
INDONESIA'S OIL

Sevinc Carlson

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Prepared for the Center for Strategic
and International Studies, Georgetown University

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Westview Special Studies in Natural Resources and Energy Management

Indonesia's Oil
Sevinc Carlson

Ranked twelfth in world oil production, Indonesia is already an important supplier of oil to Japan, and may become an increasingly important supplier to the United States. Sevinc Carlson presents here the first up-to-date and comprehensive study of the politics and economics of Indonesia's oil, and emphasizes the importance of oil to the country's economic development. Dr. Carlson examines the subject from several perspectives, focusing on the development of Indonesia's oil industry, its present and future status, and Indonesia's position in and attitude toward OPEC. In her concluding chapter she considers both the dilemmas facing Indonesia concerning the production and price of oil and the necessity of greater economic and political cooperation between Indonesia and the United States. Among the appendixes are the text of the Pertamina Law and the frame of the production sharing contract.

Sevinc Carlson is director of legal and energy studies at the Center for Strategic and International Studies, Georgetown University. Her most recent publication is *Malaysia: Search for National Unity and Economic Growth*.

Preface

The decade of the 1970s is an era of rapid and radical change in the political and economic conditions facing American policymakers and businessmen. The conjunction of the worldwide energy crisis and the communist victory in Indochina has given new emphasis to the growing importance of Indonesia—one of the largest but lesser known countries of the world. It is in this context that this study of Indonesia's oil was written: its purpose is to provide a timely overview of the present situation. The study addresses prospective developments in this important area for the information of Americans concerned with U.S. energy problems and the strategic situation in Southeast Asia.

Indonesia is a country fully under the control of indigenous leaders of great political and economic sophistication. Because Indonesians are determined to shape their own future and have demonstrated the energy and ability to do so, it is particularly important to understand their point of view, policies, and aspirations. Consequently, a great effort has been made to use Indonesian sources as much as possible to provide reliable insights into Indonesian government thinking on questions of oil-sector development and Indonesian foreign policy. Throughout the text the term "oil" has generally been used for "petroleum."

I have been fortunate in having the benefit of extensive interviews with key Indonesian officials and scholars as well as with American business leaders and scholars knowledgeable about Indonesian affairs. I would especially like to

thank the following for the interviews and help they have given me:

In Indonesia, His Excellency Dr. Mohamed Sadli, minister of mines; His Excellency Mochtar Kusumaatmadja, now Indonesia's minister of justice; General Ali Moertopo, deputy chief of the State Intelligence Coordinating Body (BAK-IN); His Excellency Roesmin Nurjadin, ambassador to the United States; General L. B. Moerdani, head, G-1 of the Department of Defense and Security; Major General Hasnan Habib and Major General Poerbo Soewondo, also of the Department of Defense; Mr. A. R. Soehoed, vice chairman of the Investment Board; Mr. Alex Alatas, adviser, Secretariat of the foreign minister.

Among Pertamina officials, Lieutenant General Dr. Ibnu Sutowo, former president-director; Major General Soekamto Sajidiman, head of Foreign Contracts, Coordinating Division; Dr. Elrich Sanger, former head of the Legal and Foreign Marketing Division; Mr. Mufti A. S., vice director and editor-in-chief of *Pertamina Bulletin*; and Colonel George C. Benson, Washington representative.

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Sevinc Carlson

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Introduction

Indonesia is an anomaly—a poor country rich in resources. It ranks twelfth in world oil production* and is a member of the Organization of Petroleum Exporting Countries (OPEC), yet it had a per capita GNP of about \$143 in 1975—the lowest in OPEC. Unlike most OPEC countries, Indonesia is unique in that it has a very large population—over 132 million—and has been committed to ambitious development projects for several decades. It is a country with great economic, political, and military potential but has not been able to develop this potential fully for a variety of reasons.

Indonesia is the world's largest archipelago with 736 thousand square miles and over 13 thousand islands. It is endowed with abundant natural resources, especially exportable raw materials vitally needed by the developed industrial countries. In addition to oil, Indonesia has large mineral resources such as copper, bauxite, nickel, tin, coal, and iron sands. It is also among the world's major exporters of timber, natural rubber, and coffee.

Since the failure of the attempted communist revolution in 1966, a military-dominated government under the presidency of General Suharto has ruled Indonesia. Since then,

*If the People's Republic of China's oil production in 1975 was indeed 1.5 million barrels per day as estimated, then Indonesia would be thirteenth. See page 26 in Chapter 2.

Indonesia has made great strides in economic development. Under the first Five-Year Plan, 1969-74 (Repelita I), the overall GNP growth was 6-7 percent; foreign and domestic private investments and exports increased. However, population pressures threaten to negate or at least to limit the benefits of good economic performance. Economic growth has also been inhibited by factors intrinsic to the development programs undertaken by the government.

Indonesia's multiethnic population is unevenly distributed among the many islands of the archipelago, with the majority living in densely settled Java and Bali. The government's efforts to transfer the population from overcrowded Java to Sumatra and other potentially rich areas and to develop the many vital resources of those islands may be retarded by infrastructural deficiencies. However, a \$30 million loan given in August 1976 by the World Bank for the transmigration program will be helpful. The average population growth rate is nearly 2.5 percent a year. It is unlikely that the government's efforts to reduce this growth rate to 2.1 percent will be successful. Estimates are that by 1978 the number of people between the ages of 15 and 29 will be 40 to 42 million. By 1980, Indonesia's total population will be 150 million and by the end of the century 350 million. This large mass of humanity represents a potential resource for development, but also creates serious problems. Widespread unemployment and underemployment, pervasive poverty, pressures on food supplies, and massive rural-to-urban migration are placing serious strains on the political and social institutions.

Since 1966, one of the major economic policies of the government has been to attract foreign private investments. Foreign investments have been instrumental in the development of the natural resources (especially oil) and export-oriented and domestic industries. However, some of the foreign investment projects have had an adverse impact upon other sectors of the economy, and they have not created the hoped-for number of jobs. The labor force has been increasing by about one million annually and is projected to increase by about 1.2 million in the late seventies, but the

industrial labor force has been growing at perhaps one-tenth of that. Recently, a resurgence of nationalism obliged the government to impose some restrictions on foreign private investment, although foreign aid and capital are still badly needed for the various development projects. Efforts are also being made to increase labor-intensive industries to create employment opportunities.

The development strategies promoted by Western-trained Indonesian economist-technocrats have emphasized economic growth, but until recently ignored uneven distribution of income. The economic achievement has not been sufficient and has not reached the masses. There is a great disparity between the incomes of the majority, who live at subsistence levels, and a small minority who have become extremely wealthy. Although Indonesia has very fertile soil and an intensive agricultural economy, the country's food production is still incapable of feeding the current population. There is widespread malnutrition. The national targets to increase agricultural production by 4.6 percent every year—and to reach self-sufficiency in rice by 1976—have not been achieved. There have been recurring rice shortages due to drought and inadequate planning in accumulating rice stocks, and large quantities of rice have to be imported every year. However, Indonesia expects to become self-sufficient in food by 1979. Due mostly to food shortages, inflation—reduced to 2.4 percent in 1971—has again increased. Consumer prices went up 25 percent in 1972 and another 27 percent in 1973, but were brought under some control in 1974 and 1975. Although Indonesia is one of the major oil producers in the world, in 1973 only about 20 percent of the country's fertilizer consumption was met by domestic production.

Indonesia, like some other Southeast Asian countries, has a Chinese minority and problems of economic inequality between this minority and the rest of the population. It also has an internal security problem resulting from insurgency on the Sarawak border.

In recognition of the political danger inherent in the present economic and social situation, the second Five-Year

Plan, 1974–79, emphasizes aid to the poor, an increase in real incomes, production of items of mass consumption, and job creation. But the lack of internal cohesion, social discipline, administrative capability, and managerial and technical skills makes it difficult for Indonesia to find workable solutions to its many development problems.

Although Indonesia's current financial problems may be among the worst in the developing countries, the long-term prospects warrant optimism. Indonesia's potential for productive investment, employment, and economic growth is substantial. There are many opportunities for developing its natural resources, which constitute its long-term strength and are among the most challenging in the entire Pacific Basin. The oil sector is one of the principal contributors to Indonesia's current and future economic development. It is a major source of foreign exchange and an important source of government revenues.

Indonesia is already an important supplier of oil and oil products to Japan. It is as yet a minor supplier of oil to the United States but has the potential of becoming a more important supplier in the future. It also has the potential for supplying considerable amounts of liquefied natural gas (LNG) to Japan and the United States.

The rupiah (Indonesia's currency) has become strong. The International Monetary Fund (IMF) declared it to be a fully convertible currency and one of the twenty currencies now included in the IMF "currency budget." The growing inflow of foreign aid and investments demonstrates the increasing international confidence in Indonesia's economy and potential. Since 1967, more than \$4.5 billion in aid has been extended by the Intergovernmental Group for Indonesia (IGGI). Furthermore, IGGI aid is now extended in semisoft terms with shorter grace periods, higher interest rates (7.5 percent per year), and a shorter repayment period because of Indonesia's favorable balance of payments.

Indonesia is emerging as a leader in regional economic and political cooperation within the Association of South-east Asian Nations (ASEAN) and is a major promoter of the Pacific triangle which includes ASEAN, Japan, and