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Innovative Policy of Regional Development in Decentralized Indonesia

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Innovative Policy of Regional Development in Decentralized Indonesia: Local Content Policy in Extractive Industries Governance, at District of Bojonegoro, Province of East Java, Indonesia

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This paper aims to explain about how process of implementation of innovative policy introduced by a local government after Indonesian government introducing the excessive decentralisation since early 2000. Furthermore, this paper describe various problems and opportunities for implementing local content policy that enhance the social benefits of local economic development at Bojonegoro, one of resource abundance districts, after discovering and exploitation the oil and gas reserves. This paper actually put emphasizes on to what extent local government enhance local content policy that contributing for social benefit in decentralised political arrangement?

Cepu, which is placed around District of Blora and District of Bojonegoro, is one of natural resource-rich areas in Indonesia that has been explored and exploited for almost a century. After the new finding of rich oil and gas reserves, the Indonesia central government signed a joint operational agreement (JOA) with Exxon Mobil In 2006. In practices, a partnership among PERTAMINA EP CEPU[1], MOBILE CEPU ltd and AMPOLEK (CEPU) Pte. Ltd. [2] take responsibilities to operate Cepu Block.

In one hand, in term of its contribution for national oil production, Cepu block is very important for national government. The amount of oil in Cepu Block is predicted to reach approximately 600 million to 1,4 billion barrel. Additionally, the natural gas is predicted to reach 1,7 to 2 trillion cubic feet. In peak condition, Cepu Block is predicted to produce 170,000 Barrel oil per day (BODP). It means that Cepu Block contributes approximately 20 % of the total national oil production (900,000 to 1 million BODP).

On other hands, in term of its revenues, the Cepu Block is also very important for local government, especially district government of Bojonegoro. For instance, in 2012, Bojonegoro Regency received US $23 million from oil and gas Revenue Sharing Fund[3] (or it increased three times than local government revenue in 2008). Consequently, Bojonegoro's Regional Gross Domestic Product increased significantly from US $ 870 million to US $ 2,5 billion in 2011. From 2009 to 2013, the contribution of oil and gas DBH towards Regional

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[1] A subsidiary company of PERTAMINA, the only state-owned company that leading in oil business in Indonesia.

[2] A subsidiary companies of Exxon Mobil.

[3] Since decentralisation, Indonesian government has introduced arrangement of intergovernmental fiscal transfer in order to minimize regional gap. This transfer is clustered into three types, ie.: General Allocation Grants, Special Allocation Grants and Revenue Sharing Fund. the Revenu Sharing Fund. Revenue sharing involves the national government sharing property tax, personal income tax and natural resources revenue (oil, gas, forestry and mining) with the regions. The rates of revenue sharing for natural resources vary, with the producing regions receiving a disproportionately higher rate of revenue sharing. Revenue sharing accounts for over one fourth of all transfers from the national government (Jón R. Blöndal, Ian Hawkesworth and Hyun-Deok Choi, 2009).

Income consistently increases from 3,8 % to 18%, opening opportunities for quality improvement on budgetary capacity in the region (see BPS, 2013)

From the very beginning, local government of Bojonegoro realizes that they will rely on all daily social and environmental cost and burden, such as the loss of the main income source or livelihood caused by land acquisition for oil and gas project. In the meantime, oil and gas companies probably will not provide greater job opportunity and doing business for local people who are mostly low-skill labours or occasional labours. Thus, huge Regional Gross Domestic Product from oil and gas and fast local economic development will mean nothing since high-skill employee only will enjoy the most of economics benefits. Social conflict between local people and local migrant labour could raise and then social vulnerability possibly happens. It will disturb production process irreversibly.

In order to anticipate such negative impact of oil and gas production, the local government of Bojonegoro then introduced the local content policy through Regional Regulation No. 23/2011 on Acceleration of Local Economic Growth Regarding to Exploration and Exploitation and Oil and Gas Production Arrangement in Bojonegoro. In this innovative policy, local government aims to involve and empower all local potentials in the oil and gas operations such as local manpower, equipment and materials. They really deem that this new policy will generate higher benefit and job creation for local communities in Bojonegoro.

However, the tension between central government and local government then emerges. The central government identified this new policy will perhaps be burden of optimization of oil and gas production. Hence, it will threaten achievement of national targets. The converse came from local government when they think that they have strong authority to arrange oil and gas production activities. Furthermore, they cannot ignore or delay this policy due to social conflict management and minimising environmental damages and risks.

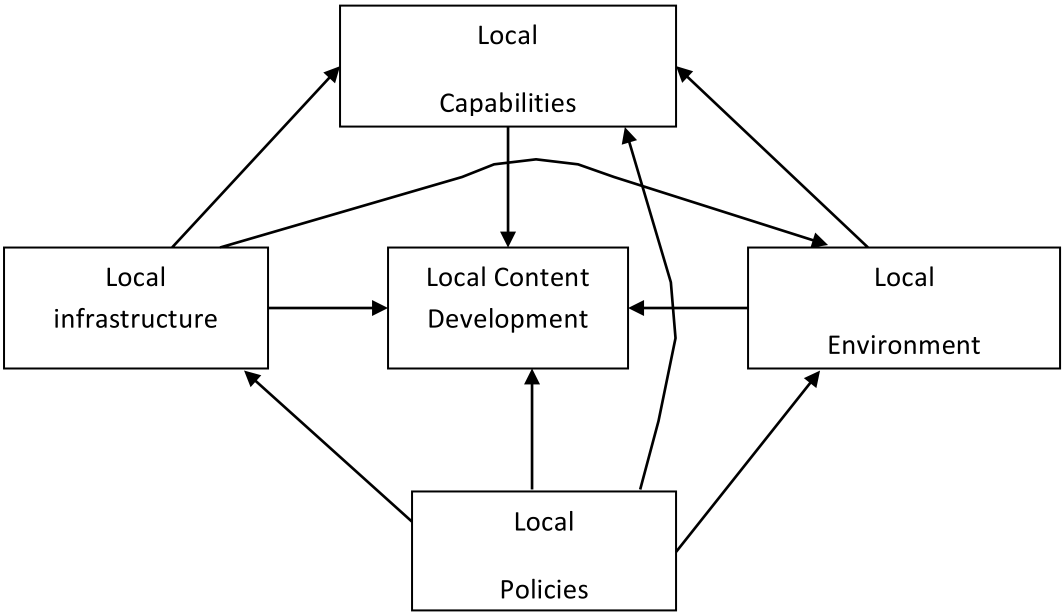
Local Content Policy in Concept

The idea of local content is defined in various explanations. For instance, with regard to local procurement, in some usages the term is equated with locally owned, whereas at the other extreme, it is sometimes used simply to describe any business that maintains a permanent operational office within a given area. Local content also has been defined in terms of the value contributed to the national economy through purchase of national goods and services. "Local value-added" is the wealth local companies create in transforming materials and services purchased from other countries into revenue-generating output. It is calculated as the value of the firm's output minus the value of all foreign purchased inputs (including raw materials, energy, contractor services and rents). The International Petroleum Industry Environmental Conservation Association (IPIECA), the global oil and gas industry association for environmental and social issues, also refers to local content as the added value brought to a host nation (or region or locality) through workforce development (employment and training of local workforce), and investments in supplier development (developing and procuring supplies and services locally) (Esteves, Coyne, Moreno, 2013).

In other words, this idea intends to overcome the problem of resource curse or problem of plenty by extending or expanding the benefits of oil, gas and mining activities for both the local or national economy. Through this idea, local stakeholders can access economic opportunities, whether they are related to employment, participation in supply chains or the provision of other related support services. These policies also can be expressed or implemented by mechanisms such as targets for local employees or suppliers, preference schemes for local businesses, industry or human capital development support from the government, or giving local businesses greater access to finance (see Ibid).

Furthermore, Abolfazi and Behrouz (2012 in G Begi & Adebesi, 2013) pointed that local content actually a resultant process or complex link among these following variables (see figure 1), i.e.:

Figure 1: model for local content development in extractive industry.



Source: G Begi & Adebesi, 2013

1. **Local Policies:** local policies are concentrated in a range of economic sectors including extractive industry. These policies include public and industrial policies, which are conceived with sustainable economic development.
2. **Local Infrastructure:** the availability of certain conditions such as information technology, local company's needs, standards, social, education etc. in the local extractive industry is the primary concern of local infrastructure factor. Because providing and maintaining the necessary infrastructure would add to high level of social welfare. Infrastructure is definitely an important variable, which has a substantial impact on local content development.
3. **Local Environment:** local environment is the factor in which all local policies, local capabilities, local infrastructure and the interaction among other factors are formed. One of the important variables is the macroeconomic environment, which is decisive for the factors, which are necessary for any investment decisions such as development of domestic prices, the exchange rates for the local currency, and the interest rate. Some particular government policies impact the environment for investment and business development. Encouraging competitiveness develops competitive oil and gas based industry.

4. **Local Capability:** local capabilities include education, skills and expertise development, transfer of technology and know-how and an active research and development portfolio within manufacturing and services of local companies. Industrial growth is not something, which could be decided by politicians, but it is a result of demanding interplays between established and emerging industrial capabilities developing local content in the extractive industry must be based on existing capabilities within manufacturing, fabrication, and services.
5. **Local Content Development:** the level of local content development depends entirely on the quality of relationships among political, infrastructure, environmental and local capability factors and the results are economic growth, industrial growth and spill over impacts.

   Local content will make its contribution effectively to the host country economy by creating and developing value added activities and competitiveness by international standards. The past experience of economics of many developed and developing countries indicate that linkages between the primary resources sector and other sector impact economic growth. Significantly, Thus, if the linkages are strong enough such as when inputs are not supplied from abroad, the economy gradually becomes diversified.

Local Content in Practices

As mentioned in previous section, the local government of district of Bojonegoro attempted to introduce the idea of local content through Regional Regulation No. 23/2011 on Acceleration of Local Economic Growth Regarding to Exploration and Exploitation and Oil and Gas Production Arrangement in Bojonegoro. Some crucial articles related to the idea of local content are:

1. Article 7

"KKS Contractor and/or K-KKS partner and Oil and Gas processor, is obliged to use local production tools".

2. Article 8

Procurement of processing services and other services done by KKS Contractor or K-KKS partner and oil and gas processor is obliged to give priority to the participation of local company, regional government-owned company (BUMD), village public enterprise (BUMDes), and cooperation. In terms of a consortium with national company and/or with Foreign Company then local company, BUMD or BUMDes, or cooperation must at least participate on 30% of the project based on the value of the Contract.

3. Article 9

Manpower procurement for the project is done with terms as follow:

- 100 % of the labour comes from local people.
- Trained and Professionals have a maximum proportion of local workers

4. Article 10

KKS Contractor or K-KKS partner is obliged to do employment reporting to the regional manpower and social affairs accordingly with the regulations.

5. Article 12 clause 1

In deciding the price of goods/service the KKS Contractor and/or K-KKS major partner and oil and gas company must compile HPS/OE that includes tax and profit for goods/service suppliers, which the minimum amount is regulated by regent.

6. Article13 clause 4 letter b:

KKS contractor and K-KKS major partner is obliged to pay its payment obligation not exceeding 30 (thirty) working days, after the verification ends.

7. Article 14 clause 2:

In goods/services procurement to BUMD, BUMDes, koperasi suppliers is given a down payment atleast20% (twenty per cent) of the contract value.

8. Article 15 clause 2:

KKS contractor and/or K-KKS partner gives information to the goods/services suppliers and public on matters such as:

- Standard operating procedure (SOP) of KKS contractor and/or K-KKS partner and oil and gas company;
- Regulations regarding with the procurement of goods/services in oil and gas industry; Health, safety, and working environment (K3L/SHE)

9. Article 16:

Motorized vehicles and heavy machineries used by KKS Contractor and/or K-KKS partner and oil and gas company for exploration and exploitation and processing of oil and gas must be listed to the Bojonegoro district's authorized authority.

10. Article 17 letter a:

"usage of non subsidized fuel for all motorized vehicles and heavy and big machineries by KKS Contractor and/or K-KKS partner and oil and gas processor".

11. Article 17 letter b:

"All motorized vehicle used by KKS contractor and/or K-KKS partner and oil and gas processor from or registered from outside the region and has been used for more than 3 (three) months id obliged to list the vehicle in Bojonegoro area".

12. Article19:

The KKS Contractor and K-KKS partner and oil and gas processor that involve in the exploration and exploitation as well as processing is obliged to:

- Establish a branch office in Bojonegoro Regency;
- Coordinate with Local Government of Bojonegoro in building production infrastructure;
- Anticipate as early as possible the possibility of disaster/negative impact that came from the activity,
- Transparently informed the district government and the public about the negative impact of each stage of Oil and gas exploration and exploitation level;
- Conducting land reclamation and fixing damaged public facility caused by the impact of oil and gas
- Exploration and processing including the mobility of heavy machineries used;
- Transparently inform related information with the development and any opportunity that can be benefitted by the local goods. Services providers, BUMD, BUMDes and cooperatives;

- Includes elements of work training as one of the focus of public programs (CSR program);
- Offers every job package that can be done by local contractor if the package can be executed by local businessmen, BUMD, BUMDes and cooperatives;
- Helping local businessmen. BUMD and BUMDes in improving its technical capability and basic terms or qualification to participate in goods and services tender.
- Respect and obey local culture and habit as well as generally applied manner in the society around the project location.

13. Article 20 number 1:

KKS Contractor and K-KKS partner and oil and gas processor involving in the exploration and exploitation is prohibited against: Building non-technical facility or placing a fix support for the establishment of project facility, such as dormitory, camp facilities, community centre, recreation centre, terminal, temporary terminal, etc to be placed in EPC area, but to be held in certain areas arranged by the Regent.

14. Article 22 clause 2:

Corporate Social Responsibility (CSR) program must be based in the real needs of Bojonegoro people

15. Article 22 clause 3:

CSR program is obliged to meet with the regional development plan (RKPD) and/or village development working plan (RKPDes)”

16. Article 23

In making the Corporate Social Responsibility (CSR) program, the operator should coordinate with the Bojonegoro’s district regional development planning to synchronize as a preventive measures to anticipate overlapping with district government working plan.

17. Article 24:

“KKS Contractor and K-KKS partner and oil and gas processor is obliged to present its CSR planning to the district head and regional parliament, regional development planning agency and head of the villager in the related location”

Sanction

1. Every KKS contractor and/or K-KKS partner and oil and gas processor that fail to comply with the terms of the regional regulation would be given sanction such as administrative sanction of withdrawing the permit given or principles business permits in Bojonegoro District Area. (Art. 27clause1)
2. The Regent could recommend BP Migas or KKS Contractor to give sanction (Article. 27 clause2)
3. Local company, BUMD, BUMDes and koperasi that violates working contract with KKS Contractor and/or K-KKS Partner and oil and gas processor could be given sanction accordingly with terms agreed in the contract (Art. 28clause1).
4. Institution given administrative rights in this Regional Regulation is the Advisory Team for Regional Construction Services (Tim Pembina Jasa Konstruksi Daerah) established by the regent decree (Art. 28clause2).
5. Administrative sanction as stated in clause (1) that can be given to service suppliers are:
    - Written warning;

◦ Limitation of business and/or profession; sanction
◦ temporary halting of business permit and/or profession;
◦ Withdrawing of business permit and/or profession.

However there are some obstacles rely on implementation process of local content policy. One of mayor issues is intergovernmental tension between local government and central government, include BP Migas. It was started when MCL was announced the winner of EPC tender worth 38 Trillion. Then the project mediates communication between EPC MCL, the tender winner, with Bojonegoro's local business community. In this process, MCL insists to continue the EPC accordingly with the directions of BP Migas, a regulatory body on oil and gas in Indonesia (see Ardhyanti, 2014).

Unfortunately, the local government did different way. Local government of Bojonegoro holds the issuance of IMB and HO permits for the EPC. They considered that the project has disobeyed of local regulation that arranges the idea of local content.

To respond this problem, BP Migas, as regulatory body, reported to and asked the vice president of Indonesia to handle this problem and communicate with the Regent of Bojonegoro. BP Migas complained on post-pone of IMB by local government of Bojonegoro. Vice President of Indonesia then accused Bojonegoro is holding back a national project. The regent of Bojonegoro also attempted to consult with the vice president.

Finally, this problem has been solved by win-win solution. The regent issued the IMB and HO for the EPC after the tender winner agrees to obey the local regulation of local content.

There are also some lesson-learnt that can be reflected in implementation of local content policy in Bojonegoro, Indonesia. First, Local economy is not the central government domain. The authority transfer to local government in economic sector need to be expanded since economic activity in rich resources region usually is the domain of the major business group that has the capital and capability. This innovation aims to intervene the economic activity process so it could favour the region.

Second, capacity building is needed. When local business groups involving within the joint operation model (partnership between local and non local businessmen) is expected, it should be more than sharing of capital. It also needs capacity building of local business group through transfer of knowledge, skill and capital.

Third, It needs to increase of PDRB in service sector by localizing the flow of money in the region. In2011, Bojonegoro's PDRB at market price with oil and gas reached 25.110 Trillion. The challenge is to make the flow of money stays inside region of Bojonegoro.

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