

Considerations for Indonesia's New Government: Transparency and Accountability in the Oil and Mining Industries

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Many countries have demonstrated that managing natural resources with a maximum of transparency and accountability contributes to broad-based economic development and reduces the risks of corruption and conflict. Occasioned by the inauguration of Indonesia's new president, this briefing offers one perspective on how the government might manage the country's extractive industries more openly and improve government-citizen dialogue.

WHY TRANSPARENCY AND ACCOUNTABILITY MATTER

Natural resource wealth can yield tremendous economic benefits, but these benefits are often not realized.

Public revenues from the extractive sectors of the 58 countries surveyed for the Resource Governance Index (RGI), which measures the quality of governance in oil, gas and mining sectors, totaled more than \$2.6 trillion in 2010. Yet many countries have missed opportunities to capitalize on their natural resource wealth because of mismanagement and corruption. In the 26 resource-rich countries where the RGI found weak and failing governance of the extractive sector, more than 300 million people (or 50 percent of the countries' combined populations) live on less than two dollars a day. By comparison, in the countries with satisfactory performance, that figure is 10 million people (or 7 percent of the population).

Indonesia is in a moment of transition and has a unique opportunity to leverage its oil, gas and mining sectors to reduce poverty.

The new government can send a clear signal that it will manage Indonesia's oil, gas and mineral resources with a maximum of transparency and accountability, which will inspire public confidence that the government will:

- manage resources for the public benefit
- reduce the risks of corruption and ensuing scandal
- ensure that the country gets the best deals possible for the exploitation of its resources
- attract new investment to Indonesia

Indonesia is compliant with the Extractive Industries Transparency Initiative (EITI), which means that the public has access to significant amounts of important information about the extractive industries. Indonesia also chaired the Open Government Partnership

ABOUT THE SERIES

This series of briefings offers key considerations for the new government of Indonesia as it forms its agenda for the management of natural resources.

(OGP), which has 65 member countries, from 2013 until October 2014, and continues to play a leadership role in the initiative's "Openness in Natural Resources Working Group." As part of OGP, Indonesia (through the UKP4 Presidential Delivery Unit) is developing the OneMap project, which will provide a uniform public cadastre of mining, forestry and other concession areas. This will help resolve the problem of overlapping licenses. These are significant developments, but greater transparency is required across all stages of the government's management of oil and mineral resources. It is therefore essential that the government complement the gains already made with additional information disclosure and outreach efforts, reducing the risk of corruption and mismanagement. This briefing identifies five critical areas where the government of Indonesia should strongly consider introducing further transparency.

CONSIDERATIONS FOR THE GOVERNMENT OF INDONESIA

Indonesia has taken a number of meaningful steps toward transparency in natural resource management, but the new government has an opportunity to implement several additional measures that can significantly improve communication between government and citizens. Indonesia received a score of 66 out of 100 on the 2013 Resource Governance Index, resulting in an assessment of "partial" success in disclosing natural resource information to its citizens. Indonesia's score on the index placed it above many countries in the Asia-Pacific region, including Malaysia and the Philippines, but below the eleven countries worldwide that were found to practice "satisfactory" transparency in managing the sector. The index revealed several areas for enhanced transparency and accountability.

"Increasing the transparency of mining-sector licensing processes can help ensure that the government gets the best deal for natural resources."

1. Licensing processes should be fully transparent, in both the oil and mining sectors.

Indonesia's petroleum-sector legislation requires that the government award the right to participate in oil contracts via a competitive process, which tracks with international best practice; and the Resource Governance Index found that the government does publish extensive information on the terms of the auctions and the justification for the selection of the company with the winning bid. But in the mining sector, the government continues to award a large number of licenses on a first-come, first-served basis. There is also significant confusion surrounding licenses awarded by subnational governments, and in general there is little information available to the public on how the government is awarding mining licenses.

Increasing the transparency of mining-sector licensing processes can help ensure that the government gets the best deal for natural resources and can help reassure citizens that the government is properly managing public resources. Indonesia stands to secure the best deals possible by consistently enforcing a license/contract award process that includes:

- clearly publicized criteria for the allocation of rights
- allocation wherever possible by open competitive tender with at least three entities expressing interest in an area under consideration
- public disclosure of the beneficial ownership information of all companies. This ensures that only the best-qualified companies undertake exploration and production in Indonesia, and will protect against corruption and conflicts of interest

2. Indonesia should publicly disclose its petroleum and mining contracts.

EITI encourages implementing countries to publicly disclose their extractive-sector contracts and licenses. Indonesia now has the opportunity to join a growing list of countries, companies and international bodies that support contract disclosure as beneficial for all stakeholders.

Petroleum and mining contracts remain outside the public domain in Indonesia, though some officials in the oil and mining sectors have begun to examine the benefits that publication of contracts could have for the country. Governments in Ecuador, Ghana, Kurdistan (Iraq), Liberia, Peru, Timor-Leste, and the United States, among others, disclose contracts publicly. A growing number of companies in the extractive sector support contract disclosure. For instance, BP published its production sharing contracts in Azerbaijan, and executives at Rio Tinto and Newmont have spoken out in favor of publication. International organizations such as the IMF and the World Bank Group also strongly encourage the disclosure of contracts, as does the International Bar Association.

“Public disclosure of contracts is becoming an increasingly common step favored by a growing number of governments, companies and international institutions”

Disclosure of contracts and licenses allows **governments** to:

- Build trust that the state is pursuing the public interest, including within communities
- Reassure investors and lower perceptions of corruption
- Increase future revenues by making it difficult for any single official or agency to sign deals with limited long-term advantages

Disclosure of contracts and licenses allows **citizens** to:

- Quantify the net returns that the country receives from the exploration and extraction of natural resources
- Understand the existing tax, local content, environmental and social obligations that guide company and government behavior, and effectively monitor whether companies and public officials are fulfilling their obligations

Disclosure of contracts and licenses allows **companies** to:

- Establish contracts and licenses that are more stable, with broader public buy-in, a stronger social license to operate, and lower pressure to renegotiate
- Lower risks of corruption in the negotiation of contracts and licenses
- Explain why revenues may not meet unrealistic public expectations (such as when companies are recouping exploration costs)

Such disclosures also reduce the bargaining leverage of unskilled or unscrupulous companies that seek to sign deals that are out-of-step with international standards.

3. The government should systematically disclose and explain revenues, volumes and other critical information on oil, gas and mining production.

Good practice calls for the regular disclosure of the revenues generated from the extractive industries. Such disclosure can improve the tax collection process, enhance public trust in government, and foster stability in a volatile sector. EITI-compliant countries such as Ghana, Norway, and Peru have used the initiative as a tool to stabilize relationships with oil and mining companies and with citizens.

Indonesia took a major step toward global recognition for progress in disclosure of natural resource revenues in October 2014, when it was deemed “compliant” under EITI. In future EITI reports, Indonesia will be expected to adhere to the new EITI standard adopted last year, which has more rigorous reporting requirements and should prove to enhance public

knowledge. Many of the revisions to the EITI standard in 2013 derived from the recognition that the disclosure of payments from companies to central government, taken alone, is insufficient to achieve broader gains associated with transparency. Indonesia's next EITI report must therefore include significant additional information, including contextual information on the contribution of the extractive sector to the broader economy, taxes collected by local government entities and the transfer of revenues from the national government to subnational governments. One of the shortcomings revealed in Indonesia's assessment in the Resource Governance Index was a lack of reporting on subnational transfers.

4. In the mineral sector, the government of Indonesia should invest in better coordinating roles and responsibilities between national and subnational governments.

Given the significant powers that local governments hold over license allocation, revenue collection and expenditure, coordination of these responsibilities is essential for effective management of the extractive sector. Transparent roles and responsibilities, understood by all, allow the executive to monitor and hold accountable those institutions failing in their duties. In many cases, subnational government officials lack the expertise and capacity to execute their roles, and information coordination between central and subnational governments is weak. Among other steps, we recommend that the new government in Jakarta consistently reach out to subnational government leaders to share information and help raise the capacity of public officials at the subnational level so that they can better carry out their responsibilities.

5. The government should better manage public expectations and educate the public about what it stands to gain from exploitation of its oil, gas and mineral resources.

It is important to clarify for citizens how natural resources are being managed and how the nation stands to benefit from them. Lack of clear communication can heighten public suspicion and mistrust; can arouse accusations of corruption (whether they are founded or not); and in worst cases can result in civil unrest among communities whose members feel harmed by resource exploitation without seeing direct benefits. The government should develop a clear communication strategy for keeping the public informed on how resources are being exploited, how revenues are being used, and strategic plans for further development of the sector. Public sensitization should also ensure that the public is aware of business opportunities available to local businesses, and what training, skills development and financial support may be available to assist them to participate at all points along the extractives value chain.

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