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Oil Wealth Wasting Away in Indonesia

By KEITH BRADSHER

BALONGAN, Indonesia - Roaring all day from the top of a chimney at a state-owned refinery here, a 30-foot-high roiling column of orange flames spewed vast clouds of black smoke visible for miles around. A 12-year-old compressor had broken down, refinery officials explained, and huge quantities of valuable propylene were being burned off for safety reasons.

Indonesia's oil industry, like the refinery, has been burning money for years, squandering the nation's mineral wealth through underinvestment, bureaucracy, corruption and a wariness of multinational companies.

So few new wells have been drilled in the last decade that annual production has dropped by more than a third. And the draining of existing fields has brought Indonesia, one of the oldest members of the Organization of the Petroleum Exporting Countries, to the ignominy of having to import oil in the last four months of 2004.

As OPEC struggles with how to respond to oil prices rising above $56 a barrel, Indonesia's failure is more than just a tragedy for a poor developing country that has failed to take advantage of a potential windfall. As OPEC's only Asian member, Indonesia should be ideally positioned to meet soaring demand from China and the rest of Asia.

Instead, its increasingly meager output has forced officials in Beijing and other Asian capitals to look farther afield, relying more on pariah states like Sudan and bringing more oil through the Strait of Malacca, where pirates have been preying on tankers and where governments worry increasingly about possible terrorist attacks. Now, Indonesian officials say they are determined to make their country an exporter again. They have raised prices and cut subsidies for gasoline and diesel to discourage waste. They have passed new laws and tax policies to encourage multinational companies to invest.

And while populists are calling for Indonesia to withdraw from OPEC, in part to save nearly $2 million a year in membership fees, Purnomo Yusgiantoro, the country's oil minister and the holder of OPEC's rotating presidency in 2004, has been holding them off by setting up a committee to study the issue and promising a brighter future for Indonesia's oil industry.

"Indonesia is expecting to produce more oil in the future," Mr. Purnomo said. "Even if we become a net importer for one year, or less than one year, what does it mean?"

A turnaround may not be so easy, though, and Indonesia's subsidies are especially ruinous.

Because of them, Indonesians have been burning cheap fuel by the tankful, contributing to urban sprawl and traffic jams in Jakarta that rival those in Los Angeles.

At the same time, factories rely heavily on diesel generators. The electricity from the generators would be more costly than electricity from coal-fired power plants if diesel fuel were not subsidized.

The question is whether Indonesia is doing enough. While new laws and tax rules have been passed, regulations that would put them into effect have not been issued.

More seriously, a 29 percent increase in retail gasoline and diesel prices on Feb. 28 still leaves both fuels selling for less than $1 a gallon. And the price increase assumed that oil would cost $35 a barrel in 2005. This means that the subsidies, which absorbed one-sixth of government spending in 2005, will cost even more.

"It's going to have a huge impact," said Ramesh Subramaniam, the principal economist for Indonesia at the Asian Development Bank.

Already, the 29 percent increase has provoked large street demonstrations and even fistfights on the floor of Parliament. The political debate in Indonesia now is over whether to roll back the increase or simply form a committee to study whether to roll it back. Further increases in fuel prices are no longer even under public discussion.

Mr. Purnomo said in an interview that he hoped to reverse a slide in production, which fell to 950,000 barrels a day late in 2004 from 1.6 million barrels a day in 1991. Mr. Purnomo said that he expected production to rebound to at least one million barrels a day and stay there.

OPEC rules require that members be exporters of crude oil, but do not specify what happens if a country temporarily becomes an importer. Mr. Purnomo said that he had an understanding with OPEC that Indonesia would be given a chance to resume exports, with no deadline set; OPEC officials declined to comment.

The scale of Indonesia's troubles, in energy terms and in environmental terms, can best be seen in its oil fields and refineries. Here in Balongan, the huge refinery run by Pertamina, the state-owned oil company, towers over a small Javanese fishing village. Young men sit on the decks of dozens of 25-foot wooden boats in the mouth of a muddy river, mending fishing nets.

Oil spills from the oceanfront refinery have severely depleted local stocks of fish. Warnipan, a 40-year-old with three grandchildren, said that a recent two-night trip with three other fishermen brought in only 73 pounds of fish, a third of their previous normal catches.

After costs for food, fuel and the large chunk of their catch they owe the boat owner, the sailors found they had earned 50 cents each on the trip. "Sometimes we can't catch any fish at all," said Mr. Warnipan, who, like many Indonesians, uses only one name.

The problem for Indonesia's oil production is that few people have the education and training to take jobs in Pertamina's nearby oil fields or refineries. So, while there is great demand in the oil industry, large numbers of unemployed young men loiter here and in neighboring communities of northern Java. As for women workers, despite the oil wealth under the ground here, this region has become best known as a source for desperately poor prostitutes for Jakarta's many brothels.

Pertamina executives did not respond to more than a dozen phone calls and faxes requesting interviews. Pertamina's refinery managers said that there had been problems in the past but that they were planning to improve environmental safety, and they cautioned that overfishing and other factors might have also affected fish stocks.

The managers also said that they hoped to build a concrete platform soon to prevent leakage from thousands of aging barrels holding toxic catalysts and other materials. The barrels currently sit in piles directly on the dirt, a practice avoided at refineries in industrialized countries.

Pertamina has been slow to look for new oil fields on its own even as older fields run dry. Multinational companies are wary of investing, troubled less by the terrorism that produced the bombing in Bali and the recent attacks in Jakarta than by the political unrest that accompanied the Asian financial crisis in 1997 and 1998 and by recent contract disputes with the government in Jakarta.

Indonesia "has been relying pretty much on early 90's investment in oil and gas," said Thomas L. Soulsby, a director of PT Energi Mega Persada, a publicly traded Indonesian oil company. "Committees sitting in Houston, London or even Sydney decided to put their investment dollars elsewhere, and Indonesia really suffered."

This part of northern Java has only one of Indonesia's large oil fields. But while local residents have complaints about the operation, at least the field and refinery here have been developed.

Exxon Mobil found a large oil field in eastern Java at Cepu more early in this decade, in an area where Pertamina and other companies had failed to find oil. Exxon Mobil geologists re-examined old data and then drilled deeper wells than anyone had tried before, finding oil in quantities that could increase Indonesia's annual output by a fifth.

But production has yet to begin as the Indonesian government, seeking a greater share of the revenue, has tried to renegotiate the terms of Exxon Mobil's contract, which runs until 2010.

The most important step Indonesia can take to attract investment is to have clear rules for contracts, said Maman Budiman, the vice president for planning, commercial and public affairs at Exxon Mobil Oil Indonesia.

Developing oil fields in Indonesia is expensive, making energy companies leery of signing away too much of the revenue once production begins. The Cepu deposits are unusually deep, four miles underground, and industry officials say that other deposits in Indonesia may be similarly deep.

"When you combine tough production-sharing terms with government uncertainty, the big players are reluctant," said Jeff Brown, an oil analyst at the International Energy Agency in Paris. "Typically, they have to get better terms to produce in harsh environments."