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# LOW OIL PRICES: IMPACTS FOR INDONESIA

*By Satya Widya Yudha*



The average crude oil price has fallen due to the increase of the United States' daily production of crude oil and the decision of OPEC to maintain its production while European and Chinese economies are slowing down. The general decline in oil prices has a positive impact for many states, but whether a country is a net oil importer or exporter is an important factor to determine whether it benefits or suffers losses from the oil price decline. In this case, Indonesia, which imported 106 million kiloliters of crude oil and 179 million kiloliters of fuel in 2014, is overall benefiting from the decrease in oil prices, despite declines in estimated nontax revenue from oil and gas.<sup>1</sup>

## ECONOMIC IMPACT

Decreased oil prices will result in lost potential revenue of almost 253 trillion Indonesian rupiahs, or \$20.24 billion, in the 2015 state income projection. However, the lowered state projection for oil and gas production of 8% also accounted for this loss. In addition, the low price of crude oil will cause a decrease in Indonesia's export commodity prices. This trend will suppress revenue from Indonesian exports, as about 60% of Indonesian exports are in the form of commodities.<sup>2</sup>

However, the decrease of oil prices will encourage the improvement of Indonesia's current account deficit. A Ministry of Trade press release on March 17 stated that "the export total for the month of February 2015 reached USD 12.3 billion while imports reached USD 11.6 billion. Therefore, a USD 738.3 million was achieved."<sup>3</sup> The current account for oil and gas itself is in a surplus condition caused by the 18.7%

<sup>1</sup> Slide presentation by the acting director general of oil and gas of the Indonesia Ministry of Energy and Mineral Resources at the House of Representatives of the Republic of Indonesia on January 20, 2015.

<sup>2</sup> "Perkembangan ekspor non gigas" [Growth of Non Oil and Gas Export Commodity], Ministry of Trade (Indonesia), <http://www.kemendag.go.id/id/economic-profile/indonesia-export-import/growth-of-non-oil-and-gas-export-commodity>.

<sup>3</sup> "Amid the Weakening of the Rupiah, the Trade Balance Remains a Surplus," Ministry of Trade (Indonesia), Press Release, March 17, 2015, <http://www.kemendag.go.id/en/news/2015/03/17/di-tengah-pelemahan-nilai-rupiah-neraca-perdagangan-masih-surplus>.

Satya Widya Yudha is Vice Chairman of Commission VII in the House of Representatives of the Republic of Indonesia. Mr. Yudha will be featured as a speaker at the upcoming Pacific Energy Summit in Beijing on May 27–29, 2015.

decrease (month to month) of oil and gas imports, as oil and gas exports only decreased 8.8% (month to month).<sup>4</sup>

The fall in world oil prices encouraged the Indonesian government to recalculate the amount of subsidized fuel prices. In its new policy, the government revoked the fuel subsidy for premium fuel and provided a subsidy fixed at 1,000 rupiahs per liter for diesel fuel. This policy is considered a win-win option for the government and the public. With the reduction in fuel subsidies, the government can maximize its spending on productive sectors. On the other hand, the public can enjoy lower fuel prices, which move in accordance with the market price. In the future, the government will set a new fuel price each month based on the results of calculations from various factors, including exchange rate and oil prices in the previous month. Thus, this policy will comply with the Indonesian constitution's mandate that the state set the fuel price.

With the revocation of the premium fuel subsidy, the reduction in diesel fuel subsidy, and the fall of oil prices, the projection of government spending on fuel subsidies in 2015 is down to a mere 88 trillion rupiahs (\$7 billion) from a 2014 level of 276 trillion rupiahs (\$22.08 billion). With savings of 188 trillion rupiahs (\$15 billion), the most important consideration now is how the government allocates the savings from fuel subsidies (consumption expenditure) to a productive expenditure (a pro-growth, pro-jobs, and pro-poor) government budget. With sizeable fiscal room, infrastructure development needs to be realized soon, particularly in the energy sector via the construction of refineries and gas pipelines to ensure energy security and even distribution of gas within the country.

<sup>4</sup> "NPI Februari surplus USD0,74miliar" [Indonesia's Current Account February Surplus USD 74 billion], Ministry of Finance (Indonesia), March 17, 2015, <http://www.kemenkeu.go.id/en/node/45135>.

## IMPACT ON ENVIRONMENTAL AND ENERGY SECURITY

Even amid falling oil prices, Indonesia has to reduce its dependence on imported fuels by diversifying its energy supply and developing a non-carbon-based fuel portfolio that can improve Indonesia's energy security. While renewable energy development is vitally important, it will take decades for Indonesia to scale up to meet the challenge. Thus, optimizing the potential benefits of natural gas can provide a near-term, affordable, and cleaner bridge fuel until clean alternatives such as nuclear, hydroelectric, solar, and wind power become larger-scale.

## PROSPECTS FOR REGIONAL COOPERATION ON OIL MARKET STABILITY

From a regional perspective, Southeast Asia has huge gas reserves but they are unevenly distributed. The Trans-ASEAN Gas Pipeline (TAGP) project, which envisages the creation of a transnational pipeline network linking almost 80% of the region's total gas reserves and utilization centers, was planned to solve this problem. However, this project still remains dormant. Significant challenges in realizing the TAGP are to reconcile the differences in pricing and market structures and to harmonize regulations in each country. For example, in Indonesia, because the constitution mandates that the government set the price of gas, prices cannot follow market rates.

There are new prospects for enhanced cooperation particularly on biodiesel as Indonesia's government recently promulgated regulations to raise the mandatory mix of biodiesel in diesel fuel from 10% to 15%. With six of the top ten palm oil-producing countries in Southeast Asia, this opens the possibility

of regional collaboration to increase biodiesel production, though imported biodiesel will continue to be in demand to fulfill domestic market needs.

## CONCLUSION

As a net importer of oil, Indonesia benefits from falling oil prices. This development provides an opportunity for the country to revise costly policies, such as the fuel subsidy system, and has provided a net benefit to the current account balance despite falling revenues from domestic oil production. Domestic laws, such as the constitutional requirement that the government set fuel prices, limit the scope for future ASEAN-wide cooperation on oil and gas. However, Indonesia's efforts to diversify energy sources, such as through increased biodiesel consumption, open the door to new avenues of cooperation. Though falling oil prices present a challenge to these initiatives, the economic viability of developing new and renewable energy should be ensured by providing attractive incentives. Continued efforts on diversifying energy resources are critical to Indonesia's energy and environmental security goals, and renewable energy and natural gas have important roles to play. ∞

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The 2015 Summit, “Strengthening Markets for Energy and Environmental Security,” will be held in Beijing, People’s Republic of China, from May 27 to 29, 2015, and will convene an exclusive group of two hundred leaders from government, business, and research organizations to explore innovative solutions to the dual challenges of rising energy demand and a changing climate.

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### THE NATIONAL BUREAU of ASIAN RESEARCH

1414 NE 42ND STREET, SUITE 300  
SEATTLE, WA 98105 • 206-632-7370

1301 PENNSYLVANIA AVENUE NW, SUITE 305  
WASHINGTON, D.C. 20004 • 202-347-9767

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