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Tumbling Oil Prices: Bittersweet Implications for Indonesia

By Keoni Indrabayu Marzuki

Synopsis

The sharp decrease in the oil price has benefitted countries dependent on oil imports to sustain their economies such as Indonesia. However it could also undermine the country's energy security.

Commentary

THE FALLING price of crude oil - from US\$110 dollar per barrel to below US\$50 dollar per barrel (based on the West Texas Intermediate and Brent Crude benchmark) – is benefitting oil-dependent economies around the globe. Oil hungry countries such as Japan, South Korea and China would be able to purchase oil at a lower price and could potentially cut their energy bills significantly.

On the contrary, oil producing countries such as Saudi Arabia, Venezuela, Iran and Russia would be negatively affected by the falling price of crude as it would slash revenue from oil and gas sectors, hence undermining government policies that are dependent on oil and gas revenues. As a net oil importer, Indonesia benefits tremendously from the dip in crude oil prices as it allows Jakarta to cut its energy import bills. Cheaper oil prices could possibly stimulate economic growth with increased consumption. From a political perspective, it could help the fledgling Jokowi administration gain greater approval from the public in the aftermath of the fuel price hike in November 2014.

Sugar-coated benefits?

The sharp decrease in oil price provides an opportunity for Indonesia to significantly minimise its trade balance deficits by cutting its hefty oil import bill. Oil and gas imports, which rose sharply in 2011, dealt a heavy blow to the country's trade balance by counteracting surpluses generated by Indonesia's non-oil and gas trade. According to official data from the Ministry of Trade, Indonesia's non-oil and gas sectors generated roughly US\$8.5 billion in surplus in 2013. The oil and gas sector, on the contrary, generated US\$12.6 billion in deficit in the same year.

The deficit is also likely to linger in the fiscal year of 2014 noting that Indonesia already faced a deficit of US\$1.6 billion in October in its trade balance due to massive imports in the oil and gas sector, climbing to US\$10.6 billion. The deficit incurred by Indonesia's imports of oil and gas would decline

following the fall in global crude oil prices and thus have an ameliorating effect on the country's lopsided balance of payments.

The tumbling oil prices also eased the economic burden of the Widodo administration which is reallocating fuel subsidies. The government has responded by lowering the price of RON 88 petrol (better known as Premium) – the staple fuel for most Indonesian vehicles – from IDR8,500/litre (about US\$0.68) in November 2014 to IDR7,600/litre (about US\$0.61) on 1 January 2015 and then to IDR6,600/litre (about US\$0.53) on 19 January 2015.

The falling retail price of oil would in turn lessen the costs of transportation, goods and services that had increased during the fuel price hikes of 2014. Moreover, it would also defuse political pressure from the opposition and the disgruntled.

A bitter aftertaste

Though tumbling oil prices are economically beneficial at first glance, there are also negative implications that may undermine the Indonesian economy. The Minister of Finance, Bambang Brodjonegoro, has expressed his concern that the tumbling oil prices will slash revenue from gas and oil exports, negating the opportunities and benefits.

Despite Indonesia's status as a net oil importer, it still relies on oil and gas exports as its primary source of revenue. If oil prices in the international market continue to slide, the country's revenue from oil and gas exports will follow suit, neutralising the gains from a lower trade deficit.

From an energy security standpoint, the drop in price is detrimental to Indonesia's short term energy security in three ways. Firstly, it deters interested parties from participating or investing in oil exploration activities. Indeed, there are other factors at play such as a high tax rate and the lack of a governmental financial support framework that would have discouraged oil exploration efforts in Indonesia.

However, even though the price of crude oil was at its peak, oil exploration efforts were lacklustre because of the high costs and risk involved. The declining crude price exacerbates the already meagre exploration effort; a protracted period of low oil prices would further discourage potential investment.

Secondly, the tumbling oil price may undermine the Widodo administration's undertaking of the Enhanced Oil Recovery (EOR) mechanism to boost production levels of Indonesia's maturing oil reservoir. EOR requires in-depth engineering and geological studies including sufficient technological capabilities and financial sustainability. It would be difficult for the government to attract external investment for additional funding because gains from EOR project may not cover the costs due to falling oil prices.

Thirdly, the tumbling oil price in the international market may also undermine Indonesia's long-term energy security projections, especially in relation to energy diversification. According to the National Energy Council (*Dewan Energi Nasional* or DEN), the role of oil in Indonesia's energy mix from 2010-2013 averages about 45 percent, which means that Indonesia is heavily reliant on oil.

In the event of an oil crisis, Indonesia would face severe consequences that could possibly undermine the country's political stability. Cheaper oil prices will promote more oil consumption and minimise incentives on the consumption of alternative energy sources such as gas. Subsequently, the infrastructure development for alternative energy would stagnate as its demand declines.

Lasting bitterness?

The positive implication of low oil price is beneficial for Indonesia in certain sectors, namely the economic and political realms. It is also beneficial from the standpoint of Indonesia's short term energy security projection due to the more affordable energy prices. Its implication on Indonesia's energy security in the long term, however, is potentially more harmful than beneficial.

Indonesia desperately needs new oil reservoirs as its reserves are expected to be depleted in 11

years according to estimates from British Petroleum (BP). Indonesia is also in urgent need of rapid development of its alternative energy sector such as gas and renewable energy sources.

So long as oil prices remain low, there would be little interest in enhancing the resilience of Indonesia's energy sector as its energy needs could be imported cheaply. The new administration should look beyond the immediate impact of the tumbling oil price and set their sights on building resilience to counter a different market dynamic in the future.

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