The Transnational Role of Foreign Companies in the Upstream Sector of Oil and Gas in Indonesia: pre-Gross Split Mechanism

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This article aims to explain how and why foreign oil and gas companies carry influence over the government in the upstream oil and gas sector. It looks at the troubling issue of domination in Indonesia particularly before the Gross Split mechanism was introduced. From a transnational point of view, states and non-states continuously attempt to overpower the other to gain the most from this industry. Although the roles and obligations of foreign oil and gas companies are strictly regulated, domination is still visible in areas of cost recovery to add to the weak domestic market resulting in an asymmetric competition. Market failures have become increasingly alarming as liftings continue to fail to reach the national quota. Using the introduction of the Gross Split mechanism as a turning point, this article looks back at how transnationalism has translated into this sector. This article is of the view that the lack of effort to enrich knowledge bases, enforce the adoption of appropriate technology and prepare its domestic market for healthy competition, has brought it further away from addressing its underlying issues.

Keywords: *transnationalism; upstream; oil; gas; foreign; companies.*

Introduction

Once a cornerstone of the oil and gas market, Indonesia pumped 1.5 million barrels of oil a day and in 1997 and was host to the meeting of oil ministers from the Organization of Petroleum Exporting Countries (OPEC), making it one of the most strategic sectors of the Indonesian economy (Salna & Rusmana, 2017). Today, it faces the troubling issue of domination being largely operated by foreign companies. The Directorate-General for Oil and Gas reveals that from the period 2001-2011 alone 74% of the upstream oil and gas sectors were managed by companies of foreign headquarters. The Regulatory Agency for Upstream Oil and Gas Activity reports a contribution of 30% to the national income from the mining sector, most of whom are of foreign headquarters (Bulletin BP Migas No. 65, 2010).

Before the Gross Split Mechanism, the Cost Recovery Mechanism reimbursed costs of exploration, development, and operation out of gross production, which heavily consumed the national budget. Reasons for this being (a) large costs including costs of preceding

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years. It is worth noting that it can take several years of exploration and investment before production can start (Indonesia Investments, 2016). Secondly, (b) it has significantly lowered profit cuts of the government. Practices in the past have shown that the government's share can be as low as 40 percent, or less, from the expected 85 percent share. It is estimated that between 2002 and 2016 nearly $4 billion was spent -in vain- by oil and gas companies in the exploration stage in Indonesia without finding reserves suitable for commercial exploitation (Indonesia Investments, 2016). The Cost Recovery Mechanism has also (c) caused infighting among Indonesian officials, with central and local governments vying for their share (MKRI, 2012). Fourth, (d) domestic production quotas have not been met for a long time. Most of Indonesia's oil production originates from maturing oil fields that are characterized by declining outputs (Indonesia Investments, 2016), which for a long time has begged the scholarly question of what the Cost Recovery Mechanism covers. Lastly (e) domination has weakened the competition among domestic oil and gas companies in the downstream sector as they have to compete with foreign, well-equipped and heavily-invested companies while securing profit against oil and gas rates that are set on international prices. These prices are not always based on 'supply and demand' as they are steered by foreign companies (MKRI, 2012). This has prompted the government to rethink its cooperation scheme without slashing investments but still reaching the national quota and cutting reasonable profits. However, it was not until 2016 when the Gross Split Mechanism was introduced as a replacement of the Cost Recovery Mechanism.

Under the Gross Split Mechanism, government profit cuts have become promising while offering something in return for oil and gas companies. It allows for efficiency of work, measurable progress, and level competition. Further, it is considerate towards investment barriers like permits and taxation (Bumi, 2017) and looks into ways of simplifying the administration to enhance its appeal. Even so, scholars argue that the Gross Split Mechanism is not fiscally superior to its predecessor in terms of risk-bearing (Bergamann & Giranza, 2017). This is problematic for the long run, as both mechanisms neither address all five forms of domination explained above, nor establish a long-term solution. The structure of the country's oil-sector institutions, definition of terms governing relationships with companies and mechanisms for transparency and accountability will have a major impact on whether Indonesia is able to reverse the decline in sector performance and increase the benefits that accrue to citizens (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016).

This article carries urgency, as non-state actors are gaining increasing relevance in the study of global governance where the superiority of states as main agents of the international world is challenged (Rosenau, 2002) and their ability to by-pass governments, are impactful (Mas'oed, 1990) to the community and themselves. In the context of Indonesia, non-state actors enjoy greater opportunities to compete and better their gains from the Cost Recovery mechanism. Energy management is central to Indonesia if not all countries.

Therefore, management insufficiency signals incompetence and long term loss from optimal income.

The government and oil and gas companies have contrasting natures and driving forces. Nonetheless, both share an interest in gaining the most and losing the least from exploration and exploitation processes. This article contrasts the government in today's transnational context against companies as non-state actors. Using Steven Vertovec (1999) examination of Transnationalism, this elaboration will look closely at first, (a) consciousness, which is a multi locality desire to connect oneself with others (Vertovec, 1999:5) creating a transnational bond held together or re-created through the mind, through cultural artifacts and a shared imagination (Cohen, 1996: 516). After the World Wars, nations have resorted to cooperation and taking part in mutual efforts to become more connected and, at the same time, gain more from working together than against each other. Secondly, (b) cultural reproduction, which states often take advantage of by using the rapid developments of global media and communications (Vertovec, 1999) to transform their identities through the policies they make and publicize it to the world. Thirdly, it also looks at (c) political engagements in the transnational world. It comes in many forms like distribution of resources (especially from constituent bodies in wealthy countries to ones in poorer countries), facilitating support in political campaigns, and providing safe havens abroad (Vertovec, 1999). Although these features are more visible among developed nations, in general, political engagement also takes the form of state-facilitated dissemination, publicity and feedback, mobilizing support, enhancing public participation and enabling more political organization in spirit of democracy, and increasing the number of engagements with of intergovernmental organizations (Alger 1997, Castells 1997). Lastly, it examines (d) avenue of capital, which is a stark development to pre World War times when most resources were allocated for military purposes. Today, governments favor the strength of the economy (Sullivan, 1982). A strong economy is associated with strong political power. This, however, generated a myriad of transnational cooperation worldwide which are defined as firms with the ability to coordinate and control operations in more than two countries, although they do not fully own them (Dicken, 1998). The rise of transnational cooperation worldwide, in turn, gave birth to a transnational capitalist class comprising of TNC executives, globalizing state bureaucrats, politicians and professionals, and consumerist elites in merchandising and the media (Sklair, 2005). Together, they constitute new power elites whose interests are global, rather than exclusively local or national, and who thereby control most of the world economy (Vertovec, 1999).

Having understood the values that governments operate in a transnational context, the above driving forces will be contrasted with the interests of transnational companies as non-state actors (McMahon, 2009) namely driven by, (a) economy, (b) environment and sustainable development and (c) governance.

This article contributes to the academic discourse by introducing a set of affiliations. By linking each driving force to a transnational actor, in this case, the government or foreign companies, it provides a rationale for their actions. This article is also an attempt to provide a deeper transnational analysis of state versus non-state actors in strategic sectors.

Foreign companies qualify as transnational actors by being able to conduct inter-state trades with governments and across the international sphere. To guide the research, it questions how transnationalism among foreign companies translate in the upstream oil and gas sector of Indonesia?. To maintain consistency, it limits its period to the PSC (Production Sharing Contract) era, (pre Gross Split Mechanism establishment) accounting for the lack of data to contribute to the discourse at the time of writing. However, it acknowledges the underlying factors that have driven the government to introduce this change. If anything, the Gross Split Mechanism strengthens the argument that governments can often find themselves cornered. Transnationalism has nudged the government to introduce regulations that favor streamlined mechanisms without truly addressing nor resolving the underlying issues within its oil and gas sector. Non-state actors have the upper-hand as they are better equipped (Academic Paper, 2017). More importantly, companies have little to pressure them into disseminating their knowledge base to their hosts. Although companies are strictly and comprehensively regulated, certain provisions still allow for a show of power. Contestation in the field of oil and gas has left the government with the 'smaller slice of a shrinking cake'.

This article will firstly look into Indonesia's past and present oil and gas provisions. Though this article is not intentionally comparative, it learns from practices of Malaysia and Saudi Arabia, home to international oil and gas powerhouses that have excelled them into the global market. It will then look closer at the cost of domination. It argues that though the failures may not be by design, little has been done to rectify the situation other than introducing the Gross Split Mechanism. The absence of the government in regulating against foreign companies in the downstream sector signals that it is not prepared to serve its market, let alone compete against international companies who are steadily distributing fuel oils downstream. Moreover, the state has still shown very little sign of long term contingency plans for its reserves with open working areas managed with insufficient mitigation. This article will contest the government against foreign mining companies by contending the respective driving forces. The analysis will show which areas the government is greatly outnumbered and how mining companies are equipped to do so.

Methodology

Empirical Secondary Data

To guide this empirical study, this article will use the help of secondary data sourced from literature studies. George J Moully (1984) states that empirical studies focus on answering the question of "why" and can be extracted from six elements, namely experience, classification, quantification, finding the relations, and approximation of the truth. To ensure an optimal experience, classification, and quantification, a range of literature studies will be used from sources.

Literature studies will use mostly, but not limited to, formal documents of the Ministry of Energy and Mineral Studies and Regulatory Agency for Upstream Oil and Gas Activity (BP Migas) and a large number of published academic research on this topic. A reliable relation analysis between the state and non-state actors in the oil and gas sector of Indonesia is gained from contrasting each classification of transnationalism against each classification of state driving force. By analyzing contested driving forces it will lead to a conclusion of a closer approximation of the truth.

Deductive-Inductive Approach

To inform this article, it will use a deductive-inductive approach which was first initiated by Francis Bacon (Mouly, 1984). deductive reasoning is used to lead to a conclusion and inductive reasoning is carried out to form a hypothesis. When logic is insufficient to inform analysis, a hypothesis is set out in advance. It helps the scholar to optimize findings and data because without knowing anything in advance, it forms absolute objectivity and a valid conclusion. Only after a hypothesis is settled, deductive reasoning is carried out. The conclusion, therefore, is a confirmation of the hypothesis.

Indonesian Oil and Gas Provisions

Indonesia has seen itself through numerous oil and gas provisions. Indonesia's first President, Soekarno, was successful in taking back the oil and gas sector from Caltex, Shell, and Stanvac in the 1960s through Kontrak Karya, replacing the Concession. This changed when his successor, Soeharto, took office and effectively took over PT. Pertamina. Soeharto used the economy for political ends but initiated a generally orderly process of development supported by large infusions of foreign aid and investment. Oil revenues were vital for the Suharto regime because they provided it with resources to compensate groups whose cooperation was essential for political stability (Worden, 1993). So powerful was PT. Pertamina under the regime that no agencies were allowed to perform an audit on its finances. Director-General Ibnu Sutowo was forced to resign in 1976 have severely damaged the credibility of Indonesian economic policy in the eyes of foreign creditors (Azwar, 2012).

Kontrak Karya was then replaced with PSC making the state responsible for managing all the contracting parties. The PSC has seen itself through three generations. The first generation (1965-1978) limited the Cost Recovery to 40%, with net profit cuts of 35% for the contractor and a Domestic Market Obligation (DMO) without a grace period. The second generation (1978-1988) saw no limit to the Cost Recovery but with net profit cuts of 15% for the contractor, investment credits of 20% and a Domestic Market Obligation (DMO) of 5 years. The third generation (1988-2016) introduced the First Tranche Petroleum (FTP), which, different to royalties, the first 20% of the Gross Domestic Production is covered by the government and oil and gas companies according to the 85:15 ratio (Bumi, 2017).

However, Indonesia's current Law Number 22/2001 on Oil and Gas is argued to have been founded on a questioned sense of security. PT. Pertamina, formerly responsible for the entirety of Indonesia's oil and gas, is now under close watch. Despite the loopholes of the regulations, there is still a hint of hope in reversing the inefficiencies of the oil and gas sector. The laws regulating oil and gas is structured as such that its level of transparency and chain of coordination are almost unmatched (Academic Paper, 2015). However, it has not translated into a finely tuned bureaucracy. Many argue that the Regulatory Agency for Upstream Oil and Gas Activity is ever more prone to lobbying and political engagements. The reason for this is because they are positioned, as if, equivalent to the contractors. As such, the scheme of relations follows that of Government to Business (G to B), when in fact the government serves as a symbol of national ownership. For this reason, it should function as a regulator and facilitator (Academic Paper, 2017).

Many attempts have been made to revise Law 22/2001 on Oil and Gas, often argued as being 'pro-foreign'. It has been blamed for the alleged mark-ups in Cost Recovery calculations, for following too closely on international oil and gas prices allegedly directed by foreign companies, enabling foreign companies to conduct business in the downstream sector (Ramli, 2012), and lack of enforcement knowledge transfers. The performance of the sector cannot be meaningfully improved without commitment to increasing accountability and good governance. Global experience has repeatedly shown that transparency and checks and balances are critical, and the current legislative process is a moment to enact reform (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016). This illustrates transnationalism as a sphere where state and non-state actors meet on common grounds with each aiming to gain more than the other. In a world where political strength is translated from economic powers, the importance of gaining the most from oil and gas fields in profit cuts, data and expertise are obvious.

Conflicts of interest in sectors as strategic as oil and gas are not unique to Indonesia. Several countries, however, have managed to make a fair share from their mining industries. Malaysia and Saudi Arabia are some of the few to name. The following sub-chapter looks deeper into their respective experiences.

Learning from Malaysia and Saudi Arabia

Adopting Indonesia's PSC in 1976, Malaysia has fared better from its extractive industry. Prior to 1976, oil companies in Malaysia operated under concessions. PETRONAS was formed as a result of the Petroleum Development Act (PDA) in 1974 and managed the entirety of Malaysia's oil and gas industry. The Production Sharing Contract (PSC) terms were introduced later on in 1976. In 1985, new PSC Terms were introduced primarily to increase foreign investments by offering a better share for the contractors. PETRONAS still holds the exclusive rights of exploration and exploitation of their working areas but conducts direct supervision of their foreign investors. This means that it holds the special right to regulate and, at the same time, operate on Malaysian working areas without mediatory mechanisms. In the downstream sector, The Directorate-General of Domestic Trade plays a vital role in establishing the price for fuel as well as determining the margin profit of companies. The selling price is assured to be above world oil prices, therefore, guaranteeing the profit margin of PETRONAS through domestic fuel resources (The Coordinating Committee for Geo-science Programs in East and Southeast Asia, 2002). The PSC requires its contractors to provide financing for all explorations and exploitation, and at the same time, insulate PETRONAS from all possible risks. As the sole regulator of its oil and gas sector, it is, however, PETRONAS is responsible to aid its knowledge base from technology transfers for every foreign investment that it generates.

The story of Malaysia is a contrast to that of Indonesia's. Through PSC, PT. Pertamina has been under watch instead of being injected with more authority. Despite being state-owned, it is still required to compete in auction and auction against foreign companies. In this sense, it does not share the same advantage with Petronas. Lastly, no mechanism is in place to ensure a fixed margin of profit of companies in the downstream sector nor is there assurance that Indonesian oil and gas rates are above world prices. Similar to PETRONAS is the experience of Saudi Arabia. Kasali (2008) explains how the state-owned Saudi Aramco is one of the few that managed to turn fate around and enjoy fair shares. In 2006, Saudi Arabia ranked highest in oil stock and production in the whole world. The total production of Saudi Aramco reached 11 million barrels/day. Indonesia, in comparison, produces 1,06 million barrels/day (Kasali, 2008).

In 1933, Standard Oil of California (Socal) offered a contract to operate on Arabian lands. Running short on operational devices, experience, and capability, they agreed on share ratios of 25:75. This exploration failed and left Saudi Arabia empty-handed. They joined cooperation with Texas Oil with a 50:50 profit share, eventually merging to become Californian Arabian Standard Oil Company (Casoc) in 1938 and eventually into Arabian American Oil Company or Aramco (Kasali, 2008). However many strategies to break away from the American hegemony failed before Saudi Aramco became the national oil company known globally today. It was not until King Faisal's strategy in 1974, aiming at a 100%-share requiring Aramco to divest significantly was the proposal accepted aiming Saudi Aramco, a national mining company of Saudi Arabia. As a powerhouse, it has contributed 700 trillion USD to the country only between 1976 and 1990. To date, 95% of the export rate and 80% of the national income of Saudi Arabia are contributed by Saudi Aramco (Kasali, 2008).

Today, Aramco is one of the few, alongside Malaysia, to use oil and gas national consolidation mechanisms. Aramco, in particular, achieves cost optimization through negotiating lower costs for rigs, materials, and services. They introduced a program to recondition equipment and materials, resulting in significant savings, and deployed offshore floating hubs to supply tools and materials. These efforts enabled a reduction in overall good costs compared to 2015 (Saudi Aramco, 2018). The system gives full control to the state-owned enterprise, guaranteeing leadership in projects executed within the country or its territorial waters. As such, the system maximizes the power and reach of the enterprise. It also eliminates the need for complex negotiations between the state and private oil and gas companies (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016).

What this informs is that profit shares, adoption of technology, and transfer of knowledge are crucial. For exporters, it serves as a measurement of political prowess and is reflected in their increasing levels of export. It helps to direct strategic decisions and long term benefits. From a transnational point of view, both countries have exercised (i) consciousness by being outward-looking and finding ways to establish long term cooperation that are just. Both place themselves as sole regulators, operators, and facilitators but in returning promising a secure and steady bureaucracy. Malaysia and Saudi Arabia also respond to (ii) cultural reproduction by establishing PETRONAS and Saudi Aramco internationally as its power house. They symbolize the nation and at the same time, the government. In terms of (iii) political engagement and (iv) avenue of capital, both countries have done well in translating their economic gains, from their steady levels of export of oil and gas, into political power over foreign companies wishing to engage in cooperation. Take away lessons from Malaysia and Saudi Arabia can be boiled down to one major note. A well-equipped and well-scrutinized government is key to establishing a strong platform for regulating, operating and facilitating oil and gas exploration and exploitation.

Various Aspects of Domination

Cost Recovery Mechanism

The Cost Recovery Mechanism dictates that operational costs be refunded by the government complying of exploration, production (including depreciation) and administration costs (including interest recovery). Many debates, fueled by alleged practices of mark-ups, have taken place on how the mechanism has, if any, benefited the country. The National Auditing Agency reported numerous calculation flaws in five working areas during the year 2004-2005 alone. The report had been addressed to the Legislative Assembly on August 8th, 2006 recording a loss of IDR 14,2 trillion and again in 2013, where another report was released issuing a redundancy of cost recoveries amounting to IDR 994,8 trillion (Detik Finance, 2014).

In January 2017, the Ministry of Energy and Mineral Resources issued Minister Regulation No. 08/2017 pertaining to the fiscal regime of the upstream sector of oil and gas. The government imposed a Gross Split Production Sharing mechanism to gradually replace the Cost Recovery Mechanism (Bergamann & Giranza, 2017). Inefficiencies of the Cost Recovery Mechanism of the upstream sector of the oil and gas sector have been blamed on the lack of auditing of fuel oil and the production costs of both Pertamina and foreign companies like Exxon Mobil, Chevron, Shell, British Petroleum, and so on. Until recently, the margin between domestic production of fuel oil and world oil prices has been contrasted against the practices of Singapore. For this reason, domestic fuel oil prices have been established through MOPS plus Alpha calculations (margin and distribution fee) (Academic Paper, 2015) contributing greatly to ineffective costs and, in turn, profit cuts after Cost Recovery.

Scholars argue that offering huge fiscal incentives when the oil and gas industry is in turmoil may not achieve dramatic results (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016). In this sense, replacing the Cost Recovery Mechanism with the Gross Split Mechanism is merely an effort to keep its contractors close by rather than addressing the current issues of the oil and gas industry at hand. Changing contract forms is not required to make a fiscal regime more attractive because any type of contract can offer similar risks and returns, depending on design (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016). By focusing on transfers of knowledge and adopting appropriate technology to sustain the effectiveness of production, risks can be better managed and, in time, cull greater profits. As very little has been done to cull this valuable knowledge and technology, there is also little to suggest that the Gross Split mechanism will cultivate better profits, reduce infighting among bureaucracies, achieve the national production quota.

Absence of the State in Asymmetric

Competition

It has been established that foreign companies can only be granted exploration and exploitation rights in the upstream sector. However, in recent years, more foreign companies are setting up a business in the downstream sector across the country (Ramli, 2012). This adds another layer to the already problematic oil and gas provisions of Indonesia. For the domestic companies and state-owned PT. Pertamina already established in refining/ purifying, marketing and distributing oil and gas, it creates an asymmetric competition. Competition against more advanced levels of technology, decades worth of collective experience and the power to influence oil and gas prices, the nature of trade shifts.

It is argued that the reason for this is due to the bureaucracy under Law 22/2001. The newly established Regulatory Agency for Upstream Oil and Gas Activity, responsible for over-viewing, is appointed and can only be dismissed by the President. It reports directly to the President which allows it to indirectly by-pass established lines of commands that were present before 2001. The Agency's role was expected to replace the centralistic role of Pertamina but is lacking the clarity of supervision and amount of authority allowed. Conditions like this work favorably well for stakeholders (including foreign investors) with interests to establish a mark in the oil and gas sector.

National and domestic companies enjoy fewer privileges in the upstream sector. The field was not designed to facilitate strong domestic markets (Academic Paper, 2017) run by, to, and for national demands, although it was what they set out to do. Domestic companies carry modalities of local wisdom that are difficult to duplicate by foreign companies. Local wisdom includes conflict mitigation on matters like land disputes and overlapping bureaucracies. They also serve the purpose of enriching the national knowledge base of Indonesian oil and gas. As a whole, it is within the interest of the government to support its domestic pillars to support stronger markets, energy resistance, and add value to its resources, expand job markets, and enable steady and long term supplies of oil and gas. Instead, most working fields are won, more often than not, by foreign companies, as if, almost by design. The challenge lies in finding the balance between supplying the field with enough investors to meet the national lifting quota whilst creating grounds for fair competition.

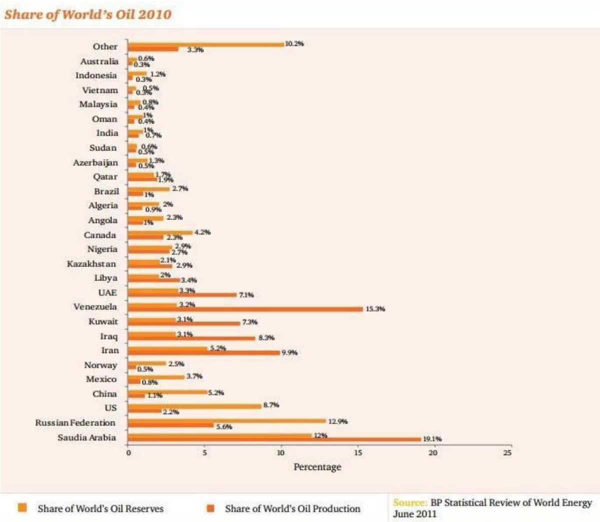
Market Failure

Three elements reflect vulnerability in the oil and gas sector. According to Notonagoro (2016), these factors make Indonesia the weaker opposition in the global competition. Firstly, the orientation of oil and gas is not directed at securing its national energy security, it is aimed at fulfilling short-term revenues which can often leave a greater burden for the state through the years to come. The view of the government is that oil and gas function as commodities to meet its high levels of demands and fast rate of consumption, rather than viewing them as useful resources to strategically improve its national development. In trying to simultaneously attract investment and make sure it derives maximum benefits, Indonesia needs a clear-eyed and objective analysis of what kinds of policies are likely to deliver long-term returns to the people of Indonesia (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016). This needs to be set out earlier than later as this will serve as its guide through settling a long term mechanism that best suits the needs of the upstream oil and gas. If change is ever to take place, it must be accompanied by a blueprint that can see ahead.

Secondly, Indonesia is running out of oil and gas (Notonagoro, 2016). Indonesian reserves are generally mature which often translate into low amounts of crude oil and uncertainty over future rewards from investment (Academic Paper, 2017). Note that the discovery of oil has decreased significantly from 2300 MMBOE in 2001 and 2002 to 1050 MMBOE in 2003 and 2004. This continues in the year 2005 and 2006 resulting in only 500 MMBOE (Partowidagdo, 2009). This is largely due to the decrease of exploration and taxes including custom taxes, value-added taxes (VAT) (on both imports and exports and import), and income taxes as regulated by Law 22/2001.

Lastly, Indonesia is vulnerable due to its constant pursuit of short-term revenue without added-value. This is a large homework for the future of Indonesian oil and gas should it wish to continue competing globally (Notonagoro, 2016). Few discoveries leading to proven reserves were made after the 1980s. Meanwhile, the country's rising economic welfare is accompanied by rising energy consumption, driven largely by the high growth of private vehicle ownership. For this reason, Indonesia has been a net oil importer since 2005 (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016). As an importer of oil and gas for its domestic consumption, it is becoming increasingly dependant on other nations to meets its needs. An example, Indonesia is dependant on oil refineries lent by neighboring countries to process its crude oil productions. For this reason, scholars have suggested shifting focus from export to improving national development by using its existing reserves for national consumption only to reduce fiscal dependence on oil and gas and prioritize (Academic Paper, 2017).

Table 1. World Oil Production



Source: BP Statistical Review of World Energy, June 2011

Driving Forces of Foreign Companies and the Contestation

Mac Mahon and der Veen (2009) argue that there are specific forces that power the strategies of oil and gas companies bringing pronged impacts in a transnational sense. The values that companies strive for are economy-driven, leadership in the environment, to sustain development and lead good governance in oil and gas. To answer how transnationalism translates in the upstream sector of Oil and Gas, each driving force is contested against core values of transnationalism to cull a broader view.

Economic Driving Force

There is a stark consciousness that mining companies are investments in developing economies. They have proven to become increasingly important for governments to make ends meet and keep industries on their feet. For most of the 20th century, the behavior of the mining industry was driven almost solely by the need of companies to make a profit (McMahon, 2009). In the year 2008 the government was able to reach its national budget from the income of Oil and Gas sectors of 35.5 billion USD by opening 22 working areas, three of which are granted to the global energy giants — Chevron Corp, ConocoPhillips and Husky Energy Inc. — pledging a total investment of 91.4 million USD for the next three years (The Jakarta Post, 2012). For every $1 million that is invested in the country, an added value of $1,6 million is achieved and increases the Gross Domestic Product of $0,7 million while opening vacancies of up to 100 (Gewati, 2017). The rest was covered by gains from the downstream sector. In contrast to this, state-owned companies only contributed $3 billion in total. Foreign companies have triggered a double-chain effect as taxes have risen further, contributing significantly to national income (Hukumonline, 2013).

Table 2. Oil and Gas Contribution to Domestic Revenues

Oil and Gas Contribution to Domestic Revenues

Year	Domestic Revenue	Oil/Gas Revenue	% of contribution
	Rp Trillion		
2005	494	104	21.05 %
2006	636	158	24.84 %
2007	706	125	17.71 %
2008	979	212	21.65 %
2009	847	126	14.88 %
2010	990	152	15.35 %
2011	1199	272	22.68 %

Source: Price Waterhousecooper: Oil and Gas in Indonesia – Investment and Taxation Guide, 2012

Joseph Stiglitz (2007) addresses issues of the oil and gas sector and their roles towards states as interest optimization by (a) limiting the gains of the receiving country. To limit competitions, they eliminate bidders who can afford to gain less and secure a wealthy margin. Companies will sell their products to their subsidiaries at lower rates hence changing the overall platform of competition. Alternatively, (b) privatization is established to optimize shares. Although bidding was intended to guarantee effective operations, secure extractions, and gains for the recipient state, in practice, private companies receive far less supervision than state-companies which provides more room for movement and implementation of strategies. Corruption is not uncommon in the mining sector. Lastly, when companies (c) have a better understanding of the market price for oil and gas, this makes them upper-hand in formulating clauses, particularly if the contract is self-fabricated.

As analyzed by Notonagoro (2016), this complexity led to a shift of orientation in oil and gas where it is no longer directed at energy security. It is aimed at fulfilling short-term revenues with no added values for generations to come. By being economically upper-hand, the government is more prone to culturally reproducing this as the norm of working with foreign companies focusing on strategic sectors of the nation like oil and gas. Political engagements are becoming increasingly centered on finding a common ground that benefits both sides, as opposed to meeting the needs of the nation at the expense of heavily invested companies. All in all, mining companies have become an avenue of capital that has presented governments the illusion of expanding their workforce, accelerating their economic growth, and contributing to a success they would have otherwise not been able to achieve. In this sense, the economic driving force exceeds the government in all four aspects.

Environmental Driving Force

More obvious than not, the environment should be preserved if not prioritized. Environmental pressures used to have profound technological repercussions for the mining industry and, arguably, moved it into the position of industrial leader in the development of environmentally friendly technology and technological processes. The legislation was introduced around the globe defining acceptable emission. There were even implications for the organization of mining companies and their specific operations—environment departments and an increased focus on community relations (McMahon, 2009). This gave birth to an increasing chain of community-focused actions aiming at giving back to the surrounding community and the nation in a general sense. Much of the early CSR (Corporate Social Responsibility) focus was on environmental management and protection (Utting & Ives, 2006).

Through the years, being environmentally-friendly has been interpreted differently by recipient states with a note to transfer of green and clean technology. Indroyono Soesilo, secretary of the Coordinating Minister for People's Welfare stated that the country is struggling to achieve a transfer of technology due to expensive copyrights that are beyond affordability (Sagita, 2012). Although industrialized nations exceed in green technology, developing countries will not be able to afford them if expensive copyright fares apply. As a country with vast marine and forest areas, Indonesia plays a significant role in absorbing emissions. Despite contributing insignificantly to the world's carbon emissions, countries with large marine and forest areas will suffer the most from climate change (Jakarta Globe, 2012). In contrast, companies that advance in the technology needed to balance this gap lack goodwill to transfer the rights of technology in a way that benefits both sides. The underpinning reason being funds and lack of enforcement. Oil and gas companies reluctant to make these transfers take advantage of CSR programs to bridge this gap. By shifting the focus, they culturally produce the notion of 'giving back'. In places where the local government is displaced, their CSR programs cull greater audiences. Understanding this, as long as political engagements continue to place international oil and gas companies as drivers, engagement will focus more on publicity and less on achieving tangible transfers of technology and knowledge that the environment needs. Oil and gas companies will continue to serve as an avenue of capital that only serves short-term revenues with no added value to the economy, and even less to the environment. In this contestation, the government has more agendas to push for but is dependant on the regime. Mining companies have a greater advantage in all regions except for consciousness.

Sustainable Development Driving Force

Multinationals have used CSR to face strong competitive pressures. Driven purely by commerce whilst facing a limit to global oil reserves, they make use of all means available to gain a competitive advantage over rivals (Frynas, 2009). CSR initiatives relating to community development have undergone a significant change from ad hoc 'assistance' to develop partnerships with government agencies and NGOs. Spending on community development programs by the oil, gas and mining sector was estimated at over $500 million in 1999. Shell alone spent $106 million on 'social investment' in 2004, although this still represents less than 0.6 percent of its net income. Such investment, however, is highly contested, as numerous projects have failed and some have exacerbated already fraught community and intra-community relations due to poor design, low community participation and the failure of companies to improve core business practices (Utting & Ives, 2006).

Being conscious of international signaling, particularly on issues of sustainable development, they compete tightly against NGO's to secure an international outreach profile. NGO's, like other non-state/ transnational actors, have greater room for movement, and often little to lose. As transnational actors, they mark areas of work where governments or mining companies are absent or have failed. In response, CSR arms have become more prominent and many companies have established special programs or trust funds to move in this direction (McMahon, 2009). The government, on the other hand, has double the responsibility. They must ensure that companies are contributing their fair share but at the same time, are committed to their responsibilities of ensuring sustainable developments. In over-branding

CSR's, it creates a culturally-produced illusion that governments and NGOs are levels, even in areas as crucial as development. Though political engagements should be utilized to achieve sustainable development, without the appropriate approach there stands little chance that intervention can be prevented. Hence, despite great efforts to seek alternative avenues of capital, governments also have more to lose if the agenda is set by non-state actors like NGOs or oil and gas companies.

Governance Driving Force

It has become increasingly clear that even with economic gains, sufficient technology to achieve the preservation of the environment, and sustainable development, it will not necessarily lead to lasting impacts if the politics do not support. It is no longer considered acceptable for firms, particularly in non-renewable resource industries, to steer clear of governance issues if the system is such that most of the benefits will be captured by the elite groups in the host country (McMahon, 2009). McMahon (2009) states that the mining industry has never been able to avoid political issues. By virtue of management, mining deposits and/or ancillary infrastructure often cross national boundaries, by virtue of freedom of movement due to loose supervision, they are able to link important sectors of a state and take advantage of it and by virtue of technology they are relied on for achieving lifting quotas without having to commit to knowledge transfer.

Though conscious of this, governments rely on companies to achieve the lifting quota, secure short and long term stocks for defense and security purposes, and contribute to their national income. The asymmetry of power is obvious. Although cultural reproductions can help shape government agendas, without the will to reprioritize appropriately, the asymmetry will remain. Despite being able to summon tangible support, unless corruption and political intervention can be eliminated, engagements will continue to work in favor of the companies. From a pragmatic point of view, this is a fast track in gaining capital and boosting national income but at a price. In the decades to come, Indonesia will struggle even more to compete globally particularly noting that market prices do not always follow 'supply and demand'. It will still have to face its shrinking oil and gas wells and prepare for national security. In this contestation, mining companies starkly prevail over the state.

Table 3. Contestation of Driving Forces

		Driving Forces of Mining Companies as Non-State Actors			
		Economy	Environment	Sustainable Development	Governance
Driving Forces of State as Transnational Actors	Consciousness	The consciousness that mining companies are an investor as much as they are an investment that the government cannot afford to lose.	Mining companies who are reluctant to make transfers of knowledge and clean technology accessible have more to lose with the building social and international pressure to make the environment a sphere for all.	Transnational companies are very conscious of international signaling. CSR arms have become much more prominent and many companies have established special CSR programs, foundations or trust funds to help move in this direction.	Mining companies are conscious that they have proximity to bureaucracy, policymaking, and information which would otherwise be difficult to access. They use this to their advantage when necessary and are reliant on these factors to ensure optimal gains.
	Cultural Reproduction	The government is more prone to culturally reproducing this as the norm of working with foreign companies, particularly in strategic sectors like oil and gas.	By shifting the focus on their social and charitable CSR actions instead of engaging in demands of a fair transfer of knowledge and technology, they culturally reproduce a sense of accomplishment and 'giving back' when, in fact, little can be traced.	By over-branding CSR's, this creates a culturally reproduced illusion that non-state actors can trump state governments even in areas as crucial as sustainable development.	Cultural reproductions play an important role in shaping the agenda for governments and mining industries. However, as long as the government still lacks the political will to set its priorities, the asymmetric balance of power will remain present.
	Political Engagements	Political engagements are becoming increasingly centered on finding a common ground that benefits both sides, as opposed to meeting the needs of a nation at the expense of heavily invested companies.	As long as political engagements continue to place large mining companies as strategic drivers, engagements will focus less on achieving transfers of technology and knowledge that the environment needs.	Political engagements should be utilized as a venue to achieve sustainable development.	The government possesses the tool of political engagement to summon for support in areas they need help in. But unless corruption and political intervention can be eliminated, the engagements will continue to work in favor of foreign mining companies.
	Avenue of Capital	Mining companies have become an avenue of capital that has presented governments the illusion of expanding their workforce, accelerating their economic growth, and contributing to a success they would have otherwise not been able to achieve.	Large mining companies will continue to serve as an avenue of capital that only serves short-term revenues with no added values to the economy, and even less to the environment.	Although the government is always in search of newer and greater avenues of capital, they have more to lose if the agenda is set by non-state actors like NGOs or mining companies.	Though large mining companies offer the much needed economic boost, in the decades to come, Indonesia will struggle even more to compete globally. Indonesia will still have to find new oil and gas wells to replace the slowly diminishing ones and with that, ensure national security.

What the above table illustrates is the contestation between the state as a central actor in the transnational sphere against foreign oil and gas companies as non-state actors. By looking into how the government translates consciousness, cultural reproduction, political engagements and avenue of capital against driving forces of companies in sectors of the economy, the environment, creating sustainable development and governance, we understand where asymmetry is most noticeable and where their tipping point lies between making culling greater profit and opening up to dense foreign investment investments.

Conclusion

For a long time, Indonesia struggled to adopt a mechanism that balances sufficient production —directly contributing to national income— and avoid the risk of dense foreign investment. This had proved to be more and more difficult. Foreign oil and gas companies have become a necessity and are much welcomed. The relationship between the government and companies have become close to dependent. There is much to be gained by inviting the world to operate in the country. Transfers of knowledge, technology, and the enlargement of the workforce are some of the most tangible exchanges to be had. However, little of this is visible. In contrast, wells are continuing to mature and shrink. An asymmetrical relation has led to unresolved cases of unfair and miscalculated cost recoveries, the absence of the state in regulating against foreign companies in the downstream sector of oil and gas, and the failure to utilize its domestic reserves for the long term and security purposes. This combination makes it a hotbed of unrest.

By contesting the driving forces that guide companies to achieve their goal against norms that are followed by the state, it is obvious that the government is far outnumbered. Table 3 (Contestation of Driving Forces), however, indicates that there is still hope in regaining balance. The environment has been a battlefield for many parties, including non-government organizations, with a battle that is still waiting to be won. In this sense, the pressures of environmental preservation can be shared or doubled, depending on mitigation plans of the government. But for now, the authority still lies in the hands of the government.

To answer the guiding question, working areas have been designed to reflect the idealism of Article 33 of the Constitution, whereby, "The land, the waters and the natural resources within shall be under the powers of the State and shall be used to the greatest benefit of the people" (MKRI, 2012), but has lacked greatly in risk mitigation. Investing greatly in research, education, and infrastructure will greatly improve Indonesia's business climate (Bria, Emmanuel., Heller, Patrick., & Lassourd, Thomas. eds., 2016). Although the state is outnumbered in power, decades of know-how, investment, and human resources supporting mammoth-scale operations, it nonetheless has bargaining power, is critical, held accountable by its citizens, and remains vigil. This is a positive start for a relatively young player in oil and gas. This article hopes to trigger more debates in ways to gain the much needed know-how and technology transfers, without having to fend off investments altogether. All in all, it is hopeful that the landscape of the oil and gas sector will progress.

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