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Fuel Price Hike and Indonesia's Energy Insecurity

By Margareth Sembiring and Yoes C. Kenawas

Synopsis

Fuel price hikes have always been unpopular in Indonesia, largely because of their wide-ranging impact on the population. Yet, it is undeniable that the current high subsidies are unsustainable. To move forward on this issue then, the government would need to focus on comprehensive measures that carefully calibrate the impacts on the various stakeholders.

Commentary

THE INDONESIAN government has finally taken a decisive measure on the longstanding, controversial fuel subsidy issue. On 22 June 2013, petrol price went up by 44 per cent to IDR 6,500 (SGD 0.83) per litre, and diesel increased by 22 per cent to IDR 5,500 (SGD 0.70). At issue was the prospect of soaring budget deficits.

Indonesian Finance Minister Chatib Basri claimed that could amount to 3.8 percent of GDP if the fuel subsidy was not reduced. However, the effect of higher fuel prices on the most vulnerable groups in the society cannot be discounted. Their purchasing power and ability to maintain their well-being would certainly be affected.

Indonesia's current energy situation

In light of the tension between salvaging the state budget and the negative impact on the people's welfare, lack of discussion on the energy security implications of the fuel subsidy should attract concern. With economic growth placing ever greater demands on energy, the fuel subsidy issue is a major threat to the nation's energy security over the long term.

According to Indonesia's Ministry of Energy and Mineral Resources, fuel accounts for almost 50 percent of final energy consumption. Fuel subsidies encourage continued reliance on this energy source. With Indonesia's energy needs continuing to rise alongside its economic growth, such high dependency on fossil fuel and on oil imports places Indonesia in a very vulnerable position.

The government has attempted to address this in its Blue Print of National Energy Management 2006–2025. It envisions energy diversification, with the goal of reducing the use of oil to below 20 percent while increasing the use of other energy sources. Another prong of the plan is to manage energy demand through energy efficiency.

Challenges to Indonesia's energy security

Challenges to achieving energy security abound, however. Diversification of energy sources raises various environmental, financial and policy concerns. Similarly, altering the energy mix and making energy usage more efficient would not be without problems as it would call for substantial infrastructure changes as well as mindset shifts at the consumer end.

The high upfront capital cost of renewable energy technology necessitates massive investments. The presence of cheap fuel, however, is a disincentive to such investment as lack of price competitiveness potentially hurts return on investment. In addition, extremely costly fuel subsidies that amounts to more than 20 percent of the annual national budget puts severe financial constraints on other energy security efforts. R&D, for example, is seriously underfunded despite some smaller successes in the development of jatropha as a new biofuel source.

Fuel subsidies and their crippling funding-misallocation impacts therefore have been perceived as a source of distortion to the Indonesian energy sector.

People's livelihoods are strongly dependent on energy supply. Highly-subsidised fuel has thus far been successful in masking the impacts of the current state of energy insecurity. This, however, may not last for too long. Barring real efforts to effectively create a more energy-secure Indonesia, fuel price increase is likely to result in harder access to energy sources, increased poverty and hardship, and difficulties in carrying out day-to-day activities.

Although the government has provided some measures to mitigate the impact, such as temporary direct cash assistance (BLSM), budget increase to build basic infrastructure, rice for the poor, and other programmes, these might not be sufficient to alleviate the negative impacts of a fuel price hike on the population in the long run.

Certain segments may not be covered under such programmes, such as the 'missing middle' identified by the Asian Development Bank (ADB) Social Protection Index, who live at the brink of poverty, but are not poor enough to qualify for assistance. Fuel price increase would impact the ability of such groups to maintain their quality of life and further exacerbate people's grievances in general. Ultimately, these could lead to regime destabilisation.

The Politics of oil subsidy

The Indonesian government also seems half-hearted in its efforts to cut the fuel subsidy and in its pursuit of energy diversification. There are a number of programmes aimed at reducing Indonesia's dependency on fossil fuel, such as a programme aimed at converting from use of kerosene to liquified petroleum gas (LPG). However, more needs to be done given increasing energy demand in the country.

The underlying challenge in achieving energy independence is short-sighted political interests. The ruling regime faces the dilemma between long-term national strategic interests and short-term politico-electoral interests. Attempts to cut the fuel subsidy may result in decline in voter support for the ruling party.

A survey by the Indonesian Survey Circle (Lingkaran Survei Indonesia) in mid-June 2013 showed close to 80 percent of respondents rejecting the cut in fuel subsidy. This could affect electoral support for the ruling Democrat Party in the 2014 General Elections. Other political parties could try to exploit the issue by arguing against the fuel price rise to attract voter support, or conversely, to maximise their political and financial gains in exchange for supporting the government's policy.

Subsidy relief points to energy security?

What makes the future look grimmer is the absence of any serious attempt by any political party to push the agenda for energy security. This was observable during the parliamentary debate preceding the fuel price increase where the government's plan to disburse the BLSM dominated the discussion. The parties involved were mainly concerned about the instant money that could influence their prospects in the 2014 General Elections.

The decision by the Yudhoyono administration to cut the fuel subsidy has been made at an opportune moment. He faces no significant threat or immediate politico-security destabilising impact on his presidency. Sound economic conditions and the people's anticipation of his departure next year have kept any negative repercussions at bay. Nevertheless, as long as more substantial efforts in energy diversification and energy efficiency are kept in the margins, the issue of energy security will inevitably re-emerge.

The government has relieved the pressure on the state budget by IDR 100 trillion (SGD 12.7 billion). Approximately IDR 9.3 trillion (SGD 1.18 billion) was disbursed through BLSM on the first day of fuel increase. What would become of the rest of it, however, is less than clear. There is an urgent need to ensure that such relief would indeed address existing market distortion and constraints arising from fuel subsidy. A conducive investment climate for energy diversification and energy efficiency needs to be nurtured to achieve energy policy objectives.

Margareth Sembiring and Yoes C. Kenawas are research analysts respectively with the Centre for Non-Traditional Security (NTS) Studies and the Indonesia Programme at the S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University in Singapore.