNs competing for the same pool of projects.

In order to find alternatives for financing, Jokowi has openly welcomed foreign and multilateral support for infrastructure investment. Jokowi made Indonesia join the China-led Asia Infrastructure Investment Bank (AIIB) and become one of its key shareholders.

Conclusion

Foreign investors can expect much of the same in terms of energy and infrastructure policy under Jokowi's second term in office. The expectation is for a continuation of heavy spending on infrastructure and a continued push to reform Indonesia's bureaucracy and regulations in order to increase the ease of doing business in Indonesia and to encourage FDI to continue.

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