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## **A Necessity or A Premature Move? The Shift of Indonesian Production Sharing Contract in the Oil and Gas Industry**

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### **ABSTRACT**

This article explains the current significant change in the business activities of the Oil and Gas Industry which Indonesia is experiencing. Production sharing contract (PSC) has been one of the mechanisms to flourish Indonesia's Oil and Gas Industry. It creates good cooperation and understanding between the state and the contractors. However, cost recovery PSC, although long-established, has been generating a lot of problems. These problems were mounting up to the point where changing the financing scheme of the PSC seemed to be more feasible rather than creating policies that would stop the contractors from asking for reimbursement. This article will explore whether the government's shift from cost recovery PSC to gross split PSC is a necessity or a premature move. The result of this research shows that the change is both a necessity and a premature move. On one hand, it is a necessity because the deterioration of the state revenue is worrying. On the other hand, it is a premature move because concrete regulations do not follow this shift, and it discourages the contractors.

**Keywords:** Regulated Industries, Oil and Gas, Production Sharing Contract, Cost Recovery, Gross Split, Indonesia

**JEL Classification:** K230

### **1. INTRODUCTION**

The Oil and Gas Industry in Indonesia has been facing a great dilemma in regards to the changing of the production sharing contract ("PSC") scheme from the cost recovery scheme to the gross split scheme. Recently, the government has issued a decision that they would use the gross split scheme for future PSCs in Indonesia's Oil and Gas industry. This decision is being newly issued through the Ministry of Energy and Mineral Resources Regulation No. 8 of 2017 concerning the gross split PSC ("MoEMR Regulation No. 8 of 2017"). The oil and gas industry is still an essential industry for Indonesia's state revenue. The high growth of oil production that occurred in 1977 and 1995 in which the oil productions have reached the amount of 1.68 million barrels/day (bpd) and 1.62 bpd respectively possessed a lot of potential and profit for the state revenue (Ministry of Energy and Mineral Resources of the Republic of Indonesia, 2015). Although

recently it is reported that Indonesia's oil reserves are expected to run out in 11 years (Yuniza et al., 2016), revenue from oil and gas still has a vital role in the state budget. This is why the scheme chosen for PSCs plays a significant part in determining the revenue of the state budget in the oil and gas industry.

The shift from the cost recovery to the gross split scheme happened as due to the State has drastically lost its revenue in regards to the high cost recovery budget that the government has to bear. In 2016 alone, the government has spent a cost recovery budget up to US\$ 11.4 billion, exceeding the oil and gas revenues of US\$ 9.29 billion (Kurniawan, 2016). It means that the government has lost US\$ 2.11 billion. If the government keeps paying for the cost recovery in the situation where oil and gas reserves are also declining, Indonesia's Oil and Gas Industry will cease to exist as we know it. Therefore, the government believes that cutting the cost recovery through the gross split PSC scheme would resolve this problem.

In this research, the author will analyze whether the changing from “cost recovery” to “gross split” is considered as a necessity or a premature move. On the one side, it can be considered as a necessity in the sense that the existing condition of Indonesia’s Oil and Gas is worrying because of the losses suffered by Indonesia in the Oil and Gas industry. Especially, because of the high cost recovery that Indonesia has to bear and the declining production of oil and gas. On the other side, it can be considered as a premature move in the sense that this monumental shift has rocked the oil and gas industry, and there were doubts from the Contractors about this new profit-sharing system. These doubts were seen because the government has not yet introduced any new regulations or law in order to complement the Gross Split financing scheme in the timely manner. Hence, at the end of this article, the authors will decide whether the application of the gross split mechanism constitutes the right step for the future of Indonesia’s Oil and Gas Industry.

## 2. DISCUSSION AND ANALYSIS

### 2.1. The Cost Recovery PSC

The application of cost recovery PSC in Indonesia based upon the reality that after the independence of Indonesia, the government did not have a clear idea towards developing Indonesia’s Oil and Gas Industry despite the abundance of resources that we have. The government’s main focus was to attract the foreign oil companies that have advanced knowledge in exploring their oil industry to be one of the contractors in the concession agreements and contracts of work (Kusumaatmadja, 1974). Therefore, the cost recovery PSC era emerged in 1960, where the state has a more significant role by having the authority to monitor its natural resources in the upstream oil and gas business activities while simultaneously share the profit of oil and gas sales. The cost recovery PSC Scheme, the contractors have advantages in the costs of exploring their respective oil and gas block because the government will reimburse these costs as well as give the Contractors deductible taxes.

Within the scope of the cost recovery PSC, Pertamina was the party who initially had a very collaborative relationship with the contractors as well as the exploration activities. Pertamina had the duty to cooperate with the appropriate government agencies for the necessary licenses and clearances as may be required to execute the petroleum operations, assists and consults with the Contractor in doing so (Machmud, 2000). However, Pertamina’s role was later eliminated and replaced by BP Migas (now known as SKK Migas) due to the enactment of Law No. 22 of 2001 concerning Oil and Gas. It is stipulated in Article 44 that BP MIGAS shall have the authority towards the performance of PSCs.

Along the way, BP Migas was abolished by the Constitutional Court as stipulated in the Constitutional Court Decision No. 36 of 2012. In its decision, one of the reasons highlighted by the Constitutional Court regarding the dissolution of the BP Migas was because since the cost recovery management system submitted by BP Migas was detrimental to the state (Constitutional Court of Indonesia, 2012). It leads to the establishment of SKK Migas through the Presidential Regulation No. 9 of 2013 as a follow-up to the transfer of tasks, functions, and organization of the executing agency for upstream oil and gas business activities.

Consequently, SKK Migas has the management, and the Contractor is responsible for the execution of the exploration. It means that the Contractor bears all the risks and puts up with all the funds. The Contractor is also responsible for the preparation and execution of the exploration activity. In contrast, SKK Migas bears no risks as a consequence of a PSC operation. In addition, SKK Migas will be the one who approves the authorization of financial expenditure after the Contractor has started commercial production (The President of Republic of Indonesia, 2004). In regards to this integration as well as a cooperative profit-sharing system, the Contractor shall have an economic interest and, therefore, severally responsible for paying taxes on the proceeds from the sales of their respective shares of production (Machmud, 2000). As we can see, the government has its grip on the exploration activity and natural resources, even though the Contractor is the one who executes it.

The reason why the cost recovery strategy has been implemented for more than 40 years was that it has been providing a delicate balance between the constitutional mandate that the Indonesian government has to maintain and the contractual rights of the contractors that expect a certain level of economic outcome (Machmud, 2000). The constitutional mandate in the sense that the Indonesian government shall be responsible for controlling Indonesia’s natural resources for the benefit of the majority of the people by managing through the state enterprise as what has been given to SKK Migas with the duties as mentioned above. The contractors shall be entitled of their contractual rights because these contractors have carried all risks within the funds and the execution of the exploration activity. Therefore, they shall be justified for the profit and the recoverable costs from the oil and gas exploration that they have been invested in. Regardless of the victorious outcome that the cost recovery PSC has provided in the past, in the end, it is proven that cost recovery PSC is no longer practical due to the increasing cost recovery that always seems to rise from year to year.

### 2.2. Ineffectiveness of Cost Recovery PSC

The long-established cost recovery system has received heavy criticisms due to increased strain in the energy industry, and big multinational oil companies started to withdraw. Since 2016 the ineffectiveness of the cost recovery PSC has become so apparent that the government decided to change it into the gross split PSC scheme. The most recent issue would be the fact that it was revealed Chevron would not be extending its contract in the Makassar strait gas block, part of Indonesia’s Deepwater Development (“IDD”) (Curthbertson, 2018). The major role in this ineffectiveness was because of two factors.

Firstly, this is because of the intrusive control from the SKK Migas due to Law No. 22 of 2001 (Roach and Dunstan, 2018). In order for the contractors to obtain approvals, the time consumed is specifically lengthened for them. Moreover, there was also drastic curtailment of the long-standing practices in which some of the types of the costs were turned out ineligible for recovery.

On the other hand, the government had actually conducted their efforts in dealing with the unfriendly outcomes of cost recovery PSC by enacted Government Regulation No. 79 of 2010. In this

regulation, the government was becoming stricter by listing all of the operating costs that can be recovered so that the Contractors would not record anything that is unrelated to exploration activities or benefitted their work programs. Another monumental effort that the government had done was regarding the transfer of exploration commitment between Oil and Gas blocks. The Minister of Energy and Mineral Resources opens the opportunity for Oil and Gas Contractors to transfer exploration commitments to another block in the case where the Contractor has more than one block of exploration in Indonesia. It is regulated in the amended version of Government Regulation No. 35 of 2004 (Amelia, 2017).

Secondly, the government had a reduction in revenue as by 2016, their cost recovery expenditures have deteriorated in the amount of US\$ 11.4 billion compared to the government’s revenue from the Oil and Gas Industry in the sum of US\$ 9.29 billion (Kurniawan, 2016). Due to the demand for reducing the cost recovery budgets from the house representatives, the government hastily introduced the newly gross split PSC system through the MoEMR Regulation No. 8 of 2017.

Despite the drawbacks of the cost recovery PSC for the government, the ineffectiveness of cost recovery PSC also burdens the Contractors. Although, the government had to reimburse the cost recovery in the exploration activities, the Contractors could only propose reimbursement to the government when their projects produce oil and gas (Cahyafitri, 2014). Considering how long it took to have a well commercially produced exploration, it is unfair to the Contractors to wait for the reimbursement after they create financial gain for the government. For example, if the Contractor had spent \$1 Million in 1998, the year of discovery from the exploration, the Contractor could only recover all \$1 Million in 2003, the year of production, the value of the money would only be in the amount of \$621,000 (Setiawan, 2016). This is because the value of money in 1998 and 2003 would have had a significant difference, and therefore, it decreases the economic value of the profit.

In the end, despite of the government’s efforts in controlling the cost recovery scheme, it is still insufficient to control the cost recovery PSC. This is because after the Plan of Development (“PoD”) is approved by the SKK Migas, the Contractor would be the one who executes all of the execution activities and only reported the expenses that have occurred to the SKK Migas or the government to reimburse the recoverable costs. From what seems to be monitoring the exploration activities, it is usually only for a false display because the government should have “monitored” the exploration to a substantial manner and dive in every aspect of the exploration.

We should also take into account an imminent factor from the exploration activity conducted by the Contractor. In July 2017, the cost recovery was in the amount of US\$ 5.87 Billion and had increased only a month before that in the sum of US\$ 4.87 billion. This increase was indeed higher than usual, which was only US\$ 800 Million to US\$ 900 Million. However, as it turned out, the increase was due to the additional cost of activities in Cepu Block that has drastically reached US\$ 200 Million. SKK Migas

confirmed that this extra cost was due to the inevitable depreciation of the Cepu Block working area (Sirait and Bayu, 2017). It shows how unpredictable the Oil and Gas Industry is and how the government either “win some” or “lose some” in this regard.

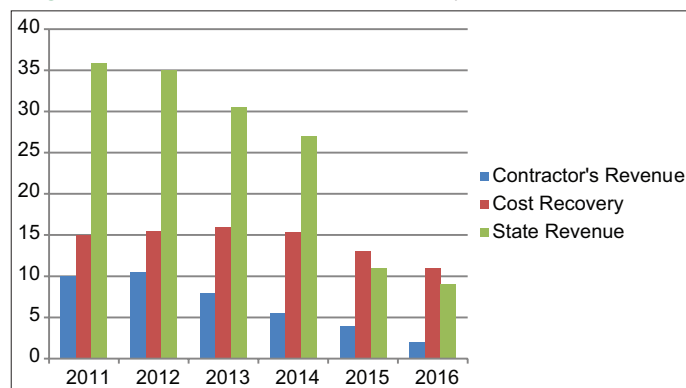
### 2.3. The Interest of Shifting Cost Recovery PSC to Gross Split PSC

The Government of the Republic of Indonesia, particularly the Ministry of Energy and Mineral Resources (“MoEMR”), sees this decision to replace the financing scheme from the “cost recovery” to the “gross split” as an urgent need for Indonesia’s Oil and Gas industry. This is because the cost recovery PSC has diagnoses that can potentially decline State revenue.

As we can see in the Figure 1 above, just 1 year before the gross split PSC was implemented, there was a peak of decline in the 2016 State Budget. The Ministry of Finance released that natural resources revenue in the 2016 State budget plan has decreased 59.7% from the target that was expected in the amount of IDR 124.894,0 billion (Ministry of Finance of the Republic of Indonesia, 2016). It led to more disappointment as the 2016 State budget plan for Oil and Gas revenue was achieved in the amount of IDR 28.440,8 billion, which was below the target as set out in the 2016 State budget (Ministry of Finance of the Republic of Indonesia, 2016). Ministry of Energy and Mineral Resources (MoEMR) announced that the Oil and Gas Industry has only contributed about 8% and 5% to total State revenue in 2015 and 2016 (Soemanto and Ratnasari, 2017). Finally, this created the amount of cost recovery more elevated than the state revenue in 2016. When the cost recovery became higher than the state revenue itself, it created a lot of liabilities for the state to pay, and thus, the exploration of Oil and Gas Industry in Indonesia became a loss rather than a gain. Especially, we are in an era where our oil reserves are expected to run out in 2030. Not to mention, fuel consumption continues to increase, reaching around 1.6 million bpd (Hendartyo , 2019). With the scarce resources that we have, Oil and Gas production is presumed to decrease. Hence, the cost recovery remains high. These imminent factors would lead to lower state revenues, and soon the Oil and Gas Industry would no longer produce any revenues for the state.

With the saddening result of the cost recovery PSC outcome, the government has decided to change the cost recovery strategy in the

Figure 1: Contractor’s revenue, cost recovery, and the state revenue



Source: Ministry of energy and mineral resources

hope of a better profit-sharing strategy so that potential investors will be attracted to Indonesia’s Oil and Gas industry again. It led to the enactment of the MoEMR Regulation No. 8 of 2017.

### 2.4. Gross Split PSC Explained

The most important difference of the gross split PSC from the cost recovery PSC is that in the gross split scheme, there will be no cost recovery. The non-existent of cost recovery is because since the government will no longer accept the reimbursement of the cost recovery borne by the Exploration activity of the Contractors. The Contractors will entirely carry the capital, risks and costs that derive from any activity or Exploration activity in the Indonesia’s Oil and Gas Industry. This decision is a brave one considering the fact that there were still a lot of Oil and Gas blocks that placed reliance on the cost recovery scheme in their PSCs.

To elaborate further regarding the gross split PSC, there is a significant difference in the production sharing mechanism compared to the cost recovery PSC. Based on the applicable MoEMR Regulation No. 8 of 2017, specifically Article 5 (1) it is stipulated that the *Base Split* between the State and the Contractor for Petroleum would be 57% for the State and 43% for the Contractor. Meanwhile, for Natural gas, the *Base Split* between the State and Contractor would be respectively 52% and 48% (Ministry of Energy and Mineral Resources of the Republic of Indonesia, 2017). The determination of the *Base Split* that each contractor is going to receive has a more demanding level, as it will be adjusted by incorporating to variable and progressive components.

Variable components, as well as *Base Split* corrections from variable components, are as follow:

- a. The block status.
- b. The field’s location.
- c. The reservoir depth.
- d. The availability of supporting infrastructure.
- e. The reservoir type.
- f. The content of carbon dioxide (CO<sub>2</sub>).
- g. The content of hydrogen-sulfide (H<sub>2</sub>S).
- h. The oil’s specific gravity.
- i. Local content in the field development period.
- j. Production phase.

Moreover, the *Base Split* is further adjusted through progressive components based on a monthly evaluation, which is conducted by SKK Migas (Ministry of Energy and Mineral Resources of the Republic of Indonesia, 2017). Progressive components, as well as *Base Split* corrections from progressive components, are as follow:

- a. The oil price (US\$/barrel).
- b. Natural gas price (US\$/MMBTU).
- c. Oil and Gas cumulative production (MMBOE)

In regards to the Oil and Gas cumulative production, there is an elaboration that is stipulated in the MoEMR Regulation No. 52 of 2017 concerning the changes to the particular provisions in the MoEMR Regulation No. 8 of 2017. It is elaborated that for fields that have been produced carried out in accordance with the plan of development of a work area managed under a new cooperation contract, the cumulative amount of Oil and Gas production starts

from 0 (zero) Ministry of Energy and Mineral Resources of the Republic of Indonesia, 2017).

The production share adjustment through variable components and progressive component is recorded in official minutes, which form an integral part of the gross split PSC (Ministry of Energy and Mineral Resources of the Republic of Indonesia, 2017). Based on the explanation as mentioned above, both revenues from the Government and the Contractor under gross split PSC can be calculated through these following components in Figure 2.

Although, gross split PSC seems as similar as the Royalty and Tax system. In fact there is a substantial difference between them in regards to the ownership of oil and gas. In the gross split PSC, the ownership of oil and gas belongs to the government. Meanwhile, in the Royalty and Tax system, the ownership belongs to the Contractor (Prahoro, 2017).

There are also certain principles that the gross split PSC uphold (Purba and SKK MIGAS, 2017):

- a) State-owned goods where all goods and equipment’s that are directly used in the oil and gas business activities purchased by Contractors became the property of the State;
- b) Procurement of goods is carried out by the contractor independently;
- c) Operating costs can be used as a deduction from income in calculating the Contractor’s taxable income;
- d) SKK Migas approves or rejects the Contractor’s Work Plan while the budget is limited to supporting data in evaluating the work plan.

Another significant change in the gross split era is regarding the reimbursement. Previously, in the cost recovery PSC scheme, the Contractors shall be reimbursed for the costs that they have expended to conduct exploration and exploitation. This is because it is in accordance with the work plan and budget as well as authorizations financial expenditure approved by SKK Migas after they have started commercial production (The President of Republic of Indonesia, 2004). Whereas, in the gross split scheme stipulated in Article 14 of the Amendments of Ministry Regulation on the gross split PSC stipulated that, operating costs incurred by the Contractor can be taken into account as a deduction against the Contractor’s income tax liability (Ministry of Energy and Mineral Resources of the Republic of Indonesia, 2017).

### 2.5. The Development of Gross Split PSC in 2019

The application of gross split PSC since 2017 has received an ongoing debate in regard to its fiscal regime and its speedy

**Figure 2:** Calculation on gross split production sharing contract

State Revenue: Base Split + Bonus + Contractor Tax + Indirect Tax
Contractor revenue: Base Split +/- Variable Component +/- Progressive Component

Source: Ministry of Energy and Mineral Resources of the Republic of Indonesia in 2017

implementation. However, it is reported that a lot of Contractors had already adopted the gross split scheme in their respective contracts. Based on the data from the Ministry of Energy and Mineral Resources, at the end of 2018 alone, there have been 32 Oil and Gas blocks using the renowned gross split scheme. The latest is the South Jambi B Block, terminated in 2020, managed by Hongkong Jindi, Co., Ltd. Oil and Gas blocks that have used gross splits consist of 11 blocks resulting from the auction in 2017 and 2018, then 20 blocks of termination or contract expiration from 2018 to 2020, in addition with one block within the amended contract of Oil and Gas industry. The total investment commitments from the 32 Oil and Gas blocks estimated to reach around US\$ 2.1 Billion or equivalent to Rp.31 Trillion (Energi, 2019). Thus, this would hopefully create an environment of trust between the Contractors and the Indonesian government as well as the betterment of the Oil and Gas industry's financial climate.

### 2.6. The Strength of Gross Split PSC

The most definite advantage of incorporating the gross split scheme is that the government would not be burdened by the recoverable cost borne by the Contractors. This advantage would potentially recover the state revenue from the Oil and Gas Industry and soon fix the financial situations that have deteriorated in 2016. The government and the MoEMR, who have enacted the MoEMR Regulation No. 8 of 2017, believe that this new scheme should incentivize exploration and exploitation activities due to the spending and operational "freedom" it conveys to Contractors. For instance, the scheme would better allow Contractors to focus on cost efficiency and reduce delays from the bureaucratic approval process for expenditures (Coopers, 2018). It can be seen through the MoEMR Regulation No. 8 of 2017, where Contractors may carry out procurement of goods and services independently. Previously, government regulation, such as PTK-007, which regulated the procurement of goods and services by Oil and Gas Contractors, was enacted to give preference to Indonesian suppliers. Not only that, for purchases in excess of certain values, detailed procedures must be complied, including the calling of tenders and approval by SKK Migas (Coopers, 2018). It will mean that government procurement regulations (such as PTK-007) may have less influence in the Contractor's procurement process, and thus, Contractors can prioritize cost efficiency and reduce the bureaucratic process (Coopers, 2018). According to the Minister of Energy and Mineral Resources, Arcandra Tahar, these production sites would inevitably cut all of the unnecessary expenses because since there are no reimburses during the production period of oil and gas production.

The concept of gross split PSC as stipulated in the MoEMR Regulation No. 8 of 2017 and its changes have actually been sufficient to regulate external factors that are beyond the control of both parties. For example, the oil price factor, when the condition of the oil price is low, the Contractor will get additional revenue sharing, so that it is economically attractive for them to carry out the operation. The gross split scheme will provide protection to investors to maintain their economic value against the decline in production or oil prices in the future. Conversely, when the price of oil is high, the profit share for the government will increase. It is the concept of sharing – The Pain and The Gain, where both parties share the benefits and risks that they will face in the future.

### 2.7. The Drawbacks of the Gross Split PSC

Gross split was expected to present a double-edged sword by both the government and Indonesia's Oil and Gas industry. This scheme was expected to both relieve the burden of declining Oil and Gas revenue while simultaneously attract foreign investors to conduct Oil and Gas exploration in Indonesia. The gross split PSC has indeed provided a space for the government to be able to gain profit without being burdened by cost recovery again. In the short term, the gross split PSC will overcome government problems where the government is charged to pay a very large cost recovery. Not to mention, it is also the most possible solution at the time towards the citizens' preconceived notion that under the cost recovery, the government had taken an advantage towards gas operating funds, and some people even regarded cost recovery as an immoral act. On the other hand, the government seems to be in a hurry to implement this regulation just because it economically eliminates cost recovery without considering that when the risk borne by the Contractor becomes greater, so does their investments in the Oil and Gas Industry in Indonesia. It is due to the fact that in terms of Oil and Gas business, not only from the taxation and revenue sharing that are influential but also from the exploration risk sector itself (Giranza and Bergmann, 2017). Also besides, in terms of taxation, the cost recovery scheme is tax-deductible. It is logical because the government will reimburse the cost recovery. However, this scheme still exists and is still used today by the government in implementing gross splits. The difference is, the operation cost will not be taxed until a certain duration of time. The fact that this taxation scheme is still being used, it proves just how unprepared the government is that it causes uncertainty in terms of regulations.

In the long run, the government must make regulations in order to fill in legal uncertainties such as tax laws. In terms of the authors' perspective, a gross split will indeed make the government not suffer losses due to the massive cost recovery burden. However, the investor's interest in investing in the Oil and Gas Industry in Indonesia will be reduced because the risk will be too large to be borne by the contractor. The government has actually tried to accommodate this by providing easier regulations by not requiring approval and also creating a leeway for the Contractors in comparison with the usual bureaucracy process (Roach and Dunstan, 2018). In addition, with a progressive scheme, where exploration of Oil and Gas Industry in Indonesia is also declining, if it continues to rely on PSC standards, the government will continue to suffer losses due to declining production, but the cost recovery burden remains large. Therefore, with a gross split PSC that prioritizes variable and progressive components, the *Base Split* for profit sharing is expected to generate interest from investors.

In regards to the undeveloped gross split scheme, the author had previously explained that investments would not be so appealing because of the risks that will be burdened by the Contractor is too high. In April 2017, Wood Mackenzie applied the gross split PSC to Offshore North West Java ("ONWJ"), Sanga Sanga, and South East Sumatra contract extension. These PSCs will be transferred to Pertamina in 2017-2018 and will be replaced under gross split terms (Mackenzie, 2017).

As illustrated in the economic evaluation chart in Figure 3, the extensions of these expiring contracts under gross split would result in the downgrading of investment and simultaneously reduce total contractor value by US\$ 480 million and increase total government share by US\$ 470 million. If this continues to go on, sooner or later, the Oil and Gas Industry in Indonesia will lose all of its potential investors. Therefore, the Gross Split PSC scheme will have to move on from its current form and this can be derived from an attempt in creating a higher share for the Contractor or improving its taxation policies.

### 2.8. New Regulation and Policy to Improve Gross Split PSC

People have often questioned whether the Gross Split PSC complimented all of the flaws in regards to the economic burden, fiscal calculation, and policies of the long-established cost recovery PSC regime. Despite the fluctuations that the Gross Split PSC may demonstrate, there are two absolute things that the Gross Split PSC will provide. Firstly, the government will be relieved from the burden of compensating the operational costs by the cost recovery system. Secondly, because of the abolishment of the cost recovery, it leads to higher costs for the Contractors because they have to burden all of the risks.

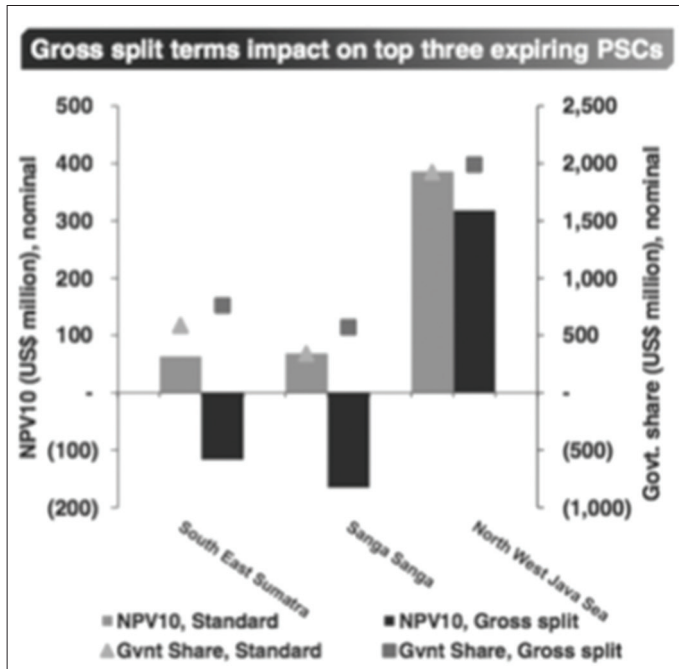
There have been criticisms regarding the shift from the cost recovery PSC to the Gross Split PSC. Firstly, due to the high cost in Gross Split PSC, people worry that the investment in the Oil and Gas Industry in Indonesia will decline. Secondly, when the gross split PSC is newly implemented, the government was not prepared in the complimenting regulation, specifically, the taxation regulation. Lastly, the government has not yet found a thorough strategic plan to accommodate the concerns of the

Contractors and the anxiety of declining investment in Oil and Gas sector.

Based on the drawbacks described above, it can also be concluded that it is too early to assume whether the gross split PSC has created more advantages for Indonesia’s Oil and Gas Industry or not. However, as sets forth in the new Government Regulation No. 53 of 2017 regarding Tax Treatment for Upstream Oil and Gas Business Activities with gross split PSC, we can see that the government has implemented stricter requirements towards contractors in comparison with the traditional PSCs. From the drafting of the Government Regulation No. 53, a 10-year tax loss carry forward restriction applies rather than the indefinite period under traditional PSCs. There is also an apparent loss in the entitlement of “assume and discharged” where the Contractors will be able to be exempted from paying indirect taxes due to the fact that the government while compensating the operational costs under traditional PSCs (Coopers, 2018). However, in this new taxation policy for the gross split PSC the taxation applies because the cost recovery is non-existent.

In conclusion, the shift of the traditional PSC towards the Gross-split PSC can be deemed as a necessity. It is because the loss experienced by the government from compensating cost recovery had brought not only a detrimental effect in the financial sector but also the loss of public trust. Hence, gross split PSC is seen as a solution because cost recovery was abolished. On the other hand, it is also seen as a premature move as when the gross split was first introduced; it was not supported by specific complimenting regulations such as taxation. It can also be seen as a premature move as the government wanted to simply gain the public trust and eliminate the government’s draining cash.

**Figure 3:** Economic evaluation chart of south east Sumatra, Sanga Sanga, and ONWJ blocks



Source: Wood Mackenzie, “Indonesia’s Gross Split PSC: Improved Efficiency at Risk of Lower Investment?” 2016

### 3. CONCLUSION

In conclusion, the shift from cost recovery PSC to gross split PSC can be deemed as both a necessity and a premature move. In the view of a necessity move, the cost recovery PSC had to be replaced, as the financing scheme for PSCs has been detrimental for Indonesia’s state revenue because the government had to continually be responsible for the operating costs of Oil and Gas field operations. As research has shown that the natural resources revenue in the 2016 State budget plan has decreased to 59.7% leaving much to be desired from the cost recovery PSC.

Furthermore, not only because of the Ineffectiveness of the cost recovery PSC itself, but gross split PSC offers several things that would advantage Indonesia’s Oil and Gas Industry, such as the certainty of the value of the profit-sharing of the Oil and Gas at the beginning of the contract. It is because cost recovery will not weigh down the government, as the state budget is not burdened with the operating cost of Oil and Gas projects. The supervision from SKK Migas is reduced as well because now the project finance and operational costs are in the hands of the contractor. For that reason, the gross split PSC shall be regarded as a necessity.

On the other hand, it cannot be denied that changing the PSC financing scheme to the gross split scheme is a premature move as this financing scheme is considered to be inconvenient for the Contractors. It is a brave step, but it creates a lot of doubts as each and every operating cost falls under the contractors' responsibilities. It would lead Contractors to be discouraged in exploring Indonesia's Oil and Gas Industry, and discouragement is not a feasible option for Indonesia's state revenue. Nevertheless, The government has actually become more committed to executing the gross split PSC as they are producing more regulations.

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