Pertamina’s Evolution: From King of the Hill to One of the Guys

Baker Center NOC Study
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Washington DC
Pertamina and Indonesia: What’s the Difference and Why Do We Care?

- Indonesia is one of the world’s oldest oil provinces
- Pertamina, an early OPEC member, was for many years a pioneer
  - PSCs
  - Innovatory LNG business structure
Pertamina and Indonesia

- Pertamina represented the government’s interests in the oil and gas sector from 1971–2001
- The company was a major earner for the country and for the government
- Pertamina played a major role in national development
Pertamina and Indonesia

- Pertamina acted as both an investor and a regulator upstream
- Pertamina controlled the key downstream assets
- Petronas found Pertamina’s model so compelling they copied it
Key Oil and Gas Installations

- Arun LNG
- Singapore
- Riau-Caltex
- Cepu, Tuban
- Cilacap Refinery
- Balikpapan & Bontang
- Tangguh LNG
Indonesia’s Oil and Gas at a Glance

<table>
<thead>
<tr>
<th>Item</th>
<th>Indonesia</th>
<th>Pertamina</th>
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<tbody>
<tr>
<td>Oil Reserves (bn bbl)</td>
<td>5.1</td>
<td>0.98 (19%)</td>
</tr>
<tr>
<td>Oil Output (bn bbl)</td>
<td>1025</td>
<td>48 (4.7%)</td>
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<tr>
<td>Gas Reserves (tcf)</td>
<td>94</td>
<td>8.8 (9.4%)</td>
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<tr>
<td>Gas Output (tcf/y)</td>
<td>3</td>
<td>0.31 (10.3%)</td>
</tr>
<tr>
<td>LNG Sales (Mmt/y)</td>
<td></td>
<td>24</td>
</tr>
<tr>
<td>Refining Capacity (kbd)</td>
<td>1055</td>
<td>128.5 (12.2%)</td>
</tr>
<tr>
<td>Refinery Output (kbd)</td>
<td>999.8</td>
<td>114.1 (11.4%)</td>
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</tbody>
</table>
Pertamina and Indonesia

- Pertamina faced a major financial crisis in 1975 amidst a gusher of revenue
  - The company diversified far beyond oil and gas
  - Stories of vast corruption echo to this day
  - But customer subsidies were not yet financially significant for either the company or the country

In 1975 Pertamina could *produce and export* its way out of a financial crisis
Pertamina and Indonesia

- The company continued as an integral part of Suharto’s New Order throughout the 1980s and early 1990s
  - Increasing LNG exports
  - Modest declines in oil output
  - Rising living standards propelled a rapid expansion of heavily subsidized oil product consumption
  - For many Indonesians Pertamina symbolized the corruption and self-serving nature of the New Order

By the mid-1990s the only real speculation was about when the country would become a net importer of oil
Pertamina and Indonesia

• When the Financial Crisis hit in 1997–98 it was clear that Pertamina was part of the problem
  – Oil product subsidies were very large relative to the Government’s budget
  – Corruption and loss of focus at Pertamina had led to high costs upstream and downstream, and a falling rate of output
  – Good prospects (Natuna, Cepu) lay fallow, interrupting the future stream of output and cash

It became an article of faith among reformers that Pertamina’s role had to be curtailed dramatically
Pertamina and Indonesia

- Back in the oil patch oil production continued to fall, and gas joined in as well
  - Oil ceased to be a *net* financial contributor to the country
  - Declining gas output threatened to replicate the oil experience, leaving Pertamina (and the Government) liable for contracted LNG deliveries well into future
  - Subsidy-fueled demand for refined products soared past domestic refining capacity

Indonesia could not expect to make the jump to industrialized status on the back of the oil and gas business
Pertamina and Indonesia

- The Oil and Gas Law of 2001 marked the end of the marriage
  - Pertamina would become a regular government-owned company
  - The government’s roles in the sector would be expressed through new regulatory agencies
  - Reducing subsidies made scant progress

Pertamina would now be subject to the same laws and financial conditions as any other company
The New P.T. Pertamina

- **Upstream:** the company has some good acreage but little to offer as an operator
  - Production (w/o) JVs remains below 50 kbd (5% of country’s output)
  - They are still attractive as an LNG partner if they bring the (implicit) sovereign guarantee with them
  - They are losing staff and status to *domestic* private producing firms
  - *Now Petronas is the model*

By 2008–09, two or three domestic upstream companies will probably be larger than Pertamina
The New P.T. Pertamina

• **Downstream:** the company remains in a strong position as an operator of all the refineries and owner of a couple of them
  - Subsidies had restrained market entry by outsiders
  - With the end in sight for downstream subsidies, competition should heat up
    • The country is a desirable market
    • Domestic capacity is exhausted
    • Significant new investment is needed throughout the downstream segment

Why should Pertamina retain *de facto* control of assets they do not own?
Indonesia and the New P.T. Pertamina – Lessons Learned

Upstream

- Decades of mixing regulations, fiduciary functions and production resulted in an unfocused and opaque operation
- Weak leadership can turn a strong hand into a weak one
  - Favorable location
  - LNG market dominance
Indonesia and the New P.T. Pertamina – Lessons Learned

Upstream

- Financial strength is essential, even in a cash cow
- Poor anticipation of output and demand trends contributed to the company’s weakness and has cost them their reputation as a reliable seller of LNG
  - Falling gas output
  - Failure to seize quickly on such new opportunities as Cepu, Natuna Island
Indonesia and the New P.T. Pertamina – Lessons Learned

Downstream

- If you subsidize something people will want more of it, and
  - Controlling subsidies once they have become a “right” is extremely difficult politically
  - Subsidies of more than 25% of the government budget were unsustainable
- It is difficult to sell shares in refineries that you don’t own