Political risks rising across Southeast Asia

By Damon Evans 9 March 2017

A tanker off the Indonesian coast. The country's upstream sector needs better cooperation, analysts say. (SKKMigas)

Political risk for foreign investors is set to increase across Southeast Asia this year, particularly in Indonesia.

A rising sense of economic nationalism is the main risk for investors in the country – the region's biggest hydrocarbons producer – Adam Schwarz of strategic and investment advisory firm Asia Group Advisors told *Interfax Natural Gas Daily*.

"Parts of the government have an exaggerated view of Indonesia's ability to exploit and monetise its underground mineral resources without foreign capital and technology," he added. The growth of identity-based politics and resource nationalism, spurred by an economy that is facing headwinds, is a threat to energy investors, analysts say. It is likely to accelerate the decline of Indonesia's ailing upstream sector.

Some 35 production-sharing licences – which are worth a combined $10 billion and account for more than 1 million barrels of oil equivalent per day of production – are due to expire in the next decade, analysis from research firm Wood Mackenzie shows.

Indonesian NOC Pertamina will need technical and financial support from foreign investors to achieve its ambitious plans to play a key role in managing the expiring assets. But foreign players remain wary about channelling new investment into the upstream sector given the rising uncertainty.

The expiring licences offer a vital opportunity that, if used properly, could revitalise the corporate landscape and give many blocks a fresh lease of life, says Woodmac. But Indonesia's energy ministry, upstream regulator SKKMigas and Pertamina will need to cooperate to ensure the continued survival of the industry.

"There is a certain negativity about Indonesian oil and gas at the moment, which is not helping Indonesia because investors will go elsewhere. Investment dollars will flow to Myanmar, Malaysia or Africa instead," Ashley Wright, a Singapore-based energy lawyer at Pinsent Masons, told *Interfax Natural Gas Daily*. "Even the most ardent nationalist has to be looking at the lack of investment and thinking something is not right here."

A Jakarta-based political risk consultant who wished to remain anonymous agreed that Indonesia has a vastly overrated sense of itself in the global energy supply chain. But, worryingly, there is no coherent policy-making process or clear direction from the president's office, he said.

"Since [President Joko Widodo] reshuffled his cabinet last July there has been a steady regression. They have lost sight of the bigger picture, which is that if foreign investors make money, they will invest. But somehow that idea is missing," added the consultant.

Lacking expertise

Schwarz says there is a mismatch in knowledge. "The view of many industry players is that decision-makers on important policies, be it contracts, concession extensions or tax treatment, are not as familiar as they need to be about the economics of the industry – particularly for oil and gas, but [also] for IPPs in power and mining contracts."

A case in point is the new gross split production-sharing contract (PSC), which was introduced in January. "The new gross split PSC doesn't look good. The objective is to improve efficiency, but the new terms will deter upstream investment," Andrew Harwood, an upstream specialist at Woodmac, told *Interfax Natural Gas Daily*. "The new terms will increase the payback period and reduce overall returns for investors. The gross split PSC can work if operators are able to materially reduce costs, but we question whether the regulatory framework in Indonesia can actually allow that to happen."

Risks are also increasing elsewhere in the region. Thailand's long-term political stability is hanging in the balance following the death of King Bhumibol Adulyadej last October, and the country's energy reforms have stalled.

Calls for a new Thai NOC and a revamped tax structure are holding up crucial legislation needed to start the bidding process for ageing major gas blocks and the delayed 21st licensing round. The king's death poses uncertainties because his son, Maha Vajiralongkorn, lacks his father's popularity. For now, the military government remains in charge, according to risk advisory firm Steve Vickers and Associates (SVA).

The energy ministry's politicisation since the May 2014 military coup has left large foreign energy companies with less access to the top floor and the feeling of being cut off from the decision-making process, said Schwarz.

The political outlook is also worsening in Myanmar, according to SVA – a country widely billed as Asia's final frontier for hydrocarbons exploration. Aung San Suu Kyi, the country's de facto leader, is struggling to meet popular expectations because of the continued dominance of the army, which will prevent her government from making progress this year.

However, Myanmar's oil and gas sector is generally less susceptible to political and legal risk, Blair Miller, a Singapore-based energy adviser at Scottish Development International, told *Interfax Natural Gas Daily*.