Government Decentralization and Resource Rent Revenue Sharing: Issues and Policy

by Allen L. Clark

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ABSTRACT

For several years, the issues surrounding fiscal decentralization of government functions, particularly with respect to increased revenue sharing, have been emerging in many nations. In no sector has this been more apparent than with respect to government revenues that are derived from the development of natural resources. These revenues are known as “resource rents.”

In most of the nations of the Asia Pacific region, Local Government Units (LGUs) have seen, and continue to see, major resource development projects in coal, fisheries, forestry, gas, metallic and non-metallic minerals, and oil taking place within their jurisdictions, yet they receive few or no additional economic benefits. Concern about the unequal sharing of economic benefits from resource development intensified with the advent of the Asian economic crisis when national government remittances to LGUs decreased dramatically. These remittances decreased even though revenues to national governments continued apace as a result of continued high international demand for resources and because payment for them was made in foreign exchange, not in depreciated local currency.

Today, most governments recognize an urgent need to address decentralization and revenue sharing issues. However, because the issues surrounding the actual processes of government decentralization and resource rent revenue sharing are relatively new, they are poorly understood. As a result, in most cases emerging problems remain largely unanticipated, unresolved, or both.

In the following discussion, the interrelations of the issues surrounding government decentralization and resource rent revenue sharing are addressed in the context of (a) the concept and nature of resource rents, (b) decentralization, (c) the impact of resource development projects, and (d) the impacts of resource rent revenue sharing on national, provincial, and local governments.
In its simplest form, government decentralization is the transfer of both authority and responsibility for public functions from the central government to subordinate levels of government (provincial and local), or in some special cases, even to the private sector. Decentralization most commonly occurs with respect to the transfer of authority and responsibility within four broad areas of government activity:

1. **Political Decentralization**: Focuses on the transfer of the responsibility and authority for political self-determination from the central government to subordinate levels of government, in particular for the formulation and implementation of policies.

2. **Administrative Decentralization**: Seeks to redistribute among different levels of government the authority, responsibility, and financial resources for providing public services.

3. **Market Decentralization**: Seeks to create a free market in which government and industry cooperate to provide public services or infrastructure; privatization and deregulation are the core elements of market decentralization.

4. **Fiscal Decentralization**: Focuses on the transfers of revenues by the national government to subordinate levels of government, or on allowing lower levels of government to raise their own funds; fiscal decentralization is the core component of decentralization.

Most of the nations of the Asia Pacific region have been implementing these four types of decentralization to a greater or lesser extent for several decades. It is arguable that in most countries administrative decentralization has progressed further than any other area of government decentralization. In most instances of administrative decentralization, however, the national government has (a) provided funding to the local government units (LGUs) specifically for the purpose of carrying out overall national programs and (b) provided strong oversight of the LGU’s activities in carrying out the programs. Such activities primarily transferred responsibility, but rarely authority. This normally left the LGUs in the
position of being implementers rather than designers of projects, and consequently with little autonomy in local development. At best, such an approach can be classified as “quasi” administrative decentralization.

Fiscal decentralization, of all the areas of decentralization, has probably proceeded most slowly, and in many nations has become a major source of discontent within the LGUs, with normal citizens, and with many if not most non-governmental organizations (NGOs). As a result, even before the Asian economic crisis that began in 1997—which has been a major catalyst for change—the issues surrounding fiscal decentralization of government functions, particularly with respect to increased revenue sharing, were emerging in many nations, e.g., Papua New Guinea, the Philippines, and China. With the Asian economic crisis, there grew an even stronger and broader demand from LGUs at the provincial, district, and community levels for a larger role in self-determination, and with it, revenue sharing. In no sector has this been more apparent than with respect to government revenues that are derived from the development of natural resources (resource rents).

In most of the nations of the Asia Pacific region, the LGUs have seen, and continue to see, major resource development projects in coal, fisheries, forestry, gas, metallic and non-metallic minerals, and oil (hereinafter, natural resources) taking place within their jurisdictions, yet they receive comparatively few additional economic benefits, or none at all. Indeed, in most cases resource development projects are regarded as “enclave” activities that largely operate outside the local economy. This inequality with respect to sharing in the economic benefits of resource development became particularly visible, and the focus of great concern, with the advent of the Asian economic crisis, when national government remittances to the LGUs decreased dramatically. Ironically, during this same period, revenues to the national government continued apace as a result of continued high international demand for resources and because revenue remittances to the government for sale of the resources were made in foreign exchange, not in depreciated local currency.

Even though most nations in the Asia Pacific region have, to a greater or lesser extent, undertaken some level of decentralization, the actual transfer of authority and responsibility has been limited, particularly in the area of fiscal decentralization with respect to resource rents (resource rent revenue sharing). Events before the Asian economic crisis, events such as the overthrow of the Marcos and Suharto governments and the secessionist movement on Bougainville Island, had thrust the issues of increased government decentralization and resource rent revenue sharing into the forefront of LGU concerns in many coun-
tries. As a result, there is both a historical need and an increasingly immediate need to address decentralization and revenue sharing issues on the part of most governments in the Asia Pacific region. However, because the issues surrounding the actual processes of real government decentralization and resource rent revenue sharing are relatively new, they are poorly understood. Consequently, the institutions of government and civil society are poorly equipped to design and implement such processes. As a result, in most cases emerging problems remain largely unanticipated, unresolved, or both.

In the following discussion, the interrelations of the issues surrounding government decentralization and resource rent revenue sharing are addressed in the context of (a) the concept and nature of resource rents, (b) decentralization, (c) the impact of resource development projects, and (d) the impacts of resource rent revenue sharing on national, provincial, and local governments.

THE CONCEPT OF RESOURCE RENTS

The classic concept of economic rent originated in the initial studies of David Ricardo, in his theory of land rent, in which he postulated that in the presence of abundant superior land, no rent could be commanded for land as long as comparable land was available for free. However, according to Ricardo, as the best land is used up, it then becomes profitable to utilize the next best quality of land (albeit at a higher cost of production), then the next best quality of land (at a still higher cost of production), and so forth. As a result, rent (in this case land rent) was defined as the difference in the cost of producing output on the poorest tract of "no rent land" being used and the value of output on any other tract of superior land. In more general terms, Ricardian economic rents can be viewed as the excess of economic return on a project above the total economic cost of the project; this is the context within which the present discussion of resource rents is framed. For a complete overview of the economic theory and application of the concept of resource rent to natural resource development, the reader is referred to the works of Garnaut and Ross.

In the case of natural resources, governments often transfer selected property rights to industry, such as the right to mine an area or to exploit an area of timber resources, in exchange for some amount of economic rent. In this case, government is considered, in economic terms, a "rent seeker." The economic rents sought accrue to the government in the form of (a) taxes on the industry and fees for use of the land on which the resource occurs or (b) as royalty payments per unit of the resource produced or utilized. These economic rents are known
collectively as “resource rents” because they are derived from the utilization of natural resources. It is important to emphasize, however, that resource rents are not defined arbitrarily by government but are determined on the basis of detailed analyses of project economics (the cost of production) and an agreed upon sharing by government and industry of the resulting profits. As will be seen later in this discussion, with governmental decentralization the LGUs and others also become rent seekers when the authority and responsibility for resource development is transferred to them from the central government.

Historically, in most nations, resource rents are remitted to the national treasury and become part of a general fund that is then apportioned according to a national development plan to the individual provincial and local governments. As a result of this process, the LGUs that are most affected by resource development and exploitation argue that they do not have an adequate role in determining either how the level of resource rent will be determined or how it will be used. They also argue that the resource rent they receive does not fairly or adequately compensate for (a) the use of the resource; (b) the accompanying social, economic, and environmental impacts of resource development and exploitation; and (c) the longer-term social and environmental costs (particularly with respect to non-renewable resources) that are associated with rehabilitation, reclamation, and readjustment. Equally important to the affected LGUs is the concern that national planning does not adequately provide for sustainable development of the local area once the resources are depleted.

The entire issue of decentralizing government control and implementing resource rent revenue sharing is, in most nations, made difficult because national constitutions almost always state that (a) the national government has overall authority and power and (b) that all natural resources belong to the state. Further, national constitutions almost always state that the derived revenues from the exploitation of the resources should be used for improving the well-being of all the nation’s citizens. Although the questions of power and ownership would appear to be relatively clear for most nations, as should be the overall use of the derived revenues, the exact nature of “national authority,” “resource ownership,” and “revenue use,” is often unclear and is widely and heatedly debated at the present time in many nations, in particular Papua New Guinea and the Philippines.

The debate over ownership and revenue use in many nations is made more complex because of the increasing trend toward broader “people empowerment,” as an adjunct to decentralization. This is a major issue that virtually ensures that the discussion over resource rent revenue distribution will increase in breadth and intensity. Indeed, in at least three nations in the Asia Pacific region
Government Decentralization and Resource Rent Revenue Sharing: Issues and Policy

(Indonesia, Papua New Guinea, and the Philippines) specific legislation has been enacted (and more is being enacted in other countries) that provides for decentralization and the sharing of resource rents, often according to a set formula, and largely in response to “people empowerment.”

**THE NATURE OF RESOURCE RENTS**

Most issues surrounding revenue generation and revenue sharing can be fairly clearly delineated, but there are a number of ancillary factors that make the process of resource rent revenue sharing much more difficult. One of the most important factors is that the nature of resource rents is not well understood by the LGUs—and often not even by the national government itself.

**Types of Resource Rents**

Resource rents encompass all direct revenues derived by a nation. The most common forms of revenues are direct taxes and fees for the use and development of the nation’s resources. Examples of the former are corporate income taxes, royalty taxes, withholding taxes, import and export taxes, and excess profits taxes. The latter include registration fees and fees for the use of land, water, and infrastructure. As a general rule, albeit with some major exceptions, the largest portion of both taxes and royalties accrue to the national treasury, while the majority of the fees (and often a portion of royalties) accrue to the LGUs. This, however, results in a major disparity in revenue distribution because taxes, which accrue to the national government, normally constitute more than 90% of all derived revenues from a resource exploitation projects.

Two additional types of resource rents that are associated with many resource development projects—in particular those in forestry, minerals, and energy—are (a) landowner compensation and (b) national and local equity participation in resource development projects. In the former, the revenue derived may be quite high, may accrue on a yearly basis (normally for the life of the development, and in some cases, beyond), and may be shared by a very small number of people. In the latter, the national government, and occasionally government at the provincial level, becomes an actual partner in a project and thereby acquires a percentage of the profits in addition to taxes and fees. Because the equity partner is normally the national government or its agent, most of the revenues from profit sharing accrue to the national government. The sharing of revenues from profit sharing may or may not make resource rent revenue sharing with LGUs more difficult.
Stability of Resource Rents

Perhaps the most critical aspect of resource rents derived from natural resource development is that of the price instabilities—both long term and short term—associated with natural resources. The most pronounced examples of this occur in the minerals and petroleum sectors, where the value of the produced and refined products (the prices of which are determined by the international economy) and the resultant supply and demand for related commodities, vary significantly over time. An increase in world economic activity normally results in higher prices, and conversely, a decline in the world economy normally results in a decline in commodity prices. As a result, the derived resource rents from natural resource developments show a similarly wide variation over time.

A partial exception to the above relates to natural resources that are sold through long-term contracts to individual producers. Ideally, a long-term contract provides a buffer against changes in world commodity prices, but most long-term contracts have re-negotiation clauses that protect the buyer from large swings in market prices. This allows the prices for most resources, and in particular those for ores, metals, timber, oil, and gas to be adjusted, albeit normally after a set period of time. As a result, international commodity prices have been characterized by long-term stability and by short-term volatility (major changes in a short period of time), which leads to instability in government-derived resource rents.

Table 1 shows that over the two-year period January 1997 through January 1999, the prices of both renewable and non-renewable natural resources dropped by an average of approximately 27% (excluding phosphate rock, which actually increased in price by 7%). Indeed, it should be noted that such declines in commodity prices for renewable and non-renewable resources are not uncommon and are often even more severe. Conversely, it must be noted that rapid price rises are also common but usually less dramatic.

The primary effect of the instability in prices and the resultant instability in resource rents to a nation is that the producing nations are often placed in a cycle of feast or famine, in which revenues fluctuate dramatically from year to year. This fluctuation in revenues makes it difficult for national governments to plan, implement, and effectively carry out long-term development plans. This is particularly true with respect to social services such as education, health, and welfare, all of which require large and consistent inputs of money from the national government over generations rather than over the several years a project may last. Price and revenue instability has an even greater impact on the LGUs of a nation, particularly if a substantial amount of their revenues are tied to resource rents. This is because LGUs, unlike the national government, often do
not have access to other sources of revenue with which they can stabilize revenue flows over time.

The Timing of Resource Rents
The extractive industries (oil, gas, and minerals), and (albeit to a differing degree) the forestry and fishing industries, have in most cases common characteristics that directly influence the timing and amount of resource rents that will accrue to the national government and, in reality, to the LGUs as part of resource rent revenue sharing. The most important of these characteristics are presented, and their effects summarized, in Table 2.

An irony of the resource industries is that although the absolute amounts of money invested are enormous (US$ billions) the reality of the industries, in most cases, is that after the large capital investment is repaid and the costs of the operation are deducted, most projects have a relatively low internal rate of return (IRR) for the company (normally 13–17%) and a modest net present value (NPV) for the government (approximately 50–60% of profit).

The low NPV to the government is largely attributable to two factors: (a) the greater part of actual revenue flows is deferred for several years, and (b) actual revenues are received over an extended period of time. This deferred and extended receipt of resource rents from natural resource development projects is of critical importance to the entire discussion of resource rent revenue sharing and will be examined in detail later in this analysis. A key point to note, however, is that resource rents do not accrue to either the national government or to the LGUs when they are most needed—at the beginning and at the end of a natural resource development project.

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<tr>
<td>Logs (Malaysia)</td>
<td>$/cum^a</td>
<td>238.3</td>
<td>162.4</td>
<td>175.5</td>
<td>-26</td>
</tr>
<tr>
<td>Fishmeal</td>
<td>$/mt^b</td>
<td>606.3</td>
<td>661.9</td>
<td>409.0</td>
<td>-33</td>
</tr>
<tr>
<td>Coal (Australia)</td>
<td>$/mt</td>
<td>35.1</td>
<td>29.2</td>
<td>26.1</td>
<td>-26</td>
</tr>
<tr>
<td>Crude oil (average)</td>
<td>$/bbl^c</td>
<td>19.2</td>
<td>13.1</td>
<td>13.5</td>
<td>-30</td>
</tr>
<tr>
<td>Natural gas (average)</td>
<td>$/mmbtu^d</td>
<td>2.6</td>
<td>2.3</td>
<td>2.0</td>
<td>-25</td>
</tr>
<tr>
<td>Copper</td>
<td>$/mt</td>
<td>2276.8</td>
<td>1654.1</td>
<td>439.5</td>
<td>-81</td>
</tr>
<tr>
<td>Gold</td>
<td>$/toze</td>
<td>331.1</td>
<td>294.2</td>
<td>283.9</td>
<td>-14</td>
</tr>
<tr>
<td>Phosphate rock</td>
<td>$/mt</td>
<td>41.0</td>
<td>43.0</td>
<td>44.0</td>
<td>+7</td>
</tr>
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Source: Data from World Bank (1999b)
Note: Figures rounded by EWC to the nearest tenth.
^a = cubic meter; ^b = metric tonne; ^c = barrel; ^d = billion British Thermal Units; ^e = troy ounce
Of particular importance to developing and emerging economies is the issue of value added resource rents, i.e., the additional resource rents that can be collected by the government because of subsequent processing or use of the raw materials within the country. Examples of activities that generate additional taxes in the form of value added resource rents include the production of refined metal through the smelting of copper ores and concentrates (such as in the Philippines and Indonesia), the cutting and polishing of gemstones that are mined locally but which are now exported as finished jewelry (as in Thailand and the Lao PDR), the processing and canning of fish (as in the Pacific Islands), and the production of plywood from raw logs (as in Indonesia and the Philippines).

Although in principle the concept of value added resource rents is quite attractive to governments, the realities of the international marketplace are such that for most nations the downstream processing of natural resources for value added rents is not economically feasible. Indeed, although Australia is one of the most mineral-rich countries in the world, it is primarily (albeit by no means
exclusively] an exporter of ores and concentrates to other nations in the Asia Pacific region, countries that then process and fabricate the metals for sale or for use in their domestic industries. As an example, although Japan has few domestic mineral resources, it is one of the region’s largest exporters of refined and fabricated metal, capturing large resource rents from value added processing of ores and concentrates from other nations. The same is true for Singapore and South Korea.

Nevertheless, when possible, the capture of value added resource rents is an excellent policy option for a county, but such a policy must be implemented on the basis of economic viability (not national pride) to ensure that there will be actual revenues to the government and that they will arrive within a reasonable time frame. As examples, Papua New Guinea and Mongolia have both considered and rejected proposals for the development of gold and copper smelters because the projects were not economically viable for them. Conversely, the Philippines developed the PASAR copper smelter in the 1980s. At present it is unprofitable (or at best marginally profitable), has a large debt, and is presently being privatized.

A major, overarching concern for the LGUs of resource-led economies is that although government decentralization and resource rent revenue sharing is intended to empower the LGUs and provide the funds for local development, these actions often create additional and unforeseen problems for the LGUs. Several of the major problems associated with decentralization and resource rent revenue sharing are discussed in the following pages.

DECENTRALIZATION

The driving force behind the government decentralization movements within the nations of the Asia Pacific region is “people empowerment,” which, although it varies somewhat in form and intensity among nations, is characterized by the desire for the “average” citizen to have a larger role in determining government policy and a more equitable participation in the fruits of economic development. The latter provides the primary linkage between the individual’s desire for government decentralization and fiscal decentralization of resource rents.

Although government decentralization is clearly a worthy goal, the actual carrying out of the process presents numerous problems, a detailed discussion of which is beyond the scope of the present paper. The following discussion therefore focuses on three key issues that arise with respect to government decentralization and that relate specifically to resource development activities and resource rent revenue sharing. These issues are internal resource allocation, the
costs of establishing new projects, and local government management capacity.

**Internal Resource Allocations versus Resource Rent Revenue Sharing**

Virtually every nation has in place a well-established procedure—internal resource allocations (IRAs)—for the transfer of funds from the national treasury to the LGUs. The transferred funds are usually earmarked for support of the LGUs, social services, and for specific national development projects that have been formulated at the national level. Such IRA funds, therefore, have three very important attributes: (a) they are directly or indirectly controlled by the central government, (b) they are allocated on the basis of overall national development planning, and (c) they are allocated without regard to the financial contribution that is made to the national treasury by a local area, e.g., resource rents paid to the state by industry for the development of the local area's natural resources.

Further complicating the issue is that the government’s normal IRA procedures for the distribution of national (non-resource rent) funds to local governments are usually focused at the provincial level, where the funds are used for the broader social and infrastructure needs of the province. As a result, the LGUs have little or no latitude in the expenditure of the IRA funds to accommodate needs resulting from resource development.

This often requires that the national government provide additional funding, a supplemental IRA, for use at the local level. However, it should be noted that such supplemental IRA allocations invariably result in “turf battles” between the provincial government and the smaller LGUs with respect to how and when the monies will be transferred, who will have control of the monies, and who will set the priorities for projects. Equally important are turf battles that may develop between competing NGOs. They may wish to direct expenditures to individual projects of special interest. Turf battles may also develop with respect to the use of Overseas Development Assistance (ODA) monies that the donor may wish to direct to support specific projects (such as infrastructure that would support resource development undertaken by the donor nation’s industry).

Even more acute is the overall problem of how the national government will address the issue of IRA, and supplemental IRA funding once the LGUs begin to receive significant funds from the resource rent revenue sharing. At this point, the national government normally wishes to (a) curtail all supplemental IRA funding and (b) reduce normal IRA funding with the expectation that the LGUs will undertake development activities and provide social services from the resource rents they receive. To a large extent, the resolution of these issues is made simpler or more difficult depending on the magnitude of the resource rents
received. Of particular concern is the issue of the decentralization of social services such as health and welfare, which in most cases continues to be provided to the provinces by the national government. However, in cases where a province receives a substantial amount of resource rent revenue sharing, they may be expected (or may want) to assume the responsibility and pay the cost for such services out of receipts from resource rent revenue sharing.

Resource Rent Sharing and the Costs of Establishing New Projects
As emphasized earlier, a fundamental difficulty with resource rent sharing in most countries is that the timing of the flow of funds to the LGUs is often exactly opposite to the timing of the actual need. This is particularly the case with respect to new resource development projects, which often involve a large influx of people to a remote area.

This dichotomy arises because the timing of the receipt of LGU resource rent revenues from a resource development is directly linked to the timing of central government resource rent collections from a project. The norm is that the level of resource rent receipts increases over time as development proceeds and as initial capital costs for the project are written off by industry. As a result, actual revenue receipts and significant resource rent revenue sharing may be delayed for several years. This problem is further exacerbated by the fact that many governments grant a “tax-free holiday” to investors, which in most cases further delays actual receipts from a project. However, the need for local government expenditures to establish needed social services and infrastructure in a new area are at their greatest during the construction, development, and early operational phases of a project, before any tax revenues collected by government can be transferred to the LGUs.

As an example, for a typical large-scale resource development project, two to four years may be required for project construction. During this time, people often migrate to the area on the merest promise of eventual employment (the Gold Rush effect). These people will need schools, health facilities, local police, and other social services. There will also be a need for constructing or expanding urban infrastructure (particularly water reticulation) and for assistance in siting and building even minimal housing. Although some services may be provided by the developer or the construction contractor, it is unlikely that industry will provide much assistance to unemployed migrants or to large segments of the local population. Providing even minimal care for these people will ultimately become and remain the responsibility of local authorities, who must suddenly find money from an already over-stretched budget and personnel from an already inadequate
and overworked staff, to respond to the needs of the migrants and meet the heightened expectations of the local population.

It should also be noted that the portion of the cost of the development of needed supporting infrastructure for a resource development program that falls to the LGUs, like the infrastructure costs borne by industry, will in large part be denominated in foreign currency to cover the costs of imports (city sanitation facilities are a common example). As a result, revenue provided to the LGUs by the central government will have to be, at least in part, from foreign exchange reserves. Alternatively, the LGU, the central government, or both may be able to utilize some part of available ODA for the foreign exchange part of the project. This, however, is normally quite difficult to effect because there is (a) a natural reluctance on the part of the ODA donor to support the project or (b) the ODA funds are tied by bi-level and-multilevel agreements that restrict their use for special purposes.

As previously discussed, the obvious resolution of this dilemma is supplemental IRA funding to meet these early establishment expenses. However, a number of issues immediately arise, such as (a) how such an initiative would be mounted; (b) what would be funded; (c) how long a national presence and funding would be necessary in the area; (d) whether the local government can cope with a sudden expansion of needed services; and (e) to which levels of local government the support should be funneled. In trying to resolve these critical establishment issues, the national government must tread carefully if it is to prevent total dependency of the LGUs on the national government and, thereby, the subversion of its own decentralization strategy.

Two of the most constructive approaches are (a) the use of Joint Development Task Forces (JDTFs) composed of government officials from all levels, as well as industry and NGO representatives who can anticipate and develop appropriate transition plans; and (b) the implementation of periodic rapid field assessment programs to assess the ongoing activities and identify emerging issues that the JDTF may address.

Decentralization and Management
The decentralization process focuses on the transfer of a significant amount of authority and responsibility for operations and decision-making, over a broad spectrum of activities, from the national government to Local Government Units. The transfer of authority and responsibility is also accompanied (albeit normally with significant controls) by a transfer of fiscal resources. In most cases, the decentralization process occurs rather rapidly, in response to national
crises. In the Philippines and Indonesia, decentralization occurred, or is occurring, in response to economic chaos resulting from the ousters of Presidents Marcos and Suharto, respectively. Elsewhere, the decentralization process takes place over a relatively extended period of time. This is the case in Papua New Guinea, where the process was recently catalyzed by two dramatic and related events, the closure of the Bougainville Mine and the resulting civil uprising on the Island of Bougainville.

Although there are many forces that build up over time and ultimately result in government decentralization, there is usually some event, or associated events, that serves as a trigger for the process. Government normally initiates decentralization shortly after the triggering event or events. This abrupt onset of the decentralization process normally results in the following:

- The actual division of authority and responsibilities between the national government and the LGU is poorly understood and unevenly implemented.
- The LGUs are inadequately staffed with technically trained and experienced personnel capable of taking over the new responsibilities.
- Procedures for the transfer of responsibility and fiscal resources are poorly defined, and are therefore very inefficient, which results in significant delays in payments and program implementation.
- Integration of the existing bureaucracy of the National Government into the Local Government Units and their activities occurs slowly. In particular, headquarters staff assigned to the LGUs delay their transfers and moves, leaving the LGUs without necessary advisors.
- The above problems almost always foster the additional problems of graft and corruption because of the lack of an established system of checks and balances on the activities of the LGUs.
- Implementation of major development projects is delayed, as the LGUs (whose staff normally lack experience) assume a greater role in negotiations and planning.

In addition to the above issues, which are largely related to personnel, there are a myriad of other issues that need to be addressed in the decentralization process, issues that are too often overlooked, or in extreme cases, ignored. A common problem is the failure to provide support facilities (e.g., cars, telecommunications, laboratories, and technicians) necessary to meet the LGU’s new responsibilities. Other common problems are the recruitment and training of personnel and the purchasing of goods and supplies.
In summary, the most fundamental deficiency of the decentralization and resource rent sharing activities is that the LGUs are, with few exceptions, unable to immediately and effectively assume the new duties and responsibilities they have been given. As a result, there is a critical need to define and implement a more reasoned and sequential approach to the decentralization and resource rent sharing processes, overall, and as it pertains to resource developments in particular. Central to any effort by LGUs to deal effectively with major resource development projects is that they develop an understanding of the impacts of such projects so that the impacts are anticipated, planned for, and mitigated. Among the most significant are the impacts of resource development projects and issues surrounding regional infrastructure developments.

**IMPACTS OF RESOURCE DEVELOPMENT PROJECTS**

Resource development within any nation is bounded by at least four basic attributes that are inherent to natural resources and their development: (a) natural resources are unevenly distributed within nations, (b) natural resources must be exploited where they occur, (c) development requires supporting infrastructure, and (d) even with the best of planning, resource developments have significant social, economic, cultural, and environmental consequences. It is critical to understand these four attributes of natural resources, as well as the limitations these attributes place on resource rent revenue sharing. The effects of these limitations must also be understood and addressed. Among the most important impacts are those associated with induced inequalities, compensatory programs, barriers to participation, social-versus-political priorities, and mistrust of government intentions.

**Decentralization and Induced Inequities**

The desire of government to strengthen local fiscal autonomy and to encourage greater grass-roots control over resource development must accommodate a substantial number of implementation issues that are normally not expressed in any policy statement. These implementation issues involve inequalities that may emerge or be accentuated directly as a result of increased local control or they involve questions relating to how different local groups will share the costs and benefits of new development. Two particular issues normally arise: (a) regional inequalities between the resource development area and adjacent areas and (b) the costs and benefits of resource development on residents in the immediate resource development area.
Inequality Between Adjacent Areas. Almost invariably, local control brings with it the potential for increased social, economic, political, and administrative inequalities between adjacent areas. Experience worldwide suggests that there are no simple or easy solutions to these issues. More important, workable strategies must be formulated in the crucible of real, evolving projects rather than through some abstract or a priori policy generalization. As an example, local government must often operate on the basis of administrative units that are based on arbitrary geographic boundaries. Exactly where within a province, municipality, or district the natural resources exist is solely a function of factors other than administrative boundaries or planning decisions. Under such circumstances, it is inevitable that some people will prosper from the capriciousness of nature, while their equally needy (and, possibly, equally affected) neighbors may receive little benefit, or no benefit at all.

Even though the decentralization strategy is designed to move political power and financial resources closer to grass-roots control, the reliance on local administrative jurisdictions may exacerbate the inequality issue. In particular, to the degree that local political or administrative decision-making is perceived to be taken, or is actually taken, out of self-interest, decentralization may inflame rather than soothe a sense of inequality.

Clearly, a solution to the question of regional inequality lies in making financial resources available to the entire region affected by resource development, rather than just to the administrative district where the resource happens to be located. However, the distribution of resource rents on the basis of those most affected makes it difficult to use resource receipts to offset these more regional problems. In short, the logic of revenue sharing from resource development needs to be carried beyond the administrative boundaries of the specific LGUs.

To address the inequality problem squarely requires a comprehensive series of development policies that may well run counter to the intended objective of decentralization—greater local control and autonomy. For example, LGU authorities will not be happy with employment policies that deliberately extend recruitment outside the province or municipality, nor will they be elated when infrastructure is deliberately planned to serve adjoining LGUs. Even with a successful regional planning effort that is designed to provide benefits to the largest group possible, there will remain the problem of how to meet recurrent costs where services are provided in area outside the LGU in which the tax base is located.

Failure to deal with the division of natural resource wealth and rents between neighboring administrative and social units can create a volatile social situation and can aggravate historical grievances and cultural enmities. Such
regional inequality is not merely an academic issue as the history of major energy (oil and gas development in Nigeria, gas development in Myanmar) and mineral development projects (copper mining in Katanga Province of Zaire, the Amazon gold rush of Brazil, the Bougainville secession in Papua New Guinea over the Bougainville copper mine) around the world clearly shows that disagreement over the division of natural resource wealth can easily lead to violent social struggles and even to armed conflicts.

**Costs and Benefits of Resource Development to Local Residents.** Because resource development often takes place in remote rural areas, the impact of such development poses special problems for local residents. Many of these special problems are either unrecognized by social planners or are ignored in the rush to bring a new development into production. In many cases, the problems themselves are disguised by the intensive construction period that precedes actual operations. During construction, long-term social problems can sometimes be mistakenly associated with the early, transient phase of resource development. Indeed, the construction period is a critical period during which unattended social issues can easily become the source of resident grievances that will chronically plague later operations of the resource development project. This occurred at the Bougainville Mine, in Papua New Guinea, and ultimately contributed to both an ongoing secessionist movement on the part of the residents of Bougainville Island and to armed conflict.7

**Compensatory Programs and Barriers to Participation**

Common compensatory programs associated with most major resource developments include employment preferences for residents, small-business development programs, village development schemes, and improved health and education services. While there is little mystery in terms of the nature of such programs, there are three nearly universal problems with implementing such compensatory benefit programs: (a) inherent barriers to resident participation, (b) the allocation of development resources through local political institutions and civil society (whose priorities may not coincide with the interests of the residents), and (c) the mistrust of government by rural residents.

Residents from remote regions often suffer from social, logistical, health, and educational handicaps that severely restrict their ability to participate in resource development. Normally, rural people will have few of the job skills or the education necessary to capture better-paying construction or operating jobs with the resource development project or to capitalize on small-business opportunities. As a result, many jobs go to skilled outsiders. This results in both accen-
tuated income inequality and social resentment against outsiders. Although, this situation is in most cases an unavoidable consequence of resource development in remote areas, it is also true that better forward planning by the central government and LGUs can dramatically improve local participation. This is also true of programs by industry that focus on skill development.

The situation is further complicated by the lengthy construction period associated with the development of major resource development projects. During the construction period, the demand for unskilled labor is at its peak, and many residents will be pulled into the construction labor force. Unfortunately, these unskilled construction workers are then often not available for company or government-sponsored training programs related to the operational phase of the project. Thus, local residents often find themselves in a circular situation where their long-term interests (for skill training related to operations) are being pre-empted by their short-term needs (for construction employment).

Specially targeted remedial (or compensatory) development programs, although formidable, could theoretically address such practical implementation problems. Regrettably, the implementation of compensatory programs is often undermined by the channeling of development funds through local authorities, whose experience and priorities reflect political, rather than developmental, realities. It should also be noted that the programs are often unsuccessful because of a lack of public-administration skills by the individuals in the LGU who are charged with administering the projects.

“Resident” versus “Political” Priorities

The assumption behind any decentralized development-funding scheme is that local leaders are better placed to identify and address local development needs than are central government planners and development specialists. While such an assumption may be accurate for some types of development needs, the assumption is probably not true for development of mega-projects in the resource sector, whose impact is beyond the experience (and perhaps the imagination) of most local officials anywhere in the world.

The problem of channeling resource development impact funding through LGUs is also heavily influenced by political realities. Elected officials often owe their primary allegiance to those who appointed or elected them to office. While it might be the case that these electors are from the area of the resource development, it is equally likely that these constituents are from some other region or local government area. This divergence of political and development priorities is especially critical when the local politicians fear that the emergence of a new
nexus of political power in the resource development district may upset the political balance of the entire electorate. An additional problem arises when local political leaders direct the flow of development funds to their own political constituencies, an action that is both natural and entirely predictable.

Once the influence of political considerations is recognized, the likely response of budgetary authorities is to “tie” the funding of compensatory development programs to specific expenditures in the affected district. The obvious problem with this approach is that it violates the self-rule principle on which decentralization/people-power strategy was established. Equally important is the fact that “tied funding” is unlikely to be the development panacea that it might at first seem to be, largely because it is inflexible and is therefore not available for use to address additional, and often more critical, development issues as they arise.

Clearly, money is not the only local resource that is subject to political prioritization. Indeed, manpower and development expertise is probably of equal or greater importance than money. Even where competent staff are available in the LGU, it is unlikely that the best development officers will be sent to the district where actual resource development is taking place if it means removing them from areas that are politically more important. This scenario of politically driven development priorities has been observed repeatedly in the ASEAN nations, the Pacific Islands, and throughout much of Africa.

Mistrust of Government Intentions
Central and local government initiatives in remote areas may suffer from psychological handicaps associated with resident perceptions of past neglect. An often-heard resident’s comment in many resource-rich districts is, “Government did not take notice of us until we had something that it wanted.” This often reflects hostility toward real or imagined favoritism shown to other nearby (usually more politically important) areas. Although this hostility tends to dissipate as resource development progresses, there often is a residual sense that government agencies, including LGUs, do not necessarily represent the interests of the most-affected area and its citizens. This feeling is further strengthened by the fact that in almost all cases the local residents bear the brunt of the costs of development (economic, social, environmental and cultural), while the major benefits flow to the government and nonresidents. Unfortunately, this perception is in many cases correct, and government failure to represent the interests of the most-affected areas and the people who live there is a continuing reality in a large number of nations.

In parallel with this resident skepticism toward government is the tenden-
cy to see the resource company as a local benefactor that provides jobs, medical care, and often schools to the local communities during the development phase and thereafter, while government resources are seen to go elsewhere. To the degree that resource companies continue to adopt such a paternalistic attitude toward residents, this feeling will be encouraged. However, such compensatory programs designed to overcome local concerns are—for historical, psychological, and political reasons—much easier to conceive than to actually implement. Nevertheless, while the enthusiastic support of local communities may not be the only factor in a successful project, it is imperative that local grievances be continually addressed. However, the real question that arises as a consequence of decentralization and resource rent revenue sharing is who has the responsibility for developing, implementing, and funding such programs—this critically important question remains unresolved in virtually every nation.

“Local” versus “Optimal” Infrastructure Priorities

Given that many resource projects are in remote areas, the cost of infrastructure development can represent a substantial fraction of total capital and operating costs. Where a new project has access to already existing infrastructure, the economic attractiveness and potential for the integration of the project into overall development planning will obviously be increased. Conversely, where new, development-necessitated infrastructure must be built, the economic viability of the development is decreased. The important issue in project-specific infrastructure vis-à-vis decentralized economic development obviously lies in planning the infrastructural links in such a manner that the optimum development impact is achieved (e.g., insuring that road or power transmission link routes also serve rural and nearby urban centers). Even in the best of circumstances, achieving this goal often involves substantial planning and a major financial input from the national government.

Planning major infrastructure is normally the primary responsibility of a national or regional planning board and is only marginally subject to the direct influence of the LGUs. On the other hand, the long-term intention of the decentralization strategy seems to be to eventually turn many recurrent costs of infrastructure (such as road maintenance) over to local authorities, particularly if there is significant resource rent sharing with the LGUs. Thus, local authorities have a vital interest in how infrastructure in their areas is planned and built. This leads to a rather difficult dilemma, however, since infrastructure decisions that may be optimal from a national development perspective may not always appear optimal from the perspective of local officials. Given the significant shift in
political power that is implied by the decentralization strategy, the views of these local officials must, therefore, be carefully addressed and factored into any national-level decision-making concerning infrastructure. This potential weighing of local versus optimal infrastructure concerns is likely to become contentious in any new resource development and may require special administrative arrangements between the various LGUs and the national authorities responsible for planning regional infrastructure.

THE ONGOING PHILIPPINE AND INDONESIAN EXPERIENCES

Two nations in Southeast Asia that have had to address the issues of decentralization and resource rent revenue sharing are the Philippines, which began addressing such issues shortly after the ouster of the Marcos Regime in 1986, and, most recently in Indonesia, which began the process after the ouster of the Suharto Regime, in 1998.

In both cases, with the ouster of the sitting government, the incoming governments were faced with massive public demonstrations for a greater role in government decision-making through decentralization, and for resource rent revenue sharing—the latter, particularly, led by the resource rich provinces of each nation. In the Philippines, however, decentralization was primarily seen as a natural extension of the “People Power” revolution of 1986, and it focused on political empowerment rather than attempting to address socio-cultural, geographic, or regional inequalities. In Indonesia, the “peoples’ revolution” appears from the beginning to have been an attempt to address socio-cultural geography and regional inequalities, particularly with respect to resource rent revenue sharing with the richest provinces. In the following discussion, the activities undertaken and underway within both countries are briefly described.

The Philippine Experience

The basic legal framework for decentralization and resource rent revenue sharing in the Philippines is set forth in the provisions of the Local Government Code (LGC) of 1991, which specifies jointly and individually the authority given to provinces, cities, municipalities, and barangays (the lowest level of local government), but excludes activities undertaken by the 14 administrative regions. The strategy that formed the foundation for the code was based on the premise that national development would be fostered through a process of bottom-up planning. Underlying this strategy was the idea that local development could occur only through a fairly massive transfer of financial resources and administrative
authority and manpower from the central government to the LGUs.

What is unusual about the approach to decentralization in the Philippines is that this transfer was done uniformly for virtually all government functions, was implemented in an extremely short period of time, and activities began almost immediately after the implementation of the LGC of 1991. Not surprisingly, as with any new system of governance, the decentralization process in the Philippines experienced a number of implementation problems (most of which have been, or will eventually be, resolved) because of the rapidity in implementing the LGC. The majority of the problems resulted from the fact that (a) not all LGUs were competently staffed or equally prepared to assume their responsibilities and (b) the new responsibilities were of greater magnitude and were more complex than anticipated.

The most pressing problems that have arisen are those associated with the transfer of financial resources, in particular IRA and resource rent revenues, to and among the LGUs. In the Philippines, both the IRA and the distribution of resource rents (consisting of 40% of total central government receipts for natural resource projects) are specifically provided for in existing legislation, and the allocations are made on the basis of a set formula, presented in Table 3.

Table 3 shows that the allocation of shares to the LGUs has considerable significance for new resource projects and may accentuate problems already existing in the allocation of IRA. This is particularly true with respect to the increasing share that is allocated to the barangays, which already appear to receive a large share of funds under the existing IRA formula.

Under the resource rent formula, the allocation of a 35% share (35% of the 40% of total resource rents allocated for sharing by the central government with the LGUs) to barangays implies that in some areas nearly 15% of total national government receipts from resource rents from a specific project will accrue to the lowest level of local government. In the smaller barangays, it might be distributed for the benefit of fewer than 5,000 people. Consequently, the distribution of “national wealth” in the Philippines according to the above formula presents a

<table>
<thead>
<tr>
<th>Province Type</th>
<th>IRA</th>
<th>National Wealth or Resource Rent</th>
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</thead>
<tbody>
<tr>
<td>Provinces</td>
<td>23%</td>
<td>20%</td>
</tr>
<tr>
<td>Municipalities</td>
<td>34%</td>
<td>Shares 45% with cities</td>
</tr>
<tr>
<td>Cities</td>
<td>23%</td>
<td>Shares 45% with municipalities</td>
</tr>
<tr>
<td>Barangays</td>
<td>20%</td>
<td>35%</td>
</tr>
</tbody>
</table>
number of problems that may affect resource development within the nation. The two most significant issues are inequities in the current IRA formulas and the role of NGOs.

Inequities in the Current IRA Formulas. Inequalities in the current IRA formulas are compounded by the revenue-sharing scheme adopted in the provisions of the LGC. The resource rent formula allocates less to the provinces, which are relatively hard-pressed, while allocating more to the barangays, which are relatively well provided for under the IRA. Consequently, the national wealth formula should be revised or the division of responsibilities between LGUs reconsidered.

However, since the objective of the natural wealth provision is to supplement the basic IRA provision for areas impacted by natural resource development, the absolute amount (i.e., IRA + national wealth) of revenue available to each LGU is important. It is not possible, however, to generalize about the adequacy of this amount because the inequalities induced as a result of the allocation of funds between LGUs is a complex matter in general and especially so in the context of resource development projects and resource rent revenue sharing.

To the degree that problems persist in the disbursement of natural wealth revenues, the attitude of LGUs toward new resource development projects is likely to be negative: new projects are viewed as bringing new and expanded responsibilities with few new financial resources. As a result, new resource developments may well be opposed by local governments or may lead to their placing unreasonable claims on the development activity. The important point is that failure to disburse the resource rent funds appropriately represents both a burden and a source of blame due to the shift in the roles of national and LGU authorities.

Arguably, the focus on LGU development planning at the barangay level is detrimental to dealing with the impact problems of a major development project. First, a focus on the barangay level is not consistent with optimal planning of regional infrastructure. Second, it should likewise be clear that the impact of any major project is likely to extend across several adjacent barangays and that replication of programs in each barangay would be costly and inefficient. Third, since the barangay containing the resource development will receive 35% of the natural wealth revenues (while adjacent barangays will receive nothing) a focus on barangay-level projects is likely to encourage disparities between adjacent areas. The all-or-nothing nature of the resource rent provisions makes barangay-level planning extremely problematic.

The Role of NGOs. The increasing involvement of NGO advocacy groups in LGU deliberations suggests a tendency to give some types of issues disproporti-
tionate weight in LGU decision-making. Of particular importance is the role that NGOs are likely to play in shaping local government attitudes toward the environmental consequences of resource development. Insofar as NGO input provides local officials with a viable alternative to the viewpoint of the resource project proponents, this contribution is useful. However, because NGO and representatives of private resource development companies are not elected officials, there exists the potential that influence by either group may not accurately represent true public opinion or that it may result in public opinion that is not based solely on fact. This situation often represents a major step toward special-interest politics and away from (elected) government management at the local level.

Strongly related to the role of NGOs is the fact that early experience with the decentralization process led LGUs to see little or no role for themselves in environmental issues.\textsuperscript{10} This is at the same time both disturbing and reassuring for the natural-resource sector developer. On the one hand, because environmental impact is one of the major costs that local residents must face in new resource development ventures, vital local interests are at stake in environmental policy decisions. On the other hand, it is normally fairly difficult for local people, or their elected representatives, to contribute constructively to technical environmental debates or negotiations. As a result, there is a natural and appropriate tendency for the LGUs to rely rather heavily on the advice and assistance of the environmental NGOs. To a lesser extent this is also true with respect to almost all of the new areas of responsibility facing the LGUs as a result of decentralization.

**Assessing the Philippine Experience.** Although the devolution of power to local government units has proceeded better than originally expected, a series of interviews in 1995 by the Local Development Assistance Program identified several problems with respect to the implementation of the resource rent distribution and associated decentralization process.\textsuperscript{11} Five of these implementation trends are of particular interest to the resource sector. These areas are:

1. In comparing revenues against the costs of meeting responsibilities, the IRA allocation formula appears to favor cities and barangays, to the detriment of provinces and municipalities.
2. The disburse system for the return of the 40% resource rent share from natural resources projects to local authorities does not seem to be functioning well.
3. Most development planning activities being undertaken by the LGUs have focused on barangay-level projects, without consideration of development activities by other levels of government.
4. There appears to be increasing involvement of NGOs and private-sector representatives in LGU deliberations, which has both positive and negative aspects.

5. The LGUs see little role for themselves in environmental matters. Where environmental issues have been addressed by LGUs, it has been with the assistance of, or as the result of pressure from, NGOs.

In the Philippines, the whole resource rent sharing and decentralization process continues to evolve, and the above observations should be viewed as a “snapshot in time” (taken in 1997) of the overall revenue sharing and devolution process rather than conclusions about its ultimate course or character.

The Indonesian Experience

Associated with the current economic crisis, Indonesia has also embarked on a process of political and economic transformation marked by decentralization and resource rent revenue sharing. However, like most nations in the Asia Pacific region, Indonesia has a long history of quasi decentralization that can be traced back to the time of the Dutch East Indies Trading Company, which established a dual system of government. The central components of the present effort are the Law on Regional Autonomy and the Law on Intergovernmental Fiscal Relations, passed on April 23 and April 25, 1999, respectively.

Law on Regional Autonomy. The law grants extensive authority to 26 of Indonesia’s 27 provinces (East Timor is to be dealt with separately) in all matters except defense, foreign, judicial, fiscal, monetary and religious affairs, and matters that are deemed “strategic” (resource rent revenue sharing issues are discussed in the following). According to the Straits Times, The Law on Regional Autonomy specifically provides, at the provincial district level, for

- More freedom to recruit, promote, and pay its own bureaucrats; draw up its own regulations, levy taxes, and run schools and health centers.
- Authority over the exploitation of local resources (presently controlled by Jakarta) such as timber, plantations, fisheries and small-scale mining.
- Political control by city councils, which will be allowed to conduct elections free of interference from the capital.
- The election of district chiefs and mayors (306 total) by local parliaments, rather than appointment by the central government.
- Termination of the practice of military officers occupying positions in the civilian government.
The Law on the Regional Autonomy to become effective two years after being signed by the President of the Republic of Indonesia

The two-year delay in implementation is presently the source of considerable concern to many LGUs and NGOs, which see the long delay as a tactic by the national government to delay, and perhaps weaken, the provisions of the law (these concerns are reflected in the history of the passage of the Law on Intergovernmental Fiscal Relations described in the following).

**Law on Intergovernmental Fiscal Relations.** Central to the ability to assume the responsibilities that decentralization brings to the provincial level are (a) the allocation by the national government of the IRA funds to all provinces, in particular to the disadvantaged and resource-poor provinces, and (b) resource rent revenue sharing, particularly with the resource-rich provinces. The sharing of resource rent revenues is specifically covered by a companion law to that on decentralization, the Law on Intergovernmental Fiscal Relations.

The original proposal was the proposed *MPR Decree XV of 1998* of the House of Representatives, which stated that

The decree on the administration of regional autonomy, management, distribution and harnessing of natural resources in a just manner to strike a fiscal balance between provincial administrations and the central government within the unitary state of the Republic of Indonesia. This decree stipulates that the administration, distribution and exploitation of natural resources shall be conducted in a just manner to improve the welfare of local people and the nation as a whole. The fiscal balance between the central and provincial governments is to be set with respect to the potential, size and population of each province and local people's income levels.

This general statement of resource rent revenue sharing was unacceptable to the provinces overall, and in particular to the resource-rich provinces of Aceh, Irian Jaya, and East Kalimantan. As a result, according to the *Far Eastern Economic Review,* this groundbreaking legislation was taken back from the House of Representatives and returned to the Ministry of Finance. Instructions were given that resource-rich provinces could be guaranteed a specific share of the revenues from their oil, gas, mining, forestry and fisheries developments. As a result, the general provisions of MPR Decree XV of 1998 were modified to provide the resource rich provinces 15% of the government's share of net oil revenues, 30% of gas revenues, and 80% of the income derived from forestry, fisheries, and mining. This allocation is now incorporated into the present Law on Intergovernmental Fiscal Relations. In total, the amount of potential resource rent revenue sharing to the provinces will exceed US$1 billion/yr. when the Law on
Intergovernmental Fiscal Relations becomes effective in 2001.

It should be noted that the resource rent revenue sharing issue in Indonesia is significantly more important in absolute monetary terms than it is in the Philippines, simply because Indonesia is a major oil and gas producer (and a member of OPEC) as well as a major producer and exporter of coal and metals. In 1997–1998, oil and gas revenues to the government amounted to approximately US$4.1 billion (approximately 33% of total government revenues), and revenues from mining were over US$1 billion (approximately 8% of total government revenues). Prior to 1999, the LGUs received no direct revenues from these developments.

**Issues Arising as a Result of the Law on Intergovernmental Fiscal Relations.** Although having just been drafted and approved, the Law on Intergovernmental Fiscal Relations is already the cause of considerable concern on the part of the international community and the national and the local governments of Indonesia. The specific concerns of the respective groups are

- The international banking community, and in particular the International Monetary Fund, worry that revenue sharing will reduce the nation’s capacity for debt repayment.
- The two-year transition period may prove to be a significant problem because the present political climate remains volatile, and the LGUs want and expect immediate action from the national government on decentralization and revenue sharing. The sharing of revenues from oil and gas is presently limited to revenues derived from onshore reserves and production, but most of the nation’s oil and gas reserves and production are offshore; therefore, most of the revenue from the nation’s oil and gas resources would not have to be shared with the provinces.
- One of the most pressing problems that the LGUs face is that of how, in the short term, can they absorb the large amounts of revenue that will flow to the provinces and districts as a result of the Law on Intergovernmental Fiscal Relations.
- Although the Law on Intergovernmental Fiscal Relations requires that the national government provide block grants of 25% of the national government IRA to the resource poor-provinces, there still remains a major problem with inequality between the provinces once revenue sharing begins.

Decentralization and resource rent revenue sharing in Indonesia are in only the earliest stages of development, and it is expected that numerous problems related to the implementation of both laws will arise during the next two years.
Additionally, unlike the Philippines, where the resource rents to be shared with the government were modest, the resource rents to be shared in Indonesia are significantly larger—as will be the associated problems.

**SUMMARY AND CONCLUSIONS**

The often closely related issues of decentralization and resource rent revenue sharing within resource-rich nations pose numerous problems as well as opportunities for the local government units and their constituents. The major problems that arise from decentralization and resource rent revenue sharing associated with natural resources are comparatively new, poorly understood, and inadequately addressed by government and the institutions of civil society. As a result, most of the emerging problems remain largely unresolved. The major issues that arise with respect to resource rent revenue sharing and decentralization are summarized in Table 4.

**Table 4. Summary of Major Issues Relating to Resource Rent Revenue Sharing and Decentralization**

<table>
<thead>
<tr>
<th>Resource Rents</th>
<th>Decentralization</th>
</tr>
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<tbody>
<tr>
<td>Resources and associated rents are unevenly distributed geographically.</td>
<td>Administrative capacity and personnel are unevenly distributed within the LGUs.</td>
</tr>
<tr>
<td>Commodity prices are variable, and as a result, associated rents fluctuate, making planning difficult.</td>
<td>Integration of national planning objectives with local objectives is difficult because of timing problems and differing priorities.</td>
</tr>
<tr>
<td>The greatest financial need at the local level occurs early in resource development, while resource rents tend to accrue in the later states; real returns may be delayed 3–7 years.</td>
<td>Fiscal receipts at the LGU level are inadequate for meeting the needs resulting from large-scale resource development projects.</td>
</tr>
<tr>
<td>Resource rents are finite, requiring efficient long-term planning for sustainable development.</td>
<td>Decreased national receipts require that the LGUs assume a larger burden for development.</td>
</tr>
</tbody>
</table>

The experiences of the Philippines and Indonesia (particularly of the Philippines) as they continue the processes of decentralization and resource rent revenue sharing show the following:
1. The move from a highly centralized government and fiscal policy is often precipitated by social upheaval and dramatic changes in government.

2. Considerable planning and lead time is required in order to effectively meet the goals of “people empowerment” arising from decentralization and resource rent revenue sharing.

3. The creation of a competent and experienced bureaucracy in the LGUs is both difficult and time consuming, but it is the cornerstone for the success of decentralization.

4. Legislative allocation of resource rent revenue sharing on a strictly percentage basis is largely ad hoc and may or may not reflect actual impact to and needs of the LGUs with respect to resource development.

As a result of the above, it is proposed that resource-rich nations undertaking programs of decentralization and resource rent revenue sharing should, as a matter of national policy, adopt and undertake the following 10-point national policy initiative:

1. Government should enter into a national planning program, with inputs from the LGUs and NGOs, to define the nature and timing of decentralization and resource rent revenue sharing activities. Alternative models for action should be developed that meet the unique needs of the individual provinces and regions.

2. National and provincial agencies should assess actual and potential resource development options for individual provinces and establish, to the extent possible, the time frame for such developments and anticipated revenues.

3. National government, with inputs from LGUs, industry, and NGOs, should define the economic, social, cultural, and environmental impacts of ongoing and planned resource development projects at the local to provincial level.

4. For those provinces anticipated to be impacted by resource developments, initial planning for the development of necessary infrastructure for the resource development should be phased with the needs for overall infrastructure development at the national and regional levels.

5. National government should establish memorandums of understanding with the LGUs specifying each group’s responsibilities and authority with respect to decentralization and activities undertaken under resource rent revenue sharing.

6. Government social programs should continue at present levels for all provinces; however, provinces that have been impacted or that are expected to
be impacted should receive supplemental IRA funding to prepare the local communities for participation in the development.

7. The national government should develop and implement training programs for the LGUs to ensure that they are able to undertake the additional management and planning activities that will arise as a result of decentralization and resource rent revenue sharing.

8. The national government should prepare an action program for overall development that reduces, to the extent possible, the inequalities that will arise as a result of resource rent revenue sharing between resource-rich and resource-poor provinces.

9. Intra-provincial working groups should be established in order to share experiences and expertise in implementing decentralization and resource rent revenue sharing programs.

10. Planning at all phases of government should emphasize sustainable and socially responsible resource development that has as a central theme the understanding that virtually no resources are truly renewable and virtually all will be depleted over time.

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