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Petroleum Paradox: The Politics of Oil and Gas Some Preliminary Thoughts on Paradoxical Social Change

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Hubungan antara sumber daya alam dan pembangunan di negara Dunia Ketiga menimbulkan beberapa pertanyaan antara lain tentang hubungan sumber daya alam dengan pembangunan, atau bagaimana sumber daya alam ini mempengaruhi sifat hubungan Indonesia Amerika. Sehubungan dengan hal yang terakhir ini, kepentingan geopolitik Amerika Serikat di masa Perang Dingin dan di masa kini di mana upaya kontraterorisme global marak akan membuat hal-hal tersebut menjadi lebih menonjol peranannya dibandingkan dengan potensi sumber daya alam Indonesia.

Introduction

A social change process, influenced by a multidimensional crisis, struck Indonesia along with the Asian monetary crisis in 1997, resulting in severe hardships to the people, with no end apparently in sight. Although it was only beginning in 1997 that the troubles struck Indonesia's economy, the condition did not appear out of nowhere. It is the result of an accumulative process, which has lasted for some time. It is this accumulative process that will be discussed in this paper; an accumulative process closely related to a paradoxical manner of social change. It is paradoxical, since the strengths of the social change process are at the same time its weaknesses.

This paper specifically focuses on the *planned, ideologically-based* social change process, commonly called *development*. The development process implemented by the New Order era has resulted in severe difficulties in overcoming the present multidimensional crisis and hardships.

Main attention is directed to the industrialization strategy taken by the New Order regime, in relation to Indonesia's wealth of natural resources, especially in the petrochemical sector. Relations between natural resources and the choice of industrialization strategy is relevant and significant in this paper, as the consequence of the pattern of relations is one of the causes of Indonesia's unending anguish.

In the context of the pattern of relations between natural resources and development, especially in the so-called Third World, a significant question could be proposed: what are the relations between natural resources and development, or more specifically, how natural resources influence industrialization strategy choices, and the character of the relations between the state and the society? A short review on how natural resources influence the character of Indonesia-US relations will also be described.

These questions will be discussed in this paper, in the context of giving light and understanding the roots of the issue, and if possible, solutions to the multidimensional crisis in Indonesia.

Natural resources and development

Natural resources and industrialization strategies

Natural resource-rich states, including Indonesia, tend to have their development strategies, more specifically industrialization strategies, influenced by their wealth of resources. This is more so if the resources are in the form of oil and natural gas. Terry Lynn Karl, in her book *Paradox of Plenty* (1997), proposed a thesis that states such as Indonesia, which need not depend on domestic taxation to finance their development process – especially in the first decade of the New Order era in Indonesia – would not have their government plan development goals and strategies under the supervision of society members, as they do not have much of a say in financing the process.

At the same time, governments could effortlessly distribute and allocate development funds among sectors and regions, based on *ad hoc* policies. The independence of the state from its constituents in the financing of the development process is the main cause of the lack of transparency, excessive centralization, lack of attention to local societal conditions, and lack of public accountability.

The New Order regime, especially in its early years, chose an export-oriented industrialization strategy (EOI). The strategy was chosen due to a number of factors: the shambles that was Indonesia's economy, as a legacy of Soekarno's regime; financial aid from Western donor countries; international political condition of the mid-1960's to the mid-1970's, when the Cold War was at its zenith, and with the US's defeat in Vietnam in 1975; and the expectation that Indonesia was to be a buffer to prevent South East Asia's fall into USSR's or PRC's zone of influence. The legitimacy of New Order's political authority was early on based on economic growth.

Ever since its independence, Indonesia did not have the ability to manage and utilize its natural resources, especially in the petrochemical sector. This is one reason why Indonesia became dependent on foreign investment, especially multinational companies, in the management of its natural resources. Government authority became dependent on the petrochemical sector, a centralization process occurred in the development of the regions, and the state became stronger while society weaker (or was weakened).

Especially since the New Order era, Indonesia utilized petrochemical resources as a source of wealth to strengthen the capacity and authority of the state, chose an industrialization strategy based on exploitation of natural resources, and increased government spending. At the same time, the dependence to natural resources, especially oil and gas, weakened mechanisms of state control, by giving incentives to corruption, and resulting in the creation and maintenance of vested interest groups, which remain a headache in the governance of present day-Indonesia.

The choice of industrialization strategy in the oil dependent-development resulted in an *ersatz* form of capitalism, in which President Soeharto, his family members and cronies, followed by other government apparatus with their own family members and entourage of cronies, could continuously and unrestrainedly sponge Indonesia's economy. The corruption and nepotism worsened with the spread of the dreaded disease into all levels of the bureaucracy, from the capital to the backwaters. The military, which had benefited greatly from Soeharto's rise to power, was also involved in corrupt practices, and by the end of the New Order era, the military has been dangerously fragmented. This condition remains to the present.

Indonesia's multidimensional crisis has accurately been predicted by an expert on Indonesia's economy, Anne Booth, in her book *The Oil Boom and After* (1992), which stated that the political decay occurring during the New Order era could swiftly turn into a crisis, if an acute economic problem struck Indonesia. This prediction was fulfilled in 1997.

Natural Resources and the Character of Indonesia-US Relations

Natural resources specifically petroleum and gas have always formed an important and integral part of Indonesia-US relations since the early independence period. Major US oil companies have and are still playing a dominant role in the Indonesian petroleum and gas industries. The US embassy in Jakarta annually published an influential statistical and policy report on the Indonesian petroleum and gas industries. Every US foreign policy on Indonesia has to take into account the interests of the US major oil companies.

Having stated this fact, it does not imply that the dominance of US oil and gas companies in Indonesia for more than five decades automatically means the character of Indonesia-US relations is solely determined by natural resources. Unlike Indonesia-Japan relations, natural resources are not the most important factor in Indonesia-US relations. The US is a resource-rich country, including oil and gas even though it also has the highest oil and gas consumption in the world. The politics of resources is an important part of the US foreign policy, but unlike Japan, it does not dominate foreign policy decision making.

The US government is committed to support the interests of US oil and gas companies in Indonesia. But unlike Japan, the US state does not dominate policy making decisions on natural resources. The US government coordinates their policies with its corporate sector. In the eyes of US foreign policy and security interests, Indonesia is more important from the strategic geopolitical point of view than natural resources. As the lone superpower and in the aftermath of the September 11, 2001 tragedy, the US views Indonesia as the largest country in Southeast Asia and the largest Muslim country in the world as playing a very important part in its geopolitical interests. The current US government, in the

second term of President George W. Bush, will support any Indonesian government as long as it follows the policies of Washington, DC specifically on global counter-terrorism.

Indonesian natural resources specifically oil and gas plays an important part and also partly shapes the character of Indonesia-US relations, but unlike Japan, it does not dominate it. The US geopolitical interests previously in the Cold War and currently in the global counter terrorism efforts have, are, and will play a far more important role in shaping the character of Indonesia-US relations.

Natural Resources and the Character of State-Society Relations

Since the early 1970's, when the price of petrochemical products in the world market fluctuated wildly, there were two hypotheses on the relations of the state and democracy in oil-producing developing nations such as Indonesia. The first hypothesis stated that authoritarian regimes, such as Soeharto's, could be in a better position to face economic crises compared to democratic ones. Democracy requires consultation and debates, and the decision-making process is less efficient and slower. Elections could result in manipulation of political life, through money politics, in the efforts to control public opinion. Furthermore, as democratically-elected governments are dependent and accountable to various interest groups in the society, or their constituents, resulted in their policies often lacking in continuity, compared to authoritarian regimes.

The second hypothesis stated that a democratic system is more capable of overcoming an economic crisis. Consultation and open debates occurring in democratic regimes are considered to result in better decisions, with a more consistent implementation. At the same time, decision-making process in the government level is more transparent. A democratic election system also compels the authorities to be accountable and responsible to the constituents, and thus providing an outlet for the society's grievances. Democracy, based on equality and participation, is regarded as the source of political legitimacy, which is not merely based on pure economic growth. Soeharto's fall in May 1998, following a year of economic crisis, seemed to confirm the arguments of the second hypothesis.

Soeharto's authoritarian regime had for more than 30 years depended on a form of government in which there was no clear-cut distinction between state finances and private finances of the bureaucrats and their families and cronies, and the absolutist government under the authority of a single Supreme Leader resulted in practices of corruption being completely out of control, and could only possibly be stopped with a complete and thorough change of the leadership.

Whether a state's leadership becomes predatorial or developmental (Evans, 1995), depends on the main source of finances for the governance, including the nature of the main source of the finances. The choice of industrialization strategy, and its implementation, is also dependent on the same factor. In other words, the New Order's authoritarianism under Soeharto, followed with state violence, is

related to the fact that financial sources of development are dependent on the fluctuations of the price of petrochemical products in the world market.

A negative relationship exists between natural resources and success in an economic growth-based development process. Resource-rich states with large numbers of population, such as Indonesia and Nigeria, tend to be less successful in the development process, while resource-poor states such as South Korea and Taiwan are successful. Their success might be caused by their lack of resources. The needs and demands to overcome poverty, in a condition in which natural resources are lacking, compelling those states to make decisions accommodating societal interests on improving standards of living. These states, following a meaningful growth, could implement a democratization process in stages, which is relatively more successful compared to Indonesia and Nigeria. This is the paradox of social change. Wealth in natural resources could be a two-edged sword to a developing nation. It could benefit the nation, but at the same time could harm it instead. It could become a blessing or a curse.

It must be noted here that possession of natural resources is not the single factor influencing the success or failure of the development of a developing nation, although it is an important one. External factors such as world economy and geopolitical interests, and internal factors such as homogeneity of a nation, should also be considered in discussions on the development of a state.

This discussion on social change in the macro level does not have any pretensions to provide solutions to Indonesia's problems due to the multidimensional crisis being suffered by Indonesia as a nation and as a society. If there is a lesson to be learned from the relations of natural resources and the development process during the New Order era, it is that a development strategy is necessary, which is not merely based on economic growth, but an alternative one, oriented on the society's welfare and justice.

This alternative strategy could only be taken when democratization, in the sense of transparent and accountable government, followed with a trusting relations in the horizontal and vertical levels, is present. In turn, democratization could only be successful when state finances are no longer dependent from income from petrochemical products, which causes the government to be unresponsive to the demands of the society. A democratization process followed with a cutback in state authorities, abolition of state violence and empowerment of the society could take place if state finances for development and governance are based on taxation and income from the manufacturing, services and information sectors, which are based on the skill and expertise in the society.

There is indeed no shortcut nor magical cure for Indonesia's hardships. If Indonesia really desires to overcome the troubles, the only way out is a systemic and structural long-term solution ideas and activities. Structural change is necessary, even a must, and mere change of personages of policies are not sufficient.

In the end, it is only us Indonesians who could give a satisfactory answer to the question: "quo vadis Indonesia?"

Conclusions

The relationship between natural resources and development has been discussed by many specialists from various different perspectives. In this context, the major focus of this research is specifically about the impact of large endowments of natural resources on a national political economy. Several questions can be raised related to this particular topic. Is it a blessing, a curse, both, or merely one of many factors to consider? Further is the presence or absence of natural resources a fundamental determinant of national development strategy?

In trying to answer these research questions, this study focuses on the relationship between the Indonesian Oil and LNG Industries on the Industrialization Strategies In The New Order Era (1967-1997). Using a comparative analysis and a qualitative research method with in-depth interviews of 25 informants from various relevant backgrounds. The unit of analysis is the nation-state and using a state-centered approach.

In the Indonesian case during the three decades rule of the New Order government, as this study shows, the presence of natural resources especially the oil and gas industries are clearly a determinant of the national development strategy. The oil and gas-derived financial windfall during the 30 year period and its volatility clearly marked on which industrialization strategy was selected and which camp of policymakers were in control of the Indonesian political economy. Though it must be emphasized that they also simultaneously cemented the power base of the increasing authoritarian and personalized power of President Suharto. In addition to authoritarianism, increasing corruption, nepotism, and collusion also became apparent; not just by the 1975 Pertamina scandal, but even during the decades after.

A comparative study between Indonesia, Venezuela, Taiwan, and South Korea, also show the same pattern. The presence or absence of natural resources is among the fundamental determinants of a particular development strategy chosen at a particular time. Apart from the factor of natural resources, other factors such as, historical conditions during the period of state formation, the existence of external threat, the role of the military and its institutionalization, and the relationship between the state and the business sector are to be taken into consideration.

A related question is whether heavy reliance on natural resource exports necessarily have a strong impact on the character of state-society relations. In comparing Indonesia, Venezuela, South Korea, and Taiwan, there is no conclusive evidence. Only Indonesia during the New Order era shows how heavy reliance of oil and gas insulated the Suharto regime from more democratic pressures. It was only when the 1997 Asian financial crisis hit the regime, was it unable to withstand its impact. Other factors such as the social structure, traditions of democracy, the role of the military are as important in determining the character of state-society relations in a particular country at a particular time.

The comparative analysis on the relationship between corruption, cronyism, collusion, and development is important. A comparative analysis of Indonesia, Nigeria, and Zaire, show that within the context of Evans continuum conceptual concept of predatory to developmental states, Indonesia has both the elements of

predatory and developmental. It depends on which sector and at which particular period which is under discussion.

Indonesia also shows similar pattern of acquiring both predatory and developmental state characteristics in the context of a comparison between the oil and gas sector with the timber sector. In one hand, these natural resources have been extracted for the benefit of state's leaders and their cronies. On the other hand, a professional bureaucracy has been created in parts of the Indonesian state and investments have been made in productive enterprises.

The Post Suharto era beginning in 1998 has brought a chaotic transition of "Reformasi", hence some analysts labeled the present time as the era of reformation. In the near future, Indonesian oil and LNG industries will face several important developmental issues. The first is concerned with the PSC (production sharing contract) under the draft of the new Law on oil and gas currently under consideration in parliament. The draft focus on the replacement of all PSCs (production sharing contract) with the COWs (contract of works). If enacted by parliament, a tremendous change will occur to these industries. More financial benefits will be granted to the contractors but simultaneously a decrease in the Indonesian state autonomy.

Second, Pertamina is under a major restructuring effort. The planned goal of the restructuring is to make the state mining company more transparent and accountable publicly by dismantling its monopolizing power and influences within the Indonesian oil and gas industries. As a result, an intense controversial debate is going on between those who favor to retain Pertamina as both an agent of development and a profit-oriented company with those who favor a purely profit-oriented company.

Third, still related to the second factor, corruption, cronyism, and collusion within Pertamina is under heavy investigations. The drafters of the new law on oil and gas industries currently under consideration in parliament aim to prevent these from happening in the future by trying to separate the agencies within Pertamina which regulate the up-stream and the down-stream aspects of these industries. If passed, no longer will Pertamina be the sole monopolizing agency.

Fourth, the decentralization issue within these industries will be a major concern. Currently, the country is under intense efforts to decentralize into regional autonomies. The current law on decentralization which went into effect in January this year stated that specifically for the oil and gas industries the central government in Jakarta will still hold the sole "authority to mine" until the year 2005. What happens next, will be of major concern to foreign and domestic contractors. Given the current disputes between Caltex and the Riau provincial government over the PSC and the present stoppage of all production activities in the Arun gas field in Aceh by Exxon Mobil due to security constraints, decentralization will be one of the major challenges to both the Indonesian government and the contractors. At the present transition period, despite its chaotic and irrational nature, it is to be hoped that no matter how messy the nature of the state has become, the people of Indonesia will still persevere despite all the formidable odds.

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