ROLE ANALYSIS OF THE PARTIES TO EUCALYPTUS OIL BUSINESS CONTRACT AS REFLECTED IN PROFIT SHARING IN THE REGENCY OF BURU

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Abstract::Eucalyptus oil business is one of the dominant sector of forestry/agriculture in the regency of Buru. At least there are more or less 1.939 workers in this industry whose livelihood depends on it. This sector is also the one with the greatest prospect in supporting the economy of the Buru regency. The routines of eucalyptus oil refining by farmers in the regency of Buru is part of the economic activities which have been carried out for generations. As a business which has been handed down for generations, the role of farmers is very important, that is as the supplier of production factors, supplier of labor and other equipment. The implication of farmers' position as owner has created a problem due to the role of the parties to eucalyptus oil business contract. This phenomenon has created a bias on the principal-agent problems since the actors related to the contract have imbalanced capacity. This study aims at investigating the role of parties to eucalyptus oil business contract. Using institutional economics approach, the findings of this study are: (1) the business contract has not placed the farmers in a position as principal but instead as worker/laborer (agent); (2) the ownership over asset (village/land), labor and means of production and others is not sufficient to bring adequate bargaining power to the farmers.
Key Words: contract, principal-agent, institutional economics

1. BACKGROUND

Eucalyptus oil business is a tradition handed down from the older generations, which is acquired based on adat law or local institution in the regency of Buru. The rules for profit sharing among farmers, processor and trader which has been observed so far has become a tradition which is difficult to change. The farmers would receive their share of the profit when it is agreed upon based on the profit and loss calculation of the capital owner. This would mean that the laborer or farmer is a party which should receive part of the profit and this should be borne by the capital owner.

The workers should receive part of the profit and the capital owner and big trader (tengkulak) should guarantee this. But this is not applied on the system or pattern of profit sharing in the eucalyptus oil business contract. As described above, this business is part of the family enterprise which has been handed down from generation to generation. The apportioning of technical and production part and the profit sharing is distributed to all members of the family. Until now, they are still applying this as the rule which has been consented upon. The simple example is the agreement among the family members to appoint one of them in charge of the production or general overseer before the production or refining process is started. The overseer of production must control the workers (from members of the family). In their language, the overseer is called as “nahkoda” (captain as in a vessel) and the assistants as “koki” (cooks).

The profit sharing for the business handed down from the previous generations has been adopted into formal rule for the traders and capitalist in carrying out this business. The adoption of this system should bring with it the responsibility for the trader and capitalist to provide incentive for the “captain” of production. However, in practice, this incentive is taken from the workers and farmers.

In this profit sharing system, the farmers and capitalists should have equal rights in demanding the fulfillment of the deal, despite the fact that it is unwritten, but unequal bargaining power in asset ownership and information has created imbalances in the enforcement of the contract. Incomplete information is partly caused by the inability of the farmer to know precisely the condition or the possibilities of situation. Information is also distributed asymmetrically so that the trader/capitalist know much more than the farmers. Profit sharing between farmers on the one hand and traders and capitalist on the other hand has resulted in injustice for the farmer. The role of captain of production (nahkoda) in this business has been well known by the capitalist, where the information related to this business has been known to the capitalist.

In short, the captain of production has a double role, where on the one hand, he works for the interest of trader and capitalist and the other hand for the laborer or farmers. However, the interest of farmers as owners is far from informed. The farmers in their capacity as owner receive the smallest portion of the profit sharing. The trader or capitalist has greater bargaining power than the farmer as principal.

According to Sesbany (2008), the weak bargaining power is generally caused by the fact that the farmers do not have access to the market and information and they are generally lacking in working capital. The weak bargaining position on farmers' part is one of the obstacles in improving their income. From the perspective performance historical development, the eucalyptus oil business in the regency of Buru has seen a shift in the profit sharing system due to the involvement of traders and capitalist in the eucalyptus oil business and acquisition of villages (land) for eucalyptus oil cultivation away from farmer ownership, which is caused by the farmers' inability in terms of their capacity and bargaining position.

This is a portrayal of what has been described above. It shows that the profit sharing system is applicable among the family members or internal circle in previous time. However, with the arrival of traders and capitalists, the implementation of profit sharing system would bring loss for the farmer. If the business is inherited (from their parents) for the whole family to run, then as a owners, the parents should received their due and the rest is shared among the workers, who are their family (children) of the owners of village land.

The profit sharing is implemented by the family for the purpose of achieving equal distribution among them. However, this system is adopted as a rule by the traders and capitalists in running the business in order to obtain greater margin. When the farmers (owner) make a contract with the trader and capitalists, then the farmer and his family would work as farm laborer in their own land and receive the same treatment as other workers. This farmer would receive a share of the profit under the same system that has been carried out in his family, that is part of the profit after deduction for the trader's or capitalist's expenses. However, it must be remembered that this is a situation which is forced upon the farmer since he has no other choice. Due to this profit sharing system, it is possible that the farmers or land owners feel that they are treated unfairly by the traders and capitalists. However, this injustice is sometimes hidden since the involved parties, as described above, has pushed the farmer into weaker position.

If we refer to the principal-agent theory, the principal is the holder of shares or owner of the enterprise, while the agent is the manager who runs the wealth of the owner. A principal-agent relation is formed when the action of an individual has an impact on other people or when an individual depends on the action of others (Stiglitz, 1987; Pratt et. al., 1985 in Gilardi, 2001). In this case, we see the interest and behavior of the people who make decisions for others and delegate authority for others to make decisions for him. Meanwhile, for the other farmers who are unwilling to make contract with the traders and capitalists, the condition is much different. They are calculating and careful in running the business and have greater capacity to optimize their profit.

The farmers who are not burdened by debt can run the business with full solidarity and allow freedom for their workers. In simple terms, when a worker comes to the land owner to ask for work, then the owner would not bind the workers with tight schedule. The owner would only establish initial agreement where the owner is acknowledged as the arbitrator for the profit sharing among them (farmer and worker). In this way, the system or pattern for profit sharing has created injustice for the farmer due to its limited role. It is often found that certain actors operating among the farmers acquire inordinate amount of profit. This may be justifiable for the actors who act as intermediary trader with monopoly or oligopoly system. The ones who receive the greater profit are traders (capitalists) since they can reduce the price paid to the farmers with the pretext that the eucalyptus oil has low quality or other. According to North (1996:33), ideally the principal should be empowered to discipline the agent in accordance with the objective of the enterprise, and agents on the other hand can monitor the principal and enforce the working agreement between them.

Referring to the description above, then in this case, the farmers are principals and the traders or capitalists are agents who are acting on behalf of the farmers as land owner (part of the factors of production). However in the institutional economics approach, the question is more focused on the power structure (who is the agent and who is the principal). The differences in economic interest can be caused by and also can be causing asymmetry of information between the farmers as principal and the trader and capitalists as agents. One of the parties or principal has both implicitly and explicitly made contract with other parties with the expectation that the agent would do what the principal expect them to do.

The rule of the game in profit sharing can be said to be far from proportional and it only benefits certain parties in it. If the profit sharing is based on the rights and obligations of each parties, then the farmers in their capacity as proprietor of the business has a better position than the traders, both intermediaries and capitalists. However in this case, the farmers (as owners) seem to be outside of the true law of contract. Therefore the question is:

What is the role of parties to the eucalyptus oil business contract as reflected in the profit sharing among them (farmers, traders and capitalists)?

2. REVIEW OF LITERATURE

Due to the imbalanced relation between the farmers and other parties to the business contract, therefore it is expected that institutional economics approach can expose a few assumptions, that is asymmetric information and conflicting objectives between principal and agent.

Institutional economics is one of the theory for dealing with the research question, the reason being that the phenomenon of eucalyptus oil business is not only an economic problem, but there are also other factors, including social, cultural, legal, political and others, which have been ignored in neoclassical economics.

2.1 Institutional Economics

Institution can be seen as rules of reward and sanction for the individuals and groups in making their choices. This definition is consistent with Commons (1934) who defines institution as:

> collective action in restraint, liberation and expansion of individual action.

Institution can also be understood as a regulation of behavior which is generally accepted by members of social groups for specific behavior in specific situation, which can be monitored by oneself or by external authority (Yustika, 2006:40). North in relation to institutional economics has mentioned three elements of institution. The first is formal rules such as law and government regulation. The second is informal rules such as norm, values and convention. The third is the enforcement of formal and informal rules.

The existence of institutional economics is a reaction on the dissatisfaction with neoclassical economics, which is a direct continuation of classical economics. According to Hasibuan (2003 in Santosa 210:83), the core idea of institutional economics is that economics is seen as a combination of social sciences, such as psychology, sociology, politics, anthropology, history and law. They summarize these disciplines into economic analysis, but there are differences of approach among them. In general, most institutional economists are against free market or free competition which is based on *laissez-faire* and maximization of profit.

Hayami & Kikuchi (1987) define institution as rules which is backed up by sanctions by the members of the community to facilitate coordination and cooperation among individuals sharing resources. Therefore, institution has three primary components, that is: (1) jurisdiction boundary, which determines what and who are part of the organization, (2) property rights, which is determined by law, custom, or consensus which regulates the relation among members of society, and (3) rule of representation, which determines who can participate in the decision making process and its consequences on organizational performance.

According to North (1990), institution consists of rules and norms in a society which determines what can and cannot be done and the task and obligation of members of society. The emphasis of North's definition is on institution as opportunity and at the same time as external obstacle or limit for economic agents. This means that institutions enforce their rules so that economic agents who are maximizing their effort are limited by other factors such as resource, technology and preferences.

In this way, the next question is how institution can reduce uncertainties in economy and business? North explains that a good institution can solve the problems of coordination and production related to the motivation of actors, environment and agent capability in dealing with the environment of the institution by building, engineering, reconstructing, developing, maintaining and enforcing rules for various parties involved.

According to experts on institution, market is not created by itself but there must be an institution which regulates the interaction pattern for actors in a transaction arena which has been agreed upon mutually. In economics, the market can only work effectively when supported by the correct institution.

Other writers such as Rutherford (1994, in Yustika 2006:40) sees institution as a general regulation of behavior which is accepted by members of a social group for specific behavior in specific situation, which can be monitored by oneself or by external authority. From the two definitions by North and Rutherford above, we could see that both give emphasis on the rule or regulation as the essence of institution. The role of institution in economics is crucial.

2.2 The Concept of Contract

Contract is an agreement between parties which is legally binding and its meaning is similar to a deal and in a contract there are two parties or more making the agreement. In other words, contract is a relation between the intention or statement of two parties which is recognized by law and would have certain legal implication. Basically, contract is an agreement which is reached by negotiation, then made and agreed upon voluntarily by persons having the capacity to make contracts (Manzilati, 2009:49). The objective of a contract must be legal and in most cases, the agreement must fulfill certain considerations (an agreement to legal value). All interaction among economic parties does not occur directly but must be accommodated under the mechanism of contract which functions as transaction media. Contract would determine the quality of exchange and magnitude of cost borne by the parties to the contract. Therefore, a contract must be defined clearly since better formulation of contract would guarantee the execution of transaction and the consequence is payment.

Basically, the legal aspect of a contract is the exercise of a promise or a set of promises. Therefore, Mallor et. al. (2004:174) states that when a set of promises has acquired the status as contract, the one who sustains loss due to breach of the contract can ask the government (judiciary) to force the defaulting party to abide by the contract.

However in the case of contract between farmers and traders and capitalists, the idea of Mallor et. al. (2004:174) is difficult to implement. The farmers do not have power, capital or legal support to require the government to enforce the existing contract. The farmers sometimes do not have any choice but they are certainly in weaker position, since their capacity and bargaining power is weak, so that the profit sharing is determined more by the traders and capitalists.

In relation to the contract as described above, the business contract between eucalyptus oil farmer and traders and capitalists is unbalanced. The asymmetry of information has resulted in high cost of transaction due to uncertainty, limited knowledge or inability in making decision which would result in the situation that the share received by farmers is determined by the decision of traders and capitalists.

This condition, according to Williamson (1983:16), cannot be separated from the opportunism of people who are selfish, self-interested and willing to use dishonest means to gain profit. They do not hesitate to lie or cheat for their own self interest. Opportunism would occur when there is opportunity to gain profit from a situation which would be ruinous for others. Klein (1980:356) states the reason why a contract become incomplete, that is: the first is that uncertainty would imply the existence of many other uncertainties and it can require large amount of cost to determine and sort out in the effort to deal with the various possibilities. The second is that the performance of contract, for instance the amount of effort expended by workers in carrying out task, is difficult to measure. In the context of business contract, the traders and capitalists as agents would try to search and obtain better opportunities. While the farmer as principal is in a position which is almost without any alternative for choosing the opportunities which would be advantageous for them.

2.3 Principal-Agent Theory

The problem of principal and agent would emerge when the owner (of a company or business) and manager are not the same person or the same party. Jensen & Meckling (1976:308) has defined agency relationship as:

> a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent.

The principal-agent theory (agency theory) describes the allocation of natural resource and work. The relation would work efficiently when there is an incentive system (reward and punishment). In the context of eucalyptus oil business, the traders and capitalists as agents would certainly try to gain better profit, while the farmers as principals are in a position where they have no other alternative in choosing a better position. Therefore it is important to understand the problem not only from the perspective of principals and agents or agency relation but taking a deeper insight into the problems caused by the unbalanced relation between farmers, traders and capitalists.

In this way, the institutional economics would see the problem not only in economic terms as the problem in allocating and distributing resource, but also look at the structure of power between existing economic actors. Considering the existing phenomena, we should approach the problem not only in terms of economic event but also to gain deeper insights to the things behind the phenomena.

In other words, institutional economics does not try to understand the rational behavior or as Jevons would have it "the mechanic effort to achieve personal satisfaction and self-interest" but also to recognize the forms of behavior, such as traditional behavior of the individuals and groups, that is the patterns which result in stability and uniformity and can be institutionalized.

3. METHOD

Based on the initial research and the existing phenomenon, this research applies the qualitative approach in the perspective of institutional economics. The relation between institutional economics and qualitative method is apparent from the fact that analysis in institutional economics is focused on the ideas on power structure. The relation between economic. Social, political, cultural, legal and other factors in the society would certainly impact individuals and groups in making decisions (transaction).

The economic aspect of the exchange process depends largely on the symmetry of power structure among the economic actors. When the existing power structure is asymmetrical, then the economic benefit would be distributed unevenly and vice versa. Qualitative research also puts a strong emphasis on the aspects of social phenomenon. Social structure is understood as a complex situation which requires deep explanation and interpretation. In this condition, the institutional economics approach provides a solution on how to understand a complex social process, while the qualitative research provides a method to correct the causal relations in the process (Yustika, 2006:100). Qualitative research is one of the humanistic research method, which places human beings as the primary subject in social/cultural events. The humanistic characteristics of qualitative research is evident from its view on the position of human beings as the primary determinants of individual behavior and social phenomenon.

The qualitative paradigm is seeing the economy not only as demand and supply sides, but also from the behavior which is patterned in the life of the society, which always interacts with and relates to political, social, cultural, legal and other aspects. In order to gain deeper insight into the social phenomenon, in this case the eucalyptus oil business, this research makes use of qualitative analysis.

4. RESULT

Eucalyptus oil business is a business which is inherited from the forefathers of the Buru people and it is acquired based on custom or local institution in the regency of

Buru. The profit sharing system is applied by the families in order to achieve equality of income among them. However, this system is adopted and made into binding rules by the traders and capitalists in running their business in order to achieve greater margin. Hence the profit sharing between farmers and traders has created injustice for the farmers. This would create social discrepancy which is getting worse from day to day and this discrepancy is manifested in the emergence of social stratification which rent asunder the social solidarity, and creates a social tension between the upper class which is dominated by capitalists and the lower class of farmers.

The emergence of the unjust profit sharing mechanism in the contract between farmers, traders and capitalists is caused by the uncertainties and differences in acquisition of information. The information held by traders (supplier of capital) is much larger than the information held by eucalyptus oil farmers due to bounded rationality. Bounded rationality may be contradictory with the operational efficiency of a transaction for the traders or capitalists.

In agency relation, there are two parties to an agreement or contract, that is the one giving authority (called principal) and the one receiving it (called agent). Lupia & McCubbins (2000) states that delegation would occur when one principal or more has chosen one agent or more to act in the interest of the principal. Lupia & McCubbins reminds us that delegation would have a consequence in the form of principal's inability to control the decisions of agents in the contract relation.

Institutional perspective has decisively stated that interaction among economic, cultural and sociological aspects are inseparable, since these factors are economic factors which forms the development towards modern economic thinking. This difference is evident in the fact that each individual would act in choosing what he/she would need and how to fulfill them (Perdana, 2001:1).

From these various perspective, the institutional perspective has emerged as a solution to solve non-economic problems which has been ignored by neoclassical economics. Motivation is assumed to be constant *ceteris paribus*, and all factors outside the economic are considered to be given. Neoclassical approach also considers that the market operates perfectly costlessly since the consumers has perfect information and producers are competing with one another to produce lowest cost. However the reality is the other way around, since information, competition, contract and exchange can be asymmetric. This has resulted in transaction cost and created inefficiency in the economy.

The economic and political concepts of classical and neoclassical economics result in oversimplified explanations because they ignore the other factors which are actually determinant of the economic activities, such as social, culture, political, religious and other factors. The problem analyzed in this research has emerged due to the lack of bargaining power and capacity on farmers' part as actors in the contract, so that profit sharing is dominated more by traders and capitalists rather than by equal negotiations among the actors.

5. CONCLUSION

1. Eucalyptus oil business is inherited from the older generations and it is sanctioned by the adat or custom law in the regency of Buru.
2. The business contract has changed the position of the farmers into nothing more than laborer.
3. Contract between the farmers and traders and capitalists has resulted in changes in profit sharing where the traders and capitalists are more

dominant in the determination of profit sharing instead of having an equal negotiation among the involved actors.

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