www.ogel.org

ISSN 1875-418X
Issue (Provisional)
Published March 2020

This article will be published in a future issue of OGEL (2020). Check website for final publication date for correct re ference. This article may not be the final version and should be considered as a draft article.

Oil, Gas & Energy Law Intelligence

"Try to be more like Norway on a Sunny Day!" Regulatory Capitalism and the Challenges of Combatting Corruption in Indonesia's Upstream Oil and Gas Sector Supply Chains

by M. Buehler

About OGEL

OGEL (Oil, Gas & Energy Law Intelligence): Focusing on recent developments in the area of oil-gas-energy law, regulation, treaties, judicial and arbitral cases, voluntary guidelines, tax and contracting, including the oil-gas-energy geopolitics.

For full Terms & Conditions and subscription rates, please visit our website at www.ogel.org.

Open to all to read and to contribute

OGEL has become the hub of a global professional and academic network. Therefore we invite all those with an interest in oil-gas-energy law and regulation to contribute. We are looking mainly for short comments on recent developments of broad interest. We would like where possible for such comments to be backed-up by provision of in-depth notes and articles (which we will be published in our 'knowledge bank') and primary legal and regulatory materials.

Please contact us at info@ogel.org if you would like to participate in this global network: we are ready to publish relevant and quality contributions with name, photo, and brief biographical description - but we will also accept anonymous ones where there is a good reason. We do not expect contributors to produce long academic articles (though we publish a select number of academic studies either as an advance version or an OGEL-focused republication), but rather concise comments from the author's professional 'workshop'.

OGEL is linked to **OGELFORUM**, a place for discussion, sharing of insights and intelligence, of relevant issues related in a significant way to oil, gas and energy issues: Policy, legislation, contracting, security strategy, climate change related to energy.

"Try to be more like Norway on a Sunny Day!" Regulatory Capitalism and the Challenges of Combatting Corruption in Indonesia's Upstream Oil and Gas Sector Supply Chains

Michael Buehler[*]

Abstract

How to achieve sustainability in natural resource-based supply chains has become a pressing question in light of mounting global demands to address the economic and social consequences of natural resource extraction. A major obstacle to sustainability in such supply chains is corruption.

Various solutions to mitigate corruption in natural resource-based supply chains have been put forward. The most prominent are the creation of oversight agencies that are tasked with implementing and monitoring complex regulatory frameworks for the sector as well as relying on "focal companies", big corporations and industry leaders, to self-regulate and transmit good corporate governance practices to their sector.

I argue that both approaches do little to curb corruption in natural resource-based supply chains as they ignore the broader political context. To exemplify this point, I will examine the regulatory framework for subcontracting in Indonesia's upstream oil and gas sector. There the main regulatory agency for the country's upstream oil and gas sector has been both a target and a perpetrator of corruption. Likewise, the capacity of "focal companies" to contain corruption within their supply chains, never strong to begin with due to various legal loopholes, is being greatly reduced as the country's upstream sector moves from cost-recovery Production Sharing Contracts (PSCs) to Gross-Split PSCs.

In this context, the opportunities to curb corruption in supply chains in Indonesia's upstream oil and gas sector remain limited for the foreseeable future. The lesson Indonesia offers, however, is that local political conditions need to be taken into account when designing corruption eradication strategies, rather than administering off-the shelf corruption prevention measures. A potential new approach to combatting corruption based on an analysis of local political conditions will be discussed in the final part of the paper.

1. Introduction[1]

In light of rapid environmental degradation and growing socio-economic inequality worldwide, companies operating in the natural resource extraction sector have come under increasing pressure to improve their supply chains in order to achieve sustainability in their operations.

A supply chain is said to safeguard sustainability if it takes the economic, environmental and social consequences of natural resource extraction into account (Linton et al. 2007).

[*] Associate Professor in Comparative Politics, Department of Politics and International Relations, School of Oriental and African Studies (SOAS), University of London. Email: mb107@soas.ac.uk

[1] I would like to thank John Bray, Jamie Davidson, Michael Kramer, Kevin O'Rourke, Gay Ordenes, Philip Shah, Clare Short, Aled Williams, and the over 50 informants interviewed under condition of anonymity for their help with this article. All remaining errors are my own.

A major obstacle to sustainable resource extraction is corruption. In fact, corruption was cited as the single most important threat to implementing sustainability in supply chains in a recent survey of stakeholders in the Brazilian upstream oil and gas sector (Silvestre 2015: 161-164).

Corruption, the abuse of public power for private gain, not only diverts resources away from societies in natural resource rich countries but may also negatively affect a broad range of other issues. For example, corruption may allow companies to bypass environmental laws or to ignore workplace safety regulations.

Corruption is prevalent in the natural resource extraction sector for several reasons. One, the state often has a heavy presence in the sector because governments try to keep control over natural commodities through State-Owned Enterprises (SOEs). Two, the bulk of natural resources are located in developing countries (Dangkua 2016: 7). Hence, companies frequently operate in countries where laws and regulations are unclear and contradictory. This facilitates government abuse and rent-seeking. Three, the exploration and exploitation of natural resources are complex undertakings. Rights holders, companies with exploration and production rights, have to collaborate with dozens if not hundreds of highly specialized subcontractors (NRGI 2018). The sheer number of contractors involved in any given project makes it challenging for rights holders to assure their subcontractors comply with good corporate governance principles as well as international and domestic laws and regulations. In addition, the important role subcontracting plays in many areas of natural resource exploitation also provides unscrupulous rights holders with opportunities to "outsource" corruption.

2. Corruption Eradication Strategies under Regulatory Capitalism

Since the collapse of the Soviet Union in 1991, neoliberalism may have become the dominant form of capitalism *ideologically*. However, *in practice*, a different type of capitalism, regulatory capitalism, has come to dominate economies around the world since the late 20th century (Braithwaite 2008a: 8).

In other words, rather than *laissez-faire* capitalism and the deregulation of economies, regulatory capitalism, under which the state regulates economic activity, has become ubiquitous, as the prevalence of audit agencies, regulatory bodies, and oversight organizations shows. Such agencies are supposed to guarantee the smooth operation of capitalism because regulatory capitalism sees such entities as part of the bureaucracy and therefore "above politics."

Regulatory capitalism not only places great hope in state agencies but also in private sector companies. Proponents of regulatory capitalism argue that self-regulation may protect corporations from reputational and legal risks at a time when companies are increasingly expected to have a "sound triple bottom line" (Braitwhaite 2008a: 7), and care about the economic, financial and social consequences of their activities.[2]

[2] A more cynical view would be that private sector companies have an incentive to self-regulate because it keeps potential competitors, which do not have the means to comply with complex regulations, from entering the market (Rogers 2003: 159).

Oversight Agencies and "Focal Companies" Tasked with Curbing Corruption

The rise of regulatory capitalism has resulted in a broad range of suggestions for how to combat corruption in natural resource-based supply chains. However, most of the proposed solutions can be subsumed under two broad categories: first, the establishment of oversight agencies; and second, creating incentives for so-called focal companies – major businesses that are typically the prime contractors in projects including exploration and production (E&P) companies as well as engineer, procurement and construction (EPC) companies – to self-regulate and thereby become transmission belts for good corporate governance principles for the entire sector.

In developing countries, where natural resource exploitation is concentrated, numerous oversight bodies and industry regulators have been established since the 1990s. Multi-lateral donor agencies such as the International Monetary Fund (IMF) or the World Bank have often encouraged (and financed) the creation of such regulatory- and oversight-bodies. Civil society organizations such as Transparency International or the Natural Resource Governance Institute (NRGI), founded and directed by former World Bank employees, also believe in the ability of regulatory agencies to contain corruption in natural resource-based supply chains.

Furthermore, focal companies are expected to introduce good corporate governance principles to the sector they are operating in. Spatial fragmentation has always been a major limitation to regulatory capitalism in general and the regulatory state in particular. Economies where small and medium-sized companies are the characteristic forms of business are much harder to regulate (and oversee) than economies where a few large business clusters dominate. Hence, the "regulatory reach of contemporary capitalism would be impossible without the lumpiness of a commerce populated by big businesses that can be enrolled to regulate smaller businesses" (Braithwaite 2008b: 414). In this context, great hopes have been placed in the regulatory capacity of big corporations or industry leaders. Scholars have claimed that "a focal company is necessary to coordinate the actions of members of the supply chain, and that the successful management of supply chains is strongly correlated with the existence of constructive and active leadership" (Silvestre 2015: 165). In short, proponents of regulatory capitalism believe that "focal companies" will inject good corporate governance principles into resource-based supply chains in countries where state capacity is limited due to "environmental turbulence" and "institutional voids" (Silvestre 2015: 156).

Technical Solutions for Political Problems?

Arguably, regulatory capitalism's faith in the potential of government regulators and "focal companies" to contain corruption in natural resource-based supply chains is, if not outright misplaced, at least overly optimistic. This is because such proposals either ignore or downplay the political context in which regulatory agencies and focal companies are embedded.

Natural resource extraction predominantly occurs in countries where corruption is systemic and endemic. This means that the regulatory framework for combating corruption in natural resource-based supply chains is not the "technocratic" solutions standing "above politics" that proponents of regulatory capitalism portray it to be. Instead, local rules and regulations are usually an expression of power dynamics within a country. Hence, regulatory agencies often become important nodal points in corruption networks that reach deep into the natural

resource sector (Bilal 2017) and the enforcement of rules and regulations is often selective as a result.

Furthermore, expectations for big corporations to self-regulate in light of weak or absent state enforcement of regulations are equally problematic. Corporations in the natural resource sector may simply not have the capacity to enforce good corporate governance practices across supply chains with hundreds of subcontractors. In fact, the politicized regulatory framework of a host country may make it difficult even for foreign-listed corporations to comply with transnational legislation aimed at curbing corruption such as the Foreign Corrupt Practices Act (FCPA) or the Anti-Bribery Act UK 2010 (UKBA). Again, local political conditions are important determinants of focal companies' potential to curb corruption in natural resource based-supply chains.

3. Indonesia's Upstream Oil and Gas Sector

Indonesia's upstream oil and gas sector is an ideal vantage point from which to critically examine the capacity of regulatory agencies and focal companies to contain corruption in natural resource-based supply chains. This is for two main reasons: One, corruption has been rampant in Indonesia's extractive sector for decades (Seda 2005), due to a combination of a predatory oligarchy dominating the political system (Winters 2011), a byzantine bureaucracy (Buehler 2011), and a complex, often contradictory, regulatory environment (Smith 2007). Two, Indonesia's upstream oil- and gas-sector relies on regulatory agencies and "focal companies" to combat corruption in the sector's complex supply chains. Over the last two decades, rights holders and subcontractors have become subject to an ever growing number of transnational rules and domestic laws aimed at curbing corruption in the extractive industries. Regulatory capitalism, in other words, is the modus operandi for fighting corruption in Indonesia's upstream oil and gas sector.

A few words on how corruption is understood in the remainder of this article are necessary prior to an analysis of the regulatory framework that was set in place after the fall of Suharto in 1998 to mitigate corruption in Indonesia's upstream oil and gas sector.

3.1 How "Corruption" is Defined under Indonesian Law

While corruption is commonly defined as the abuse of public power for private gain, a broader understanding of corruption is used in this analysis. This is for several reasons: One, many people engage in corruption not only for *private* gain but to further the interests of the company they are working for; because they want to secure their job; or because they are eager to get promoted (Curry 2014:3; Piper 2017: 31). Two, the main Indonesian laws against corruption, Law No. 31/ 1999 on the Eradication of the Criminal Act of Corruption and Law No. 20/ 2001 Concerning Amendment of Law No. 31/ 1999 on the Eradication of the Criminal Act of Corruption define corruption in broader terms than the standard definition of corruption does.[3] According to Indonesian law, criminal acts of corruption include activities that cause a "loss to the state's finances; related to bribery; related to malfeasance; related to extortion; related to tort; related to conflict of interest in procurement; and related to gratuity" (GLG 2019, online). Both laws also punish bribe-taking and bribe-giving.

[3] There is also Law No. 11/ 1980 Regarding Bribery adopted in 1980 that outlines punishments for everyone bribing an Indonesian official. Since 1998, the GoI has also issued over a dozen regulations and decrees that amend and expand the two aforementioned laws (Prabandani 2016).

It is important to emphasize that Indonesian laws and regulations on the eradication of criminal acts of corruption only sanction the bribing of a *public* official or if a loss to the *state*'s finances occurs. If individuals who are *not* employed by the Government of Indonesia (GoI) or any of the State Owned Enterprises (SOE) and only private sector companies are involved in the kind of activities listed above, this does not qualify as corruption under Indonesian law. Aforementioned activities between such individuals would therefore be tried for fraud or embezzlement under Indonesia's Criminal Code (GLI 2019, online).

Nevertheless, the different types of criminal acts of corruption as defined under Indonesian law *directly* or *indirectly* affect the majority of subcontractors in Indonesia's upstream oil and gas sector.

The laws *directly* affect anyone working for an SOE or any subcontractor in a commercial relationship with an SOE who engages in any of the aforementioned activities. Such individuals can be charged with corruption as a *state* entity is directly involved in the activity.

Indonesian laws also apply *indirectly* to subcontractors in the private sector, even though they may not be in an immediate commercial relationship with the GoI or an SOE. To understand how these laws apply to subcontractors that are not in a direct commercial relationship with the GoI, a brief account of the contractual arrangements between the GoI and rights holders that regulate the exploration and exploitation of oil and gas across the archipelago state is necessary.

Contractual Arrangements in Indonesia's Upstream Oil and Gas Sector

A concession system dominated the early years of commercial oil and gas production around the world. Under such a system, governments provided concessions to (mostly foreign) oil and gas companies. In a concession system, a government signs the ownership of natural resources over to a company for a clearly defined territory during a limited period of time.

After growing criticism about the "colonial" nature of such arrangements, the sector looked for other forms of contractual agreements between governments and oil and gas companies. In this context, Indonesia pioneered Production Sharing Contracts (PSCs) in the 1960s (Fabrikant 1973). Under a PSC, a government maintains its ownership of natural resources at all times. It merely contracts a company to extract the resources on behalf of the government. After PSCs had been introduced in Indonesia in 1966 (Fabrikant 1973: 15), they quickly became the dominant contractual arrangement in the upstream oil and gas sector in developing countries around the world.

An important part of PSCs is the cost-recovery mechanism. It stipulates that rights holders can reclaim costs associated with the exploration and exploitation of oil and gas from the GoI before any oil and gas revenues are due to the Indonesian state.[4]

It is because of this cost-recovery mechanism that even contractors and subcontractors that are *not* in a direct commercial relationship with the Indonesian state are subject to the country's laws and regulations against corruption. Concretely, if a rights holder purchases

[4] While cost-recovery was already an integral part of the first PSCs adopted in 1966 (Fabrikant 1973: 18), Government Regulation No. 79/ 2010 on Operating Costs That Can Be Recovered And Treatment For Income Tax In The Upstream Oil And Gas Business Sector most recently outlined the expenses that can be reclaimed from the Indonesian state.

goods or services from a subcontractor through a tender or procurement process whose integrity has been compromised through, for instance, bid rigging or the misclassification of goods by the subcontractor, and if such subpar goods or services are subsequently billed to the GoI by the rights holder through the cost-recovery PSC, a "loss to the state" has occurred and the Indonesian corruption laws will therefore apply. In other words, a private sector subcontractor, even if not directly engaging with the GoI, is tied to the Indonesian state through the rights holder's supply chain and the cost-recovery mechanism that subjects the rights holder to Indonesia's anti-corruption laws. This legal arrangement creates, at least theoretically, incentives for rights holders to combat corruption in their supply chains.[5]

3.2 The Regulatory Framework Aimed at Curbing Corruption in Indonesia's Upstream Oil and Gas Sector Supply Chains

Indonesia's upstream oil and gas sector is complex. While there were only a few foreign rights holders left operating in Indonesia at the time of writing, including Chevron Pacific Indonesia, Total E&P, ConocoPhillips, and ExxonMobil (ICLG 2019)[6], there were 6947 vendors and suppliers in Indonesia's upstream oil and gas sector as of 2016 (ACE-SOAS 2018: 5).

In most countries, "[i]nternational major petroleum and mining companies and most major OFS [Oilfield Services], EPC [Engineering, Procurement, and Construction] and other contractors are subject to a range of regulations that set a minimum standard for procurement anticorruption and compliance" (Martini 2014: 7). This is also the case in Indonesia.

Since the fall of the Suharto regime in 1998, a complex regulatory environment has emerged that aims at containing corruption in supply chains in the upstream oil and gas sector. Consequently, the awarding of subcontracts in Indonesia's upstream oil and gas sector is subject to various rules and regulations. A number of government entities are tasked with monitoring compliance with this complex regulatory framework. The following section will review regulations and rules set out in transnational norms and domestic laws and regulations as well as by the Special Task Force for Upstream Oil and Gas Business Activities (SKK Migas – *Satuan Kerja Khusus Pelaksana Kegiatan Usaha Hulu Minyak dan Gas*). This is to provide a backdrop to the subsequent analysis of why regulatory capitalism has struggled to curb corruption in Indonesia's upstream oil and gas sector supply chains.

3.2.1 Transnational Norms and National Laws and Regulations

Transnational Norms

There are various transnational norms that can be mustered to curb corruption in supply chains in Indonesia's upstream oil and gas sector.

Indonesia is a party to the United Nations Convention Against Corruption (UNCAC), which the Indonesian national parliament ratified with Law No. 7/ 2006 Regarding the Ratification of UNCAC in 2006. In addition, Indonesia is a party to the United Nations Convention

[5] Companies operating in Indonesia but listed in the United States of America and/ or the United Kingdom have additional incentives to combat corruption in their supply chains as they fall under transnational bribery regimes such as the FCPA and the UKBA mentioned above. I will elaborate below on the challenges these companies face when it comes to adhering to these transnational bribery regimes in places such as Indonesia.

[6] No major foreign oil company has invested in Indonesia's upstream oil- and gas-sector since 2017.

against Transnational Organized Crime (UNTOC), which was ratified by the Indonesian national parliament with Law No. 5/ 2009 Regarding the Ratification of UNTOC in 2009.

Furthermore, companies operating in Indonesia but which are organized under United States law, have their principal place of business in the United States, are listed on a stock exchange in the United States, or otherwise have the necessary territorial connections to the United States are subject to the US Foreign Corrupt Practices Act (FCPA), which was adopted in 1977.[7] Furthermore, in July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act become federal law in the USA. Section 1504 of the Dodd-Frank Act imposed "new disclosure and reporting obligations on extractive industry companies that are issuers of securities with the SEC [the US Security and Exchange Commission], pertaining to their operations in foreign countries" (Topal and Toledano 2013: 279). Section 1504 is usually referred to as the Transparency Amendment and was modelled after the Energy Security Trough Transparency Act (ESTTA) of 2009. In 2012, the SEC also issued rules about the Transparency Amendment, after which it became binding.[8] After the Transparency Amendment was first challenged in court, then re-introduced, only to be struck down again through a Congressional Review Act in 2016, the SEC proposed a reduced version of the Transparency Amendment in December 2019. The new proposal had yet to be adopted at the time of writing. Likewise, any individual or company with links to the United Kingdom is subject to the UK Bribery Act 2010 (UKBA), which was adopted in 2011 pursuant to the requirements of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Persons subject to the jurisdiction of the implementing legislation in the 43 countries that have ratified the OECD convention can be prosecuted if they bribe a public official in Indonesia.[9]

In addition to these transnational norms, the Extractive Industry Transparency Initiative (EITI) was launched in 2002 by former World Bank employees with the goal to create a transnational governance framework for the extractive industries. The EITI aims at increasing accountability by improving transparency in the extractive industry through stipulations that require companies to publish what they pay to governments while governments publish receipts of what they have received. Indonesia began working towards compliance with EITI requirements in 2009 and became a full member in 2014.[10]

Finally, the International Organization for Standardization (ISO) has also designed several corruption eradication systems including the ISO 9001: 2015 on Quality Management and the ISO 37001: 2016 Anti-Bribery Management Systems. These are purely voluntary standards but some contractors in Indonesia have begun working towards compliance with these ISO

[7] The FCPA applies to all US companies, whether SEC registrants or not, and to foreign companies as well as US companies that are SEC registrants, as well as foreign companies that are not SEC registrants but commit an act in furtherance of a corrupt practice while in US territory.

[8] There is no Indonesian law that makes it illegal for an Indonesian citizen to bribe a foreign official. However, Indonesia has signed Memoranda of Understanding (MoU) with several Asian countries, including with South Korea's Independent Commission Against Corruption on Mutual Cooperation on Combating Corruption; with the People's Republic of China's Ministry of Supervision; with Vietnam's Government Inspectorate; and an International Cooperation on Combating Corruption with India's Central Vigilance Commission (Sidharta and Ratna 2015: 90).

[9] For a list of the 43 countries that had ratified the OECD Anti-Bribery Convention as of May 2019, see https://www.oecd.org/corruption/oecdantibriberyconvention.htm Indonesia is not a party to the OECD Anti-Bribery Convention but has observer status.

[10] It is important to note that EITI is not directly operative at the national level but requires legislation by the participating countries.

standards. Likewise, SKK Migas, the Special Task Force for Upstream Oil and Gas Business Activities, had adopted ISO 9001: 2015 as a standard to procure goods and services at the time of writing.

National Laws and Regulations

In addition to these transnational norms, SOEs operating in Indonesia's upstream oil and gas sector, subcontractors in direct commercial relations with SOEs, as well as subcontractors working for a rights holder that has signed a cost-recovery PSC with the GoI, are all subject to Indonesia's aforementioned anti-corruption laws as well as the country's public procurement regulations. A few words on Indonesia's public procurement system are therefore in order.

Public procurement in Indonesia has a checkered past. Corruption in public procurement has been rampant ever since Indonesia became an independent nation state in 1949. However, corrupt practices became more institutionalized during the New Order military dictatorship, which lasted from 1965 until 1998. In 1980, President Suharto issued Presidential Decree No. 10/1980.[11] The decree established the Control Team for the Procurement of Government Goods, also known as "Team 10." Team 10 was under the direct control of President Suharto. Due to Team 10's proximity to Suharto, over U$ 60 billion in procurement contracts were channeled to loyalists and friends of the military dictator during the eight years Team 10 was active (Winters 2011: 164). A few players close to Suharto continued to control the procurement process after Team 10 was abolished. A narrow circle of New Order elites not only decided who was allowed to participate in public procurement tenders but also enacted and enforced entry barriers on these cartels. Suharto himself regulated access to projects through a "politics of proximity" in which he favored crony capitalists, military generals and an increasing number of family members towards the end of his reign.

At the local level, Suharto controlled access to the construction industry through various organizations. Potential spoilers to this procurement cartel were kept in check through one of almost two dozen corruption eradication agencies that were established during the New Order. Everyone who accepted the rules set out by Suharto and his cronies was relatively safe from prosecution for corruption and collusion during the procurement process.

After the collapse of the New Order dictatorship in 1998, the GoI formally committed to comprehensive public procurement reforms. While Indonesia had yet to adopt a national procurement law at the time of writing, there are several decrees and regulations that, although of lower status in Indonesia's legal hierarchy than laws, have created a comprehensive regulatory framework for government procurement in Indonesia. Presidential Decree (Keputusan Presiden) No. 80/2003 on public procurement was adopted in 2003. The decree superseded previous presidential decrees and also took precedence over subnational procurement regulations. The decree regulated procurement of all goods, works and services that are paid through public funds. It applied to all levels of the state apparatus.

In 2010, Presidential Regulation (Peraturan Presiden) No. 54/ 2010 on Public Goods and Services Procurement replaced Presidential Decree No. 80/ 2003. In addition to streamlining stipulations from the previous decree, Presidential Regulation No. 54/ 2010 required

[11] Presidential Decree No. 29/ 1984 regulated government contracts but the oil industry was exempt from this decree (Pompe 1992: 254). It is therefore not discussed here.

permanent procurement service units (PSU) (ULP - Unit Layanan Pengadaan) to be established at both the national and subnational level. It further required that procurement units at both the national and subnational level had to conduct procurement through an electronic procurement system (LSPE- Layanan Pengadaan Secara Elektronik) system by 2012 (MCC 2017: 1). Presidential Decree No. 70/ 2012 on the Second Amendment of Presidential Decree No. 54/ 2010 reiterated and specified the requirements for PSUs.

In 2015, Presidential Regulation No. 4/ 2015 amended Presidential Regulation No. 54/ 2010. It specified rules for procurement collaterals such as advance-payment bonds, bid bonds, maintenance bonds, objection appeal bonds and performance bonds. On 22 March 2018, Presidential Regulation (Peraturan Presiden) No. 16/ 2018 on the Public Procurement of Goods and Services replaced Presidential Regulation No. 54/ 2010. The new rules regulate the procurement process of all entities that are fully or partially funded by the GoI. PP No. 16/ 2018 streamlined and simplified the procurement process to which government entities are subjected. The regulation also shifted the focus of controls from executing public procurement towards the budgeting and planning phase of public procurement [12] and strengthened the position of the National Public Procurement Agency (LKPP - Lembaga Kebijakan Pengadaan Barang/Jasa Pemerintah) that was established in 2005. PP No. 16/ 2018 provided LKPP with the authority to draft and issue the implementing regulations for the decree.

In addition to the aforementioned presidential decrees and regulations that focus exclusively on public procurement, several new laws were issued after 1998 that *indirectly* contribute to Indonesia's public procurement system. For example, the State Finances Law No. 17/2003, the State Treasury Law No. 1/2004 and the State Audit Law No. 15/2004 all contain paragraphs on public procurement mechanisms. A construction law dating from 1999 also stipulates regulations on the procurement of civil works and consulting services as does Indonesia's Competition Law No. 5/1999.. Presidential Decree No. 85/ 2006 on the sixth amendment of Presidential Decree No. 80/ 2003 put forward various rules on preventing bribery and other corrupt practices in public procurement (Supandji 2007: 152). Law No. 2/ 2017 on Construction Services also contains stipulations on procurement.

In addition to these regulations on public procurement that apply to subcontractors providing goods and services to SOEs, as well as subcontractors working for rights holders that have a cost-recovery PSC with the GoI, there are also procedures set by the oversight agency SKK Migas that regulate the awarding of subcontracts in Indonesia's upstream oil and gas sector. These will be discussed in the next paragraph.

3.2.2 The Special Task Force for Upstream Oil and Gas Business Activities (SKK Migas)

The collapse of the New Order military dictatorship in the context of the Asian financial crisis in 1998 paved the way for political and economic reforms in Indonesia. In exchange for development aid, multi-lateral donor agencies such as the World Bank and the International Monetary Fund (IMF) required the GoI to implement governance reforms in a variety of fields, including the natural resource extraction sector. In this context, the Indonesian national parliament adopted Law No. 22/ 2001 Concerning Oil and Gas. The law ended the monopoly

[12] Interview with Informant 4 (22 December 2018). In the past few years, controls over the actual procurement process have become rigid enough for corruption to shift towards the budgeting and planning phase of public procurement projects. The new regulation addresses this reality by paying more attention to containing corruption in the budgeting and planning stage of the public procurement process.

of state-owned oil company Pertamina over the energy sector. In addition, it aimed at increasing transparency and accountability by revoking Pertamina's right to regulate the oil and gas sector. The new law also established an independent regulatory agency called Oil and Gas Upstream Business Activities Operational Agency (BP Migas-Badan Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi). BP Migas' task was to establish an accountable and transparent regulatory framework for the energy sector and assure companies operating in the oil and gas sector complied with it.

However, in 2012, the Constitutional Court argued that Law No. 22/ 2001 and the creation of BP Migas had violated Article 33 of the Indonesian constitution, which requires natural resources to be under the control of the state (Taufik 2016). Consequently, the law was revoked and BP Migas was abolished the same year (Davidson 2015: 109).

After the Constitutional Court decision, the national parliament began debating a new law for the oil and gas sector. Despite almost seven years of deliberation, at this writing, the Indonesian legislature has yet to reach an agreement on a draft.

However, already in 2013, then Indonesian president Susilo Bambang Yudhoyono issued presidential regulation No. 9/ 2013. It established the Special Taskforce for Upstream Oil and Gas Business Activities (SKK Migas – Satuan Kerja Khusus Pelaksana Kegiatan Usaha Hulu Minyak dan Gas Bumi), which replaced BP Migas. SKK Migas is situated within the Ministry of Energy and Mineral Resources (MEMR), which issues policies and monitors the upstream oil and gas sector, mainly through its Directorate General of Oil and Gas (MEMR 2018, online). The Indonesian president directly appoints the chair of SKK Migas.

SKK Migas has various tasks. The oversight agency signs PSCs on behalf of the GoI. It then monitors companies operating in the upstream oil and gas sector to assure they comply with the rules and requirements stipulated in their PSCs. SKK Migas also has to approve a company's annual Work Programme and Budget (WP&B). Finally, SKK Migas publishes operating guidelines for works in the upstream oil and gas sector and audits companies (Braithwaite et al. 2010: 19). In this context, SKK Migas also issues and monitors tender and procurement rules.

The most recent SKK Migas publications on tender and procurement rules for rights holders and subcontractors in Indonesia's upstream oil and gas sector, and therefore of relevance to the topic of this article, are the Revision of the Second Book on Supply Chain Management Guidelines for Production Sharing Contractors (SKK Migas 2017a) and the Implementing Guidelines for Tender (SKK Migas 2017b). The following paragraphs provide a short overview of these SKK Migas publications.

Revision of the Second Book on Supply Chain Management Guidelines for Production Sharing Contractors

The "Revision of the Second Book on Supply Chain Management Guidelines for Production Sharing Contractors" (SKK Migas 2017a) aims at accelerating and simplifying the tender process in the upstream oil and gas sector.[13] The regulations cover "the whole activities of the procurement of goods/service, except the procurement of land, lawyer/legal consultant

[13] The GoI hoped this would stimulate exploration and production of oil and gas deposits that have been in decline for years.

service and insurance, which abides by the provision in the special guidance for the procurement" (SKK Migas 2017a: Article 2.2). The document also introduced new local content requirements, an approved manufacturer list (AML), and a Centralized Integrated Vendor Database (CIVD).

SKK Migas is in charge of monitoring compliance with the rules outlined in the document. In this context, rights holders that have signed a cost-recovery-based PSC with the GoI have to submit detailed lists of the goods and services they intend to purchase based on a Plan of Development (PoD), Plan of Further Development (PoFD), Put on Production (PoP) and/ or a Work Program and Budget (WP&B) and/ or a plan of work/ activity that have already been approved by SKK Migas. Such procurement lists then need to be approved by SKK Migas if the value of the goods and services purchased exceeds a certain amount.

SKK Migas' tender and procurement guidelines also list exceptions to these rules as well as sanctions that will be imposed if rules are violated.

Implementing Guidelines for Tender

SKK Migas' "Implementing Guidelines for Tender" (SKK Migas 2017b) specify the procurement of goods and services for activities in the upstream oil and gas sector conducted under the Revision of the Second Book on Supply Chain Management Guidelines for Production Sharing Contractors (SKK Migas 2017a) outlined above. The Implementing Guidelines include specified tender timelines, issued regulations supportive of enhanced oil recovery (EOR), created an e-catalogue for the purchase of goods and services, and established an Approved Manufacturer List (AML) as well as a Centralized Integrated Vendor Database (CIVD).

To summarize, the paragraphs above showed how transnational norms as well as national laws and regulations try to hold focal companies accountable for corruption within their supply chain, implicitly relying on such companies to regulate their supply chains. In addition, SKK Migas is in charge of implementing and monitoring a complex regulatory framework aimed at preventing corruption in upstream oil and gas sector supply chains. This shows that "regulatory capitalism" has become the modus operandi in Indonesia's upstream oil and gas sector since 1998.

The following paragraphs will scrutinize the assumptions of regulatory capitalism on how to achieve sustainability in natural resource based supply chains by critically examining the capacity of Indonesia's main regulatory agency SKK Migas and "focal companies" to combat corruption in supply chains in the upstream oil and gas sector.

4. The Political Economy of Regulatory Capitalism

The exploration and exploitation of oil and gas in Indonesia has a long and turbulent history, dating back to at least 1849 (Lindblad 2006). "Exploratory drilling began in 1871. The first petroleum concession was granted by the colonial government in 1883 for exploration in North Sumatra and the first commercial discovery was made there two years later" (Fabrikant 1973: 1-2).

The exploitation and exploration of oil and gas was regulated in the Dutch East Indies' first mining law, which was adopted in 1907 (Fabrikant 1973: 2).[14] The law introduced a concession system for the exploration and exploitation of oil, as already mentioned above. Since the colonial government granted full ownership of oil and gas deposits to concessionaries for a given period of time, the emerging nationalist movement called for an end to the concession system. Consequently, the first constitution of Indonesia ratified in 1945 declared that all natural resources on the territory of the republic belong to the state.

Theoretically, the concession system was thereby void. However, the turbulent decade after independence, characterized by weak state capacity and political instability, prevented sweeping changes in the way oil and gas exploration and exploitation was organized (Fabrikant 1973: 1-4). Only after the GoI adopted Law No. 44/ 1960 on Petroleum and Natural Gas Mining did the sector experience an overhaul *in practice*. The law did not specify the relationship between the GoI and oil companies but stipulated that it is "entirely to the discretion of the Government to determine the contents of each of the contract [sic]" (Fabrikant 1973: 15).

It is against this backdrop that the first Production Sharing Contract was signed on 18th August 1966 between Permina, then the state oil company, and the Independent Indonesian American Petroleum Company (IIAPCO) (Fabrikant 1973: 22). While the broad terms of this PSC and subsequent PSCs were public, details about specific contracts between the GoI and oil companies were not (Fabrikant 1973: 23). In short, contract transparency in Indonesia's oil and gas sector was absent from the start.

Two years later, Pertamina, the state oil company, created in 1968 through a merger between Pertamin and Permina, was tasked with regulating and overseeing the oil and gas sector. This dual role as both a regulator and a commercial enterprise facilitated conflicts of interest. Soon, Pertamina became synonymous for corrupt and collusive business practices, a reputation it kept throughout the New Order.

4.1 Regulatory Agencies and Corruption in Indonesia's Upstream Oil and Gas Sector

In light of the endemic corruption and rent-seeking in the upstream oil and gas sector, multi-lateral donor agencies demanded the creation of an independent oversight agency for the sector after the collapse of the New Order dictatorship in 1998. To this end, Law No. 22/ 2001 was adopted in 2001 and BP Migas was established, which eventually morphed into SKK Migas in 2012, as mentioned above.

However, rather than being a neutral regulator standing above politics as envisioned by proponents of regulatory capitalism within the GoI and multilateral donor agencies, BP Migas and SKK Migas immediately became part of corruption networks that span across Indonesia's upstream oil and gas sector.

SKK Migas' responsibility to regulate the upstream oil and gas sector and assure that rights holders and contractors comply with these rules, as mentioned above. This provides SKK Migas with tremendous power to extort payments and rents from companies should it wish to do so. At the same time, SKK Migas' strategic position within the ecology of Indonesia's upstream oil and gas sector makes the regulatory agency also vulnerable to predatory

[14] The law itself was based on the East Indies Mining Law of 1989 (Fabrikant 1973: 2).

behavior emanating both from the public and private sector. A brief account of several past corruption cases that involved SKK Migas leaders shows that the regulatory agency has acted as both a bribe-payer and a bribe-taker.

From the start political elites with entrenched interests in the oil and gas sector criticized Law No. 22/ 2001 and the regulatory oversight agency BP Migas, SKK Migas' predecessor, as tools of foreign intervention in Indonesia's natural resource sector. However, the attacks on Law No. 22/ 2001 and BP Migas were not so much triggered by patriotic feelings but the result of infights between different political parties over the spoils from subcontracting in Indonesia's upstream oil and gas sector. As an energy analyst wrote about Raden Priyono, BP Migas' chairman in 2011:

> "Despite being an efficient and decisive [BP Migas] chairman, Priyono did not always observe the nation's anti-corruption laws. [A BP Migas] contact recounts how subcontractors that wanted to have their bids decided upon favorably by BP Migas were typically directed by Priyono to visit parliamentarians from selected political parties. Priyono would direct one subcontractor to a parliamentarian from one party, the next subcontractor to a parliamentarian from the next party, and so on, so that largesse would be spread equally between parties. Visited parliamentarians would request payment in exchange for their willingness to recommend to Priyono that favorable consideration be given to that subcontractor.
>
> Priyono would send would-be subcontractors to large, secular parties (like the at-that-time ruling Democrat Party, the Suhartoist Golkar party and the nationalist PDI-P party), but tended not to send the contractors to smaller Islamic parties (like PAN, PKB, PBB, and PPP). These smaller, and (at that time) out-of-favor parties (and/or in some case, their affiliated religious organizations) rebelled, and eventually brought a challenge against BP Migas to the Constitutional Court. The head of the court at that time, Mahfud Mahmodin, who was close to these Islamic parties, helped to bring about a ruling that [BP Migas] was unconstitutional."[15]

After the Constitutional Court had declared BP Migas unconstitutional, its successor SKK Migas continued to be embroiled in corruption cases. In August 2013, Indonesia's Corruption Eradication Commission (KPK - Komisi Pemberantasan Korupsi) arrested then SKK Migas Chair Rudi Rubiandini. He eventually pleaded guilty to having accepted bribes from three contractors, namely Fossus Energy (U$ 900,000), PT Kaltim Parna Industry (U$ 522,000) and Kernel Oil (U$ 159,000). These contractors had paid bribes to either expedite or influence the approval process of project proposals submitted to SKK Migas.

Rubiandini claimed that he had requested bribes from contractors because he himself had been asked for payments. Sutan Bhatoegana, a member of the Indonesian national parliament and then Chairman of Commission VII that oversees Energy, Mineral Resources, Research and Technology and Environmental Affairs, had asked Rubiandini for a U$ 10,000 "Lebaran bonus" for each of the 54 legislators in Commission VII (Septian et al. 2014: 20). This was to celebrate the end of the Holy Month of Ramadan, a time of spiritual reflection, personal improvement and introspection in Indonesia. The payment to these MPs was necessary, Rubiandini told prosecutors, to have parliament approve the budget for the Ministry of Energy and Mineral Resources (MEMR). Rubiandini also claimed that then Energy Minister

[15] Email conversation with Informant 21 (9 December 2018).

Jero Wacik too had asked him to pay off MPs in Commission VII in order to have the budget for the MEMR approved.

Just how entrenched the practice of demanding payments in exchange for approving budgets is was shown by Rubiandini's second confession to KPK investigators: Another reason for why he had asked oil and gas contractors for bribes was that Bhatoegana and other members of Commission VII had asked Rubiandini to pay another U$ 1 million in addition to the aforementioned "Lebaran bonus." The U$ 1 million had been promised to Commission VII by Raden Priyono when he was chair of BP Migas, the predecessor of SKK Migas, between 2008 and 2012, according to Bhatoegana. Since BP Migas had been dissolved before it had paid off the MPs in Commission VII, SKK Migas had to foot those "debts", Bhatoegana argued according to Rubiandini's confession to the KPK (Septian et al. 2014: 20).

These vignettes about the involvement of high-level BP Migas and SKK Migas staff in various corruption schemes should not suggest, however, that corruption surrounding the oversight agency for Indonesia's upstream oil and gas sector can be reduced to incidents of *individual* corruption. Rather, corruption surrounding the oversight agency is *systemic*. This is shown by the following excerpt from an unpublished report by an energy sector analyst:

> "SKK Migas has five deputyships: planning; operations; commercial affairs; business support; and finance."
>
> Deputy of Operations
>
> As the name suggests, the office of the Deputy of Operations advises PSCs on how to improve operations, and considers itself to be involved in "project management." Significantly, it also determines the specifications of subcontracts that will be put out to procurement.
>
> Chairman Sunaryadi sacked Iwan Ratman, one of the four division heads inside the office of the Deputy of Operations, after the latter confessed to conveying illicit funds to former SKK Migas Chairman Rubiandini.
>
> Deputy of Business Support
>
> The office of the Deputy of Business Support oversees the actual procurement of subcontracts by PSCs.
>
> According to an SKK Migas insider, the office of the Deputy of Business Support is most responsible for "conveying gratification" – aka paying bribes – to parliament. Widjonarko was the head of this office, which at that time was known as General Affairs, before leaving the post to become SKK Migas vice chairman and then acting chairman. Gerhard Rumeser also served as Deputy of General Affairs before moving to the position of expert staff. Both were found by the Jakarta Corruption Court to have passed along bribes to former Chairman Rubiandini, and both were sacked by Chairman Sunaryadi."[16]

[16] Email conversation with Informant 21 (11 December 2018).

Eventually, SKK Migas chair Rubiandini was sentenced to seven years in jail for corruption and money laundering in April 2014.[17] Member of Parliament Sutan Bhatoegana was sentenced to 10 years in jail in August 2015 (Jakarta Post 2015) but died in November 2016. Energy Minister Jero Wacik was sentenced to four years in jail in February 2016 in the context of a different corruption case.[18] Finally, former BP Migas chair Raden Priyono was arrested together with his former deputy for finance, Djoko Harsono, in February 2016 in the context of another corruption case. Raden Priyono was accused of having directly appointed Trans-Pacific Petrochemical Indotama (TPPI) although BP Migas own rules would have required an open tender (Arnaz 2016). The case against Raden Priyono was on-going at the time of writing (Tribun Timur 2018).[19]

To summarize, several staff BP Migas and SKK Migas staff at the highest level abused their powerful positions as gatekeepers to contract approvals in the upstream oil and gas sector, as the accusations and verdicts against former chairs of these regulators Raden Priyono and Rudi Rubiandini show. At the same time, high-level BP Migas and SKK Migas figures accepted and demanded bribes also because they themselves were constantly asked for payments from both their superiors in the MEMR as well as members of the Indonesian national parliament. This shows that corruption at SKK Migas cannot be simply dismissed as the personal transgression of isolated individuals.[20] Rather, the regular demands for payments from a broad range of players show that corruption is systemic and endemic. It also shows that the main oversight agency in charge of monitoring supply chains in the upstream oil and gas sector was a perpetrator as well as a target of corruption.

4.2 Focal Companies and Corruption in Indonesia's Upstream Oil and Gas Sector

To improve the image of SKK Migas after the arrest of chairman Rubiandini for corruption, Amien Sunaryadi, a deputy chair of the Corruption Eradication Commission between 2003 and 2007, was appointed chairman of the regulatory agency in 2014. Sunaryadi had no previous experience in the energy sector. However, he adopted several measures that were aimed at improving accountability and transparency within SKK Migas. For instance, Sunaryadi believed that contractors tried to bribe SKK Migas personnel because the regulatory agency took too long to approve contracts. This resulted from the fact that SKK Migas had to approve an enormous number of contracts. Many of these contracts were low value contracts. Overburdened by the sheer number of contracts that needed approval, SKK Migas became very inefficient. Project delays and the costs associated with it therefore often created perverse incentives for contractors to bribe SKK Migas in order to expedite contract approvals, according to Sunaryadi (Tempo 2015). To address this issue, Sunaryadi raised the ceiling for contract values that needed SKK Migas approval from U$ 5 Million to U$ 20

[17] Another indication that corrupt activities within SKK Migas were a regular occurrence in the past were the newspaper articles that surfaced after the arrest of Rubiandini. Allegedly, Rubiandini had been reported to the Corruption Eradication Commission by disgruntled former BP Migas employees who had not received jobs after BP Migas had been transformed into SKK Migas in 2013 (Hamid 2013). In Indonesia, superiors often tolerate, even encourage, corrupt practices by their staff in order to protect themselves from corruption allegations by employees (Conkling 1979).

[18] Wacik had embezzled almost U$ 600,000 from the MEMR's operational funds to finance personal expenses (The Straits Times 2016).

[19] Karaya Warnika, another former chair of BP Migas was interrogated by the KPK, in 2014. However, he was never declared a suspect.

[20] See Buehler 2019 for an argument about how a moralistic understanding of corruption propagated by Indonesia's Corruption Eradication Commission has been counterproductive.

million.[21] To contain the risk of corrupt practices in contracts with a value below U$ 20 million, SKK Migas under Sunaryadi included a Right to Audit clause in SKK Migas Implementing Guidelines for Tender (SKK Migas 2017b). The clause also includes a requirement for subcontractors to adhere to the US Foreign Corrupt Practices Act (FCPA) as well as the United Kingdom's Anti-Bribery and Corruption Act (Tempo 2015). In other words, rights holders were given the right to audit their subcontractors to assure compliance with transnational norms such as the FCPA and the UKBA[22] as well as Indonesian laws and regulations. In short, Sunaryadi placed great hopes on "focal companies" to self-regulate and thereby contain corruption in their supply chains in the upstream oil and gas sector.

However, transnational norms against corruption in natural resource-based supply chains aimed at "focal companies" are not very effective. Transnational norms such as the FCPA, the UKBA, as well as initiatives such as the EITI have undoubtedly made it more difficult to engage in corrupt activities in Indonesia's upstream oil and gas sector. Yet, the capacity of these laws and initiatives to curb corruption remains weak as they are "either too limited in scope…or leave too much leeway in their rule-setting…" (Topal and Toledano 2013: 272).[23]

One major challenge to the effectiveness of transnational norms and conventions is their limited scope. The FCPA, the UKBA and the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions only apply to companies that meet the necessary jurisdictional nexus (in case of the FCPA); that are registered in the UK (in case of the UKBA); or that belong to one of the 43 countries that have signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.[24] This is of concern because Indonesia's upstream oil and gas sector has seen an increase of Chinese and South Korean contractors in recent years (Xin 2018). The majority of these companies are not bound by aforementioned international norms and conventions such as the FCPA and the UKBA.

In addition, legal scholars have questioned the effectiveness of these transnational norms in combatting corruption by pointing out the discrepancies between the FCPA and the UKBA. For example, the FCPA punishes bribing a *foreign official* while the UKBA outlaws bribing *any individual*. Furthermore, the FCPA differs from the UKBA in its understanding of what constitutes corruption. The FCPA punishes only the *payment* of bribes. *Taking* bribes or other forms of corruption are not covered by the FCPA. Furthermore, collusion or nepotism, which constitute a significant part of corrupt activities in Indonesia (and other resource-rich countries) are not punishable offenses under the FCPA. In fact, facilitating payments that are paid to a bureaucrat to expedite a "routine governmental action" are permitted under anti-bribery provisions of the FCPA.[25] In addition, the FCPA and the UKBA differ in their definition of intent, corporate liability and senior official liability, as well as successor liability. Finally, they define extraterritorial jurisdictional limits differently.

[21] See Anechiarico et al. 1996 and The Economist 2015 on how comprehensive regulatory frameworks against corruption can make governments as well as public and private sector companies so inefficient that the costs of containing corruption are higher than the gains of containing corruption.
[22] Interview with Informants 5 and 6 (20 December 2018).
[23] See also Sivachenko 2013: 404.
[24] These developments have stoked fears among companies listed in the USA and the UK about competitors not bound by such international laws and regulations having an unfair advantage to conduct business in the upstream oil and gas sector in Indonesia and elsewhere. In fact, this has been a concern of the business community ever since the FCPA was introduced in 1977 (Topal and Toledano 2013).
[25] However, such "grease money", referred to as *uang licin* or *uang semir* (possibly from the Dutch word smeren: to grease/ to polish) in Indonesian, is illegal under Indonesia's anti-corruption laws (GLI 2019).

These ambiguities in the definition of key concepts such as what constitutes a bribe or a corrupt act in addition to discrepancies in the stipulations between the FCPA and the UKBA "creates a level of ambiguity that makes it incredibly difficult, if not impossible, for international companies to effectively and efficiently regulate against bribery" (Hills 2014: 474). Hills identified several "practical business problems (Hills 2014: 275) these discrepancies create in addition to the challenges when it comes to pursuing affirmative defence and compliance defence strategies in court should one get sued under any of these acts (Hills 2014: 476- 477). The fact that most FCPA cases never go to trial but are usually settled through non-prosecution agreements (NPAs) and non-debarment in exchange for admission of fault and the payment of a fine shows the difficulties companies face in mounting effective affirmative defenses and compliance defenses under the vague FCPA rules. "As such, some critics have suggested that in practice, the FCPA's provisions frequently mean simply what enforcement agencies want them to mean" (Sivachenko 2013: 406). While NPAs at least allow the enforcement of FCPA stipulations to some degree, the UKBA, which does not entail the possibility of NPAs, has a poor record when it comes to enforcement. Only few cases had been brought to court under the UKBA at the time of writing (Hills 2014: 482).

Finally, some scholars have argued that the broad jurisdictional reach, especially that of the FCPA, has actually undermined effective corruption monitoring in supply chains. "[T]oday there is little a corporation can do to avoid prosecution for the unauthorized acts of its employees or the resulting hefty penalties and damaging publicity. In turn, such helplessness leads to an undesired and unexpected result: a significant drop in a corporation's incentive to vigorously monitor its own compliance and conduct" (Sivachenko 2014: 396-397).

In short, there are numerous challenges when it comes to complying with and enforcing transnational norms against corruption. Some of these challenges are the result of vague definitions as well as discrepancies in the FCPA and the UKBA. As a result, legal analysts have questioned the effectiveness of such transnational norms to combat corruption in general and in supply chains in particular (Hills 2014: 489; Sivachenko 2013: 414). It is also extremely challenging for companies to set up effective compliance programs for their supply chain contractors under these circumstances (Grieser 2008: 311-313).

The EITI's impact on mitigating corruption in the extractive industry has been qualified on different grounds. Most important, countries join the EITI voluntarily. Once a member of the EITI, a country then needs to implement disclosure rules that apply to all companies, foreign or domestic, state- or private-owned. However, the implementation of the EITI disclosure rules is at the discretion of the country. There is no guarantee, in other words, that the EITI rules are *really* implemented. "It is far easier for a country…to subscribe to international standards than to enforce them effectively" (Bayer et al 2010: 10). Several informants interviewed for this paper thought that the GoI has neither the will nor the capacity to implement the EITI.

Another longstanding critique of the EITI is the considerable leeway governments have to interpret the initiative's disclosure requirements. The lobbying of companies has led to the implementation of rather vague disclosure requirements in many countries. Often, the EITI has only resulted in the disclosure of *aggregate* data that does little in terms of increasing transparency and accountability in the extractive industry (Boldbaatar et al. 2019; Topal and Toledano 2013: 291).

This is no different in Indonesia, where the EITI has only led to the disclosure of aggregate data on revenue streams. More detailed data that would increase transparency in the upstream oil and gas sector remains unavailable. Furthermore, the EITI has failed to increase contract transparency in Indonesia's oil and gas sector. The overwhelming number of contracts in the industry is not available in the public domain (Ponsford 2018), an issue that has plagued the Indonesian oil and gas sector from the beginning, as mentioned above.

In short, the capacity of "focal companies" to curb corruption in supply chains in the upstream oil and gas sector is limited by the discrepancies in the transnational and national legal framework to which these companies are tied and which was briefly outlined above, as well as local conditions that may be an obstacle to their implementation

Finally, the role of "focal companies" in combatting corruption in the upstream oil and gas sector will be greatly reduced in the next few years as Indonesia's oil and gas sector shifts from cost-recovery PSCs to Gross-Split PSCs, as the following paragraphs will show.

A Shift from Cost-Recovery PSCs to Gross-Split PSCs

Almost from the start, the cost-recovery mechanism in Indonesia's PSCs was subject to abuse. Rights holders and contractors inflated their costs and submitted invoices for services that had not been rendered as well as goods that had not been delivered. The Audit Board of the Republic of Indonesia (BPK – *Badan Pemeriksa Keuangan Republik Indonesia*) stated in a report in 2005 that oil and gas contractors had claimed expenses for goods and services such as dancing courses, charity contributions, DVD movies, parties, and pilgrimages to Saudi Arabia (Buehler 2009: 16).

Such blatant abuses of the cost-recovery mechanism led to calls for reform. In 2008 discussions began whether the cost-recovery PSC system should be abolished. Raden Priyono, then chair of regulator BP Migas, was adamantly opposed to abolishing the cost-recovery PSC system. In his view, abolishing the cost-recovery mechanism would decrease the leverage of BP Migas to monitor rights holders' project budget and procurement process. "Without the cost-recovery mechanism, we are unable to verify that the investors have correctly implemented their plans ," Priyono said (Buehler 2009: 16). Subsequently, Purnomo Yusgiantoro, then minister for energy and mineral resources, assured investors and regulators alike that the GoI only wanted to improve the cost-recovery PSCs system, not abolish it.

Eventually, the GoI drafted a list of items excluded from the cost-recovery process and capped the overall amount of costs recoverable for the first time in 2009 in an attempt to contain at least the most egregious abuses. In addition, the GoI and Pertamina announced that they would start working towards compliance with the EITI so that Indonesia could become a member and increase accountability and transparency in the country's upstream oil and gas sector (Buehler 2009: 15).

However, despite these pledges not to abolish cost-recovery PSCs, almost a decade later, in January 2017, the MEMR issued Regulation No. 8/ 2017 on Gross-Split Production Sharing Contracts[26] The new regulation put forward a PSC model under which the GoI and rights holders agree on a split of gross revenue *prior* to the exploration and exploitation of oil and

[26] In December 2017, the GoI issued Government Regulation No. 53/ 2017, which clarified tax matters that had not been addressed in MEMR No. 8/ 2017.

gas deposits. The share of revenues the rights holder receives under a Gross-Split PSC is significantly higher than under the cost-recovery PSC. In exchange, however, the cost-recovery mechanism is abolished. In other words, rights holders can no longer reclaim their project expenses from the GoI.

The GoI argued that Gross-Split PCSs would curb losses to the state while expediting project approval and execution. On the other hand, analysts and industry representatives worried that Gross Split PSCs may increase the risk to oil and gas companies in exploring and exploiting new oil and gas deposits and therefore deter investment in Indonesia (Potter 2017).[27]

Three years after the introduction of Gross-Split PSCs, it is evident that many stipulations of the MEMR Regulation No. 8/ 2017 are either unclear or in direct violation of existing laws. MEMR Regulation No. 26/ 2017 on Mechanisms for Investment Cost Recovery and its amendment MEMR Regulation No. 47/ 2017 on the Amendment to Regulation of the Ministry of Energy and Mineral Resources No. 26/ 2017 on Mechanisms for Investment Cost Recovery have not brought more clarity on the subject either.

Rights holders are allowed to transfer their existing cost-recovery PSCs to Gross-Split PSC if they wish to do so. It was unclear at this writing whether contractors whose PSCs are running out but who still had costs to recover would be able to do so after the expiration of their PSCs. Finally, it was unclear at this writing whether cost-recovery PSC that were up for *renewal* would be shifted to Gross-Split PSCs. All *new* PSCs will have to be Gross-Split PSCs according to MEMR Regulation No. 8/ 2017. However, the new regulation seems to provide the GoI with considerable power to grant exemptions.[28] Since MEMR Regulation No. 8/ 2017 was enacted, 45 Gross-Split PSCs have been enacted (O'Rourke 2019: 13).

Besides the short-term implications, and the confusion and legal uncertainty the introduction of Gross-Split PSCs has created in Indonesia's upstream oil and gas sector, the long-term impact of this shift from cost-recovery PSCs to Gross-Split PSCs remained largely unclear at this writing. In fact, it may take decades before the impact of this shift will be fully understood as existing cost-recovery PSCs, some of which run until 2040,[29] will remain in place.

However, it is clear that the shift from cost-recovery PSCs to Gross-Split PSCs will make it more difficult to combat corruption in supply chains in Indonesia's upstream oil and gas sector through focal companies. This is because practices that qualified as corruption under Indonesian law under cost-recovery PSCs will no longer qualify as such under Gross-Split PSCs. Under the latter, cost manipulation, the undersupply of material, or the overcharging of services by subcontractors can no longer be billed to the Indonesian state by rights holders as the cost recovery mechanism no longer exists. In other words, such activities would simply reduce the revenues of the rights holder, but no longer constitute "losses to the state" since the GoI is no longer paying for the costs of the exploration and exploitation of oil

[27] Under a Gross-Split PSC, the oil and gas company will pay for the exploration costs even if no oil or gas deposits are found. Hence, Gross-Split PSCs shift considerably financial risks from the GoI to the oil and gas company compared to cost-recovery PSCs.

[28] In December 2019, Indonesia's Minister for Energy& Mineral Resources Arifin Tasrif informed the national parliament that he considered revising MEMR Regulation No. 8/ 2017 to allow oil- and gas- companies to choose whether they want to sign a cost-recovery PSC or Gross-Split PSC with the GoI. Tasrif did not provide any timeline for this revision (O'Rourke 2019: 13).

[29] Interview with Informant 1 (6 December 2018).

and gas under Gross-Split PSCs. Since the GoI is also not *directly* involved with most subcontractors, they can no longer be prosecuted under Indonesia's corruption eradication laws. The shift from cost-recovery PSCs to Gross-Split PSCs will sever the ties between the Indonesian state and subcontractors since costs will be borne solely by the rights holder. Consequently, many of the practices described above will simply no longer constitute "corruption" as the state is no longer involved. Hence, Gross-Split PSCs dramatically narrow the range of practices that qualify as corruption. The capacity of focal companies to combat corruption in their supply chains shrinks accordingly.

One could think of policies and contractual solutions to mitigate the challenges the shift from cost-recovery PSCs to Gross-Split PSCs poses for containing corruption in supply chains. For example, the GoI could require rights holders to flow good governance requirements down its supply chain. However, such strategies are not without their own risks for companies that adopt them. While transnational conventions and government policies require companies to come up with effective third party compliance programs, this is challenging for several reasons. One, companies will struggle to establish third part compliance programs that are broad enough to protect them from third party corruption because *different types of contractors* in supply chain may pose different corruption risks. This is particularly the case in the upstream oil and gas sector, where certain services can only be delivered by a small number of contractors, while other services can be delivered by many contractors. Collusion and corruption is more likely in the first sector than the second. Third party compliance programs struggle to address the diversity in corruption risks that complex supply chains create.

In addition, due diligence of *individual* companies is difficult in countries such as Indonesia where information on beneficial ownership is largely absent and where "right-to-audit" clauses are undermined by a combination of poor record keeping and a lack of public and private sector entities that can verify such records. This context may create perverse incentives for companies to deliberately keep their third party compliance programs vague. "Compliance programs are intended to reduce legal risks and promote ethnical behavior, but an unintended effect may be to create added legal risks. Some degree of control is essential in pushing improvements in the conditions of suppliers' factories abroad. Yet, the more involved an organization becomes in policing and enforcing conditions with independent contractors, the greater the potential for legal liability" (Grieser 2008: 325). Concretely, if a company establishes standards for contractors in its supply chain, then fails to enforce these, the company may expose itself to reputational risks. Likewise, a company may become the subject of litigation or a government investigation because its third party compliance program created expectations it was unable to meet (Walker 2006: 8). Hence, in order to avoid such risks, companies may want to keep third party compliance programs vague, particularly if they do not have much information and/ or control over contractors in their supply chain. Likewise, rights holders may keep right-to-audit clauses less stringent than they ought to be in order to contain corruption effectively because the more stringent such clauses are, the more they will be perceived as a duty of rights holders vis-à-vis contractors from a legal perspective (Walker 2006: 8).

To summarize, policy or contractual solutions are unlikely to effectively address the challenges a shift from cost-recovery PSCs to Gross-Split PSCs will bring to fighting corruption in supply chains in Indonesia's upstream oil and gas sector. Solutions that take the broader political context in which such initiatives are situated into account are therefore worth considering. This is the subject of the next section.

5. Political Settlement Analysis and Combatting Corruption in Indonesia

Regulatory capitalism's initiatives to curb corruption in supply chains in the upstream oil and gas sector have been criticized for their technical nature (Bilal 2017) and the very high level of abstraction at which they operate (Fenster 2006).

Corruption eradication initiatives that are designed based on the assumptions of regulatory capitalism are therefore often politically naïve and formulaic. "The thrust of recommendations generally centers on the need to build or strengthen the capacity of the state to better manage its natural resources, improve its governance, increase transparency and accountability mechanisms. Or put more simply: try to become more like Norway on a sunny day!" (Bilal 2016: 2). Hence, such initiatives assume "too much of the state, of government information, and of the public…" (Fenster 2006: 892).

Initiatives that address corruption risks in natural resource extraction in general and in upstream oil and gas sector supply chains in particular in such a technocratic manner remain ineffective because they assume that the implementation of such initiatives is "immune from the power and economic (self-) interests and incentives of the ruling and dominant actors" (Bilal 2017: 2).

However, the Indonesian case sketched above has shown that the initiatives put forward by multilateral donor agencies and NGOs operating in their intellectual orbit are rarely the technical fixes that stand "above politics." Instead, corruption eradication initiatives are, if not outright politicized, never immune to the dynamics of the broader political context in which they are embedded.

In response to the poor record of such "off-the-shelf" corruption eradication initiatives, a recent body of works has argued for an approach to combatting corruption that takes "political settlements," that is concrete political realities on the ground, into account.
A political settlement analysis of a specific place at a given time, rather than abstract assumptions about the context in which corruption eradication initiatives are embedded, will allow for a more realistic assessment of the opportunities and challenges to combat corruption in natural resource-based supply chains.

The goal of such a political settlement analysis is to identify coalitions in support or opposition to existing or planned policies. These conditions circumscribe the scope for combatting corruption (Leftwich 2011). Important dimensions of political settlements in that respect are (1) the degree of elite inclusion, (2) the reason for why elites accept a certain settlement, as well as the (3) norms prevalent in the state apparatus (Kelsall 2016: 3).

In other words, does the majority of elites accept the existing political settlement (inclusive) or is the political system marred by elite conflicts that often turn violent (exclusive)? Furthermore, are elites joining a settlement because of a common vision and shared goals or mainly because they expect a share of spoils? Finally, is the state based on a Weberian rational-legal bureaucracy or clientelistic relations and nepotism? (Kelsall 2016: 4).

The following paragraphs provide a brief account of the political settlement in Indonesia after 1998 and how it affects anti-corruption initiatives in general and in upstream oil and gas sector supply chains in particular.

A Political Settlement Analysis of Indonesia

Arguably, the political settlement in place in Indonesia most closely resembles a "hybrid regime." The first dimension of a political settlement analysis examines the relationship between elites. In Indonesia, the degree of elite inclusion is fairly high. The majority of Indonesian powerholders have accepted the political structure set in place in 1998.[30] In fact, accounts of the centripetal nature of Indonesia's party system (Mietzner 2008), and the cartelization of Indonesian politics (Slater 2004) suggest that, if anything, the degree of elite inclusion has increased in recent years.

The second dimension of a political settlement analysis asks for the means through which this elite inclusion is achieved. Are elites motivated to accept and join the existing political structure because of spoils or because of a shared vision? While the majority of Indonesian elites have accepted the existing political structure as mentioned above, they are primarily driven to do so by spoils. Indonesian politics has been deeply transactional ever since the country became independent in 1945. While clientelistic relations were oriented somewhat downward during Indonesia's experiment with electoral democracy throughout the 1950s, clientelistic relations shifted directions during the New Order military dictatorship. They eventually culminated in a highly centralized network of clientelistic relations that all emanated from Suharto, the dictator (McLeod 2000).

After the collapse of the New Order regime in 1998 and the democratization of politics that followed, clientelistic relations became less hierarchical Suharto's political monopoly was replaced by an oligopoly in which different networks within the ruling elite compete with one another for rents that access to the state offers (Dick and Mullholland 2010).

For example, parliament quickly understood how to commodify and monetize the leverage it gained over the executive branch of government as a result of various laws adopted since 1998. The Indonesian parliament has not only become infamous for accepting money to create or change laws but also for demanding payments from the executive branch of government in order to approve the government's budget. The aforementioned scandal surrounding SKK Migas' chair Rudi Rubiandini who paid parliamentarians to approve the budget for SKK Migas' operations is a case in point.

Likewise, the judiciary has gained formal independence compared to the New Order period. The "one-roof" system introduced after 1998 has assured a level of independence unheard of during the New Order.[31] However, the judiciary is also frequently abusing these powers by demanding money to sway court verdicts or to extract rents from the executive branch of government (Dick and Mullholland 2016: 44).

[30] There are, of course, radical elements in Indonesia that reject the current political order, but they are confined to the margins of the political arena.

[31] A "one-roof system" denotes self-management in financial, administrative and personnel terms. While such a system lowers the risk of executive government interference in the judiciary, it may also undermine reform dynamics within the judiciary as other government branches have little leverage left to initiate legal reforms (Buehler 2009: 17).

In fact, the demise of the Suharto regime in 1998 not only replaced the centralized and hierarchical patronage network with a system where political elites compete more vigorously for access to rents and spoils, but new power centers have also emerged as a result of Indonesia's reform efforts. This has only added to the complexity of the Indonesian context corruption initiatives need to take into account.

Twenty years after the collapse of the kleptocratic New Order dictatorship, corruption remains so endemic and systemic in Indonesia that an actual "crackdown would unseat much of the political elite" (Dick and Mullholland 2016: 46). In fact, endemic and systemic corruption and rent-seeking is the very reason for the relatively high degree of elite inclusion mentioned above. While "the state has become a site of fierce intra-elite contestation for the political spoils…" this "has not resulted in unstable coalition government…Our troubling contention is that this elite democratic consensus has been underpinned by a high level of corruption" (Dick and Mullholland 2016: 84).

In this context, the last dimension of a political settlement analysis, namely whether the bureaucratic culture is defined by personal or impersonal decision-making (3), has also remained largely unchanged in Indonesia over past decades. While great efforts have been taken to reform the state apparatus (Buehler 2009), corruption in Indonesia's bureaucracy remains endemic and systemic. Many bureaucratic posts need to be bought (Kristiansen and Ramli 2006). Therefore, bureaucrats resort to corruption in order to pay back the loans they had to take out to buy themselves into the state administration. Likewise, bureaucratic recruitment is not based on needs, while promotions are not based on merit (Buehler 2009).

The political settlement analysis of Indonesia briefly sketched above suggests that the scope for curbing corruption in supply chains in Indonesia's upstream oil and gas sector through measures suggested by proponents of regulatory capitalism remains severely limited. Regulatory capitalism relies on oversight and monitoring agencies as well as self-regulation by "focal companies" that are supposed to be motivated by comprehensive anti-corruption rules. However, in a country such as Indonesia where corruption is endemic and systemic in all branches of government, it is unclear how the operations of oversight and monitoring agencies in line with their mandate are guaranteed and how the implementation of anti-corruption legislation is assured.[32]

Overall, then, the measures put forward by proponents of regulatory capitalism have been largely unsuccessful in combating corruption in supply chains in Indonesia's upstream oil and gas sector. Rather than "standing above politics," regulatory agencies such as SKK Migas were deeply involved in political power plays since their inception. In other words, regulatory agencies in Indonesia's upstream oil and gas sector are not (and cannot be) the neutral player proponents of regulatory capitalism expect them to be.

Hence, SKK Migas, and any agency that replaces it once the GoI adopts a new oil and gas law, will remain an important nodal point in the corruption networks that span across Indonesia's oil and gas sector. In this context, it matters little whether the agency is run by "good people" or not, as the systemic nature of corruption in the sector entangles the

[32] The solutions to combat corruption proposed by regulatory capitalism may be more effective in different political contexts. In Bulgaria, for instance, the bureaucracy was comparatively effective when the country embarked upon reforms in 1989 (Kelsall 2016: 7). Unlike in Indonesia, establishing oversight agencies embedded within such a bureaucracy in combination with (institutional) measures to ring-fence such oversight agencies from predatory political elites may therefore be a viable anti-corruption strategy.

oversight agency in networks that cannot be tamed by an individual's sheer will and determination. In addition to the various obstacles raised about SKK Migas' capacity to combat corruption in upstream oil and gas supply chains, the future mandate of SKK Migas is unclear. Under the new Gross-Split PSC system, SKK Migas will no longer be monitoring procurement and tenders since cost-recovery no longer exists. The much reduced role of SKK Migas will only entail controlling Work Programs and Budgets (WP&B) put forward by rights holders and then monitor whether activities in the upstream oil and gas sector are conducted in compliance with the WP&Bs (Lukito and Watson 2017: 2).

While the GoI could require rights holders to flow good governance requirements down its supply chain this will expose companies to associational liability risks. Therefore, right holders face perverse incentives to keep third party compliance programs as vague as possible, as mentioned above.

Furthermore, relying on focal companies to act as transmission belts for good business practices set out in international, transnational and domestic laws is also likely to remain ineffective. Not only are there discrepancies and loopholes in the transnational and domestic regulatory framework, as noted above, but a shift from cost-recovery PSCs to Gross-Split PSCs will greatly reduce the leverage to combat corruption in Indonesia's upstream oil and gas sector supply chains through such companies as most practices simply no longer result in a "loss to the state" as explained above. To address this situation, the GoI could issue a law or a regulation that declares a decline in the state's share in a Gross-Split PSCs as a "loss to the state if this decline had been caused by activities that fell under Indonesia's corruption eradication laws under cost-recovery PSCs. However, no such solution had been proposed by the GoI or any other industry stakeholder at the time of writing.

In any case, any new law or regulation would be subject to the same challenges existing laws and regulations are facing, namely systemic and endemic corruption at all levels of the bureaucracy and in all branches of the government. This context makes the enforcement of any regulation difficult, as shown above.

To overcome these obstacles, a new way of "problematizing" corruption is needed. This is the subject of the next section.

6. Corruption Eradication in the Context of Indonesia's Political Settlement

The paragraphs above showed that despite the presence of oversight agencies and a comprehensive regulatory framework for the upstream oil and gas industry, the measures adopted under regulatory capitalism have done little to curb corruption in supply chains in Indonesia's upstream oil and gas sector.

This incapacity to effectively contain corruption in supply chains in the upstream oil and gas sector is symptomatic of broader weaknesses and shortcomings in Indonesia's approach to curbing corruption. There are several reasons why Indonesia's approach to eradicating corruption has not been very effective. Most important, the KPK, the country's foremost corruption eradication agency, has framed corruption as the result of moral lapses by individuals. The assumptions based on which the KPK has "problematized" corruption are captured by the following excerpt: "[t]he defining qualities of any moral ideology of

accountability include: the idea that personal behavior is core to the critique of the performance of political elites and public officials: and that poor performance by officials and elites is fundamentally the result of personal rather than political failings. Indeed, the character of the political system is frequently viewed as a product of the sum of different individuals' morality…" (Rodan and Hughes 2014:13).

How corruption is "problematized" is important because it shapes the solutions proposed to contain it. As a result of this moralistic understanding of corruption the KPK has focused on the arrests of (high-profile) *individuals* who were subsequently portrayed as "bad people." For instance, a KPK report stated that corruptors are humans "with a sordid soul, no longer civilized. They are prehistorical humans" (KPK 2014: 49).

Likewise, as a result of this moralistic understanding of corruption, the KPK's prevention strategies have focused on improving the moral integrity of individuals. For example, the KPK has conducted surveys to identify the "integrity" of Indonesian citizens during elections. Likewise, the KPK has run various programs to teach "proper values" to children as well as adults in the hope that once these values are internalized, corruption will decline.

A moralistic understanding of corruption is unconducive to combatting corruption effectively for several reasons. One, it expects people to simply "do the right thing." However, in a context in which corruption is systemic and endemic, standing up against corruption may be dangerous and have profound consequences for one's career and private life (Buehler 2019). In other words, there are few incentives to do "the right thing" as engaging in corruption in a place such as Indonesia is rarely a question of individual choice. Instead, it is the result of complex interdependencies between different actors that do not allow individuals to simply "opt-out." Two, and more importantly, a moralistic understanding of corruption centering around "bad individuals" and "personal transgressions" results in politically conservative strategies. Problematizing corruption in moral terms and ascribing responsibility for its existence to individuals shifts the focus away from the kind of political settlements sketched above that allow corruption to flourish in the first place. The *endemic* and *systemic* character of corruption facilitated and sustained by *networks* of predatory elites is rarely discussed, if at all. Ordinary Indonesians therefore do not understand themselves as a group in opposition to the country's predatory elites. Such a consciousness would be required, however, for solidarity between ordinary Indonesians to develop. This is a prerequisite for the understanding that the fight against predatory networks prevalent in Indonesia requires *collective*, not individual, engagement against the political and economic conditions that keep Indonesia's predatory elites in power.

Since moralistic corruption eradication strategies prevent a much needed critique of existing political settlements, different ways of thinking about corruption may give rise to more effective strategies to combat corruption in the natural resource sector and beyond.

Arguably, a *democratic* understanding of the causes of corruption is more conductive to find effective solutions against the abuse of public power for private gains (Rodan and Hughes 2014: 151). Such an approach sees power differentials and socio-economic inequality as the key determinants of corruption.

Several suggestions on how to combat corruption more effectively follow from such a democratic understanding of corruption. Rather than pretending that there are quick,

technical fixes to corruption like proponents of regulatory capitalism do, a democratic understanding of corruption acknowledges that combatting corruption is a multi-generational effort that needs to be driven in a bottom-up fashion by broad societal demands for more accountability and transparency in the political system. While it is beyond the mandate of the KPK to foster such alliances, the way the agency "problematizes" corruption and what kind of outreach activities it supports have the potential to shape the corruption eradication debate in Indonesia along the lines suggested above. Likewise, rather than supporting oversight agencies and relying on focal companies to curb corruption in natural-resource based supply chains, multi-lateral donor agencies ought to support alliances and organizations that have addressed socio-economic inequalities and the predatory character of Indonesia's political structures for decades, including peasant organizations, as well as trade- and labor-unions.

Furthermore, a democratic understanding of corruption acknowledges the endemic and systemic nature of corruption. Consequently, instead of arresting individuals, the KPK ought to investigate corruption networks and aim at dismantling them. This would require collecting intelligence on networks of corruptors, then focus on those players whose arrest will lead to a collapse of the network. In addition to disrupting corruption networks through such kinetic approaches, the KPK also ought to encourage an environment that facilitates the defection of core members of such networks. This suggests pressing for a better witness protection system, leniency laws for key witnesses and collaborators, and more powerful legal instruments. Arguably, a racketeering law modeled after the US-American RICO Act (Racketeerer Influenced and Corruption Organizations) would be the first step in this direction.[33] A RICO style law would allow the KPK to hold leaders of corruption networks accountable for the organized activities of lower rung network members. This may be especially effective when confronted with complex supply chains, in which most subcontractors no longer have a direct or indirect relationship with the state as mentioned above.

7. Conclusion

The article critically examined the main propositions regulatory capitalism put forward to curb corruption in natural resource-based supply chains. These were the creation of oversight agencies and the reliance on focal companies to act as transmission belts for good corporate practice.

The article then criticized such approaches for ignoring the political context in which oversight agencies and focal companies are embedded. This argument was exemplified through an in-depth account of Indonesia's upstream oil- and gas sector. The case study showed that the extensive regulatory framework established to contain corruption in the sector's supply chains was rendered ineffective by the broader political dynamics that had encroached Indonesia's oil- and gas oversight agency from its inception. Rather than standing "above politics" as regulatory capitalism assumed, BP Migas and its successor SKK Migas became important nodal points in corruption networks spanning between the

[33] In September 2018, the KPK arrested 21 members of parliament in Malang City (Walden 2018). This was the first time a network of corruption was tackled by the KPK. It therefore raised hopes that these arrests would signal a new approach to fighting graft in the archipelago state.

Indonesian national parliament, the executive branch of government, including the MEMR, as well as the private sector.

The article then showed how the second proposition put forward by regulatory capitalism, namely relying on focal companies to introduce good corporate practices and self-regulate the sector, was also unlikely to effectively fight corruption in supply chains in Indonesia's upstream oil and gas sector. The article identified numerous shortcomings and loopholes in the national and transnational regulatory and legal framework, which focal companies are supposed to transmit to the business sector they are operating in. Furthermore, combatting corruption by relying on focal companies becomes increasingly irrelevant as a strategy, as Indonesia's upstream oil- and gas-sector moves from cost-recovery PSCs to Gross-Split PSCs. Since the costs incurred due to fraudulent tender, procurement- and business-practices can no longer be billed to the GoI as there is no cost-recovery mechanisms available any longer under Gross-Split PSCs, such practices no longer fall under Indonesia's anti-corruption laws. This will dramatically reduce the capacity of focal companies to combat corruption within their supply chains.

Against this backdrop, the article argued that corruption eradication initiatives need to take political realities on the ground into account. A political settlement analysis of Indonesia then suggested that corruption and rent-seeking is at the very heart of Indonesia's elite-coalition that dominates politics. Corruption is also endemic and systemic in the country's state apparatus. In this context, the suggestions put forward by regulatory capitalism are unlikely to be effective, no matter how much they are "fine-tuned." In other words, in a country where corruption is prevalent at all levels of the state apparatus and across all three branches of government, oversight agencies and focal companies will always be exposed or even be an integral part of predatory networks. The puzzle of "Who guards the guardians?" cannot effectively be solved in such an environment, as the judiciary or the parliament, which play this role in systems were corruption is less prevalent, do not perform these functions in places such as Indonesia.

In light of these challenges, the article suggested a fundamental re-thinking of how corruption is perceived and fought. Rather than relying on a moralistic understanding of corruption, which currently determines the strategies of the KPK, a democratic understanding of corruption is needed. Such an understanding of corruption will emphasize socio-economic inequality as the root of corruption in places such as Indonesia. Arguably, this is more likely to lead to awareness among ordinary Indonesians of their place in the country's political ecology than moralistic approaches to corruption. It is such an awareness that has led to the rise of mass movements against predatory elite networks and the implementation of effective anti-corruption measures elsewhere, a precondition for fighting corruption in natural-resource based supply chains more effectively.

Bibliography

ACE-SOAS. “Research on Corruption Risks in Indonesian Upstream Oil& Gas Industry – Mitigation Policy Analysis – Evidence Based Approach.” *Unpublished report*. London, SOAS, 2018.

Anechiarico, Frank, James B. Jacobs, and James B. Jacobs. *The pursuit of absolute integrity: How corruption control makes government ineffective*. Chicago: University of Chicago Press, 1996.

Arnaz, Farouk. “Police Arrest Former SKK Migas Chief for Condensate Graft Case,” The Jakarta Globe, (12 February 2016), online. Available at https://jakartaglobe.id/news/police-arrest-former-skkmigas-chief-condensate-graft-case/ (Accessed 23 December 2018).

Bayer, Daniel Sandy, Ronald E. Berenbeim, and Rebecca Walker. *Safeguarding Intellectual Property and Addressing Corruption in the Global Supply Chain*, (2012), online. Available at https://www.conference-board.org/publications/publicationdetail.cfm?publicationid=2379 (Accessed 14 March 2020).

Bilal, San. “On the political economy of reforms in the extractive sector,” *GREAT Insights Magazine*, Vol. 6, Issue 3 (July/ August 2017). Available at https://ecdpm.org/great-insights/mining-for-development/political-economy-reforms-extractive-sector/ (Accessed 16 October 2019).

Boldbaatar, D., N. C. Kunz, and E. Werker. "Improved resource governance through transparency: Evidence from Mongolia." *The Extractive Industries and Society* Vol. 6, Issue 3 (July 2019): 775-787.

Braithwaite, John. *Regulatory Capitalism: How it Works, Ideas for Making it Work Better*. Cheltenham: Edward Elgar Publishing, 2008a.

Braithwaite, John. “The Regulatory State?” In: R.A.W. Rhodes, Sarah A. Binder, and Bert A. Rockman. Eds. *The Oxford Handbook of Political Institutions* Oxford: Oxford University Press, 2008b, pp. 1 –23.

Braithwaite, David, Soepraptono Soelaiman, Gatot K Wiroyudo, Herucokro Trimurdadi, Sugiharto Soeleman, Sutadi Pudjo Utomo, and Pri Agung Rakhmanto. *Fossil Fuels – At What Cost? Government support for upstream oil and gas activities in Indonesia. International Institute for Sustainable Development* (Geneva, 2010, online). Available at https://www.iisd.org/gsi/sites/default/files/ffs_awc_indonesia.pdf (Accessed 30 December 2018).

Buehler, Michael. 2019. “Indonesia takes wrong turn in the fight against corruption: New legislation will undermine the KPK, but the bigger mistake is conceptual,” *The Financial Times*, October 2. Available at https://www.ft.com/content/048ecc9c-7819-3553-9ec7-546dd19f09ae (Accessed 16 October 2019).

Buehler, Michael. "Indonesia's Law on Public Services: changing state–society relations or continuing politics as usual?" *Bulletin of Indonesian Economic Studies* Vol. 47, No. 1 (2011): 65-86.

Buehler, Michael. “The ‘judicial mafia’ and judicial reform in Indonesia.” *Van Zorge Report*, Vol. XI, No. 12 (25 November 2009): 10-23.

Conkling, Robert. “Authority and change in the Indonesian bureaucracy,” *American Ethnologist* Vol. 6, No. 3 (August 1979): 543–54.

Curry, William Sims. *Government Abuse: Fraud, Waste, and Incompetence in Awarding Contracts in the United States.* New York: Routledge, 2017.

Dangkua, Armatra Rizwan. *Managing Corruption Risks in the Oil and Gas Industry: A Case Study of Indonesia.* unpublished MSc dissertation University of Dundee, 2016.

Davidson, Jamie S. "The demise of Indonesia's upstream oil and gas regulatory agency: An alternative perspective." *Contemporary Southeast Asia* Vol. 37, No. 1 (2015): 109-133.

Dick, Howard and Jeremy Mulholland. “The Politics of Corruption in Indonesia” *Georgetown Journal of International Affairs* Vol. 17, No. 1 (2016): 43-49.

Dick, Howard, and Jeremy Mulholland. "The state as marketplace: Slush funds and intra-elite rivalry." In Edward Aspinall and Gerry van Klinken (Eds). *The State and Illegality in Indonesia* Leiden: KITLV Press, 2010, pp. 65-85.

Fabrikant, Robert. *Oil discovery and technical change in Southeast Asia: legal aspects of production sharing contracts in the Indonesian petroleum industry.* Singapore: ISEAS, 1973.

Fenster, Mark. “The Opacity of Transparency” Iowa Law Review (2006): 885-949 Available at http://scholarship.law.ufl.edu/facultypub/46 (Accessed 19 October 2019).

Economist. “The Anti-Bribery Business,” *The Economist* (9 May 2015, online), Available at https://www.economist.com/business/2015/05/09/the-anti-bribery-business (Accessed 24 December 2018).

Global Legal Insight (GLI). “Bribery and Corruption 2019: Indonesia,” Global Legal Insight online report. Available at https://www.globallegalinsights.com/practice-areas/bribery-and-corruption-laws-and-regulations/indonesia (Accessed 2 January 2019)

Hills, Lindsey. “Universal Anti-Bribery Legislation Can Save International Business: A Comparison of the FCPA and the UKBA in an Attempt to Create Universal Legislation to Combat Bribery around the Globe,” *Richmond Journal of Global Law and Business*, Vol. 13, No. 3 (2014):469-492.

Grieser, Aaron. “Defining the Outer Limits of Global Compliance Programs: Emerging Legal and Reputational Liability in Corporate Supply Chains,” *Oregon Review of International Law* 10, No. 1 (2008): 285-326.

ICLG. *Oil and Gas Law and Regulations*, online Available at https://www.iclg.com (Accessed 28 September 2019).

Jakarta Post. “Sutan Bhatoegana gets 10 years in prison,” *The Jakarta Post* (19 August 2015), online. Available at https://www.thejakartapost.com/news/2015/08/19/sutan-batugana-gets-10-years-prison.html (Accessed 23 December 2018).

Hamid, Abdul. “Rumor Konspirasi Berhembus, Lambok Tetap Dilantik Jadi Deputi SKK Migas,” *Dunia Energi* (26 August 2013, online), Available at http://www.dunia-energi.com/rumor-konspirasi-berhembus-lambok-tetap-dilantik-jadi-deputi-skk-migas/ (Accessed 23 December 2018).

Kelsall, Tim. “Thinking and Working with Political Settlements” Overseas Development Institute (ODI), *Briefing (2016). Available at* https://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/10185.pdf (Accessed 12 October 2019).

Komisi Pemberantasan Korupsi Republik Indonesia. *Laporan Tahunan 2014* (2014) Available at https://www.kpk.go.id/id/publikasi/laporan-tahunan (Accessed 19 October 2019).

Kristiansen, Stein, and Muhid Ramli. "Buying an income: The market for civil service positions in Indonesia." *Contemporary Southeast Asia* Vol. 28, No. 2 (2006): 207-233.

Leftwich, Adrian. "Thinking and Working Politically: What does it mean, why is it important and how do you do it." In DLP (Development Leadership Program) Ed. Politics, Leadership and Coalitions in Development: Implications of the DLP Research Evidence. *Research and Policy Workshop* (Frankfurt, Germany: Developmental Leadership Program, 2011), pp. 3-13.

Lindblad Thomas J. The Petroleum Industry in Indonesia before the Second World War, *Bulletin of Indonesian Economic Studies* Vol. 25, No. 2 (1989): 53-77,

Linton, Jonathan D., Robert Klassen, and Vaidyanathan Jayaraman. "Sustainable supply chains: An introduction." *Journal of operations management* Vol. 25, No. 6 (2007): 1075-1082.

Lukito Alexander and Tim Watson. “Indonesia Energy, Utilities& Mining News Flash: Special Edition – Gross Split PSCs,” *PriceWaterhouseCoopers* (February 2017, online). Available at https://www.pwc.com/id/en/energy-utilities-mining-newsflash/assets/2017/pwc-indonesia-eu&m-newsflash-vol.60.pdf (Accessed 27 December 2018).

Martini, Maíra. “Local content policies and corruption in the oil and gas industry,” *U4/ Anti-Corruption Resource Centre,* online (2014). Available at https://www.u4.no/publications/local-content-policies-and-corruption-in-the-oil-and-gas-industry.pdf (Accessed 19 June 2019).

MCC. 2017. *Baseline Report: MCC Procurement Modernization Project. MCC-15-LC-002*. Bethesda, ABT Associates. Available at https://www.academia.edu/37735517/ABT_Associates._Baseline_Report_MCC_Indonesia_Procurement_Modernization_Project_Bethesda_MD_2017_ (Accessed 16 October 2019).

McLeod Ross H. “Soeharto’s Indonesia: A Better Class of Corruption,” *Agenda: A Journal of Policy Analysis and Reform* Vol. 7, No. 2 (2000): 99-112.

Mietzner, Marcus. "Comparing Indonesia's party systems of the 1950s and the post-Suharto era: From centrifugal to centripetal inter-party competition." *Journal of Southeast Asian Studies* Vol. 39, No. 3 (2008): 431-453.

Ministry of Energy and Mineral Resources (MEMR). "Struktur Organisasi dan Pejabat Struktural Direktorat Jenderal Minyak Dan Gas Bumi: Kementerian Energi dan Sumber Daya Mineral," (Jakarta, MEMR, 2018, online) Available at https://www.esdm.go.id/en/profile/duties-functions/directorate-general-of-oil-and-gas (Accessed 30 December 2018).

Natural Resource Governance Institute (NRGI). "BHP, Others Increase Scrutiny of Subcontracting Corruption Risks," *NRGI Blog* (9 November 2018), Available at https://resourcegovernance.org/blog/bhp-others-increase-scrutiny-subcontracting-corruption-risks (Accessed 19 June 2019).

O'Rourke, Kevin. "Energy Minister Arifin Tasrif told parliamentarians that he is considering providing oil-and-gas investors with a choice of their preferred contract framework," *Reformasi: Weekly Review* 6 December 2019, pp. 13-15.

Piper, Charles E. *Contract and Procurement Fraud Investigation Guidebook* (New York: Routledge, 2017).

Pompe, Sebastian. 1992. 'Small enterprises and company law in Indonesia; A study of the limited company in Indonesian commercial practice', *Bijdragen tot de Taal-, Land- en Volkenkunde* Vol. 148, No. 1, pp. 67-81.

Ponsford, Victor James. "It is time for Indonesia to take the plunge on contract transparency," *EITI, online*. Available at https://eiti.org/blog/it-is-time-for-indonesia-to-take-plunge-on-contract-transparency (Accessed 4 January 2019).

Potter, Steve. "Indonesia's oil regime needs an overhaul," *Financial Times* (5 July 2017, online) Available at https://www.ft.com/content/84b951fe-6168-11e7-8814-0ac7eb84e5f1#comments-anchor (Accessed 2 January 2018).

Prabandani, Hendra W. (2016). "Tackling Corruption in Indonesia: Government Efforts on Corruption Prevention and Eradication," Power Point Presentation presented at *Tackling Corruption in ASEAN-Legislation, Strategies and Regional Cooperation*, Bangkok, 15-16 November 2016. Available at http://birohukum.bappenas.go.id/data/data_presentasi/6%20Indonesian%20Gov%20Perspective-Hendra%20Prabandani.pdf (Accessed 3 September 2019).

Rambu Energy. "Indonesia's energy ministry extends contracts of two PSCs," (14 December 2018, online). Available at https://www.rambuenergy.com/2018/12/indonesias-energy-ministry-extends-contracts-of-two-pscs/ (Accessed 30 December 2018).

Rodan, Garry and Caroline Hughes. *The Politics of Accountability in Southeast Asia: The Dominance of Moral Ideologies.* Oxford: Oxford University Press, 2014.

Rogers, Everett M. *Diffusion of innovations*. Fifth Edition. New York City: Free Press, 2003.

Seda, F.. Petroleum Paradox: The Politics of Oil and Gas. In B. Resosudarmo (Ed.), *The Politics and Economics of Indonesia's Natural Resources* (pp. 179-190). ISEAS–Yusof Ishak Institute (2005).

Septian, Anton, Kartika Chandra, Khairul Anam, and Bunga Manggiasih. "Perk-Belly Politics," *Tempo Magazine* (9 February 2014), pp. 16-20.

Sidharta, Deny and Winotia Ratna. "Indonesia," In Homer E Moyer Jr. *Anti-Corruption Regulation: In 43 Jurisdictions Worldwide*. London: Law Business Research Ltd., 2015. pp. 90-94. Available at https://www.soemath.com/public/images/page/download1_298_AC2015%20Indonesia.pdf (Accessed 2 January 2019).

Silvestre, Bruno S. "Sustainable supply chain management in emerging economies: Environmental turbulence, institutional voids and sustainability trajectories." *International Journal of Production Economics* No. 167 (2015): 156-169.

Sivachenko, Irina. "Corporate Victims of Victimless Crime: How the FCPA's Statutory Ambiguity, Coupled with Strict Liability, Hurts Businesses and Discourages Compliance," Boston College Law Review 54, No. 1 (2013): 393-432.

SKK Migas. *Pedoman Tata Kerja Nomor: PTK-007/SKKMA0000/2017/S0 (Revisi 04) Buku Kedua. Pedoman Pelaksanaan Pengadaan Barang/ Jasa* [Revision of the Second Book on Supply Chain Management Guidelines for Production Sharing Contractors] (Jakarta: 2017a) Available at https://skkmigas.go.id/images/upload/file/2017/06/PTK_007_Buku_Kedua_Rev_04.pdf (Accessed 19 December 2018)

SKK Migas. *Petunjuk Pelaksanaan Tender Nomor: EDR-0167/SKKMH0000/2017/S7* [Implementing Guidelines for Tender] (Jakarta: 2017b) Available at https://skkmigas.go.id/images/upload/file/2017/07/PTK_007_Rev_04_Juklak_Final_Ceta.pdf (Accessed 19 December 2018)

Slater, Dan. "Indonesia's accountability trap: Party cartels and presidential power after democratic transition." *Indonesia* No. 78 (2004): 61-92.

Smith, Benjamin B. *Hard times in the lands of plenty: oil politics in Iran and Indonesia*. Ithaca: Cornell University Press, 2007.

Straits Times. "Former Indonesian minister sentenced to four years in jail for corruption," *The Straits Times* (9 February 2016), online. Available at https://www.straitstimes.com/asia/east-asia/former-indon-minister-sentenced-to-4-years-in-jail-for-corruption (Accessed 23 December 2018).

Supandji Hendarman. 'International anti-bribery standards in public procurement in Indonesia', in ADB/OECD. *Fighting Bribery in Public Procurement in Asia and the Pacific*. Bali: Indonesia, 2007.

Taufik, Giri Ahmad. “Finding the right model for Indonesia’s oil and gas management,” *The Conversation*, (19 October 2016). Available at https://theconversation.com/finding-the-right-model-for-indonesias-oil-and-gas-management-59077 (Accessed 18 December 2018).

Tempo. “Amien Sunaryadi: Contractors had to pay fees right from the start,” *Tempo English* (13 January 2015, online), Available at https://en.tempo.co/read/634634/amien-sunaryadi-contractors-had-to-pay-fees-right-from-the-start (Accessed 23 December 2018).

Topal, Julien and Perrine Toledano. “Why the Extractive Industry Should Support Mandatory Transparency: A Shared Value Approach,” *Business and Society Review* Vol. 118, No. 3 (2013): 271-298.

Tribun Timur. “Bareskrim Pulangkan Tersangka Korupsi Kondensat,” *Tribun Timur*, (8 January 2018), online. Available at http://www.tribunnews.com/nasional/2018/01/08/bareskrim-pulangkan-tersangka-korupsi-kondensat (Accessed 23 December 2018).

Walden, Max. “Indonesia’s Independent Corruption Fighters Intensify Their War,” *Voice of America*, 6 September 2018. Available at https://www.voanews.com/east-asia-pacific/indonesias-independent-corruption-fighters-intensify-their-war (Accessed 29 September 2019).

Walker, Rebecca. “Am I my brother's keeper? The advantages and potential pitfalls of extending compliance requirements to suppliers and other third parties,” *Ethikos* (May/June 2006): 5-11.Winters, Jeffrey A. *Oligarchy*. Cambridge University Press, 2011.

Xin, Zheng. 2018. “PetroChina looking to tap Indonesia’s LNG reserves,” *China Daily* (February 18). Available at http://www.chinadaily.com.cn/a/201802/01/WS5a727daca3106e7dcc13a292.html (Accessed 16 October 2019).