

Federal Government's Relationship with the Sabah State Government on the Oil Royalty Issue

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Abstract

How does the relationship between the federal government and the Sabah state government affect Sabah's oil royalties' revenue? Although Sabah under Musa Aman's administration had a close relationship with the federal government led by Najib Razak, it was seen as advantageous in providing oil profits higher than five percent. This study found that ideological similarity between the federal government and the Sabah state government only benefited both parties in the negotiation process in achieving one objective. On the other hand, matters between the federal and state governments will become complicated if both governments comprise different political parties. This article also reviewed the five major contributors of Sabah's income sources and found that oil revenues were not the main contributor.

Keywords: *close relationship, federal government, Sabah state government, oil royalties, income*

1. Introduction

In many countries, the local petroleum resources are owned by the federal government. Such ownership affects the size and source of the oil profits earned (Ross 2012:88). Oil royalty revenue is a major issue that is often linked to the tension between the federal government and the state government. The oil issue in Malaysia is linked to the relationship between the federal government and the state government, which is more focused on the issue of oil royalty payments. For example, Kelantan is an oil-producing state that receives courtesy money from Petronas, which should be paying royalties from oil profits (Zailanni Amit, 2017). Meanwhile, the oil royalty payments for the state of Terengganu were stopped by the federal government due to the defeat of the party

representing the federal government during the General Election (GE) in 1999 (Mohammad Agus, 2004). A different situation applies for Sarawak where the development of oil royalty payment claims is supported by the unification of the government and opposition parties within the state to demand a higher oil royalty payment of 20 percent as opposed to the original payment of five percent (Atar et al. 2018).

Similarly, oil royalty has been an issue vociferously fought by the opposition party in the state of Sabah during the administrative era of Musa Aman to demand a minimum of 20 percent return of oil royalty revenue. During his administration, Musa Aman was the Barisan Nasional (BN) Chairman for Sabah and had a close relationship with the federal government. This closeness was the main pillar to ensure BN's continuous and strong administration in the state (Borneo Today, 29 April 2017). However, such close relationship did not prevent the BN government under his administration from remaining silent regarding the oil royalty issue and Musa Aman also took his own approach in solving the state's oil royalty issue (Astro Awani, 12 July 2014). He also made several efforts to obtain oil royalty profits that were more than the set amount.

Among the efforts implemented by Musa Aman was instructing the Minister of Special Tasks Sabah to conduct discussions related to oil royalties with Petronas (News Straits Times, 15 July 2014). He also met the former Prime Minister Dato' Sri Mohd Najib Bin Tun Abd Razak to discuss the oil royalty issue in Sabah. He was confident that the federal government would prioritize and pay attention to the state of Sabah regarding the right to profit from oil royalties as what was implied to Sarawak (New Straits Times, 15 November 2014). However, his efforts to claim

higher oil profits allegedly failed as every decision was subject to and controlled by the federal government (Borneo Today, 31 March 2017).

This article aims to explore the implications of the relationship between the federal government and the Sabah state government regarding the oil royalty issue in the state. It also contributes to the study related to Sabah's sources of income, which is mainly linked to the oil royalty issue that is considered the main income contributor to the state. This article obtained primary sources through interviews with two politicians. Additionally, primary sources were collected from the State Government Financial Statements and Financial Management of Sabah State Departments/Agencies 2003-2007 as well as the Sabah State Legislative Assembly Statements. Secondary sources were also used in this study by referring to local newspapers, such as Astro Awani, News Straits Times, Borneo Today and The Borneo Post. The scope of this study started during Musa Aman's administration from 2003 to 2017.

2. Background of the Oil Issue in Sabah

In Malaysia, oil production has gone through two main phases. The first phase shows the lack of federal government involvement in local oil production. However, since the 1960s, oil companies increased their exploration activities in Malaysian waters, which had an impact on changes in federal government policy. This situation led to a transition to the second phase when the federal government established Petronas in 1974 to regulate the oil industry to obtain greater profits (Gale, 1981). The federal government's supervision of petroleum was further strengthened by the implementation of the Petroleum Development Act 1974, which aims for the exploration and exploitation of petroleum either onshore or offshore by a Corporation that will be vested with all ownership and exclusive rights, powers, freedoms, and privileges in relation to said petroleum, and to control the use and development activities related to petroleum and its output to make provisions regarding the establishment of a Corporation under the Companies Act 1965 [Act 125] or under laws relating to the incorporation of companies and regarding the powers of the Corporation and for making provisions on matters related or incidental to it. The impact from the implementation of such Act can be seen through the establishment of Petronas as a corporation that manages petroleum in this country and the implementation of the Production Sharing Contract (PSC) system. This partnership system has been implemented in countries that adopt a federalism system. Ahmad and Mottu (2002) stated that most

federal countries use some form of revenue shared-or assignment of formula to share oil revenues that are collected by the federal government.

The agreement signed between the Sabah government and the federal government also had an impact on the granting of oil production jurisdiction under Petronas and the payment of five percent oil royalties to the state of Sabah (Faisal, 2018). The provision of five percent profit by the federal government caused opposition from some political party groups in Sabah. The pressure to demand higher profits can be seen in the run-up to the general election. It includes the 1990 general election when Joseph Pairin Kitingan demanded a higher oil royalty of 50 percent (Jomo & Wee, 2002). The oil royalty issue continues even though the state government was under the leadership of BN. This situation was proven in 2014 when elite members of the Sabah BN party demanded a total of 20 percent oil profits (Faisal, 2018). The total oil royalty profit of five percent was claimed by Tun Stephens Donald who argued that the Malaysia Agreement 1963 (MA63) allocates 20 percent of the total oil royalty to the state (Daily Express, 7 June 2014). Nevertheless, the five percent oil royalty profit continued to be implemented during Musa Aman's administration since the signing of an agreement between the federal government and the state government in 1976.

The background of the oil royalty claim issue in Sabah differs from the situation in the states of Kelantan and Terengganu. This is because the federal government was administered by Najib Razak from BN, which was the same ruling party of the Sabah state government. Therefore, the same political ideology between the federal and state governments could offer advantages to the state government, especially in the issue of claims for oil profits in the state. Therefore, the main question for this article is to what extent does the relationship between the federal government and the state government of Sabah have an impact on the results of higher oil royalty claims during the Musa Aman era?

3. Kinship Politics and Its Practice Across Political Parties in Sabah

Kinship politics, better known as nepotism, describes the actions of individuals who prioritize the interests of family, friends, and social networks close to them (Budi Anto et al., 2008). This action can be seen in daily business relationships, such as those related to social, economic, and political. According to Budi Anto et al. (2008), kinship politics was practiced during the reign of the king or feudal to strengthen the legacy of family institutions. The development of

kinship politics in Sabah's political situation was evidenced during the leadership of Datu Mustapha Datu Harun who chose individuals who were qualified to hold positions to reduce challenges toward his position (Mohammad Agus, 2002). Similarly, Musa Aman elected his family members as the state's assemblymen during his administration while denying other individuals who worked harder and were more qualified (Eko Prayitno Joko et al., 2018).

The appointment of family members as assemblymen in political parties has an impact on the cooperation and unity in fighting for the party's ideology. Moreover, there is unity among members of the political party on every decision by the highest leader due to kinship politics. It also shows a positive relationship between the federal government and the state government where the ideological similarity of political parties between both can strengthen the friendship between the federal and state leaders. This can facilitate both parties to achieve the same goal. For example, the close relationship in kinship politics between Datu Mustapha Datu Harun and Tunku Abdul Rahman facilitated the formation of the Federation of Malaysia (Asmady Idris & Suzalie Mohamad, 2014). Likewise, the kinship politics during Musa Aman's administration demonstrated the close relationship between the federal government under the leadership of Najib Razak (Astro Awani, 17 September 2015).

4. Income Contribution of the State of Sabah

The development of Sabah's petroleum royalty revenue is divided into three tables according to the time scope, which started in 2003-2007, 2008-2012, and 2013-2017. Between 2003 to 2006, the amount of oil royalty revenue doubled from RM207.36 million to RM409.73 million. However, in 2007, the total oil royalties decreased slightly to RM365.37 million. It later showed a consistent increase from RM750.90 million in 2008 to RM941.25 million in 2012, before decreasing from RM975.34 million in 2013 to RM787.83 million in 2016. However, the state's oil royalty revenue increased significantly in 2017, amounting to RM 1,264.44 million. The main factor to the difference for each oil royalty revenue was influenced by petroleum production and oil prices throughout the year (State Government Financial Reports and Sabah State Agency Financial Performance from 2003 to 2017). This is supported by Muhammad Anuar (1978:39) who stated that the signing of the Petroleum Development Act 1974 saw Malaysia implementing a production-sharing contract with two main conditions, namely royalty

clauses and fixed allocations that can benefit the government according to the increase of global oil prices.

Regarding the interpretation of the main revenue contributors, the sources of revenue for Sabah are petroleum royalties, sales tax, land revenue, water revenue, and forest revenue. The tables below show the amounts obtained for each source of income in Sabah from 2003 to 2017. The increase in petroleum royalties in 2004 compared to 2003 was indeed expected by Musa Aman who stated that petroleum's contribution to Sabah would increase by ten percent of the state's total estimated revenue¹. Several issues related to oil resources were expressed by Musa Aman throughout 2004 to 2016 aside from the increase and decrease in petroleum royalty revenue to Sabah's state income. In 2007, an issue emerged related to the release of rights by the Sabah state government to royalties or other payments that must be paid pursuant to any lease, license, or oil application agreement under the Sabah land ordinance or any other written law concerning petroleum². In 2010³ and 2011⁴, Sabah petroleum royalties reached RM 826.55 million and RM 831.18 million, respectively. During these periods, the Sabah state government led by Musa Aman proposed a review regarding the amount of Sabah oil royalties obtained by the state government. Moreover, 2016 witnessed an issue related to the demand for 20 percent oil royalty revenue with a status that has not yet been reviewed⁵. In the same year, petroleum royalty revenue slightly decreased to RM 961.94 million in 2015 compared to RM 787.83 million in 2016. This was due to the drop in oil prices at the global level (New Straits Times, 19 April 2016).

Overall, from 2003 to 2007, petroleum royalties were the third contributor to Sabah's state income in comparison to sales tax as the main contributor and forest revenue as the second contributor. However,

¹ Sabah State Legislative Assembly. 2003. Sabah State Legislative Assembly Statement. 11 & 338. The Second Meeting of the First Term of the Eleventh Sabah State Legislative Assembly

² Sabah State Legislative Assembly. 2007. Sabah State Legislative Assembly Statement. 119. First Meeting of the Fourth Term of the Twelfth Sabah State Legislative Assembly

³ Sabah State Legislative Assembly. 2010. Sabah State Legislative Assembly Statement. 133. First Meeting of the Third Term of the Thirteenth Sabah State Legislative Assembly

⁴ Sabah State Legislative Assembly. 2011. Sabah State Legislative Assembly Statement. 82. The First Meeting of the Fourth Term of the Thirteenth Sabah State Legislative Assembly

⁵ Sabah State Legislative Assembly. 2016. Sabah State Legislative Assembly Statement. 102. First Meeting of the Fourth Term of the Fourteenth Sabah State Legislative Assembly

petroleum royalties became the second contributor after sales tax, which remained the main contributor to Sabah's state income from 2008 to 2016.

Petroleum royalties became the main source of revenue for the Sabah state government in 2017.

Table 1: Sources of Revenue for the Sabah State Government from 2003 to 2007

Major Source of Revenue	RM (million)				
	2003	2004	2005	2006	2007
Petroleum Royalties	207.36	254.89	276.65	409.73	365.37
Sales Tax	391.07	442.80	588.20	656.07	1,046.52
Land Revenue	149.54	117.99	86.45	101.52	205.02
Water Revenue	80.55	91.52	95.37	94.42	104.76
Forest Revenue	336.23	384.38	465.62	505.16	550.93
Total	1,164.75	1,291.58	1,512.29	1,766.90	2,272.60

Source: Report on State Government Financial Statements and Financial Management of Sabah State Departments/Agencies Year 2003-2017

Table 2: Sources of Sabah State Government Revenue from 2008 to 2012

Major Source of Revenue	RM (million)				
	2008	2009	2010	2011	2012
Petroleum Royalties	750.90	742.98	826.55	831.18	941.25
Sales Tax	1,326.66	957.97	1,169.50	1,439.49	1,240.32
Land Revenue	186.17	140.70	286.81	321.58	215.73
Water Revenue	105.34	117.74	133.73	138.98	151.74
Forest Revenue	446.54	345.03	297.09	202.85	176.53
Total	2,815.61	2,304.42	2,713.68	2,934.08	2,725.57

Source: Report on State Government Financial Statements and Financial Management of Sabah State Departments/Agencies Year 2003-2017

Table 3: Sources of Sabah State Government Revenue from 2013 to 2017

Major Source of Revenue	RM (million)				
	2013	2014	2015	2016	2017
Petroleum Royalties	975.34	978.54	961.94	787.83	1,246.44
Sales Tax	1,107.47	1,167.42	992.12	1,012.59	1,116.85
Land Revenue	275.66	238.54	226.07	213.71	267.19
Water Revenue	156.64	170.72	213.91	247.98	236.44
Forest Revenue	181.59	185.55	189.40	225.43	200.99
Total	2,696.70	2,740.77	2,583.44	2,487.54	3,067.91

Source: Report on State Government Financial Statements and Financial Management of Sabah State Departments/Agencies Year 2003-2017

5. Implications of the Relationship Between the Sabah State Government and the Federal Government on Oil Royalties

BN was the political party that controlled both the Sabah state administration under Musa Aman and the federal government led by Najib Razak. The similarity in ideology and political goals hence established a close relationship between the state and federal governments and benefited both parties. This was due to the kinship politics that prioritized the interests of closest individuals, such as friends and social networks, across all matters related to social, economic, and political matters (Budi Anto et al., 2008). The close relationship between the federal and state governments under BN has limitations in intervention and influence because there was a division of power that was already listed in the Federal Constitution. For example, matters regarding development, roads, education, and medicine were under the jurisdiction of the federal government. On the other hand, the state government had jurisdiction over land and natural resources (Interviewee 1: 2023).

The dominance of a similar political party between the federal government and the state government offered advantages and facilitated negotiations for both parties. On the other hand, dealings between the federal and state governments would be complicated if both governments were from different political parties (Interviewee 2: 2023). This situation occurred in the state of Kelantan where ideological differences existed between the state government party and the federal government of different political parties, halting the former from receiving oil royalties (Zailanni Amit, 2017). Leaders also play an important role in determining the direction of the relationship between the state government and the federal government. For example, the role of the Prime Minister not only focuses on the state of Sabah but the position necessitates the responsibility of being fair to other states in the country (Interviewee 1: 2023).

The close relationship between the state government of Sabah and the federal government does not cause injustice to the distribution of oil profits to other states in the country. This is because equality is the key to the oil resources available in this country. The equality formula proposed by Rahman Yaakob has been benefiting not only oil-producing states but also those without such resources. It explains the main purpose of forming a federation that offers advantages and opportunities for states without oil resources to experience such wealth. Such condition applies not only to oil profits but also to other profits, such as palm oil. This is the benefit of a federated country (Interviewee 2: 2023).

However, the ideological similarity of political parties and the close relationship between the federal and state governments did not give the latter any advantage to obtain a higher royalty revenue of 20 percent as worked by Musa Aman in 2016⁶. This is because 20 percent is considered too high (Interviewee 1: 2023). Despite receiving only five percent of oil royalty profits, the state government still receives special assistance from the federal government. A good relationship under the leadership of Barisan Nasional has had an impact on the development and improvement of life⁷. In fact, assistance like special aid allows the state government to develop the local infrastructure (Interviewee 1: 2023). Thus, the interest of Petronas in managing petroleum affairs in Sabah can reduce the burden on the state government, which is perceived as unable to manage oil resources on its own at a high cost (Interviewee 1: 2023).

6. Conclusion

This article discusses the relationship between the federal government and the Sabah state government regarding the oil issue in the state. The division of power between both governments has been enshrined in the Federal Constitution. Therefore, there is a limitation for the federal government in determining the policy and allocation of powers given to the Sabah state government. The close relationship between Sabah during the administration era of Musa Aman with the federal government did not give any advantage for the state to demand a higher amount of oil royalty revenue. This is because the 20 percent demand is considered too high by the federal government. Nevertheless, the ideological similarity of political parties in the administration of the state government or the federal government is the main factor that gives advantages and facilitates the negotiations for both parties. This article also found five sources of revenue for the Sabah state government, namely petroleum royalties, sales tax, land revenue, water revenue, and forest revenue. Between 2003 to 2017, petroleum royalties only became the main source of income for Sabah in 2017. Additionally, oil revenue is affected by the world oil price.

⁶Sabah State Legislative Assembly. 2016. Sabah State Legislative Assembly Statement. 102. First Meeting of the Fourth Term of the Fourteenth Sabah State Legislative Assembly

⁷Sabah State Legislative Assembly. 2004. Sabah State Legislative Assembly Statement. 12. The Third Meeting of the First Term of the Twelfth Sabah State Legislative Assembly

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Interview

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