The Politics and Economics of Indonesia’s Natural Resources

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1 INTRODUCTION

Budy P. Resosudarmo

The fall of President Soeharto provided the impetus for the transformation from an authoritarian society to a more democratic one in Indonesia, and for the move from a highly centralised towards a much more decentralised system of government. These transformations offered the prospect that Indonesia would be able to manage its natural resources better, and achieve a long-term development path that embraced both resource sustainability and equity.

Thus far, however, the radical changes that have taken place in Indonesia have created an environment of political uncertainty, inconsistent laws and regulations, weak law enforcement, a weak governmental system and insecurity of land tenure. The immediate effects have been to increase the number of conflicts between various levels of government, local communities and companies carrying out natural resource extraction activities, increase the level of corruption in local areas, and increase the number of local taxes and local natural resource extraction licences. The management of natural resources in the country may not have worsened, but neither has it improved.

BACKGROUND

Indonesia is a massive archipelago stretching between the Indian and Pacific oceans and linking the continents of Asia and Australia. It is a diversified country both in terms of its population and in terms of its natural resources. In 2004 Indonesia had a population of approximately 230 million consisting of around 350 ethnic groups. Most of these groups have their own language and customary (adat) laws, regulations and norms. The two largest ethnic groups are the Javanese (45 per cent of the population) and the Sundanese (14 per cent). The population is growing at an annual rate of about 1.5 per cent. The majority of
Indonesians – 61 per cent – live in Java and Bali, which together have a land area comprising only around 7 per cent of Indonesia. Another 21 per cent live in Sumatra (27 per cent of Indonesia), while the remaining 18 per cent inhabit Sulawesi, Kalimantan, Nusa Tenggara, Maluku and Papua – the greater part of Indonesia in terms of land area. The majority of the population is Muslim (88 per cent). Nevertheless other religions and denominations are represented; Protestants comprise 5 per cent of the population, Catholics 3 per cent and Hindus 2 per cent.

It is well known that Indonesia has abundant natural resources such as oil, gas and minerals as well as rich and very diverse forest and marine resources. Oil and gas are found in Aceh, Riau, South Sumatra and East Kalimantan. Mineral ores such as copper and gold are abundant in Papua, coal in most of Kalimantan and West Sumatra, tin on the island of Bangka, and nickel in South Sulawesi and North Maluku.

Indonesia’s vast rainforests account for over 50 per cent of the tropical forests in the Southeast Asian region and more than 10 per cent of the world’s total tropical forests (Barbier 1998). In terms of area, the country’s tropical forests are third only to those of Brazil and Congo (Zaire). In them are found extremely diverse flora and fauna with abundant nutrients and untapped medicinal potential. Indonesia also carries the world’s largest remaining mangrove forests and has the largest area of coral reefs of any country. Indonesia’s waters are among the most productive of all tropical seas. The Banda–Flores Sea, for instance, lies at the heart of global marine biodiversity (Dutton et al. 2001); nowhere else on earth is there a comparable diversity of marine resources (see Chapter 10 by Dutton).1

Forest and marine resources have always been important for Indonesia. At least 20 million Indonesians depend on the forests for their livelihood (Sunderlin et al. 2000). Similarly, millions of Indonesians have been, and continue to be, dependent on marine resources in one way or another. Fish stocks in Indonesian waters provide a source of income and livelihood for at least 5 million fishermen. Fish provide more than 60 per cent of the animal protein intake of the average Indonesian and are the only affordable source of protein for the majority of the population (Bailey 1988).

The exploitation of Indonesia’s natural resources intensified greatly after Soeharto came to power in 1966–67. The president was quick to realise the potential of the country’s abundant forests, oil, gas and minerals for development. Realising that large-scale resource extraction could be performed only with the involvement of foreign companies, he enacted three important laws in the first year of his presidency. These were Law 1/1967 on foreign investment, which provided clear procedures for foreign operations in Indonesia along with generous tax concessions for foreign companies; Law 5/1967 on forestry, which put all forests under the control of the state;2 and Law 11/1967 on mining, infer-
ring that all lands within the Republic of Indonesia could be used for mining. These three laws effectively made all of the country’s natural resources available for extraction by large-scale operations with a foreign investment component.3

Soeharto’s policy turned out to be effective. Within a few years several multinational companies were carrying out natural resource extraction in Indonesia, their operations protected by his regime, which was then virtually politically unchallenged. During the 1970s, several major foreign companies became involved in oil extraction. During this period, oil became Indonesia’s main export commodity and the country’s major source of government revenue. In the 1980s, the role of oil in the Indonesian economy declined while that of other natural resource products, such as liquefied natural gas (LNG), copper, gold and timber, increased. By the mid-1990s, Indonesia had become the world’s largest exporter of LNG and hardwood plywood,4 the second largest producer of tin (after China), the third largest exporter of thermal coal (after Australia and South Africa) and the third largest exporter of copper (after the United States and Chile).5 It also produced significant quantities of gold, nickel and forest products other than hardwood plywood. During the 1990s, oil and gas contributed approximately 30 per cent of the country’s total exports (Kuncoro and Resosudarmo 2004), minerals and related products 19 per cent6 and forest products 10 per cent (Simangunsong 2004).

It is important to note that while natural resource revenues were the main engine of economic growth during the 1970s and remain of critical importance to the Indonesian economy, since the 1980s the non-natural resource-based sector, particularly labour-intensive, export-oriented industry, has taken over as the main generator of economic growth. The Indonesian economy grew at an annual rate of about 7 per cent from the early 1970s to the mid-1990s, while the number of people living below the poverty line declined from around 40 per cent in the early 1970s to below 15 per cent in the mid-1990s.7 Nevertheless, these statistics cannot hide the fact that Indonesia remained a poor nation.

The exploitation of natural resources has not been without problems. One of the major problems concerned the granting of rights to exploit Indonesia’s natural resources. Extraction rights were mainly given to individuals or companies that were close to Soeharto, and that played a key role in strengthening his regime (see Chapter 9 by Gellert and Chapter 11 by Seda). The granting of rights was not based on considerations of resource sustainability or of a fair return (of benefits) to the general public. The result was a sharp acceleration in cases of environmental degradation (see Chapter 6 by Fox, Adhuri and Resosudarmo, Chapter 8 by Azis and Salim and Chapter 10 by Dutton).8 As the years went by, there was mounting criticism of the government for its failure to ensure that resource utilisation benefited most of the population, for its failure to control the rate of exploitation of mineral reserves and for its failure to pro-
tect the interests of future generations. Conflicts between local communities and large natural resource extraction companies increased and intensified as the perception strengthened that while it was local resources and local land that was being exploited, local communities were receiving little or no benefit from these activities (see Chapter 8 by Azis and Salim).

By the mid-1990s, two major criticisms with regard to natural resource extraction had reached their peak among the general public: the skewed distribution of benefits and the unsustainability of the rate of extraction. Many also believed that as long as Soeharto remained in power and as long as Indonesia was unable to move to a more democratic society, these problems of natural resource management would persist.

In 1997 Indonesia, like other nations in the East Asian region, was engulfed by a severe economic crisis. The crisis shattered the economy, prompting social unrest and creating a volatile political situation. Many Indonesians, particularly the elites, questioned Soeharto’s credibility in governing the country. In May 1998, after a massive riot in Jakarta and widespread demonstrations in major cities across the country, Soeharto was forced to step down from the presidency after 32 years in power.

The fall of Soeharto created an opportunity for Indonesia to foster the development of a more democratic society, in a process often referred to as reformasi. In the political arena, Laws 2/1999 and 31/2002 allowed the establishment of new political parties with clearly defined rights to compete in elections. The enactment of Laws 3/1999 and 12/2003 paved the way for the two democratic elections that were held in 1999 and 2004. These elections were conducted remarkably smoothly, with relatively few cases of violence or electoral fraud. In the April 2004 general election, 11 of the 24 participating parties succeeded in gaining seats in parliament for their candidates. Later in the same year, Indonesians elected their president and vice-president directly for the first time. The two rounds of presidential elections held in July and September 2004 went extremely well, with Susilo Bambang Yudhoyono and Jusuf Kalla being elected president and vice-president. More importantly, there is now a balance of political power between the president and parliament and among political parties (see Chapter 2 by Aspinall), a balance that had been lacking under Soeharto.

Another change that has transformed Indonesia was the adoption in 2001 of a much more decentralised system of government. This was achieved through the enactment of Law 22/1999 on local government and Law 25/1999 on fiscal balancing between the central and regional governments. In 2001, authority for all but a few areas of governance was transferred from the central government to districts and municipalities, including authority for agriculture, industry, trade and investment, education, health and natural resource management (Alm, Aten and Bahl 2001). The main goal of the decentralisation policy was to give
the regions a greater say in the development and growth of their own localities, thus giving them the capacity to fulfil their growth potential and distribute more of the benefits of economic growth to their residents. The new policy also sought to resolve the longstanding tensions between some regions and the central government over the unfair distribution of benefits from natural resource extraction, by giving resource-rich regions a greater share of the revenue generated by their own natural resources.

On the face of it, these rapid changes in the political and governmental landscape should have provided an opportunity for Indonesia to adopt a long-term development path that would embrace both resource sustainability and equity. This book examines exactly this issue, that is, whether or not reformasi and decentralisation has improved the management of the country’s natural resources, particularly in the mining, fisheries and forestry sectors. Indeed, the main goal of the book is to provide a greater understanding of the current problems in managing Indonesia’s natural resources.

THE GLOBAL ECONOMY AND CHINA’S DEVELOPMENT

Macroeconomic indicators suggest that the Indonesian economy has performed reasonably well in the last few years. Output has been growing at an annual rate of approximately 4.8 per cent. GDP has returned to the pre-crisis level, although per capita income is still 4 per cent below the 1997 level because Indonesia’s population has increased. Inflation fell from about 15 per cent in early 2002 to below 5 per cent in February 2004. International reserves have been growing steadily and the government’s fiscal policy is considered relatively prudent. However, this improvement in economic performance has not been without challenges, particularly since investment has not bounced back to its pre-crisis level (see Chapter 3 by McLeod).

The recent improvement in the global economy has affected Indonesia positively, while also creating some setbacks for the economy. The impact of the increasing world price of oil, for example, has been mixed. Because Indonesia exports oil, higher oil prices have generated higher revenues for the country. On the other hand, the government policy of subsidising domestic fuel prices puts severe pressure on the country’s fiscal position and reduces the incentive to improve efficiency in fuel use. If this policy is maintained, domestic demand for fuel will increase rapidly, causing Indonesia’s emissions of carbon dioxide to rise (see Chapter 4 by McKibbin). The rapid increase in domestic demand for fuel also reduces the net gain to Indonesia from oil exports (Resosudarmo and Tanujaya 2002).

A second issue concerns the balance of trade between Asia and the United States. The balance of trade is tilted towards Asia, inducing large capital out-
flows from Asia to the United States. If this trend continues, investment in Indonesia is unlikely to recover quickly (see Chapter 4 by McKibbin). A slow rate of investment, particularly in the manufacturing sector, would push the country to rely even more on the production of natural resources, increasing the pressure on Indonesia's mineral reserves, forest cover and marine resources.

A third issue relates to China’s high growth, huge inflows of foreign direct investment and rapid expansion in world trade over the last several years. The rapid pace of development in China is at the same time both threatening and promising for Indonesian exports. It is threatening because China and Indonesia compete in the same export markets, in areas such as garments, textiles and footwear. It is promising because China is also increasing its imports, providing an opportunity for Indonesia to export more of its products, particularly primary products, to China. Hence Indonesia can expect to experience a negative terms of trade effect for manufacturing and a positive terms of trade effect for primary sectors such as forest products, including logs, lumber and woodchips (see Chapter 5 by Coxhead and Chapter 9 by Gellert). If Indonesia is not cautious, the increased pressure on Indonesia’s natural resources caused by demand from China will lead to even more unsustainable levels of extraction.

REFORMASI, DECENTRALISATION AND NATURAL RESOURCES

In some respects, reformasi and the implementation of decentralisation have improved Indonesia’s ability to respond to natural resource-related issues. For example, the new political environment has created opportunities for government to formulate better laws and regulations related to natural resource management; allowed local communities and local governments to have a greater say in the management of natural resources in their areas; and enabled the exposure of conflicts and mismanagement of natural resources through the media and parliamentary debates. A fairer system for the sharing of natural resource revenue between the central government and local governments is now in place, ensuring that local communities enjoy a larger portion of the benefits of natural resource extraction (see Chapter 7 by Alisjahbana).

But these changes have also generated challenges, including an environment of political uncertainty, inconsistent laws and regulations, weak law enforcement, a weak governmental system and insecurity of land tenure (see Chapter 6 by Fox, Adhuri and Resosudarmo, Chapter 9 by Gellert, Chapter 14 by Hardjono and Chapter 15 by Patlis). In general, it is possible to identify four important immediate effects of reformasi and the implementation of the decentralisation policy.

The first is the intensified disharmony among various levels of government. There has been an increase in conflicts between the central government and
local governments, particularly in cases or sectors where the centre wishes to assert its dominance. The resistance of the central government to the erosion of its authority is apparent in its limited commitment to many aspects of the decentralisation process (see Chapter 6 by Fox, Adhuri and Resosudarmo, Chapter 7 by Alisjahbana and Chapter 15 by Patlis). There has also been an increase in disputes among local governments, particularly in cases where the relevant laws and regulations are ambiguous. Especially common are jurisdictional disputes over natural resources that lie on provincial/district borders (see Chapter 13 by Erman and Chapter 14 by Hardjono). In addition, sectoral government departments are coming into conflict, particularly over the designation of land use. An obvious example is the dispute between the Forestry and Mining Ministries over the right to mine in protection forests (see Chapter 15 by Patlis and Chapter 16 by Marifa).

The second immediate effect of *reformasi* and decentralisation has been to increase the number of disputes involving local communities over the right to exploit natural resources. These disputes tend to be of two types. The first occurs between local communities and the state or a large natural resource company, and typically concerns the ownership of land that the local people, based on *adat* law, claim or reclaim as theirs. Usually the government has given a company sole authority to extract natural resources in the area (see Chapter 13 by Erman). The second type of dispute occurs among local communities themselves as they compete to gain a higher share of the benefits of local natural resources. Given the ambiguity of laws and regulations, the increase in natural resource extraction by locals and the heightened interest in surveillance of local resources, it is not surprising that the number of disputes among local communities has increased (see Chapter 6 by Fox, Adhuri and Resosudarmo and Chapter 13 by Erman).

The third immediate effect has been to alter the nature of corruption. The era of centralised politics has disappeared, to be replaced by a system in which power and authority are far more diffused. The centralised nature of corruption – a one-stop shop for the giving and receiving of favours – has gone, to be replaced by a more fragmented bribe collection system. Under the new system, central government officials, ministry officials, local government officials, the military, the police and members of the national and local legislatures are all demanding bribes (see Chapter 11 by Seda and Chapter 9 by Gellert). Closely linked to this bribe collection system is the flourishing activity of illegal extraction of natural resources (see Chapter 12 by Obidzinski and Chapter 13 by Erman).

The fourth immediate effect has been for local governments to succumb to the strong temptation to raise revenues in the form of nuisance taxes and natural resource extraction licences (see Chapter 6 by Fox, Adhuri and Resosudarmo and Chapter 15 by Patlis). The primary argument for the application of
such taxes and licences is that local governments face increasing expenditure responsibilities. Local governments are gratified that reformasi and the decentralisation process have given them the authority to make decisions affecting their own local jurisdictions, but they also tend to feel overwhelmed by their new responsibilities. These include several tasks that were formerly the responsibility of the central government, such as the payment of all civil servant salaries (including those of several million central government employees reassigned to regional positions) and the provision of extensive public services in their regions. Among the latter are primary and secondary education, health clinics, local and regional roads, water supply and sewerage (see Chapter 7 by Alisjahbana). However, local governments also have ‘other’ motivations for the proliferation of taxes and extraction licences, including those associated with corrupt behaviour by some local officers (see Chapter 6 by Fox, Adhuri and Resosudarmo, Chapter 12 by Obidzinski and Chapter 13 by Erman).

One might conclude that, although reformasi and decentralisation held out the promise of better management of the country’s natural resources and of a move to a more sustainable development path, in practice this has not been the case. Indonesia continues to lose its valuable natural resources at a rapid and unsustainable pace.

THE ORGANISATION OF THE BOOK

This book is divided into five parts. Part I gives an account of recent political and economic developments in Indonesia (see Chapter 2 by Aspinall and Chapter 3 by McLeod). It provides the foundation for later discussion of the issues of natural resources and sustainable development.

Part II discusses issues related to globalisation, decentralisation and sustainable development. It begins by providing readers with an overview of current developments in the global economy and trends in international trade as well as their implications for the Indonesian economy and natural resource utilisation (see Chapter 4 by McKibbin and Chapter 5 by Coxhead). Chapter 6 by Fox, Adhuri and Resosudarmo analyses major issues related to reformasi, decentralisation, and natural resource extraction and management. Chapter 7 by Alisjahbana offers a critical and robust analysis of the current arrangements for sharing natural resource revenue between the centre and the regions. Despite the complex nature of the arrangements and their calculation, such an analysis is important because this was one of the main incentives for the regions to have a decentralised system of government. Part II closes with a discussion of the prospects for Indonesia to move to a more sustainable development path (see Chapter 8 by Azis and Salim).
Part III considers current challenges in the management of Indonesia’s natural resources, particularly forestry, fisheries, oil and gas (see Chapter 9 by Gellert, Chapter 10 by Dutton and Chapter 11 by Seda). In addition to explaining the obstacles and difficulties in managing resources, these chapters describe the historical background of extraction activities in these sectors.

Part IV deals with illegal extraction and conflicts. Chapter 12 by Obidzinski examines major issues related to illegal logging, Chapter 13 by Erman discusses illegal mining in West Sumatra, and Chapter 14 by Hardjono illustrates how conflicts among local governments and between local governments and local communities have surfaced since the implementation of the decentralisation policy.

The final part of the book, Part V, focuses on the law and institutional problems related to natural resources. Chapter 15 by Patlis analyses current issues related to the enactment of new laws and offers some ideas for the way forward. Chapter 16 by Marifa suggests some directions for institutional transformation to achieve better management of the country’s natural resources.

NOTES

1 See Resosudarmo and Subiman (2003) for a comprehensive review of biodiversity in Indonesia.
2 Under this law, 70 per cent of Indonesia’s land area came under the control of the forestry department.
3 The basic agrarian law, Law 5/1960, also supported Soeharto’s policy of large-scale natural resource exploitation through foreign investment. It specified that in cases of conflict between the state and local communities over land use, national interests would prevail.
7 See Badan Pusat Statistik (BPS) at <http://www.bps.go.id/index.shtml>.
8 See also Resosudarmo, Subiman and Rahayu (2000) and Resosudarmo and Subiman (2003).
9 Previously Soeharto had restricted the number of political parties or groupings that could contest elections to just three. Golkar (Golongan Karya) was the political vehicle of the regime; it was a ‘functional group’ and was never officially declared a party. All the Islamic parties were merged into the United Development Party (PPP), while the nationalist and Christian parties were forced to amalgamate under the banner of the Indonesian Democracy Party (PDI).