Case Study

REVENUE WATCH INSTITUTE

Fueling the Future

Indonesia Plans for its New Oil Wealth

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Summary

Indonesia's "big bang" decentralization of 2001 resulted in subnational governments with unprecedented control over revenues and expenditures and the responsibility to provide services to citizens. Rural regions with residents who survived on a little more than a dollar a day were assigned substantial shares of resource revenues extracted from their areas. While decentralization brought districts new wealth and responsibility, it did not automatically equip them to manage their windfall revenues. Nor did it guarantee that these governments would be open with citizens about budgets and development plans—or even have the capacity to carry through those plans for sustainable social and economic development.

Blora and Bojonegoro are two underdeveloped districts on the Indonesian island of Java. Seated atop a recently exploited oil field, the districts are raking in substantial resource revenues from this discovery but are unequipped to manage them. From 2008 to late 2010, the Revenue Watch Institute (RWI) and the Open Society Foundations Local Government and Public Service Reform Initiative (OSF-LGI) joined forces with local partners to help the districts implement an oil revenue transparency and sustainable development planning project. RWI and OSF-LGI provided funding, capacity building and technical assistance to the partners and district governments.

While the project's approach was resource-intensive, it paid rich dividends. Blora and Bojonegoro both formalized the project's transparency mechanism with a district regulation. Both managed to broaden the scope of transparency to not only cover revenues but also health and safety issues, environmental risk and impacts, corporate social responsibility and community development. Both governments agreed to implement the project's sustainable development plan. Blora also allocated a budget for the project's transparency team and convinced its government to increase the budgets of its health and education sectors, while Bojonegoro is working with the oil company to coordinate its corporate social responsibility and community development projects with the district's planning agency.

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Indonesia and the Cepu Block

Blora and Bojonegoro, two districts in the East and Central Java provinces of Indonesia, are home to more than two million people. Inhabiting villages isolated by severely damaged roads, the residents survive on subsistence agriculture and a per capita income of four million rupiah, or roughly $472, a year. Just under these villages lies part of a recently discovered oil reserve. This

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reserve, known as the Cepu Block, is estimated to hold more than 1.4 billion barrels of oil and to eventually contribute up to 20 percent of Indonesia's oil production.[1]

For centuries, the reserve has been rich with oil, but this latest discovery is considered the "jackpot" of the Cepu Block. In 2005, the government oil and gas management agency, BP Migas, signed production-sharing contracts with the country's other leading oil companies, which acquired the rights to exploit the reserve until 2035 and a 15 percent equity share in oil and gas projects. Once peak production is achieved, Blora could receive up to 10 billion rupiah, or $1 million, per year and Bojonegoro could receive 700 to 800 billion, or roughly $88 million. If managed correctly, these increases could triple their budgets.

This valuable natural resource, however, does not come without a price. Indonesia's complicated history with oil has been clouded with abuse, corruption and poor management. Since the first drop was discovered in the 1890s, Indonesia has experienced both the best and the worst oil has to offer. As production boomed during the 1970s and '80s, the country became an emerging Asian economic tiger, producing nearly 1.6 million barrels of oil per day and using its oil wealth to diversify its economy. But, by 1989, corruption and poor governance of oil revenues nearly bankrupted the country. It still struggles with massive poverty with the poorest, least developed regions, like Blora and Bojonegoro, suffering the worst consequences. Today, nearly 40 percent of the districts' populations live below the poverty line. Their unemployment levels continue to rise while education enrollment and performance remain stagnant.

After Indonesia's fiscal decentralization in 2001, the national government passed a revenue-sharing law in 2004 that gave producing districts, like Blora and Bojonegoro, a 15 percent share of the country's resource revenues. On one hand, this regulation gave local governments greater

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To help local communities advance their social and economic development, RWI is pioneering regional approaches to planning and management of natural resource wealth. To learn more: revenuewatch.org/subnational

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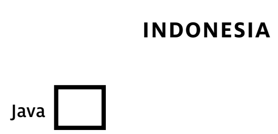

The Cepu Block falls between Blora and Bojonegoro, creating conflicts between the two districts. While Bojonegoro began receiving shares in 2004, Blora is only beginning to reap the benefits of its oil and is now working to garner more shares.

1 Bojonegoro Institute, *Policy Study: the urgency of a district regulation concerning transparency in the governance of oil and gas* (Bojonegoro, Indonesia: Bojonegoro Institute, 2010).

opportunity and authority to manage their revenues and create sustainable social and economic development. On the other hand, the oil production and revenues brought large-scale corruption, conflict and environmental damage.

Resource revenues can be highly volatile and unpredictable. Their sheer magnitude can make them difficult to manage, and dependence on them can crowd out other industries. If the local population and government do not prepare for and properly deal with these challenges, only few may benefit, while the majority's well-being may actually decline and the area could wind up worse off than before extraction.

To help the districts reap the maximum benefits of this newfound wealth and avoid the "resource curse," RWI and LGI launched a subnational project in Blora and Bojonegoro in 2008. A world pioneer in implementing transparency for sustainable development at the local level, the three-year project helped the districts develop a revenue transparency mechanism and a midterm development plan. These two innovative instruments were crucial to ensure the districts' windfall revenues not only created sustainable social and economic development but also strengthened non-oil sectors to support the economy once oil is depleted.

Putting the project into action

At the outset of the project, RWI and LGI partnered with Pattiro, a Jakarta-based non-governmental organization founded in 1999. Pattiro was formed to help local governments increase their capacity and capability as they took the reins from the central government. Its experience with Indonesia's decentralization, as well as its widespread networks at local levels, made Pattiro a strong national partner for the project.[2] Pattiro then selected two local partners, the Institute for Discourse Research and Application (LPAW) in Blora and Bojonegoro Institute (BI) in Bojonegoro.[3]

The project's main goal was to help the local partners, governments and other stakeholders understand the challenges of oil wealth and develop two important instruments to manage that wealth: a transparency mechanism and a midterm development plan. These instruments connect two links in the extractive value chain that are inseparable: revenue transparency and revenue management. The transparency mechanism's output—increased information available to local stakeholders—is then incorporated into the participatory planning model, which results in better revenue management.

RWI and LGI provided Pattiro, BI and LPAW with several intensive training sessions and workshops to strengthen their capacity, so they could, in turn, provide technical assistance and build the capacity of Blora and Bojonegoro's governments and other stakeholders. In these training sessions, RWI and LGI focused on helping the local partners understand the extractive value chain and the issues surrounding oil wealth, which range from revenue-sharing laws and revenue flows to oil production and project cycles to the volatility of oil prices. The partners were also introduced to international best practice standards—such as the Global Reporting Initiative and the Voluntary Principles on Human Rights—that companies use to help address the strong social and environmental concerns of local communities. RWI and LGI also made a point to ensure the subnational project became part of Indonesia's campaign to join the Extractive Industries Transparency Initiative (EITI), a global standard for improved transparency in the oil, gas and mining

2 See Pattiro's website, http://www.pattiro.org.

3 Interview with Iskandar Saha at Pattiro, June 4, 2011. LPAW began as a study group with an interest in writing and cultural issues. It had some experience with the social aspect of oil through a study of the social and economic conditions of communities around oil wells that it conducted in April 2006. BI began as an extra-parliamentary pressure group with a reputation for organizing big demonstrations against the district government's deals with a financial backer for the district-owned company, set up as a participating interest in the production-sharing contract.

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At peak production, the Cepu Block could provide Blora with a total of $1 million and Bojonegoro with a total of roughly $88 million per year. For residents surviving on $472 per capita per year, this new wealth could bring transformative change.

The partcipatory planning of the subnational project in action, members of each district's multi-stakeholder groups met to plot out their plans for sustainable social and economic development.

sector.[4] Finally, RWI and LGI connected the partners with RWI's greater network of civil society promoting transparency in Asia Pacific and stressed the advantages of joining forces with the local media.

Armed with this new knowledge, BI and LPAW's first step was to secure local government ownership of the project in both Blora and Bojonegoro. This was done by developing and negotiating a Memorandum of Understanding (MoU), an agreement among the partners to improve governance of oil revenues through a transparency mechanism and participatory sustainable development plan. The MoU was signed in June 2008, and, shortly after, both of the district governments issued decrees, which legitimized the projects in Blora and Bojonegoro.[5] After achieving this milestone, each partner organized a seminar and set of three district-level workshops, which took place between 2008 and 2010.

The public seminars were held to open the discourse with key stakeholders. The topics discussed included decentralization that changed the oil revenue distribution, revenue stream and each district's shares. These events aimed to help communities manage their expectations as the revenue shares started to arrive.[6] The partners assisted in predicting the windfall revenues each district would receive and also explained the central government's authoritative role over all oil and gas matters. Each of the seminars took place within the district's traditional meeting hall, a visual show of support from the government.

In these seminars, core teams were chosen to lead the remaining process, including the three workshops, with the support of BI and LPAW. "We wanted people who were committed to social

4 While the project was beginning at the subnational level, in Jakarta RWI and partners were pushing at the national level for Indonesia to adopt the Extractive Industries' Transparency Initiative (EITI), a global set of voluntary standards designed to promote transparency in the extractive industry. Since Presidential Regulation No. 26, 2010, was signed (about transparency of state and district revenues from the extractive industries) Indonesia adopted EITI in April 2010. In October of that year, it was accepted as an EITI candidate country. This means that Indonesia has until October 2012 to complete an EITI validation assessment to meet the requirements of the designation of an EITI compliant status. The project in Blora and Bojonegoro can also be seen as the implementation of EITI at the district level.

5 A month after the MoU was signed, Adi Purwanto, the current head of Mining and Energy Office of the Blora District, was interviewed. He said, "When LPAW approached me with ideas of transparency and sustainable development and a multi-stakeholders' effort, I was very happy. Transparency is a cornerstone of good governance."

6 Hopes in Blora were very high. Some calculated that when production peaked in 2012, Blora would receive more than 1 trillion rupiah a year in revenue shares.

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development," said Hamdun Muhammad of LPAW, "but also had capacity and competence in their fields and a personal history of good performance and service."[7] The teams consisted of members from various backgrounds, including farmers' groups, women's groups, parliamentarians, NGOs, religious organizations and government officials. Representatives from the oil companies were present but only committed to a passive role.

Following the seminars, each district's core team joined representatives from all of the stakeholders—government, civil society and oil companies—for a series of three workshops. These workshops were held to gather information on specific needs and challenges and to figure out each district's next steps.

Held in October 2008, Workshop I aimed to share the knowledge the partners had learned in their training sessions and help the districts understand the challenges that lie ahead. Once the core teams and stakeholders had a better understanding of the issues of oil wealth, they were required to define strategic goals along with a vision for their district.

Blora and Bojonegoro are two of the least developed areas of Indonesia. Residents survive on subsistence agriculture and inhabit remote villages. While the districts' newfound oil can generate great wealth, it can also bring instability, unwise spending and environmental damage.

As participants worked together to conceive these initial goals and plans, the partners introduced them to the national regulations governing the sharing of oil revenue and addressed the issues of oil revenue calculations, transparency and freedom of information, corporate social responsibility and community development programs. To raise awareness of the dangers of bad governance, RWI brought in an expert to explain the "resource curse." He delivered a sobering reminder that oil can be a ticket to disaster if not managed wisely. RWI also walked participants through the

7 Interview with Hamdun Muhammad, May 29, 2011.

extractive industry value chain to stress the vital roles that transparency and planning play in achieving sustainable development.

By the end of the three-day workshop, the participants developed a collective vision as well as issued mandates for the core teams to obtain a formal decree from the district governments.

Understanding the districts and their challenges

Blora and Bojonegoro are similar socio-economically, but their geographical differences posed quite a challenge to the project. While the Cepu Block straddles both districts, government regulation states that oil revenue shares are calculated according to the well head's position rather than the reserve's location. The Cepu Block's producing well heads are located in Bojonegoro, so, starting in 2004, the district began receiving revenue shares while Blora only just began receiving shares. Once peak production is achieved, Blora could receive up to 10 billion rupiah and Bojonegoro could receive 700 billion to 800 billion.

Blora initially had high expectations, but as the district learned about the difference in revenue distribution, serious trust issues came to the forefront. Not only did tensions arise between districts, but there were also trust issues among the oil companies, civil society, and central and district governments that needed to be addressed throughout the project.

The conflict between the two districts has carried on since the project ended. Blora is advocating for revising the regulation on revenue sharing. In Bojonegoro, a parliamentarian has started a movement to formally change the name of the Cepu Block (Cepu is a subdistrict of Blora) to the Bojonegoro Block, so the district will not have to share any revenues with Blora. Hamdun Muhammad of LPAW dismisses this action as a move of blatant selfishness, which he feels will not impact Blora's struggle for a better deal.

Held in June 2009, Workshop II aimed to flesh out each district's vision, as well as the strategic goals for the transparency mechanism and midterm development plan. This workshop also explored the unique social and economic conditions of the two districts and delved deeper into the complexities of oil revenues and their impacts on development. While oil can generate great wealth, the revenues can also be volatile and bring instability, unwise spending and corruption. To avoid these issues, transparency and sustainable planning are vital.

To help Blora address these issues, experts hired for the project trained the district government on how to secure a fair deal from the central government. "We needed to know exactly what the oil companies were taking and how the central government calculated the revenue shares for our district," said Adi Purwanto, head of the office. "I was very happy that LPAW and Pattiro brought in experts to explain these calculations. I committed myself to assist the formulation of a transparency mechanism and the formalization of that mechanism into law." By the close of Workshop II, Blora's participants had produced a revised vision and an agreement to continue work on their goals of a transparency mechanism and sustainable development plan.

Since Bojonegoro had been receiving windfall revenues from oil blocks since 2004, the district had experienced firsthand the difficulties posed by the volatility of oil revenues. Due to the rise and fall of oil prices, the Ministry of Finance continued to make revisions on the regulation of the revenue shares. In 2009, Bojonegoro's budget was revised three times, and the district suffered due to the rescheduling of development projects. The silver lining of the experience, however, was that the district government was open to the project and the plans its partners proposed.

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At the close of Workshop II, Bojonegoro's participants were able to solidify their vision and continue work on finalizing the transparency mechanism and midterm development plan.

Each district used the time between Workshops II and III to flesh out the two instruments. The core teams responsible for the transparency mechanism held a series of intense discussions to continue developing their models. Questions asked were: what is the role of this mechanism, what information needs to be transparent, what institution will be responsible for the work, how will the information be published, and who will cover the budget. The core teams responsible for participatory sustainable development plan conducted research and held a series of discussions to develop a comprehensive sustainable development proposal. By using such planning tools as SWOT, the teams made certain the proposals carefully examined the resources owned and their related problems. These discussions were held every two weeks for months, resulting in two strong proposals that were then finalized in the last workshop.

During this time, RWI also brought in an expert on oil transparency to explain EITI and the possibilities of implementing the initiative at the subnational level. The expert advised on how to communicate with oil companies, focusing on the language to use and the steps to take to build trust and garner support. This training was widely reported by the national media and proved strategic in encouraging the national government to adopt EITI.

The final agreed-upon transparency mechanisms, along with the sustainable development proposals, were to be reviewed and finalized in Workshop III and then presented to the district governments. By the close of the third workshop, the districts had produced transparency teams and finalized their transparency mechanism and sustainable development proposals. Each district then planned to present them to its government in hopes of legitimizing the transparency mechanisms in the form of a local regulation and formally adopting the sustainable development proposals in the government's midterm plans.

Initial outcomes

At the close of the final workshop, Blora's government kept its word. It sanctioned the transparency mechanism as a decree and enshrined it within its regulation. Blora's transparency team also received an allocation of 100 million rupiah in the 2011 budget. The government adopted the sustainable development plan to use as a guide in 2012, while Parliament agreed to reallocate a portion of the oil revenue to the health and education sectors as suggested in the project's midterm plan. LPAW, the project's partner, was also invited to speak to the heads of government to assist with next steps for the district. Numerous other local governments eager to learn about subnational revenue transparency have also visited Blora to learn about its project implementation.[8]

Now more knowledgeable about expected resource revenue transfers from the central government, the district could actively engage with the central government to ensure they received their rightful amount. Blora's struggles and close cooperation with the district government has made it a leading member of Indonesia's Oil and Gas Producing Districts' Consultation Forum (FKDPM), a think tank and consultative body representing the country's oil-producing provinces and districts. Through this forum, Blora is advocating for change in regulation that determines revenue shares based on well head locations.

In order to obtain that increase from the central government, Blora needs information on local company contracts to calculate its fair share. While there have been significant developments in the national legal framework for transparency and accountability—including the adoption of EITI principles, the 2008 Freedom of Information Act (FOI) and the publishing of Presidential

8 Interview with Adi Purwanto, June 30, 2011.

The people of Indonesia understand that oil is a valuable resource that comes at a price. To avoid corruption and poor management, transparency, good governance and sustainable planning must be instilled at the subnational and national levels.

Regulation Number 26 in 2010—the actual effectiveness of these laws are still subject to criticism, especially at the local level. To test the FOI Act, LPAW requested information on a contract involving a district-owned company, but the company refused to disclose the information.[9] This was the first time civil society used the FOI Act to obtain information on a government-owned company.

While LPAW's efforts to obtain information garnered both national and subnational media attention and support, it found that the time and funds required to engage in this dispute would make it nearly impossible for citizens or civil societies on a tight budget to pursue such an endeavor. Still, Purwanto of Blora's Mining and Energy Office remains hopeful. Relentless in his efforts to secure a better deal for Blora, he has visited the central Parliament, the vice president and ministries of the interior, finance, energy and mineral resources. He said. "The transparency team, LPAW and Pattiro have been very helpful in this struggle."

In Bojonegoro, the government's enthusiasm for the project helped the multi-stakeholder group make significant strides. By 2012, the transparency mechanism will be enshrined as a district regulation. BI, the project's partner, and the district government have signed a MoU stating their intent to consider the sustainable development proposal in their annual and midterm plans.

BI's multi-stakeholder approach successfully brought together oil company representatives, the government and citizens to discuss issues ranging from safety and community development. Though the oil company initially would not commit to playing a larger role, it has begun to better coordinate its corporate social responsibility (CSR) programs with the Bojonegoro District Planning Agency. While the CSR funds are small compared with revenue shares, they mean much to the citizens.

9 Because of the dispute, the district-owned company postponed its plan to write a new contract with its financial backer.

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Overall increased transparency and monitoring of budgets in both districts has ensured that there will be less corruption and mismanagement of local resource revenues.

Lessons learned and recommendations

Despite the considerable developments in both Blora and Bojonegoro, the partners did encounter a number of challenges that should provide lessons for future subnational projects in Indonesia and elsewhere.

Multi-stakeholder Engagement and Involvement

Securing the involvement of all stakeholders is key to any project. For the subnational project, building trust and increasing engagement of stakeholders required a huge amount of time and energy as well as good capacity and creativity from the implementers. Learning that the project needed to devote more than a third of its time, especially in the initial phase, to this aspect offered a valuable lesson and also brought up an important concern. While these efforts proved to build a strong foundation for the success of the program, RWI and LGI realized replicating and implementing this model in other districts would require the luxury of funds and support from strong organizations.

A better-informed citizenry is crucial for engaging multi-stakeholders. This project showed how a qualified civil society can play the lead role in driving quality engagement with all multi-stakeholders. Through capacity building and mentoring, Pattiro, LPAW and BI possessed the necessary resources and experience to assist the district governments in creating campaigns to inform citizens and develop a widespread demand for oil revenue transparency and participatory sustainable development planning. Even when people knew very little about the government's budget or where the revenues came from, most welcomed the idea of having more information about this new money and more say in how it would be spent.

Finding the proper way to engage with the project's various stakeholders was another obstacle for the partners. Because the project engaged with a variety of stakeholders, each of different strata, it had to engage in formal as well as informal advocacy efforts. In Bojonegoro, BI's informal approach resulted in the company and the district planning agency communicating better and coordinating community development and corporate social responsibility programs.

One of the most difficult challenges the project faced was securing the support and commitment of the oil companies. Their participation was critical because transparency and accountability cannot be achieved, revenue shares cannot be projected and budgets cannot be planned without knowing the amount of oil extracted. District-owned companies were much more reluctant than multinational corporations to offer their support and disclose information mainly because they did not possess the authority to participate in the project as fully as the partners needed.

Going forward, the project and its partners need to request the help of government officials, who have power over their district-owned companies, to ensure their support. Better multi-stakeholder communication and trust should solve this challenge unless the district government's support is merely at a formal, rather than practical level.

While the multinational corporations seemed cooperative during the process, to some extent they hid behind the fact that they don't have enough authority to make any decisions to join the transparency team or disclose information. To tackle this challenge, project implementers must work toward more informal communication and relationships with the companies if they want to secure their support for the project.

Combining Participatory Approach and Transparency Model

What made this project so unique was its pioneering approach of combining two instruments—the transparency model and the participatory development plan—as one inseparable part in the implementation.

With the two-pronged approach, however, came double the amount of work. While both instruments are inseparable in the context of the value chain, each has its own problems. The partners and stakeholders struggled to maintain the connection as they ensured each instrument was implemented correctly. For example, there was a period when the participatory planning component consumed too much time and energy.

While the project's approach was demanding in terms of staff time and efforts, it was also highly rewarding. This subnational model is even more advanced than the national model, which only works toward revenue transparency through EITI and does not have a participatory revenue management component.

Capacity Building and Technical Assistance

The project at every level needed capacity and technical assistance. First, it was essential that the project implementers' knowledge was as advanced as that of the stakeholders they needed to assist, so they had the legitimacy to assist them. This required a series of trainings and coaching from RWI and LGI, since the extractive industry was a new and complex subject to the partners. As a result of this capacity building, the project implementers were able to advance as organizations and strengthen their standing in their respective districts. As Yunus of LPAW testifies, "In the beginning of this project, we were nothing but a small local NGO, but now everybody in this district regards us as a reputable organization. We understand the details of revenue flow from oil, and many of our members have contributed articles on the subject in district and national newspapers."

Secondly, RWI, LGI and its partners needed to take the information about the extractive industry and modify it within the local context. There is an abundance of material on both participatory planning and transparency models at the international level, but hardly any focuses on the subnational level. Much time was devoted to capacity building and technical assistance, but it proved a pivotal foundation for the project's success.

Taking the District Efforts to the National Level

Since oil in Indonesia is handled directly by the central government, the project cannot ignore the importance of gaining national support to strengthen the advocacy at district level. While Blora and Bojonegoro made considerable progress involving their governments, there is a real danger that the oil-aware, multi-stakeholder, sustainable development plans will be set aside by the district and central governments regardless of the commitments made. The efforts in both Blora and Bojonegoro have to aim to secure the support of BP Migas, so the districts have a better chance of ensuring transparency and accountability of oil revenues. Since Indonesia has joined EITI, BP Migas should help districts by providing information early on to help them calculate their revenue projections accurately.

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The Revenue Watch Institute promotes the effective, transparent and accountable management of oil, gas and mineral resources for the public good. Through capacity building, technical assistance, research, funding and advocacy, we help countries to realize the development benefits of their natural resource wealth.

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