

**INSTITUTIONAL CHANGE AND RESOURCE GOVERNANCE IN
HYDROCARBON AND MINING INDUSTRIES IN INDONESIA**

by

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ABSTRACT

This research attempted to answer two questions related to the resource governance in Indonesia. The first question is why and how the governance in hydrocarbon and mining industries change the way they do. The second one is why both governances change to different trajectory. Institutional change, developed by North (1990, 2005, and 2009); Lowndes and Robert (2013); and Campbell (2004), is the main theoretical framework use to answer those questions. The theorist proposed that a study of institutional change should consider; institutional elements, the agent of change, the sources of change, and the process as well as mechanism of institutional change. In addition, theories (1977) about bargaining relationship between state and business developed initially by Vernon () and developed further by Luo () by the name of political bargaining relations are used to explore the way in which interaction among actors could change initial institutional arrangements. Meanwhile, governing interdependence and actors' capacity in economic activities developed by Weiss (1991) are used to analyse how actors act in their respective role in the structure as well as react to problems and challenges from their environment. Qualitative comparative research method became a guideline to make a research design and process tracing is the method of analysis. The development of the resource governance in Indonesia extractive industry is an important case study for research about institutional change that also provides an alternative framework for further studies on resource-rich countries other than using dominant perspectives like resource curse and rentier state.

The study shows that a government could generate two different types of resource governances for its extractive industry. Indonesia has different institutional arrangement for both hydrocarbon and mining sectors. Both were also changing to a different mode of governance and influencing by different factors although locating in the same political, economic, and social environment. Dominant actors, institutional elements that change, as well as process and mechanism of institutional change are all different. Hence, it is possible that extractive industry could have different institutional arrangement despite historically, having similar point of departure.

Those basic findings provided an alternative point of view than previous studies about resource-rich countries that is usually starting from a continuous struggling political and economic condition producing weak institution, rent-seeking behaviour of dominant elites, as well as social conflict emerge in the region against either the corrupt government or the company, or both. In this regard, institutionalism developing by North (1991, 2005, and 2009) gives an interesting point of departure. He pointed learning process as an important capacity and process for expanding actors' ability to act and interact. Furthermore, he highlighted openness as an important factor and mechanism in an institutional change and understanding historical path of the case as crucial process to uncover the source of different outcome and trajectory of change.

The result of my study is that institutional change in both mining and hydrocarbon industries happens in both element of rule and procedure. The process is influenced by similar factors; the political and economic environment and it happens both evolutionary and revolutionary. Incremental development happens as part of actors' transition and adaptation to the bigger change. Both types of change are following a historical path, that means gradual shift is usually followed by the big change, usually happen in rule element, and so does the big change is followed further

by smaller one, usually in procedure element. The source is from both internal and external factors. The mechanism of change is following North, Wallis, and Weingast (2005) mechanism of transition from limited to open access order. The transition involved the continuous interaction with other actors, shifting from personal to impersonal exchange among actors, and the emergence of perpetual-life organization (in Indonesia case, such organization is both national companies and bureaucratic agencies).

In conclusion, analyzing about institutional change in resource governance of a resource-rich country gave a valuable insight that was usually obscured by prejudice about the weak institution embedded in the governmental system and rent-seeking behavior done by elites. Such insight is important to produce an alternative analysis highlighting how actors, both the dominant and the usual ones, always move by themselves, expanding their capacity to act and interact with each other. In this regard, starting from the prejudice stated could not give a better and deeper analysis as the institutional arrangement and structure is not owned and directed only by the movement of dominant

Keywords: institutional change, resource governance, learning process, openness

This thesis is dedicated to my beloved country, REPUBLIC OF INDONESIA; my parents, Drs. Fuldiaratman, M.Pd and Dra. Roseli Theis M.S.; and my husband, Henderi, S.S.T., MBA.

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List of Figures

Figure 3.1. Indonesia Oil Reserves.....	104
Figure 3.2. Indonesia Gas Reserves	104

List of Charts

Chart 3.1. Oil and Gas Production in Indonesia.....	103
Chart 6.1. Comparison of Government Revenue from Hydrocarbon and Mining Industry.....	188

LIST OF ABBREVIATION

ANTAM	: Aneka Tambang, a State-owned Mining Company
BPPKA	:Badan Pembinaan dan Pengusahaan Kontraktor Asing (the Managerial Body of Foreign Contractor, former name of BP Migas)
BP Migas	: Badan Pelaksana Usaha Hulu Minyak dan Gas Bumi (Implementing Body for Upstream Operation)
BPH Migas	: Badan Pelaksana Usaha Hilir Minyak dan Gas Bumi (Implementing Body for Downstream Operation)
CoW	: Contract of Work
FMC	: Foreign Mining Company
FOC	: Foreign Oil Company
GOI	: Government of Indonesia
HoR	: House of Representative
LAO	: Limited Access Order
MEMR	: Ministry of Mineral and Energy Resources
MEM	: Ministry of Energy and Mining, former name of MEMR
MNC	: Multi National Company
MoF	: Ministry of Finance
NMC	: National Mining Company
NOC	: National Oil Company
OAO	: Open Access Order
PSC	: Production Sharing Contract
PTBA	: name of a national coal mining company
SKK Migas	: Satuan Kerja Khusus Minyak dan Gas Bumi
SoC	: State-owned Company

TABLE OF CONTENTS

ABSTRACT.....	i
DEDICATION.....	iii
ACKNOWLEDGMENTS	iv
LIST OF FIGURES.....	v
LIST OF CHARTS	vi
LIST OF ABBREVIATIONS	vii
TABLE OF CONTENT	viii
CHAPTER I INTRODUCTION	1
1.1. Background of the Research	1
1.2. Overview of the Republic of Indonesia	10
1.3. Institutionalism and Institutional Change	15
1.4. Focus of the Research and Research Questions.....	18
1.5. Research Design.....	19
1.6. Hypothesis.....	20
1.7. Structure of The Chapters	22
CHAPTER II THEORETICAL FRAMEWORK	24
2.1. Introduction.....	24
2.2. Institutionalism and Institutional Evolution and Change: Definition and Elements	30

2.3. Institutional Change: The Path, Process, and Mechanism	41
2.4. Limitations of Resource Curse Literature in the Studies of Resource Governance.....	49
2.5. Theoretical Frameworks of Government and Business Relations	57
2.5.1. Actor’s Capacity	64
2.6. Comparative Historical Institutionalism and the Process Tracking Method	65
2.6.1. Data Collection	70
2.7. Operationalisation of the Frameworks and Method.....	71
2.8. Conclusion: Basic Assumptions and Hypothesis.....	73
CHAPTER III INSTITUTIONAL CHANGE IN INDONESIA’S POLITICAL ECONOMY	
.....	76
3.1. Introduction.....	76
3.2. Institutional change in Indonesia’s political and economic sectors	80
3.3. General View on Hydrocarbon and Mining Industries in Indonesia	86
3.3.1. Historical Path of the Hydrocarbon and Mining Industries	90
3.3.2. State Control and Foreign Investment	96
3.4. Conclusion	106
CHAPTER IV INDONESIA HYDROCARBON INDUSTRY.....	108
4.1. Introduction.....	108
4.2. The Rule Element	109

4.3. The Procedure Element	125
4.4. Process and Mechanism of Change	138
CHAPTER V INDONESIA MINING INDUSTRY	143
5.1. Introduction.....	143
5.2. The Rule Element	144
5.3. The Procedure Element	148
5.4. Process and Mechanism of Change	177
5.5. Conclusion	182
CHAPTER VI COMPARISON BETWEEN THE HYDROCARBON AND MINING INDUSTRIES IN INDONESIA	186
6.1. Introduction.....	186
6.2. The Rule Element	189
6.3. The Procedure Element	198
6.4. Process and Mechanism of Change	208
6.5. Theoretical Reflection.....	227
6.6. Conclusion	231
CHAPTER VII CONCLUSION.....	235
BIBLIOGRAPHY	

CHAPTER I

INTRODUCTION

1.1. Background of the Research

Oil producing countries consist of many newly independent states and have attracted many researchers as they challenged the supremacy of international oil enterprises, which dominated supply within the oil market until 1970. Some of the countries are not only oil-rich, but also resource-rich. This situation means that resource governance is complex and could be varied based on the different kinds of extractive industries in those countries. Unfortunately, such complexity is still rarely captured by previous studies as they mostly emphasise the interlinkage of resource-richness, governance, and general national economic performance. Such studies could result in an incomplete and too shallow conclusion regarding the nature of government and resource governance in developing countries.

North (2005, p. viii) stated that he did not consider the nature of societal change and the way in which human understand and act accordingly to such change in his earlier work on New Institutional Economic (NIE). Furthermore, he highlighted the importance of understanding economic change as a unique societal process and that, however we try, our knowledge and understanding are always imperfect. In this regard, there is no clear-cut model or recipe for economic change that is able to ensure a positive economic growth (North, 2005). The author further posited that humans, as vital institutional actors, have a belief system in which they know the consequences of their actions. In this way, humans build upon preferences blended into perceptions about their environment and understand their environment through a learning process that is assumed to comprise of accumulation of both individual experiences and experiences from past generations. Hence, he emphasised that it is important to focus our

attention on human learning, i.e. what is learned and how it is shared among members of society. However humans act upon their understanding, there will always be gap between their intentions and the actual outcome, something that we often call uncertainty and unpredictability in the environment. This gap results from the changes which happen in our environment while we are learning and understanding it (North, 2005, p. ix). This reality implies that imperfect human understanding is a condition that always occurs and should be dealt with, meaning our capacity to adapt is important in the attempt to achieve our goals and realise our plans.

Vernon (1972, 1977, and 1998) consistently considered multinational companies (MNCs) as in constant conflict with government. This conflictual relationship between state and business is a consequence of their asymmetrical goals, jurisdictions, and responsibilities. Eden (2000, p. 336) explained their differences further; the state has broad goals covering all sectors, for instance the political, economic, and social arenas, jurisdiction is limited by national borders, and as it manages state affairs the government is responsible towards the citizen. On the other hand, profit maximisation is the primary goal of an MNC as its main responsibility is its shareholders and it operates globally (across national boundaries).

The obsolescing bargaining framework is famous for analysing state and business relations. This framework makes an important contribution to political and economic sciences, especially regarding the dynamic nature of this relationship. Vernon (1977 and 1998) explained that at the beginning phase, many states compete to attract foreign investment made by MNCs into their economies. However, after being chosen as the host country for their operations, a government has stronger position in comparison to MNCs. This means that MNCs begin to lose their advantage over governments and therefore their bargaining power is also weakened. This situation exists as both parties enter a contractual relationship as the rule of the game for their

further interaction within the country's jurisdiction. MNCs become vulnerable to changing policies and attitudes which will influence their operations within the state's boundaries. This scenario is exacerbated by the increasing cost of leaving as MNCs have already invested in their operation's expenditures, while the government has a stronger position as it has benefited from such investment. The ownership structure within the country determines this situation. The protection of property rights is usually determined by both the contract and national and local regulations; however, the gap between regulation and actual practice is crucial for a sustainable and long lasting interaction. A smaller gap means that MNCs could have more certainty to conduct their operations and benefit from their investment. It also means that the government could gain more trust from other MNCs which are considering investment, thus enabling them to secure their operations in the face of changing domestic political and economic environments.

However, this does not mean that both actors have static advantage and disadvantage positions (zero-sum interactions). Long and sustained government and MNC relations are more beneficial for both actors under unchanging domestic and international circumstances. Nevertheless, both actors should always have an exit strategy for disadvantage situations; thus, both need not only certainty from the contract but also a flexible attitude in their mutual interactions.

Governance of natural resources is suggested can lead to strong or poor economic performance based on several related factors. Some researchers suggested that a country's political system (democracy or autocracy) (see Karl, 1997; Luong and Weinthal, 2013; Bianca and Sarbu, 2015, for example) and the ownership structure (public or private ownership) (see Luong and Weinthal 2013; Bianca and Sarbu, 2015) demonstrated a pattern of weak institutions and the inability of governments to produce wealth for their citizens despite their richness. Some

researchers posited that democratic countries tend to have private ownership to manage their natural resources and limit their intervention in such affairs. On the other hand, autocratic countries prefer a state monopoly over their resources and the resultant income serves elites rather than the public need (Karl, 1997). Some other researchers suggested that a dominant path to study resource-rich countries that are classified as rentier states facing the resource curse involves identifying the weaknesses and highlighting the factors that confirm the “weak institution” arguments about the country’s governance; the path ends by emphasising the importance of reforming such governance and their structures by copying the liberal and neoliberal path of Western, developed countries. The over-emphasising of the usefulness of developed countries’ lenses to look and assess resource governance in developing countries is particularly dominant, and therefore academia has tended to undermine the importance of investigating a country-specific path of development and change. This is my main objective in studying the dynamic of resource governance in Indonesia.

There are some common situations in resource-rich countries. However, such commonality is not adequate to understand and explain country-specific environments that together establish a unique feature for each country. Generating conclusions from only the general commonality without recognising their uniqueness could potentially mislead the outcome of our analysis and create a gap between what we think we know and what actually happens in those countries.

The majority of resource-rich countries are Third World countries which gained their independence during Cold War. Many of them had autocratic systems as newly independent countries, but not many retain these systems in 2018. Some of them have transitioned towards democracy and some have been successful in developing a democratic political system which as

improved over time. They did not have a similar form of democracy or political economic institutions but, together with developed countries, they have survived the various economic and political crises which have taken place since 1990s. Thus, researches about resource-rich countries' failure offered only a one-sided story regarding the complex political, economic, and social development path and process taken by these nations. Over-emphasising and over-simplifying such complexity by having prejudice and premature conclusions about weak institutions and rentier states could present a false illustration and trigger rejection and negative opinions and assumptions with regards to the developed Western world. This misunderstanding from the First and Third World Countries need to stop. Thus, there is a need for academia to attempt to look deeply into developing countries with a non-prejudiced, unbiased lens and build an analytical framework that does not undermine the struggle and complexity of these nations. The search for a framework that is built on their point of view is urgent in order to generate a more update and complete understanding about what actually happens in developing countries.

Although previous studies on the subject constitute an important starting point, letting the information and data tell the actual story about the mechanisms and processes in their political and economic systems is also an important step in building a new framework for studying resource-rich developing countries.

There are several explicit and implicit lessons that I have collected from studying both literatures. First and foremost is that the developing countries are neither uniform nor have a static position, capacity, and action in governing their natural resources. Each of them has different political, economic, and social circumstances and therefore generalisation could barely develop our understanding about the way in which the real world is actually run. Resource curse and rentier state literatures tend to generalise resource-rich and developing countries as having

certain characteristics causing them to fail to govern their richness. The literatures were once important starting points guiding investors from developed countries to understand the challenge they would face when interacting and establishing relationships with elites and governments from such countries. However, both literature types have a static point of view, avoiding or worse ignoring the development in those countries. The nation-states were once newly independent countries which were in their initial step to build all their nations' sectors. As the business entities nowadays have changed, the resource-rich countries have also transformed, developed, and changed.

Secondly, by looking into government and business relationships, it is important to acknowledge that actors grow over time and their position with regards to other parties in a certain period could shift. The problem is how to overcome this dynamic condition as it is an inevitable fact social science scholars need to consider in their studies. Nothing is static in social relations and we can neither isolate nor control social actors and keep them in the imaginary moulds we call models, theories and concepts. Looking into such conditions without having strict prejudice is vital in developing our knowledge and understanding about developing countries.

It is important to rewrite and reconsider our initial assumptions drawing from knowledge about developed Western countries when studying developing countries. They do not merely consist of East Asian countries and the rest and each one is worth the effort of extensive study. They are not walking the same path as developed countries and hence studying them from that perspective fails to do justice to their own histories and paths. Existing frameworks are important and valuable starting points, but continuing the analysis in the same path and drawing the result in the same way by using developed countries' lenses could be misleading. Studies about

developing countries are not supposed to use a mirroring method of analysis where they are fit into the existing frameworks and the aspects that do not fit are concluded (or judged) to be wrong, poor, or not efficient. These studies then unwisely suggest certain paths and formulas that the researchers believe will work as well as in the developed countries.

Drawing from the importance of looking closely into how governments govern their natural resources, I intend to present an alternative approach which is useful in understanding two kinds of mining governance in Indonesia: the hydrocarbon and mineral mining industries. Indonesia has been chosen as this country has a complex political and economic realm surrounding its resource governance since its independence in August 1945. The complexity arose from the political and economic development, which went through institutional change. It also came from the development of actors' capacity to interact and establish as well as prolong their relationship with each other, especially the one categorised as transformational and adaptive capacity. Institutional change, actors' capacity, and the relationship among actors are conceptual frameworks that are combined to provide an analysis capturing the complexity of resource governance in Indonesia.

On the other hand, researches about institutional change provide a variety of viewpoints. Some of them discussed the source of these changes, whether endogenous or exogenous, as well as the agent of change, whether individual, collective, or organisation (Lowndes and Robert, 2013 and Campbell, 2004). The others explained the processes of change, whether spontaneous, by design, random, or gradual, and the scope of changes, and whether they were isolated or involved sets of related institutions (North, 1991; North, 2005; and North, Wallis, and Weingast, 2009). Those researches imply a complex nature of studies about institutional change. Such studies are important as institutional stability and a static view regarding social order has

dominated institutionalists' attention and pursuing both stability and order has been considered the main goal of society and thus change has been considered as a form of disorder.

This thesis presents an analysis of institutional change in Indonesia's resource governance. It focuses on the dynamic of resource governance in Indonesia in which institutional arrangement is changing and the position and role of political organisations in the governance is also shifting. This shift is affected by change in the rules governing the extractive industries. Although the dynamic of the organisational level is not the focus of my analysis, I explain the general learning steps which occurred within governmental bodies related to mining. On the other hand, I posit that changes in the rule happen as part of changes that occurred in the national political and economic realm. Hence, the dynamic in governing the industries is not the result of individual and collective actors' attempt to change the rules.

The search for wealth and power by various international economic actors, especially states, has been a primary concern in International Political Economy studies. States are considered as influential organisational actors in both political and economic systems. However, since the globalisation has intensified transnational economic activities, there are other actors that challenge states' domination in those activities, namely multinational enterprises (MNEs). Thus, both actors are involved in competitive and conflictual as well as cooperative relationships in their effort to pursue power and wealth as they conduct their activities within states' territories and across territorial boundaries.

States and MNEs have different characteristics in their political economic activities (Stiglitz, 2007). A state has ownership rights over and is bounded by its territory and all resources within its internationally-recognised boundaries. State could also collect rent from private actors and foreigners operating within its territory by claiming ownership over resources

extracted and produce from the area. The amount of collected rent is usually agreed through a contract signed between government that represents the state and its citizens and representative from the company (or companies as in the case of a joint company). The contract legally binds both actors over a certain period of time and usually consists of permission to enter and exit, rights and obligations, as well as procedures and consequences for compliance and disobeying the agreement. Thus, each contract always has financial consequences through the national fiscal system as well as involving other political, economic and social structures as MNEs operate within territorial boundaries of one or more states.

A state has the autonomy to choose what, when, and how policy will be conducted with regards to every issue and sector. Thus, a state is sensitive to any threats towards its sovereignty, particularly about its ownership rights and autonomy. On the other hand, MNEs do not have such rights and also have the freedom to act. Even though they are independent actors in the international arena, they still have to deal with different regulations, laws, and societal environments in the different states in which they operate. As a profit-oriented actor, the company will make decisions by calculating potential profit and loss as well as the economic benefits of their government and societal relations.

Stopford, Strange, and Henley (1991) argued that this reality changes the nature of international economic systems and challenges the primary position of the state as dominant actor. The contemporary international system has been shaped not only by interstate bargains, but also cooperation and competition between states and firms and also between firms. These authors claimed that in the globalised economic system, state authority and legacy is weakened. Thus, analysis of the decision-making process and strategy to gain wealth from interstate relationships is no longer adequate to explain the dynamics of the international economy.

The world economic system consists of both international and domestic actors and interactions. On the one hand, the interaction at the international level is shaped by interstate relationships, bargaining between states and multinational enterprises, and inter- and intra-firm coordination and competition. On the other hand, interaction in the domestic economic environment is shaped by the relationship between the government and foreign business entities. Although the interactions happen within a state jurisdiction, the transnational nature of the oil industry means that the relationship has to face both opportunities and constraints due to the ever-changing domestic and international political and economic environment.

Resource governance, which is the main focus of this study, is the dynamic of actors' relationships and the institutional arrangement of extractive industries in Indonesia. This dynamic is understood as institutional change that consists of changes in rules as well as changes within related organisations as the agents of change. Thus, institutional change is influenced by organisational actors (in this thesis the actors are governmental bodies and mining enterprises). Moreover, the changes also affect the way in which organisations act and interact with each other.

1.2. Overview of the Republic of Indonesia

Indonesia is a country located in the intersection of the Indian and Pacific Oceans. This country consists of many islands located on the equator. Its location makes the country rich in various natural resources, especially minerals. This richness is combined with difficult topography, which means the extractive industry faces challenges in many locations. The areas with resources that are easy to extract, exploit, and produce are predominantly located on the two big islands, Java and Sumatra, while activities on other islands, which also have big deposits of

various minerals, were not developed until the 1997 political reform. Inequality of political and economic development in many islands is a direct consequence of these conditions.

Following independence, Indonesia's economy struggled to find the most suitable strategy in order to fund development projects, produce more money and distribute it to the suffering society. This difficult situation was also influenced by the power struggle among elites, especially the search for a suitable political system that could maintain Indonesia's independence and gain support and legitimation from other political and social movements that spread all over the country. The disagreement among elites in governing the industry was heavily instigated by different opinions regarding the way in which the government should deal with foreign companies and foreign investment. The pro-liberalisation movement claimed that the government should invite foreign investors to enter the Indonesian economy as the available government capital was not adequate to fund the development projects. However, the painful experiences of colonialism were still felt strongly in various regions. The citizens sounded their rejection of the government's liberalisation plan and strongly insisted that the government should rely on national power to run the industrialisation projects. However, the reality soon hit the pro-nationalist elites as this policy led to economic stagnation and resulted in poor economic growth. The elites needed to seek a new approach to save the hard-won independence and solve the economic problems.

These difficulties were also shaped by the fact that the Republic of Indonesia consists of many islands with different languages, culture, and political and economic potency and structures. Nation and state building were not an easy task for whoever took the leading position of this newly independent country. The challenging domestic political economic condition has not been properly studied in previous researches. Economic historians such as Anne Booth

(1998) attempted to capture the history of Indonesia's economic development process over a long period of time from the country's precolonial period until the 20th century. Other economists have attempted to understand the paradox of Indonesia's poor economic performance after the independence until the mid-1960s and the miraculous economic growth from 1969 to 1990. Booth (1998, Chapter IV) attempted to explain the connection between economic performance and national economic policy from the colonial period to the post-colonial era (lasting for 150 years); however, she did not take into account the different nature, ideology, and style of the colonial and independent governments as the government of Indonesia only began to exist since the declaration of Independence in 1945. Her analysis did shed some light regarding the factors behind those performances, and the diverse economic strategy both in the East Indies and Indonesia. However, it failed to provide significant insights into the development of industrial governance with regards to government and business entities as the leading actors.

The negligence regarding the linkage between political and economic institutional development means it is not possible to find an alternative answer to why the institutional structure of Indonesia's political economy has developed to its current state, particularly regarding the governance of extractive industries. Furthermore, the national economic development trajectory and the reasons behind the poor economic growth are seen differently by researchers and academics. Some of them blame protectionist tendencies and nationalist sentiments resulting in unfavourable policies towards market economy and business. On the other hand, some of them, usually the insider/Indonesian academics, argue that due to the inability and lack of political will from the government to empower domestic economic players as opposed to foreign and international economic players the society has no control over the financial and profit flow from the resources found in the country's soil or farmed from its rivers

and seas. Both groups of academics proposed an extreme viewpoint, an argument framed as pro-neoliberalist vs pro-nationalist. This inflexible and timid approach is not helping the students and readers to understand the actual condition in the country and has also failed to establish a basis for policy evaluation and consideration for policy makers. It is about time that a more diffuse approach considering both sides is considered by using a different lens.

In addition, the tendency to neglect the social, political and economic conditions in which the institution was established and developed has resulted in immature or premature judgment about the development trajectories that actually take place driven by the actors vs the unintended results driven by the uncertain and unpredictable nature of the country's local, national and regional political and economic realm. Those layers of social environment heavily shape or influence the way in which political and economic actors perceive and interact with each other. Thus, previous studies neglected the way in which actors behave and react regarding other actors' actions and attitudes as well as their environment. Most importantly, severe negligence has been found regarding the diversity of governmental actors and business entities. In this study, it is proposed that without this diverse understanding about the diversity of governmental and business actors no new result can be found in this topic of study. Furthermore, it will not be possible to identify the root cause of the puzzling question about why the economic development trajectories in Indonesia have taken unprecedented directions and failed to produce a satisfying result from both extreme perspectives. This is because the direction of the study is no longer adequate to add value from the existing literature about Indonesia's resource governance and it also highlights the need to change the analytical lens through which this topic will be studied.

The analytical focus on the way in which the government of Indonesia governs the country's interdependence with business entities proposes a valuable point of view to understand

the institutional development trajectory of the political and economic realm of the nation. Unfortunately, this viewpoint is rare in the previous and recent researches from Indonesianists inside and outside the country. The tendency to study the Indonesian political and economic realm during a specific period of time without considering the historical path experienced by both the government and businesses as well as society to some extent has resulted in exhausted and unoriginal analysis and descriptions about the country's actual condition and direction. In addition, the tendency to study the topic in pieces also influenced an incomprehensive picture and created a tendency to quickly generalise the way in which the governance has developed in the same way for the same type of industries. A generalisation has often been made that the extractive industry consists of the same institutional arrangement even though it has several types of governance based on the differentiation between hydrocarbons with coal and mineral industries.

Previous studies about resource governance in Indonesia could be located in at least two opposite polar; namely the pro-nationalist or the pro-liberalist. The first group of researchers advocated the importance of government involvement and protection towards the country's natural resources (see for example Bakhri, 2013; Utomo, 2010; Tim ReforMiner Institute, 2011; Syeirazi, 2009; Yuwono, 2014; Pradnyana, 2014; Syeirazi, 2017; Salamudin, 2011; Sudrajat, 2013; Rizky and Majidi, 2008). On the other hand, the second group emphasised the acute problems of plummeting foreign investment in both the hydrocarbon and mining industries as the country needs the investment to conduct more exploration activities and boost national production, especially oil and gas products (See for example Machmud, 2000; Hadi et al., 2012; OECD, 2016). The other study see government intervention as the source of economic problems and crisis (Hill, 1999). This study places emphasis on the institutional development (and change)

of the country's resource governance and is the first attempt to analyse what the country has actually experienced in terms of governing its natural resources, especially in the hydrocarbon and general mining sectors. It is also an attempt to show how a developing country's resource governance should be presented by exploring what path it took, complete with the transformation and changes which have taken place over time; following this, the study analyses why the shifting happened by using the dynamic of actors and the relationship between government and business as the unit of explanation.

1.3. Institutionalism and Institutional Change

Although change is an important subject, it is believed to contradict the notion of stability and order. Stability is assumed to be a primary goal of institutionalisation and the importance of an institution, the notion sometimes considered as the same as a rule. This is why a clearer concept of institutional change did not develop until after the 2000s. North (1991) mentioned institutional change in his books on institutionalism. However, he had not yet provided more applicable and operable explanations about the concept. Several later institutionalists began to develop the concept further in order to both answer critics about institutionalists' static point of view (see Peters, 2008 for example) about the subject and to progress the framework further to address important development in the real world. The static point of view is no longer adequate to analyse recent development in the Third World countries. Development in all sectors is an actual condition that both governmental and business actors have to face during interactions. Hence, in order to stay relevant in studying the political economics of developing countries, institutionalists have to develop their framework to address such dynamic circumstances in political and economic environments as well as the simultaneous dynamics of actors and their interactions. There is still much room for development for institutionalism as an important

framework to analyse resource governance in developing countries. Such dynamic governance in resource-rich countries needs to be analysed further rather than starting from assumption that the countries having a rentier state tendency and are most likely to experience the resource curse due to their weak institutions. We could learn and analyse so much more by avoiding such assumptions. This is my primary reason for choosing institutional change as my main framework in this research. Because of the chosen framework, my research begins by seeing a complex institutional arrangement in Indonesia's political and economic environments and attempting to understand one small piece of the oldest and complex industry in this country: the extractive industry.

North (1991, p. 18, 49, and 68) posited that an institutional framework consists of political structure, property structure, and social structure. Furthermore, he argued that a process of institutional change is not easy as it influences the pay-off structure that actors expect to gain from their commitment to the institutional arrangement. Meanwhile, he argued that credible commitment is particularly important in ensuring that the development of the institution is moving towards a positive direction, such as more open access with strong enforcement and adjustment mechanisms to protect the leverage of being inside an institution as opposed to being outside of the institution.

Studies about institutional change have built upon the institutionalist perspective of the dynamic nature of actors, actors' interactions and their institutional arrangement (see for example Soderbaum, 2008; Bell, 2011; Brousseau, Garrouste, and Reynaud, 2011; Caballero and Soto-Onate, 2015; Koontz, et al., 2015 as he called it adaptive institution; Bakir and Jarvis, 2017; Bakir and Gunduz, 2017; and Arbatli, 2018). Unlike dominant political economic frameworks which consider actors and their relationships from a static viewpoint,

institutionalism places both actors and institutions as part of a more complex web of interactions consisting of many actors and many institutions that, most of the time, engage in relationships involving various forms of institutional arrangement. These complex views are strengths and also weaknesses of institutionalism. As a theory, it has various difficulties to satisfy other theoretical traditions wherein sophisticated methodology and making predictions and generalisations are paramount for a good study. Nevertheless, as an analytical framework, it provides researchers with complex and more complete analytical tools to look into social and qualitative data gathered by a unique case (and cases) by avoiding an over-simplistic view of social relationships, which could lead to a significant discrepancy between the theoretical ideal and the actual condition in the field. Institutionalism also has a tendency to offer more descriptive analysis. Thus, researchers need to be fully aware of these difficulties and endeavour to overcome such problems.

The study of resource governance from the perspective of the relationship between government and corporations was introduced by Raymond Vernon (1971, 1977, and 1998) in his books. His studies proposed an alternative perspective among domination of resource curse and rentier state in studying the subject. Vernon recognised the importance of the negotiation process for first-entry terms of contract for a foreign corporation in developing countries. He also highlighted the shifting favourable terms from government towards a company over time. Initially, the government can take advantage of the corporation's eagerness to enter the national industry by accommodating and adjusting their business and economic plans in favour of the government agenda. Nevertheless, after some time, the bargaining position of the government is weakened as the corporation becomes an important source of national revenue and has settled

down its operation and become an influential part of national economy. These conditions illustrate an obsolescing bargaining power in government and business relations.

1.4. Focus of the Research and Research Questions

This research focuses on the institutional change in the governance of the extractive industry in Indonesia. The change is argued to be influenced by the changing political economic environment at both the national and subnational levels. Furthermore, the change influences the interaction between the government and companies.

Resource governance in resource-rich countries is often presumed to result in stagnant and negative economic growth and is also thought to increase rent-seeking behaviour, which could also hinder political development. The richness is blamed as the curse for such countries due to their inability to pursue a “Western” model of political and economic development, namely democracy and liberalism. Despite this strong assumption, I attempt to present an analysis of the change in resource governance in one developing country – Indonesia – which has been directly influenced by political economic development since the country’s independence in 1945.

This development also affects the capacity development of various governmental bodies (especially the bureaucracy system and the bureaucrats) in Indonesia to do their jobs either more efficiently, more transparently, or more in a more accessible manner for other parties which are not among the decision makers or elites. This condition also implies the improvement in the way in which they interact, establish, and manage relationships with business entities (especially companies) in conducting their role and authority as the governing entities. The complexity of the diversity of organisations shaping government behaviour towards the industry, and in particular towards the corporations related to the industry, is a crucial aspect. The outcome of

their relationship is assumed to be seen in the changing nature and development of extractive industry institutions in Indonesia.

From the above, this study attempts to present answers regarding several research questions. The main question is: **Why does the resource governance of extractive industry in Indonesia develop and change the way it does?** It is important to note that the main object of this study is the hydrocarbon and mineral industries in Indonesia. In addition, as the findings show that there is similarity and differences in the institutional development of the hydrocarbon and general mining industries in Indonesia, the following question emerged: **Why do such differences exist even though political, economic, and social landscapes are the same and both industries are classified as extractive industries?**

1.5. Research Design

The research uses the process tracing method and historical institutionalism as the method of analysis by combining literature-based study and interviews. The first step is determining the initial condition of the establishment of national resource governance in Indonesia from 1945 to 2018. The second step is determining the actors involved in both elements of institutional arrangement: the rule and the procedure elements. Subsequently, the research is expanded into gathering and analysing data relating to interactions among government and companies as the two dominant actors. In addition, data about the changing domestic political and economic environment in relation to the extractive industries is also important to provide a context in which institutional change happens.

The research uses historical data of the hydrocarbon and mining industries in the form of reports, news, regulations, speeches, and analysis in books, articles, and journals from 1945 (the Independence of Indonesia) to 2017 (last interview). The large amount of data is selected and

categorised based on the analytical frameworks designed from combining several theoretical frameworks and a literature review related to the study. The data is classified based on elements of institutions, changes that happen in each element, the mechanism of change, etc.

This is a qualitative research using a single case study; resource governance in Indonesia. The governance is found to have different institutional arrangements between two primary sectors in the industry: hydrocarbon and mining. Process tracing is used as the method of analysis to provide a causal process and mechanism by which institutional change in both sectors takes place. Hence, this study could also be classified as an explaining-outcome process tracing (Trampusch and Palier, 2016, p. 443; Lange, 2013).

1.6. Hypothesis

The research question and frameworks used in this study have been clearly stated in the previous sections. Based on the above discussion, I have posited several assumptions and hypothesis that will be analysed and presented further in this thesis.

Firstly, an institutional change has taken place in both the hydrocarbon and mining sectors in Indonesia. This change is influenced by actors' preferences, perceptions, and actions (North, 2005). North further explained that the learning process is not only experienced by individual actors but also by organisation as it consists of various people with their own timing and learning processes. Hence, the development of organisational actors could be understood as a result of the development of their members. However, my analysis focuses on organisational actors: the government and business entities. Furthermore, as actors interact with both other actors and the environment, an understanding of both context and openness is beneficial to

generate analysis about the causal processes and mechanisms regarding why change happens in national resource governance.

As suggested by Lowndes and Roberts (2013), this change happens in all elements: rules and procedures. Secondly, there is a different trajectory as the hydrocarbon sector has established a different form of contractual relationship compared to the general mining sector as the national government has invited subnational governments to become involved in governing the mining sector. The differentiation is further sharpened by different governmental actors that bridge or are active in the relationship between the government and companies. Thirdly, institutional change in both sectors results from the learning process, enforcement, adaptation, and transformative mechanisms as a result of interaction among actors and between actors and the domestic political economic environment. These processes and mechanisms imply that, while change happens in institutional resource governance arrangements, the actors also develop through the process of learning. Additionally, their interaction with other actors and environment also changes through the same process that is adjoined by the three mechanisms happening simultaneously.

Changes happen both incrementally and abruptly. They appear to happen abruptly because they happen via rules. Meanwhile, prior and after such changes, it is evident that incremental changes happen in the way in which actors complete their tasks or interact with other actors. They are also affected by openness and the intense relationship between global and international affairs and actors. Rather than a mirroring or copying the path taken by developed countries, the process is more about adjusting to new conditions, addressing current problems, accommodating other actors, and having better strategies for achieving their goals through various means and opportunities.

1.7. Structure of the Chapters

This thesis is intended to provide an alternative framework for further studies about resource governance in developing countries. I choose Institutional change as my main analytical framework. The framework has been developed by various institutionalists, especially North (1990), North (1991), Campbell (2004), North and Weingast (2009), and Lowndes and Robert (2013). This framework also generates the writing structure for presenting the findings of this study (Chapters 4, 5, and 6).

The first chapter presents the research questions, introducing the literatures used to analyse the governance of Indonesia's extractive industries. It also provides an overview of the Republic of Indonesia. The second chapter presents a more detailed explanation of the theoretical frameworks used in analysis, while the third chapter presents general analysis on institutional change in political and economic systems in Indonesia. In the second chapter, I highlight the importance of seeing political economic events as a process which is dynamic and developing throughout time. In addition, bargaining relations between government and business are used as a framework to assess the way in which such relationships affect and are influenced by changes in institutional arrangements. These two frameworks have some common grounds as they view political economic events as a process that starts in the past and continues to the future. They also consider actors' interaction as a valuable perspective. However, both also have common disagreements as they see the process as either static (as posited by resource governance as well as business and state relations) or as dynamic (as emphasised by Historical Institutionalists). The second chapter also explains the way in which comparative history and the process tracing method have shaped the research design, as well as the strategies used to collect information and

analyse the data in order to answer the research questions provided in the first chapter. The research process provides valuable insights for further researches involving the related topic.

The findings of the research are presented in four chapters: Chapter III to Chapter VI. The third chapter provides a general view on the changes which have happened in political and economic environments in Indonesia as well as giving a short historical background about resource governance in the extractive industries in Indonesia. The fourth and fifth chapter intends to answer the first question about why extractive industries' institutions in Indonesia have developed in the way they have. It generates the second question answered in Chapter VI about why both industries governance develop in different path. The findings demonstrate the need to go beyond the resource curse and rentier state frameworks in order to discover the different institutional trajectories for different sectors in the extractive industry, produced by the same government in the same domestic political economic system. This finding also highlights the importance of looking at the historical institutionalism path to understand why a different path emerged and sustained.

Finally, Chapter VII provides a conclusion about the research and highlights important points explained in the previous chapters.

CHAPTER II

THEORETICAL FRAMEWORK AND RESEARCH METHOD

2.1. Introduction

Studying institutional change as a growth process of a society and nation in developing countries is valuable in order to understand the complex nature of political economic settings that influence the way in which governments and businesses have established their relationship. This complexity is often neglected either because of prejudice towards developing countries as simply having rent-seeking behaviour and weak institutions, or because of the researcher's inability to understand political, economic, and social settings behind a government's preferences, decisions, and choices of action. The latter could happen because researchers in this area often have a rigid belief system about liberalism as the finest paradigm for economic growth and democracy as the supreme political ideology. This single-minded attitude could influence our judgment while exploring and analysing institutional change in a specific nation. This potentially leads to a negative perception of the resource nationalism conducted by developing countries and the argument that a government's behaviour should change to fit into liberalism and democracy. Developing countries deserve to be seen and heard as they have their own political, economic, and social structure and settings, their own growth and their own developmental processes and mechanisms. This thesis is one of many attempts to do so.

Hence, my primary research question explores why the institutional arrangement of Indonesia's resource governance has developed in the way it has. I intend to understand the growth process of the governance and analyse the mechanism behind such

development. To achieve this, I use the theory of institutional change developed by institutionalists like Lowndes and Robert (2013), Campbell (2004), and North (1990). Historical institutionalists posited that analysing institutional elements provides an insight into consistent changes and the vital elements which are constantly found in every setting and order within society. Interaction is one of the most crucial elements in social settings. An abundance of literature has examined this element within different settings. Political economists are have also focused on interactions as the main element in their studies and theories, namely state and business relationships, political and economic relations among nations, etc.

It is important to note that elements other than interaction constantly change, including actors, situations, environments, agendas, and structures. Hence, although various kinds of interaction always exist in social settings, the kind, scope, and configuration change as changes happen in actors and environments related to its existence. It is also important to recognise the interlinkage of various interactions in the social setting and how they influence and constraint each other's behaviour and choices of action. Such information could improve our empirical and theoretical understanding of how an institution works and interacts with actors within similar and different arrangements or settings (Ostrom, 1990, p. xiv).

The constant changes in political, economic, and social environments are undermined by many resource curse researchers in their analyses of resource governance in developing countries. This leads to a stringent analytical outcome focusing on certain institutional factors that are assumed to be closely related to the industry, primarily categorised as weak and inefficient institutions. I thus study, the interaction between government and business entities in resource governance is the main focus to provide an

alternative analysis to study the development of resource governance in Indonesia, especially comparing different institutional arrangements in the country's hydrocarbon and mining industries in the country. I argue that, although they are often categorised as identical extractive industries, there are different kinds of governance between both sectors. This is because different kinds of interaction between government and companies that happen and institutionalised in both industries.

The importance of state involvement in governing economic activities is a classic debate in both political and economic discourse. The dominant view considers the state as a problem for and enemy of economic growth and suggests that the market (as the opposite of the state) is the best government for the economy. Resource nationalism is an important reason behind government intervention in managing economic sectors (Wiens, 2015). Rosales (2016) stated that there are various motivations behind such behaviour. Elites from a state could use jargon to cover up their rent-seeking intentions by using their political authority to collect money from companies, while others could use a similar policy for the purpose of funding national development projects or other social purposes. Hence, it is difficult to differentiate and separate both intentions from a single event. We need further investigation of the political and economic situation surrounding the policy, public and elite opinion regarding this matter, as well as the institutional arrangement in the sector under study.

This perception implies that such problems emerge from acknowledging that the state is in fact an organisation of organisations; it is not unitary and therefore it is possible to find competing and conflicting actors within the state realm that prevent the state from pursuing the most productive and efficient way to govern both political and economic activities. It is also implied that there are varieties of state capacity and strategies to

address the problem. In other words, domestic structure, architecture, and institutional arrangement are important in understanding a state's actions.

The irony is that many theories force unitary characteristics on states, which can be misleading and lead to an incomplete understanding of the complexity behind states' capacities, actions, and strategies. Such views result in a simplification (and generalisation) about states without looking into the dynamic learning process and openness of institutional actors (see Luong and Weingast, 2010 and Karl, 1997 for example). This tendency for generalisation and the lack of adequate analytical frameworks to study developed countries is another problem that becomes my main concern in conducting this research. Developing countries deserve more attention from the academic community and, as a citizen from one of these nations, I intend to provide an appropriate framework by using and combining several related frameworks to present the diversity of extractive industry governance in Indonesia.

The results of this study could provide an important insight for further studies about institutional change in developing country's resource governance. The history of institutional change in developing countries is not merely about the weakness of domestic institutions and social conflicts. It is a history of continuity, transformation, learning experience, and growth in interconnected realms of politics, economics, and society in a certain period of time. It is also a history of organisational development within governmental bodies and their relationships with each other and with non-state actors, especially business entities. There is no place for a static view in this study as the dynamic happens between the institutional actors (government and enterprises), in the actors' relationships, and in the institutional arrangements of extractive industries. Thus, adaptive and transformative capacities are important frameworks to look into change and

transformation of institutional actors. At the same time, theory about institutional change in combination with concepts about government and business relations are used to explore the dynamic in the resource governance in Indonesia's extractive industries.

The understanding about variation of states' capacities, actions and strategies is also important when observing and analysing the mechanisms of institutional transformation (Weiss and Hobson, 1995; Weiss, 1998; Weiss, 2004; Bakir, 2014). However, it is also important to place such capacity within the context of the relationship between government and companies. The study of government and business relations was primarily developed by international business scholars. The continuing imbalanced perception about the nature and the development of this relationship, particularly the lack of understanding from governments as well as the political, economic and social sides, needs to be addressed from the perspective of international political economy. In addition, the consideration of this relationship in terms of its institutional development could capture a more "helicopter view" by taking the historical timeline and the development in the political, economic and social sectors of the host country into account. The actors are treated as having both dynamic perceptions and situations that could lead to certain changing dimensions in their interaction patterns.

In this chapter, I highlight that Indonesia has a peculiar governance style in its extractive industry. The country's experience demonstrates that the extractive industry could have different governance styles depending on how both governmental and business actors perceive challenges and opportunities specifically related to the hydrocarbon and general mining industries. Different approaches and strategies have been used by both government and business entities in these industries, which have experienced similar political, economic, and social domestic situations. They have

different international economic challenges and have gone in different institutional development directions. Is the different governance from both industries caused by the difference in the international economic challenge or does it result from different perceptions and situations perceived by both parties?

As shown in the previous chapter, it is important to consider alternative points of view to study the institutional development in Indonesia's hydrocarbon and mining industries. The simple approach of the rentier state and resource curse perspective is no longer adequate to address such differences in a developing country with bright, positive economic growth following the political and economic crises in 1997 and 1998. The country, of course, could not be compared with the liberal developed countries in terms of efficient bureaucracy, government bodies, and political process within the country. However, the developing countries are worth studying as the process they produce is certainly distinctive to their specific national and local political, economic, and social condition. The explorative nature of this research is what gives the research a fresh, alternative perspective for further study on this theme by attempting to have less prejudice about the nature of both actors and about which direction and strategy should be taken by the GoI in managing its mineral resources. Prejudices should be minimalised in order to trace the process of institutional development through the actual chain of conditions in Indonesia and its hydrocarbon and mining industries. Furthermore, although this may be true for some basic principles, there is no intention to make careless generalisations that this alternative view could be replicated for studying other countries.

2.2. Institutionalism and Institutional Evolution and Change: Definition and Elements

North (1990 and 1991) separated institutions from organisations. An institution is defined as a set of regulations and rules of the game which constrain and enable organisations (the player) to operate, cooperate, and solve their differences within the institutional arrangement. North (1990) explained that there are different kinds, levels, and scopes of influence an institution can have. An institution is part of a bigger and larger institution and exists together with other institutions. Thus, an organisation could have several memberships in those many institutions. This means an organisation and its interaction with other actors becomes more complex and possibly causes clashes. Unlike Vernon (1977) North considered government and business relations as a positive sum as both cooperate to achieve their goals and collecting benefits from their operations. Changes are inherent within such relationships as not only the configuration of members within the institution change over time, but also the members, which usually consist of many organisations, also deal with changes in both their internal structure and external situation. North considered this situation as affecting the incentive structure among members to change their initial institutional structure in order to fit their current circumstances.

An institution consists of external as well as internal constraints on actors' actions (North, 1990 and 1991). External factors mean that the social, political, and economic environment limits actors' choices, decisions, actions, and patterns of interaction. Internal constraints mean that actors' resources and capabilities determine their ability to implement the decisions they make and the bargaining position they have, as well as the

benefits they can gain from their interaction. In general, an institution is able to constrain action, determine actors' opportunities, and facilitate interaction among actors.

An institution is assumed to be stable until it is disrupted external forces. External factors, such as war and crisis, are assumed as primary sources of institutional change. However, other scholars found that change can also come from internal factors. The shift in bargaining power between actors affects their preferences and capabilities of action. This shift can lead to unpredictable strategies and actions in their interactions with others. Finally, a changing bargaining relation is able to transform and reproduce new rules of the game. In conclusion, institutions are not static and rigid; there is always space for different and unpredictable action from the actors. However, North (2005) underlined two stumbling blocks in the institutional changing process: the cost of changing institutional arrangements, and actors' preferences for maintaining their status quo. This means that once an institution is established, it cannot easily be modified or shifted merely by actions or interactions among actors.

Institutionalism goes beyond discourse about actors vs structure. Institutionalists emphasise more on role of both rules and actors in determining performance and outcome from an institutional arrangement, especially the orderly condition that ensures actors within certain arrangements will receive the maximum benefit from their involvement. Despite the importance of stability in an institution, many institutionalists recognise the importance of understanding change, transformation, and evolution as part of an institution's developmental process.

Lowndes and Robert (2013) further described the differences between institutions and organisations. An organisation is both an institution and an actor and could be both institution and player. This means that it has not only rules, procedures, and narratives

constraining individuals which operate within its structure, but also acts as a unitary actor in a larger institutional arrangement. Rules, procedures, and narratives are considered by Lowndes and Robert (2013) as elements of institutions.

There are discourses about the concept of institutional change. Some consider that institutionalism had a static and linear assumption that focuses on stability as one of actors' goals in establishing and maintaining institutional arrangements (Weyland, 2008, p. 281). Historical institutionalists expected a stable and long lasting institutional arrangement once it is established. Meanwhile, rational choice institutionalists considered that to change existing institutions, a change in the equilibria of actors' preferences is necessary. It is not easy for institutional actors to change their preferences and are rarely incentivised to change the way they act and interact with each other, especially when there is less benefit to change than to stay within the existing arrangement. Both types of institutionalist are assumed to tell a little about institutional change. However, as political change happens simultaneously in the same region, some institutionalists have attempted to explain the dynamic of institutional arrangement domestically and regionally as well as adjusting their previous propositions regarding the path and process of change (Weyland, 2008, p. 283). Weyland (2008) noticed the importance of considering actors' capacities in determining the trajectory and path to change in an institution by also considering the external influences on actors' preferences and designs, as well as the trajectory of change available in the region. He proposed a point of view that considered both demand and supply side of institutional change in his article about a New Theory of Institutional Change.

Institutions have three dimensions: regulative, normative, and cultural-cognitive (Palthe, 2014). The regulative dimension consists of formal laws and constitutions that

justify certain actions and patterns of interactions, while at the same time set borders between what and how an action can be done or cannot be done, what goals can be and cannot be pursued, what expectations can be and cannot be had, and what role should be fulfilled. The normative dimension is the values, norms, and traditions that suggest appropriate goals to pursue, roles, and strategy of actions. Lastly, the cultural-cognitive dimension means that the institution involves a belief system and learning process for individual actors as well as organisational actors. It also involves the framing of reality and how to perceive, understand, and process information from themselves and the environment.

The actors establish rules of the game in their interactions in order to constrain the behaviour of themselves and others and therefore protect social order. The development of the rules of the game within society is determined by the openness of the established institution towards new actors and their flexibility to overcome new challenges. North (2005) stated there are at least three phases on the development of social order: the limited order, the transition towards a more open order, and the open social order. The dominant and more powerful actors can limit the other actors' range of actions in a limited social order. This condition results in an imposed order; there is order in society but rather than benefitting all actors, the goal is primarily to maintain the power and position of the dominant actors as well as to protect and increase the benefit they can gain from existing institutions. In a transition phase, there is a tendency to make the rules more flexible and adapt with new challenges and new actors. However, there is a limitation to the openness process since there are resisting parties that will attempt to maintain their position and status quo within the institution. Finally, there are loose rules of the game in an open social order. Each actor has a huge range of alternative choices of decision and can interact with others through various strategies and actions.

The main critical view of historical institutionalism (HI) is its narrow point of view about actors' actions and their dynamic interactions with others. There is no static pattern of action and interaction because actors can face similar situations and deal with similar challenges, but they can choose different preferences and strategies of actions. Another critical point is that it fails to explain why an institution can be maintained over time even though it involves different generations. This means that an institution itself is dynamic and can have adjustment mechanisms to adapt to change. HI also does not explicitly recognise that institutions which constrain actors consist of multiple levels and sectors. Consequently, HI has the potential to offer broader framework of analysis and explanation about social interaction in various levels and sectors.

Every actor and relation always has a starting point that will be the path taken in the present and future. Pierson (2000, p. 252) defined path dependence as 'social process grounded in a dynamic increasing return'. Path dependence acknowledges that institutionalisation, institutional development and change involve a process of interaction among actors. The more frequent the interaction, the more positive feedback each actor can get. This feedback is the source of information to act further, to obey or disobey their previous agreement. An institution can survive and develop as long as actors perceive it as more beneficial to be maintained than to be broken.

Institutional continuity is also influenced by its flexibility to the changing nature of political, social, and economic environment, as well as to the changing preferences, expectations, and behaviours of actors. This flexibility can facilitate the initiative to modify the institution. This modification can be considered as the continuity of the path as long as the basic characteristics of the previous arrangement are retained. The modification only happens in the supporting elements. However, there is still a lack of

study to differentiate between basic and supporting elements of an institution. This understanding is required because continuity can mean both the survival of the same arrangement throughout time and the modification of its supporting elements. Basic elements of an institution consist of values, norms, and principles that are respected and protected by all actors; they are the core of institution and determine the existence and specialty of the institution. On the other hand, the supporting elements support the core to function effectively and efficiently. They can be tangible or intangible such as actors' resources, compatibility of actors' goals, trust between actors, strong and effective bureaucracy, the existence of dispute settlement mechanisms, dominant actors, etc.

Historical institutionalists also acknowledge that the path can change. This is likely to happen at a critical juncture which later determines the different path to be taken. It happens when the basic elements of an institution are changing, which can happen naturally or forcefully. This means that the source of change can be internal, for instance from the dynamic within institution, or external, such as a global crisis or war. The change can occur in all sectors simultaneously or in just one sector. It can also be a gradual process or a revolutionary one. Connolly (2013) explained that there are four frameworks of institutional change: incidental, social conflict, endogenous, and exogenous. The incidental view argues that any decision can lead to unintended outcomes that change the institutional arrangement; this means that an 'accidental decision' can become a critical juncture that changes the path. The social conflict framework considers the change to be the result of conflict among actors, especially the dominant actors. The endogenous approach views that different internal conditions can change the rules, while the exogenous approach see external forces as the source of institutional change.

North, Wallis and Weingast (2009) proposed a view on the process of institutional development by investigating the interaction among actors that have access to the institution within social interactions, which they called social order. There are three types of social order: foraging order, limited access order (LAO), and open access order (OAO). The first type exists in a small community in which individuals gather and act together to protect and to fulfil their needs. LAO is the second step in which the society is bigger with more complex interaction. The main characteristic of LAO is the personal exchange with centralised authority and close institution, meaning that the advantages of being within an institution are determined and controlled by a small group of dominant elites. This situation is not easy to change as the elites have an interest in maintaining the status quo as the authoritative group. Thus, it might take longer to move from LAO towards OAO. The loss of elite control in OAO is a consequence of advanced institutionalisation in actors' relations. This means that personal change is replaced by interpersonal change in which there is protocol that binds and manages relationships among actors in their attempt to achieve their goals and protect their interests. There is more freedom to join the institution in OAO, which is why it is known as open access. The movement from LAO to OAO uses the mechanism of change rather than mechanism of progress. This means that there is always the possibility to go back to LAO after enjoying OAO for a period of time (North, Cecil, and Weingast, 2009, p. 12). Therefore, actors' commitment to maintain an OAO should be credible in order to stay in OAO. In the transition from LAO to OAO, there is a doorstep condition which implies that both actors and institutional ability and commitment will have more impersonal exchange in their interactions. This transition involves a more complex regulation to manage such exchanges in society (North, Cecil, and Weingast, 2009, p. 26).

Nevertheless, a basic agreement should be underlined first before we talk further about how an institution will change and how actors can attempt to change or adapt to such changes despite the benefits they have collected from the initial arrangement. We need to understand what institutionalism means with regards to institutional change and the elements, steps, and outcomes of such process. Different institutionalists have proposed different analytical frameworks to study the process of institutional transformation and evolution. Despite different trajectories of their studies about change, a common basic agreement about change can be established. From this point, I attempt to draw a simple analytical model of institutional change derived from the commonalities and differences proposed by previous studies. The initial model is adjusted to suit the empirical conditions during my research as well as to suit the specific conditions of Indonesia's resource governance.

Scholars like Peters (2008, Chapter I) considered that institutionalism and institutionalists find it difficult to explain institutional change. This is because branches of institutionalism have different opinions regarding the nature and dimensions of an institution and the source of change within its nature. Rational choice institutionalists consider the incentive structure as the main dimension of an institution, suggesting that individual actors – as the players in institutional games – act rationally based on calculating the potential benefits they could gain from playing or exiting. Changes to the incentive structure that directly affect the benefits they receive would lead to an attempt to reject or support the change.

Campbell (2004, p. 32) posited that analysing institutional change necessitates careful consideration. Some institutionalists have attempted to analyse continuity and discontinuity within institutional arrangements. A continuous change pattern means

evolutionary and transformative paths, while a discontinuous one means a punctuated equilibrium. However, there are two factors that need further consideration: the dimensions of institutions that could be changed and the time frame for this change. Considering both factors is important to understand the nature of institutional change (Campbell, 2004, p. 32-33).

The change has several basic patterns: incremental and evolutionary patterns. Incremental patterns mean that change happens in a gradual process wherein it is impossible to track who started it and when. It follows along a single path of change and runs in a single direction. On the other hand, an evolutionary change means that an initial or old institutional arrangement is transformed, gaining some characteristics that are distinctly different compared to its predecessor. An equilibrium condition could also be understood as a stability condition. It occurs in between the old and new arrangements. Such stability could be disrupted by actors' social learning. This learning process is intended to adjust with current internal and external challenges and problems (Campbell, 2004, p. 34).

Why does institutional change happen? The answer is dependent on the perspective of researchers or theorists. Based on the explanation above, there are various reasons for changes to happen in institutional elements. Thus, focusing on smaller parts of an institution is crucial in order to see the pattern and mechanism of institutional change. I use Campbell's category of institutional elements: the rules, the norms, and the practices. Rules consist of written agreement and codes of conduct about how things are done, acceptable and punishable behaviours and actions, as well as structured and required actors' interactions within institutional arrangements. Meanwhile, norms consist of publicly known and socially agreed codes of conduct in more general human interactions

in the form of culture and tradition. In this regard, norms often precede and exist long before institutional arrangements are established. Practice is influenced by both rules and norms, while procedure, as part of practice, is generated from the rules agreed by actors.

This explanation also implies that changing rules most often involves actors' actions, behaviours, and interactions with other actors and the relevant circumstances. Rule change could be influenced by both endogenous and exogenous factors. The driving force of change could be attempts from actors to change it or it could also be influenced by actors' attempt to adapt to a changing situation either inside and outside the institutional arrangements. Both the transformative and adaptive capacity of actors involved determines the process and mechanism of change. Both capacities could potentially lead to a gradual and incremental change or a critical juncture, such as crises or shocking events that force a dramatic directional shift for the institution. Thus, although stability is an important achievement for an institutional arrangement, change is also a situation that inherently exists in various forms of social interaction.

This study's main focus is to observe institutional change in resource governance in Indonesia. Researches about institutional change mostly originate from political wings of institutionalism and involve a more historical approach. The importance of identifying the agents of change and mechanism of change has been highlighted in such studies, although they have different analytical framework and methods. Adequate time frame, selection of case (or cases), not focusing on generalisation but looking into variation, perceiving the dynamics of both actors, the agenda, the actors' relationships, and institutional arrangement are among the main principals of studying institutional change.

There are various propositions about institutional change from different institutional branches. Critical juncture is considered by historical institutionalists as the

starting point for an institutional change to happen. Meanwhile, rational choice institutionalists have a different view about change; they consider the incentive structure as the reason behind institutional change. In addition, there are other viewpoints about institutional change that have explored different aspects that the writers considered to have been overlooked by other studies. For example, Davis (2010) proposed a study that attempted to bridging gap between empirical and historical focuses on the flexibility of an institution and its growth. He proposed that it is important to distinguish between an economic institution and meta-institutions which affect the rules differently. Economic institutions that consist of policies and laws are considered to determine the quality of an institution, while meta-institutions operate on a broader dimension. Meta-institutions operate on bigger political, economic, and social arenas and determine the flexibility of an institution as they have various related institutions operating and linking to form more complex and bigger arrangements. Constitution and common law are among such institutions. Meanwhile, an economic institution specifically regulates economic interactions among economic actors. It determines the quality of these institutions to establish and maintain order. Industrial-specific governance is an example of such institution.

North (1991) proposed a more economic approach to the analysis of institutional change. Due to the tendency to see economic activities from a static viewpoint and considering state and firm relationship as a zero sum game, the theory of change has not developed within economics. He proposed an early political economic theory of institutional change which emphasises the dynamic interaction and relationship between state and firm. It is not only about a contractual relationship which marks the beginning and the end of such a relationship.

Technology is one factor that is considered to trigger institutional change in the relationship between governments and enterprises (North and Lewis, 1971). Through technology, a company has both advantages and disadvantages compared to the others in front of government and thus attracts different kind of leverage.

As a basic principal for institutional study, the state is not a unitary actor as it is an organisation of many organisations. As the institutional and organisational characteristics of a state are unique, generalisation could be misleading. It is important to not easily jump to conclusions or have prejudice while observing and analysing a state. Such attitudes could cause us as researchers to omit important elements intentionally or unintentionally. It is important to obey the guidance from the institutional framework while having an open mind to see the empirical situation.

2.3. Institutional Change: The Path, Process, and Mechanism

Study about institutional change has mostly been conducted by historical institutionalists who analysed the evolution of systems, structures, and societies within a certain awareness of space and time frame. There are three main theories that have been used in this thesis to explain institutional evolution in the governance of extractive resources in Indonesia. North and Weingast (1991), Campbell (2004), and Lowndes and Robert (2013) provided valuable insights about institutional change using frameworks of resources, actors, goals, and mechanisms. Their frameworks are combined to guide my analyses regarding various lenses and elements that should and could be considered to investigate resource governance. Even though they have different focuses, they do have agreement about some underlying assumptions needed before studying institutional change. They also critically address some of the tendencies and approaches used by

institutionalists. Thus, combining their insights is an important step to capture the complexities of the studies of institutional change in different periods of time.

Based on the previous explanation, I posit that institutional change results from at least two elements. Actors and their actions to change the institutional arrangement are seen as the dominant factor which leads to institutional change (see North, 1991 for example). Another factor is the existence of other institutions (at the same level or at an upper level) which endorse and enforce change within a certain arrangement. The last factor is the relationship between actors as agents of change, which could be included in the first factor but with the need to emphasise the cooperative capacity which endorses and enforces current institutions to change their elements.

The second factor affects current institutional arrangement through both the scope of rules and procedures affected by the change, as well as by the changing capacities and roles of actors in the new institutional arrangements. I posit that there are certain elements that could change as a result of institutional arrangement. The dynamic elements that institutional actors have are role and authority. These elements are primarily based on their access to and position within the decision-making process and statements from contractual arrangements among actors. Another element of an institutional actor is their capacity, especially transformative and adaptive capacities (Weiss, 1998).

Furthermore, considering the survivability of an institution, it is also worth explaining the temporality and sustainability of an institutional element in the face of change. These elements influence the scope, speed, and time needed for a transition and the process of change from previous to new institutional arrangements. This is because change could happen spontaneously, incrementally or revolutionary (Campbell, 2004).

All of these elements constitute the causal mechanism of an institutional change, which is the primary analytical method in this thesis.

In his books, North (1990 and 1994) implied that the learning process is experienced by an organisation (both the government and companies are organisations) as institutional actors make their preferences, perceptions, and capacities to act. These factors change constantly, although not at the same time, space, and speed. Therefore, the outcomes are also varied, as is the actors' adaptive and transformative capacity to accept the change and absorb it into the existing institutional and organisational structure and arrangement.

North, Wallis, and Weingast (2009) showed how actors deal with problems and challenges¹. Such problems are assumed to contain an incentive structure which makes actors adjust the way in which they act and interact with other actors and the environment surrounding the problem. Indeed, actors' capacity to gather, filter, and analyse information about the problem leads to different choices, plans, and decisions. The organisation discussed in the books mentioned above is a state actor, the government. Social order is a vital goal in order to minimise violence and to ensure people can conduct their business and other economic activities securely and free from oppression from other parties, especially dominant and powerful ones. There is no actor that could solve problem of violence immediately and each actor learns from previous decisions as well as from other societies. Learning capacity is the most important aspect underlined in this book and others by North, highlighting actors' capacity to create better institutions (see North, Wallis, and Weingast, 2009; North, 1990 and 2005). Hence, they proposed stages

¹ In their book, violence is a social problem that needs to be controlled by authoritative bodies in order to create and maintain social order.

in which society transforms its accumulated knowledge into a better institutional structure and arrangement. The phases are natural state, limited access order, and open access order. In each step, state actors rise through an increasingly expanding network of interactions, indicating a more open attitude towards other actors' entrance into the business and better knowledge. This ultimately leads to trust and expansion of cooperative and collaborative action among actors. The three stages of society in dealing with problem of violence will be discussed briefly later.

Natural state is the first form of institutional arrangement, wherein members of society agrees to manage their political and economic affairs. The process is simply agreed by individuals in the society and the scope of legitimation is still small, consisting of limited tasks, sources of action, and authority. As the society grows, communal problems also become more commonplace. This situation requires a more complex institutional structure. This is LAO in which elite groups have more members from various occupations with differing expertise and economic levels. There is also differentiation of tasks and sharing of authority among different groups doing different, but often overlapping, tasks managing a number of society affairs.

During this second phase, there is already a form of power and task sharing in which different tasks and authority are given to different groups of elites. However, the accessibility, transparency, responsibility for public goals and existence of public control is very limited or non-existent. This means that public affairs are translated into policy and political or economic decisions by elites through their own perceptions and understanding as well as their scope of knowledge and interest. Most nation states, especially developing countries, are still in this phase of social order in 2019.

The last stage is OAO. Most developed rich states are already in this phase. The institutional structure has a clearer differentiation of tasks and authority with the institutionalisation of public control with public interest as the ultimate goal pursued by the authoritative body. Individual elites have lost their privilege in this kind of state as most political and economic exchanges are impersonal; personal linkages and networks no longer dominate state affairs. These circumstances also mean that the institutionalisation process has succeeded in creating a perpetuated bureaucratic organisation in which public affairs are dealt with and transformed into policies, bills, strategic plans and actions. Nevertheless, it does not mean that there is no problem in this phase as destructive self-centred elites who manipulate state organisations for their own interest still exist with different strategies. However, such negative behaviour is neither acceptable nor able to be shown openly in public. They have to be very secretive and thus have limited access and scope of control across sectors as such behaviour is punishable by law and social norms.

North, Wallis, and Weingast (2009) stated that the stages of society development do not happen in the progressive path. This means that there is no guarantee that once a nation-state is located in one phase it will automatically move on to the next stages; indeed, it could deteriorate to lower phases due to internal crises and conflict. Thus, the society and elites should constantly seek improvement to maintain and expand their capacity despite their current position in the stage so that regime and generation change will not negatively influence the country's position and performance.

Path dependence and punctuated equilibrium are the two most common mechanisms of institutional change evident in the various literatures about institutionalism (see example North, 1990; Lowndes and Robert, 2013; Campbell, 2004).

The concept is closely related and used by historical institutionalists as they consider context and time as important factors in analysing the mechanism of institutional change. Therefore, studying change relies on the availability of historical data and an understanding of its context. Path dependence uses both factors to build up its context-specific analysis of the sequence of stability and change events within the institutional structure and arrangement. Meanwhile, punctuated equilibrium focuses on influential and important events or sequences of events that affect the way in which actors function and complete their tasks (practice element) and how they are perceived and accepted by society and public norms (normative or narrative element).

Furthermore, the change could happen incrementally or abruptly. This means that the change could take place gradually in smaller areas until the changes are recognised by the public or realised by other actors. This process could also be recognised as a bottom-up mechanism of changes in which actors (organisations) attempt to develop themselves and such actions influence other actors to do the same, resulting in a more extensive change which happens in bigger or higher structures or arrangements. On the other hand, there are also top-down mechanisms. This means that the initiator of change is a higher authority – the government – where rule elements are changed (formal regulation). Nevertheless, such mechanisms are initially and mostly proposed by members (or a group of members) of an institution.

A challenge in studying institutional change is to identify the source of change. Lowndes and Robert (2013), North (1990), and Campbell (2004) proposed exploring exogenous and endogenous factors, or a combination of both, as the source of change. Exogenous factors mean that the source of change comes from outside the institutional structure, whereas endogenous factors come from inside the structure. Hence, it is

important to clarify what is meant by institutional structure and the boundary between endogenous and exogenous factors of institutional change within the structure and or arrangement.

I understand institutional structure as represented by specific sectors in which actors act and interact. The hydrocarbon and mining industries are the two structures I intend to analyse in this thesis. Therefore, actors directly and closely related to institutional arrangement of both sectors, as well as their regulative, practical, and normative elements, are part of the structure that has become my focus of study in explaining institutional change within Indonesia's extractive resource governance. It also means that other aspects are included in the exogenous factors of the structure, especially the wider political, economic, and social environment in which resource governance exists and is legalised and practiced.

An important process in which institutional change could happen is exchange between actors. By conducting exchanges with each other, an actor not only gains information about other actors, but also understands more about themselves. While competing and collaborating with others, they challenge their limited resources and capacities in order to achieve their goals. They develop their knowledge, use their potency, and expand their capacity through exchanging and interacting with others. This is the essence of the learning process which is the most essential element of being human and establishing organisation. In this thesis, I focus on organisations as institutional actors and agents of change. Nevertheless, it is important to appreciate the benefit that an organisation can provide for its human members, leaders, workers, and managers. The organisation grows as the human grows. Hence, research on institutional change is

essentially a study of both human and organisational development. It provides process(s) to be discovered and mechanism(s) to be analysed.

Weiss and Hobson (2003, p. 175) stated that Governing Interdependence (GI) is related to coordination and collaboration by converting political autonomy into economic capacity. It is a system of central coordination based on the cooperation of government and industry. Policy is seen as the result of regular and extensive consultation and coordination with the private sector. State capacity is also determined by institutional depth and breadth. Institutional depth is related to the degree to which boundaries of the state and the orientation of state actors define a public sphere distinguishable from larger society; meanwhile, the institutional breadth refers to the density of the link between state activities and those of the social entities. The incentive structure is a pay-off structure, and is apparent in political and economic processes that incorporate the specific institutions involved and the consequent structure of political and economic exchange. The technical capacity refers to the ability of bureaucrats to acquire insider knowledge regarding the industry as well as the technological sophistication which is vital to understand the industry. Political capacity means facilitating intra-elite agreement over how the strategy is to be implemented.

An important task of using Weiss' GI is expanding the scope of the state capacity concept and challenging the prerequisite of this concept. GI and the notion of embedded autonomy are usually used to examine economic development or performance as a result of government and business relations. Could GI be used to look at the institutional development of resource governance in Indonesia in terms of state and business relationship and capacities to interact with each other? Along this line of thinking, I also use the framework of governing interdependence developed by Weiss and Hobson

(1995). They gave a different proposal emphasising a different relationship between the government and companies which goes beyond the simple concept of a bargaining relationship. She proposed looking into the essence of having (and acting as) a leader that governs the interdependence relationship between the government and companies. Furthermore, she also highlighted the importance of assessing a state's capacity to perform this role. Unfortunately, Weiss' concept is not popular among researchers and hence it is difficult to find further studies that have used and complete her proposal.

A basic assumption taken from the state capacity concept is that state actors are not a unitary or monolithic structure (Weiss, 1998). A state could also have a transformative capability with general attitudes often seen as state intervention in economic activity. GI requires reciprocal consent which results from negotiation and compact as the core aspect in business and state relations. Collaborative and institutional linkage is also crucial in governing the relationship and is often known as political nurturing of collaboration.

2.4. Limitations of Resource Curse Literature in the Studies of Resource

Governance

Resource governance is the main topic in this study, and institutional elements and interactions are the main focus of the analysis. Indonesia has experienced a changing institution in its extractive industry. I argue that the changes have predominantly been caused by a dynamic interaction among institutional actors both within the industry and in other related institutional settings, which means that the actors involved in the industry are also members of other domestic and international institutional settings. This multi-membership means that the exposure of external factors could influence the way in which the actors operate, manage, and interact with each other.

Resource governance considers ownership and management over hydrocarbon and mineral resources as policy tools. This means that there are various policies taken by the government in conducting this strategy. On one side, the government tightly controls its resources through various policy instruments that severely limit business operations in the field. On the other side, the government uses a looser strategy to gain control, mainly through taxation in order to collect rent from mining production while giving managerial and operational freedom to the companies. However, most states are located in between these two extremes as they use various limitations as well as allowing various freedoms and incentives to encourage companies into doing what they want them to do as well as letting them do their job the way they want.

Luong and Weinthal (2010) considered ownership structure as something dynamic, while in Indonesia's case ownership rights are fixed and have not changed. The way in which the government uses and protects the rights are developing, but the owners of national natural resources are always Indonesian people and the ownership is managed by the government as the people's representative in dealing with business entities. Despite my criticisms of their ownership structure thesis, both authors make an important assumption that the resource curse supporters assume and believe that institutions in such states are stagnant or unchanging (Luong and Weinthal, 2010, p. 3). This perspective inspired the consideration of the institutional development in the governance of extractive industry with government and business entities' relationship as the explaining factors shaping this development. By doing so, I try to combine Susan Strange's (1994) assumption that a government has to deal with companies in an era of globalised production. Even though she chose to consider state and market relations instead of state and companies' relations as the main focus in her book, these statements have encouraged

me to consider the foreign companies as another dominant player in an industry institution within a state.

Unfortunately, such strategic action is often generalised and mistakenly classified into “government intervention” as the opposite of the *laissez faire* concept of “liberalism” or “neoliberalism” in Western countries. Such prejudice leads to early judgment (which is mostly negative) of the government strategies in developing countries as hindering their own national economic growth, slowing their economic development, or making their country unattractive for foreign investment. The explicit similarity of all such judgment is the tendency to relate resource governance in developing countries with outcomes such as overall national economic performance, and then stretching it to national poverty level. This omits an important aspect of resource governance: serving the national and public interest as well as achieving national political, economic, and social goals as part of national grand policy strategies. Governments and societies in developing countries are not entirely filled with foolish, stupid, or rent-seeking people and actors. Their situation is identical to developed countries, where there is combination of smart and kind people alongside stupid and self-interested individuals within the political and economic power base. Thus, the complexity in the decision-making process is also present in resource-rich developing countries.

Government intervention in the economy, conducted by developing countries, is often classified as taking either predatory or developmental forms, while developed countries are usually have a more *laissez faire* principals in governing their extractive industries. It is often assumed that the latter form is ultimately the most beneficial form of resource governance. Thus, development strategies directed by the International Monetary Fund (IMF) and the World Bank (WB) reflect the importance of mirroring

developed countries' path to ensure the success of national development while neglecting the unique characteristics of each country. It is important for academia to understand governments in developing countries and their governance strategies in an objective manner. This does not mean presenting all positive things from the governance structure in developing countries while omitting or avoiding negative situations and problems which have emerged in the past; instead, it means looking deeper into the matter by using developing countries' point of view and seeing things through their lenses. The study of developing countries is not only about developmental states in East Asia and Singapore, while considering the rest as mainly having the characteristics of predatory states and then being surprised by their growth but criticising their choices of action by using the perspectives of developing countries. It is not about conflicting interest of government and business actors in extractive industries. Rather, it is about understanding the complexity of a continuous and long relationship between state and business and studying such complexity properly.

Because of the reasons stated above, studying resource governance is important for researchers in various fields, especially political economic scholars. Understanding the complexity of these countries' resource governance could make a significant contribution to the development of studies in the political and economic fields. Analysing the way in which the actors process and conduct their actions and strategies towards other actors as well as towards the national and local political and economic environment is part of the attempt to expand the study of resource governance in developing countries. It is also important to acknowledge the way in which institutional change happens in such governance structures and to study the process of change, analysing the areas of an

institution in which change takes place and the implications for actors' actions and their relationships with other actors, as well as the governance.

Studies about resource governance provide intense analyses of the relationship between government and business entities. In several studies, resource governance has been explored in terms of its ability to generate economic rent and become a source for government income and development funds (see Singh and Bourgoignie (2013) edited book for example). Some others have seen it in terms of governments' inability to manage their natural resources due to weak institutions, which leads to the resource curse phenomenon (see Karl, 1997; Luong and Weinthal, 2010 for example). Such phenomena could also produce resource nationalism, which hinders national growth due to isolationist policies and over-suspicious behaviours and attitudes regarding foreign investment and foreign companies.

Both negative conditions are the result of a combination of domestic and international factors. Domestic factors refer to the interrelation between domestic political, economic, and societal spheres. On the other hand, most external factors come from the multidimensional effects of globalisation and the intense relationships among nations.

The resource curse is dominant as an analytical framework to examine resource governance in developing countries such as Indonesia. This is due to the tendency of previous studies to focus on economic performance (i.e. economic growth) and a static view of governance itself. The results of such studies are mostly dominated by presenting institutional weakness in resource-rich countries as the dominant factor affecting their negative performance, such as significant inequality of income distribution, stagnant and negative economic growth, inflation, etc. (see for example Karl, 1997; Luong and

Weinthal, 2010). The tendency of these studies is to have a static view about how governance is run, to focus on elites' behaviour, to assume there is one-way interaction from government towards other actors, and to consider the government as a unitary actor. Consequently, this research attempts to provide an alternative analytical process by using those neglected assumptions. This means that Indonesia's resource governance is analysed from the basic assumption that it is about the history of institutional change in such governance. The government and business relationships are presented as explanatory elements of the transformation process while the government is intentionally considered as an organisation of organisations, which together with other actors acts and interacts within multiple institutions.

On the other hand, the actual concern for governments and societies in developing countries is to maximise income from the abundance of resources while maintaining their ownership of such resources and overcoming various environmental and social problems caused by extractive activities in their neighbourhoods. Thus, resource nationalism is an embedded value in society (including employees in various ministries and other governmental bodies, see for example transcriptions of my interviews with high profile persons and employees in such agencies) rather than merely a discourse or mental construction for elites' agenda.

Arbatli (2018) stated that there are ups and downs, ebbs and flows in the implementation of resource nationalism as oil is now seen more as a tool for foreign policy, while resource nationalism and the principle of permanent sovereignty over resources (UN resolutions 1966) is used more frequently as a domestic policy tool. This means that, since the 1990s, the government has used resource nationalism in a more pragmatic manner.

It is not a matter of strong or weak bureaucracy within a state (state potency); instead, the focus is on the government's capacity to decide what it wants with its authority and potency, as well as how this can be achieved (Weiss and Hobson, 2003). While state potency might be given and static, government capacity is dynamic and something to be strived for. Therefore, autonomy is an element of a state's potency, but policy and regulation indicate the capacity to achieve the state's goals and protect its interests. The government needs to know its potency in order to be able to generate the capacity to achieve its goals.

On the other hand, supporters of the resource curse concept assumed that the ownership of natural resources (state potency) has an embedded weak institution which leads to poor economic performance (Karl, 1997). Meanwhile, Luong and Weingast (2010) proposed a slightly different viewpoint about negative government performance in resource-rich countries. They assumed that weak institutions rather than the oil curse leads to poor and negative outcomes in these nations, especially in their political and economic performance (Luong and Weingast, 2010, p. 2). Another argument made by these authors is that a weak institution containing a wrong set of institutions needed to encourage better performance. They also repeatedly underlined that the resource curse considers weak institution as inherently attached to the states, meaning there is no way for the government to escape the "curse". According to this perception, Norway is often considered as the outlier among resource-rich states as it has successfully escaped from the "curse".

Property rights determine actors' role and authority to act towards their property and other actors. Ownership is another term for property rights claimed by state, while property rights are commonly used by companies and individuals. In order to maintain their rights, actors used their capacity to control access to their property (Weiss and

Hobson, 2003). An act to control is to expand and gain a more significant advantage from their property and ownership by bargaining with other actors, negotiating, and releasing some constraints and giving incentives. The existing structure of rights and the characteristics of their enforcement define the existing wealth-maximising opportunities of the actors that could be realised by political and economic exchange.

Hence, this study emphasises the importance of shifting the way academics perceive and conduct research from a static viewpoint towards a more dynamic perspective by using a less judgmental and less prejudice analytical framework for developing countries. This thesis is one of many attempts to do so. Such dynamism is considered by taking into account the complex situations and varieties of opportunities and constraints that institutional actors have to deal with during a certain period of time. Campbell acknowledged that both actors and their institutional arrangements are constantly changing in different scopes and speeds (2004).

Resource nationalism is not an ideology to govern an industry. It is a policy choice or policy instrument. Thus, it originates from the political and economic decision-making process rather than a national belief system. The fact that pro-resource nationalism always exists in developing countries means that ownership over their resources is important. Their concerns are about the rent generated from these resources as well as control over the use and management of both the resources and the income for the public.

This understanding also means that rent-seeking behaviour could come from a strategic approach regarding the ownership and control over resources. Such behaviour cannot be isolated as the attitudes and interests of elites only. It is a matter of perception regarding their situation and capacity both to use and manage their resources and to

generate rent. Thus, this behaviour could come from a strategic political economy consideration and not merely from elites' pragmatism, especially if we locate such behaviour in an open access society in which elites' decisions are not the only important aspect. A lack of consideration regarding the complexity of state organisations (and the government) could be misleading and will not improve our understanding of resource governance in developing countries in doorstep conditions and in the early phases of becoming an open access society.

Gustaffson and Scurrah (2018) proposed looking into resource governance by considering the complexity of organisations within the resource-rich states. This is important for analysis of the strategic actions taken by weaker governmental organisations in governing resources. Local governments are considered to be examples of such organisations.

2.5. Theoretical Frameworks of Government and Business Relations

The extensive government and business relationship literature was mainly contributed to by international business scholars. As such, their main viewpoint highlighted the challenges and difficulties faced by multinational enterprises in their operations around the world, especially regarding the inevitable relations with the governments of both their home and host countries.

The concept of obsolescing bargaining is an important starting point to understand how the initial condition during negotiations could determine who gained the upper hand in the beginning of the relationship (Vernon, 1977 and 2000). However, the condition changes over time and the contractual terms could potentially shift in favour of other parties. Multinational Companies (MNCs) often got the upper hand in the beginning of the contractual relationship, but since the amount of investment and assets grow bigger

over time, the risk of losing them also increases; thus, the government could gain a stronger position. This shifting is very likely to happen in mining as the industry typically has longer contracts and high investment. The risk increases because the government's capacity to act in any mining affairs could also grow over time as globalisation in information and technology make information and education sharing across borders more intense, creating a younger generation of both political and economic elites.

Various studies in host government and MNC relations assume that MNCs have stronger position than governments, especially regarding natural resource industries such as hydrocarbons. This asymmetric bargaining power results in a bargaining outcome that is more favourable towards MNCs' interests and goals. This condition results in a dynamic relationship between governments and oil companies. In the early stages of the oil industry, MNCs dominated both access to factor production, technology, and the market. Several scholars have argued that one of main concerns of MNCs is the 'outsider' status in the host country (Eden and Molot, 2002). This means that there is liability of foreignness that they have to overcome in the early stages of their activities after deciding to enter. MNCs attempt to develop their organisational legitimacy by building sustainable and trustful relationships with the state. This legitimacy can be enhanced by developing partnerships with local partners.

Bargaining advantage refers to the bargaining resources and capabilities that determine actors' available choices to achieve their goals. Grosse (1996) argued that the outcome of government and MNC relations is dependent on the bargaining advantage each actor has. Each actor brings their own resources and strategies to the negotiation process. Both factors are assumed to determine the alternative choices available and the ability to pursue their goals. In his schema about the bargaining context between the host

government and MNCs, Grosse (2005) concluded that the government is the one which sets the rules of the game in their relations. This is different from our view that the rules of the game are determined by all actors in the oil industry.

Obsolescing bargaining relations provided early theory on state and firm relationships. This framework assumes such relations as a zero sum game, which means the advantage of one actor is a disadvantage for the others. The bargaining model considered governments and companies not as rivals, but as partners to gain wealth (Vivoda, 2011). Companies possess resources protected by property rights as well as tacit and relational resources. The first variant is related to a firm's specific advantage, especially its financial and technological abilities, while tacit resources result from its strategic operation and learning process. The relational resources place companies in their networks and relationships with other actors, thus determining their access to information and knowledge about market conditions, rivalries, and the political, social, and economic environment at the national and global levels.

The bargaining model focuses on the first-time or initial bargaining process between governments and foreign companies (Vivoda, 2009 and Vivoda, 2011). The outcome that is taken into account is an MNC's decision to enter the host country. Foreign companies can choose to invest or not, while the government can choose to receive the investment or not. However, it is generally assumed that investment will benefit both parties. In the initial process, the MNC has a stronger bargaining position as it is assumed that the MNC always has the option not to invest and to move the funding to other countries, while the same option might be not available to the government. There are many countries that have similar comparative advantages that offer different incentive structures to attract foreign investment, whereas governments do not always have other

sources of investment. Thus, in this initial phase, MNCs can gain more benefits than the government. However, over time, the advantage becomes obsolete and shifts towards the government as it has more mature industrial capacities and sufficient funding, managerial capabilities, and technological ability to sustain the production process. Furthermore, through their cooperation with MNCs, the government obtains access to the international market. Thus, both production capability and the ability to sell products shift towards the government.

Eden, Lenway, and Schuler (2004, p. 2) define the political bargaining model (PBM) as “iterated political bargaining negotiated between government and companies over a wide array of government policies at the industrial level”. It uses transaction cost principles and a resource-based view to sharpen the obsolescing bargaining model (OBM). The OBM assumes that bargaining relations are the function of compatibility and conflicting goals, resources, and capabilities of actors. The more resourceful and capable the actors, the more they are able to gain benefits from this bargaining. However, the PBM assumes that perceptions about each other and abstract objectives, for instance the need for learning and knowledge, also influence such bargaining. MNCs enter host countries not only to gain access to the domestic market and factors production, but also to learn and gather more knowledge and skills about various strategies to handle different situations. MNCs’ global competencies are derived from their abilities to survive in various environments. They learn from their subsidiaries in many countries. The PBM emphasises the attachments and relations MNCs establish with their domestic affiliates. It takes time and commitment to build and develop positive relations since, within the host country, MNCs are often viewed as enemies and rivals for wealth and power. In conclusion, governments and MNCs are involved in a political bargaining relationship where their interaction agenda is not only about ownership and profit sharing, but also

wider industrial and economic issues (Eden and Molot, 2002, p. 4). Moreover, MNCs seek more favourable public policies through their interactions and negotiations with governments and other economic actors.

Furthermore, Brewer (1992, p. 301-302) classified four typologies of issue that are important in analysing bargaining relations between government and MNCs: distribution, regulation, protection-interaction, and redistribution. These typologies are based on the tangibility and consistency of the impact of a policy on MNCs' actions. MNCs are assumed to actively attempt to change their political environment; they do not passively react and the political environment is not given. Distribution issues appear when the policy impact is tangible and symmetrical. MNCs enjoy many benefits and incentives from their relations with government and therefore it is not directly conflictual. The protection-interaction issues emerge when the impact is symbolic and symmetrical. All companies have to deal with the same conditions when this issue appears as the government has the same policies towards them. They are classified as regulation issues when the impact is tangible and asymmetrical, the government and MNCs' relationship is conflictual, and it happens in an open political process. MNCs act collectively in order to have a more significant impact on the political process. Lastly, redistribution issues are indicated by symbolic and asymmetrical impact. MNCs' elites interact directly with governmental elites and reach a consensus. Furthermore, the determinant of MNCs' power differs across issues. The sources of MNCs' power in these issues originates from their access to governmental elites, an exceptional negotiation ability, and the cohesiveness of companies' coalition to pursue their interests in the political process. Thus, this issue approach emphasises MNC's organisational ability as partners of the government to develop the economy.

The cooperative bargaining model refers to adjustment of one's behaviour to the actual and anticipated preferences of other actors (Luo, 2004). This model acknowledges cooperation and competition as the nature of bargaining relations between governments and companies. Both happen simultaneously through partnership interaction. Cooperation is indicated by accommodation of the needs of others, interdependence of goal achievement, and collaboration of capabilities between actors. On the other hand, competition indicates both opportunities to bargain and the probability of conflict. Luo created this newer version of the bargaining model as a criticism of the previous theory which emphasised more on the competition and conflict between governments and MNCs to gain access to resources, exploit them, and control revenue generated from them (2004, p. 432).

Luo created four types of competition and cooperation relations in government and MNC interaction: estranger, contender, partner, and integrator (2004, p. 437-440). The estranger type reflects a distance relation between actors. They are not interdependent and their interactions consist of compliance and circumvention. Compliance means that actors follow the rules of the game, while circumvention means one actor challenges the supremacy of the others. This actor attempts to break the constraining rules that the other actors follow during their relations. In the contender type, there is limited interdependence between both actors but their bargaining power is asymmetrical. In this condition, the outcome from their interactions depends on both actors' range alternatives. The one with the greater bargaining power is likely to gain a more favourable concession from this process. In a conflictual situation, one actor can apply the threat to exit or the threat to expropriate.

The partnership type means that MNCs attempt to accommodate social needs in the host country and comply with domestic values, norms, and traditions. This means that

MNCs seek to achieve an 'insider' position in the national industry as they need legitimacy to survive and overcome the liability of foreignness. Lastly, in the integrator type, governments and MNCs create a coalition to reach their objectives as their resources are complementary and their goals are interdependent. There is a close interaction that is reflected in personal relations from both elites. The common pattern of behaviour from the actors is accommodation; they tend to have compromising preferences and strategic actions to respond to the demands of others and changing conditions. MNCs tend to influence the host government's policies through lobbying and take advantage of political and economic support from their home government.

The ability of each actor to access, gain and process information from their interactions is different. This difference can lead to asymmetric information power and capabilities to respond among actors. Thus, actors always face uncertainty during their interactions with others. An institution can overcome this problem by providing access to information that is available to all related actors; however, this is also problematic since each actor can be considered as a rival to the others. Access to information is one kind of power that can be a source of comparative advantage within one actor. This issue involves the distributional dimension of an institution and means that an institution has to gain information from each actor to distribute it to the others. On the other hand, from the actors' perspective, it means that each actor has to give up their comparative advantage in order to gain more from the institution. This distributional dimension is also a consequence of being within an institutional framework. This is why institutions can constrain actors' behaviours and limit their choices of action. The initiators of the institution usually design an institution that is long lasting, can be inherited by a successor, and can be used to anticipate the movements of others.

2.5.1. Actors' Capacity:

Good resource governance is related to government capacity in four sectors: policy-making, strategy-making, operational decision-making, and monitoring and evaluation (Lahn et al., 2007, p. 8). Alternatively, Lubiantara (2017) explained that the governance structure in the hydrocarbon sector is often related to how the government and political elites perceive oil and gas; for example whether it is perceived as merely a commodity or as an engine for economic growth. There is a huge difference between both perceptions in generating national resource governance in Indonesia. The first perception leads to strict regulation with little flexibility and consideration for economic and business challenges that companies are dealing with locally, nationally, and globally. This condition makes regulative and practical elements of institutional arrangement in resource governance insensitive to the dynamics of the international and domestic oil market and competition. On the other hand, the second perception is assumed to give the authoritative body in the governance a broader view, more flexibility, and greater sensitivity with regards to the company and market situation. Hence, the four capacities mentioned earlier could be analysed as closely related to government perceptions regarding the extractive sectors.

Meanwhile, Weiss (1995) posited that state capacity determines whether it is able to govern an interdependence situation with business entities. She believed that there are differences between commanding, leading, and governing, where the latter would give the best result as the government and companies are able to cooperate and collaborate in achieving their goals although they actually have different goals. Such capacity is known as transformative capacity and, with their institutional structure, developing countries are considered as the ones that have the privilege to do the governing.

Actors' capacity is often closely related to their strengths and weaknesses, which are determined by their institutional and administrative capacity. In other words, state capacity is determined by how much can be achieved by forcing other actors to act in accordance with the state's own path to success.

2.6. Comparative Historical Institutionalism and the Process Tracking Method

As a scientific journey, I use a comparative historical method in an attempt to answer my research questions. This method provides tools for both exploratory research and an analytical framework in my attempt to understand resource governance in Indonesia. This means I can find the process of change in the governance as well as in the larger context, the national political and economic realm. After finding such process(s), it is possible to analyse the mechanism of change in the resource governance of both the hydrocarbon and mining industries. Lange (2013) named this tool the process tracing method.

I use both narrative comparisons as the methods for comparing the process and mechanism of change in two extractive industries in Indonesia: the hydrocarbon and mining industries. I have chosen this method as, in the preliminary research, I found that both sectors started with the same regulation but at a certain point the institutional arrangements for both changed and developed in different directions.

This study is a qualitative research that uses interviews, documents, journals, and books as the primary and secondary resources. The interviews are conducted in Indonesia with governmental agency representatives and company representatives. In addition, I was allowed to observe a meeting between SKK Migas and the oil and gas contractors in 2015 discussing the recent policy issued by the Bank of Indonesia which obligates the business entities to use the Rupiah as the main currency in their domestic transactions,

including in the domestic oil trade between companies and between companies and the government. I have also been able to obtain additional information from various hydrocarbon companies by attending an annual exhibition for the hydrocarbon industry held by IPA (Indonesia Petroleum Association) in 2016. The collected data and information is analysed using the process tracing method.

Understanding the social world has stimulated philosophers and social scientists to develop social science as a separate discipline from natural science. However, there are competing perspectives about social reality, especially from naturalists and constructivists (Moses and Knutsen, 2012, p. 7). Naturalists believe that in the social world there is the 'Real World' that is separate from our perception about it, while constructivists believe that the truth in the social world is socially constructed and determined by people's perceptions about it. Naturalists emphasise the importance of reasoning that is backed up by the observable reality and the single truth and pattern in social reality. The followers of this view believe in the existence of general patterns of human action. On the other hand, Constructivists believe that people's actions are derived by their perceptions and beliefs regarding the world and therefore the meaning behind this action can help us to understand social facts. There is no single method to understand and discover the social world because each social event is unique and has different meaning for actors. Although constructivists argue that there are many ways to capture the meaning behind human behaviour and actions, they value case study as an important method to analyse and understand it (Moses and Knutsen, 2012, p. 7-12).

However, nowadays, social scientist cannot be fully divided into both categories as there is also a moderate perspective known as scientific realism, which acknowledges the complexities of truth and understanding within the social world that are influenced by

human perceptions and actions. However, along with naturalists, scientific realists believe that besides people's construction of social reality, there is the 'Real World' out there. They believe in different paths and ways to understand and discover the 'Real World' and thus avoided the generalisation of social facts. This is because most social facts consist of multiple layers of human interpretation and consequently the falsification principle cannot be applied. Scientific realists also contend that different contexts can lead to different behaviours and actions. Thus, the social world is an open system and not a closed and rigid one. It is unpredictable and uncertain (Moses and Knutsen, 2012, p. 12-14).

All three perspectives recognise the same method in conducting social research such as case studies, statistics, and comparative methods. However, Moses and Knutsen (2012, p. 15-16, 49) argued that naturalists have a hierarchy of methods with experiments as the first and primary method to discover the 'Real World', whereas non-experimental methods such as statistics, comparison, and case studies are secondary. On the other hand, they posited that constructivists analyse the processes and sequences of events throughout time in order to find the meaning of events (Moses and Knutsen, 2012, p. 225). Process tracing is an important tool to ascertain the interlinkage of historical events. By doing so, constructivists can understand more about an event based on its context, the actors' motivation, roles, and interpretations, and the interactions between actors and the context of space and time. Regarding this tendency, naturalists value the narrative method when studying social events and extract social facts (Moses and Knutsen, p. 231). Moreover, Mahoney and Rueschemeyer (2003, p. 11-15) argued that causal narration in the sequence of events and historical process throughout time is the central focus in conducting this method. Lange (2013) posited that there are three kind of analysis in this method: the causal narrative, process tracing, and pattern matching. The causal narrative is a useful

tool to answer why questions, while process tracing is most suitable for how questions.

Pattern matching is applied to test the ability of a theory or concept to explain a case.

Comparative analysis is significant in order to extract conclusions regarding how different political systems affect the decision-making structure and relationship among oil actors, especially in developing countries which are known to have a unique and specific political structure, ideology, culture, and process. I contend that the collaboration of those systems shapes the way in which the domestic political and economic elites establish their relationships and achieve their commitments, while at the same time gaining profit and leverage.

A process tracing and process-oriented narrative comparison research has been designed to explore the similarities and differences in the selected cases (Lange, 2013, p. 48). Process tracing is a term usually used in the case study method. It focuses on the sequence of events throughout the research time frame in order to illustrate the institutionalisation process and the development of institutions. Such research conducts analysis on data collected during research by paying attention to the process, the sequences of events as a whole within a case (Bennett and Checkel, 2015, p. 7). Bennett and Checkel explained further that the method could be used for many purposes such as testing hypotheses about causal mechanisms explained by or generated from a theoretical framework, developing (complementing) existing theories, or developing new theories (2015, p. 7-8. See also Trampusch and Palier, 2016, p. 439).

There are several steps to conduct process tracing research. According to table 2, which shows types of process tracing (Trampusch and Palier, 2016, p. 443), my research could be categorised as explaining outcome process tracing that is part of a more inductive type of process tracing. This method has been chosen as I want to understand

how and why institutional change happens and results in different trajectories for different kinds of extractive industry in Indonesia. Trampusch and Palier (2016, p. 448) explained that “the main merit of process tracing is to unpack causality and how it develops in time”, and “if one states that context and time matter, one needs to use process tracing, because things do not happen ‘ceteris paribus’ and mechanisms have to be understood within their specific institutional and historical environment”. This explanation also implies that the types of hypotheses derived from theories would reflect a probabilistic model rather than a deterministic one as suggested by supporters of Bayesian logic. I decided not to use Bayesian logic in my process tracing method as I do not intend to prepare and generate deterministic hypotheses to be tested in my research. I prefer, for the sake of the intention to provide alternative analysis to that produced by resource curse researchers, I went back and forth between the theories used and the findings during my research. By doing so, I purposely had an imaginary discussion between my understanding about theories and my findings in order to generate a more thorough analysis about the way in which such development has taken place in Indonesia’s resource governance.

I learned where to look in the case being studied by theoretical framework used in this study and I generated the causal mechanism used in my hypotheses from the theories. The change in institutional arrangement of resource governance in two extractive industries in Indonesia is the outcome that I seek to analyse, while actors, environment, interactions among actors (and their initial to current capacities) as well as interactions between actors and the environment are the causal factors. By using process tracing, the analysis searches for a causal process and mechanism behind institutional change in the resource governance generated by the causal factors as informed by theories. One general process and three general mechanisms generated from the theories discussed earlier form

the basis for my hypotheses: the learning process (including the process of openness), and enforcing, adaptive, and transformative mechanisms.

The way in which the process tracing method is actually used in my research is as follows. The first step is to identify the actors and interconnectivity among actors so that the initial condition of the institutionalisation process can be inferred. The next step is to derive the institutional development and determine the feedback, adjustment, and enforcement mechanisms. The exploration and explanation of the institutionalisation process and the institutional development of each case is the first goal of the design.

Subsequently, by using process-oriented narrative, the similarities and differences in the institution is generated and the findings can be placed in their own context in order to find the limitations and any issues which may affect the findings when they are applied in other contexts. By doing so, the researcher can achieve a deeper and broader understanding of the cases.

2.6.1. Data Collection

A study about governance over a long time frame requires the collection of historical data from literature and relevant official documents. Additionally, interviews are conducted to observe and analyse the preferences of actors, their perceptions towards each other, their current situations including their perceptions about opportunities and problems, and challenges within the current institutional arrangement. Selected interviewees are mainly high profile persons in their respected organisations, especially the ones from government agencies and national and local companies. Some of them are former or current chief secretaries for their respective offices. Meanwhile, interviewees from foreign companies have different backgrounds; they are mainly employees without a structural position within their companies and only one of them has a higher position.

It is also part of the ethical considerations to ask for permission to mention their names in this thesis. Thus, for the purpose of not implicating their individual positions and their organisations, persons from the companies are mentioned as representatives from national or foreign companies without their names or their companies' names.

2.7. Operationalisation of the Frameworks and Method

Process tracing has been chosen as the most suitable method to analyse the data as it investigates a changing situation from an initial point towards a point of destination. The user of this method often uses a causal mechanism in their analysis. There are two important principals in doing this method. The first principal is recognising the connection between the initial and destination point in a specific context (or case), and the second is recognising actors as individual actors and looking at them from the perspective of actors' relations. I generate several steps in conducting this research from those two principals.

First of all is determining the point of departure and the point of destination. One thing I have focused on during the research is recognition of the initial point and the development points of the extractive industries institutions. By doing so, the difference in the development paths in the hydrocarbon and mining industries have been accurately captured and it has been possible to avoid judging and treating the governance in both sectors as uniform. Treating both institutions and the actors' relations using the same viewpoint is the main problem in analysing their development process.

In this stage, I identify governmental agencies that closely interact with companies as targeted sources for interviews. SKK Migas, Ministry of Finance (MoF), Ministry of Energy and Mineral Resources (MEMR), House of Representative, and one Governor in Indonesia are the one who agree to be interviewed. The Governor of West Sumatra is

chosen as the one region that have been through all phase of interaction with mining companies since independence. The mines in the area were already closed but the local government succeeded to transform it into tourist destination. In addition, I also pinpoint big foreign oil and mining companies that have long period of interaction with government, especially the ones that have experienced regime changes in the country. I choose one random NMC, among 3 other NMC, that have headquarter office in Jakarta and 1 regional-owned company, to get general views about government and companies relations from state-owned companies' side. Furthermore, I come to IPA exhibition in Jakarta in order to make short interview to many MNCs at the same time and place. Unfortunately, only 1 FOC welcome to have a discussion about the topic and the rest are rejecting my intention.

The second step is by identifying the dominant and participant actors. In this step, I look into each actor's actions and learning experience through the actors' relations perspective. Therefore, the focus is on the relationships among actors while analysing individual actions. By doing so, I connect the learning experience of an agency individually with its interaction with other actors. It is important to note that the government consists of various agencies vertically and horizontally, meaning that each agency simultaneously deals with agencies at the same level as well as those above and below. Meanwhile, the companies also consist of various types based on the ownership and nature of their jobs.

Lastly, the third step is positioning the actors' relations into the institutional development process. This is an important process as the connectivity between actors' relations and the development in extractive industries governance is the main hypothesis in this research. By using this logic, I have conducted two case studies by looking into the

hydrocarbon and mining industries separately, with the findings then compared for a wider analysis. This process demonstrates the value of looking into natural resource governance in the resource-rich countries sector by sector rather than treating the extracting industry as one entity.

The challenge involved in analysing the results of the interviews is to validate the data mentioned during interviews and also to triangulate it with documents, articles, and papers released by the government, as well as news and reports from official websites and respected national newspapers. It should be possible to look beyond those sources to extract a rigorous and valid understanding about both the sectors being studied and the context surrounding them. Next, discussion between frameworks and my understanding will lead to an analytical outcome that was expected to be constructed and reconstructed or refocused and expanded throughout my period of research depending on new insights and understanding gained during the research process. This is one of many advantages of conducting a qualitative within-case research method in which I could closely engage with and imagine dialogues between theories, data, and context. Of course, such research also becomes a disadvantage for more positivistic researchers and methodologist as the analytical outcome is often highly objective and not generalisable. In this regard, I follow Lange (2013) methodological framework to ensure my design and method are stated clearly in order to give a sense of transparency and an accountable research process while also making me more responsible with regards to how my research is conducted.

2.8. Conclusion: Basic Assumptions and Hypothesis

This is not an evaluation research as there is neither proposed ideal resource governance nor a government and business relationship that functions as a model to evaluate government performance in governing extractive industries. In addition, unlike

the resource curse it does not focus on government performance. Rather, this study focuses on institutional change itself, something which is rare in existing studies of resource-rich countries. This is not a behavioural study like rentier state studies and neither is it a story of progress; instead, it is a story of evolution and change.

What kind of problems, shortcomings, or critics for researches on institutionalism does this thesis answer? First and foremost is the scarcity of research on institutional change that considers both the dynamic of institutional arrangement as well as the dynamic of actors and their interactions with each other. Secondly, this research provides an alternative framework to look into resource governance in a developing country without starting its assumption from resource curse prejudice or presenting a negative portrayal of resource nationalism. It is valuable to look into the institutional elements and processes as well as the mechanisms provided by such countries in governing their extractive industry by giving full acknowledgement and consideration to their complex political, economic, and social environments.

In earlier studies, institutional change has been understood and analysed as a change in equilibria. Emphasising equilibria as the paramount desire for order created by an institutional arrangement is one way to simplify the complex nature of a social environment. However, this simplification is not helpful for academia or the public to understand more about resource governance in developing countries. The goals and desirable outcomes of institutional arrangement could differ depending on actors' preferences and situations. The goals could also change over time. The government, as one of the dominant and important institutional actors, for example had survival as the primary goal during their early period of independence. Over time, the goal shifted from gaining more sovereignty and independence to: economic development; protecting the

domestic market; smoothing the country's industrialisation; gaining more revenue from its ownership over land and resources; gaining more independence from foreign imported products; or distributing wealth more equally to the country's citizens and securing domestic demand within certain markets. This complex goal structure has not been captured well by previous studies on institutional change. Thus, I contend that actors' learning process and their capacity structure influence the way in which institutional change happens.

On the other hand, institutionalists have acknowledged the multidimensional characteristics of institutions (see North, 1991). However, empirical studies which illustrate this complexity are still limited. The interconnectivity between institutional actors at different levels has not received sufficient attention. This interconnectivity is vital to understand the complexity which could make the gap narrower between what institutionalism sees and what, how, and why an institution exists in reality. The study also contributes to existing literature on the study of government and business relations by presenting the complexity nature of this relationship due to the different perceptions and situations experienced, seen, and perceived by related actors. There are also differences in actors' capacities to access information, analyse, and understand it to do their respective role in the institutional arrangement.

CHAPTER III

INDONESIA'S POLITICAL ECONOMY DEVELOPMENT

3.1. Introduction

Indonesia is one of the developing countries that survived the economic and political crises in Asia which started in 1997. This country has experienced a vast changing political, economic, and social environment since the 1998 reformation, which marked an end to President Soeharto's 32-year authoritarian regime (Acharya, 2015). Despite various criticisms of how the government dealt with problems emerging from the inexperience of political and economic actors in a dynamic Indonesia, it is important to recognise the survivability of this nation having undergone various problems both nationally and locally. It has faced challenges in a more globalised and interdependent world and has been able to survive and build the country. Unfortunately, analysis about the problems faced by governments in developing countries is more dominant than analysis about the dynamics of their political and economic institutions.

Indonesia's Oil Industry was developed in the early era right after the country's independence as the government needed to collect development funds to start industrialisation (Chalmers and Hadiz, 1997, p.5). There are three rights in the hydrocarbon industry. Mineral rights mean the rights over the resources beneath and above the land, while mining rights mean the rights to explore and produce oil from oilfields. The final aspect is economic rights, which mean the rights to get profit from oil trading (Sanusi, 2004). Based on the Dutch Colonial Mining Law before independence, the concessionary contract was the only oil contract model (Carlson, 1977, p. 8; and Darmono, 2009, p. 18). Based on this model, the government did not have any control over a company's activities. Furthermore, the government's only task was collecting

royalties and tax from the company. In other words, the company had ownership rights over the land and the resources beneath and above it during the contract period. This system was greatly opposed by the government of Indonesia because, according to article 33 in the 1945 Constitution, the government has sole ownership of the land and all resources beneath and above it and is obliged to use it to provide welfare and wealth for the citizens (Darmono, 2009, p. 18).

Meanwhile, it is important to explicitly note that elites and citizens in the early period perceived the hydrocarbon industry as a source of instant development funds and also as an important sector supporting their industrialisation projects and the economic development of the newly independent Indonesia. However, they also had a different perspective and suggested strategies about how to manage this extractive industry (Darmono, 2009, Chapter VI and Machmud, 2000, p. 48-54). One group, known as nationalists, perceived the domestic ability to control and manage the operation of oil and mining fields as showing a strong and sovereign Indonesia while foreign investment, especially from the former colonial power, the Dutch and its companies, as a threat to the national politics and economy. Nevertheless, another group perceived foreign investment and having good relationships with foreign companies and their home states as important in boosting national economic projects. These contrasting opinions are always present among elites and citizens, thus affecting the dynamic behaviour and attitudes in national and local environments.

Luong and Weinthal (2010) proposed to look at four types of ownership structure that they believe to be determining factors in a government's performance to maximise national revenue from oil companies' operations. They posited that the government's control over the industry is the result of the ownership structure of natural resources. Moreover, the way in which the government conducts its authority over the industry

determines how much profit can be collected from oil mining operations. According to their classification, Indonesia is moving from S1 to S2 types of structure. It means that Indonesia had a state ownership with control and afterwards has a private ownership with control over its extractive industry. In this regard, these authors decided to determine ownership structure only from the oil regulation (Luong and Weinthal, 2010, p. 7). This is misleading because the country actually has two separate resource governance for its hydrocarbon and mining sectors. Considering ownership structure is institutional arrangement in the resource governance, generalization about the type of ownership structure based only on the rule element of both sectors is not a good starting point for my research. I found that there is no change in the country's ownership structure as it is always a state ownership with control. The change actually happens mostly in procedure element of institutional arrangement. Chapter IV, V, and VI present the further analysis to prove such hypothesis. Nevertheless, their books gave me insight on how to highlight institutional change in this thesis.

This study found that resource governance could have different forms in different resource sectors despite all being governed by the government of Indonesia (GoI). The hydrocarbon and general mining sectors, as part of the natural resource industry in Indonesia, have different institutional arrangements. Questions about why and how such differences have resulted from similar political and economic systems have triggered my interest in conducting this research. Such differences in governing the natural resource industry have rarely been noted and analysed in previous researches about resource-rich countries, creating an over-simplification regarding the complexity of resource governance in developing countries.

The complexity is a consequence of the dynamic and changing political and economic conditions faced by the government both at the national and local levels

(Davidson, 2015, Chapter II; and OECD, 2016, p. 21). This situation also means that, despite external dynamism that should be dealt with, the country also has an internal dynamic situation as national and subnational political and economic actors grow and develop. Although institutionalism is often criticised as lacking in its ability to study dynamic and changing situations, this framework, especially its historical and sociological branches, recognises the development of actors in dealing with the changing social settings and environments.

Indonesia has been chosen as the case study because of the fast and dynamic development of the political and economic governance during the country's 67 years of independence. The country has already experienced authoritative, transition towards democratic, and limited liberal democratic governmental systems while maintaining Pancasila (The Five Principles) as the national ideology (Davidson, 2015). This dynamic situation has had a two-sided influence for Indonesia's development as a whole. It has helped the government and society to become more mature in managing their internal affairs as well as their interactions with international actors, particularly foreign companies. On the other hand, the situation has made it difficult and less-attractive for foreign investors to enter and sustain their operations. Regime change usually also policy, attitude, and strategy alterations. Therefore, business entities should always be ready to have a different strategy to deal with new elites with new policies at both the national and subnational levels.

This political dynamic not only happens at the national level but also at the regional level, and it results in greater uncertainty in predicting future challenges the company may face during its operations in the country. There is no insurance that it will be able to continue to operate in a changing political and social situation once there has been significant investment of capital in the exploration phase. Changing authoritative

elites, especially at the regional level, could lead to changing regional regulations or opposition to the company's operations from elites or local citizens, which could hinder or become a disadvantage for their operations in the region. On the other hand, companies also have to deal with the dynamic of international business as well as the high risk, high cost, and time consuming nature of the industry. The decreasing value of coal in the international market since 2014 is a recent example of difficulties faced by coal mining companies as they had to adjust their economic calculations about their operations and strategy to survive and make profit.

As a trade commodity, minerals have been widespread since the Industrial Revolution. However, many societies had already used minerals and done simple mining activities in order to obtain minerals from the earth. Coal was mainly used as an energy source to operate industrial machines and electricity, while other minerals were used as raw material for producing goods. After hydrocarbon was found and its usage became widely known in the 1800s, coal mining was significantly neglected as the former was cheaper and easier to use. However, after the Oil Boom in the 1980s many countries and companies sought alternative energy sources to reduce their dependency on oil, which was mainly produced by members of OPEC. Therefore, coal mining has emerged in many countries and this has marked a new beginning in coal mining industries in developing countries, including Indonesia.

3.2. Institutional change in Indonesia's political and economic sectors:

The country has undergone a particularly dynamic political and economic situation since its independence. Literatures on the history of Indonesia such as Booth (1991) considered looking into the country's development, starting from the pre-independence era; however, the very distinct nature of the pre- and post-independence

governmental structure – caused by the difference between colonial and native governmental elites – is not actually helpful in understanding the process and phases of institutional change which took place in resource governance. The government in both periods are completely changing. However, the problems become legacy made by colonial for the independent government. Among the problem is the existing oil contract made by colonial with Shell, Stanvac, and Caltex.

The independent Indonesia also experienced a changing political structure as the president changed. This change and dynamism did not mean that all sectors transformed into a new structure, instead it had elements of continuation, transformation, and also change in which old forms and ideas influenced, were infused into, or were replaced by new ones. The elements of certainty and flexibility are mixed together to form a unique structure in each country. Thus, we could see certain form of enforcement as well as adaptability in forming and executing government policies and dealing with problems and challenges. Weiss (1995) called this ability the transformative and adaptive capacity of the system. Both capacities are vital for a country's survivability. However, Weiss limited her proposition to the main elements differentiating between developed and developing countries, in which the former are considered to govern their countries' interdependence with private sectors. Hence, we could conclude that the survivability of a nation is closely related to its experience with institutional change. Institutional change in resource governance involves political economic elements in the country.

This study attempts to examine why and how the GoI has produced different institutions for the hydrocarbon and mining industries even though both are considered as extractive industries. This approach is valuable for further studies aiming to discover the complexity of institutional arrangements for governing extractive industries in developing countries. In addition, this study could serve as an alternative to and be complementary

for the resource curse as the dominant analytical framework for exploring resource-rich countries.

The structure of resource governance is closely related to elites and citizens' perception regarding foreign involvement in the national economy (Booth, 1991). Experiences of the nation determine such perceptions. Indonesian elites did not gain much opportunity both in political and economic structure during the colonial era, while native Indonesians generally suffered from colonial violence and a repressive approach to ensure their compliance. Both actors gained bitter experience regarding foreigners governing their country and claiming ownership of their natural resources. Rejection and negative views towards foreigners, especially those from the Netherlands, the origin of Indonesia's colonists, was not unexpected, neither was President Soekarno's decision to choose the Soviet Union and other communist countries as his closest allies to lead the newly independent Indonesia.

However, the gap between ideology and practice was determined by national capacity to develop the political and economic sectors as a newly independent country. At that moment, there were too many unsolved problems and too little resources and ability to actually find and executing proper solutions. Inexperienced elites as well as bureaucrats and a lack of native businessmen were among the major problems. Looking back into that period, it was a particularly complex situation that a newly independent country had to face in order to survive.

Historical institutionalists posited that previous choices could constrain elites' range of choices and capacity to execute them. North (1991) also argued that the incentive structure among elites and elites' groups determined the direction of institutions and institutional change as well as development. For the early period of the Republic of Indonesia, this perception might hold true. The first and second Presidents of Indonesia –

President Soekarno and Soeharto – were the main figures in the Indonesian political structure. During their regime, all trajectories of national political and economic development were determined by them and their groups. Both periods contributed to the growth and development of national bureaucratic structure and capacity, as well as domestic businessmen. This contribution, nonetheless, was not perfect or entirely beneficial for the country. The main negative outcome from both periods was the neglected local political capacity improvement. This problem was a consequence of a highly strict central authority in managing subnational affairs, and it was unsurprising that the decentralisation policy in 1999 produced many problems which persist today.

Industrialisation in Indonesia is closely related to rent collected by Pertamina and later on by the GoI from hydrocarbon companies. President Soeharto determined industrialisation as an important element for positive economic growth that could prolong his regime. Authoritarianism was chosen as a viable and best strategy not only for his position, but also for a stable political situation after the challenging political and economic environment following the end of the Soekarno regime. Both presidents had a very different approach and strategy to govern political, economic, and social life nationally and locally. Soekarno chose socialism as the best political ideology for Indonesia, while Soeharto chose a mixture between nationalism and liberalism in his government. Moreover, Soeharto emphasised the importance of strong national economic structure with industrialisation as a key component in his development projects to solve national problems. Such decisions determined the future of the nation's resource governance while also ending the struggle of both elites and citizens during the isolationism conducted by Soekarno. In the Soeharto era, Indonesia was a country able to take advantage of its openness and cooperation with foreigners through foreign investment, loans, and aid, as well as foreign companies' operations in the region. This

situation was not evident during the Soekarno era as he was fundamentally against foreign involvement in the country.

Such extreme differences in governance style and approach from both regimes contributed to the way in which the nation developed its resource governance. The most basic thing the country could learn from both regimes was that isolationism generated only problems without viable solutions to national problems; openness and cooperation with other countries and foreign companies would be better and more advantageous than closing all doors. The only thing both elites and citizens need to learn is to handle and manage such relationships better for the interests of both the nation and the companies. There is no advantage to being so self-centred in a relationship with global actors. Managing and balancing both interests will be an important but challenging task for the government. It is even more challenging as the actors involved in the relationship are not simply the government and companies; the government consists of various bodies with often overlapping authority and roles, each possessing their own perceptions, goals, strategies, and capacities as well as pride. Meanwhile, the companies involved also have different scope of action, role, and organisational model. Such complexity is something that has often been over-simplified by previous studies involving resource governance and is therefore the primary contribution this study makes to the literature on resource-rich countries. The analysis about institutional change in Indonesia's resource governance considers the positioning of those actors within both the process and mechanism of change.

The following analysis relates to the phases of industrialisation in Indonesia. At first, national economic structure was mostly determined by the agricultural sector with farmers and farming made the biggest contribution in the national financial structure and revenue. This situation persisted during the Soekarno regime because no other economic

activity was conducted during this period. Soekarno halted new mining contracts for foreign companies until a new regulation made by the newly independent Indonesia that was different from previous contractual system, which was considered as harmful and threatening to the national interest. However, although they could not continue their operation due to security reasons due to the *Lasykar Minyak* occupation in their oilfields, the previous holders of mining contracts – the big three companies of Shell, Stanvac, and Caltex – were respected and recognised by the national government (Darmono, 2009; Machmud, 2000).

In the Indonesian context, the bureaucratic organisations of government are clearly developing themselves. This developmental capacity is evident from their commitment to engage in various international negotiations, to adopt new international agreements, and to cooperate with preferred developed and developing countries compatible with the national interest. Such openness indicates that the nation does indeed have the adaptive capacity to learn, interact, cooperate, and make commitments with others. It also means that Indonesia does not have weak institutions that only consist of dominant elites pursuing their own personal interests while neglecting the public interest. Soeharto built the country to have a transformative capacity to deal with crises, take advantage of its international networking to conduct development projects, and produce national leaders and statesmen for the future.

Nevertheless, his way of doing things was not without flaw as there was a trade-off and negative as well as unintended outcome from his policies and the decision to run the country in an authoritarian manner. He sacrificed local political elites and dynamics for the sake of national stability, chose businessmen of Chinese descent as his economic allies, used liberal and socialist political practices pragmatically and strategically, limited access to politics, and let his family and cronies have their own way in pursuing their

personal economic interests (Bowie and Unger, 1997, p. 45-48). His supporters and opponents exist until today as he indeed contributed greatly to the current existence and survivability of the Republic of Indonesia. He succeeded in leading the country through various political, economic, and social crises, while at the same time creating huge problems and challenges that the country and its citizens still have to deal with today (Robison, 2009). Weak, pragmatic and self-centred local elites, with weak transformative and governing capacities, are among the problem caused by Soeharto's 32 years of oversight and disregard towards subnational authority and power, as well as the unequal attention paid towards the regional development. Hence, variation in the regional elites' capacity in governing their political and economic affairs made a company should be aware and adjust with variety of local elites' attitudes and approaches in managing the region. Operating in different regions means that the company might need to have different strategies to handle administrative and public affairs with local governmental agencies and elites.

3.3. General View on Hydrocarbon and Mining Industries in Indonesia

There are at least two dominant opinions within Indonesian political economic elites on governing extractive industries. On the one hand, the liberalist and neoliberalist supporters attempted to liberalise the old nationalistic, centralistic, and close bureaucracy in the governance of the economic sector. They argued that liberalisation is a key proposition to achieve rapid economic growth with a balance opportunity to all citizens in their pursuit of wealth and better productivity and efficiency in the bureaucratic system governing the economic sector (Chalmers and Hadiz, 1997, Chapter IV). The involvement of political elites could hinder such growth by making governance less productive and efficient in supporting economic activities. On the other hand, the pro-nationalistic approach advocated a more conservative approach in developing and

reforming the political and economic sectors. Their main point is the imbalanced capacities of local political and economic actors to compete at the same level with their national and international or multinational counterparts.

Immediately following Indonesia's independence on 17 August 1945, the most important political affairs were the unity of many islands and the people under the same nation state and government. Alternatively, in terms of economic matters, the government needed huge amounts of capital to establish a proper economic system in accordance with Indonesia's experience with other countries and foreign companies (Oon, 1986). In order to handle both critical problems, the government initially used nationalist as well as socialist jargon. During President Soekarno's legacy, there was tendency to apply communist and socialist systems; however, the nationalist movement challenged this view.

From the historical path above, we can draw a pattern of institutional development in the hydrocarbon industry. At first, when the government needed hydrocarbon revenue to drive development in other economic sectors, all management and authority was given to Pertamina, the only national hydrocarbon company. Pertamina's action and movement were under direct supervision from the President. Thus, despite the company's obligation to give an annual report to the Ministry of Mining and Energy, it had to report to and ask permission from the nation leader. This condition meant that the Ministry had an indirect line of command and little ability to influence Pertamina (Sidemen, 2015).

However, during the 1998 economic crisis, the IMF asked the government to reorganise its national resource governance based on liberal and neoliberal ideas (Nasution, 2015, p. 2). In the oil industry, the government decided to override Pertamina's authority over exploration, production, and distribution of oil and gas by releasing UU No. 21 Tahun 2001. Ibnu Sutowo, former President Director of Pertamina,

was concerned about the company's decreasing capital to develop oil and gas industries. This is because, before 2001, the oil and gas revenue was collected and managed by Pertamina. On the other hand, since 2001, this revenue has been collected and distributed by the government through the Ministry of Finance.

On the other hand, the discussion above also shows that the oil industry's players were also dynamic. Initially, private companies dominated this industry; however, over time governments in some countries tried to gain some control to fulfil domestic needs by various strategies (Victor, Hults, and Thurber, 2012). The most common way was by forming a national hydrocarbon company that has tasks and authorities are varied, including negotiating and signing contracts. Both governments and business entities should also be ready to adapt to those changes. The challenges involved in entering the industry and maintaining operations within an area not only originate from the host government's policy but also the political and economic situation and changes in the home country, as well as global changes. These factors influence the ability of players to enter and to stay in a country, as well as the rules of the game. For example, in the beginning a major Multinational Oil Company can dictate the contract and usually work with their own company branches and subsidiaries. However, the more challenging the area (in deep sea or remote areas), the more risk the company is exposed to. This encourages joint operations among foreign companies or between foreign companies and national companies, which can have positive and negative effects for both parties. However, looking at the growing number of joint operation agreements in Indonesia, this approach was a favourite strategy of both foreign companies and Pertamina.

The path taken by the GoI to manage the hydrocarbon industry has varied over time as is evident from different regulations, governmental bodies involved in the industry, and Pertamina's position in the industry. All agreed that hydrocarbons were an

important resource for the industry and a source of income for the government. However, the way in which governments have regulated, managed, and involved themselves in the industry varies, especially in developing countries due to their political, economic, and social institutional development. There are always new and different positions of actors, levels of openness to outsiders, and external challenges. Those factors influence a government's strategic view and actions in handling the industry.

Institutionalism, especially historical institutionalism, sees this matter from the learning process perspective (North, 2005). All events, negotiations, and arrangements result from a learning process for both the government and the company as they have to deal with each other to achieve their goals. As long as there is a mutual need, they had to adjust to each other. The situation could be more complicated when there is external pressure that tries to change the rules of the game. This was the case surrounding the pros and cons of law number 22 of 2001. The liberalisation of the hydrocarbon industry was not something initiated and discussed by the main actors, the government, Pertamina, and the FOCs. Instead, it began with the government's need to obtain a loan from the IMF. The letter of intent signed between GoI and IMF clearly stated that the loan would be given with several requirements, one of which was to liberalise Indonesia's oil industry (Nasution, 2015, p. 2).

During the first stage, right after independence, the government acted in groups of Ministries and Governors, as well as Armed Forces and Parliament to make important decisions and establish the blueprint for Indonesia's hydrocarbon industry. As Pertamina dominated the scene, it handled most activities including negotiation, signing the contracts, and controlling as well as evaluating FOC operations. This initiated the second stage, starting from 1971, where Pertamina and the contractors were the main players in the industry. Pertamina managed all activities from listing and offering working areas,

negotiating terms of contract with foreign companies, handling the negotiation with various governmental bodies and local government, issuing permission to conduct operations, approving working plans, and evaluating as well as watching the works and achievements. The Ministry of Energy only received annual reports from those activities (Sidemen, 2015). Above all domination, Pertamina was closely managed and took orders from President Soeharto. The company was seen as money machine to develop Soeharto and his family's legacy in Indonesia's political and economic scene (Robison, 2009). The third stage of change happen GoI established an agency under MEMR to handle day to day affairs regarding hydrocarbon business operations with the companies. Pertamina's task is shifting toward purely operating hydrocarbon business, without having responsibility as administrator for oil contractors anymore.

3.3.1. Historical Path of the Hydrocarbon and Mining Industries

The Dutch colonial government started mining activities in the East Indies (Indonesia) during the 19th century (Darmono, 2009; Poeradisastra and Haryanto, 2016). Previously, it had focused more on producing crops and various spices as valuable trade commodities in Europe. The first mining concession was obtained by a private tin company named "Biliton" in the Belitung working area in 1850. This management policy was followed by the establishment of Jawatan Geologi in 1852, which was responsible for managing the mining concessions and mining companies in the region. At this time, mining activities were managed based on 1810 Netherlands Mining Law. Another concession was given for coal mining in Ombilin, West Sumatra in 1891.

The mining management and policy from 1900 until 1960 was based on the *Indische Mijnwet* 1899 and the 1906 *Mijn Ordonantie* as further instruction in implementing the *Mijnwet* (Zulkifli, 2014, Chapter I; and Darmono, 2009, Chapter IV). The *Mijnwet* also explicitly stated that the mining concession would be exclusively given

to Dutch or Dutch-based companies. The colonial government had the authority to issue mining concessions for valuable minerals, while concessions for mining activities of other less-significant minerals were given to local government. This statement was criticised by other countries, especially American-based mining companies and the US government. Thus, the *Mijnwet* was amended in 1910 with an additional article known as article 5A, which stated that foreign investment was allowed in the mining industry in the East Indies via a contractual system, not a concessionary system. This article was further amended in 1918 to allow the colonial government to take part in exploration and mining activities in other areas than those already specified in the contracts and concessions with mining companies. This centralistic approach succeeded in boosting exploration projects and mineral (especially tin and coal) production. Until 1938, 471 mining permits were issued by the colonial government; these permits allowed the companies to independently manage their organisation and operation and also own their production while paying tax and sharing with the government.

During the Japanese occupation from 1942-1945, the Japanese Army established a *Chisitsu Chosajo* or a Central Office of Mining Governmental Agency. However, as they focused more on producing oil as the main energy source for their industry at home and for the war with the allied forces, there was no general mining activity during their occupation period. After Indonesia's independence, the mining industry was intended to be conducted by the government and Indonesian citizens or companies. However, at that time Indonesia did not have any means to take over the industry in terms of capital, technology and skilled workers. Thus, there were no mining operations until the first Mining Law issued in 1967 (Hayati, 2015).

The Dutch colonial government managed mining licensing as well as mining activities within the East Indies (Darmono, 2009). Previously, they attempted to

monopolise the industry only to government-related companies. The colonial government established a Special Committee for Mining in 1852, which later became the Colonial Mining Office (Dienst van het Mijnwezen). The office was responsible for conducting geological exploration to find exact mining reserves as an important step to expand mining activities in the region. The first coal mine was operated in Ombilin, Sawahlunto, West Sumatra in 1891 (Darmono, 2009; Arif, 2014). The private sector collaborated with the colonial government in operating the mines. However, the increasing international demand for coal products as well as the increasing interest from the Dutch private sector in Indonesian mines helped to end the monopoly.

The most important event for mining rules in the region during this period was the independence of the East Indies. This huge shift in the region meant that the colonial government policy and decision-making was no longer the determinant factor in the industry. The political and economic transition period was the most important and anticipated time by international as well as domestic elites as the first step would determine the direction of mining governance within this newly independent and resource-rich country. At this time, nationalistic sentiment was widespread domestically due to severe discrimination and painful experiences during the colonial period. Thus, the government could not take citizens' voice lightly, especially during the critical moment when the Dutch government actively rejected the independence declaration and attempted to reacquire governance by using diplomatic and military means.

After independence, a group of former Indonesian workers in the oilfields during Dutch occupation gathered to establish a movement. They were known as *Lasykar Minyak* (Oil Troops) (Darmono, 2009, p. 118). This group established small oil companies in order to manage existing oilfields left by foreign companies during World War II. One local company was named Permiri (Perusahaan Minyak Republik Indonesia/

Republic of Indonesia's Oil Company) in 1946. The company managed oilfields in South Sumatra but it was disbanded in 1948; although it succeeded in repairing refinery facilities in Plaju, these facilities could not be operated because there was still no oil production during this time.

Other major oilfields were in North Sumatra and Aceh (Darmono, 2009, Chapter VI). Lasykar Minyak had established Tambang Minyak Sumatra Utara (North Sumatra Oil Mining/ TMSU) and Perusahaan Tambang Minyak Negara (State Oil Mining Company/ PTMN) in Aceh. However, Shell owned the fields and according to the Round Table Agreement, the government had to recognise and protect their contract. The status of those oilfields triggered an internal conflict between pro-liberalism, pro-communism, and nationalism during the 1950s. Meanwhile, pro-liberalism elites sought as much help and investment as possible from foreign countries and nationalist and communist spokespeople demanded that government should not recognise its contracts with FOCs, especially Shell. They believed that Indonesian would be able to revive and operate those oilfields by themselves. In the middle of this chaos, Serikat Buruh Minyak (SBM), one of many people's movements which was pro-communism, formed Perusahaan Tambang Minyak Republik Indonesia (PTMRI) in North Sumatra and Central Java.

Regarding Shell's decision to sell oilfields in North Sumatra, security reasons were the primary factor. The company was seen as a threat due to its Dutch origin. Furthermore, *Lasykar Minyak* (Oil Troops) took over the area and it has been a source of internal conflict ever since (Darmono, 2009, p. 118). The government tried to control the group's movements by establishing a Sumatra Utara Oil Company and appointing pro-government elites from the Troops as the director. The company was supervised by both the Governor of Aceh and the Governor of North Sumatra with the help of the Indonesian Army. In June 1957, the government held a meeting in North Sumatra regarding the

oilfield's status. The Mining Work Commission, established after the Hasan Petition, suggested that the government should return the site to Shell. The suggestion was approved in the Cabinet meeting, but the economic commission in parliament did not agree. Thus, the conflict also affected the government's ability to produce a timely solution. Nevertheless, Government Regulation number 24 in 1965 declared that the government took over the North Sumatra oilfield. This regulation marked government control in the oil industry (Darmono, 2009, p. 18-19).

The GoI committed to building a strong national economy by establishing several national mining companies after issuing a policy to end all mining contracts made by colonial government and take over all assets of Dutch-based companies. PT Antam, PTBA, and PT Timah were established to take over management and operation of mining operations in Bangka, Belitung, and Singkep. As the GoI held a majority share in these companies, it could enjoy subsidised fuel and electricity (Antam, 2016). However, this leverage only persisted until early 2000 when the government finally decided to cut subsidised fuel to businesses because, unlike in hydrocarbon businesses, national mining companies do not have a public service obligation. The NMCs are business oriented and owned by the government, yet they do not represent direct government management of the industry. The government emphasises the importance of developing vertically-integrated mining operations wherein the raw minerals are processed domestically before exports and international sales. This policy is designed to increase the economic value of Indonesia's mining products. The national companies often had an image as merely land diggers, while the importer countries and foreign companies could buy Indonesia's raw minerals at a cheaper price and sell their already-processed mining products on the international market at a higher price.

The local people are also actors in the mining industry. Some of them take part in small scale mining operations individually or collectively. The activity is often unknown by local authorities so it is difficult to manage. Moreover, if it is conducted in a mining working area, it could lead to conflict between the company as the contract or license holder and the local people (Prayitno, 2017). On the other hand, the citizens are also the landowners. The contract or licensing only means that the company has a license or permission to mine in the working area without any guarantee that mining operations will actually take place. Thus, it should pay rent to use the land to the landowners and local government, fulfil all requirements, get permission, and submit documents before starting the project. The process might take a long time and involve negotiation with various authoritative bodies and elites. Moreover, such companies should consider a community development programme or company social responsibility (CSR) project suitable for their operating areas and also take part (usually financially) in local events. There are some companies who handle political and social activities by themselves, while others use independent organisations for such activities.

From 1945 until the late 1960s, the GoI's focus on developing its economic condition could be seen from the structure of its first ministerial cabinet. They established the Ministry of Industry and Trade, which was the leading actor in managing Indonesia economic sector (Darmono, 2009). However, the newly independent country had to face economic stagnation in the late 1960s due to the lack of capital to pursue its industrialisation and economic plan (Booth, 1998, p. 168-172; and van-Zaden and Marks, 2012, Chapter VII). During this time, the nationalist sentiment became more apparent among citizens and political elites. They considered foreign investment as another form of foreign colonialism and imperialism which could endanger national sovereignty. Soekarno, the President at the time, considered socialism as the most suitable ideology to

govern Indonesia. He had absolute authority in governing all sectors and his regime had unlimited time. There was almost no foreign investment or operations during this time period. There was not only inadequate domestic capital, but also only a limited number of skilled workers who could handle industrial machines and managing business activities.

In the political sphere, there was an important change of regime from Soekarno to Soeharto after 1965. The Soeharto era marked the beginning of openness towards foreign investment in the Indonesian economy. His cabinet invited foreign banks and companies to fund national development projects, including the mining industry. The government determined that a contractual system should function as the basis for their relationship with foreign mining companies. While collecting funding for national development projects through international investment, the GoI also committed to developing domestic business capabilities to provide domestic needs of mining products and also to take over Dutch-based mining companies which had already nationalised in the early 1960s.

3.3.2. State Control and Foreign Investment

The hydrocarbon industry in Indonesia was established long before the country's independence in 1945. The colonial government established the oil mining industry, explored oil and collected rent from the oil mining operations in the East Indies (the former name of Indonesia). After the independence of Indonesia in 1945, a group of citizens took over the oilfields and demanded that the GoI nationalise the company.

The GoI managed the hydrocarbon industry after the independence, largely because of pressure from society. The oilfields in Java and Sumatra were abandoned by Caltex, Shell, and Stanvac (the only three oil contractors Indonesia inherited from the colonial government) during World War II, which was followed by Japanese occupation (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 13). The former workers in

those oilfields mobilise themselves and local people to confiscate the areas and demand that the government take over the facilities. They attempted to operate the facilities by themselves and asked for government support and mandate to do so.

The workers called themselves *Lasykar Minyak* (Oil Troops) and established three national oil companies in Sumatra and Java without the government's consent (Darmono, 2009). The companies were PTMNRI (Perusahaan Tambang Minyak Negara Republik Indonesia/ Republic of Indonesia Oil Mining Company) in North Sumatra, PTMN (Perusahaan Tambang Minyak Nasional/ National Oil Mining Company) in Cepu, Central Java, and PERMIRI (Perusahaan Minyak Republik Indonesia/ Republic of Indonesia Oil Company) in South Sumatra.

The resultant situation created chaos as the GoI was newly established and had too many problems to properly focus on the industry. Therefore, it chose the most plausible method to prevent the situation from deteriorating by giving authority to the Indonesian Army to manage the situation in the oilfields and surrounding areas. The Army worked together with local government to control the situation. During this time, the government decided to stop any oil industry activities from the three major oil companies: Royal Dutch Shell in Pangkalan Brandan, Stanvac in Prabumulih, South Sumatra, and Caltex in Kalimantan.

The companies had to wait for a further decision from the GoI regarding whether they could continue working with the previous contracts or negotiate new contracts. The GoI considered the fact that there was no money to support the national development projects and revive economic activities after the extensive period of Dutch and Japanese occupation. Moreover, the government did not have capital or capabilities to take over the oil industry itself. On the other hand, the oil industry had provided a significant funding for the colonial government for 50 years. Therefore, the GoI allowed the entrance of

foreign oil companies in Indonesia, starting with renegotiation of contracts with the three existing MNCs. The negotiation process took months, meaning there were no oil mining operations during this time. One of the important issues discussed in the contract was the requirement to sign and establish a joint venture between the MNCs and the three NOCs. The Three NOCs were formed from rearrangement of three companies established by the Oil Troops: Pertamina, Permina, and Permigan. Each MNC signed a contract of work (CoW) with an NOC. A CoW was a new form of contract to replace the concessionary contracts the companies had signed with the colonial government.

The national political system was unstable in 1950s. A Prime Minister could not hold his position for more than two years during this period. Thus, until 1950 there was no agreement among elites about how management in existing oilfields would be conducted and who would be responsible for managing them (particularly choosing between management by foreign or local companies).

In 1956, the government established a *panitia negara* (state committee) to analyse the importance of annulling the Roundtable Agreement and to determine the blueprint of national resource governance (Darmono, ed., 2009, p. 146). At the end of 1959, the commission completed their tasks and produced a draft law to replace the Indische Mijnwet 1899. The draft was meant to give back the ownership and control of the oil industry to the GoI and provide a mandate to the government to use it for public needs. Unfortunately, this draft did not become law until 1960 because of the pros and contras in the parliament about foreign oil companies' status in the national oil industry. However, from 1959 to 1960, no new oil concessions were given to foreign oil companies. During this process, the government attempted to regulate existing concessions according to national and public needs by conducting a series of negotiations with big companies, such

as Shell, Stanvac, and Caltex, to adjust the contract. This was a significant first step towards national oil and mining regulation.

During the commission's working period, the government issued PP No. 34 Tahun 1956 (Government Regulation Number 34 Year 1956,) known as the Banteng programme, in response to public demand to end the Dutch monopoly in vital industries such as the oil industry. This programme unilaterally discarded the Roundtable Agreement and meant that the government took over the oilfields owned by Shell. The regulation also specified government control over TMSU. This decision was supported by the North Sumatra population through a general people's meeting in 1957. To neutralise the intense situation in North Sumatra, the Ministry of Industry asked the Chief of the Indonesian Army to take over management of the oilfields in July 1957.

After lengthy discussions following independence, the government issued the first oil and gas law in 1960. According to Law Number 44/ 1960, Indonesia's oil industry had to be controlled through national companies (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 16). This law legalised the establishment of three national oil companies: Permina, Permigan, and Pertamina. The CoW became a new contract system wherein the government hoped to gain more rent and at the same time fulfil their obligation to secure the national interest. Under this new system, the GoI attempted to negotiate more favourable – for the government – terms of contract with both Stanvac and Caltex. After three years of negotiation, the first oil contract between Pertamina and Stanvac was signed, followed by Permigan and Caltex and finally Permina and Shell in 1966. However, before any activities took place, Shell decided to pull out of Indonesia because the growing nationalist sentiment resulting from their Dutch origin.

This decision was also considered as an opportunity for the Indonesian Army to take a greater role in the Indonesian economy and industrialisation process. Some of their

officials became general directors and directors in the companies. For security reasons, Major General Abdul Haris Nasution took over the oilfields and renamed TMSU as ETMSU (Perusahaan Eksplorasi Tambang Minyak Sumatra Utara/ North Sumatra Oil Mine Exploration) (Darmono, ed., 2009, p. 18). The Board of Directors was composed of the Minister of Industry, the Minister of Finance, the Minister of Trade, the Regional Military Commander in Aceh and the Governor of Aceh, the North Sumatra Military Commander, and the Governor of North Sumatra. Later on, the company was renamed Permina (Perusahaan Minyak Nasional/ National Oil Company) with Ibnu Sutowo as the Chairman (Darmono, ed., 2009, p. 146). The company succeeded in exporting its first production in 1958.

Another state oil company was Pertamina. The company was originally known as NIAM, a joint venture between BPM and the Dutch government. After Indonesia's independence, it became Permindo (Perusahaan Minyak Indonesia/ Indonesia Oil Company) in 1959 as a joint venture between BPM and the GoI (Darmono, ed., 2009, p. 147). After their old concession ended in 1960, the GoI took over all of the company's assets in the country and Permindo became Pertamina (Perusahaan Tambang Minyak Nasional/ National Oil Mining Company). It was responsible for distributing and oil marketing within the country and abroad. Pertamina took control of all oil and gas marketing and distribution tasks as well as facilities from the three major companies (Shell, Stanvac and Caltex) in 1963. Its position was legalised by Ministerial regulation Number 90/MP/OIL and Ministerial Regulation Number 66/MP/GAS in July 1966.

The government decided to maintain order and control of the situation in the Sumatra and Java oilfields by appointing the Indonesia Army to handle the situation. Both regions were managed and controlled by the Armed Forces of Indonesia until the situation settled. PTMRI in Central Java was renamed Tambang Minyak Nglobo (Nglobo

Oil Mining/ TMN), which later became PN Permigan (Perusahaan Minyak dan Gas Nasional/ National Oil and Gas Company). PN Permigan was established with Government Regulation Number 199 in 1961 and was responsible for operating oilfields in Cepu, Surabaya, Bongas (West Java), and Bula (Pulau Seram) after the GoI bought it from Shell. Permigan was found to have an affiliation with pro-communist elites during the political upheaval between the Communist Party and the Indonesian Army in 1965 (Sanusi, 2004, p. 23-24).

After the conflict was resolved, Ibnu Sutowo dissolved Permigan. According to Ministerial Regulation Number 6/M/OIL and number 66/M/GAS in 1966, PN Pertamina took over Permigan's tasks in marketing and distribution of oil and gas. The oil facility in Cepu was transformed into an oil and gas government training centre as part of the Oil and Gas Academy. The Academy was established in 1962 in Bandung, West Java, under management of the Ministry of Oil and Gas (Darmono, ed., 2009, p. 148-149).

Prior to the establishment of Pertamina and Permigan in 1961, the GoI established its first state-owned hydrocarbons companies, Permina in 1957 (Darmono, 2009). The Army was mandated by the central government to keep peace in the surrounding area of the North Sumatra oilfields. General A.H. Nasution, the Army's Chief Commander in Sumatra, appointed Major General Ibnu Sutowo – an Army doctor who was known for his hardworking character – to turn around the Indonesia hydrocarbon industry which had been dominated by foreign companies for more than 50 years with zero Indonesian involvement (Karma, 1979). Although Indonesia lacked the necessary capital and technical capability to manage the industry at the time, Ibnu Sutowo proposed a nationalistic project to strengthen the GoI and NOC bargaining position in comparison to the FOCs. He worked together with the Indonesians who had previously worked in the oilfields to recover the facilities. Later, in 1968, he became the first President Director of

Pertamina and was also appointed as Minister of Mines. This event marked the beginning of the military's dual role in the security and civil sectors. Thus, the establishment of first NOCs could be seen as a competition among Indonesian key elites, the Armed Forces and the technocrat-bureaucrats in the government.

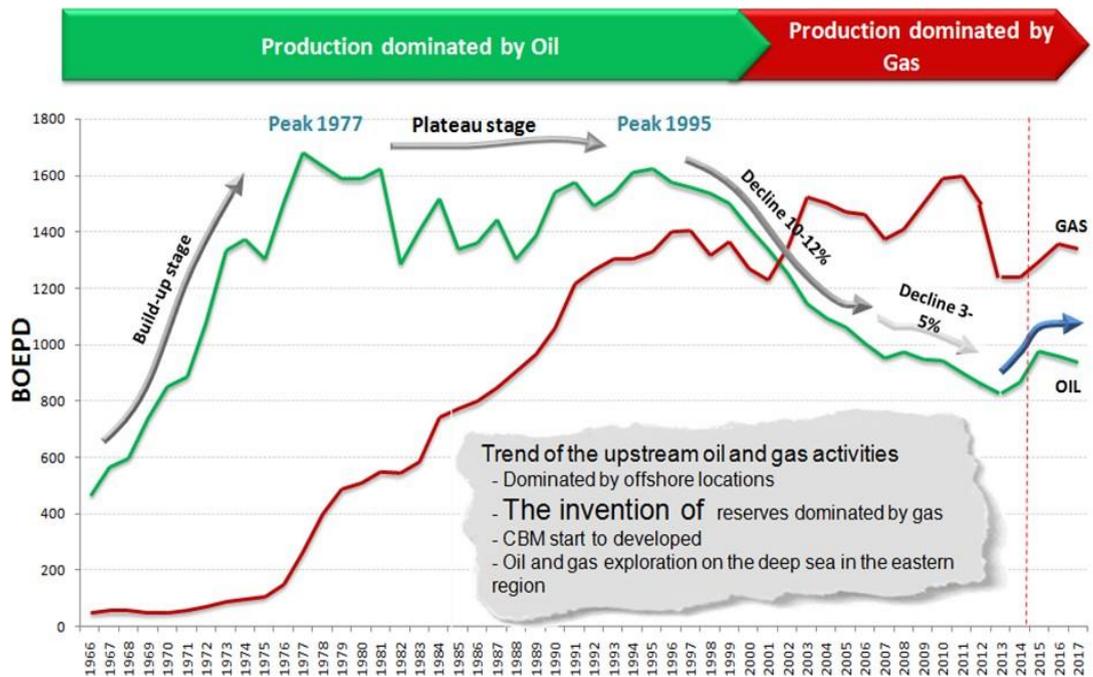
Even though this contractual system was better than concessions, the majority of the public wanted to take over all oil industry activities. This situation encouraged the government to establish an integrated national oil industry by bargaining to buy all oil production and refinery facilities of Shell, Caltex, and Stanvac (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 19-20). Shell's assets were bought in 1965, but Stanvac's facilities were not acquired until 1969. In addition, the government released a new contractual system called profit sharing contracts to replace the contract of CoW work. From 1966 to 1975 (end of Ibnu Sutowo leadership period), there were 59 already-signed production sharing contracts (PSCs), while during the Piet Haryono era there were 25 PSCs.

In conclusion, the development stage in the governance of Indonesia's hydrocarbon industry was the establishment of Pertamina with authority as supervisor and manager of the oil contractors. A short historical explanation in this subsection is important to demonstrate how personal exchanges were dominant prior to institutionalisation of the interaction between government and companies. After Pertamina gained authority over the industry, the institution entered the first stage of its development, which is similar to North, Wallis, and Weingast's limited access order (LAO).

The oil and gas sector contributes significantly to the national revenue (Kuncoro, et al., 2009, p. xiv). From 2003 to 2006, it shared 29% of national revenue and 69.5% of non-tax revenue. Until 2006, the exploration activities found 1.23 billion barrels of oil

and 1.37 trillion barrels of gas. However, more than 90% of oil production came from the top ten companies with Chevron Pacific Indonesia as the top player. On the other hand, 87 to 93% of gas production was dominated by ten companies with Total as the leading one. Pertamina was still a secondary player in both oil and gas production.

Chart 3.1. Indonesian Oil and Gas Production Comparison



Source: SKK Migas, 2014

Indonesia's upstream activities exist both offshore and onshore (Kuncoro et al., 2009, p. xv). The offshore operation is concentrated in East Kalimantan, while the onshore activities are concentrated in Riau, South Sumatra, and East Kalimantan. Gas is mostly produced from oil and gas fields in South Sumatra and East Kalimantan.

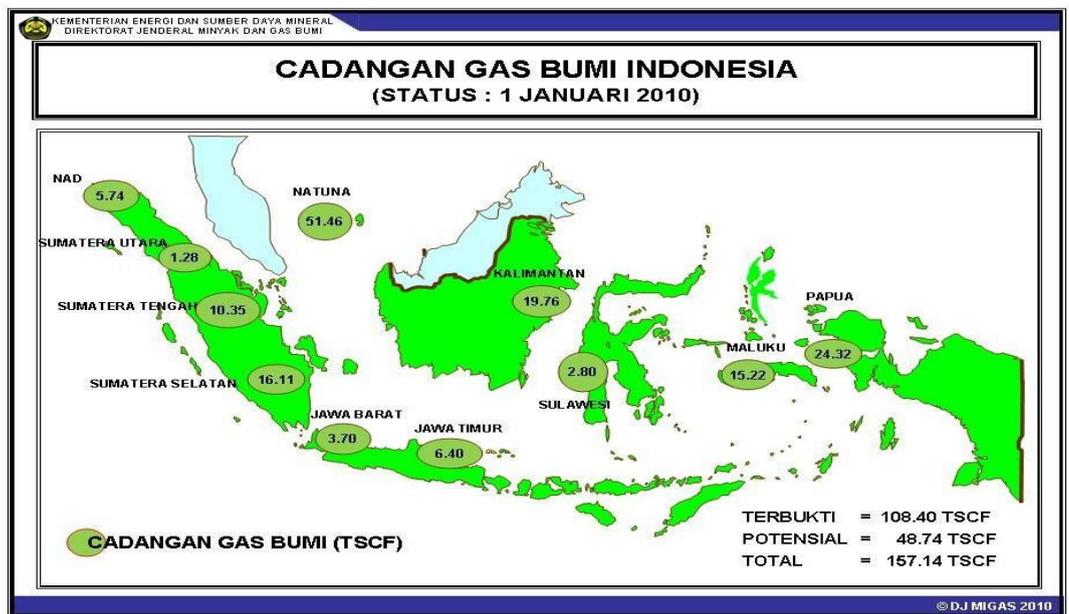
Figure 3.1. Indonesia Oil Reserves



Source: Directorate General of Oil and Gas, Ministry of Energy and Mineral

Resources, 2013

Figure 3.2. Indonesia's Gas Reserves



Source: Directorate General Oil and Gas, Ministry of Energy and Mineral

Resources, 2010

Since 2001, there has been no significant exploration activity and very little investment in exploration. This condition has been worsened by old, dry oilfields exploited since the 1970s as well as broker activities in the oil industry, especially regarding the ability of Pertamina and the government to buy or sell oil directly from producers or to consumers. Another problem that an unhealthy oil trading system has created inefficiency in collecting revenue from national production and consequently the government and Pertamina have lost profits from oil exports. This practice was already known since the 1980s, but the government did not take any action to reduce or limit it because influential political and economic elites were enjoying significant profits from this activity, with no concern about public needs and the national interest.

Oil rent has funded various national development projects (Patmosukismo, 2011, p. 131-155), especially during the Oil Boom. During the early 1970s, oil contributed 27% of the total national revenue and in 1981 its contribution doubled to 71% (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 22-23). Pertamina also succeeded in rebuilding oil facilities and locating new onshore oil and gas sources. The first new offshore resource was found by Japan Petroleum Company (Japex) in 1965. Afterwards, there were several identifications of offshore oil reserves in many areas. In 1958, Indonesia was also able to export raw oil until the country became an OPEC member from 1962 to 2006. Unfortunately, during this peak period, Pertamina's profit was not managed by the Ministry of Finance (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 23). It was intended to fund and was used by the Army and President Soeharto's cronies to build their business empire. Pertamina's financial condition was covered during Ibnu Sutowo's management and was revealed after overseas newspapers revealed Pertamina's financial crisis in 1974. Up to 1976, Pertamina was unable to develop a strong national oil industry with the available revenue.

Moreover, the company had incurred debt from various overseas banks to build the infrastructures needed for the oil industry and to invest in various social and business sectors, as well as to function as a money machine for politicians, the Army and President Soeharto's cronies. The company invested in many non-oil sectors without government consultation (related ministries, such as the Ministry of Finance). This condition led to the NOC financial crisis during the first Oil Boom in 1973. Foreign media and the Sinar Harapan, a national newspaper, were among the first to release the news (Setiono and Juwono, ed., 2013, p. 43). The Minister of Mining and Energy, Mr. Sadli, reacted in August 1975 by announcing that the government would take over Pertamina. Several ministers and heads of governmental bodies worked together to overcome the crisis.

3.4. Conclusion

The intention of this study is to analyse institutional change in the hydrocarbon and mining industries in Indonesia. I took an interest in this topic because the tendency to study resource governance in developing countries obscures the fact that resource governance consists of a complex web of interaction and relations among actors with institutional arrangements related to their interests, operations, and responsibilities. For the purpose of this study I compare institutional arrangement in the hydrocarbon and mining industries in Indonesia, finding that both have different configurations and trajectories despite being conducted by the same government, led by the same Ministry of Energy and Mineral Resources for their operations and Ministry of Finance for their financial affairs.

These different resource governance styles are difficult to identify and analyse when we use the resource curse and resource nationalism because both frameworks direct our attention more towards resource governance performance and outcomes. On the other hand, using historical institutionalism has enabled me to find the differences as it is

necessary to investigate the historical path of both industries and track the development of both institutional arrangements until the present. Resource governance literature provides an important insight to focus my analysis into government and business entities as the main actors in institutional change. Various literatures derived from resource governance and institutionalism are also used to complement this analysis. Governing interdependence and governing capacity, as developed by Weiss and Hobson (1999), as well as frameworks of government and business relations are used to assess the mechanisms and processes of institutional change in Indonesia's resource governance.

This chapter is crucial to establish a template of the resource governance established by GoI and developed over time through its continued and long lasting relations and interactions with the private sector. It provides analysis about the political and economic environment affecting institutional structure and arrangement occurrence. Both institutional arrangement and actors' capacity have developed significantly since 1945. The bridge between those processes of change is the actors' interactions and their relationships. Hence, dynamism and change is an important analytical framework in both empirical and theoretical terms. Understanding change is important to lessen the gap between theoretical or hypothetical situations and empirical or factual conditions in political economy. This understanding requires knowledge and understanding about the complexity of situations that influenced the scope of the case and the related actors. It therefore provides a better and more complete picture of what actually happens in the field instead of assuming where and why things go the way they do solely based on partial information about the situation. Thus, it is valuable to combine historical institutionalism with the other analytical frameworks employed in this study.

CHAPTER IV

INDONESIA'S HYDROCARBON INDUSTRY

4.1. Introduction

The hydrocarbon industry in Indonesia has a distinct institutional arrangement that is different from other mining governance systems in the country. This uniqueness is primarily determined by its institutional structure generated from the contractual system between government and businesses, as well as national political and economic structures. Such structures determine actors involved within the arrangement; however, they do not mean the actors involved are solely established by the institution. Hydrocarbon governance is influenced by various institutional arrangements involving national and subnational structures, as well as political, societal, financial, monetary, environmental, and administrative structures. The governance is also determined not only by government-business relations, but also inter and intra-governmental relations, inter and intra-business relations, business-society relations, and government-society relations. Therefore, at an empirical level, resource governance has an extremely complex web of interactions involving various levels and forms of institutional arrangement. For analytical purposes, this thesis focuses on government-business relations to explain the institutional change and transformation in Indonesia's hydrocarbon and mining industries.

The history of the national hydrocarbon industry is much more than Soeharto's cash cow, the rentier state tendency, and the resource nationalism vs liberalism discourse. Looking back to the beginning of the industry after independence in 1945, former Indonesian workers in the oilfields occupied the land and attempted to convince the government that they could continue the operations and that the industry should be

managed by Indonesia for Indonesian people (Yuwono, 2014, p. 43-50; Bartlett III, et al. 1972. P. 57-130). This sentiment emerged from the painful experience of being neglected and discriminated and the wealth gained from their natural resources during decades of foreign occupation, as well as from the fear of once again being mere bystanders after independence. Unfortunately, studies about resource governance in developing countries have often neglected such historical facts. This initial decision determined the next steps taken by the government through various agencies and reactions of the companies related to both sectors to the newly independent country, as well as the institutional arrangements established in the sectors. During 1960 to 1971, both hydrocarbon and mining industries had a similar governance trajectory and structure. However, as the nation's governmental structure changed and transformed, the hydrocarbon and mining industries were governed by different institutional arrangements despite still being controlled by the government of Indonesia (GoI) (Machmud, 2000).

This thesis provides an analysis of the institutional change experienced by the hydrocarbon and mining industries in Indonesia. This specific chapter explores why and how governance in the hydrocarbon industry has developed, changed, and transformed to its current state in 2019. The analysis contains the development of institutional arrangement and its surrounding political and economic environment.

4.1. The Rule Element

The GoI had a significant opportunity to attract foreign oil companies as a result of the already-known oil reserves and production before independence, especially investment from Japan and the United States. However, national sentiment was paramount after independence, especially hatred towards Dutch companies. There are three rights in the hydrocarbon industry: mineral rights, mining rights, and economic

rights (Sanusi, 2004). Based on the Dutch Colonial Mining Law before independence, the concessionary contract was the only model of oil contract (Jin-Bee, 1982, p. 11-17). Based on this model, the government did not have any control over company activities. Furthermore, government only collected royalties and taxes. In other words, companies had ownership rights over the land and the resources beneath and above it during the contract period (Darmono, 2009, Chapter VIII). This system was greatly opposed by the GoI because, according to article 33 in the 1945 Constitution, the government had sole ownership over the land and all resources beneath and above it and was obliged to use it to provide welfare and wealth for the citizens.

The first regulation for the mining industry in the Republic of Indonesia, including the hydrocarbon sector, was the Law No. 44 Year 1960 (Darmono, 2009, p. 164; Carlson, 1977, p. 11). The law was intended to replace the *Indische Mijnwet* 1899 as a basis for oil negotiation and contract after independence (Carlson, 1977, p. 8). However, the gap between intention and actual outcome was proven to be wide as inexperience negotiators and unprepared organisational infrastructure resulted in a series of stalled negotiations between the government and the three big companies which existed as a colonial legacy (Shell, Stanvac, and Caltex). The negotiation mainly discussed the transition from the colonial concessionary contracts to another form of contract, namely Contract of Work (CoW). Distrust between both actors was not unprecedented as this was the first time they negotiated face to face in an unstable political and economic condition of newly independent country and under threat of the *Lasykar Minyak* (the Oil Troops), who occupied the companies' oilfields immediately after independence. The occupation and Soekarno's later choice to halt any decision regarding the oil industry had cost them more than 10 years of operation and profit. The CoW with Shell, Caltex, and Stanvac was negotiated from 1960 to 1963 (Machmud, 2000, Chapter 3). The negotiation stalled and it

was hard to achieve any agreement because the companies were reluctant to agree to the GoI's new proposal. It specified GoI involvement in managing industries and it also stated the FOCs' position as contractors for state-owned oil companies. The GoI was determined to renew the contracts as mandated by article 33 in the 1945 Constitution¹ due to the growing nationalist sentiment among elites and people, and awareness of the importance of its hydrocarbon sector for national political and economic plans as well as for foreign countries. Moreover, through the new contract, it was expected that national oil companies and the GoI could not only gain a larger share but also learn how the FOCs operated and managed the industry.

This condition was relaxed a little bit after Soeharto took over the presidency and passed Law No. I/ 1967, open for foreign investment in the sector. The Law was complemented by Law No. 8 Year 1971, which legalised Pertamina as the only national oil company with vast authority to govern the hydrocarbon industry. These laws were valid and became the basis for resource governance in the sector for 30 years. Other regulations were made based on needs at the time. During that period of time, Pertamina remained unbothered as the leading actor in the industry in spite of the existence of related ministerial changes and the development of a national bureaucratic system.

Institutional change in the regulative element of this sector was mainly affected by domestic discourse between nationalism and liberalism, as well as the road to openness in the national political and economic environment. The government committed to have a continuous interaction with the outside world through various international organisations and to adopt a variety of international agreements. This affected the way in which governmental agencies functioned, transforming and developing their organisational

¹ Article 33 Constitution 1945 stated that land, water, and the natural resources beneath shall be controlled by the State and be exploited for the maximum welfare of the people

capacity to do their job and to cooperate with foreign organisations and enforcing the adoption of international codes of conduct in both activities. This implies that government have capacity to engage in discussion concerning different type of states involving new ideas and approaches and to

Pertamina also developed the ability to absorb knowledge and learn from the FOCs in terms of business operations to organisational and managerial aspects. Learning by doing was the system set and developed by Soeharto and Ibnu Sutowo to empower Pertamina in conducting its task as regulator and business entity, although the company was criticised for being a cash cow for Soeharto and his cronies, as well as being inefficient and lacking the capacity to dominate oil production nationally. Despite its weakness, it is both unfair and a huge mistake to undermine the things that only Pertamina achieved by being in its position for 30 years prior to the newest Law No. 22 Year 2001, which separated the company's regulator and business functions.

The regulator function is taken back by the government by establishing an Independent Regulator Agency (IRA), namely the Implementing Body of Oil and Gas (BP Migas) that only survived for 10 years (Davidson, 2015b). Although Davidson ignored the long history of this agency, which was actually born and established by Pertamina under the name BKKA (*Badan Koordinator Kontraktor Asing/* Coordinating Body for Foreign Contractor) in his article about the demise of BP Migas, this system of managing oil and gas contractors through a third party established by the government has been proven to be advantageous in ensuring the industry run wells and is generally under direct government supervision. Although it is not problem-free, this system is the primary reason behind the government's success in governing the industry until 2019 despite all

the problems and unsatisfying outcomes caused by the plummeting national oil production.

BP Migas was dissolved in 2012 by the Judicial Committee under acquisition of being against the 1945 Constitution as the agency was not a national company involved directly in oil and gas business operations (Sihotang, 2014). In addition, its position in the government structure was also problematic as the board of directors was directly appointed by and had sole responsibility towards the President. Moreover, its image of preferring to advocate foreign companies' interests rather than the national interest became a subject of criticism from nationalist factions among elites and citizens. On the other hand, Davidson (2015b) stated his assumption about the political economic circumstances behind the 2010 Committee decision to dissolve the agency despite the results of similar proposals and judicial review processes in 2003 and 2007 that were in favour with BP Migas. Unfortunately, the decision was not followed up by House of Representatives through the creation of a new oil and gas Law to replace the 2001 Law, which was in fact the basis of BP Migas' establishment in 2002. The result is that now, SKK Migas, established by President Yudhoyono as a temporary body to function as a regulator in the hydrocarbon industry, is an agency without the exact authority to complete its regulatory task (Lubiantara, 2017). The anecdote is that SKK Migas is the one that has a relationship with the companies, but Ministry of Energy and Mineral Resources (MEMR) is the one that marries them at the end. After the marriage, the agency is responsible for managing their day-to-day affairs with the companies (Sidemen, 2015).

In general, the regulatory development of the hydrocarbon sector could be categorised as both incremental and revolutionary, especially from the 1971 governance

regime to 2001. Pertamina was the centre of the hydrocarbon industry for almost 30 years. It established several systems to manage hydrocarbon contracts in Indonesia. In the earlier era, foreign oil companies were only allowed to operate in Indonesia by making a joint venture with Pertamina. The oil contracts given during this period were CoWs, which were a replacement for the concessionary contracts given by the colonial government before Indonesia's independence in 1945. In the CoW system, the government appointed the companies as contractors for Pertamina with the main task of oil mining operations in the agreed oilfields (Machmud, 2000, p. 48-51). The CoW was not the best choice because it was considered as a concession model in new terms. The system actually meant that the GoI and NOCs had greater control over and a bigger share of oil production, but it was different in the implementation. NOCs still did not get access to FOCs' operation and development plans, while the GoI also did not get as large a share as expected. This indicates that the government's main function was collecting tax and other forms of rent from oil production.

Initially, the government did not have a clear policy regarding the oil industry (Bartlett III, et al. 1972, p. 104-130). However, public opinion led to two choices, nationalisation or forming national companies to conduct operations in Indonesian soil. The government looked for a new contract model which it believed could satisfy both the national interest and national sentiment. On one hand, the government wanted to build a strong oil industry through national capital and capacities. On the other hand, it had no money to fund any development plans. Foreign investment was required to fund the newly established country. Nevertheless, a traumatic colonialism period caused by discrimination and exploitation of both Indonesia's natural richness and manpower also needed to be overcome. The government had to maintain Indonesia's independence while

gaining Indonesian's trust and support². The government proposed the new CoW model to replace concession model. The first CoW was signed between Pertamina and PAN AM in 1962 (Darmono, ed., 2009, p. 20; and Machmud, 2000, p. 48). This agreement referred to the first Government Regulation about Oil and Mining Industry No. 44/ 1960. The law affirmed foreign oil companies' status in Indonesia' oil industry. FOCs no longer had the right to mine and sell oil because they were contractors for the national oil companies. Thus, they had to sign contracts as contractors with Pertamina or Permina or Permigan in order to continue their operation in Indonesia. However, Shell, Caltex, and Stanvac were hesitant about this new position. After a series of negotiations, they agreed with this new contractual system. The agreement was known as the Tokyo Agreement (Jin-bee, 1982, p. 21; and Machmud, 2000, p. 48). The contract with PAN AM was considered as a prototype and became a pilot project to convince the big three to agree to the government's proposal (Machmud, 2000, p. 51-53).

According to this new law, the companies agreed to waive their concession contracts with the former colonial government and became contractors for a state-owned company (Machmud, 2000, p. 48). They were given 20 years to continue operations in the agreed areas and 30 years to explore new working areas. In addition, they had to provide oil for domestic needs and all facilities bought within the period would be owned by the GoI within 10 to 15 years (Darmono, ed., 2009, p. 21). Shell received two working areas in South Sumatra and Kalimantan, while Caltex took locations in East and West Java and Stanvac only got a working area in Sumatra.

²Being a legitimate and trusted government was very significant in order to maintain Indonesia's independence. This was because Indonesians consist of several tribes and societies. The main focus of the government was to build and spread nationalism, national identity, language, and culture that could be accepted by all societies and tribes.

The CoW was replaced by production sharing contracts (PSCs). This type of contract was adopted from Indonesia's traditional law between landowners and farmers (Machmud, 2000, Chapter 3). The first prototype was signed between Pertamina and the Independent Indonesian American Petroleum Company (IIAPCO) in 1966. There was doubt about the legality of the first PSC signed by Ibnu Sutowo and IIAPCO. A number of economists and politicians considered it as a violation of Law No. 44/ 1960, relating to the mining and hydrocarbon industries, and Law No. I/ 1967, relating to foreign investment (Machmud, 2000, p. 54). Afterwards, there was a group of politicians and economists who supported the CoW model and another group were more supportive of the PSC system. The State Ministry of Economy and the Ministry of Mining and Energy considered CoW as the shortest and most feasible way to get rent from FOCs' operations. The government needed to get significant amounts of money as soon as possible in order to implement their development plan and build a strong and prosperous Indonesia domestically and abroad.

PSCs were intended to allow the flow of information from the oil contractors to benefit Pertamina. The flow of information used several documents that needed to be submitted and approved by Pertamina before the contractor could start their activity. In addition, there was also an obligation for the contractors to submit reports quarterly and annually. Ibnu Sutowo, the first Director of Pertamina, proposed this system to develop the NOC's capacity as a mining company rather than just as a supervisor for contractors (Bartlett III, et al. 1972, p. 5-15).

However, Pertamina acted outside its authority by investing in other economic sectors not related to its core status as an oil company. This condition led to the Pertamina financial crisis in 1976. Following the crisis, the company lost its freedom to manage and

obtain more capital for mining operations. An important lesson from the Pertamina crisis was to diversify the source of national income.

Ibnu Sutowo initiated the PSC as a new form of oil contract in Indonesia (Bartlett III, et al. 1972, Chapter XIV). This contract was inspired by traditional agricultural contracts between farmers and landlords in Java. There were then several modifications to adjust to domestic and global challenges. PSC was meant to underline the ownership right of Indonesian over their land and any economic activities done (Bartlett III, et al, 1972). The contract is the sole model especially in upstream activities of the industry although the Law stated that other scheme could also be used. Government has bigger share in in the financial scheme of the contract (Lubiantara, 2015). This is to ensure that domestic demand on oil products is fulfilled by national production. Some financial related clauses in the PSC underlined government's perception in governing the industry (Henderi, 2017). The cost recovery clause in the contract implies government participation and commitment to develop the industry; given the government's authority to explore and exploit hydrocarbons from the land, companies are contracted to do so by giving them authority to operate in certain oilfields during certain periods of time.

After independence, oil products and revenue from oil industry is used to fund development and industrialization projects. However, after national production plummet before 2000, Indonesia is highly dependent on oil import to support national industries. The country decided to end their membership in OPEC in 2006 following the change of country's status from oil producer to net oil importer. This signalled a challenge to enhance exploration activities to find new oil sites despite the risk is high and the outcome is uncertain. Pertamina shift their focus from being a bystander with limited contribution to national oil production into a competitive companies seeking new contracts, especially in the commercial oilfields in which previous contract is already

ended. Its position as state-owned company gave them special privilege position where the company could submit proposal to target certain oilfields to the government. Such policy is challenged by the initial contract holder that wishing to renew their contract.

The first generation of the contract was those that were signed from 1964 to 1977. These contracts stated that Pertamina was the main operator and the contractors were obliged to provide all costs of operation (Lubiantara, 2015). The contractor could receive cost recovery payments amounting to 40% of total production each year and 60% of the production would be divided with Pertamina. Pertamina received 65% and the contractor got 35% (Henderi, 2017). Pertamina had to pay taxes based on the contractors' income. In addition, contractors had to prioritise the fulfilment of domestic obligations (minimum 25% of production) with a basic price of US\$ 0.20 per barrel per day. All equipment and facilities bought by the company were owned by Pertamina and 10% of the contractor's interest was given to the national company after commercial production. From 1974 to 1977, due to the Oil Boom, contractors were obliged to make additional payments to the government due to higher international oil prices (Sanusi, 2004, p. 30).

The second generation of PSCs was introduced in the 1980s. The change in the contract resulted from the United States' policy. The US government asked the contractors to pay their taxes directly to the host government rather than Pertamina as the national oil company. This contract stated that all operational costs could be considered for calculation as cost recovery. After total production and costs was calculated, 65.91% of production went to Pertamina and 34.09% went to the contractor. Moreover, for gas, 31.08% went to Pertamina and 68.20% went to contractor (Nasir, 2014, p. 272). The contractors were obliged to pay 56% of their taxes to the GoI and could also get several incentives regarding domestic market obligation (DMO) and capital calculation.

Alongside PSCs, Pertamina also signed several other types of contract (Sanusi, 2004, p. 131). The first type is Technical Assistance Contract (TAC). This contract was a partnership between Pertamina and private oil companies in order to rehabilitate mature wells or abandoned oilfields in Pertamina's working areas. The company was responsible for all operation management, while the contractors provided money for the projects. The contractors could claim cost recovery maximum 40% per year and received 35% of net production (total oil production after taxes). The second type is Enhanced Oil Recovery (EOR), which was a joint venture between the company and FOCs in order to increase oil production in Pertamina's oilfields. The NOC was obliged to cover 50% of operating costs, while FOCs covered the other half.

The institutionalisation of the industry happened after the Indonesian government gave Pertamina authority for managing the oil contractors and oilfields. This institution was influenced by changing domestic political, economic, and social conditions. It was also influenced by the changing prices and conditions in the international hydrocarbon market. In 1980, when the second Oil Boom took place in the international oil market, FOCs once again gained momentum to get more preferable conditions to invest in the hydrocarbons industry. In this era, FOCs, NOCs, and the government went hand in hand to gain larger profits from hydrocarbons.

According to Sidemen (2015), there was dissatisfaction with the 1971 regulation. FOCs wanted more transparent and accountable hydrocarbon business management, while many governmental bodies as well as local governments asked for opportunities to become involved in the business with the hope of financial gains. Hydrocarbon investment used to be managed under one control, Pertamina; even though Pertamina was also a player in the industry, it managed FOC contracts as well as any administrative requirements for an operation to begin within an area. This system could cut negotiation

costs and shorten any administrative and political preparations before operations. However, Pertamina could not work alone in order to empower and educate domestic private companies with regards to their involvement in the industry, as well as the involvement of local governments and wider society. With big responsibilities from upstream to downstream operation management, Pertamina could not establish efficient public communication with local governments and society around working areas. This condition led to misunderstandings between the company, government and society. Pertamina was accused of being corrupt and a golden goose for maintaining Soeharto's regime. While this may have been true, it was not the whole picture of this vital national company.

Furthermore, according to Yuwono (2014), the oil and gas industry in Indonesia was used as a money machine for political elites, especially President Soeharto, to build his family's companies. Soeharto used Ibnu Sutowo and his ideas to develop Pertamina's business in non-oil sectors; he gave permission to Ibnu Sutowo to sign contracts with foreign oil companies and to obtain foreign debt. In the Soeharto era, Pertamina was the government's right hand and provided services to the citizens as well as finances for to the ruling party (the Golkar Party). This condition made it a rent-seeker and rent-collector company. Pertamina could not develop maximally as a business entity because of its dual position as an oil company and as the oil contractor supervisor. The crisis, the slow development of Pertamina's capacity as oil producer, and the suspected corruption led to a decrease in the oil industry's contribution to total national income from 71% in 1971 to 24% in 1993/1994 (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 36). Since then, oil and gas has contributed between 20 and 30% of total state revenue.

Pertamina's monopoly in the hydrocarbon industry was used by the President and his inner circle to build and maintain their influences in business and politics. Thus, the

reformation era of Indonesian politics since 1998 also triggered parliament to issue Law No. 22/ 2001, which was followed by government regulation specifying Pertamina's change in status from PN Pertamina to Pertamina Persero. This new law emerged as parliament and government were concerned about Pertamina's power in the national oil industry and also as suggested by World Bank in its 2000 study on Indonesia Oil and Gas sector (World Bank, 2000). This company monopolised all activities in the oil sector without the government's control. This was understandable due to the company's position as a public service company with an obligation to provide sufficient oil and gas for domestic needs. However, the government's weak control meant that Pertamina acted beyond its obligations and was not able to perform well. This condition was understood after 2001, when Pertamina only contributed 10% of the total national oil production. This means that more than 90% of national oil was exploited and managed by foreign companies (Syeirazi, 2009). The government's aim of building a strong national oil company that could dominate national oil industry had yet to be reached. This condition was the source of strong criticism of the new law from academics, economists, and oil practitioners. They argued that liberalising the national oil industry and removing Pertamina as regulator in both upstream and downstream operations would only weaken the position and control of both the company and the government in the national oil industry.

After the Ibnu Sutowo era, Pertamina struggled to balance economic needs with social responsibilities (Daryono, et al. 2013, Chapter VIII). This was a hard task for any state-owned company, especially those involved in both upstream and downstream operations. The company had a specific managerial body, with BPPKA (*Badan Pembinaan Pengusahaan Kontraktor Asing/ National Development and Foreign Commercial Contractors*) assigned to deal with all issues related to oil contracts and

foreign contractors (Darmono, 2009; and Machmud, 2000, p. 49). Consequently, Pertamina could cut bureaucratic lines in oil investment as the negotiation and the signing of the contracts, as well as all related permissions from various governmental bodies and provinces, were overseen by this body. This system meant that Indonesia's oil industry became attractive and friendly towards foreign companies. On the other hand, the government could not learn about and control the oil industry because it did not have first-hand experience in the field and therefore could not fully grasp the reality and practicality of running an oil business. This created various economic problems as well as political and formal issues when the government took over the oil industry management in 2001.

An important development in the industry was the establishment of a body called *Dinas Koordinasi Kontraktor Asing* (DKKA/ Foreign Contractor Coordinating Body) in the late 1960s. Its main task was to negotiate and deal with FOCs. This body was part of Pertamina and was renamed *Badan Koordinasi Kontraktor Asing* (BKKA/ Foreign Contractor Coordination Body) in the late 1970s and later *Badan Pembinaan Pengusahaan Kontraktor Asing* (BPPKA/ Foreign Contractor Supervisor Agency) in the late 1980s (Machmud, 2000, p. 150). This body had a direct line of command to the President Director of Pertamina and was known to exercise huge control in managing contracts with FOCs and supervising their operations. This body successfully built a good relationship with the FOCs, but without coordinating and involving the related ministries and local government. Thus, it experienced strong criticism from the government and FOCs during the 1990s, as well as attempts to issue a new oil and gas law. Pertamina's monopoly in the hydrocarbon industry was used by the President and his inner circle to build and maintain their influences in business and politics. Thus, the reformation era of

Indonesian politics beginning in 1998 also triggered parliament to issue Law No. 22/2001 about oil and gas industry.

In the earlier era, the hydrocarbon business was under Pertamina's governance and the company was mandated by national law to represent the government as manager over the resources as well as the main player in the industry. All companies that wanted to operate in the oilfields needed to sign a contract and gain approval for their Work and Budgetary Plan (including the Plan of Development) (Utomo, 2010). This power encouraged Ibnu Sutowo to overstep his authority by investing outside the company's core business and buying oil tankers with administrative problem, ultimately leading to the "Pertamina Crisis" in 1976. Afterwards, the government closely and strictly managed and oversaw the management of Pertamina, including restrictions on funding and capital. From the 1980s until 2001, the company was more focused on governing the hydrocarbon industry rather than its core duty as a company.

It was difficult for Pertamina to gain public and government trust. The government only gave limited capital to improve the company's performance and make new investments needed in order to fulfil its obligation in providing hydrocarbon products for the domestic market. On the other hand, the local government asked for direct involvement in the industry (including the rent collected by the central government). This political and economic condition meant that Law No. 22/2001 was a good starting point for creating a transformation both in Pertamina's business management and in the national oil industry's rules of the game.

The 2001 Oil Law was meant to create a national industry that could have a strong bargaining position in the global oil industry while also being transparent and environmentally friendly. The state authorities were divided between regulators, the

government, and corporations in order to encourage and maintain a competitive domestic oil market. Once, Pertamina was responsible for all functions. However, legally it became identical to the other oil companies. The regulator of the upstream industry was the MEMR, which was helped by the Implementing Body, and the downstream activities were managed by BPH Migas.

BP Migas (*Badan Pelaksana Usaha Hulu Minyak dan Gas Bumi/* Implementing Body of Upstream Oil and Gas Industry) was established in 2003 as mandated by the Law of Oil and Gas No. 22/ 2001. The GoI formed this new government agency to represent the state in signing contracts with FOCs (Syeirazi, 2017). The agency was also responsible for monitoring and managing upstream oil and gas operations, while downstream activities were managed by BPH Migas (*Badan Pelaksana Hilir Usaha Minyak dan Gas Bumi/* Government Agency on Downstream Oil and Gas Industry). BP Migas was a state-owned non-profit legal entity, which led to criticism from politicians as well as domestic academicians and practitioners.

The Special Task Force for Upstream Hydrocarbons and Gas Business Activities (*Satuan Kerja Khusus Migas/ SKK Migas*) is an institution established by the GoI under Presidential Regulation No. 9 of 2013 on the Management of Upstream Hydrocarbons and Gas Business Activities. This organisation is assigned to manage the upstream hydrocarbons and gas business activities under a cooperation contract. This institution has been established to exploit the state's hydrocarbon and gas natural resources and therefore generate the maximum benefits and revenue for the greatest welfare of the people. This agency replaced the former Implementing Body (BP Migas) which was established in 2001 (SKK Migas, 2012).

It would appear to have strengthened the government's bargaining position in the industry, especially regarding communication and negotiation with foreign companies, although the side effect has been the creation of uncertain and unpredictable political conditions and an unsupportive environment for oil investment. As predicted, the oil production plummeted and President Susilo Bambang Yudhoyono declared Indonesia as a net oil importer and thus halted their membership of OPEC.

From the learning process, we can also conclude that the historical regulations considered society as nothing more than users of oil and gas. As a matter of fact, in the beginning, it was a society group which initiated the rehabilitation of the already-destroyed oil refinery facilities in Sumatra and Java. They also pressured the government to take over the facilities from FOCs, as well as pushing (and accelerating) the government's decision to establish national oil companies.

4.2. The Procedure Element

Ibnu Sutowo began to set up a strategy to develop Pertamina as well as the oil industry. With a new regulation and contractual agreement, Pertamina succeeded in several ways (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 22-23). It was able to improve national oil production from 490,000 barrels per day in 1965 to 1.62 billion barrels per day in 1979. This achievement was also influenced by the first Oil Boom in 1973. The oil and gas sector's contribution to national revenue improved significantly from 66 trillion Rupiahs (27%) in 1969/1970 to 8.628 trillion Rupiahs (71%) of total revenue. This profit was invested to fund national development programmes in all sectors. Despite this, in the following year the country had to deal with high inflation. Another of Pertamina's achievements was building new refineries and exploring new offshore oilfields. The first offshore commercial founding was by Japan Petroleum

Company (Japex) in North Sumatera's offshore area in 1965. In addition, Indonesia had proven itself as an oil exporter since 1958 and joined OPEC in 1962.

Indonesia began to diversify its hydrocarbon industry in the early 1970s (Hertzmark, 2007, p. 13). Mobil Oil one of the first companies to discover gas in Arun, Aceh. Gas exploration and production was developed with Japan as the main export destination. The company completed the first LNG facility in Indonesia in 1977. In addition, Gas was also found in Bontang, East Kalimantan during the 1970s and the field started to produce gas commercially in 1979. Revenue from LNG exports helped Pertamina to recover financially after the company's financial crisis in 1976. Indonesia's gas production increased steadily until the country became one of the largest LNG exporters in the world.

The GoI established Perusahaan Gas Negara (PGN/ State Gas Company) in 1965 and the company became a public corporation 1984 with main responsibility was distributing gas to medium-sized industries and households (PGN, n.d.). The government issued a policy through a Presidential Decree in August 1997 that regulated national gas development, transmission, and distribution (Darmono, 2009). It was intended to clarify the relationship between Law No. 44/ 1960 and Presidential Decree No. 37/ 1994 with regards to the roles of Pertamina and PGN in the national gas industry. Prior to 1994, Pertamina had exclusive rights for transmitting gas.

The Ministry of Mines and Energy (MME) was responsible for the development and implementation of government policies in the energy sector (World Bank, 2000, p. 4). It worked together with other related ministries through a Badan Koordinasi Energi (BAKOREN/ Energy Coordinating Board). The Ministry was established in 1978 to manage the state energy industry, which included Pertamina, PGN, and PLN (Perusahaan

Listrik Negara/ State Electricity Company). The World Bank (2000, p. 16) explored the cause of Pertamina's inefficiency in their study about Indonesia's hydrocarbon industry and argued that the inefficiency was caused by outdated legislation, especially regarding the implementation of government interference in Pertamina's decisions and operations. During President Soeharto's regime, the company was used to award contracts to the President's children, family members, and government officials. The company had to deal with its public service obligation (PSO) to meet the domestic market demand on oil and gas, while simultaneously signing contracts with inefficient domestic business entities related to the President. Thus, it focused on producing a certain amount of oil and gas without paying proper attention to the most efficient production methods. Moreover, it had to fulfil the PSO rather than spending more capital and energy on exploration and exploitation activities. Those conditions led to distrust from the GoI and society about Pertamina's ability and capacity to run pure hydrocarbon business activities under Law No. 22/ 2001.

BP Migas (*Badan Pelaksana Usaha Hulu Minyak Bumi dan Gas/ Upstream Oil and Gas Agency*) was established in 2003 (Latham and Watkins, 2012, p. 1). It was a state-owned non-profit legal entity formed by the government to replace Pertamina's position as regulator of the hydrocarbon industry. Based on the 2001 article, BP Migas had several tasks throughout the process of contract provision. Firstly, it provided and gave advice to the MEMR regarding listing, updating, and preparing the working areas and contracts with oil companies. Secondly, it was responsible for negotiating and signing contracts with contractors. Thirdly, it conducted assessments for field development plans for working areas which were going to produce for the first time and submitted these plans to the MEMR for the Ministry's approval. Fourthly, It was responsible for approving plans for the development of exploration and production operation in general

as well as the working plans and budgets. It had to conduct monitoring of oil companies' operations and report its findings based on the PoD, working, and budgeting plans to the MEMR (Partowidagdo, 2009). Finally, it was also charged with appointing sellers for the government's oil share in order to maximise the state's revenue and profit.

BP Migas' state-owned non-profit legal status led to criticism from politicians as well as domestic academicians and practitioners. At least three judicial review proposals have been submitted to Constitutional Court regarding articles in Law No. 22/2001 about the establishment of BP Migas. The latest proposal was granted in November 2012. The Court argued that state control in conducting business should be represented by a state-owned enterprise which signs a contract with other business entities.

The Special Task Force for Upstream Hydrocarbons and Gas Business Activities (SKK Migas) replaced BP Migas. This institution was established by the GoI under Presidential Regulation No. 9 of 2013 on the Management of Upstream Hydrocarbons and Gas Business Activities. SKK Migas is assigned to manage the upstream hydrocarbons and gas business activities under a cooperation contract. The establishment of this institution has been designed to exploit the state's hydrocarbons and gas natural resources to generate the maximum benefits and revenue for the greatest welfare of the people.

Since Law No. 22/ 2001, administrative procedures have become more complicated because the contractors have to deal with various governmental bodies and local government directly rather than with assistance from Pertamina (IPA, 2015). There was a transfer of authority and responsibility under the new law followed by Government Regulation Number 35/ 2004. The MEMR has the responsibility to list a working area for bidding. It also determines whether and to what extent PSC terms need to be changed to

attract new investment, whether additional blocks should be put on offer and whether specific terms of PSCs should be approved. The Ministry also expects to consult with local governments as the areas are under their management. In the old system, the Ministry interacted with FOCs through Pertamina. Pertamina was responsible for monitoring upstream activities and reservoirs, maintaining data about reservoirs and cost accounting for refined price setting.

Those factors have affected the development and the future of Indonesia's hydrocarbon industry. From 2001 to 2016, there was a significant decline in Indonesia's oil production and therefore President Susilo Bambang Yudhoyono decided to end the country's OPEC membership in 2006. Moreover, there have been very few surveys and exploration activities in new areas, while the number of foreign companies interesting in the industry has also fallen. Existing contractors, both FOCs and Pertamina, are more focused on operating in existing oilfields because these require less capital and resources and are less risky. Unfortunately, some remote areas with potential oil and gas reserves as well as deep sea water areas remain untouched.

Pertamina gets first offer for any open oilfields by paying attention to its technical and financial abilities. This is mainly because the government retains ownership of the working areas, meaning that that FOC has to return the areas to the GoI through the MEMR at the end of the contract. Moreover, all data about the area should be submitted to the Ministry because it belongs to the GoI. Data exchange among contractors can be conducted after the MEMR gives permission.

The GoI sets its investment priority sectors every five years. Under the National Mid-term Development Plan in 2010-2014, the oil and gas industry was one of five priority sectors. Oil and Gas Law No. 22/2001 was determined to have created an

inefficient and bureaucratic system in Indonesia's oil industry. The fiscal policy stated in the law was also unattractive for new and existing investors. This is because Indonesia's oilfields are already mature and therefore the country requires more capital and higher technology in order to produce oil while new fields are still difficult to find, mostly because they are located in deeper areas or offshore, which adds further challenges regarding the environment and acceptance from the surrounding neighbourhood.

Furthermore, FOCs had to pay taxes after they began producing oil as stated in the *lex-specialis* principle of Law No. 8/ 1997, but this provision has been replaced by Law No. 22/2001 which requires companies to pay taxes before they have found and produced oil. This change in regulation and policy has discouraged FOCs from taking risks and funding new surveys and other explorative operations to find new oilfields, while Indonesia desperately needs such activities to maintain and increase oil production. From the 1980s until the early 1990s, 200 wells were drilled per year; however, since then only 30 wells have been drilled per year.

BP Migas (*Badan Pelaksana Usaha Hulu Minyak dan Gas Bumi/* Implementing Body of Upstream Oil and Gas Industry) was established in 2003 as mandated by the Law of Oil and Gas No. 22/ 2001. Davidson (2015b) categorised the agency as an Independent Regulatory Agency (IRA). The GoI formed this new government agency to represent the state in signing contracts with FOCs. Moreover, the agency was also responsible for monitoring and managing upstream oil and gas operations, while downstream activities were managed by BPH Migas (*Badan Pelaksana Hilir Usaha Minyak dan Gas Bumi/* Government Agency on Downstream Oil and Gas Industry). Law No. 22/ 2001 generated several regulations and protocols in adjusting the governance of the industry into the new system with BP Migas as the focal player representing the government. Based on Ministerial regulation No. 040 and 033/ 2006, the MEMR offers working areas through

auctions or direct proposals. Direct proposals follow up on an FOC's proposal regarding one or more open working areas after joint study conducted between the FOC and the GoI. This regulation appointed the Agency to oversee management and operation of FOCs. The oil contracts last for 30 years, including the exploration and exploitation period, and they could be renewed for an additional 20 years. The contractor should begin their operation a maximum of 180 days after the contract is signed. In case the contractor cannot fulfil their obligation, the agency could advise the MEMR to end their contract. The GoI could ask the FOCs to offer the contract to a national company before offering it to others. The right to use the land should also be negotiated between the community and the FOC, and the landlord should give their permission to operate within the areas as long as the FOC are able to present the relevant contract. FOCs also have an obligation to empower surrounding society, protect the environment, and use local manpower and products. Foreign workers can only be used in the positions and tasks where Indonesians are unavailable or do not have the requisite capabilities and expertise.

The implementing body's task was to oversee the implementation of contracts, while the MEMR had to develop the contracts and cooperation with FOCs. The regulation also positioned Pertamina and other FOCs on the same page with the same treatment. JOB and JOA were managed by the new agency, while TAC and EOR remain under Pertamina's authority until the end of the contracts. The TAC and EOR working areas still belong to Pertamina and the NOC has also had to sign a contract with the agency, just like other oil companies in Indonesia.

From the explanation above, it is evident that Law No. 8/ 2001 led to greater uncertainty and unpredictability in the national oil industry. BPPKA (National Development and Foreign Commercial Contractors) was removed from Pertamina, and

the government established BP Migas (Implementing Body of Oil and Gas Industry) to handle all issues related to oil contracts and contractors. Unfortunately, Pertamina was positioned on the same page as other oil companies but with a different mandate as a public service company. This factor has been the main source of criticism from several analysts, politicians, and practitioners, who believed that this law led to liberalisation in the national oil industry by letting national oil companies compete with other foreign and private companies to get oil contracts.

On one hand, the law gave Pertamina a good opportunity to focus more on its position as a business entity, develop its business strategies and operation, and prove its abilities domestically and abroad. On the other hand, the government, which did not have any practical experience regarding oil and gas operation, had to deal with establishing a new oil industry management system based on the new law. This required a speedy learning process and consideration and acceptance from foreign contractors, especially with several contracts due in the years following 2001. As expected, several companies did not renew their contracts for various reasons: oil production plummeted and there was no new exploration operation, while the old oilfields were drying. Fortunately, the situation was recovered due to significant development in the gas industry. The gas production increased each year, meaning the national company (PGN/ Perusahaan Gas Nasional/ National Gas Company) was able to play a significant role in the operations even though it was not as powerful as Pertamina.

Another important step was to cut off Pertamina's monopoly position in downstream activities. It was important for the government and Indonesian citizens to open access towards downstream projects in order to get the most value for their money in purchasing oil and gas products. Competition created efficiency and guaranteed the

availability of the products in the domestic market. However, it would not be easy for private and foreign players to involve in this project because Pertamina had been there for a long time with facilities and access to the deeper areas.

Regarding government and foreign companies' relations, the GoI issued incentive packages to stimulate foreign investment in Indonesia, particularly in the hydrocarbon industry (Sanusi, p. 129-131). This decision was influenced by a significant decrease in national oil production. The decline of survey and exploration activities to search for new oilfields, combined with the mature oilfields that had already been exploited exhaustively and the high cost of developing oil operations in unconventional areas, resulted in this scenario. Therefore, the GoI issued several packages that were expected to boost investment in the upstream operations.

The first package was launched in September 1988 and tried to give more attractive financial regulations to the company, especially reducing the DMO and first tranche petroleum (FTP) figures which would need to be paid by FOCs. The second package was launched on February 1989. The GoI launched those packages because of slower global oil investment caused by cheaper oil prices and the emergence of new oil producing countries in Central Asia and Latin America. Furthermore, the incentives were also given in order to encourage more surveys and exploration projects due to the decrease in Indonesia's oil production from mature oilfields. Indonesia needed new oilfields to maintain pace with OPEC's production obligations and to fulfil domestic demands. The third package was announced in August 1992 and was meant to encourage exploration in unconventional areas, such as deep water and frontier territories. The last package was announced in January 1994.

Under the new law, an FOC had to spend more time and money on preparing any requirement needed before they could actually operate in the area. Various ministries and local government policies needed to be fulfilled by the FOCs themselves. BP Migas and SKK Migas could only assist them along the process. Thus, the hardest problems, such as the overlapping use of working areas, could not be solved quickly.

Pertamina conducted integrated management operations consisting of exploration and exploitation activities, refineries, transportation and selling of oil and gas. To do so, they established various subsidiaries in the region and abroad. They also bought refineries and facilities from Shell and Stanvac, which has often been considered as a nationalisation move by academicians and researchers (compare between Sanusi and Purwoto and Kuncoro in Kuncoro et al., 2014, Chapter II).

Based on Law No. 8 Year 1971, Pertamina was the sole player in the national oil industry. Its economic activities were meant to provide national development funds. In order to do so, they cooperated with various oil contractors, especially onshore. The company established a new contractual system to replace the old concessional contract which was considered incapable of maximising rent from oil industry activities. It was legalised under Law No. 44 Year 1960 and known as the *kontrak karya* (Contract of Work/ CoW) (Purwoto and Kuncoro in Kuncoro et al., 2009, Chapter II, p. 19). Foreign companies were contractors according to this law and did not get concessionary rights in oilfields. However, Ibnu Sutowo suggested a different type of contract. He proposed the PWC, which was expected to maintain Indonesia's mineral and mining rights. Thus, the main duty of foreign companies was to be operators of NOCs. They would be paid after they succeeded in exploiting oil and would get their share of the oil production profits based on the contract.

During the initial stage of government involvement in the hydrocarbons industry, state-owned hydrocarbon companies such as Permina, Pertamina, and Permigan officially operated under the supervision and guidance of the Department of Mining. However, in the field, they could operate effectively by associating closely with local military authorities. This was the beginning of official military activity in Indonesia's hydrocarbon industry. Later on, when those three companies merged as Pertamina, General Ibnu Sutowo, one of higher officials in Indonesia's Military Troops, became the first President Director. Consequently, the government issued Law No. 8/1971, which strengthened Pertamina's monopoly as the sole company mandated to operate and control the hydrocarbon industry.

Financial sharing scheme stated in previous section is designed by government as the result of compromise between two opposite opinions; the pro and contra factions of foreign companies' entry into one of vital industry in the country. The pro-foreign investment faction argued that, realistically, the country do not have enough financial and technical resources to do all operations just by domestic force and resources. Hence, foreign companies, that have both capital and technical capacity needed to extract natural resources, are needed. On the other hand, the contra faction posit that we need to ensure that the country's natural resource should be extracted to generate wealth for the people, not the foreign companies per se. The companies' sole interest to generate profit as much as possible without consideration toward people who actually own the land and the resource are generally proven to produce both environmental and normative problems. The elites are always suspected to let the companies do as they see fit as long as they gain benefit, either politically or economically, from such attitude.

The existence of foreign oil companies triggered protests from some groups of Indonesians, especially from the Persatuan Buruh Minyak (Oil Labour Union/ PERBUM). The major event was a large demonstration initiated by PERBUM in Plaju oilfield, South Sumatra (Darmono, ed., 2009, p. 22). The protesters demanded a nationalisation policy towards FOC assets in the country, letting the workers take control of operations. Although the government did not enforce such a nationalisation policy, it established a working group consisting of representatives from national and foreign oil companies, the military, the Ministries of Oil and Gas, and the Labour Union (Darmono, ed., 2009, p. 23). Their main task was to evaluate FOCs' operations and provide recommendations to the government. The government took the first step to handle the situation by buying refineries and distribution facilities from the three major companies.

After this first heroic involvement of society in the hydrocarbon industry, both society and local government did not have any access to the governance of this sector. The national government monopolised important interactions with the companies, while the subnational government had only limited access to the profit sharing scheme of natural resource revenue from central to local government. Moreover, society was also treated passively as merely an object of the companies' Corporate Social Responsibility (CSR) projects. Consequently, society could ask companies to fund social events or build public facilities for the citizens in their working area. Therefore, at this stage there was still very limited subnational government and societal involvement in the industry.

There are always different points of view regarding this development. Some people saw it negatively as the government decided to liberalise this crucial industry while the NOC – Pertamina – still had limited capacity and capabilities to take control. The situation was known as the foreigner's domination within a national industry and

national economic matters. On the other hand, others considered it in a more optimistic way. It was an opportunity for both the government and Pertamina to mature and to be able to do their tasks more effectively and efficiently. Previously, the line between regulators, policy makers, and business operators was too vague. Nonetheless, a simple question still remained unanswered: What would be best for the state as well as the company in their mutual relations? What was wrong with previous arrangement and what needed to be fixed in the new one?

The government looked for recognition as an already-democratised and liberal, country, while the international community asked for more transparency, accountability, and openness of national industries, especially in the closely regulated hydrocarbon industry. Those circumstances led to a decision to replace the 1971 Oil and Gas Law with Law No. 22/ 2001. The new regulation changed Pertamina's function as regulator and policy maker in the industry, returning these roles to the government through the MEMR. Pertamina was positioned in the same level as other oil contractors (the FOCs and private national companies) with the main task of fulfilling domestic demand for oil and gas products. The next challenge was that, due to this strategy, FOCs needed more time to comply with various ministerial regulations, local government desires, and pressure from local people before actually doing their job, whether it was explorative or exploitative operation. The contract period was too short to complete political matters or explore more potential areas.

During the 1990s, the GoI sought a more significant role and authority in managing the hydrocarbon industry. The Ministry, for example, submitted a draft to the House of Representatives. It was rejected by the House due to its counter-productive proposal to dismiss Pertamina. Afterwards, the GoI asked for a World Bank recommendation to reform the industry. This international body released its report about

Indonesia's reformation plan in the oil and gas sector in 2000 and argued that Pertamina's monopoly role was inefficient because the company was acting both as a contractor and manager of overall operations and activities within the industry. It stated that it was important to reform Pertamina by detaching and simplifying some of its activities, operations, and roles. It was also important to reform the company internally in order to create healthier structures and procedures as a business entity. In other words, the industrial structure of the hydrocarbon sector as well as the government agencies involved in the sector should be liberalised. World Bank argued that liberalisation was necessary to deal with future challenges such as low oil prices, slow investment in the sector, declining oil production, and fulfilling domestic demand (World Bank, 2000). Furthermore, WB proposed that Pertamina was positioned on the same page with the same treatment as other oil companies. The first important step would be a separation between the contractor and manager roles. Thus, BPPKA was to be removed from Pertamina and the GoI would relocate it as another government body or as a part of the MEMR.

4.3. Process and Mechanism of Change

Development projects were considered to be very important during the Soeharto regime. His ability to deal with challenges in the national economy was determined by his decision to centralise all political economic decisions. Authoritarianism was considered as important choice to pursue a stable political situation and ensure economic development projects ran smoothly and were funded well by resource rent. This position generated many problems for Pertamina in balancing its role as part of the government and as business entity. Ultimately, the company had more regulative and controlling functions with regards to oil contractors, mostly foreign companies, as opposed to actual mining operations. However, Pertamina succeeded in a downstream project by establishing a national distribution system ensuring hydrocarbon products, especially fuel,

could be used nationwide. Although the task was not done perfectly, the company showed that its 20-year monopoly in downstream activity had gained it sufficient leverage to sell their fuel products in Indonesia after 2001.

In this section I will analyse the mechanism and process of changes in the national hydrocarbon industry by combining my interpretation of the institutional change frameworks developed by Campbell (2004), Lowndes and Robert (2013), and North (1991 and 2005). It will explore the dimension, source, process, and mechanism of institutional changes. There are three dimensions of institution being studied (the rule, procedure, and normative institutional elements), two sources of change (endogenous and exogenous sources), two change processes (incremental and revolutionary), and two mechanisms of change (path dependence and punctuated). In addition, there are several indicators that change happen in an institutional arrangement and could affect all dimensions as proposed by North, Wallis, and Weingast (2009): the shift from personal to impersonal exchange, the establishment of perpetual-life organisations, and credible commitment. Such indicators could be seen as part of institutional actors' road and commitment to a more open, transparent, accountable, and accessible institutional arrangement to create a more stable but flexible order, minimising risk from their dynamic activity and interaction with the environment and other actors as well as solving internal and external problems and challenges during their period of contract and interaction.

First of all, it is important to analyse the positioning of actors in the governance. The MEMR is the regulator, together with other ministries. Companies, on the other hand, are objects of the regulation conducting both administrative affairs and business operations in the country. This structure could be seen as a simple arrangement based only on the different tasks and roles of the organisations as primary actors. Nevertheless,

we should look beyond institutions as the first hypothesis states that an actor is not doing their task and dealing with other actors and the environment in a stagnant manner. Actors develop their knowledge, strategy, and capacity through their exposure to the world outside their own organisation. To do so, the actor themselves should decide and commit to interact in a cooperative and, if possible, a collaborative way with other actors in order to achieve their goals. Economists always argue that a compatible goal and the actors' respected comparative advantage could be an incentive to build a cooperative and collaborative action in achieving the common goal. This would allow also allow them to achieve their personal goal as long as this does not prevent others achieving their goals or hurt their relationship (). In this regard, economic institutionalists like North (1991) emphasise the importance of the institutionalisation process in order to prolong the already established good relationship, attracting newcomers to join such institutions, protecting rights and ensuring compliance through institutional rewards and punishments. Each organisation will identify itself as belonging to either the government or company category and could benefit from such an arrangement by compromising, making credible commitments, and compliance with regulation and standardised procedures.

The institutional structure put Pertamina at the centre of resource governance. The company led the industry by acting as an administrator as well as a mining operator. This dualism was criticised and considered suspicious as such structure put the NOC in an awkward position. As administrator, Pertamina had access to all papers and reports about the companies' business plans and operations, meanwhile, as a fellow oil contractor and oilfield operator, the NOC was their competitor. Although its contribution to national oil production and revenue from its business activities was way below the big foreign companies, this arrangement was disadvantageous for NOC as Pertamina had a wealth of information about the company's affairs and operations in Indonesia. This information is

usually considered as a business secret and it could become source of unfavourable government policies.

In spite of the problematic institutional structure, such a strategy is commonly used by developing countries to gain control and simultaneously speed up the learning process to govern the industry and conduct mining and business operations. Both activities were something new and Indonesia's role in resource governance was oppressed during the colonial period. Independence created an opportunity for direct involvement in all sectors of economic activity and protection of national interest while also managing their interdependence relationship with FOCs. This privileged position for Pertamina get was demonstrated after the new Oil and Gas Law No. 22 Year 2001 cut off its administrator role and mandated the NOC to focus on expanding its business operation and on increasing its contribution to national oil and gas production and revenue.

Pertamina has proven publicly that, despite criticism and accusations regarding its former function as Soeharto's cash cow for his family members and cronies, the company has shown positive improvement in terms of its ability to compete with its foreign counterparts and obtain new contracts in various potential oilfields. Its learning process for over 30 years has been advantageous in its strategy to be equal competitor within the hydrocarbon industry's new institutional structure and arrangement. In downstream projects, its dominant position is unbeatable. The NOC has access to all regions in Indonesia, including small cities. It has the requisite infrastructure to distribute fuel as such tasks were its primary responsibility before the new law was released. This task and monopoly position as the sole fuel distributor, which is approved and allowed by law, has also been taken by the government. It is not been done perfectly but it will be beneficial in the company's future efforts to complete its task as the only national oil company the country has.

Pertamina has been successful in dealing with major changes in its legal role and task. Moreover, the way the government has managed state-owned companies is also changing. Other than Law 1971, which regulated all organisational structure, authority, and responsibility of Pertamina, other policies regulated all organisations of state-owned companies under one Ministry. Thus, particularly for its organisational structure, the NOC is managed by the Ministry of State-Owned Companies. This development means that the national government has generally attempted to share tasks and authority among their ministries and agencies in order to properly manage and be responsive in dealing with any problems and challenges.

CHAPTER V

INDONESIA'S MINING INDUSTRY

5.1. Introduction

The mining industry is a high capital and high risk business. The companies use transportation (mainly through land and water) several times during the exploration, processing, production, and distribution stages (a Foreign Mining Company, 2016). Thus, both the availability of fuel and government permission to use the land and water are crucial for the company. Moreover, it needs to seek new sources of metal periodically in order to secure production and fulfil its customer contracts. However, new exploration also means new contracts so these companies will have to spend more time negotiating with the central government; as well as dealing with local government and local people prior to starting their project. The licensing or contract is strictly a license to mine and does not include license to do other related activities such as to use land and river, to build mining sites, shelters, and stockpile warehouses, or to move their materials from one place to another (Arif, 2014). There are also several requirements, permissions, and documents that should be submitted beforehand and each activity should be stated in the plan of development (PoD) reported to the government and also approved by the government before starting their operations (Sudrajat, 2013).

Indonesia's mineral production mainly involves coal, bauxite, copper, tin, and nickel from several producing regions such as Kalimantan, Sumatra, Papua, Sulawesi, and Maluku (Darmono, 2009). PTBA and PT Timah (Persero), which are owned by the GoI (65%) and the public (35%) produce coal and tin. Unlike PT Timah, the dominant domestic tin producer (Salim and Munadi, 2016), Adaro, an FMC, is the one that dominate domestic coal production (Arif, 2014, p. 65 and 67). Meanwhile, Antam Tbk,

another state-owned mining enterprise, produces nickel, ore and bauxite, as well as small amounts of gold (Antam, 2016). On the other hand, Copper and gold production and exportation has been dominated by PT Freeport Indonesia since 1967 (Darmono, 2009). The country's mining industry is very dynamic with the involvement and interaction of three major players: the GoI, the NMCs, and FMCs. The actors' ability, specialisation, local contribution, and support from their home country could determine their bargaining position and power in the interaction with national and local governments.

The interactions among companies are limited and mainly relate to the need for bigger companies to hire out some of their projects to service companies (subcontractors). However, each company also mostly negotiates directly with the government and legislative bodies. Thus, the mining business association has a minimal role and contribution from the perspective of business and state interactions.

Indonesia has abundant mineral resources and the country has also been known as one of the world's biggest producers of coal, tin, nickel, and copper. Unfortunately, NMCs, like PTBA and Antam, have minimal contribution despite having been active for the past 40 years. This is because they mainly export raw minerals, which have the smallest economic value in the market, without processing it. Export destinations such as China and Japan become richer by processing these materials, producing various end products, and selling them back to the international market. Indonesia is not far behind other countries in terms of human resources and technological abilities to process the minerals. The NMCs need government incentives and support to fund their operations.

5.2. The Rule Element

The GoI intended to follow the nationalist sentiment and planned to monopolise mining industry. They established a *Badan Pimpinan Umum Perusahaan-perusahaan*

Tambang (BPU *Tambang*/ General Authoritative Agency for Mining Companies). The Agency managed several foreign mining companies which were nationalised as instructed by Law No. 10 Year 1959 (Darmono, 2009, p. 180). However, the government development project had to be funded, yet there was no money available to do so. The quickest solution was to seek for international help through loans, aid, and investment.

In order to handle the problem, government issued the 1967 Foreign Investment Law which allowed foreign investment in vital sectors such as mining as long as the investors collaborated with national companies in the activities and operations (Darmono, 2009, p. 180). The government intended to ensure a technological and know-how knowledge transfer from MNCs to national business entities. By doing so, the government attempted to develop strong national companies that could be entrusted to manage the abundant resources. This Law created an opportunity for foreign companies to take part in Indonesia's mining industry. However, this requirement is omitted in 1994 so that FMCs could conduct their operation without has to cooperate with domestic company. The GoI's main purpose was to collect company and production taxes from their operations in order to fund its development projects, to maintain the country's independence, and to develop national political and economic conditions (Darmono, 2009). FMCs were the only reliable business entities for conducting mining operations in the country at that time as there was still no capable and reliable domestic private mining operation.

Hence, the mining industry was generally regulated by two laws; the Law about Foreign Investment No. 1 Year 1967 and the Law about General Mining No. 11 Year 1967. Both laws allowed the GoI to commence mining by inviting foreign investors and companies to mine by themselves and by collaborating with national mining companies. Since independence, both the public and the GoI had considered the mining industry as an

important sector in supporting the national economy and providing welfare for citizens. Thus, both the government and ex-colonial companies' Indonesian mining workers committed to governing and taking part in the industry by nationalising Dutch-based mining companies and establishing several national mining companies. These companies were previously managed by *BPU Tambang* (General Authoritative Agency for Mining Companies).

According to the law, mineral sources were divided into three categories based on the importance of different minerals to the national economy as perceived by the GoI. The A type consisted of minerals considered as having strategic economic value such as hydrocarbons and coal, while type B consisted of vital minerals often used in industry, especially metals, and type C included minerals which were not included in either type A or type B such as granite, nitrate, marble, etc. The national government managed the mining industry for types A and B, while the subnational government was given authority for managing the type C mining operations under their jurisdiction. From 1945 until 1999, the national government has absolute power in negotiating with mining companies and managing the mining industry as a whole. The Mining Law and its derivation, Government Regulation No. 32 Year 1969, placed the national government at the centre of mining industry governance. The subnational government, particularly at the municipal level, was given the authority to manage the mining industry after the enactment of the 1999 Decentralisation Act (Hayati, 2015, p. 41-42 and Trihastuti, 2013).

After 1970, the government established three national mining companies by merging three nationalised mining companies: PTBA (*Perusahaan Tambang Batu Bara*/ National Company for Coal Mining), PN Timah (National Company for Tin Mining), and PN Aneka Tambang (Antam) (Darmono, 2009, p. 133-135). Government capital was the only source of funding for the companies. However, in 1995, the government gave the

companies permission to collect public capital to expand and develop their operations (Darmono, 2009). Thus, in 1995 they conducted an initial public offering for 35% of their stock while retaining 65% government ownership. By doing so, they could boost their production and industrial activities. They could build more smelters, factories, mineral processing facilities, ports, and establish relevant and significant subsidiaries to support their development projects and international operations.

The 1967 Law regulated the contractual system for government and mining companies' relations (for both the hydrocarbon and general mining industries). There are three types of contract signed between government and companies: they are CoW, CCoW (Susilo and Pratomo, 2004, p. 27-30; Darmono, 2009, p. 182-196), and Mining Authorization for People's Mining and Regional Mining Permit (Sigit, 1986 in Susilo and Pratomo, p. 139; Darmono, 2009, p. 194).

Foreign investors had liberty to operate and explore the related working areas covered in the contract, but they also had an obligation to share the profits from product-selling activities. In order to learn about business operations, the government also stated that foreign investor should establish joint projects with national companies in their domestic operation (Darmono, 2009). In the early stages of their implementation, they had to face the challenge of societal resistance towards foreign companies. Some of the resistance movements forced several foreign companies to halt their operations or sell their contracts to the government. On the other hand, the only income for the government at that time came from mining operations; thus, the government had to look for a strategy to maintain social and political harmony while developing domestic industries as the main foundation of national economic development.

The government could reach an agreement with foreign companies in a CoW format. The companies are considered as government contractors with rights and

obligations. Paying tax and royalties as well as complying with national regulations are among the obligation towards the government, while freedom to conduct mining operations as well as to gain profit from the production and trading activities in agreed mining areas are among their rights. The contract with Freeport McMoran was the first to contract in CoW format (Haluk, 2014, Soehoed, 2005a and 2005b). From 1967 to 2017, eight generations of CoW were signed between the government and companies. The differences between them mainly involve the specific financial obligations of companies towards the government. However, there was a five-year period from 1975 to 1996 when these contracts were managed by PTBA, an NMC (Darmono, 2009, p. 190-192). In 1996, the Ministry of Mining and Energy (MME) took over the authority to manage mining working areas and to negotiate and sign contracts with the companies and the system was renamed as the Coal Contract of Work (CCoW) (Arif, 2014).

The returning authority of the MME as the one that signed the CCoW was considered as implying that the government and the companies are at the same level in front of the contract. It also means that any change in the existing contract should be negotiated and agreed between both parties. This situation can also be seen as a violation of Mining Law 1967 (interview with a Member of Parliament, February 2017). Nonetheless, the no law-based system ran without challenges from any governmental agencies until Mining Law No. 4/ 2009 was issued. The system was consequently finally recognised by national law and put under supervision of the MEMR (previously known as the MME).

5.3. The Procedure Element

From 1967 to 1999, there was a relatively stable policy regime due to an unchanging president and strictly controlled political, economic, and social sectors. The local authorities did not have real authority to manage their potential and already-proven

natural resources. National companies still learnt to manage the companies, to conduct mining operations, and to use technology and machines related to their operations. Domestic energy consumption also increased steadily, while international exploration and consumption increased rapidly due to vast industrial development in developed and developing countries. However, exploration of new mineral sources was mainly affordable only by large, foreign companies with abundant capital to fund their operations and the latest technology to reduce exploration costs and minimise risk (Sigit, 1995, p. 186-188). During this time, Indonesia still lacked skilled manpower and had no capital to develop NMCs. The government decided to give up 35% of its share of the NMCs so the companies could collect more public funding to develop their businesses. The conditions also improved with the increasingly educated and skilled domestic manpower who could take part in more managerial and technical jobs.

The first important agenda that should be underlined in the mining industry is the designation of mining areas and tender processes for mining working areas. This process depends heavily on good communication and intense sharing of data and knowledge between the government and companies, especially the data about potential mineral sources in a geographical location. In this regard, the government established a system which ensures reliable information because, in order to obtain a contract or mining license in certain areas, companies require approval from the MEMR about the status of the mines. However, the government is not active in its control of the mining industry as it has limitations such as limited knowledge regarding operational activities. More importantly, however, it also has limited capital and manpower to do the job.

The second agenda relates to the divestment policy to transfer the ownership and control of companies' operations to domestic actors. The domestic players could be national or subnational governments; national or local companies; domestic private

companies; or a collaboration between those actors. The divestment policy means that mining companies which originated from outside Indonesia (foreign companies) or those with operations in more than two countries (MNCs) should transfer a minimum of 50% of their share towards national actors on a gradual basis. A successful example of this policy is PT Indonesia Asahan Aluminium (PT Inalum), which was taken over by the government in 2013 (Sudaryana, 2016). The company was established in 1976 by a consortium consisting of 12 Japan-based companies, which held a 90% share in the company, and the GoI, which had a 10% share. The government's share increased to 25% in 1978, to 41% in 1987 and 1998. The GoI took full ownership in 2013 following the initial agreement with the consortium and the company officially became a state-owned company. On the other hand, The GoI only owns approximately 9.36% of PT Freeport Indonesia despite the company entering the country more than 40 years ago. The divestment programme is not working smoothly for Freeport and the GoI. The process has been negotiated since 2001, but still there is no significant development as of March 2017.

The third agenda relates to the utilisation of local content and the moratorium on giving new mining licenses in 2014 for a certain amount of time. The first policy was aimed to help the growth of local and domestic mining service companies by emphasising foreign companies' obligation to use materials produce domestically as well as services provided by domestic companies unless no companies provide such services (Sudaryana, 2016; Poeradisastra and Haryanto, 2016). The moratorium was issued as part of the government's project to evaluate all mining licenses, which significantly increased in the years following 2001. The project is known as a clean and clear project. Thus, during the evaluation period, the subnational government is not allowed to issue new mining

licenses to domestic and foreign companies until a further decision is taken by the national government.

In addition, there has been another important agenda relating to mining industry governance in Indonesia since 2014. The government banned raw mineral exports and added an obligation for mining companies to pay a certain amount for reclamation projects based on their working areas (Sudaryana, 2016). The GoI had already issued such a policy earlier to encourage industrialisation of agriculture, farming, and non-metal mining products, which was expected to increase the economic value of the raw materials. In this regard, it is also a policy which emphasises the government's goal of developing downstream operations within the mining industry (Antam, 2016). The national mining industry's focus on upstream activities has caused not only severe environmental degradation in respected mining areas, but also in the surrounding areas which endangers the livelihood of local people. In the wider picture, the decentralisation policy launched at the end of the 1990s meant that the local governments and people within mining areas became heavily dependent on income from companies' activities as well as their CSR projects (Septiari, 2014).

On one hand, the condition is to be expected from such a policy. On the other hand, the existing mines already have limited mineral reserves and potency as they have already been exploited for more than ten years. Therefore, in the next ten years, the local governments and its citizens should seek for a new reliable source of income to avoid further social, economic and security issues in the future. The national government has realised this problem and it has already established a reclamation after-mining policy as a system that is expected to solve both environmental and social problems. So far, the success story of this reclamation is West Sumatra ex-coal mining area in Ombilin. The mine was operated by a national company and was already unable to keep up with the

increasing production costs due to old mining equipment and a significantly decreasing number of coal productions.

After independence, the government established a ministry to represent the government, protect the national interest and achieve national development projects and priorities related to mining, energy resources and the extractive industry: the MME (which then became the MEMR). The Ministry worked closely with President Soeharto in deciding important matters related to the industry. During his regime, Soeharto controlled governance in all sectors, especially important sectors such as the mining industry. Thus, the ministries, subnational governments, and other governmental bodies only had limited liberties in making decisions and taking action even though they had the authority to do so.

The government regulations related to the mining industry have become more complicated with the openness and development of Indonesia's political, economic, and social systems. The more the country's elites and people interact with external actors and environments, the more awareness they have about the way in which they have to deal with various actors in national and international arenas. Moreover, they also have greater awareness about their own potencies, strengths, and weaknesses in dealing with others. Various governmental agencies and citizens also develop new desires, knowledges, preferences, and abilities to employ different approaches to solve problems and make decisions regarding different actors, especially business entities. The government established the Ministry of Environment and Forestry to implement its commitment regarding environmental protection. In addition, the Ministry of Finance began to make separate calculations for national income based on different industries, with oil and gas as well as general mining considered as different sectors. This could imply the importance of the extractive industry as the main source of national income. Even though tax has

become the dominant source of state income over the past 15 years, a significant percentage has originated from tax and royalties payment made mainly by mining companies. The Ministry of Transportation, which has authority in managing transportation within national land, water, and air, has also attempted to collect income by charging all water transportation through various terms such as permission to sail and transferring goods service; despite the name, this does not involve any government services.

An important change in the relationship between the government and mining companies is the shift from the *Kuasa Pertambangan* (Mining Authorisation Holder) system for domestic-based mining companies and the CoW system for foreign and multinational mining companies to a license-based system in which all companies are treated equally regardless of their origin. The main difference between these two systems is that the government has gained a stronger position in the latter. In a contractual system, both the government and the company are at the same level, which means any changes related to business operations should be negotiated and agreed by both parties. Meanwhile, in the later system, the government provides companies with licenses to operate within the given area and they are also obliged to comply with every change in national and subnational regulations without prior negotiation. In the former system, domestic companies received special treatment as they did not have to pay royalties to the government as an additional tax obligation, while foreign companies were obliged to pay both tax and royalties.

The second change relates to the authoritative party that can issue mining licenses. According to the former regulation, the national government has monopoly authority to conduct negotiations and sign contracts with foreign and multinational companies as well as to provide Mining Authorisation Holder status for domestic companies. There is no

control mechanism towards the national government in issuing the CoW and Mining Authorisation Holder system. Following the Law of Decentralisation, which came into effect in 2000, subnational governments, especially in regencies, also have the same authority. By law, the national government has had to share its authority in managing the mining sector so that the local governments are able to collect revenue from mining operations within their areas to fund local development projects. The contract or license is only a license for exploration and mining operations in the working area. However, local people own the land so the company needs to negotiate directly, primarily by consulting and cooperating with local authorities, with the landowner to buy the land and determine compensation (Septiari, 2014). Sometimes, if not most of the time, the landowner asks for significant compensation and the local elites also ask for a share from the landowner, from the company, or from both parties.

This practice is very common in many regions in Indonesia and the national government often does not know and is unable to trace and control such practices. The negative impacts of decentralisation are evident in the many suspicions and findings of local elite corruption as well as contract and national law violations. The national government has established the KPK (*Komisi Pemberantasan Korupsi/* Corruption Eradication Commission) to investigate and reduce the amount of corruption, while the MEMR has issued a clean and clear project to evaluate the system of mining licensing in subnational governments. The Ministry of Domestic Affairs has also evaluated several local policies and regulations which are not in line with national plans and violate national laws.

On the other hand, the problem arising from the authority transfer was fake, problematic, and overlapping mining licenses given by the municipal government to unknown and unreliable companies. The MEMR, especially the Directorate of Mineral

and Coal, issued a “clean and clear” certification project for all existing mining contracts and licenses issued by local governments. During the process, new licenses or auctions for new working areas were halted. Due to this policy, domestic companies were also unable to expand their exploration project to find new mineral sources in other areas to maintain their production level.

The third change relates to the use of forestry areas for mining. Based on Law No. 11 Year 1967, mines could be created in all areas under GoI jurisdiction. However, with the increasing concern regarding environmental degradation and international recognition of the importance of Indonesian forestry areas, the GoI established the Ministry of Environment and Forestry. The Ministry issued the Law on Environment, which prohibits any mines in forests which are categorised as protected areas managed by the GoI. However, the GoI could award special mining licenses to any mining companies for special reasons, such as for fulfilling domestic needs. Unfortunately, getting these licenses is not easy as the companies and their operation plans in the areas require approval by different ministries, which make it a long and difficult process. Thus, even though they have already targeted the locations as their new resource reserves, some companies have difficulties completing projects in such areas.

A further challenge for mining industry institutions arises from small-scale and unauthorised mining by individuals or groups. Some of their activities are conducted in a mining area operated by a legal mining license holder. The responsibility to manage and control such activities belongs to subnational governments. This is a more realistic approach as the local governments are geographically closer and should have more knowledge about these activities and those involved in them, unlike the national government which does not have adequate information or the capabilities to manage them. Nonetheless, there is also a possibility that local elites with connections to

governmental offices are the ones who are responsible for these activities, potentially meaning the local government is unable to manage them.

Both practices from unclear and unclean mining licenses as well as illegal mining are often related to the illegal mineral trade. This activity has significantly reduced both subnational and national income from the mining industry. In order to limit illegal activities, the national government has renovated and relaunched several ports that are specifically used to transport mining products from mining areas. Moreover, the national and subnational governments cooperate with law enforcement agencies such as the national and district attorneys, the KPK, the police, and Indonesia's Armed Forces to conduct periodic inspections of mining areas which are suspected to have illegal mining operations. This operation could minimise illegal activities although they cannot be fully stopped due to the limited manpower and capital of the related authoritative bodies.

The agendas, system changes, problems, and challenges have already been discussed in this section. It has provided an important basic understanding about the context in which an actor acts and builds a mutual relationship with others. It is important to note that the government does not consist of single or unified agencies and various levels of government agencies are involved in managing the industry. On the other hand, the business entities also consist of different type of companies. The next discussion will focus on the analysis of actors' characteristics, perceptions, and tendencies as well as their capabilities to act and to cooperate with the other agencies within the same organisation (as "government" or as "business entities") in order to establish and develop a mining industry institution.

Based on the above discussion about important events in the institutional arrangement of the mining sector, we could make classifications of actors whose actions and decisions may affect the direction and implementation of both regulations and

procedures. The actors are mainly divided into government and business entities. However, the government consists of bureaucratic actors represented by different ministries and related governmental bodies, as well as different levels: national and subnational (which consists of provincial and municipal government). On the other hand, mining business entities do not consist of similar scales and types of business. From the study, there are at least two categories: the origin and scale of operations. The origin category contains domestic and foreign mining companies, while from scale factor includes small-scale (usually local companies), medium scale (usually national, both state-owned and private companies), and large-scale (usually foreign, especially MNCs). Different companies could have different and similar perceptions and strategies in their interactions with the government. Moreover, both actors (government and business entities) could have unified actions as a group or individual approaches in their interactions with other parties.

In addition, it is also worth considering society as another party in the mining industry institution even though it does not have a direct influence in determining the rules of the game. Society is not only often excluded from the discussion of government and companies' relations, but its role is also considered as static. However, societies in different regions could have different perceptions, expectations, and strategies in interacting with both the government and companies. Moreover, they also have different scopes of action (as individuals, as a group or via representation from local elites) and different levels of interaction depending on their role and engagement with the other parties in the industry.

The first learning process of the GoI was its willingness, following the actual decentralisation policy, to share some of its authority to manage the mining industry. Before the reformation era in 1999, the national government controlled all political,

economic, and social sectors without giving any of its authority to others, especially the subnational government. President Soeharto was the centre of the government's policies and the sole decision maker for all sectors. His word was effectively the law and was followed by all provinces and ministries, as well as the House of Representatives. The authoritarian model of governance was covered by regular general elections every five years to choose the already-decided winning party and the House of Representative's power structure as well as the already-decided and elected President. The government had only one voice and move in the already-decided and dictated goals, direction, plans, and projects; differing opinions were not permitted and could lead to a political, legal, or military approach. Opposing parties could be fired from their public positions, become a political criminal, or be banished without trace.

The government still needs to improve its performance, especially to deal with and to synergise more governmental agencies that use their authorities to benefit from mining activities. Since the reformation, the ministries have gained more authority to determine their goals, plans, and projects. They can interpret the national law and plan from their own perspective and with their own priorities in mind. However, their ability in conducting their tasks is not equal. There are some ministries which are more advanced than others in terms of catching up with and adjusting their systems to the global demand for more transparent and accountable governance practices. Many policies are overlapping and create confusion and resistance from companies. One important solution from the government is the establishment of a one-door policy to issue mining licenses and national requirements to enter and prolong mining activities in the country. The MEMR shares some of its authority in assessing and issuing mining licenses with the BKPM (*Badan Koordinasi Penanaman Modal*/ Indonesia's Investment Coordinating

Board). It also collaborates with the Board by placing some of its staff to handle the tasks and smoothen the transition period.

Not all ministries are relevant in this study. The MEMR is the one which has the most tasks and interactions with mining companies. Previously, it was involved in the negotiation process until mining contracts were issued, they also manage and control mining operations in Indonesia. In 1990, government established the Ministry of State-owned Enterprises to oversee the management of national companies at an administrative level. Due to growing concerns about environmental damage and protection, the mining companies also need to meet environmental requirements from the Ministry of Forestry and Environment before starting their mining operation. Finally, the Ministry of Finance is responsible for managing companies' financial reports and payment of their financial obligation as stated in the contract or mining license. In fact, Indonesia has a Coordinator Ministry of Economic Affairs to gather and lead all ministries related to the business sector.

The House of Representatives main task is related to discussing and issuing national laws. However, sometimes they use their rights to ask the government about its plans and projects, including the mining sector. Furthermore, the government is also obliged to consult the House before deciding on mining areas, signing contracts and issuing mining licenses. However, as the Members of Parliament were chosen not based on their knowledge, education or job background, as well as expertise, it is not easy for them to ensure that the GoI's actions and policies are inline or at least not against the Constitution and national laws. In reality, there were ten years (from 1999 to 2009) during which mining sector governance could be considered as against the 1967 Mining Law, with Parliament issuing a new mining law in 2009 (interview with a Member of Parliament, February 2017).

Despite these problems, all ministries and the House have one common agreement regarding governance of natural resources. The government needs to be involved in managing and running the business in order to maximise government profits from companies' existence and operations and to minimise the negative effects from those activities. It also has a common perception that mining companies are effectively a cash machine. That is why it attempts to charge them by using many and overlapping ministerial regulations or policies. It also attempts to renegotiate contracts when the international market price of mining products increases and closes its eyes when the companies are producing a negative business environment. Moreover, the government also ignores the fact that most big companies make a valuable contribution in developing the regions where they operate. There is no reward system for their good mining practice or their compliance with the regulations.

Another development in the governance practice is the government's use of its authority without public control in order to become a more transparent and accountable government. The GoI committed to a more transparent and accountable governance practice by establishing the KPK in 2002. The Committee has succeeded in investigating and bringing corrupt elites to justice even though corruption is still a huge problem in the country. It also supported the decentralisation process by collaborating with several ministries to watch and investigate local government activities in managing their regions in various sectors. The clean and clear policy is one mining industry-related example of MEMR and KPK collaboration. The programme is expected to increase local government awareness regarding the good governance code of conduct. This step is particularly important in order to attract more foreign investors to the mining industry, which has already suffered since reformation due to political instability and frequently changing regimes, especially at the subnational level.

Since 1999, the national government has decided to decentralise the political system by sharing some of its authority with subnational governments. Nonetheless, some local governments are more advanced as they have different ability levels and access to the information and data needed to establish a relevant mining policy. They also have different understandings regarding the mining sector, for example the region's mining potency, the mining companies' operation, or small-scale or people-led mining practices. The Governor or Regent has the authority to decide policies for all sectors, including the mining industry, because the subnational government only has limited capital (money, skilled employees, and knowledge) to complete these important tasks. The elites are not directly controlled by the national government and do not have to consult with relevant bodies at the provincial level in practicing this authority. In fact, most elites act as "little kings" who make local policies or regulations that contravene national interests and projects. Moreover, many mining producing regions have established a Distamben (*Dinas Pertambangan dan Energi/ Energy and Mining Body*) without clearly define this body's role, authority, and tasks in managing the mining sector. This agency is not directly related to the MEMR, which also means there is no control over whether the director is appointed by the Governor or the Regent and whether employees fully understand their roles. In addition, it also does not have the authority, means, and ability to actively interact, collect data, and watch companies' operations in its region. This condition has created ineffective and passive local mining governance.

There have been changes in the government's perception of the national economic security, concern, and agenda which emphasise domestic actors' ability to produce mining products. Public opinion values the national ability to fulfil domestic demand for mining products highly. This view is mainly influenced by national awareness and self-esteem as a resource-rich country. However, the actual condition of the national mining

industry tells a different story. Mines are usually located in forests and difficult-to-reach areas. Furthermore, national companies usually have limited capital and therefore they cannot afford failure during the exploration phase and uncommercial mineral findings. As national companies they are domestic market-oriented, which could reduce the economic incentive to develop and expand their projects. Government and public expectations are also higher and could become a burden in managing their revenue and profit. They should pay particular attention to sustainable CSR projects in order to avoid criticism and losing favour from local people and the government. Moreover, the dynamic of mineral product prices in the global market as well as the changing global mining industry competition are further challenges for their business plans and operations.

On the other hand, foreign and multinational mining companies usually have sufficient capital and the necessary experience to manage business risk and facing challenges both inside and outside the company. They place more emphasis on economic goals (profit) and a business approach in their business plans and development projects, while establishing and maintaining good relationships with local people and governments. By doing so, they are able to focus more on increasing product quality and quantity while maintaining low and manageable production costs to secure profit. Some of them also use independent institutions to handle tax-related matters, while some others establish a special section in their organisation, mostly consisting of Indonesian professionals. In addition, they also have superior equipment and the requisite technical ability to explore and produce minerals as well as a greater commitment to the host country's regulations and requirements to prolong and secure their operations. They have more experience, ability, and flexibility to meet international standards of business management and mining operations.

The mining industry in Indonesia did not develop as quickly as in other resource-rich countries due to the government's dependency on hydrocarbons, especially oil, as they are easier to explore, need less time from exploration to production, have cheaper production costs, and command higher prices in the international market. In the initial stage of the industry, coal, tin, and copper mining in Indonesia were mainly run by big foreign companies such as Adaro and Freeport. Adaro, which originated as a Spanish national mining company, focused its operation only in Indonesia and especially in the southern part of Kalimantan Island. On the other hand, PT Freeport Indonesia was a subsidiary of a multinational mining company which originated in the US, Freeport McMoran Inc. It signed CCoW and CoW agreements with the government from the late 1960s until the early 1980s. It became one of the largest mining companies and has continued to operate in Indonesia despite the ups and downs in the international prices of mining products and the rapidly changing national and local regime and policies in the last ten years.

The second stage was the entrance of NMCs in the industry. There are three NMCs, of which the GoI has a 65% share. Antam Tbk (*Aneka Tambang, Tbk*) produced various mineral products, especially ore and nickel, while the other two NMCs are PTBA (*Perusahaan Tambang Bukit Asam/ Bukit Asam Mining Company*), which produces coal, and PT Timah, which produces tin. Both of them were established to take over Dutch-based coal and tin mining companies which had operated in the East Indies since the 1890s. As the GoI has 65% ownership of the companies, their management is overseen by the Ministry of National Enterprises while their operations are supervised by the MEMR.

National companies have to pay royalties and tax to the government, like any other company, while also providing several social services for local citizens in their operation areas. Their CSR activities mean that both society and local governments will

always expect demand more services without appreciating the difficult situation faced by the companies. The lack of knowledge and information regarding the business conditions mean local governments have not been flexible or able to adjust their approach towards business entities. Thus, their main (if not the only) perception and attitude towards business has been as their cash machine and not as their partner in develop and strengthen the local economy and society.

The third stage was the emergence and development of private and local mining companies. Some local mining companies were established by local governments to obtain bigger profits rather than merely waiting for tax and royalties payments by the foreign companies to the central government. However, developing the business is another story. The lack of capital, management strategy, and technological know-how to establish an effective mining operation are the three biggest problems these companies face. Unfortunately, they are also used by local elites as political tools to gain support and direct public opinion, especially during elections. Despite this, they still manage to mine and produce some mining products, which are predominantly traded in the domestic market. On the other hand, local service companies are also well developed as most the bigger companies regularly use them as subcontractors. Meanwhile, the larger foreign companies pay more attention to managing all operation activities, dealing with their financial and legal obligations to the government, and managing CSR projects.

The fourth stage is management of traditional miners, especially illegal and problematic ones. Such operations have been around forever, especially gold mining. One important characteristic of their operations is the use of traditional and simple methods of mining. However, nowadays, these mining operations are often managed by small groups or local companies who manage a number of traditional miners, including the distribution of people working in several mining areas, the collection of the products, and the resultant

trading activities. They operate as middlemen between miners and bigger companies that will buy their products. Unfortunately, many of these activities are illegal and not under government supervision. Several problems have arisen from such activities. On a national scale, such groups and companies often take part in illegal exports of mining products, which prevents the government from receiving the maximum profit from mining trade. Furthermore, there is no protection given towards the miners involved in the activities. Traditional mining methods are risky because there are no safety measurements. Thus, the miners' health and life are at risk and they do not have health insurance or other protection as well as leverage like legal workers in legal mining companies. Subnational governments, especially at the municipal level, have the biggest authority in managing such activities under Mining Law No. 11 Year 1967 and also under Mining Law No. 4 Year 2009. However, only in the last 15 years has the local government been able to make a greater commitment and reduce such activities by cooperating with law enforcement bodies such as the Indonesian Army and the police.

On the other hand, the agenda for mining operations is also expanding. The first issue is the rising awareness of and commitment to environmental protection and good mining practices following the after-mining reclamation obligatory fund. Many mining areas are already mature and no longer have sufficient mineral reserves. Thus, some companies have closed down their operations due to the rising cost of producing and continuing their operation. However, mining companies' operations affect the lives of people in the surrounding area. A sudden closing down of a company could cause social and economic problems if the local government does not prepare beforehand to diversify people's source of income and stop their dependency on income from the mining industry. Another important agenda is the rising awareness and commitment to manpower protection as mining operations have a high level of risk. Last but not least is CSR as a

form of compensation for any activities which are damaging to the people around mining areas. Furthermore, CSR could also be viewed as an important bridge in building and securing a good relationship between companies and local citizens.

Society has different views and opinions regarding the existence and operations of foreign companies. Firstly, as a foreign body, the company is considered as an intruder and a threat to national sovereignty. Secondly, such companies are job providers which function as a source of income for citizens near the operation fields, factories, warehouses, and offices. Thirdly, by conducting CSR projects, the company becomes a partner in improving the living environment and funding small businesses as well as local economic, social, and cultural projects. Despite the advantages for both local elites and society, these operations also have disadvantages as they destroy the ecosystem and surrounding environment and also pose a threat to the morals and traditions of the local people as foreign workers have their own way of living, which is often against local culture.

The first two points have a different direction of interaction compared to the third point. The interaction between companies and society in the first two points is mostly one directional. This means that the government and the businesses determine how and in what way they interact with local people. Meanwhile, there are two methods of interaction in the third point, which means that the society also starts to actively voice its concerns and demands to the companies or the government.

Society strategies in approaching government and business entities involve cooperating, direct negotiation in various agendas, and the use of violence or threats individually or in a group. The former mining workers' movement to take over mining sites in several regions immediately following the country's independence is an important example of the scale and ability of society to voice its concerns and opinions. Society

roles in the mining industry include landowners, workers, and the supporting system (providing accommodation and food as well as other services to the workers), as well as intruders (in terms of illegal mining). The people, usually individually, are the landlords of mining areas and their main concern is receiving sufficient compensation for the land. As a group, they act as an environment in which the workers and company live. This means that the company should establish and maintain a good relationship with them.

The main agendas which concern this societal group is environmental protection, job opportunities, CSR, and compensation. There are several examples of such problems. The most well-known problem is the conflict between Papua citizens and Freeport and the government, which have been accused of negligence regarding the citizens' role and existence (Haluk, 2014). Despite large-scale mining and income collected by companies as well as tax and royalties paid to the government, Papua society is still less-developed in terms of education, access to cheaper daily essentials and fuel, interconnectivity with other regions, and the variety of occupation compared to Java or Sumatra. Moreover, the region had to deal with a separation movement which threatened the integration between different native groups in the region. This condition led to an ineffective lobby, strategy and scale of action in dealing with the national government and Freeport.

National and subnational government relations involve control and sharing authority. The Constitution generally positioned the national government authority (rights and obligation) to translate national interests, manage and distribute public properties, and represent the Indonesian citizens in interacting with international actors. However, the 1999 Decentralisation Act shared the authority with the subnational government. This was anticipated as the previous law was issued according to the contemporary national situation, when the priority was consolidating political elites and parties to establish a political system that was recognised by and legitimate in front of citizens and the

international community. However, the Act did not clearly define a control and coordination line between national, provincial, and municipal government despite the fact that there was an indirect interaction and control line between the national government and municipal authorities.

The number and quality of mining licenses issued from 1999 to 2014 was uncontrollable by the national government. On the other hand, when there was a change of regime from the former Regent to the new one, the new elites could also allocate licenses for the same working areas to other companies as long as the result was more profitable than the existing scenario. An example of dirty practice regarding this matter is the mining licenses given to dummy or fictitious companies owned, established, or related to the elites or important persons in order to fund their campaigns prior to their appointment as the new Regent. Thus, the first step taken by the GoI was by taking back the authority to issuing mining licenses from the municipal government and giving it to the provincial government (Sudaryana, 2016). This action was taken based on an amendment of the Act with Government Regulation No. 4 Year 2014. The new system is expected to be able to effectively reduce corruption as there is direct control from central to provincial government and there is direct communication and interaction from municipal to provincial government.

There are several important agendas which have received attention from national and subnational governments. One of them relates to the environmental degradation caused by mining activities. The Mining Law highlights companies' obligation to fund reclamation projects in order to rehabilitate the environment once a mining operation ends. However, this obligation is in the form of a reclamation fund which is paid to the national government, so the management of the reclamation project is conducted by the subnational government under supervision of the national authority. Consequently,

national and subnational governments need to work hand in hand to conduct and accelerate these projects.

The national government also issued a controversial policy which becomes a problem for national company, especially Antam. Despite the fact that Antam's income primarily originated from ore exports to China and Japan, the government issued a ban on ore exports in 2014 (interview with Antam, 2016). On one hand, the government made the regulation in order to increase the value of the country's mining production, thus enabling the domestic mining industry to develop its activities to gain more experience and ability, as well as profit from smelter and half-product and end-product trade in the international market. On the other hand, prior to the implementation of the regulation, the RRC had bought more ore from Indonesia and other Southeast Asian countries to cover their stockpile. Subsequently, the price of ore decreased significantly and Antam Tbk – as the biggest ore exporter to the RRC market before 2013 – lost its position in the market and was replaced by the newly emerging mining industry in Asia. The company faced a difficult situation as it needed to find another source of income during 2014 and 2015. Fortunately, its gold production margin was enough to cover the ore business. However, gold was not its main production and was predicted to stop in 2018 due to the decreasing gold reserves in the company's working areas. It has also been unable to identify more sources due to the government's policy to halt the issuing of licenses for new working areas until the conclusion of the 'clean and clear' project, which intends to solve the overlapping licenses issued by some municipal governments.

The recent companies' and government's concern is the long and difficult renegotiation of contracts and licensing arrangements. In addition, the government has no award system or other forms of incentives for compliance with financial and other obligations to the national and subnational governments. It could be argued that this

implies the government does not consider companies as partners in national and subnational economic development plans and projects. Moreover, the national government, especially the MEMR, is often unresponsive to the companies' difficult situation, especially regarding the slow global economic growth and the significant decrease in mining product prices in the international market. For example, there is a time where they tried to contact the MEMR by sending a letter and did not get any response despite sending a second letter (interview with an FMC, 2016). The national government not only provides financial incentives (such as tax allowance), but also demands a bigger share from the operations through renegotiation of contracts.

The foreign companies which operate in Indonesia could be categorised based on their capital, technical ability and area coverage into small, medium, and large companies. The difference is mainly the transparency and accountability of their operations and their commitment to comply with their obligations and the government requirements specified in their contracts or mining licenses. However, the international mining market, especially in Asia, is changing with the success mining in Vietnam and Cambodia, combined with the loose regulations and demand for foreign investors in these countries; they are a strong competitor to replace Indonesia's position as a world leading producer of tin and coal. This international challenge is also worsened by the government's policy to ban exports of raw mineral. Indonesia has already lost its position as the biggest ore provider for China. Recently, China's business entities began a new strategy to secure their need for ore from Indonesia by entering the country as mining companies so that they could obtain the ore they needed without breaking the ore export ban.

National mining companies have developed rapidly during the past ten years. They have been able to enjoy greater independence in managing their activities and also to acquire capital from the public, even though they are only allowed to get 35% of public

investment and they are still 65% government owned. Although the amount of public investment is still very limited, the government demands that these companies establish a vertically integrated mining industry, which means they should do all activities from surveying, land digging, exploring, transporting, as well as processing the raw minerals to become half or fully processed products as these products have greater value in the international market. The smelter facilities have been in place since 1990 but with a small capacity. Before 1998, they also could enjoy various facilities in their operations such as easy processing and licensing to obtain land for mining sites and many administrative requirements before starting their mining operations, as well as subsidised fuel and electricity. They have had to maintain low production costs without those facilities since 2000. This process has matured those companies and encouraged creativity to find various ways to stay alive and keep going forward in their activities as state-owned enterprises which are expected to keep the national dignity to mine and produce minerals from their own land. This ability is considered as crucial by the government and society. Both the GoI and the public are determined to take part in any business activities within their land. Despite the country's inability to obtain more capital and better technology and equipment, as well as to give bigger salaries to the workers in comparison to foreign companies, Indonesia should have its own companies in natural resource-related industries.

Another problem in the business and state relations relates to the operations of local companies, people, and illegal mining. The government does not have clear regulations to manage, watch, and control local companies. Most of them cannot perform well or even continue due the lack of capital, skilled manpower and good information and access to potential projects. On the other hand, larger companies have attempted and committed to comply with the changing government regulations, even though by law they

are only obliged to comply with those regulations issued before signing the contract. However, smaller companies have sometimes attempted bad corporate governance by collaborating with corrupt local elites; they have also failed to comply with their obligations and made fake reports to the related ministries.

When the local authorities took charge of managing mining activities within their regions, they established a special office to handle mining-related affairs. The office is known as the Dinas Pertambangan Daerah (Local Mining Office). However, the support and level of authority given by subnational governments to this office are different based on their different management abilities, financial resources, and understanding of the mining industry. There is also a problem with regards to their ability to access, collect, as well as to process mining-related data from mineral potency and reserves (proven and unproven) to mining companies' existence and operation within their region. The local authorities often demonstrate unprofessionalism and favouritism in awarding licenses and ignorance of organised business operations by issuing overlapping licenses in the same working areas or by lobbying individual elites, leading to corruption and collusion. Sometimes, they manipulate the system by establishing dummy companies which are related to them. They appear as new and real companies which will receive mining licenses before selling these licenses to foreign companies at a higher price.

Furthermore, sometimes some of these authorities also acted as local kings who have the ability to mobilise people to initiate conflict with companies or to protect companies (usually as local bodyguards) from societal violence. Such practices are often uncontrollable by legitimate authorities as they have public sentiment and could stir up favourable public opinion. However, the 1998 national reformation and decentralisation project has prevented many of these issues. Moreover, the local elites also attempts to collect money from companies through various means such as using local regulations and

sending official demand letters to the company's office regardless of the national interest, as well as the financial requirements in the company's mining contract and licensing. In addition, it is able to ask companies to fund various social and local projects directly or by using local regulations.

Companies have to build and maintain good relationships with local authorities, especially related to community development projects, licensing and funding various local events and compliance with various local regulations. However, some of them act as the "mafia" in doing business by initiating conflict with local people, cooperating with corrupt elites, and becoming involved in local politics. In order to carry out its operation in Kalimantan, the FMCs hire about 70% of local workers to establish a good relationship and to avoid resistance and conflict with local people in the surrounding mining sites. They only use foreign workers for specific positions. This is also because foreign workers are not familiar with local customs and traditions and they tend to continue their way of life, for instance drinking and prostitution which are against local norms and beliefs.

Large-scale FMCs face slight difficulties due to the high service costs charged by local and national service companies. In hiring contract workers for example, the local company could propose a higher salary for its workers than the national wage standard or when small or medium scale mining companies use its services. Large companies, such as Adaro, subcontract their exploration and production activities while prioritising matters regarding financial and tax affairs relating to the government and customers as well as CSR projects themselves. Local workers constitute 99% of branch offices near mining sites. This strategy helps to maintain a close relationship and to ensure the company is reachable by the society. Acceptance and support from society and local authorities could determine a company's security and ability to continue its operations (A Foreign Mining Company, 2016). At the same time, small-scale illegal mining by individuals or a group

of people sometimes happen. However, with clearer mining governance, the problem could be handled quietly. Thus, mining companies have closer and more intense communication regarding technical matters with provincial and regency authorities and local people. Their relationship and communication with central government mainly exists before starting operations because of the administrative requirements. The central government's main concern during the mining contract period is financial affairs, tax compliance and various obligations as stated in the contract. In addition, if mining production increases in the international market, the government will propose a contract renegotiation. Lastly, various requirements about land reclamation and obligations must be fulfilled before the contract ends.

Company to company relationships are not as intense as the companies' interactions and relationship with the government. They use business associations to act as a mediator in dealing with the government regarding common issues and concerns, even though their voice often goes unheard and the government is unresponsive (or slow in responding) to business opinions and demands. On the other hand, companies deal directly with other companies, for instance mining, hydrocarbon or plantation companies, regarding matters such as overlapping working areas. They consider business to business negotiations and approaches to solve this problem as easier to handle than dealing with national and subnational governments.

Interactions among companies are mainly related to subcontractor operations. Some large and medium-size companies do not directly take part in the operations. They are more focused on overall business management while actual mining operations are conducted by service companies. The main companies handle important matters such as administrative, political and financial affairs, as well as CSR and community development projects related to the society. This trend encourages domestic service

companies to grow in terms of skill, knowledge, and mechanical abilities and also provide more jobs to local people. These organisations are predominantly owned and managed by domestic private sectors. Moreover, the mining companies are obliged by the Law to use national and local products unless they are not available domestically. This policy is aimed to develop the national assembly and manufacture industry because raw materials and machine parts can be provided and assembled in Indonesia. A company only needs to import technological equipment which is not produced in Indonesia.

The society and companies' interactions are mainly conducted through local governments. Nonetheless, the increasing number of educated people has also increased the number and expanded the scope of collective actions. There are various types and levels of social association which interact with and voice their interests and needs to the government. An example of an active association is related to environmental protection and such associations mainly focus on raising awareness among companies and the government regarding the importance of minimising the damage caused by mining activities; examples include infertile land, which makes farming more difficult, and health problems suffered by people surrounding mining areas.

Another example is traditional society associations, especially in West Papua where they have been active for several years to ask Freeport and the national government to recognise their existence as the landlords of Freeport's mining areas (Haluk, 2014). A representative from the association claimed that, despite active operations in the region for more than fifty years, both the company and the GoI had not attempted to involve local people in the management and supervision of the operations and has not distributed the income collected evenly. Even though the region is well known for having large amounts of mineral deposits, the society and the region itself have not developed well. The society has lower education levels compared with Java or Sumatra, and public goods

such as food and fuel are limited and very expensive. Moreover, security problems caused by conflict between the Army and the pro-separation movement or conflict between different kin are commonplace. This is mainly due to the unbalanced development programme conducted in different regions in Indonesia.

On the other hand, local people could also take part as small-scale mining in various areas, including within working areas, under the legal licensing and contract. Such mining activities are also regulated by the 2009 Mining Law (Darmono, 2009; Salim HS, 2013). Individuals or groups of miners should get mining licenses (usually from local authorities) before starting these activities (Prayitno, 2017). However, they do not operate based on mining security standards or good mining operations practice. There have already been many cases of neglected mining holes, usually from illegal mining practices, in various mining sites which are often unknown by the authorities. One example of collaboration between national companies and the government to deal with this problem is Ombilin, West Sumatra. PTBA was appointed as a buyer for small-scale coal mining surrounding its working area (interview with Governor of West Sumatra, 2017). This arrangement not only encouraged the company to legalise its operations with the local government, but also provided legal trade partners. Unfortunately, it also caused problems for PTBA as the company had an oversupply while the market price for coal was decreasing.

Another society role in the mining industry is as landowners of mining sites. Companies need to negotiate to buy the land on an individual basis. The mining contract or license they have already signed with or received from the MEMR is only a license to mine; realisation of their plans and actually starting their operations is a different matter entirely. They should deal with subnational governments from provincial to local governments and village chiefs to the actual landowners in order to obtain land

certificates. There is no standard price to buy the land so the price is fully dependent upon the local authorities and landowners (A Foreign Mining Company, 2016). This condition is a burden, especially for small and medium-size foreign companies which are taking the first steps of their mining operations in Indonesia. Moreover, illegal mining is often related to illegal trade, which causes financial losses for the state.

In conclusion, there is an urgent need to synergise the opinions, understandings, and attitudes of national and subnational governments as well as the landowners within listed mining working areas in order to simplify and make it easier for foreign investors to enter the industry. Even though the main concern for both the government and society is to profit financially from such companies, they should also consider the economic interests and calculations of these businesses. Thus, all parties could attract each other to build a stronger and longer relationship in realising national development projects, plans, and goals.

5.4. Process and Mechanism of Change

The development process of business practice is from FMC domination to NMC and private domestic company involvement in the mining sector. Following independence, some mining concessions were granted to foreign mining companies and mining operations which were on hold until the government determined their status under the newly independent government regime. Those concessions were issued by the former colonial government and, due to public opinion, they were considered as a threat to national sovereignty. The public asked the GoI to nationalise the companies use local companies to take charge of their operations. Thus, the first step regarding the mining industry taken by the GoI was nationalising the mining sector and establishing three national mining bodies to handle mining operations. These three bodies become three national mining companies in the 1970s.

The institutional development process in the interactions between governmental bodies is mainly the change from an authority monopoly to a shared authority without control, and finally to an authority sharing system with control. This is expected to produce which can create harmonious and efficient (not overlapping) policies and actions between the agencies. In fact, the interaction between the different levels of government could also be viewed as a mentor-mentee relationship in which the national government has responsibility to educate and train the subnational government to govern and deal with many issues. The concern in this relationship is the limited transparency and accountability of the latter. Thus, intense supervision and evaluation as well as training is necessary.

The contractual system has been changed to issuing licenses in an attempt to put the government above the companies and symbolise the government as the owner of the land. Moreover, companies are now subject to various national and regional regulations before and during their permitted or contract period. The central government does not have a unify regulation regarding company organisation and operation. Thus, companies are sometimes subject to similar tax components from different ministries and are obliged to pay both bills. The government has also issued the clean and clear policy, which is an attempt to list and organise working areas by providing a clean and clear certificate. Getting this certificate means that the working area is free from overlapping licensing and use from other business entities and operations.

There are three institutional development processes which happen side by side in the government and business relationship. The first process is the change from simple requirements with more freedom in operating to more complicated requirements and regulations with less operational freedom in operating. In the earlier era, mining companies only needed to deal with the MEMR and the Ministry of Finance during their

contract period. The MEMR was a leading authority in all matters regarding contract negotiations or license issuance as well as technical matters and held the authority to control companies' activities. It also assessed their operation plans and projects as well as production, import, and export. Companies had obligation to share their operation data and submit annual reviews to the MEMR. The Ministry could then evaluate their business performance and compliance with their obligations to various law and government regulations. The Ministry of Finance was responsible for handling all taxation and any financial matters regarding payment for their financial obligations to the national government. It could then calculate and share the money to subnational governments as stated in the Decentralisation Law.

However, several ministries have begun to take part in managing their activities since 2000, such as the Ministry of Environment and Forestry in 2008. This involvement focused on the administrative and financial requirements needed before getting a license to mine protected forests. The process is complicated, takes a long time and has with strict clauses. Moreover, getting a license to use a protected area is expensive. Another ministry closely related to mining companies' activities is the Ministry of Transportation. It has issued shipping and loading service fee without actually providing this service. The actual meaning of the regulation is to charge every ship that uses waters under Indonesia's jurisdiction. Thus, the name and actual meaning of the regulation are very different. However, in order to secure their operations, the companies, especially large ones, have chosen to comply with the regulation and paid the taxation. These decisions are also made to avoid any delays in distribution, which could lead to credibility issues as they will be unable to meet the deadlines agreed with buyers and customers. This could ultimately lead to profit losses.

The second type of development is the change from a contractual system to a mining licensing system (only the right to mine). According to mining the CoW and the CCoW, the companies have several obligations, mostly related to tax and royalty, such as obeying national and subnational regulations related to their operations on Indonesia soil. Nevertheless, the national regulations have changed on a regular basis since the beginning of the Reformation Era in 1998. Furthermore, the provincial and municipal government have also established some local regulations which are often not inline or may even contravene national law. Unfortunately, the companies are not in a position to ignore them as they have to protect and maintain their assets and operations to avoid significant losses due to their inability to fulfil commitments with international buyers.

An important development in the government and companies' approach in their relationship relates to their obligation towards society in their surrounding area. In the earlier era, the government's concern regarding companies' activities was entirely related to their financial obligation (tax and royalties) to the state. However, due to the growing international concern about more diverse issue such as environmental and social protection within economic activities, both actors have realised the importance of establishing and maintaining a close relationship with society. CSR programmes are directed towards achieving these goals. On one hand, both the national and subnational government have the advantage of developing social and economic conditions around mining area. On the other hand, the companies also have advantages such as securing their asset and operations from local resistance to operations in the area and preventing the possibility of violence and boycotts of public space, which could obstruct their activities and workers. The GoI made aregulation that limits the use of foreign workers and imports of materials by issuing the obligation to use local people and local content and production unless there is a specific need for skilled workers or rare materials which

are domestically unavailable. By doing so, the entrance of foreign companies in the area is expected to open more job opportunities for local people, both as workers and as providers of facilities for the workers and the companies' activities. However, there is still problem could emerge when the company discriminate between local and foreign workers (Erman, 2005). There are various conflicts between local citizen and mining companies due to various reasons: mainly disagreement over price of the land/mines, the destruction of environment surrounding mines, and disrespecting toward traditional society sacred land, and ignoring people's voice and participation, usually by giving only brief information regarding negative impacts that could emerge from mining operations in their land (see for example Sangaji, 2002; Maimunah, 2012; and Haluk, 2014). In addition, the government could also be in conflict with mining companies (see for example Jati, 2018).

The third development process is the change from the central government's sole authority in managing the mining industry and interacting with business entities to a shared system of responsibility between the national, provincial, and municipal governments. The decision of PTBA to stop its operations in Ombilin, West Sumatra, without many issues is one of the success stories of the local government's attempt to shift local dependency on the mining industry to more diverse jobs and sources of income. The local government developed the tourism sector to replace mining; however, the process took ten years. This demonstrates that it was not an easy job and it should be done step by step to not cause any social and economic problems to the people, the government, or the company itself. Moreover, it needs the local government's commitment and perseverance to lead the process. Thus, the national government's supervision and support is important to help subnational governments through this process as they have different capabilities.

5.5. Conclusion

Indonesia's mining institutions have experienced several changes in agenda, influential actors, and the nature of the bargaining relationship among the related parties. However, the constant factors in the rules of the game are the owner of land, the state, and the main dominant affairs the government is concerned with: financial-related affairs or the money collected or expected from mining operations. According to the Western perspective, the mining contract is sacred, unchanging, and respected. However, in Indonesia, such an agreement in the contract and the reality could be very different as the contract is only a license. There is no guarantee from the government that companies will actually conduct their operations based on their economic calculations and business plans. There are too many social and political factors that should be dealt with both before operations start and once they have started. Furthermore, the dynamic of the international market could also affect government expectations and lead to a renegotiation of the contract, which often does not take the company's interests into account. The renegotiation often ends in a stalemate because the government does not want to lower its expectations. On the other hand, the government only does so in order to obtain larger profits for its public obligations. This dilemmatic relationship could be overcome by strategic communication and consultation with the central authorities. Close and intense communication and consultation with central government, especially the MEMR, is needed in order to smoothen the negotiation process with landlords and provincial and local governments.

Historical institutionalism is very useful in capturing the government and business relationship within the mining institution as a whole. We can analyse actors' perceptions, preferences, and attitudes not as a whole but as dynamics, therefore avoiding the trap of believing that the actors will always act rationally. We could also capture the uneven

ability to act and react as well as uneven information the actors have and have access to. Those differences lead to a dynamic relationship as they have more access and ability to achieve their goals and establish a better plan. Furthermore, the actors not only act by themselves, but also manage a joint operation with other actors in achieving their goals. Thus, their strategy and pattern of interaction is highly dynamic as they are more exposed to bigger challenges and face different problems. However, the concept of the resource curse and a bargaining political relationship, as well as Luong and Wienthal's ownership structure and Sarbu's Ownership and Control frameworks, only focus partially on the government perspective and its development process; they neglect the companies as other actors in the national industry as well as the interaction between government and business entities in an attempt to examine society's position in the relationship. On the other hand, economy approach on state and business relations are emphasising too much on business factors such as taxation, capital, management, and technology as economic factor.

The development of the mining industry's institution, as analysed from the state and business relations perspective, has three stages. The first stage was the general government's policy towards mining companies where the rules of the game in the interactions were regulated by the contract signed by both parties. The central government, especially the MEMR, under the President's direction, was the dominant authority in managing the mining industry. The government's main concern during this period was to collect income from companies' tax and royalties, provide jobs to the local citizens, and encourage domestic involvement in the mining industry, especially as service providers in the operations of FMCs.

The second stage is the establishment of integrated but specialised national mining companies (NMCs). The government nationalised Dutch-based mining companies which produced coal, tin, and other strategic minerals, placing them under the management of

three main NMCs (PTBA, PT Timah, and Antam). The GoI owned 100% of those companies before 1985. As the international market of their products increased, the GoI decided to sell 35% of its shares so the companies could obtain more capital from the public, expand their operations, and increase their product output. The government also encouraged them to establish a vertically integrated operation, meaning they were expected to conduct exploration as well as processing the minerals domestically before exporting them. During this stage, FMCs were still enjoying many freedoms in their operations. However, a new approach in the managing mining industry was approaching and was marked by a series of contract renegotiation proposals sent by the government as the 2009 Mining Law came into effect.

The third stage is a more complicated agenda in government and mining companies' interactions. The Law of Decentralisation Year 1999 marked the beginning of the subnational government's involvement in dealing with business. Furthermore, various ministries also issued several regulations which affected mining operations, for example the prohibition against mining in protected forest areas which was regulated by the Ministry of Forestry and Environment. The obligation to pay for transporting mining products through land and sea, which was managed by the Ministry of Transportation, is another example of the involvement of ministries other than the MEMR in managing companies' related activities. Another example is the regulation of mining product exports issued by the Ministry of Trade. In the earlier era (before 1999), the main regulators were the Ministry of Energy and Mining, which managed mining companies' operations, and the Ministry of Finance, which managing companies' financial obligations to the state. Other agendas also emerged such as manpower protection as part of companies' obligation besides hiring local citizens in the operations, as well as the companies' obligations in terms of reclamation after-mine projects as part of

environmental protection in mining areas; this is because mines are generally known to cause environmental degradation as land is dug in order to explore and extract minerals.

By looking at the government's learning process in managing the mining industry, the openness of mining institutions could also be analysed. An important stage in the process is sharing authority vertically from central government to subnational government, as well as horizontally by involving more governmental bodies in managing companies' activities. Thus, a better, more accountable and transparent mining management system is to be expected as the involvement of more actors also indicates more information sharing between agencies and public knowledge regarding the way in which the government practices its authority. However, it also implies there has been no change in the ownership structure of the Indonesia mining industry as previously implied by Luong and Wienthal (2010) The land and water under Indonesia jurisdiction is owned by the citizens and managed by the government. There is no transfer of ownership as the companies are considered as government contractors which require permission to operate in the region.

CHAPTER VI

COMPARISON BETWEEN THE HYDROCARBON AND MINING INDUSTRIES IN INDONESIA

6.1. Introduction

The mining and hydrocarbon industries were initially regulated by the *Indische Mijnwet* released by the Dutch Colonial Government in 1899 (Darmono, 2009). During this initial stage, the colonial government encouraged the private sector to explore the potency of developing oil and gas as well as other mining industries in the Dutch East Indies (Indonesia). The government invested in the project, while the private sector conducted the actual surveys and explorations in the field. Their relationship was bound by a contract signed by both parties. Afterwards, international mining societies were attracted to take part in exploring potential oil and mining areas in Indonesia, which encouraged the government to release an amendment of the *Mijnwet*. This was known as 5A contract, which generally aimed to protect the Dutch based private sector's interests in the region while preventing the foreign companies from entering the industry. During this period of time, the Indonesian people and elites were forced to be mere spectators without the authority to become involved either as the actual owners of the land or as the beneficiaries from the operation.

This historical background heavily influenced the political and economic will as well as the trajectory of the choices taken by both the government and society in managing both industries after the country's independence in 1945. The enforced nationalisation of the mining areas and oilfields highlighted the importance of having new regulations and management strategies to maximise profits from mining operations in the country (Darmono, 2009). Initially, the society and some elites were determined to take

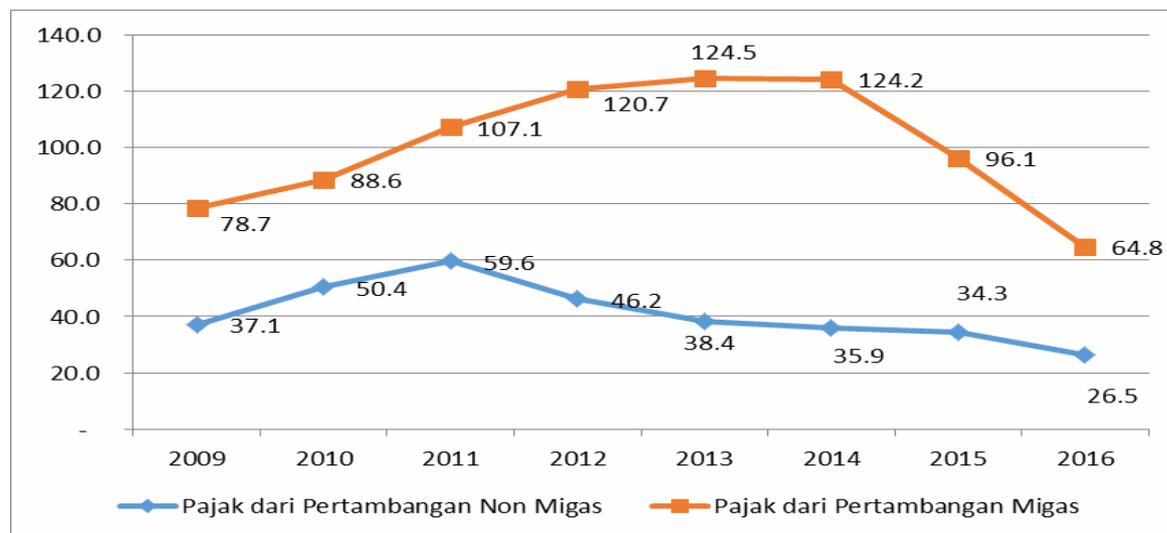
over and monopolise the sector by only allowing Indonesian people or companies to begin operations. However, the reality forced the GoI to choose an alternative strategy in order to obtain funding for national development projects.

The reality is that no Indonesian people or companies were capable of fully taking over the operation. They did not have the necessary capital, managerial knowledge, and technical capabilities to actually manage the industry independently. These circumstances formed the general background behind the release of Law No. 37 Year 1960, which regulated both the hydrocarbon and mining industries as one sector, and Law No. 1 Year 1967, which regulated private and foreign investment (Darmono, 2009).

There are two separate paths taken by governmental agencies in governing the two sectors of the extractive industries. This difference emerges as the government has different perceptions, expectations, and approaches in the hydrocarbon and mining industries. The hydrocarbon industry has historically been a very important sector for the Indonesian economy. Oil and gas revenue was the biggest source of government income to finance national development projects before taxation took over this role and position (Henderi, 2017; Sudaryana, 2016; Tampubolon, 2015). On the other hand, the mining industry was not considered as important until the late 1980s when coal prices started rising (A Foreign Mining Company, 2016). Beforehand, mining activities in Indonesia were conducted mainly by three state-owned mining companies (Antam, PTBA, and PT Timah) which took over the nationalised foreign companies; the society that conducted small-scale gold mining; and an FMC (Freeport) which operated in the largest mining area in West Papua. Those three business actors had been active since the beginning of the country's mining industry (Sudaryana, 2016). Initially, the government loosely managed the mining operations without much expectation or control. However, since 1990, the mining industry has become popular and attracted more domestic and foreign

investment. The business has developed rapidly and the government has consequently taken mining governance more seriously (Warnika, 2017).

Chart 6.1. A Comparison of Government Revenue from the Hydrocarbon and Mining Industries



Source: Ministry of Finance, 2017

The governmental agencies involved in managing the industry and interacting with the companies are not a single entity (A Foreign Mining Company, 2016). Furthermore, they do not act unitarily or harmoniously with one another (Sudaryana, 2016 and Tampubolon, 2015). It is important to note that each agency brings its own agendas, priorities, and interests in its interactions with other agencies as well as with the business entities (Sidemen, 2015). The different agencies also have different authorities, information, and access to information, as well as capabilities in conducting their tasks and achieving their goals. They also have limitations and needs to collaborate with other agencies in order to have a bigger impact. On the other hand, the business entities also consist of different types of companies and business associations: fully and partially state-owned companies, domestic private companies, and foreign companies (Sidemen, 2015). There are also main companies, which focus on overall and managerial operations, and

service companies, which provide services in conducting actual mining operations in the field. All types of companies give different levels of pressure and have a different nature as well as frequency and intensity of interaction with the government. Based on this basic understanding of the need to acknowledge the diversity of actors involved in the interaction and shaping the industries' institution, I analyse the similarities and differences of the actors and rules of the game between the hydrocarbon and mining industries.

6.2. The Rule Element

The government established a state-owned company to handle oil and gas mining operation as well as to act as the government's representative in all related matters from conducting negotiations, signing contracts, and supervising operations during the period of contract (Sidemen, 2015; Tampubolon, 2015; Warnika, 2017). Pertamina, the national oil company, took the lead in handling all technical and administrative matters regarding both business operations of the contractors and its own operations. At the initial phase, during 1970 to 1976, Pertamina was also given authority to collect rent from the companies (Bartlett III et al., 1972). This authority was given as the Director of Pertamina, Ibnu Sutowo, initiated a new form contract which was a mixed form of concessionary contracts under the 1899 *Mijnwet* and the CoW under Law No. 44 Year 1960. Thus, Pertamina had two roles as an oil and gas company and as supervisor of foreign oil companies (FOCs).

The contract was known as a PSC, which was adjusted several times from the first contract in 1967 to 1998 (Machmud, 2000). The main guideline of the contract is that the contractors (the companies) have obligation to share a certain percent of their oil and gas production to fulfil domestic need. All financial obligations (taxes, royalties, and bonuses) are determined in the contract and paid directly to the government; the

companies are supposed to be free from other financial charges which are not stated in the contract. Moreover, even though the companies should bear all the risks of the mining operations, they could claim cost recovery once the commercial production has finished. This contract has established the main rules of the game by specifying the roles, rights, and obligations of both the government and companies. There is no change in the form of the contract as of the end of the research in July 2017. However, several institutional elements of rule and practice do change.

During Pertamina's regime as the lead actor in managing the industry, they established a *Badan Pembinaan dan Pengusahaan Kontraktor Asing* (BPPKA/ the Managerial Body of Foreign Contractor) in 1980 (Sihotang, 2015). The agency operated under Pertamina and closely interacted in handling day to day management of the contractors' affairs related to their operation. Meanwhile, Pertamina also conducted its own mining activities in its own oilfields as an oil company. Consequently, Pertamina was also an actor and therefore the organisation needed to supervise itself (Sihotang, 2015; Warnika 2017). This situation became a concern for foreign companies which considered it as unfair and awkward (IPA, 2016).

Moreover, the government regulates the industry from upstream to downstream activity as oil is the main energy source for in housing and industry. During the earlier era, Pertamina was authorised to represent the government in all activities so the company monopolised all distribution activities towards all regions nationwide (Tampubolon, 2015). No foreign companies were allowed to take part in this activity. On the other hand, the majority of oil production was dominated by foreign companies, with Pertamina contributing just 10% of total oil production in the 1990s and early 2000s (Tampubolon, 2015). This condition became a serious concern among elites and the public as they expected that, as a representative of the resource owners, Pertamina would have a bigger

contribution equal to its age in the industry. Alongside the suspicions about Pertamina's mismanagement of state capital, this triggered the issuance of the new Oil and Gas Law Year 2001 which restructured Pertamina as a simple hydrocarbon company with mining operations as the core activity (Warnika, 2017). The authority to manage and govern the industry was returned to the MEMR, which later on established BP Migas to take over Pertamina's (BPPKA) task in managing the contractors' operations (Sihotang, 2015). This agency has direct responsibility to the President. From 2001 to 2013, a minimal number of new exploration contracts were signed by BP Migas and FOCs and therefore, in contrast with the contract signed by Pertamina and FOCs, there has been no change in the form of contract signed between both actors.

BP Migas has been replaced by a temporary body named SKK Migas which is controlled by the MEMR. Unfortunately, the government has not released a new Law to legalise this agency. Thus, SKK Migas has remained a temporary body and does not have a definite authority to decide any important issues (Sihotang, 2015). Instead, it simply represents the government (the MEMR) in negotiating contracts and conducting any day to day administrative affairs related to the various regulations released by different ministries. Its main function is delivering new government regulations and policies to the companies and discussing the business interests with the government in order to find the most beneficial strategies to accommodate government interests based on the actual business scenario at the time of releasing new policies (SKK Migas, 2013; SKK Migas, 2014; SKK Migas, 2015; SKK Migas, 2016). However the organisation's disadvantageous position in front of national law is that the body serves an important role in bridging government and business interests in their interaction in order to maximise profit for both actors from the contract. It is an important intermediary actor in waiving bureaucracy limited actions in dealing with dynamic hydrocarbon business and market

situations and ensuring the acceptance and adjustment needed in following recent policies, which are more complicated than previous regulations (IPA, 2016).

The MEMR took over the leading position in the hydrocarbon industry from Pertamina since 2001. However, the agency is predominantly a side actor which has no understanding or abilities to directly manage the hydrocarbon industry. As the learning process progress, the Ministry is able to take a more active role as the regulator. However, its bureaucratic nature limits their willingness and ability to fully understand and directly and frequently interact with the businesses. One of its handicaps is the limited budget in conducting an active supervision role regarding actual mining operations and various adjustments needed by the business entities to accommodate their own needs and government demands (Sihotang, 2015). Moreover, the various educational backgrounds and lack of specialisation among the Ministry's staff has also limited its ability to fully understand the actual operations, challenges, and situations in the field. This means it is difficult to make breakthroughs in the management strategies and style in order to attract more reliable and bigger investors, as well as in giving more straightforward and appropriate incentives for new survey and exploration projects to overcome the mature oilfields and expensive operational costs. The lack of both projects in the last 20 years has caused Indonesia's oil production to fall significantly and the domestic oil need could not be fulfilled without exporting oil from outside the country (SKK Migas, 2016). The MEMR and SKK Migas have attempted to ease the hydrocarbon regulations in Indonesia, especially regarding the bureaucratic requirements to invest in the country. Since 2015, the related ministries agreed to cut the bureaucratic line into a single system (known as central one door policy) with BKPM (*Badan Koordinasi Penanaman Modal/* Investment Coordinating Board) as the first door for foreign investment (BKPM Pers Release, 2016).

On the other hand, the MEMR has been responsible for mining industry governance since the very beginning. It is responsible for negotiating, signing contract (issuing mining licenses), and supervising the mining operations. It handles both technical and administrative tasks of governing the mining companies' operations. However, it also has to face similar challenges regarding the limited capital and resources needed to play a more active role in supervising all mining working areas (Sudaryana, 2016).

The mining rules of the game involved a CoW between the MEMR and the companies as well as national laws and policies related to the industry. Law No. 37 Year 1960 guided the industry until 2009. The MEMR was a leading actor throughout this period. The mining contract gave more freedom towards the companies in their operations in the mining areas; however, they had to adjust to changes in government regulations, including those regarding financial obligations. The mining contract only determined that the government and companies had a 60:40 share arrangement and there was no domestic obligation to provide the domestic demand for certain mining products (A Foreign Mining Company, 2016). This was mainly influenced by the fact that the mining industry covers a large variety of mining products.

Mining institutions have been heavily influenced by the release of the Decentralisation Law Year 1999, which placed the local governments as governmental agencies with the authority to sign mining contracts (A Foreign Mining Company, 2016; Antam, 2016; Sudaryana, 2016). Initially, such authority was monopolised by the MEMR. This arrangement became a problem afterwards as many local elites misused this authority for their personal benefit (Sudaryana, 2016). An important development in the mining governance is the transition from contractual-based system to a license-based system. The MEMR leads all negotiations, agreements, and adjustments needed in transferring all mining contracts to mining licenses (Sudaryana, 2016). State-owned,

private, and FMCs are subject to this policy. This type of arrangement means that the mining companies are given a license to do mining operations and that the government has the upper hand, whereas the contractual system recognises the government and companies as actors with an equal position before law.

An important step in the reformation era was the establishment of the KPK (*Komisi Pemberantasan Korupsi/ Commission for Eradicating Corruption*). This agency's existence and progressive move has introduced various bureaucratic reforms in several ministries. The government's accountability and transparency in hydrocarbon governance has also positively increased as impersonal relations and clearer procedures and protocols have been enforced to replace the more personal-based relations and negotiations between the government and companies (A Foreign Mining Company, 2016; A Foreign Oil Company, 2016; IPA, 2016; Prayitno, 2017).

The subnational government has been another leading actor in the mining institution since 1999 (Warnika, 2017). These bodies consist of provincial and local governments which have been given authority to establish their own regional bureaucratic agencies and systems (Prayitno, 2017). They are supervised and consulted by the Ministry of Domestic Affairs and report directly to the President. However, before 1999, they did not have any authority nor information and managerial ability to handle political, economic, and social matters in their respective regions (Prayitno, 2017). All important decisions and policies were dictated by the President and national government, meaning that the subnational elites had no other choice than to follow the lead and decisions even though they were not suitable for handling most regional affairs. The regional development was therefore asymmetrical, which led to various problems and jealousy, especially in the resource-rich regions. Java and Sumatra, the two most advanced regions in the country, had hydrocarbon and mining areas which had been exhaustively explored

and exploited. On the other hand, the eastern regions had different experiences; some areas in Kalimantan, Sulawesi, and Papua had partially good regional economic growth, particularly in the main oil, gas, and mining working areas, while other areas were still poorly developed. Meanwhile, Maluku, Timor Timur, and Nusa Tenggara experienced much slower economic growth. The variety of regional conditions has created differences in governance capacity and style in managing their resources, not to mention their interactions with business entities (A Foreign Mining Company, 2016; Hijrah, 2017; Sudaryana, 2016).

The government established three state-owned mining companies (PTBA, PT Timah, and Antam) which handled different mining products (Darmono, 2009). They ran the business after the government succeeded in taking over the working areas from foreign companies in the 1960s. However, they did not have the same governance authority and burden as Pertamina. Instead, they focus on running and developing the companies without the public service obligation as a burden as the mining products are mainly exported. They mainly export raw products instead of half or fully produced products, which have significantly higher economic value in the international market.

Unfortunately, mining can also be done illegally by an individual or a group. Such activities usually happen in known mining working areas (contracted by mining companies) and are conducted without any safety measurements (Prayitno, 2017; Sudaryana, 2016). The area is legally contracted by the company which holds the rights to mining operations; thus, such activities are a violation of the contract and the company's property rights. Illegal mining also creates economic problems nationally as it leads to a surplus in the domestic market and cheaper prices for certain mining products, which also means big losses for the producers. Illegal trade, especially illegal export of products, causes major losses in terms of national and regional revenue (Henderi, 2017; Hijrah,

2017). In order to handle these matters, the subnational government cooperates with law enforcement agencies – KPK, Army, and Police – to prevent illegal mining and at the same time protect both mining companies' property rights and the Indonesian citizens involved in such activities (Prayitno, 2017).

Pertamina and the NMCs are owned by the government. However, they have different tasks and receive different treatment from the government. Pertamina has a public service obligation, which means it has to meet domestic demand for hydrocarbon products and therefore the company's products are mainly delivered for domestic purposes (Antam, 2016; Tampubolon, 2015). On the other hand, the NMCs are essentially treated in the same way as foreign companies, except they are given various limitations in conducting their business (Antam, 2016). They are 70% government owned, and are only able to collect 30% of their capital from public and foreign investment. They are also allowed to export most their products so the trading mainly happens in the Asian market and many of their trading partners are also Asian-based companies, especially China.

In addition, through Pertamina, the government monopolised all distribution of fuel products before 2001. After 2001, the government established BPH Migas (*Badan Pelaksana Hilir Minyak dan Gas Bumi/* Implementing Body for Downstream Business of Oil and Gas) as the government agency which handles the distribution of hydrocarbon products, mainly fuel (Sidemen, 2015; Warnika, 2017). However, there is no such agency for mining products. All companies are allowed to handle the distribution and trading on their own (A Foreign Mining Company, 2016; Antam, 2016). Some FOCs – Petronas and Shell – have been able to obtain permission to distribute and sell fuel domestically only in the past five years. Thus, there are separate protocols for upstream and downstream business operations in the hydrocarbon industry (Tampubolon, 2015; Warnika, 2017). On the other hand, mining companies have the freedom to trade and sell all mining products

both domestically and abroad. There were no restrictions until the government banned the export of raw minerals and instructed that they must be processed to half or fully processed products before being sold abroad (A Foreign Mining Company, 2016; Antam, 2016). Both domestic and foreign mining companies are subject to this restriction.

In conclusion, the element of rule in resource governance of hydrocarbon and mining industries has similarities and differences. They are handled differently mainly because of the different nature of the business and domestic needs with regards to hydrocarbon and mining products. First and foremost is that the general agreement about the ownership of hydrocarbon and mineral resources is constant and agreed by both actors. The government represents Indonesian citizens as the owners and direct claimants of the land and everything beneath and above it. Meanwhile, as contractors companies are given authority by the government to conduct business operations within certain working areas and within a certain period of time as stated in the contract. This means that the government has the right to collect tax, royalties, and any payments generated from such operations within its territory on behalf of the people (Henderi, 2017; Warnika, 2017). At the same time, companies get rights to collect any profit and benefit from their operations as long as the rules issued by the government are followed. Nevertheless, the government initially used one regulation as a guideline to govern both industries. Both industries are also handled by the MEMR as the leading actor and representative of the government even though the Ministry's main role is different. The MEMR handles all tasks as regulator, supervisor, and administrator in the mining industry (Sudaryana, 2016). On the other hand, for the hydrocarbon industry the MEMR mostly acts as a regulator and partially (in collaboration with SKK Migas) as an initial negotiator, supervisor, and administrator (Sidemen, 2015; Sihotang, 2015).

As the understanding about the operational and economic value of both sectors has developed, the governance strategies for both sectors as well as the nature of relationship between governmental and business actors have developed in different trajectories. The regulations, protocols and guidelines of hydrocarbon and mining industries governance are separated and even government revenue from both sectors is calculated separately. The PSC is the main contractual model employed in the hydrocarbon industry, while the mining license the most recent model in the mining sector.

The GoI is exposed to studies and analysis from various foreign and international organisations (Tampubolon, 2015; Sidemen, 2015; Warnika, 2017). This openness has led to some foreign recommendations regarding the government's attempts to establish better regulations and governance to manage and attract more investment in both industries. The GoI adopted some of the recommendations that could be absorbed into Indonesia's bureaucratic culture. However, the process takes time and energy as the reformation also takes place in all sectors at the same time but with different pace. Thus, harmonisation of policy among governmental agencies is still an unsolved task as of 2017 (Sihotang, 2015).

6.3. The Procedure Element

The ministries involved in managing both industries are essentially the same (A Foreign Mining Company, 2015; A Foreign Oil Company, 2016; Sidemen, 2015; Sihotang, 2015; Sudaryana, 2016). The MEMR takes the lead from the negotiation to contract signing, as well as managing and supervising the mining operations. Meanwhile, the Ministry of Finance (MoF) is responsible for collecting taxes, royalties and other financial obligations subjected to business entities by the contracts or licenses and national law. On the other hand, the Ministry of Transportation regulates the use of land,

water, or air transportation across Indonesia's territories and the Ministry of Forestry and Environment manages the mining in forest areas, as well as assessing the impact of mining operations in and surrounding working areas. Meanwhile, the management of workers and human resources in the industries is handled by the Ministry of Manpower. Another important body is the Ministry of State-Owned Enterprises, established in 2003 to manage the companies in terms of organisation and management. NOCs and NMCs are also managed by this Ministry so they have additional rules to follow. This Ministry's main focus is to oversee the management and administrative part of running the state-owned enterprises.

However, these ministries act individually and often issue inharmonious policies, especially if the business activities involve certain payments that could be collected according to their respective authorities (A Foreign Mining Company, 2016; A Foreign Oil Company, 2016). For example, shipping which uses rivers to transport mining products, mining equipment, as well as exporting machines and materials from abroad needs government permission involving administrative requirements and certain service charges. The same protocols are also needed for mining in protected forest areas and onshore locations involving one or more regional authorities.

Such protocols often prolonged the main activities of the companies, which are surveying, exploration, mining and exploitation, refining, and producing the end mining products, such as fuel, oil and gas, coal, tin, and other mining products. This bureaucratic approach towards business is necessary for the government not only to make sure that all business operations are appropriate and not violating the national regulations, but also to protect the national and public interest and security from unsafe and unsecure business practices (Warnika, 2017). Understanding and obeying such requirements is also necessary for by the companies to determine their strategies, calculate the production

costs and assess the profitability of the operations (A Foreign Mining Company, 2016). Without such rules of the game, both the government and the companies would be unable to maximise their gains from their ownership and contractual rights over the working areas as there are no exact protocols as a standard to determine, decide, and calculate their actions towards other actors and establish as well as develop their relationship.

Another issue regarding government action is control and supervision. The structural characteristic of governmental agencies means that each ministry has its own role and works within a system and directs the government in achieving a set of goals. However, another nature of the structural relations between different agencies involves cooperation and coordination as well as competition and overlapping action. Governing the hydrocarbon and mining industries involves a number of agencies. This linkage of actors could lead to overlaps in translating and executing their authority, as well as issuing regulations and policies (A Foreign Mining Company, 2016). In the hydrocarbon industry, for instance, the Ministry of Transportation has the authority to regulate any use of water, air, or land transportation. Meanwhile, the transportation of mining equipment and products across Indonesian boundaries, in or out of the country, is also within the authority of the Ministry of Foreign Affairs. Consequently, the regulation of similar business activities comes from multiple ministries. The related ministries for mining operations are expected to communicate in issuing relevant policies which concern those activities. The President has established several Coordinating Ministries to facilitate such forums. Both industries are generally managed by a Coordinating Ministry of Economic Affairs, with the MEMR as the lead in mining operations affairs and the MoF as the lead in financial affairs related to the industries. However, the coordination between ministries is difficult as all agencies, including the Coordinating Ministry, have the same structure (Henderi, 2017). This means that they cannot force each other to act harmoniously and

communicate or coordinate with each other in dealing with companies. These circumstances have created difficulties in both sectors.

The government has made a turnaround from enjoying the oil revenue as the state's main source of income. Since 2000, taxation replaced the domination of the industry in the country's financial structure (Henderi, 2017). This decision was triggered by the significant decreasing of national oil production and reserves and the immature gas production and mining industry management. At the same time, political and bureaucratic reformation was widely conducted in many ministries. The process happened more rapidly in all departments of the MoF. Thus, the Ministry has established the Directorate General of Tax to collect money from economic activities in the country. As expected, hydrocarbon operations were the first place to look at as the contractors have extensive business activities. However, the cost recovery system stated in the contract made it difficult for the government to collect more money as the companies calculated it as an operational cost in order to reduce their financial obligations towards the government. The MoF is still working to find a better approach in handling this matter, especially to track and prevent misbehaviour in the recovered cost calculations (Henderi, 2017).

However, the differences originate from the existence of SKK Migas and the different role and position of Pertamina in the hydrocarbon Industry, while the MEMR directly governs the mining operation and the three NMCs are fully business oriented since they were established with less politicisation and political involvement in running and managing the companies (Sidemen, 2015; Sudaryana, 2016; Tampubolon, 2015). The relationship between Pertamina and the NMCs and other actors is discussed later in this chapter.

SKK Migas does not facilitate coordination among governmental agencies. Rather, it is an intermediary actor between government and companies to discuss

important matters concerning both parties (Sihotang, 2015). Furthermore, this agency does not have the authority to introduce regulations and issue policies regarding the oil and gas industries. Thus, it has to deal with this lack of authority in its interactions with other ministries. The MoF and the MEMR are the bodies that regularly communicate with this agency as they supervise companies' operations. It also collects the most up to date information about government policies and regulations relating to mining and business operations. Thus, it regularly communicates with various related ministries and agencies despite the fact that, unlike other government agencies, it cannot issue policies,. It also provides recommendation for the government based on meetings with companies and other related parties related to certain issues. I attended a meeting about the implementation of a government regulation relating to the obligation to use Rupiahs in oil and gas trading, especially in tax and royalty payments as well as in the payment for the government's share from oil and gas production and in domestic selling and buying activities. Following these meetings, SKK Migas gave a report and recommendation to the President, the MEMR, and the Bank of Indonesia about the implementation of the policy.

In contrast, the mining industry governance does not have a body with the characteristics of SKK Migas. This sector only has different ministries, national, and subnational governments which issue policies on an individual basis without any further consideration of the mining business situation. Thus, the issued policies and the current business development are often mismatched and put the companies in a difficult situation. This is mainly caused by inadequate information collected and gathered by the governmental agencies from the mining field and the market to assess the situation before issuing a policy. This situation is actually not unavoidable and could be addressed with a proper approach, proven by the success of SKK Migas' programme of establishing a

digital system to collect data and information directly from the companies (SKK Migas, 2016). In fact, the MEMR could also process such information based on the various reports it receives from the companies. Unfortunately, not all mining companies have a positive attitude towards their government obligations regarding their financial as well as administrative requirements they need to fulfil after obtaining the contract or during their operation period (A Foreign Mining Company, 2016; Sudaryana, 2016). This is also one of the difficulties faced by the government in doing its job properly.

Furthermore, as other ministries has the same level of authority in the governmental structure, the MEMR does not have the authority to force other ministries to issue policies related to mining operations in line with their priorities and choices of action (Sudaryana, 2016). Actually, there is a Coordinative Ministry of Economic Affairs that has such authority; however, the harmonisation of ministries' policies to regulate the extractive industries is still in the early stages and remains an occasional occurrence. This lack of synergy also exists in national and subnational policies towards companies and mining operations in the working areas. Overlapping policies are especially evident in companies' and financial obligations and profit sharing. Subnational governments, and also the local people, expect to receive the money first, despite the statement in the regulation that all payments are made to the MoF which has the authority and task of distributing these payments to the respective regions (A Foreign Mining Company, 2016; Hijrah, 2017). Afterwards, the provincial level of government is obligated to share the money with the municipal government to fund development projects benefiting the whole society. This misinformation is still found by the companies while dealing with subnational governments, proving that there is a lack of knowledge and information and a lack of socialisation from the national government to the regional authority.

Another level of government involved in both sectors is the subnational government, which consists of two main levels: provincial and municipal. Following independence in 1945, local governments took the dominant position in handling the industry. They cooperated with groups of local citizens to take over oilfields in some parts of Java and Sumatra (Darmono, 2009). However, their role later diminished as the central government centralised all governance of political and economic sectors. For the hydrocarbon industry, the centralisation of governance was complete, including collecting tax and royalties from business operations and distributing the income to the regions. The local governments were unaware of exactly how much money originated from their resources and did not get to calculate how much money they were supposed to receive from mining operations in their respective areas (Hijrah, 2017). There was no transparency and accountability in the national and subnational government relations before the decentralisation policy is issued.

This condition changed after the general political reformation started in 1998. The subnational governments got a 15% share of the profit from total revenue of oil and gas operation in their regions with a certain percentage of profit breaking down into provincial, municipal, as well as cross-province and cross-municipality areas (Hijrah, 2017). Subnational governments which host oil and gas working areas receive profit information and have been able to calculate the local revenue. Furthermore, they have the authority to make their own local development plans and projects, including the budgetary plan to be submitted to the central government (Prayitno, 2017). They have been able to learn and develop the local political and economic capacity by directly practicing it in the field. However, there is no step by step process, transition phase, training, or clear assistance system from the national government. The result is an asymmetry in local elites' ability to transform their potency into capacity; some of them

perform well in establishing better development in their regions, while some others are not able to do so.

On the other hand, the municipal government had some authority in governing mining industry after the 1999 Decentralisation Law came into effect (Hijrah, 2017; Sudaryana, 2016). Unlike other subnational levels, the municipal government was initially allowed to sign mining contracts with companies. Meanwhile, national and provincial governments did not have control over the decisions taken by municipal elites. This became a significant problem in the governance of the industry as there were many overlapping working areas for more than one company in the same or different sectors. The lack of organised information about working areas from different sectors caused this problem together with the lack of willingness and ability to collect and organise industrial information at the subnational level (Sudaryana, 2016). The authority held by subnational governments was not supported by the capacity to govern the business operation in their respective regions. Nevertheless, some of them were able to manage the relations with companies properly. This is the main problem in the governing interdependence between state and business identified by Weiss and Hobson (2003) as the autonomy held by the state is not supported by the capacity to execute it.

Led by the MEMR, the central government handled the problems with mining contracts and licenses as well as overlapping working areas by issuing a “clean and clear” policy (MEMR, 2016 and Sudaryana, 2016). It evaluated all licenses and contracts issued by local government, assess them, and gave clean and clear certificates to the proper ones. Meanwhile, problematic licenses and contracts have been terminated. Recently, the authority was taken back by the government and has been transferred to provincial governments in order to ensure direct control.

The desire to develop local governments' capacity, especially regarding financial matter, has led to regular meetings with the MEMR and some training by related ministries (Hijrah, 2017). However, it takes a long time to achieve an ideal outcome as there is variation in the speed and ability to learn from local bureaucrats and elites as well as the political system's capacity to reform and handle more complicated matters. As of 2017, most local governments are still more focused on securing local revenue and getting funding for their development projects rather than creating better development projects and more productive relations with companies operating within their regions (Hijrah, 2017). Public and private collaboration projects are still very limited and are mostly initiated by the companies themselves.

In conclusion, the policy network between ministries and between national bodies is still in an early stage. Specific organisations need to learn to do their own task while occasionally working together with the other agencies. The idea of collaborating and having joint projects across ministries has always existed. However, the difficulties and problems have arisen from the implementation and therefore the result of such cooperation is still far from ideal. However, the capacity to reform their organisations as well as identifying their potency and transforming it into organisational capacity is improving. The next step in the learning process is to learn to work together harmoniously with other governmental bodies by sharing, storing, and processing information in order to solve problems faster and more accurately.

The national and subnational governments are able to work together within an institutional arrangement after opening up the limited order of the centralised political system with a sharing authority system (Prayitno, 2017; Sudaryana, 2016). There is a linkage between their actions and reactions as well as protocols and procedures to sustain and enforce this relationship. Their willingness and ability to share authority is the

doorstep condition for an open political economic order. Indonesia is passing this doorstep and working on binding the governmental agencies into “a governance linkage”. This linkage begins with mutual evaluation and supervision. The national government assesses and fixes the problems caused by subnational elites’ decisions and actions meanwhile, the subnational government can propose solutions, give suggestions, and make complaints regarding the choices and policies made by national authoritative bodies. They are free to question the decisions and policies made by the higher authoritative bodies in issues and agendas of concern. This is a kind of control mechanism which ensures that the linkage works openly and properly. This two-step method is supported with an open access network of information which provides the knowledge necessary to assess and solve problems and deal with challenges. These three factors are the essence of transforming state potency into capacity, which is one kind of transformative attitude in developing the industry.

However, subnational governments have different levels of managerial authority in the two sectors. They are able to negotiate directly with mining companies and sign contracts or issue mining licenses (Sudaryana, 2016); however, they do not have such authority in the hydrocarbon industry as this authority falls to the government, represented by the MEMR and SKK Migas (Sihotang, 2015). There is no share of authority in the hydrocarbon industry. Nevertheless, the subnational governments have had the right to get a share of the profits from mining operations since 1999 (Hijrah, 2017). They are not authorised to collect the money directly from companies as the payment is made directly to the MoF. The MEMR and the MoF have held events to socialise and train the subnational governments to calculate and estimate the amount of money they receive from the profit sharing system and determine how to distribute the money according to the Law. The distribution of the profit is especially important as it

involves the provincial, municipal, and local levels of government. The percentage gained by each level is fixed according to the Law.

5.1. Process and Mechanism of Change

This approach of analysing government actions in Indonesia in terms of its interactions with business entities provides a more complete understanding of the way in which the government has moved from a limited social order into an open social order while governing its interdependence with companies in developing the hydrocarbon and mining industries. Most importantly, this approach acknowledges the learning process of the Indonesian government and avoids identifying and labelling Indonesia as a resource-rich country that tends to have rentier collector attitude, is trapped in the “Dutch Disease”, and has had difficulties recovering from a dependency on a single source of revenue. There are different paths which lead to different institutional outcomes from studying both sectors. Nevertheless, we could consider this as an element of the variation of choices the government has made in dealing with distinctly different industries. Oil and gas is highly valued economically and strategically as the main source of energy for the country’s industrialisation, while the mining sector is considered as an important part of the industry which contributes to state revenue.

Determining and agreeing the rules of the game is crucial in a long-term relationship among actors. Those rules involve a number of protocols, procedures, and financial affairs which are known, understood, and agreed by all parties involved. This means that all actors have access towards information about mining operations in order to issue appropriate protocols for achieving both parties’ goals. It also means that there is a system to collect, process, and share this information among the related agencies. The MEMR has the leading role in this system for both sectors as this Ministry is responsible for issuing general regulations and policy about mining operations, such as determining

and opening bids for working areas, signing oil and gas contracts, and providing mining licenses (Sidemen, 2015; Sudaryana, 2016).

From this point, the hydrocarbon and mining sectors have a different path because the first sector has SKK Migas as the supervisor and intermediary actor for the government and companies in discussions regarding important matters. SKK Migas intensively communicates and cooperates with various governmental bodies such as the National Bank, the MoF, and other ministries regarding their recent policies, procedures, and concerns (Sihotang, 2015). Meanwhile, this agency also communicates and gathers oil and gas companies to ascertain their opinions, complains, commitments, and any adjustments needed to follow those recent policies. This agency helps the government to react faster and to accommodate business situations both in the field and in the market (SKK Migas, 2016). Unfortunately, it is legally a temporary body and does not have a clear position in the government structure. It does not have the necessary power and authority to make any decisions for both actors. An example is the policy to use Rupiahs in all transactions, especially in selling oil and gas within the country (SKK Migas' Meeting with the Contractors, 2015). This policy resulted in extensive discussions between SKK Migas, Pertamina, and some large hydrocarbon companies in order to determine the most plausible way to accommodate both government and business interests. There are steps in the implementation of this policy based on the recommendations from this meeting. Both the government and companies understood each other and committed to follow the rules and adjust their expectations. This series of meetings in which the best strategies to accommodate each other are discussed and determined took a long time. Fortunately, the result is satisfying for both parties and the policy has been implemented steadily and smoothly.

In contrast, the government has used a more bureaucratic approach in governing the mining sector (A Foreign Mining Company, 2016). This involves less interaction and no discussion with the companies, leading to a lack of understanding between both actors and a lack of accommodation towards mining business dynamics both in the field and in the market. The government has issued some controversial policies that make it difficult for businesses to operate in the country. One of them is the requirement to process raw minerals before selling them abroad. This policy became controversial because there was no system to discuss it beforehand or to discuss the steps in implementing it in a way that would not heavily burden business entities and cause various losses. This policy became a significant problem for companies as they already had business agreements and commitments with foreign buyers with specific deadlines. Violations of these commitments cost them a huge amount of money, not to mention their credibility in international market.

The government reacted slowly to companies' complaints and suggestions in implementing recent policies (A Foreign Mining Company, 2016). Most of the time, the government did not react to business concerns at all. They let the companies figure out the recommendations and negotiate them individually with the related body. There is more personal interaction and vague protocols in this sector in comparison to the hydrocarbon industry. This means that the mining sector less attractive, unpredictable, and costly for potential foreign companies which initially wanted to enter the industry and it also means that the government has lost potential revenue from the industry.

The decentralisation policy in 1999 has created opportunities for subnational governments to take part in managing mining operations in their jurisdiction. However, they are given more authority in dealing with mining companies than in hydrocarbon governance. The most significant difference is their ability to negotiate and sign contracts

with mining companies, while the authority to sign a PSC is centralised in SKK Migas (Sihotang, 2015; Sudaryana, 2016). The MEMR handles the negotiation prior to the signing of a PSC and afterwards SKK Migas manages the companies' day to day operations. Thus, SKK Migas has more frequent interaction to discuss more technical and wider issues with the companies, while after the negotiation the MEMR mostly has indirect interaction through various reports submitted by the companies through SKK Migas. SKK Migas and the MEMR have a special relationship in which SKK Migas has the authority to manage its organisation although structurally it is subordinate to the MEMR (Sidemen, 2015; Sihotang, 2015). Furthermore, the MEMR needs to consult with SKK Migas before issuing policies which directly influence day to day operations in the oilfields, while SKK Migas holds discussions with companies about their positions and recommendations regarding issues of concern.

This kind of interaction does not exist in mining governance structure. The MEMR works alone from negotiation to signing the contract or issuing a mining license. Subsequently, it collects annual report from mining companies while not actively being involved (neither knowing nor understanding) and updated regarding the situation faced by the companies in the field (Sudaryana, 2016). It does not have a structure that has the ability and budget to complete technical tasks while interacting with the companies to submit recommendations before issuing a policy or regulation. There is a serious disconnect between what companies need from the government and what the government actually does.

There is a recent example to illustrate this problem. 2013 and 2014 were difficult years for mining companies since the international market prices for mining commodities decreased significantly (A Foreign Mining Company 2016; Antam, 2016). The companies needed to rearrange their operations in the field to avoid bigger profit losses and

inefficient production costs. During this time, the government issued an export ban policy for raw minerals, especially ore. This policy became a big hit for many companies, especially the NMC Antam Tbk, which relied heavily on exporting ore to China as its main destination. However, due to complaints and resistance from some mining companies, especially the most profitable ones, various adjustments were made by the MEMR. First, there were negotiations with the intention of convincing the companies to follow the new regulations with some exceptions for the companies until they agreed to do so. This management practice drew complaints from NMCs and other mining companies. However, it is not easy to fix this problem as the MEMR, particularly the Directorate General of Coal and Mining, has the limitations mentioned previously. They did not have enough money and manpower to actually survey the conditions in the fields, there was no system or staff allocated to update the information about international market for mining commodities, and there was also no system to gather the opinions of mining contractors and business entities before actually releasing a policy.

However, the government approaches the mining industry differently. The companies do not have to submit the work and budget plan and PoD to be approved by the MEMR upon their operation (Sudaryana, 2016). Thus, the only source of information that a mining company shares with the government is the annual report. Moreover, the financial system, particularly taxation, and companies' obligations towards the government are different in both sectors. The tax obligation for the hydrocarbon companies is accounted as part of the production costs, which could be recovered through a cost recovery system (Hijrah, 2017). On the other hand, the tax obligation for mining companies is not part of the contract and therefore has to be paid by the companies. The hydrocarbon companies also have to fulfil a DMO (Domestic Market Obligation), which

is an obligation to provide 25% from their total production to the domestic market, while the mining companies do not have such obligations (Tampubolon, 2015).

Another difference related to the involvement of subnational governments in the governance. Subnational governments do not have direct involvement in any phase of hydrocarbon mining operations. They do not have the authority to negotiate, sign, and terminate a contract. They also do not have the authority or the ability to supervise the mining operations as there is limited access to information regarding these matters. They do have authority to accept and cooperate with the hydrocarbon companies and support them to do their job smoothly, as well as make sure that their existence in the area is advantageous for the local population (A Foreign Oil Company, 2016). They actively initiate various community development programmes and ask for funding from companies to realise the projects; however, sometimes they also reject proposals or demand more from the companies which could hinder their operations.

A recent example is the Tangguh Project established by BP in Papua (A Foreign Oil Company, 2016). The company made a series of deals with the local government and society representatives while preparing to start the project. Both the local government and society sounded their concerns and demands to the company, which were assessed and dealt with by the company itself without any support from the national government. There are no standards for the way in which the subnational government should deal with these companies. This problem emerges for all new oil and gas projects in working areas run by new companies. Pertamina handled such matters until 2001 and ensured that FOCs could start operating as soon as possible once the contract was signed (Sidemen, 2015; Sihotang, 2015; and Tampubolon, 2015). Any administrative requirements needed by FOCs were also completed in consultation and cooperation with Pertamina. This is one of

the reasons why a BPPKA was established as it enabled Pertamina to function both as a company and as a manager and supervisor of oil and gas contractors.

The NOC and the NMCs have been treated differently by the government (Antam, 2016). While Pertamina was frequently given investment by the state and had authority to manage revenue from other contractors until 1976, the latter was established and only received government investment in the beginning and had to learn how to run and develop the company to survive and be profitable. However, as state-owned companies, they were obliged to share most of their profits with the government, and even Pertamina had a PSO to fulfil domestic demand on fuel.

Unlike state-owned companies, foreign companies managed by Pertamina enjoyed privileges of a smooth entrance to their working areas and the ability to start operations in a timely fashion (Tampubolon, 2015). Various requirements and regulations from various governmental agencies were fulfilled and obeyed by the companies in conjunction with Pertamina. However, such privileges have never been enjoyed by mining companies. Once they have been awarded a contract, they have to deal with all governmental agencies and subnational governments by themselves. The privileges highlighted above stopped when BPPKA was taken out of Pertamina and became BP Migas in 2003. Since then, FOCs have also had to deal directly with local governments.

During the earlier era, the government mostly considered companies as cash machines with financial benefit as the most important factor (Warnika, 2017)., the government's agenda and concerns became more varied after the 1998 economic crisis and political reformation (Sudaryana, 2016). The government expected to develop strong mining industries not only to produce and sell raw minerals to the international market, but also to be able to produce half or fully processed products which have higher economic value in the market. Therefore, it encouraged all companies, including state-

owned, private, and foreign ones, to build smelters in Indonesia. In addition, the export of raw minerals was banned. The government has also forced the implementation of this policy through a punishment mechanism for any company that failed to obey this rule. The government threatened these companies by terminating export permissions and not giving them chance to prolong a contract which was due to end in three years.

Contrastingly, the government's recent policy in the hydrocarbon sector focuses on encouraging more exploration projects in non-conventional areas, such as onshore (Sihotang, 2015). However, there are a small number of non-conventional projects compared to conventional ones. This is because the costs and risks are higher in such areas and the expected profit once they are capable of producing oil and gas is still low compared to the capital required and the cost of oil production in other oil-rich countries. Few big companies have remained or want to enter this industry, so oil production has remained low and gas production is not increasing significantly even though Indonesia has significant gas potential (Sihotang, 2015).

Another difference between both sectors is the government's supervision of the mining operations. SKK Migas plays an important role in supervising the hydrocarbon business operations (Sihotang, 2015). The organisation generally understands and updated important information related to both businesses and the market. It represents the government in dealing with and supervising the companies' day to day operations. Unlike SKK Migas, the MEMR cannot perform supervision or actively update information and recent developments regarding the mining operations and markets. This is due to its bureaucratic nature, limited budget, and the lack of expert staff to handle the supervision.

SKK Migas inherited BPPKA under the Pertamina tradition, where there was a close relationship with the contractors while conducting operations in the organisation's own working areas (SKK Migas, 2013). Pertamina's conflict of interest, as both

controller and player in the industry, was a concern for both the foreign companies and the GoI. Thus, along with the political reformation wave starting with President Soeharto's resignation in 1998, the new Oil and Gas Law legalised the separation of those tasks. The GoI reacquired the controller function from Pertamina and adopted the BPPKA structure to establish BP Migas as a special governmental agency. Pertamina is now mandated to focus all its effort to secure and fulfil domestic needs for oil and gas products. Furthermore, the GoI has also removed Pertamina's sole authority in the national distribution of fuel, gas, and other products and established BPH Migas as a special government agency with this authority.

BP Migas not only inherited the working system of BPPKA and its connections with hydrocarbon companies. The agency got more authority in negotiating with the companies, evaluating and agreeing on the PoD. As part of the government, the agency enjoyed the ability and authority to interact and cooperate with other bodies and agencies, including the subnational governments. However, its existence became subject to complaints from some academic associations which led to the abolishment of BP Migas in 2012 (Sihotang, 2015; SKK Migas, 2013). As a way to ease the uncertainty in the national management of the hydrocarbon industry, the GoI established a temporary body called SKK Migas. It had the same task in bridging the GoI and companies' interests regarding the changing political and economic situation affecting the industry.

Unfortunately, the agency has not inherited its predecessor's authority in making decisions (Sihotang, 2015). It negotiates until reaching agreement with the companies regarding issues concerning both the GoI and businesses. However, all the decisions are under authority of the MEMR. Thus, SKK Migas gives its proposals and recommendations about the relevant issues and these proposals are then legalised and enacted by the MEMR (Sidemen, 2015). Nevertheless, once a decision is made, the

implementation of the decision is returns to SKK Migas in the field with the cooperation of the companies that agreed to it. This agency might not have the authority, but it is indeed the centre of hydrocarbon governance which is keeping it alive, ensuring it is credible, and working more effectively than governances in other industrial sectors.

A recent and important breakthrough made by SKK Migas despite its limited authority is the online system connecting the agency and the companies (SKK Migas, 2016). This system has been in place since 2014 and ensures the openness of the data and more importantly updates the current situation in all working areas through an information technology system. After succeeding in maintaining this system, SKK Migas established and managed a similar system in 2015. The system connects companies' data with the relevant ministries, particularly the MoF and the Ministry of Environment. Such movement is particularly important in supporting the government's desire to control and evaluate the amount of cost recovery (as stated in the contract) companies can gain, which has the potential to reduce government profit. Thus, the GoI and especially the MoF have focused on making sure that the amount of money claimed by the companies as part of cost recovery is correct and reasonable.

Another challenge relates to the dilemma of the negative effect of mining on the environment and positive impact in terms of the boost for local economic development. Most of the time the company, or collaboration between the company and the government, builds road, ports, education and healthcare facilities as well as providing information technology, electricity, and water as supporting systems for the mining operation base (A Foreign Oil Company, 2016). The mining base and factory also creates various employment opportunities for the people in the area. Unfortunately, if local governments cannot manage these opportunities wisely, the short-term advantage turns into a heavy reliance on one sector. This problem is admitted and widely addressed by

local governments in resource-rich regions and they have made efforts to diversify local people's sources of income by promoting other sectors.

One success story is West Sumatra, which was known as a coal producing province and hosted one of the oldest mining working areas in Sumatra (Prayitno, 2017). Sawahlunto, a municipal in the region, succeeded in transforming the city from a former mining area into a tourist destination. The process was not short and smooth or without social conflict. It took more than ten years to transform the city after the coal reserves began running out and PTBA ended its active operations in the area. As one of NMCs, cooperate with provincial and municipal elites along the process so the people in the area are not suffered during the transformation. Pangkalan Brandan and some other cities in Sumatra and Java that also ever hosted oilfields are also succeeded to develop their local industry and diversify people's source of income along with the end mining operations in the areas.

President Soeharto established a special Ministry to assist the local private sector to grow and take part in the extractive industry when Pertamina fell into crisis in 1973 with the hope to strengthen the national position in the hydrocarbon industry (Sidemen, 2015). Unfortunately, it was not an easy task as this Ministry did not have the requisite capital, knowledge, and technology. The goal was not achieved until the Ministry completed its working period, nevertheless some private domestic companies did emerge afterwards. Two major private oil companies succeeded in producing oil, multiple regional companies attempted to take part in downstream oil and gas projects, while some smaller companies could not continue their upstream operations due to the lack of capital and some others continued their work as subcontractors providing services for the bigger companies.

The connectivity among actors and the working system in the mining governance is markedly different compared to the hydrocarbon sector (A Foreign Mining Company, 2016 and Antam, 2016). The main reason behind this difference is the non-existence of intermediary actors between government and business. Both actors work individually and mostly have no connection with each other.

The local government also interacts with the companies because the working areas are within their jurisdiction (A Foreign Mining Company, 2016 and A Foreign Oil Company, 2016). However, the agenda is mostly limited to CSR projects initiated by companies or proposed by local elites or organisations. In addition, their main concern is getting their share of the profit collected by the government from both sectors. Sometimes, there are misunderstandings when the local government is unaware that the company makes payments to the central government so that it can be distributed to all resource producing provinces and municipals. The company is unable or not allowed to pay directly to the local government. Such issues are usually solved by clear communication between the national authority, the subnational government, and the related company.

I have attempted to study the process of institutional development in two extractive industries in Indonesia, rather than exploring economic performance and following the assumption of either the resource curse's weak institution or the ownership structure. In order to do so, I have focused on the relationship between government and companies and also their individual development throughout the interaction process. The shift in the governance direction of the hydrocarbon industry is primarily a result of Pertamina's 30 years of work as the manager of oil and gas contractors. Although Pertamina did indeed represent the government in doing governing the industry, its core

existence as a business entity influenced its choice of action, approach, and governing style.

Regardless of the public criticism of Pertamina's work during this time¹, the company provides an example of how important an existence of a body which could intermediate government and companies long-term interaction to balance their interests and solve problems through cooperation. The company set a standard and example for other sectors to create a cooperative governing style by assessing companies' interest and adjusting to their conditions while achieving the national goal and protecting the national interest. The system is not yet ideal, but it has developed in a good direction towards a partnership. There are various problems that need to be solved, but the government's attempts to involve the companies in discussing the implementation of national policies have been highly appreciated by business entities (IPA, 2016). On the other hand, Antam, PTBA, and PT Timah (the NMCs) are treated like other mining companies (Antam, 2016). They do not have the authority to sign contracts or oversee the mining contractors with the exception of PTBA, which had authority for signing coal mining contracts for approximately two years. However, the company did not establish a system to manage and oversee the mining contractors. The NMCs were only responsible for conducting their mining operations and exporting to the overseas market, while the MEMR handled all matters related to mining industry governance. Unlike Pertamina, with its PSO to fulfil the domestic market need for oil products, the NMCs do not have such obligations.

Therefore, the nature of state-owned, foreign, and domestic private companies in both sectors was very different until 2001. Pertamina represented the government from negotiation to managing and overseeing the oil and gas contractors. Since then, Pertamina has been treated the same as other contractors with the exception of the privilege of

¹ Refer to criticisms of Pertamina's monopoly in the industry, which has been explained in Chapter III

getting the first offer to take over an oilfield left by its previous contractor. Besides this and being “the insider” (or part of society) in the industry, there are no other advantages.

As the first player the industry ever had Pertamina has facilities nationwide, including refineries, pipelines, distribution lines and fuel stations. It also has these facilities in the rural areas. Thus, it is not easy for a new player, especially a foreign company, to enter the downstream oil and gas business. Pertamina and foreign companies often compete to get potential oilfields, especially existing locations where the contract has come to an end. The nature of the business in both sectors is also different. Oil and gas compete to explore and produce similar products with different qualities, quantities, and techniques. Thus, the cooperation among the main companies is more intense and varied. On the other hand, the mining industry consists of different types of mineral and produces and sells different products. In comparison to the oil and gas sector the competition is not as intense, while the cooperation is also limited to the joint venture scheme and the use of subcontractors in mining operations. The hydrocarbon and mining industries involve the cooperation of various companies which have various specialisations and provide different types of service. The contractors sign PSCs with the government and obtain rights to mine in specific working areas. Meanwhile, as the real job of exploring and exploiting the hydrocarbons and minerals could be conducted by different companies assigned by the main office, the government encourages domestic private sectors to take part in supporting working area contractors.

A slightly different type of cooperation exists between hydrocarbon contractors that operate in the same working areas with various schemes, such as JOAs (Joint Operating Agreements), Technical Assistance Contracts (TACs), Enhanced Oil Recovery (EOR) or joint venture schemes (Tampubolon, 2015). In addition to those schemes, SKK Migas also facilitates another type of cooperation with the purpose of reducing operation

costs (SKK Migas, 2015). The companies working close to each other are encouraged by SKK Migas to rent the same equipment or use existing refinery facilities, for example the government's existing pipelines and refineries. This cooperation has taken place several times and has successfully reduced the cost in difficult situations where the market price of oil has plummeted. On the other hand, it is difficult to find another form of cooperation among mining companies other than using service subcontractors. It is also not common to have a joint venture in the mining sector. The most recent example of such cooperation is the joint venture between Antam and Freeport relating to smelter operations for anode slime.

In addition to cooperation among companies, there are also some problems which have arisen in their relations. The problems mostly come from overlapping working areas, usually with plantation areas. SKK Migas usually helps the relevant parties, the companies and the local government, to agree on a joint land use agreement to solve such problems (SKK Migas 2015). However, the mining companies negotiate by themselves, without assistance from the MEMR, or involve the local government only if it is necessary in solving similar problems (A Foreign Mining Company, 2016). The role of SKK Migas in assisting the companies in dispute situation becomes more prudent and is a leverage enjoyed only by hydrocarbon companies.

In conclusion, the cooperation among companies exists in a slightly different form in the two industries. The difference is primarily the different governance styles and the different nature of the operation. Pertamina and SKK Migas play an important role in the different governance styles of both industries. Their existence and actions make it possible for the companies to conduct joint operations, joint ventures, and ensure cost efficiency by sharing expensive equipment. On the other hand, a joint venture, which means joint investment and capital, is the only form of cooperation that can be found

among mining companies. Nevertheless, there is a similarity in both industries in terms of the companies' need to use service companies to do part of the operations instead of completing all activities by themselves.

The business association of hydrocarbon companies is also different in comparison to the association of mining companies. The former has an active role in reading and evaluating new policies related to the industry in order to give official recommendations representing the business' interests and position (IPA, 2016). One such association is the Indonesia Petroleum Association (IPA), which holds an annual event attended by all companies and related governmental agencies, including the MEMR, the Ministry of Environment, and SKK Migas, as well as some service and consultation companies and media which gather to discuss recent developments in the industry. At scheduled days after this special gathering for all relevant entities, the event is opened to the public. The participants provide data through brochures and public presentations that bring government, companies and society closer to understand what existing projects there are, how the companies operate and how the ministries govern the industry.

These events are also conducted on a smaller scale by the association of coal companies (A Foreign Mining Company, 2016). However, the specialisation of the events attracts smaller participants and guests. The event is not as widely known as the IPA annual convention. This condition affects the limited public understanding about how mining operations are conducted and how the industry is managed.

Government and companies are two dominant actors shaping the hydrocarbon and mining industries in Indonesia. However, both of them live in the society. Thus, acknowledging society as an actor and recognising the role it plays in the industry is also crucial. I posited that society views see companies in both industries as similar entities which pose both opportunities and threats to people's lives and the environment. There is

no argument about the contribution of mining operations in terms of creating more jobs and developing the economic prospects of local citizens. However, the resistance comes from the concerns of both local governments and the people that such activities endanger the environment, the quality of farming produce and sea life. The root of the problems is that society has historically been neglected by both governments and companies. People have only had a voice and the ability to fight for their rights since the 1998 political reformation. Thus, this new wave of access to information and the opportunity to voice their concerns towards the government and companies has been used extensively.

The most recent example was about Tangguh Project and Freeport operation in Papua, which initiated complaints from the locals and traditional society (A Foreign Oil Company, 2016). They asked for more transparency regarding the companies' operations and economic contribution towards society as compensation for damaging their environment and neglecting them for more than 20 years. The citizens were smart and well informed because such complaints were also directed towards national and local governments. They asked the elites to involve the society more often before making agreements with the companies. They claimed that they are the actual and direct owners of the land, meaning their rights should be acknowledged and fulfilled by both dominant actors. This case was widely covered in the national media and became high profile. Both the government and companies have recently had to deal with the rising societal awareness of their lives and environment. The younger generation is more educated, so they also have more capacity to access up to date information and act accordingly.

The national government has attempted several projects in response to this recent social development (Hijrah, 2017; Sudaryana, 2016). It conducted more socialisation so that the people could understand how mining operations are actually conducted. It also trained the subnational government to calculate the government's share and profit from

mining operations and understand how the companies actually pay their financial obligations. This activity could be seen as an attempt to be more transparent and accountable in sharing the mining profit to the region, which was a concern for resource-rich regions when the national government monopolised all the revenue and decided the amount to share for all regions without asking the opinion of the subnational governments. The national government neglected the fact that, despite the advantages of such operations in their area, the government and people in resource-rich regions also deal directly with the companies' personnel and are affected the most by the mining operations. However, these attempts at transparency are not sufficient. The national government has limited budget and manpower to be able to provide assistance in all regions, especially in more rural areas; thus, the subnational government is responsible for this task of hearing and responding to people's complaints.

From the learning process, we can also conclude that previous and recent regulation considered society as little more than a user of oil and gas. As a matter of fact, at the beginning of the industry, it was a group of people who decided to rehabilitate the already-destroyed oil refinery facilities in Sumatra and Java. They also pressured the government to take over the facilities from FOCs, as well as pushing (and accelerate) the government's decision to establish national oil companies. The interaction between society and companies has mainly been conducted through local government. Nonetheless, the increasing number of educated people has also increased the amount and expanded the scope of collective action. There are various types and levels of social association which interact with and voice their interests and needs to the government. Another societal role in mining industry is as a landowner of mining sites. Each company needs to negotiate to buy the land on an individual basis. The mining contract or license

that has already been signed with the MEMR is only a license to mine, while realisation of the company's plans and starting their operation is a different matter entirely.

In conclusion, the government and companies do pay attention and attempt to hold and support development projects in the region through various programmes, mainly through CSR to fund local events and programmes as well as the economic empowerment project to help local people grow their businesses, which are usually small-scale businesses (Antam, 2016; A Foreign Oil Company, 2016; A Foreign Mining Company, 2016; Tampubolon, 2015). From the government and company perspective, this programme could also be viewing society as the object in the industry. The people themselves have attempted to change their passive position by sounding their concerns to both dominant actors. Such action is still limited but has begun to arise recently. Nevertheless, it is always worth mentioning that the current active position of the GoI in managing and governing the extractive industries was historically initiated by a people's movement immediately after the country's independence. They took over the oilfields and demanded that the government take over the management, allowing the group to operate the business.

Despite the fact that the government then neglected society's wishes in managing and governing the mining operations and businesses, there was a high level of awareness and people did make themselves heard, even in negative ways (such as stealing equipment, treating the companies and operations' staff badly, or demanding large amounts of money to compensate the use of their land as mining areas or oil and gas fields) (A Foreign Oil Company, 2016). On the other hand, they have supported the mining operations in their own way by providing food and other daily needs or local shelter for the workers. They also take advantage of the operations through employment

and the use of public facilities built by the companies in the areas, usually the roads, ports and other forms of transportation, as well as education and health facilities.

6.4. Theoretical Reflection

There are certain principles that have never changed in government and business relations in Indonesia's hydrocarbon and mining industry. They are the ownership structure and the government's desire to govern (directing and controlling) those industries which are often seen as vital for the national economy. The government and business relations cover diverse issues and involve both local economic development projects and the direct influence of the industry on the local citizens. Subnational governments mainly take the lead in directly hosting the companies as they operate within their areas. Their interaction is mostly personal and deals with specific issues related to unique situations in the region. Meanwhile, the national government provides the general guidelines for company operations and overall business practices within Indonesian boundaries. It interacts with the companies by using more impersonal relations and a bureaucratic approach involving regulations and policies. Nevertheless, it is important to note that the existence of SKK Migas in the hydrocarbon industry plays a significant role in differentiating the nature of national government relations with hydrocarbon companies from its relations with mining companies.

The recent concept proposed by Luong and Weinthal (2010) was named the "Ownership Structure". At a glance, they attempt to move beyond the resource curse's assumption. Unfortunately, in the process, they made the same judgment of simplifying the government's act to governing the hydrocarbon industry as mostly driven by its claim as owner of the land and the elites' desire to stay in power. Their concept could be replicated in an authoritative political system or LAO. However, it could not be used to understand the governance of the industry in a more democratic society or a nation in

which democratisation is taking place. Such conditions could be classified as OAO or the transition towards OAO. LAO and OAO are two types of economic governance introduced by North, Wallis, and Weingast (2009) which have been explained in Chapter II.

In addition, Luong and Weinthal also falsely classified Indonesia as moving from S1 structure towards S2 in its recent development (2010, p. 346-348). The research found that the ownership structure in the extractive industry is fixed in S1 and S2 as the government is representing the people as the owners of the land while controlling the hydrocarbon industry but weakly and vaguely controlling the mining industry. S1 and S2 assume that the state holds the biggest equity share of the natural resources, while the first type means that the state controls the industry and the latter means that the industry is run without state control. On the other hand, P1 and P2 mean that the private sectors own most of the equity in the mining operations. Like the S1 and S2 classifications, P1 means that the private companies operate under state control, whereas P2 means that private sector operates without control. The fact is that the GoI intervenes and actively oversees operations of oil and gas contractors through various means, while the PSC as the main form of oil contract in Indonesia clearly states that the oil explored is owned by the government until there is a handover from the government to companies at the point of transfer. This means that the hydrocarbon sector should be classified as S1.

The key concepts of governing interdependence proposed by Weiss (1998) and Weiss and Hobson (2003) are mutual dependence, institutionalised cooperation, the government's proactive role in managing the cooperation, and institutional insulation. Interdependence means they need each other in order to achieve their goals. It also marks a mutual relation of adjusting with each other. The state takes a proactive role, using its autonomy to consult and to elicit consensus and cooperation from the private sector.

Weiss considered this to be a special kind of infrastructural power encompassing both the coordinated and the cooperative quality of that power.

In the natural resource industry, interdependence is an obvious base for cooperation as it belongs to the people in a country's jurisdiction. No matter how big and capable a hydrocarbon company is in terms of conducting mining operations, it cannot do anything without permission and support from the government. In addition, a common feature is that the government in a resource-rich country does not have the ability to monopolise all the mining operations on its own as this process requires a lot of capital, knowledge, high-end technology, and management. Therefore, the government needs to cooperate with hydrocarbon companies in order to gain profit from the natural resources it owns.

A long-term cooperation needs a steady interaction and stable environment to achieve both parties' goals and interests. Such relations need to be institutionalised with agreed and fixed rules of the game containing each party's rights and obligations, as well as clear protocols and procedures which need to be followed. One of the most important things to maintain a well-organised cooperation is the system of knowledge and information sharing. Such a system supports the actors to understand each other's job and interests although they have different preferences and choices of action. Governing interdependence is conducted when the rules of the game respect and accommodate both actors' preferences and existence.

The first stage is competitive bargaining relations, in which other actors are more dominant than the others and there is limited cooperation within organisations and between parties. This first phase mainly existed in the 1980s as the government implemented a programme to increase private domestic involvement in the hydrocarbon industry and at the same time the oil companies struggled due to the falling oil prices after

a significant windfall after the Oil Boom. If we take a closer look, this condition provided a better opportunity for private domestic companies to enter the industry as the cost of production was also lower than in previous period. However, oil operations are not only about the opportunities and they also involve significant capital and the ability to take losses from unsuccessful exploration and exploitation, which is not something the small companies were capable of. Therefore the large foreign (mostly multinational) companies continued to dominate the industry

The second stage is cooperative bargaining relations, in which the actors develop a partnership within their category (among governmental bodies or among mining and hydrocarbon companies) to achieve greater goals which could not be achieved by acting individually. There is competition as well as cooperation between actors. Pertamina was appointed as the manager for oil contractors and oilfields nationwide, which meant that other companies could only enter and work in the field after signing a contract with Pertamina and subsequently getting approval for their PoD proposal and work and budget plan. Moreover, cooperation with Pertamina could only take place through several schemes, namely TAC, JOA, and EOR. The government established such policies to allow Pertamina to learn how to manage the operations and handle high-level technological equipment.

During the earlier era, when public information was not as accessible as it is today and the government paid more attention to building a good image for the citizens, companies were only granted an exception in following the regulations by engaging in a good relationship, usually involving money as bribery, with political elites, namely Soeharto's cronies. This practice was known as personal exchange in North's view. However, on the surface, this practice was hidden from both the public and law enforcement agencies. From the 2000s onwards, with the establishment of the KPK, the

governance practice in both sectors has moved towards impersonal exchange involving a set of protocols and procedures in the interaction between the government and companies. The rules of the game are also impartially enforced towards all type of companies with few exceptions given to NOCs, NMCs, and the domestic private sectors.

6.5. Conclusion

This chapter attempts to answer the second research question; why and how resource governances in hydrocarbon and mining sectors develop in different direction. The discussion analyse institutional elements that change in both sectors: the rule and procedure element. Furthermore, mechanism of institutional change is analysed based on North, Wallis, and Weingast (2009) proposition about transition from limited to open access order.

Based on discussion above, it is clear that institutional actor always develop themselves to gain more knowledge and understanding in order to do their task better. North (2009) named it as a learning process. Thus, we have both the changing institutional arrangement and also the dynamic of institutional actors. This perspective mans that static point of view need to be reconsidered in further studies about resource-rich countries.

In addition, the research also studies the way in which the governance of two extractive industries in Indonesia have been shaped by government and companies' relations. This point of view is generally introduced and conceptualised by Weiss (1998) and Weiss and Hobson (2003), who named it "governing interdependence". This concept proposes another viewpoint regarding Strange (1994)'s proposition that, in the globalisation of business and economic activities, the government must also learn to deal with companies as business entities. She called this state and market relations with

economic diplomacy as the main activity. While economic diplomacy has been used to refer to all relations between economic and business actors in the world, governing interdependence specifically highlight the importance of state capacity framework to analyse the actual and intense interaction between the government and companies, with the government as the leading actor or the one which governs the industry.

There are some principal differences between the governance behaviour of governing, imposing, and letting businesses have their own way. The government's act to govern involves a wide spectrum of policies and codes of conduct surrounding business activities within its jurisdiction, while the act to impose involves a one way interaction between the policy maker and businesses. The letting type of action is a choice by elites not to intervene in business activities through politicisation. Businesses have more liberty in conducting their activities in this type.

The imposing type means that businesses have many limited choices of action. They are obligated to follow all rules set by the government without needing to consider the situation and challenges involved in each specific activity. The governing type is the best situation to manage the interdependence between government and business as it involves good relations strengthened by adequate interaction, communication, and trust between the related parties. Both need to understand each other's situation and interests, cooperating to achieve common goals. It is possible for the government in a state to not only conduct one type of approach over time and towards all sectors. This dynamic of choice and action should be fully considered and understood by a researcher before choosing an approach to analyse relations between governments and businesses.

The government's act to control the industry is a basic principal stated in article 33 of Indonesia's 1945 Constitution. It is mandated to protect the country's land and use the abundance of natural resources within its jurisdiction for public advantage and to

fulfil domestic needs for oil and gas as well as mining products. At the same time, the companies also act to protect their rights and control their liberty in business operations and management. The focus of their relations is balancing and accommodating both agendas and interests to achieve their economic goals. The government uses its authority to regulate, make decisions, and issue policies to govern the industry, while the companies use their comparative advantage in terms of knowledge and technological know-how in mining operations and business management. As the GoI opens up the governance by involving more governmental bodies and the subnational government, the more complex requirements and regulations will need to be followed, fulfilled, and obeyed by the companies.

Analysing the relations between the government and companies in the hydrocarbon and mining industries in Indonesia by using governing interdependence as a framework, it is possible to generate several theses. The first important aspect is the existence of SKK Migas as an intermediary actor between government and business entities.

By taking a closer look at the difference between SKK Migas' and the MEMR's priorities and strategies in governing the industry, we could see a second, vital difference between both industries. SKK Migas has built and managed a system ensuring direct sharing of knowledge and information between the company and the agency. Another important strategy is holding regular meetings to discuss the implementation of a concerning policy or issue with some of the companies as representatives of oil and gas contractors. This kind of meeting ensures that companies understand the government's expectations and interests behind the policy, while at the same time voicing their concerns and positions regarding the government through the agency. I assume that this practice could be understood as the government's willingness to recognise the companies as

partners in achieving its goals, protecting the public interest, and conducting its development and economic programmes.

This valuable standpoint actually enables the academic community to avoid a biased judgment about resource-rich countries under the resource curse label. Moreover, supporters of the resource curse concept have mostly focused on the national economic performance and the financial structure of states in which extractive industries, especially the oil and gas sectors, play an important role in their economy. However, the concept neglects the fact that the government is not a unitary actor; rather, there are various agencies and many layers of government which influence the governance of the industry. It also disregards the fact that government's actions in dealing with the companies and governing the industry are dynamic and progress as they gain further exposure to the international standards of business and governance practice, as well as the flow of information, technology, and opportunities to introduce better options and strategies in governing. Both government and companies have not remained in the same room and at the same time as they were in the beginning of their relations.

CHAPTER VII

CONCLUSION

The chapters in this thesis present an analysis about institutional change in hydrocarbon and mining industries in Indonesia. At early stage of my research, I seek a framework for explaining the development of resource governance in Indonesia's extractive industry. The starting point and conclusion generated from such studies are generally connecting the poor performance in such countries with their political and economic system, authoritarianism and nationalism. Moreover, previous studies also rely heavily on a static perspective regarding institutions in developing countries, which are also resource-rich. It implies that they do not actually attempted to understand and analyse what process and mechanism happen in the governance, especially related to the way in which institutional actors develop their capacities to act and interact with each other.

The massive political economic development experienced by the actors is far too complicated to be captured and analysed via the static viewpoint provided by existing studies. This chapter also intends to provide an alternative viewpoint in studying resource governance in developing countries and demonstrates that the previous frameworks, namely resource curse and rentier state, might provide a good starting point for studying this topic. However, it is not sufficient to explain the resource governance trajectories. It is also not adequate to understand the way in which the learning experience and process of the developing countries to be more open institutionally. It is important to also emphasise that, despite the institutional dynamic in resource governance, the political and economic actors are also dynamic as they develop internally in order to adapt to changes and deal with problems and challenges derived from their previous decisions and actions.

This is because the actors that are taken into account in this research are organisations rather than the elites. Political and economic organisations are dynamic and developing themselves as they welcome new individuals and new managerial regimes.

An intense and complex relationship between government and companies exists in the extractive industry. This is because, unlike other industries such as agriculture, Multinational Oil Enterprises (MOEs) have been the main actors in the international oil industry since the discovery of oil. They are known as the seven sisters and consist of Exxon, Mobil, BP, Shell, Chevron, Texaco, and Gulf (Victor, Hults, and Thurber, 2012, p. 273). The complexity in this relationship is caused by the high cost and high risk character of the exploration, production, and distribution process. There is uncertain precision in geographical information, unpredictable risk in the drilling process, and environmental damage in the exploration phase. While crude oil is found and explored, the refining phase to produce various petroleum products needs high technological and technical capabilities. The distribution phase also has to face the risk of leaking through cross border pipes as well as through oil tankers, which can reduce the amount of oil traded in the international market and damage the environment.

Slightly different in comparison with the hydrocarbon sector, more actors take part in mining operations as they can be achieved both traditionally by individuals or groups of people and in a more modern manner by using more sophisticated methods and technology. This means that mining operations can be done by governments, companies, and society at the same time (Spiegel, 2011). This is a unique differentiation between the mining and oil industries as there is no individual or group of people without having an organised firm which conducts oil and gas exploration and production. Since 2000, there have been growing concerns about safe mining operations and good business practice; consequently, most governments have paid more attention to regulating the small scale

mining usually conducted by individuals and groups of people (Suryana, 2016). This type of mining operation produces various problems, especially regarding worker safety, environmental damage, and illegal trading of raw mineral (Spiegel, 2011; Resosudarmo, 2005, p. 206-209).

Using this path of research, I argue that at a certain point, the governance of hydrocarbon and mining sectors has developed into different trajectories. The shift could be explained by looking into the interaction between the change in institutional arrangement in both sectors and the way in which government and business relations have developed differently in both sectors. This important but neglected fact is interesting and valuable because previous researches have tended to make general assumptions that resource governance in the extractive industry has both static, uniform, and unified institutional arrangement as well as a simple form of government and business relations without considering the dynamic and development of actors and the fact that government is also an organisation of organisations that is either uniform or unified in their interests, perceptions, and strategies towards corporations.

This research explores the institutional development of Indonesia's extractive industries by looking at the relationship between government and companies in the hydrocarbon and mining sectors. This viewpoint has mostly been overlooked by previous researches on resource-rich countries. The resource curse is a dominant framework wherein such countries are labelled as having poor economic performance and weak institutions (see for example Karl, 1997). They look at the government with a static view, meaning they fail to acknowledge the changing and dynamic action of governments over different periods of time. Their tendency to focus more on the elites' interest and action in managing the financial affairs of the extractive industries is misleading. They neglect the

complexity of government and companies relations. They also do not take the diversity of governmental agencies that take part in managing the industry into account.

Therefore, I posit that both the governance of extractive industries and the actors involved in the institution are not static; rather, they have developed individually and institutionally. There are more choices available for the actors, and the scope of agenda and issues covered in their interactions are wider as well. Collecting rent from the companies is not the only activity of concern to both parties. Moreover, when there are more actors involved from both sectors, their interactions become more complicated. The more the actors are exposed to the international environment, the more familiar they will become with international standards for both the governance of the industry and the business operations. Therefore, treating the development of extractive industry institutions as a process can establish a valuable understanding of how a resource-rich country manages its industry. Meanwhile, the relationship between the government and companies, as the unit of explanation, provides a proper focus on the actors' individual development through their interactions. This means that there are two processes as the main focus in this research: the institutional arrangement and the relationships among actors.

This is where my thesis attempts to fill the gap from previous studies about resource-rich developing countries. There are two research questions in this thesis. The first one is why and how resource governances in hydrocarbon and mining industries in Indonesia develop the way they are. The second question is why and how governance for hydrocarbon industry is different from mining industry.

Moving on from that perspective is not an easy task. Searching for an alternative framework to look into the resource governance in such countries bring me to the primary frameworks used in the analysis; they are Institutionalism and Institutional Change

developed by North (1991 and 2005), North, Wallis, and Weingast (2009), Lowndes and Robert (2013), and Campbell (2004). Institutionalism provides the most suitable analytical framework to look at the development of the rules of the game as a process. In this framework, the institution is considered as dynamic and changing over time rather than something that is static and impossible to change. Meanwhile, the framework also underlines the importance of looking at the learning experience of the actors involved. This learning process is the main assumption used to examine both the development of the institutions and the development in actors' relations.

North, Wallis, and Weingast (2009) proposed a comprehensive framework to analyse institutionalisation within society. Moreover, he emphasised several key themes crucial in understanding the initial steps for establishing, the development process of, and finally changes to the institutional structure and framework. The learning process that contains both aggregating information as well as accumulating knowledge about the environment as well as other actors' preferences and actions is the basic concept. Furthermore, the incentive structure, including the pay-off structure as well as ownership and property rights protection, is also an important concept. This is generated from the basic human needs: survival and security, as well as achieving goals and wealth. The main factors evident in all the key themes are the interactions and relationships among actors. There is always a bigger advantage to being inside the institutional framework rather than outside the structure.

Institutional change in the hydrocarbon and mining industries in Indonesia is analysed by using the phases of institutional openness proposed by North and Weingast (2009), the process and mechanism of change established by Campbell (2004) and Lowndes and Robert (2013), as well as other research articles related to the subject. North and Weingast (2009) stated that it is important to understand that institutional openness

could go forward as well as backward throughout time. It is not about progress but more about process. Meanwhile, Campbell (2004) explained the importance of considering the timeframe in the study of change as, in general, change could happen both incrementally and revolutionary. This means that change could be triggered by a sudden development influencing a social situation on a large scale or could happen slowly, meaning it is often impossible to track who the actual initiator was or when the change began. The first situation is often understood by historical institutionalists in terms of ‘path dependence’, which means current decisions made by actors are influenced by previous decisions taken by their predecessors and will affect further decisions in the future (North, 1990 and 2005). On the other hand, Lowndes and Robert (2013) emphasised the importance of determining which element of institutions could experience change and how much time is needed by each element to change. Both North and Weingast (2009) and North (1990) posited that an actor (most importantly an elite or a group of elites) must have an incentive to change their current institutional arrangement and gather support from their group in order to pursue their goal. This framework considers actors’ actions as the most plausible mechanism for changing an institution. Furthermore, Campbell (2004) and Lowndes and Robert (2013) made an important contribution to the framework by recognising the importance of considering different elements of institutions that could have different mechanisms of change. Along with both propositions, I also use bargaining relations between government and business as my main unit of analysis in order to understand changes that have occurred in resource governance of Indonesia’s extractive industry. In addition, I highlight the development in the Indonesian government’s capacity to govern the extractive industry and to build, maintain, and strengthen its relationship with and ability to solve problems in its interaction with companies.

The development of government capacity is evident in the wider scope of issues managed and the more open opportunities for subnational government and other ministries to become involved in governing the hydrocarbon and mining industries. The government pays more attention to details involving wider agendas and issues which lead to set of requirements, permissions, and documents to be fulfilled before allowing the mining operations to start. This could be seen as a more complicated bureaucracy and administrative affairs system compared to the simpler requirements in the earlier era. It also involves more agencies authorised to handle various issues in comparison to fewer authoritative bodies issuing various policies and regulations to be followed.

This point of view is still rarely used in international political economy literature. One common and dominant perspective used to analyse the governance in resource-rich countries is the “resource curse”. The supporters of this theory posited that being a resource-rich nation brings disadvantages for a country and its citizens, namely poor economic performance as well as political and social conflict over resource ownership and management authority. The financial systems in such countries have also received the most attention from political and economic scholars. Some of them blame weak institutions for unsuccessful resource management which has failed to distribute welfare and wealth evenly for the people. The researches used both concepts are inevitably trapped in perceiving the government’s actions through a biased and judgmental assumption. There are some labels attached to a resource-rich government, such as: having weak political and economic institutions and prioritising money and profit from the extractive business (rent-seeking behaviour), and using the money to get public recognition to maintain their position and authority.

In my opinion, the labels come from the reluctant to analyse governance as a process. Tracing this process could prevent a government being judged before its

dynamic attitude, approach, and strategy towards the industry has been properly examined. Therefore, this research focuses on analysing the mechanism and process of institutional change in hydrocarbon and mining industries by using process tracing and comparative historical method developed by Lange (2013). This is an attempt of to move beyond resource curse domination in studying the governments of resource-rich countries.

This research provides analysis and comparison of government and companies' relations in two Indonesia's extractive industries, the hydrocarbon and mining. This country is resource-rich and has more than 60 years of experience in managing the industry. As a developing nation, it has a dynamic political, economic, and social system which has triggered a reformation towards better development in governance practice. In addition, there is also a distinct strategy to manage the extractive industries proven by various initiatives introduced by the government in its interactions with companies and its management of the industry.

The institutional development in both sectors is analysed by using North, Wallis, and Weingast's (2009) concept of society typologies and the steps to move forwards from limited access order (LAO) to more open access order (OAO). The process of moving from LAO towards OAO is long and not smooth, but it is believed to be better than LAO. North also mentioned a doorstep condition, which could also be seen as another term for a path dependence (commonly used by historical institutionalists) each society will pass by before reaching OAO. Moreover, this movement needs a credible commitment to keep moving forward and each actor should always be cautious as the road is not one way; the society could be moving backwards rather than forwards. One important point in this process is that OAO is not a final destination. It is not an ideal system in which all

problems can be solved smoothly and where all actors do their jobs well and collect profit from their ownership or works.

Societal order needs to be maintained, protected, and enforced by a mechanism that requires actors' commitment to follow and protect the rules while also punishing those who violate the agreement. Furthermore, in an institution there might be an outsider who is not among the recognised actors in the system and cannot claim the benefits from it. Alternatively, there might be a free-rider that enjoys the benefits even though they do not belong in the system. As an actor also develops themselves, there might also be changed in the preference, attachment, and commitment to comply with the agreement. Thus, it is also plausible and valuable to analyse the development of an institution from the perspective of actors' relations, in which the self-development of the actors is also part of the explanation.

It clearly presents in the discussion chapters from Chapter III to Chapter VI that the government has different approaches in governing the hydrocarbon and general mining industries. It uses a stricter and more regulated approach in the hydrocarbon sector, while a more freedom is given to mining companies. This difference is part of a historical path set and chosen at the beginning of industrial development. In addition, it is also caused by different governments' perceptions, expectations towards the business, and the different governance structure in both sectors. After independence, the government issued the first Mining Law in 1960, which became the guidance in governing both industries. Afterwards, the government established state-owned companies in both sectors with different tasks. Pertamina is a merger of three national oil companies and its primary role is to collect rent from oil operations by attracting, negotiating, and signing contracts with foreign companies while at the same time managing and overseeing them (Darmono, 2009). Moreover, it has a public service obligation to provide oil as the main energy

source for supporting national development programmes through industrialisation projects. On the other hand, there are three mining companies resulting from the management of small foreign companies which were nationalised. Their main task is managing mining operations and producing mineral products for overseas markets.

The nature of the hydrocarbon and general mining businesses and companies in both sectors are also different. The hydrocarbon industry was a major source of income for the government until the 1990s, when taxation replaced its position (Henderi, 2017). Moreover, domestic demand for oil increased significantly as hydrocarbon fuels became the dominant energy source for housing and industry. Thus, the GoI paid special attention to this sector both upstream and downstream of business operations.

On the other hand, even though mining products are also widely used in various industries, there are many types of mining products and most mining companies do not produce the end products which are actually used by the domestic customer. Exports of raw minerals have become the dominant business in the sector, while the domestic market's demand for mining products is not fulfilled (Sudaryana, 2016). This condition affects both the government's approach in mining governance and public perceptions regarding the industry.

The pattern and approach in the governance development from LAO to OAO has taken different paths. This difference originated from the government's authority to manage the entrance of newcomers in the industry, especially those with a share of authority. Prior to 2001, the hydrocarbon business was governed by Pertamina, which was mandated by national law to represent both the government and the main players in the industry. All companies that wanted to operate in the oilfields needed to sign the contract and obtain approval for their Work and Budgetary Plan (including the Plan of Development). This power ultimately led the first Director of Pertamina, Ibnu Sutowo, to

cross his authority by investing outside the company's core business and buying oil tankers which had administrative problems. This course of events in 1976 was known as the "Pertamina Crisis". Afterwards, the government closely and strictly managed and oversaw the management of Pertamina, including restrictions on receiving capital other than state funding. From the 1980s to 2001, the company was more focused on governing the hydrocarbon industry and was failing its core duty as a company. As its performance was low, the public perceived that "the nation's hydrocarbon industry was under domination of foreign companies" and that "the government was intentionally selling the nation's resources to foreigners and putting the public interest aside".

The government did not pay much attention to governing the mining industry as the 1960 Law was unreplaceable for more than 40 years. There was no urgency from Parliament in releasing a new Mining Law which could cover a changing situation in both the industry and the country as a whole during this period of time. The industry itself was rising in the 1980s as many companies were attracted to invest and operate in Indonesia; moreover, commodity prices were rising while the oil price plummeted significantly.

Actors are dynamic as they learn from their exposure to new information and knowledge. A government consists of independent and dynamic agencies, while business entities also consist of independent and dynamic agencies, from individuals to associations. Thus, their relations are also dynamic and changing as they are exposed to new information and knowledge to realise their actual and potential capacity, their limitations, as well as the range of strategies to act and establish relations with other actors.

There are several questions which instigate deeper thought while comparing the governance of the hydrocarbon and mining industries in Indonesia. The thought process itself starts from many questions which emerged throughout the research process. The

first is related to the diversity of governance in the different sectors despite their identical classification as extractive industries which are conducted by the same government with the same political, economic, and social system and situation. Interestingly, this diversity is often ignored by previous researches which argue that governments apply a similar style in governing the industry, particularly natural resources or the extractive industries. This ignorance also takes another form by neglecting the fact that the government is not unitary actor in which all agencies act harmoniously and have similar level of capacities to process information, to make and implement policies.

Secondly, the need to identify the actors' learning and development processes. The actors themselves develop as they are exposed to new information and knowledge. Their exposure to a larger system and attachment to the international system with different standards of action also influences their governing style. However, they could be influenced differently as there is also a difference in the ability to access and process the information.

Thirdly, the previous decision taken by elites in the past influences the way in which actors' developing themselves and changing in institutional arrangement happens in the present and future. In this regard, looking interconnectivity between resource governance in both sectors and institutional arrangement in larger political and economic system is crucial for analysing mechanism and process of institutional change.

The government and companies' relations comprise actors' intended actions towards other actors in order to get what they want from such interactions. This relationship could be seen as a process wherein the actors interact more than once and even exist in the same sphere with capacities and intentions to maintain and develop the relationship by establishing rules of the game which bind all relevant parties.

From discussion of the findings, there are two elements that changes in the institutional arrangements for both sectors. The rule element consist of contractual system for oil, gas, and mining; while the procedure element consist variety of government and companies administrative, financial, and legal affairs.

The source of change in rule element for hydrocarbon industry in 1998 came from internal pressure, the end of Soeharto's regime and the beginning of Reformation era, as well as external pressure, from the requirement for getting financial support from IMF and World Bank. The result is a slightly liberalized-look in new hydrocarbon 2001 regulation by making a big change in the structure of its hydrocarbon industry governance. Pertamina is no longer positioned as both supervisor and competitor for other oil and gas companies. The NOC has only responsibility as a business entity and its function as supervisor is given to BP Migas and later to SKK Migas and MEMR. This is a crucial decision proven that government has capacity to deal with economic and political problems. It also proves that government has both adaptive and transformative capacities to compromise between external pressure and internal discourse, the long debate between pro liberalisation and nationalist faction.

On the other hand, the rule element in mining industry changed in 2009. In contrast with hydrocarbon sector, the change came from rising nationalist sentiment regarding governance of mining. Public generally view elites as 'selling the country land and resources to foreigner, while ignoring and sacrificing public interest' for elites' political and economic interest'. Susilo Bambang Yudhoyono, the President for two periods of time (2004 to 2009 and 2009 to 2014) attempted to answer the accusation by pushing the House to release a new mining regulation. The 2009 mining law has more strict regulation for further mining operation in the country. Among highlighted rules are: government should stop releasing new mining contracts and renegotiate to change it into

a license-based contractual system, CSR become an obligation for the company, and the company should build smelter facilities and process raw minerals to be mineral products in the Indonesian soil. The later clause also existed in previous law, but it is never enforced seriously by the government. According to the law, government should make utmost attempt to renegotiate all existing contract and change it into license. In this way, the government is no longer positioning as contractual parties with obligation and responsibility towards the mining companies. Licensing system means that government gave permission for the companies to conduct mining operations in certain mines, but the license could be revoked single-handedly by the government in case there are problems emerged during their license period. Previous contractual system means that the government have to renegotiate and compromise with companies' need and interest. This change is crucial marked the change from previously more liberalistic government's approach toward mining companies toward a more nationalistic strategy.

Furthermore, changes in procedure elements of institutional arrangement in both sectors' governance consist of developing of actors' capacity to act and interact within the structure. Big shifting role of actors happens in hydrocarbon industry. Pertamina was once a supervisor for oil and gas contractor. The NOC even had right to collect rent from foreign companies and invest it to other projects as it saw fit. After Pertamina Crisis in 1976, the right was taken off and return to MoF. Although having difficulties to get capital for their operations and expansion project, the company has leverage of having distribution routes, facilities, and system to nationwide. Such leverage is advantageous after its public service obligation, to supply and distribute fuel to all regions in the country, was also cut off and government decided to give foreign companies' opportunity in downstream operation. The new competitor's access is not comparable to Pertamina. The NOC is still dominating domestic fuel market as primary supplier.

Meanwhile, after 2001 law of hydrocarbon industry is activated, its role as supervisor was taken back by BP Migas. This agency was responsible for handling all matters related to oil and gas contractors. Its main task was to improve national oil production that plummet since the beginning of Reformation Era. It had authority to decide and make policy to fulfil the task. The agency' position and authority as MEMR is seen as an ideal structure for the sector. However, its vast authority without control mechanism from other agencies rose public suspicion and therefore the agency is replaced by SKK Migas.

Unlike BP Migas, which task and authority dictated by the Law, SKK Migas was established only by Presidential Regulation. This new agency is having similar task, supervising oil and gas contractor, but without having authority to decide and make policy on their own. The agency is also positioned under MEMR supervision. This positioning became a challenge for conducting their task effectively. They could not directly call and discuss problems and matters happen in the industry with related ministries. All have to be proposed to MEMR and the ministry is the one that could do so. However, although it is not ideal, the agency's existence is crucial to bridging government and companies' opposite interest and approach related to business operations and related affairs. In this regard, implementation of government policies related to the industry could be done by the companies without much problem. The communication is done two ways with compromise to companies' circumstances.

BP Migas have their organizational structure and experience from initially established by Pertamina specially to conduct its task to supervise the contractors. Having access to all companies' information and plans is proven to be beneficial to improve the agency's capacity to govern the industry effectively. It is important to underline that the effectiveness does not mean without problems. The decreasing oil production is unsolved

problems as investment on explorative operation is high risk and high capital. There is no new oilfield found after all attempts made by both BP Migas and SKK Migas. National production is still heavily relied on mature oilfields with various strategies, to increase its production. It is not a surprise that Indonesia halted its membership in OPEC as of 2006 due to the country being net oil importer since 2004.

In contrast with the governance of hydrocarbon industry presented above, the learning process in the governance of mining sector is different. MEMR is the one that always be supervisor for mining contractors. However, unlike Pertamina and BP Migas, the agency never actually oversaw the mining operation as they have limited expertise and budget to conduct close inspection in the mines. Hence, their main strategy is to have a more bureaucratic approach and one way interaction with mining companies. The mining contractors, like the hydrocarbon companies, have administrative obligation to submit various documents to MEMR and seeking government approval before conducting any operations in the mines. However, such information and data is not properly preserve and analyse properly (based on my visit to its library and a discussion with its staff) to grasp the business operations and companies' circumstances and make a better policy to support expansion of their operation. Companies have limited communication and interaction with MEMR and thus government could not response effectively to companies' voice. The mining companies generally understand and attempt to fulfil their obligation to the government by themselves without having consultation with their direct supervisor, the MEMR. In this regard, companies' capacity to process new policies and obligations from both national and subnational government is distinguishable. Big company with big capital is able to constantly check the newest regulation for their operation and financial obligation. They even have special section that is responsible to do that task and to discuss it with staffs in MEMR or other ministries. On the other hand,

many other companies could not afford to do so. There is a very loose government's supervision and governance structure in mining sector. All ministries have their own strategy to deal with the companies. Thus, the institutional structure is somehow messy and complex with so many agencies involved without having coordination. Mining companies are in disadvantage position in such structure. Such circumstance also means that mining sector has many of loophole in which corruption and other negative elites' behaviour are unsupervised and uncontrolled.

Important change in procedure element of the sector happens when decentralization policy came into effect. MEMR should share some of its authority, to negotiate with and give contract to mining companies, with subnational government. This policy produce large amount of unreliable mining contracts signed by local governments. To deal with this problem, MEMR implement a clean and clear project to evaluate every contract made by subnational government and classify it between the one that is reliable and the one that is problematic and fictitious. The mines with clean and clear certificate are expected to free from problems and the companies are allowed to operate in the area. Meanwhile, the ones that are not certified means that there are problems related to the land, mostly overlapping rights to use the land.

Above analysis shows that generally, GoI have transformation from limited to a more open access order. The bureaucratic system, especially the ministries related to economic activities, developed to be perpetual life organizations. It means that impersonal exchange, through a more standardize procedure based on regulations, is replacing personal exchange based on elites personal connection and leadership. The government adapts with changes, happen both in rule and procedure elements of institutional arrangement, without has to rely on top bureaucratic elites' direction and leadership. Furthermore, it also means that learning processes of both individuals and the

organization affect the way in which further development happen in the resource governance. It also means that the way in which government deal with business entities is also developing along with its learning process and transformation.

In conclusion, both learning process and adaptive mechanism of institutional actors to deal with changes happen in institutional arrangement of both sectors are indeed different and complex. Such complexity is better understood by using Institutionalism and institutional change framework.

It would be valuable to continue the focus on institutional change of resource governance in developing countries. First of all, it is important to analyse the variety of government styles in managing different economic sectors by conducting case or comparative studies. By doing so, the research could provide a wider range of analysis and conclusions regarding the way in which a government governs its interdependence with business entities. Furthermore, by using a qualitative comparative method, the study could be expanded to compare the government and business relations of an industry in different countries with similar or different characteristics. By doing so, the framework would be able to cover a wider area and sectoral studies.

In order to do so, there are two basic guidelines that I propose to be followed in further researches on resource governance in developing countries. The first one is that it is important to keep in mind that the both government and business entities are not unitary. Furthermore, they are not static as they always develop their capacities along with their learning process. It means that their exposure to larger institutional arrangement in national, local, and global environments could change the way in which they perceive and process information as well as determine their choice of actions and decisions.

Secondly, it is important not to make too early judgement both the governance of an industry and the pattern of government and companies' relations in the industry. Process tracing is a method that utilises an objective perception in accompanying a researcher to study the development process in politic, economic, and social realms. An early justification could cause a research to overlook the real set of events, such as changes in institutional arrangements and changes in the relationship patterns among actors.

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