

Case study: Malaysia

Shifting alliances based on
subnational petroleum revenue sharing



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MALAYSIA, KEY INDICATORS 2015

POPULATION

30.3 millionⁱ

GDP PER CAPITA (PPP)

\$27,000ⁱⁱ

MAIN NATURAL RESOURCES

Natural gas, petroleum, copper, tin, bauxite, iron oreⁱⁱⁱ

RESOURCE RENTS AS % OF GDP

8^{iv}

POLITICAL SYSTEM

Constitutional monarchy;
Westminster parliamentary
democracy

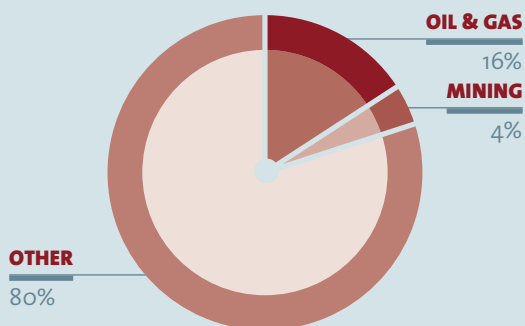
RULING PARTY

Barisan Nasional (National Front)

OPPOSITION PARTIES

Pakatan Harapan (Alliance of Hope)

EXPORT SHARES, 2015^v



ⁱ DataBank 2015: Population, total," World Bank (2015), accessed 5 September 2016, <http://data.worldbank.org/indicator/SP.POP.TOTL>.

ⁱⁱ "DataBank 2015: GDP per capita (current US\$)," World Bank (2015), accessed 5 September 2016, <http://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD>.

ⁱⁱⁱ U.S. Department of the Interior, U.S. Geological Survey, 2013 *Minerals Yearbook: Malaysia*, accessed 5 September 2016, <http://minerals.usgs.gov/minerals/pubs/country/2013/myb3-2013-my.pdf>.

^{iv} "DataBank 2015: Total natural resource rents (% of GDP)," World Bank (2015), accessed 5 September 2016, <http://data.worldbank.org/indicator/NY.GDP.TOTL.RT.ZS>.

^v "DataBank 2015: Fuel exports as % of merchandise exports," World Bank (2015), accessed 5 September 2016, <http://data.worldbank.org/indicator/TX.VAL.FUEL.ZS.UN> and "DataBank 2015: Ores and metals exports as % of merchandise exports," World Bank (2015), accessed 5 September 2016, <http://data.worldbank.org/indicator/TX.VAL.MMTL.ZS.UN>.



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Political system

The political system in Malaysia is based on a federal, multiparty Westminster system with a constitutional monarchy. The Barisan Nasional (BN, National Front) coalition has ruled the country since its independence in 1957, and all of Malaysia's prime ministers to date have come from the United Malays National Organization (UMNO) party. However, during the last two elections (in 2008 and 2013) the coalition failed to secure a two-thirds majority in parliament. This gave space to a growing opposition force.

Resource endowments and governance

Oil was first discovered in 1910 in Miri, Sarawak. Since the 1960s, Malaysia has become a leading oil producer in Asia. The oil sector is governed by the Petroleum Development Act of 1974, which gives the national oil and gas company, Petronas, the exclusive right to manage the sector with only broad policy guidance from government and little legislative oversight.

In 1975, Malaysia's 13 states signed agreements with Petronas and the federal government entitling the states to a 5 percent royalty on revenue from local onshore and offshore oil and gas production paid in cash.⁹⁴ Due to the strengthening of opposition parties at both the national and state levels from 2008 onwards, the issue of petroleum royalties has become the subject of intense political debate. The states of Sabah and Sarawak, while controlled by the ruling coalition, have demanded a larger share of oil revenues. Furthermore, the government has been reluctant to grant petroleum royalties to opposition-controlled states, leading the state of Kelantan to file a lawsuit against Petronas to demand the payment of outstanding petroleum royalties due since 1998.⁹⁵ As a response, the federal government offered to make

⁹⁴ The five oil-producing states are Sabah and Sarawak in East Malaysia, and Kelantan, Terengganu and Pahang in Peninsular Malaysia. Oil was most recently found in Pahang in 2012.

⁹⁵ The Kelantan state government argues that in return for ownership over onshore and offshore petroleum in the state, Petronas is obliged to make cash payments twice a year to Kelantan of 5 percent of revenues generated.

token “goodwill payments”⁹⁶ to Kelantan, but still refuses to acknowledge the state’s royalty rights on the grounds that exploration takes place beyond three nautical miles from its shores.⁹⁷

This study examines policy-making processes on natural resources within the ruling and opposition coalitions looking at dynamics between political parties in Sarawak and the federal government.

Varied political engagement with natural resources

Despite its federal system, Malaysia practices a centralized, top-down form of government, with political power concentrated in the office of the prime minister. The roles of legislature and executive are fused, meaning there is little, if any, direct oversight over the management of natural resources. The parties in the ruling BN coalition lack clear and robust mechanisms for deciding, planning and executing key policies regarding natural resources. There is minimal policy engagement on natural resources by political parties at the party’s national executive branch level and only nominal engagement at the state level.

An important institutional feature of policy formation on petroleum is the deference and delegation of decision-making powers from the government to Petronas. There are very few sources of external opinion, leaving Petronas as the main policy-making and regulating institution in the oil sector. Saifuddin Abdullah, a former member of the UMNO (the main political party in BN coalition) Supreme Council, the party’s governing body, said, “In all of the five years I was there, no meeting ever discussed policy adequately or thoroughly. Discussions were very general, with no position papers.”

However, discussions on natural resource management within the opposition coalition seem to be more informed, especially on the issue of subnational royalty payments to oil-producing states. For instance, an opposition parliamentarian from the Democratic Action Party (DAP) said, “Natural resource extraction is an important matter in regards to state policy and state power. Hence, the party state committees in oil and gas rich states Sabah and Sarawak will discuss and announce their positions vis-à-vis natural resource extraction.” The opposition coalition has also engaged external parties, such

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MP Dato’ Saifuddin Abdullah

Kelantan lawmakers have since claimed that the federal government owes as much as RM12 billion in oil royalties to the state government.

⁹⁶ The issue of oil royalties is particularly salient in Kelantan, as the government projected a state budget deficit for 2016, with state revenues totaling only RM593.8 million. See, for example, <https://www.malaysiakini.com/news/318287>.

⁹⁷ According to the Territorial Sea Act 2012, all natural resources beyond three nautical miles from any state shores automatically belong to the federal government, although this is being contested as unconstitutional by the Sarawak chief minister.

as non-governmental organizations, sector experts and researchers, on the incorporation of references to the EITI into the coalition's 2013 election manifesto, but these consultations with external parties remain infrequent.

In terms of internal consultations, the opposition coalition coordinates among its three member parties on oil royalties before a common position is reached. Dato' Saifuddin Abdullah, MP, and now a member of the opposition People's Justice Party (PKR) who is assisting with the coalition's common policy framework, said, "Each of the three parties discusses respectively, and then brings policies to the presidential council for a final decision."

The royalty row: a political call for greater autonomy

In 2014, the Sarawak legislative assembly passed a motion to increase its petroleum royalty claim to 20 percent, leading opposition politicians from the state of Sabah to demand the same. The premise for this argument is that more natural resource revenues should be given to Sarawak for its economic development, noting it is the second poorest state in Malaysia.⁹⁸ Pressure from both these BN-ruled states for a greater share of the nation's oil wealth is an important emerging dynamic, given their political importance. Long considered the BN coalition's "fixed deposits," Sabah and Sarawak together account for 47 out of the 133 BN seats in the federal parliament (112 are needed for a simple majority). Sarawak Chief Minister Adenan Satem⁹⁹ has recently warned the federal cabinet that if the issue of petroleum royalties and greater autonomy is not resolved, the BN coalition could lose control of the state in the next election.¹⁰⁰

The issues of the size of petroleum royalties and the perceived mistreatment of the states of Sabah and Sarawak have also led to a call for the creation of its own petroleum company and for Petronas to employ more Sarawakians.¹⁰¹ These demands reflect contestation between the Sarawak state government and the federal government over demands for greater state-level autonomy and the right of the state to manage its own finance and taxation. The prevailing mood among locals in Sarawak is for more devolution and a

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An opposition MP from the Democratic Action Party

⁹⁸ Incidence of poverty by state, Malaysia, 2014 (Economic Planning Unit, 2014).

⁹⁹ At the time of writing, Adenan Satem was still the Sarawak Chief Minister. He passed away on 11 January 2017 and was replaced by Abang Abdul Rahman Zohari Abang Openg.

¹⁰⁰ Richard T.W. "Adenan: BN risks losing in GE if autonomy promises not met," *Free Malaysia Today*, 29 July 2016, <http://www.freemalaysiatoday.com/category/nation/2016/07/29/adenan-bn-risks-losing-in-ge-if-autonomy-promises-not-met>.

¹⁰¹ Following the prime minister's intervention, Chief Minister Adenan and Petronas have agreed that it must raise the number of Sarawakians in its local operations to at least 60 percent by 2020. See, for example, Sharon Ling, "Sarawak govt reaches amicable settlement with Petronas," *The Star Online*, 27 August 2016, <http://www.thestar.com.my/news/nation/2016/08/27/sarawak-govt-reaches-amicable-settlement-with-petronas>.

return to the spirit of the 1963 Malaysia Agreement.¹⁰² Parties across the political divide in Sarawak have responded by becoming increasingly vocal in asserting the rights of Sarawakians.

A central development in the debate on petroleum royalties is the rapidly evolving dynamic between the federal government and Sarawak politicians from within the ruling coalition and the opposition. Despite the significance of Sarawak to the ruling coalition's political survival, clear fault lines are beginning to emerge between coalition partners on the larger issue of state autonomy. In the recently concluded 2016 Sarawak state elections, every major party in Sarawak promised to implement the 20 percent petroleum royalty allocation, including Parti Pesaka Bumiputera Bersatu (PBB), a BN coalition party and the most dominant political force in Sarawak. This demand for a greater share in the nation's oil wealth is symptomatic of longstanding grievances in Sarawak regarding federal neglect of development allocations and federal interference related to issues within the state's exclusive authority such as religious freedom. Thus, it is imperative to view the issue of petroleum royalty payments in light of widespread dissatisfaction with the current power-sharing arrangement between the state and federal governments.

Despite being the second largest BN coalition party with 14 MPs in the federal parliament, Juanda Jaya, a PBB member of the Sarawak legislative assembly, alleged that UMNO does not see his party as an equal partner. The BN coalition's lack of formal procedures means that in practice UMNO does not consult or share the contents of its internal discussions with coalition parties. As a consequence, other parties in the ruling coalition, such as PBB, remain relatively independent of the decisions made by their main political ally UMNO and lack formal procedures for internal consultation and policy formulation. In terms of policy formation within PBB, the party's president occasionally consults with the party's supreme council (its main decision-making body) or other external parties. However, the president has discretionary authority to decide the position of the party and by extension that of the state government on a host of policy issues.

Heightened debate has increased inter-party dialogue

Under Chief Minister Adenan's leadership, a new dynamic is taking shape between the Sarawak government and state opposition parties. The state government has increasingly attempted to distance itself from peninsula-based BN coalition parties, even if this comes at the expense of aligning itself with the opposition. For example, while the DAP tabled the original motion in the state legislative assembly in 2014 to increase

¹⁰² The Malaysia Agreement enshrined the autonomy and special interests of Sabahans and Sarawakians upon the formation of Malaysia.

petroleum royalties to 20 percent, it was an amended version tabled by a PBB backbencher (which included a further demand for development grants) that was eventually passed. Thus, the prevailing political discourse in Sarawak appears to transcend partisan divides, with both the state government and opposition parties united in their demands for greater petroleum royalty payments, as well as more safeguards to protect local Sarawakian employment in Petronas.

While the government and opposition parties are divided at the national level, this does not apply to politics in Sarawak where parties manage to reach consensus on substantial policy matters. For example, Juanda said that there is unofficial interaction between the chief minister and representatives from opposition parties to discuss policy issues, suggesting that interactions across the political divide are much more cordial than at the national level. This unique political development is possible because all parties have a vested interest in appearing to champion and lead the discourse on the state's autonomy and its oil rights. The heightened debate on revenue sharing and political autonomy, for example, has led the prime minister and Petronas to engage with the Sarawak chief minister to offer increased employment and capacity building. Thus, the jostling of parties in Sarawak is as much motivated by a genuine desire to return to the conditions of the Malaysia Agreement, as it is a tacit admission by all key political actors that Sarawakians will support the party that promises them more autonomy.