Moreover, Russian oil producers can still rely on the government for financial support. It already spends just under $40bn/year in estimated fuel subsidies.

Russia's largest oil producer – Rosneft – which accounted for 36% of the country's total 2014 oil output is still 70% owned by the state, despite the massive privatisation of the national oil industry in late 1990s (see Table).

State support of the Russian petroleum industry is generous, especially where its state-controlled sector is concerned. And last year about a third of Russia's oil was actually controlled by the state, based on its ownership stakes in the producers.

This support acts as a bulwark against external pressure on Russian oil companies. Recent history is instructive in this respect. In 2009 the average European spot price of Brent Blend dropped to just above $60/b but almost nothing happened to Russian oil production – in fact it rose a little (see Figure 2). Also, spot prices of Brent fell from an average $27.6/b in 1985 to $14.4/b in 1986 and were below $15/b in 1988. Yet Russian oil production was consistently above 550mn mt/y all those years.

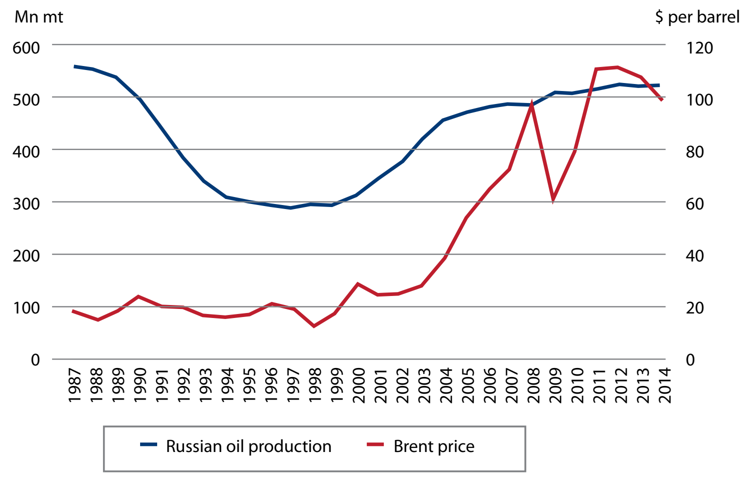
Allowing for the recent weakening of the ruble, the world oil price in Russian rubles has remained almost the same.

Between June 2008 – just before the crash – and June 2015 the average European spot price of Brent Blend, denominated in US dollars, has more than halved – from $132.3/b down to less than $61.5/b, while expressed in rubles it has risen from 3,148/b to 3,369/b. So, if spending is all conducted in rubles, the export sales revenues of Russian oil companies have risen while Brent has fallen.

But as Russian companies have to spend the bulk of their income (including for tax payments) in dollars, this gain is only theoretical.

And last but not least, although producing Russian oil was never cheap, the average technical break-even costs of oil production in Russia are now around $5/b. Even taking into account the long-term oil supply costs of some $40-50/b, as western analysts usually do, there would still be some room for lowering the world oil price without killing off Russia's oil industry. ●

Figure 2: Relation between Brent (annual average, $/b) and Russian oil/condensate production (mn mt) 1987-2014



Sources: BP, EIA, Gapmer

New law hands Pertamina power

Indonesia urgently needs investors with deep pockets to avert a looming energy crisis. But a proposed new oil and gas law to have the opposite effect

THE new law being reviewed by Indonesia's policy makers will unequivocally give state Pertamina significant privileges and establish a national operator to buy oil and gas, a draft proposal shows.

The moves show a greater desire for energy security, although analysts doubt if the law in its present guise will achieve that. They also reflect the government's ambition to manage pricing.

This nationalist spirit in the proposed law is obviously worrying for foreign investors who have spent considerable sums investing in the sector, said Charles Ball, an energy specialist at law firm Reed Smith.

It is no surprise that investment has stagnated in recent years – direct investment stood at $19.4bn in 2014 – and as a result the production outlook is weak, particularly for oil. Investors remain interested in Indonesia's geological potential, particularly in the eastern basins.

But the cost to drill a single well in the technically challenging frontier region ranges from $100mn-$200mn, which is far beyond the reach of most local players, the Indonesian Petroleum Association's executive director, Dipnala Tamzil, said.

Critically, "if the government does nothing (to attract investors) then there will be an energy crisis by 2019," Tamzil told journalists during a round-table discussion.

Nevertheless "the sense of urgency to get big projects going is not there," warned Sacha Winzenried, an energy specialist at consultancy PwC in Indonesia.

Inpex's Abadi floating liquefied natural gas project, Chevron's Indonesia Deepwater Development (IDD) scheme and BP's Tangguh liquefied natural gas expansion project, representing billions of dollars in potential investment, are all frozen by political indecision.

The country's 2001 oil and gas law has been awaiting key amendments since the constitutional court disbanded the former upstream regulator BPMigas in late 2012 for abusing its power.

The court set up a temporary upstream taskforce, SKK Migas, to carry out the regulator's role but as BPMigas' role in the upstream sector was at the centre of the oil and gas law, the constitutional court had to ask the government to amend the law to reflect the new reality and that process that has been delayed for several years.

Consequently, as Indonesia's output continues to wane and demand rises, investment in the sector has slowed. Low levels of exploration reflect the uncertain business environment. The reserves replacement ratio for oil is dangerously low, and while it is better for gas, it's still a declining trend, warned Tamzil.

Unfortunately, hopes that the new oil and gas law could kick-start investment appear dim.

The future of production-sharing contracts (PSCs) remains unclear. Some 27 PSCs are due to expire over the next five years, representing 30% of Indonesia's total production. But Pertamina will get right of first refusal on the blocks as the law aims to tighten the state's grip on the upstream sector.

The new draft law also establishes the compulsory sale and purchase of oil and gas, through a new state operator, in quantities that satisfy domestic market needs. This is set at 25% of production under existing PSCs. But it's not clear how much production investors will be forced to sell – it seems it will fluctuate with demand – nor at what price.

Positively, the new law looks set to streamline the regulatory and supervisory roles of the various government agencies, which would have an immediately positive effect on production, said Winzenried.

Indonesia's investment coordinating board (BKPM) will become a one-stop permitting shop for the industry, rather than operators having to obtain hundreds of permits from 17 government agencies, which has resulted in severe delays, as well as increased costs.

The draft law will also create a new upstream cooperation organiser known as BUMN-K, which will take over the functions of SKKMigas. Private companies will enter into cooperation contracts with BUMN-K to explore and produce oil and gas in the working areas. However, the new draft is silent on any particular cost-recovery mechanisms.

Under the draft law, upstream oil and gas operations will be controlled through the BUMN-K, which owns the upstream business licence. As a result, private investors will see their activities severely curtailed, since they are limited to providing capital and technology under cooperation agreements, said Ball.

To boot, upstream licences will no longer be awarded directly, but via individual special purpose vehicles, which limit investors' legal recourse.

The Canadian think-tank Fraser Institute's global petroleum survey found Indonesia's oil and gas sector was among the worst in the world for investors, scoring even lower than neighboring Timor Leste, Dr Kurtubi, a lawmaker involved in assessing the draft law, told *PE*. The upstream sector will be hoping that Kurtubi will help revise the new law so that it attracts investment, rather than deters it. It is due to be implemented by 2016. ●

Conoco sells Indonesian assets

US major ConocoPhillips is seeking buyers for its legacy Block B fields in the Natuna Sea, along with its transportation infrastructure and onshore receiving plant.

The potential pullback comes only four months after ConocoPhillips' chief executive Ryan Lance visited Indonesia's president, Joko Widodo, and pledged to increase investment in the country.

At the time, energy and mineral resources minister Sudirman Said revealed the US company planned to invest $2.5bn over the next three to four years, a similar amount as in the previous four years.

ConocoPhillips dismissed suggestions that the move was in response to low oil prices. Some analysts believe the uncertain fiscal and regulatory environment in south-east Asia's largest oil and gas producer could be to blame.

The sector was thrown into turmoil when the then upstream regulator BPMigas was disbanded by the constitutional court in 2012.

As a result, a new oil and gas law is in the works, that investors hope will improve the business environment.

Under control

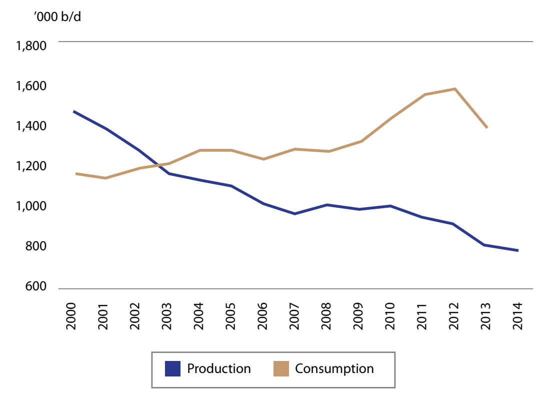
ConocoPhillips has held the block for 47 years and is entitled to run it until 2028. It operates the South Natuna Block B with a 40% interest on behalf of partners Inpex of Japan (35%) and US major Chevron (25%).

The block is expected to produce 335mn ft³/day of gas and 30,000 b/d of liquids this year, according to data from Upstream Oil and Gas Regulatory Special Task Force (SKKMigas), which temporarily replaces BPMigas.

Block B sits under about 300 ft of water and has 11 offshore platforms, four producing subsea fields, and one FPSO in addition to two dedicated floating storage and offloading vessels.

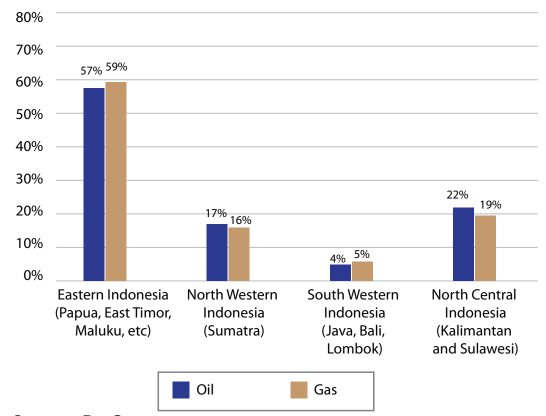
The infrastructure supports three producing oilfields, as well as 16 natural gasfields. Eight of the gasfields are

Indonesia oil production and consumption



Source: BP Statistical Review of World Energy, SKK Migas

Figure 2: Oil and gas reserves in Indonesia



Source: PwC