POLITICS & ECONOMICS

Indonesia's lucrative market for Opec

Jakarta wants to clean up its energy sector and hopes big Mideast exporters take up the investment opportunities it creates / DAMON EVANS, Jakarta

INDONESIA, a net oil importer, rejoined Opec in December after a seven-year hiatus. That the group had approved Jakarta's membership reactivation baffled markets: the world's biggest producers were getting a consumer in their midst.

The country, expected to be the world's largest gasoline importer by 2018, believes closer ties with Middle Eastern producers will help it secure stable energy supplies and drive the so-called oil mafia, which controls imports, out of business. Jakarta hopes Opec will offer a source of external pressure that will make the industry more transparent and stamp out the shadowy cabal.

For Opec, the return of Indonesia offers an opportunity to sew up more custom, as demand for its oil wanes in the US and it faces rising competition from Russia and other non-Opec producers.

Indonesia has consistently failed to reverse declining oil production, which stood at 0.792m barrels a day in 2015, down from some 1.5m b/d in the mid-1990s. It became a net oil importer in 2004, and demand now stands at around 1.6m b/d, meaning more than half is imported.

Its refining capacity has also stagnated since the turn of the century. As a result, the nation relies heavily on neighbouring Singapore, a global refining hub, for supplies of gasoline. The lack of new investment in Indonesia was a conscious effort to protect vested interests, argue critics. But now the reformist government of President Joko Widodo is determined to clean up the energy sector and bring in capital.

In terms of value, imports of oil from Singapore expanded more than fourfold over the decade through 2014. By then nearly 70% of domestic gasoline consumption was met with barrels refined in Singapore. The import business had been a huge money maker for Pertamina's oil trading arm, Petral, disbanded in May 2015 amid accusations of graft.

Hong Kong-based Petral, which carried out most of its trades in Singapore, held a near monopoly on the trading of crude and oil products in and out of Asia's only Opec member. Results from an initial audit released in November found that intervention by third parties, often referred to as the oil mafia, resulted in Pertamina paying higher prices for fuel and crude imports. The investigation revealed that these groups "had participated in oil imports through Petral, and the importers had been obliged to accept purchase conditions that involved unfairly high prices", the national oil company's (NOC) chief executive, Dwi Soetjipto, said.

The oil mafia syphoned off up to $400m a year from oil imports handled by Pertamina or Petral, Ari Soemarno, a former head of Pertamina and presidential advisor, claimed after Widodo took office in October 2014.

Available infrastructure

Pertamina's new vehicle for oil buying, the Integrated Supply Chain, which started importing crude early last year, has yielded more competitive pricing with savings of $103m at the end of the third quarter 2015, the NOC reported.

With exports primed to ramp up from Iran and other Mideast producers, Indonesia expects to buy crude on even more favourable terms in future. Jakarta hopes this direct trade, alongside the building of new refining capacity, will help undermine the oil mafias.

Middle Eastern countries have upped efforts to tap into Indonesia's ambitious $25bn expansion plan to overhaul its refinery sector over the next decade. Cooperating with strategic partners is seen as necessary as Pertamina cannot bear the investment itself. Saudi Aramco, which has already teamed up with the company to improve the existing Cilacap refinery, is well positioned to win an open tender for the development of a new 300,000 b/d site in Tuban, East Java.

A decision is expected by March once a presidential regulation has been issued. This will cover options designed to accelerate refinery development, such as public-private partnerships, state-funded projects, and private developments, which would be a first. A range of fiscal and non-fiscal incentives is being drafted too. Meanwhile Iran is eyeing tie-ups with local private companies to build a new refinery.

While the oil mafia has yet to be fully dealt with, the president, known locally as Jokowi, has sent a clear signal to members of the political and business elite that he will come down hard if they are thought to be obstructing matters.

A recent example was the scandal that erupted in November when energy minister Sudirman Said released a recording of House of Representatives Speaker (DPR) Setya Novanto demanding a 20% stake in US mining company Freeport's local unit, in exchange for a mining contract extension. Setya was subsequently investigated by the DPR's Ethics Council (MKD).

The president's role in the case was remarkably well managed, said Adam Schwarz of consultancy Asia Group Advisors. Jokowi allowed Sudirman to serve as the figurehead for the crusade, but wasn't a silent critic, publicly criticising Setya and calling on law enforcement to pursue the case. It was a landmark moment for Indonesian politics, when Setya resigned as speaker after it became clear MKD members favoured his removal.

"This represents a clear break with the past where political leaders have shied away from taking on the powerful and deeply entrenched political and economic interests of Indonesia's energy and resources sector, out of concern it would trigger an expanding circle of embarrassing revelations," Schwarz wrote in *The Jakarta Post*. The taped recording also implicated Muhammad Reza Chalid, who was secretly caught allegedly orchestrating the Freeport deal with Setya. The businessman has reportedly raked in trillions of rupiah over the past decade by controlling a significant portion of the fuel-import business via Singapore, either directly or through proxies.

Jokowi's message is clear. Corruption will not be tolerated. There will be no more skimming from imports if he gets his way. PE