

Corruption in Indonesia:
Ten Years after the 1998
Economic Crisis

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Centralized versus Decentralized Corruption

- Shleifer and Vishny (1993) distinguishes between centralized and decentralized corruption
 - The latter is worse for economic growth than the former because it creates high uncertainty
- Under centralized corruption
 - Mechanisms to stop deviations from the agreed pattern of corruption
 - A bribe payer will receive a guarantee that he was getting the whole package: no more request for bribes from other parts of the bureaucracy

Pre-1998 Corruption

- Corruption was centralized and predictable
- Entrepreneurs involved Suharto's family to reduce the uncertainties created through harassment by lower level bureaucrats
- Transaction costs associated with corruption and bureaucratic red tape could be calculated accurately and factored into the cost of doing business
- Bribes were paid to all these protectors in the form of dividend from their respective shares
- Punishment was reserved for those who deviated from the agreed pattern of corruption

Post-1998 Corruption

- Power and authority are now more diffuse
 - Political parties
 - Decentralization
- Centralized corruption – one-stop shopping – is gone replaced by a more fragmented bribe collection system
- The number of bribe-takers has increased to such an extent that corruption may be more detrimental to economic efficiency than in the Suharto era

Decentralization and Corruption

- While in other countries decentralization may have nothing to do with corrupt behavior, in Indonesia, already burdened with Suharto's corruption, it only worsens the fragmentation of the bribe collection system
- The phenomenon is called “overgrazing the commons”, in which officials from all levels of government and many different agencies prey on the same economic activities

Bribe rates have declined

(as % of production cost in 37 districts in Java)

<i>Size (annual revenue)</i>	2001	2004
Small (<Rp. 1 billion)	10.7	5.8
Smaller-medium (Rp. 1-5 billion)	11.4	7.3
Larger-medium (Rp. 5-10 billion)	8.4	6.5
Large (>Rp. 10 billion)	8.5	6.7
All firms	9.8	6.5

But bribe uncertainty have increased

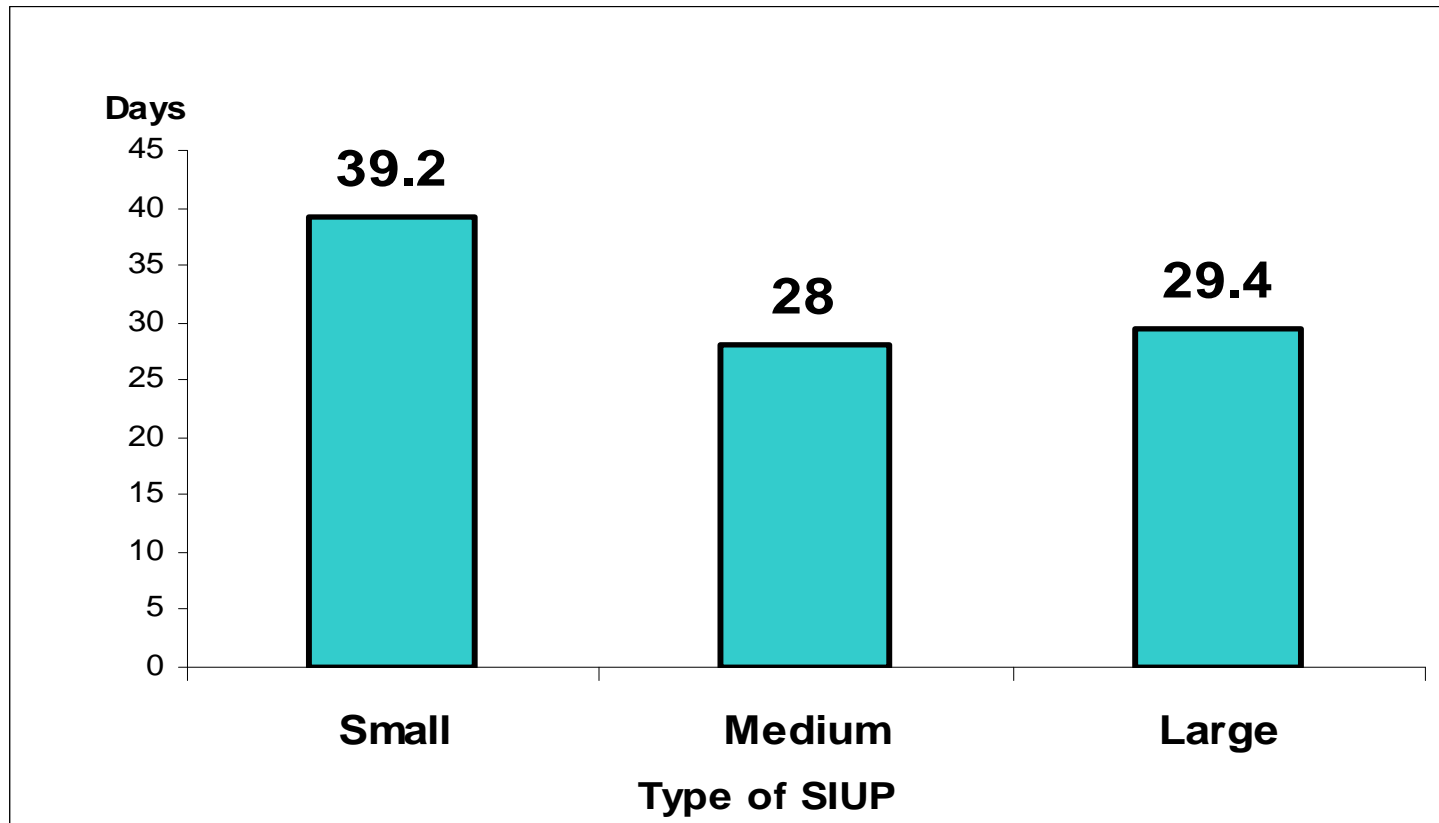
(1: very predictable to 6: very unpredictable)

<i>Size (annual revenue)</i>	2001	2004
Small (<Rp. 1 billion)	3.6	4.2
Smaller-medium (Rp. 1-5 billion)	3.6	4.0
Larger-medium (Rp. 5-10 billion)	3.9	3.7
Large (>Rp. 10 billion)	3.8	3.8
All firms	3.7	3.9

And More Licenses and Permits

<i>Size (annual revenue)</i>	2001	2004
Small (<Rp. 1 billion)	4.9	4.4
Smaller-medium (Rp. 1-5 billion)	6.3	6.0
Larger-medium (Rp. 5-10 billion)	7.3	7.7
Large (>Rp. 10 billion)	8.6	12.0
All firms	6.6	7.6

Time Spent to Obtain SIUP by Size of the Firm (Median)



SIUP for small businesses is taking longest
time

Democracy and Corruption

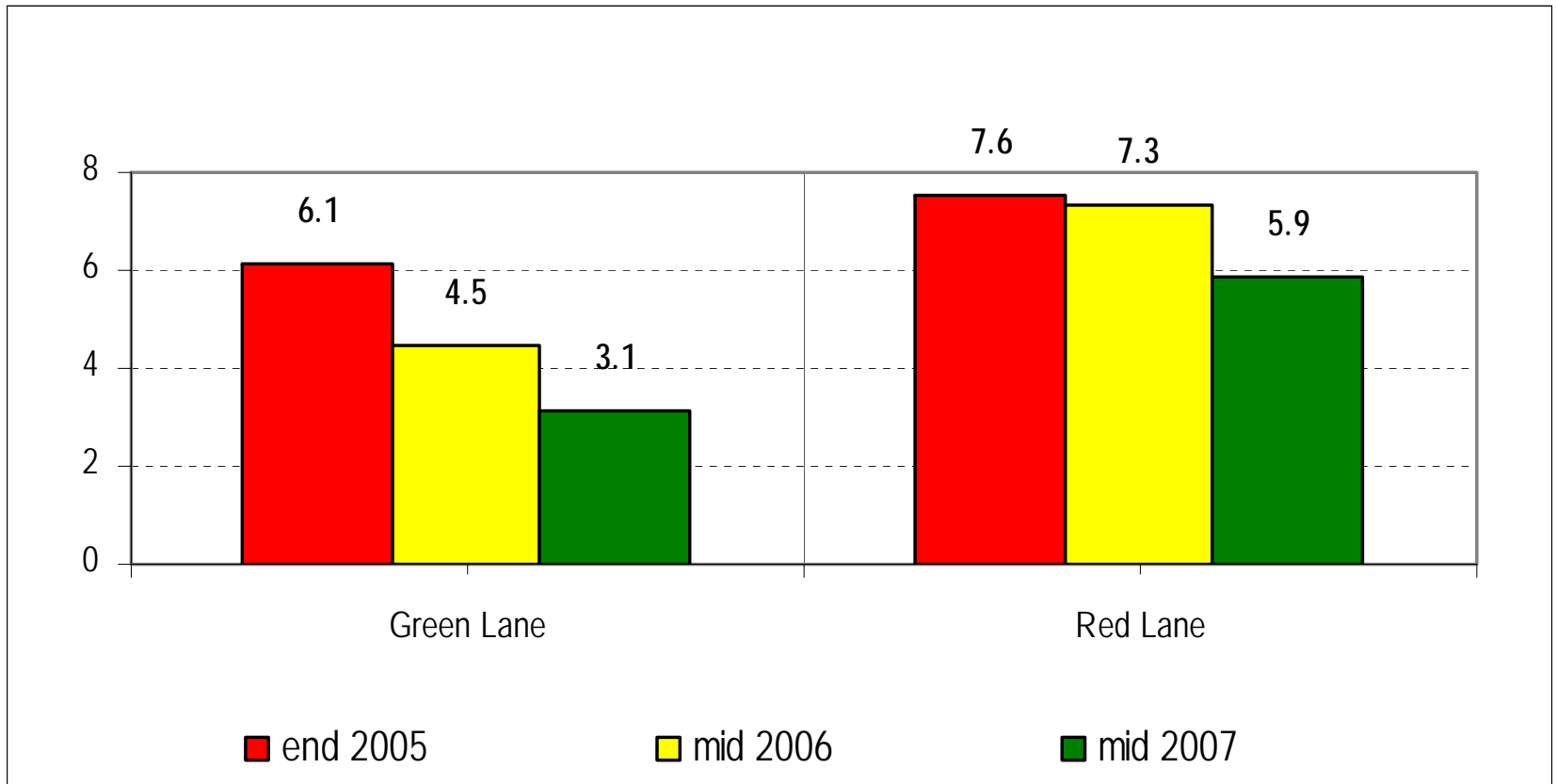
- Democratization has turned corruption into a potent political issue
 - Fed up with fragmentation of corruption
- (SBY) made tackling corruption his central campaign promise and quickly established the Corruption Eradication Commission (Komisi Pemberantasan Korupsi, KPK)
- Period of “testing the waters”
 - avoid targeting national figures with strong political connection
 - the first phase of the post-New Order anti-corruption drive has been conducted at the level of provinces and districts

Efforts to control corruption

- Anti corruption efforts have produced prosecutions but little institutional reform
- The judicial system and the civil service are in need of serious reform
- Some experiments have been made but the results are mixed
 - Raising salaries of Ministry of Finance officials

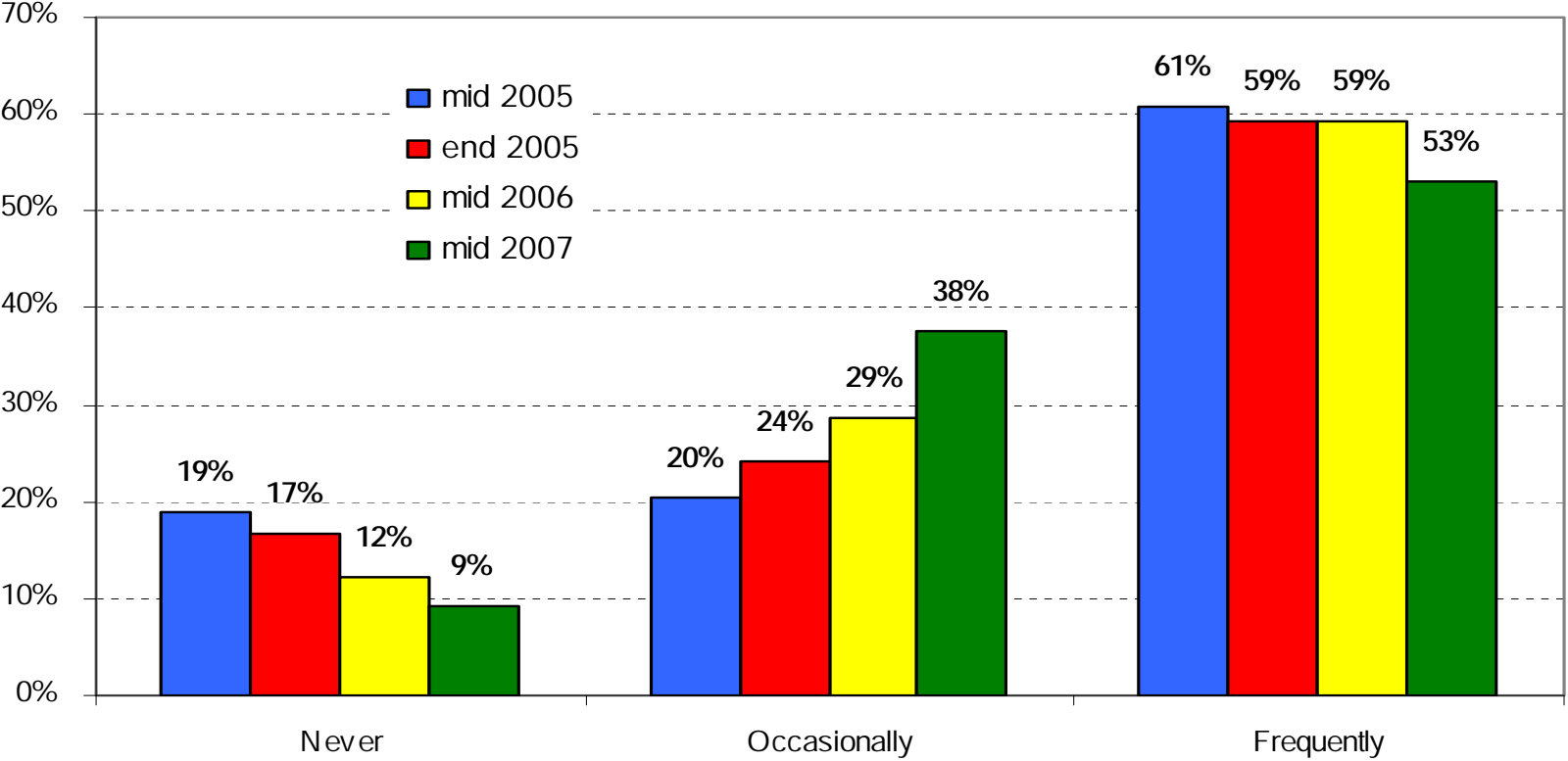
Experiment of salaries' increase for custom officials

Import Clearance Time has improved for both green and red lanes in days (means)



Increase in salaries is a good thing

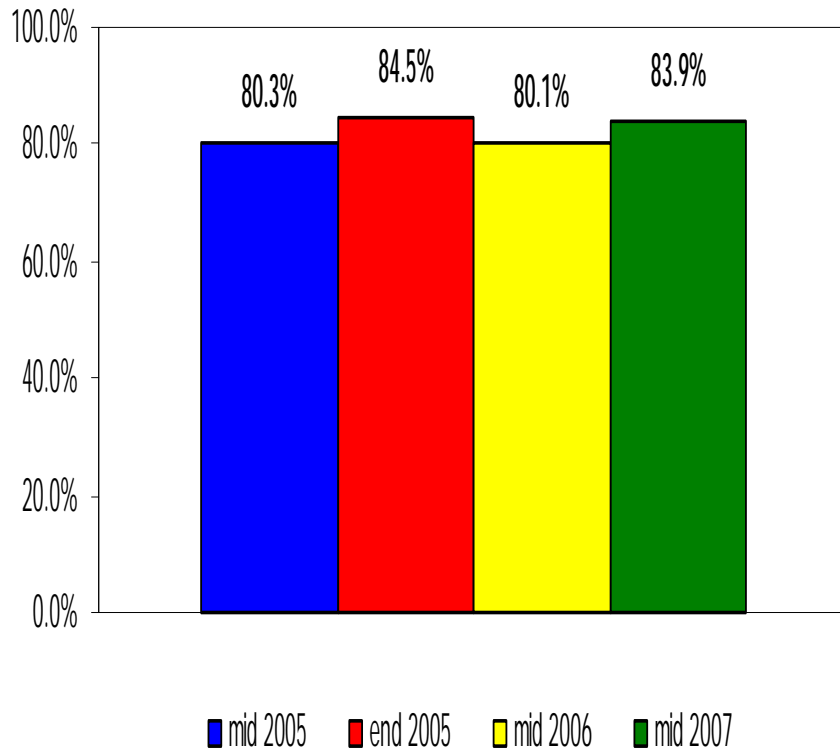
But the percentage of those who said never paid bribe has dropped



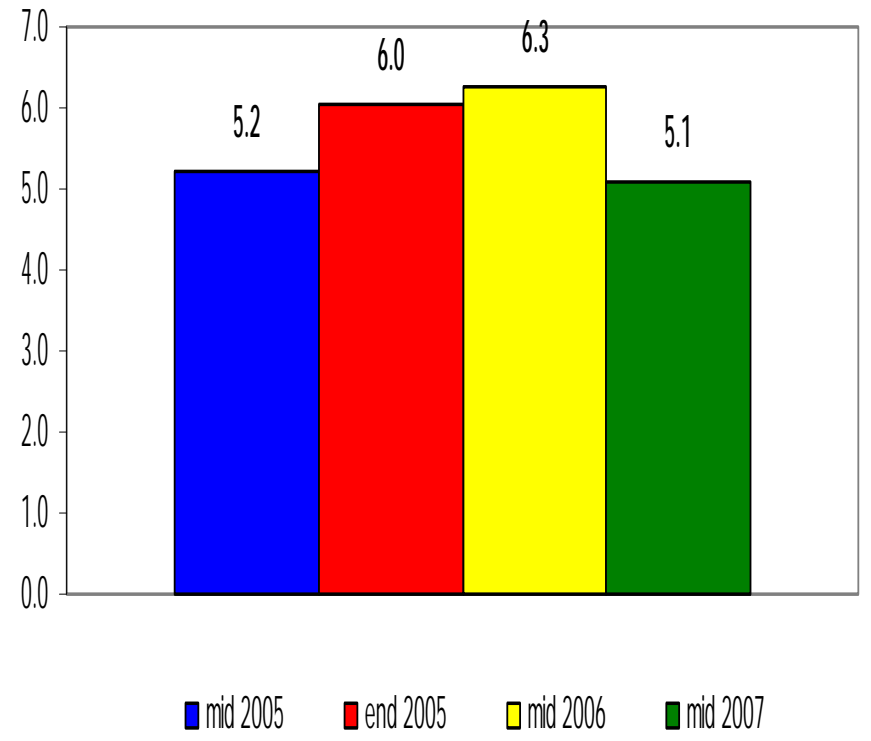
Experiment of tax officials' salary increase

VAT Refund is getting shorter and % of initial claim refunded has increased

VAT Refund as a % of the Initial Claim



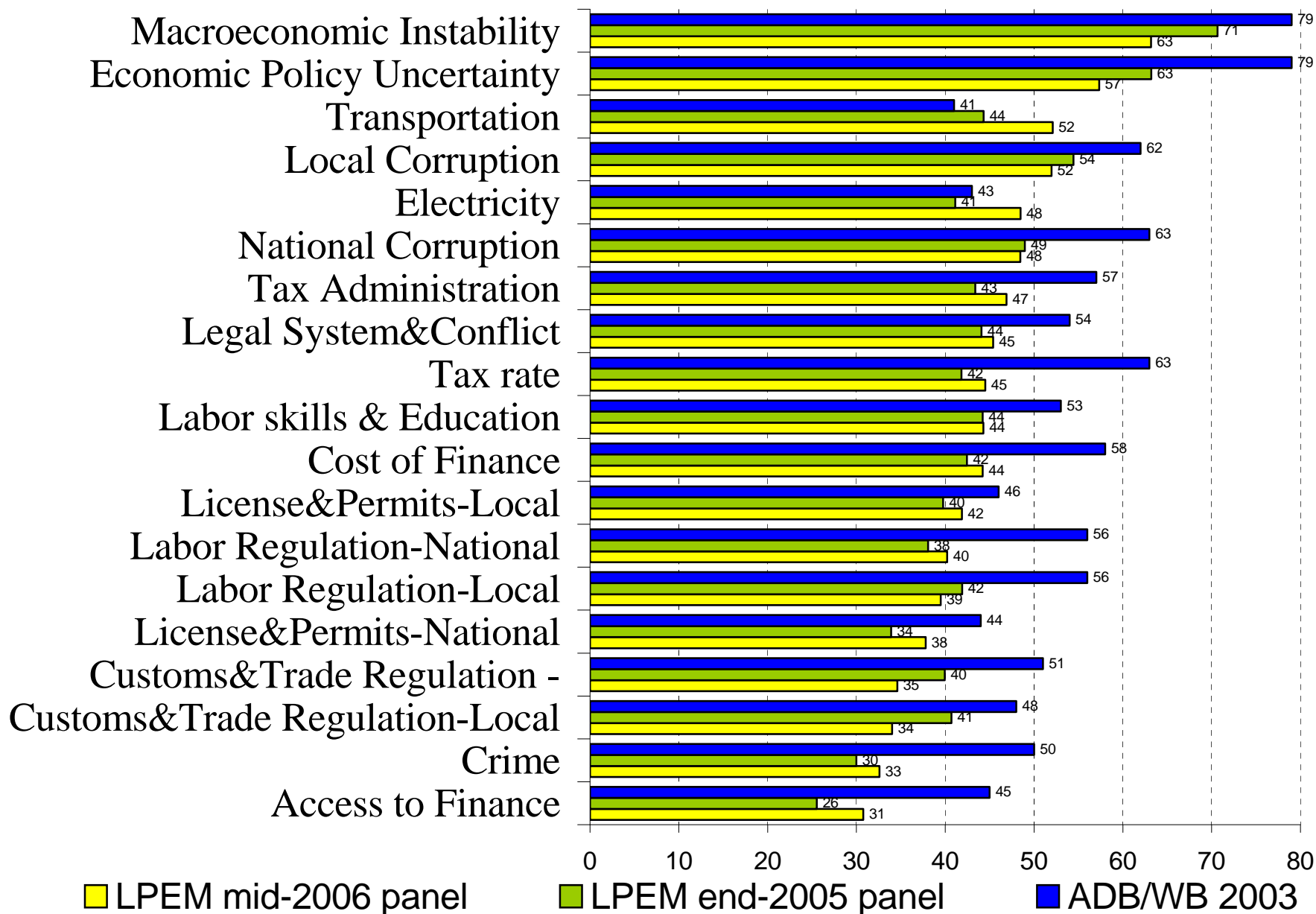
Time to process VAT Refund (month)



Moderating effects on local corruption

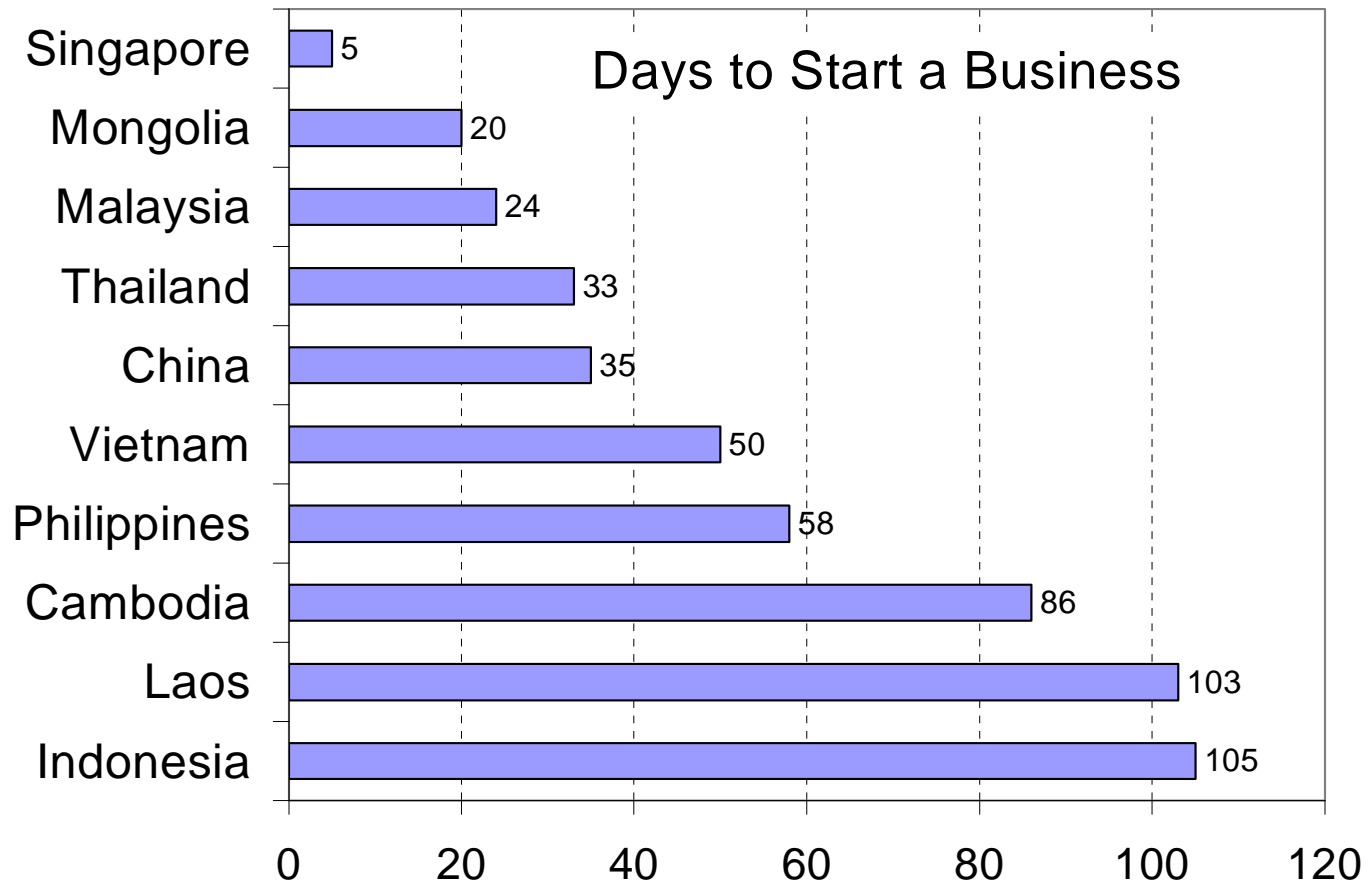
- Anti-corruption prosecutions are having some effect, particularly at the district level
- Direct local accountability mechanisms through local legislation (DPRD), local media and local voters
- Movement from bribes to fees – increase of user fee charges
- Decentralization also encourages competition between regions (districts) to attract businesses makes local corrupt behavior less sustainable

Percent of respondents reporting obstacle to be moderate, severe, or very severe (ranked by mid-2006 survey)



Can International competition make national corruption less sustainable?

Indonesia now has the slowest business start-up time of any country in Asia



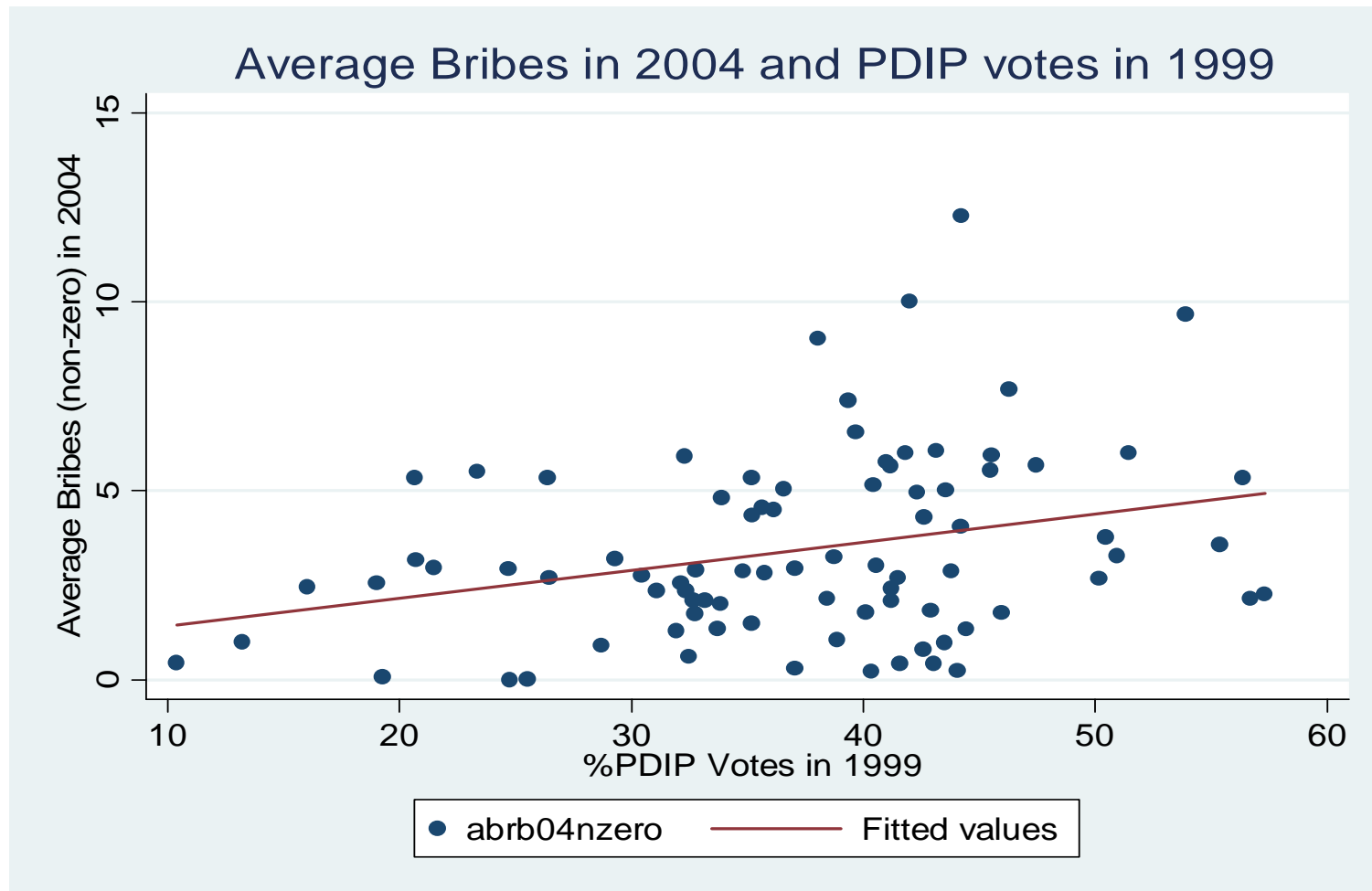
Challenges at the National Level

- Some cases before the courts today do involve national leaders and politicians
- But pursuing national-level corruption at the same speed may prove a formidable challenge
- Economic of scale of corruption
 - Temptation: even if get caught the proceeds are still high
- Political finance

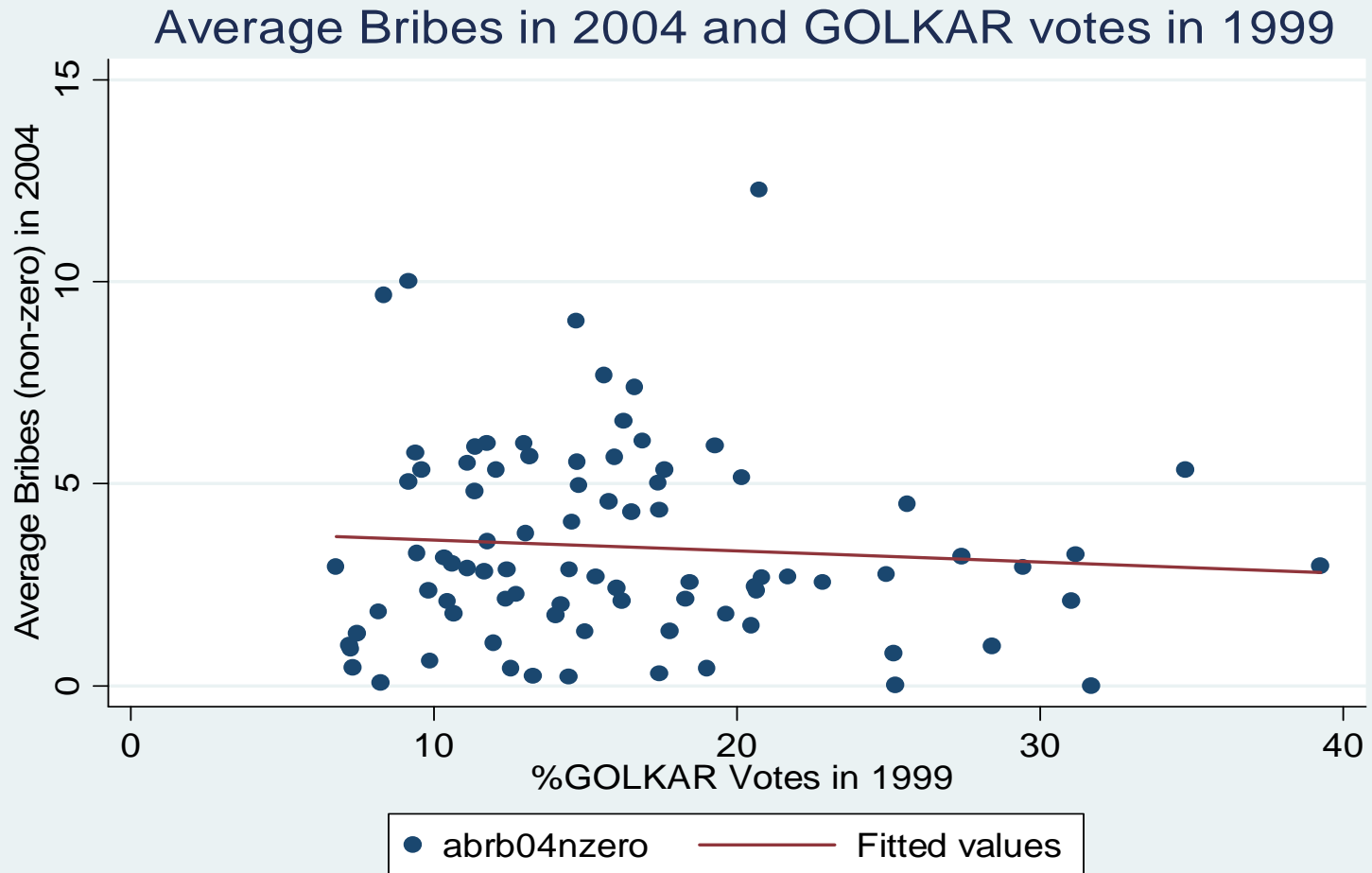
Democracy and Political Finance

- Political Finance/Political Party Funding
 - Entrance costs to power both the national and local are high
 - Recovering cost of entry creates corruption
 - Coming from corrupt government officials
 - illicit gaining by power holders
from public procurement, sale of services,
sale of public offices and tapping of
government budgets
 - Creating red tape to extract bribes

Recovering high cost of political entry can create new corruption



Experienced incumbents may have other means to recover cost

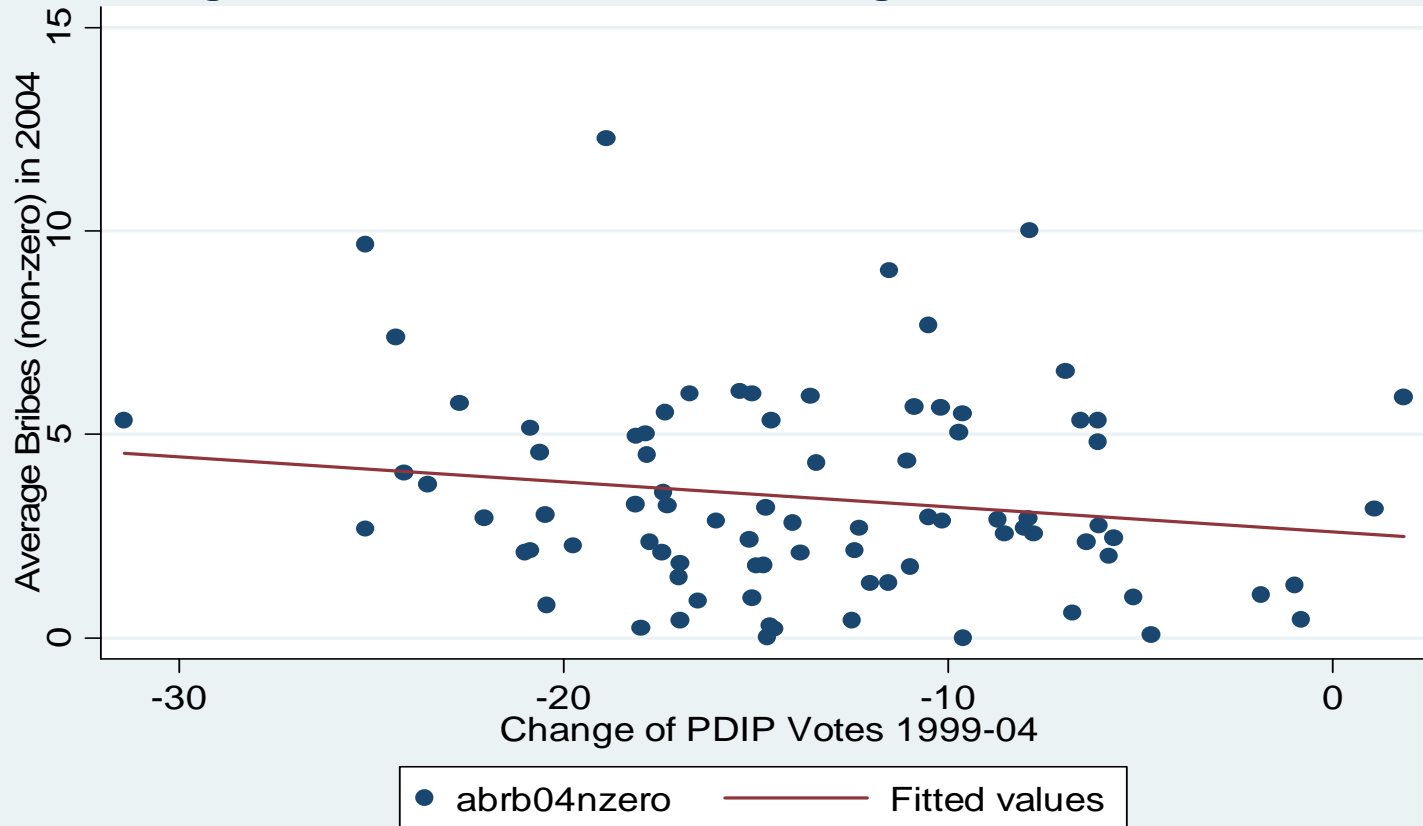


Democratization has moderating effects on local corruption

- At the local level the issue of corruption is a powerful vote-getter (Henderson and Kuncoro [2006])
 - In recent provincial elections in West Java and North Sumatra perceived corrupt and inept incumbents were soundly defeated despite enjoying the support of big political parties

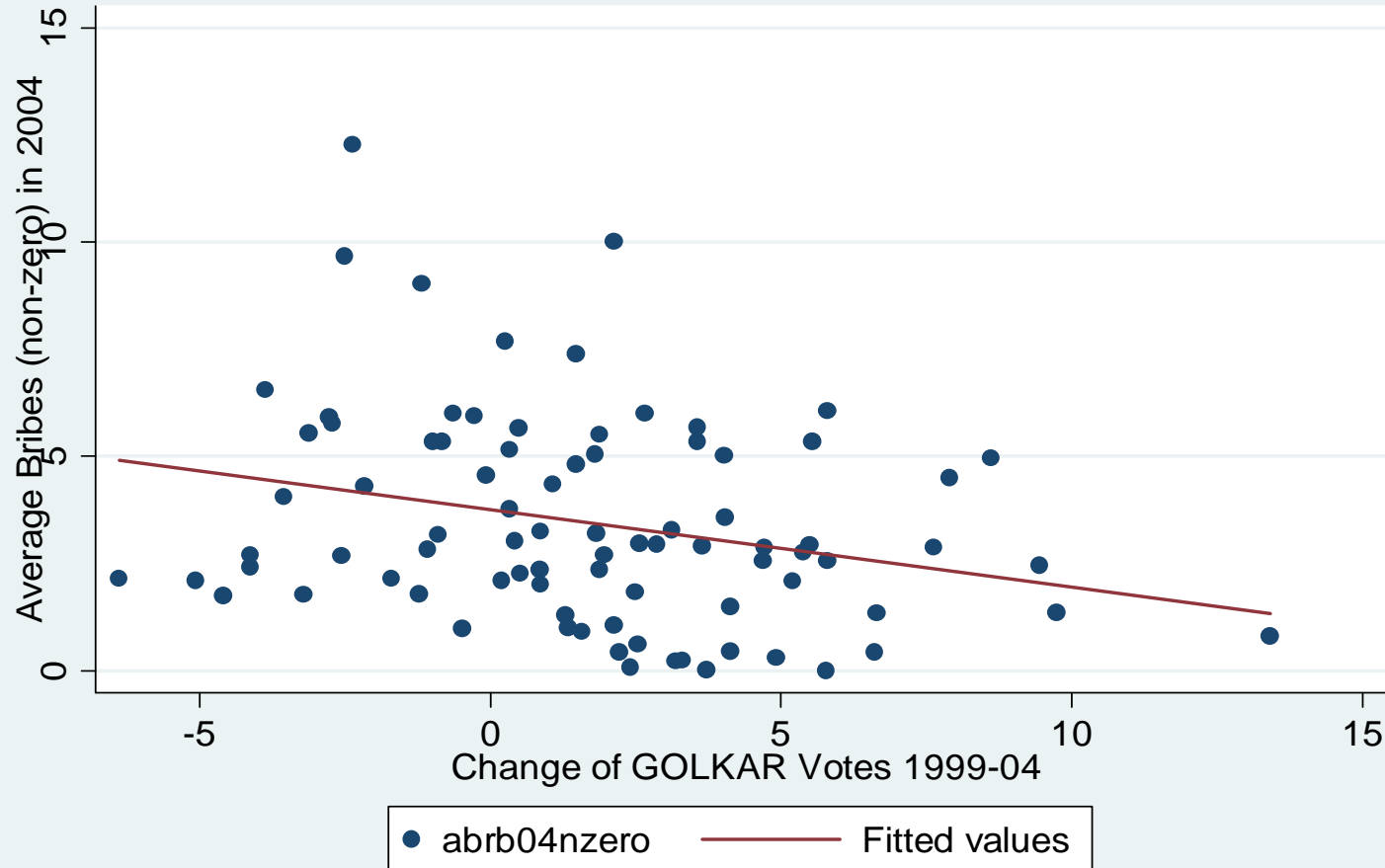
More corrupt means less votes

Average Bribes in 2004 and Change of PDIP votes 1999-04



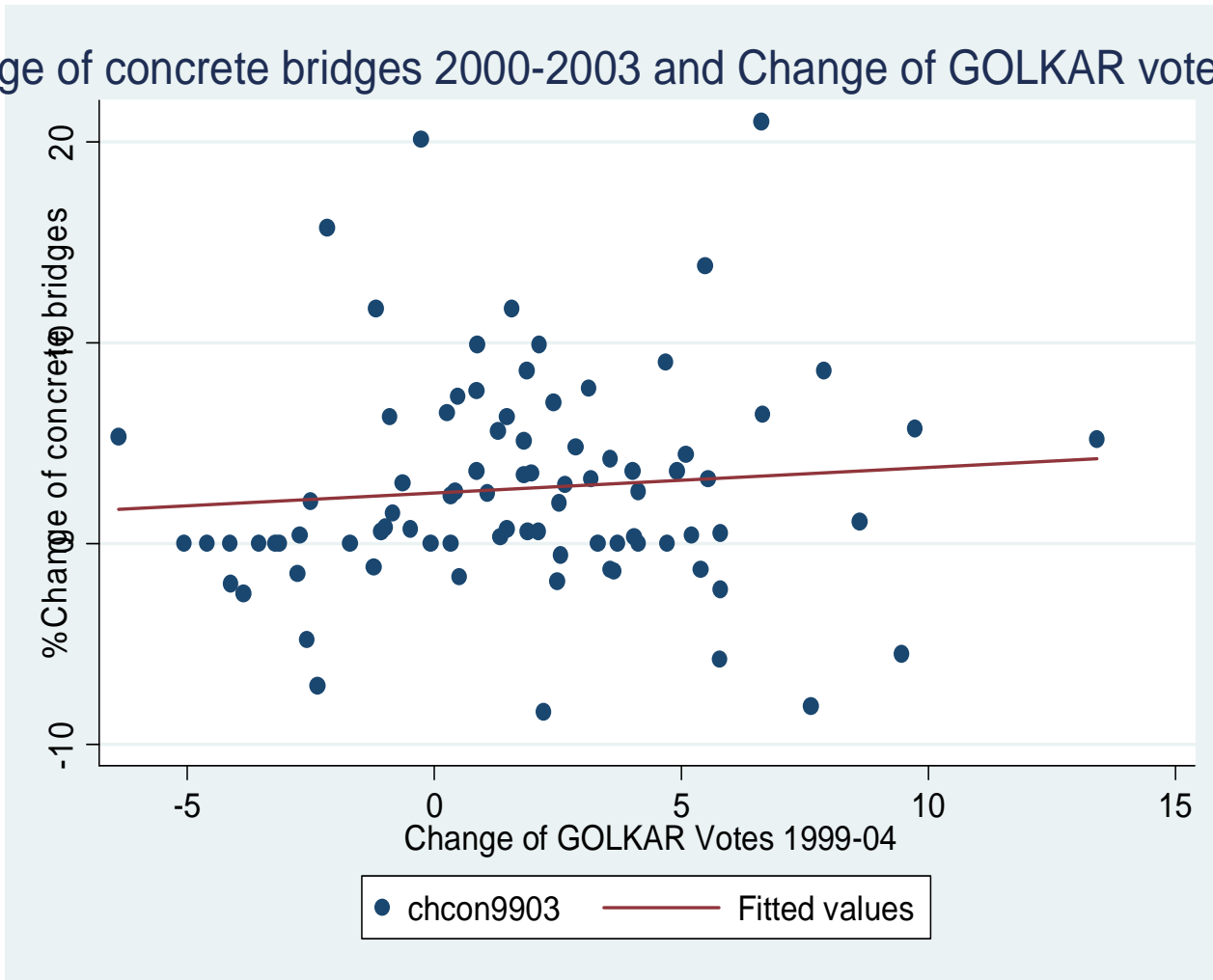
More corrupt means less votes

Average Bribes in 2004 and Change of GOLKAR votes 1999-04



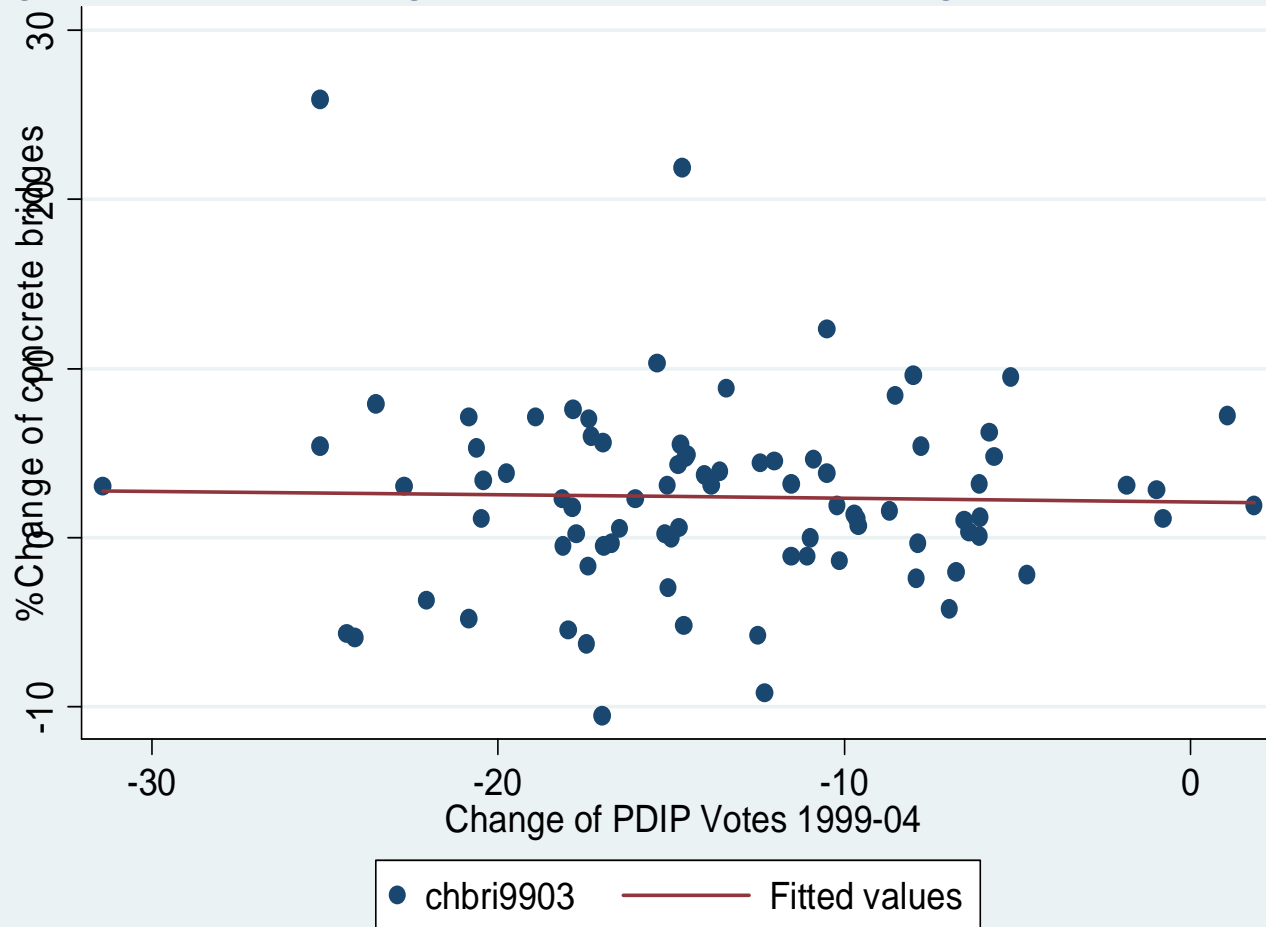
Bridges and votes

Change of concrete bridges 2000-2003 and Change of GOLKAR votes 1999-04



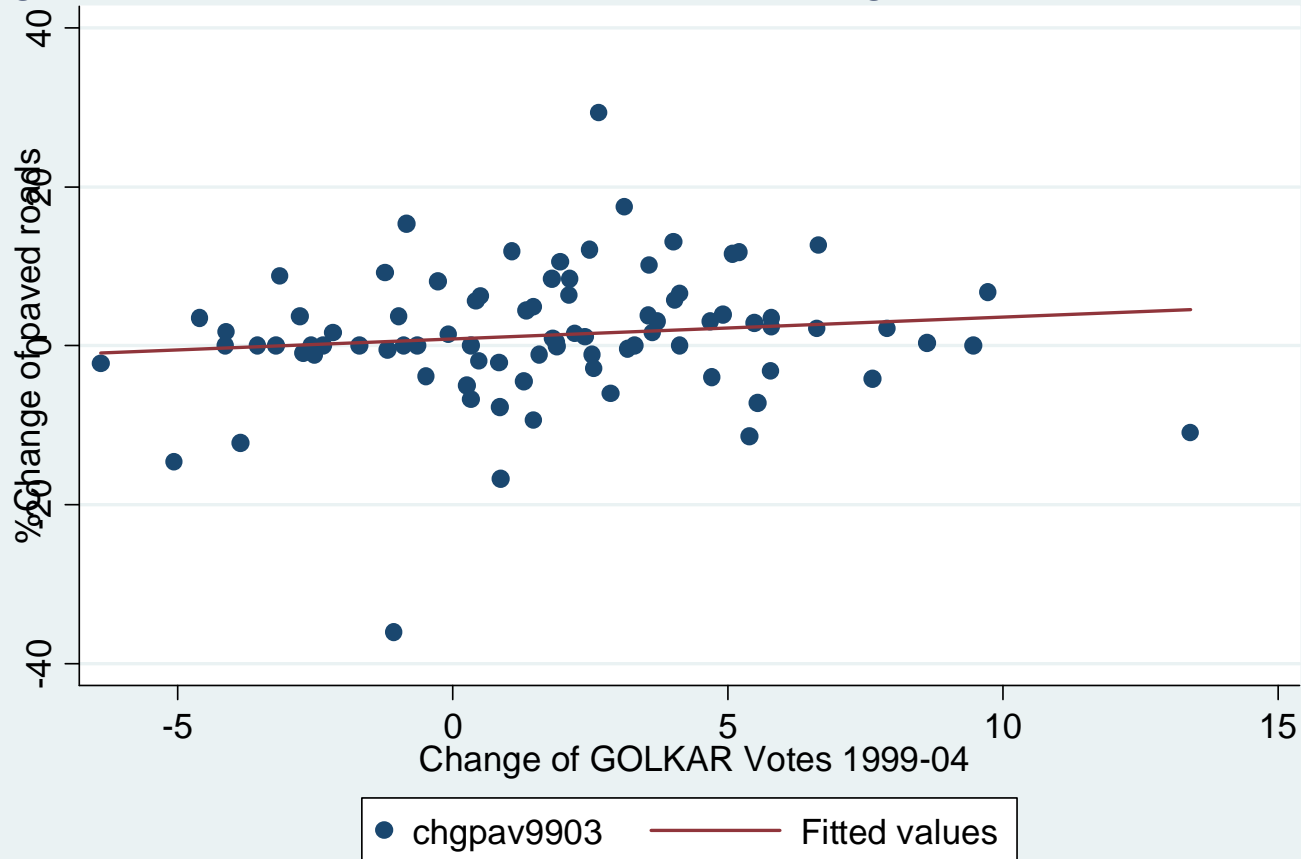
Bridges and votes

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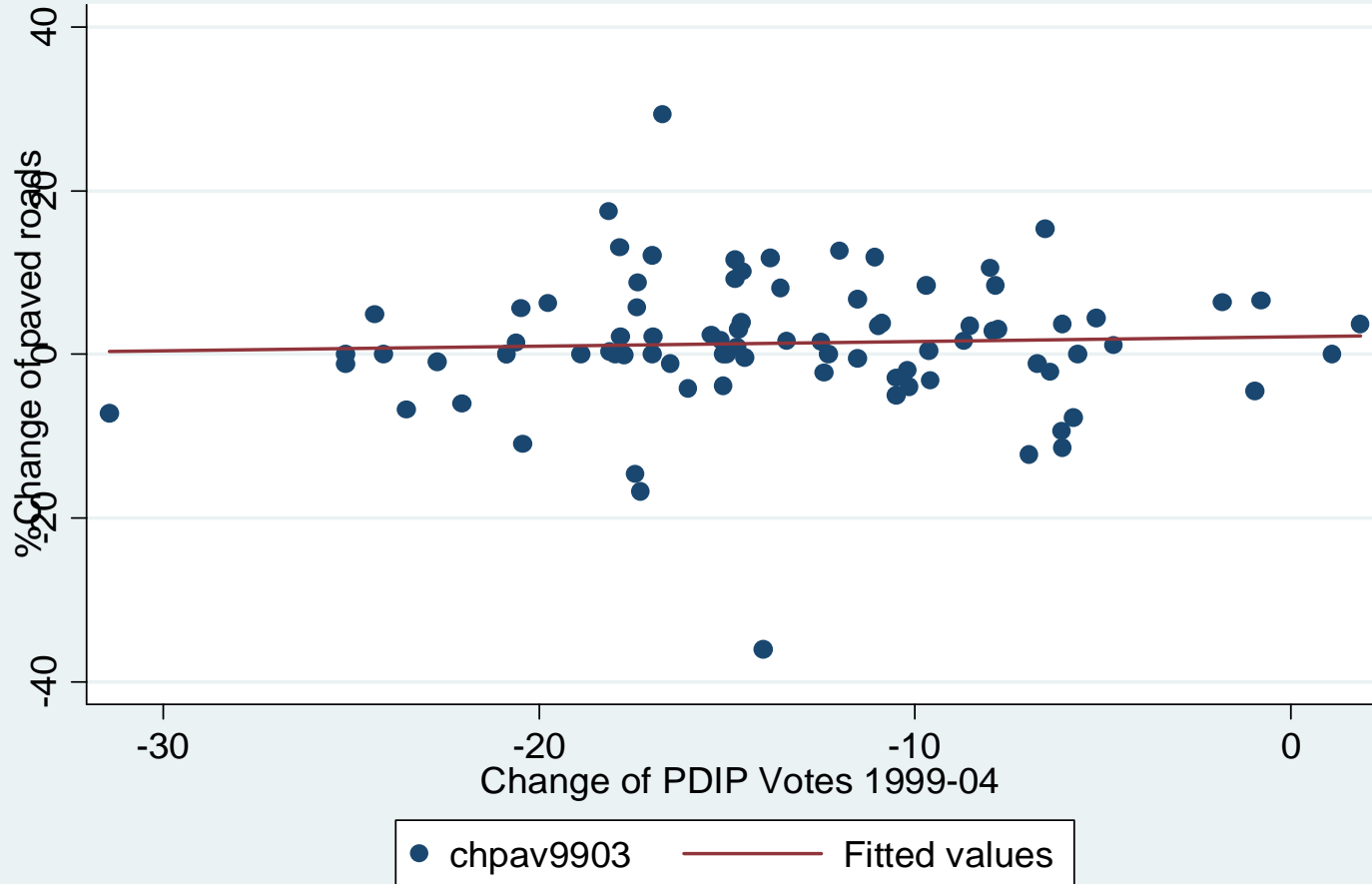
Paved roads and votes

Change of paved roads 2000-2003 and Change of GOLKAR votes 1999-04



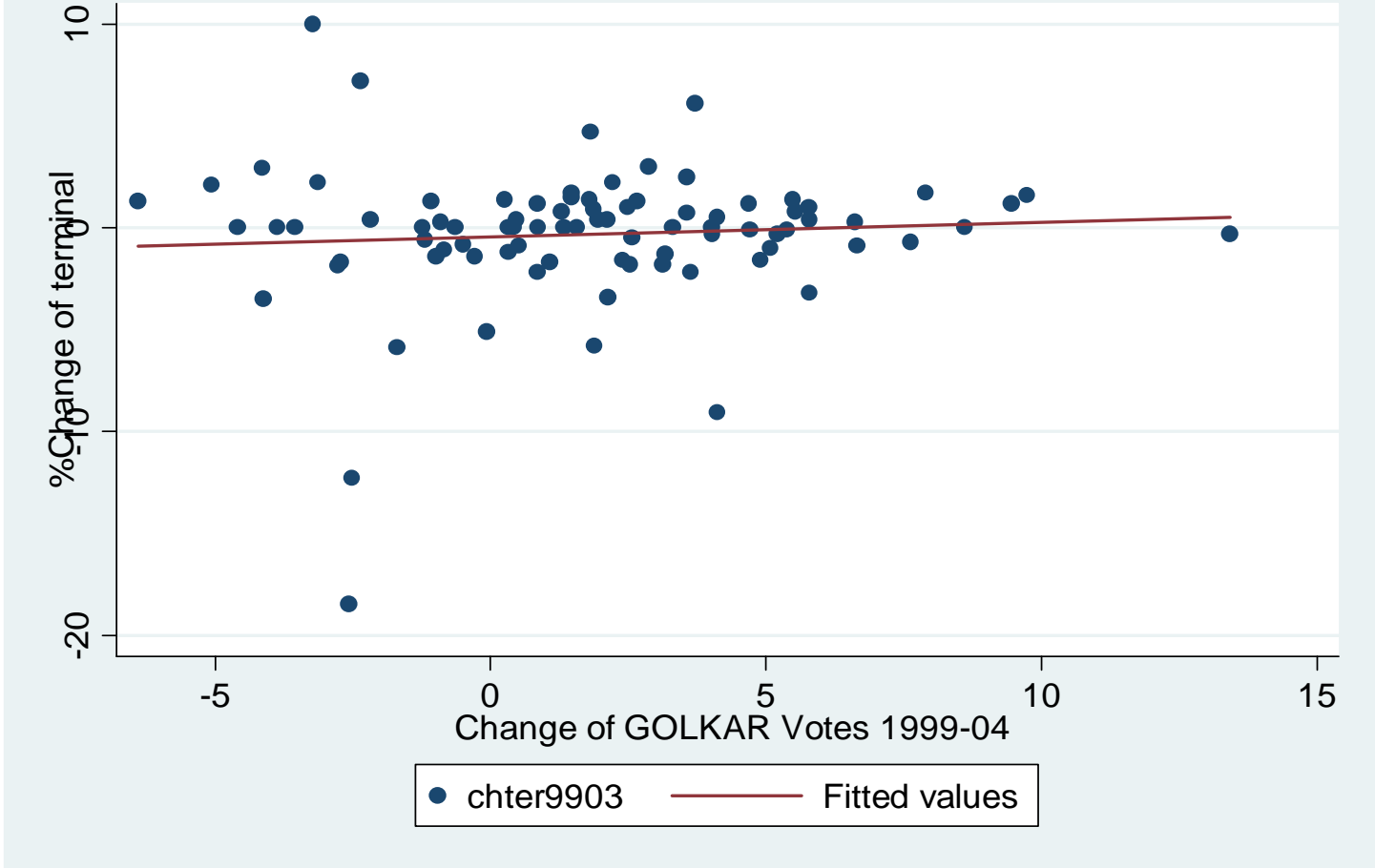
Paved roads and votes

Change of paved roads 2000-2003 and Change of PDIP votes 1999-04



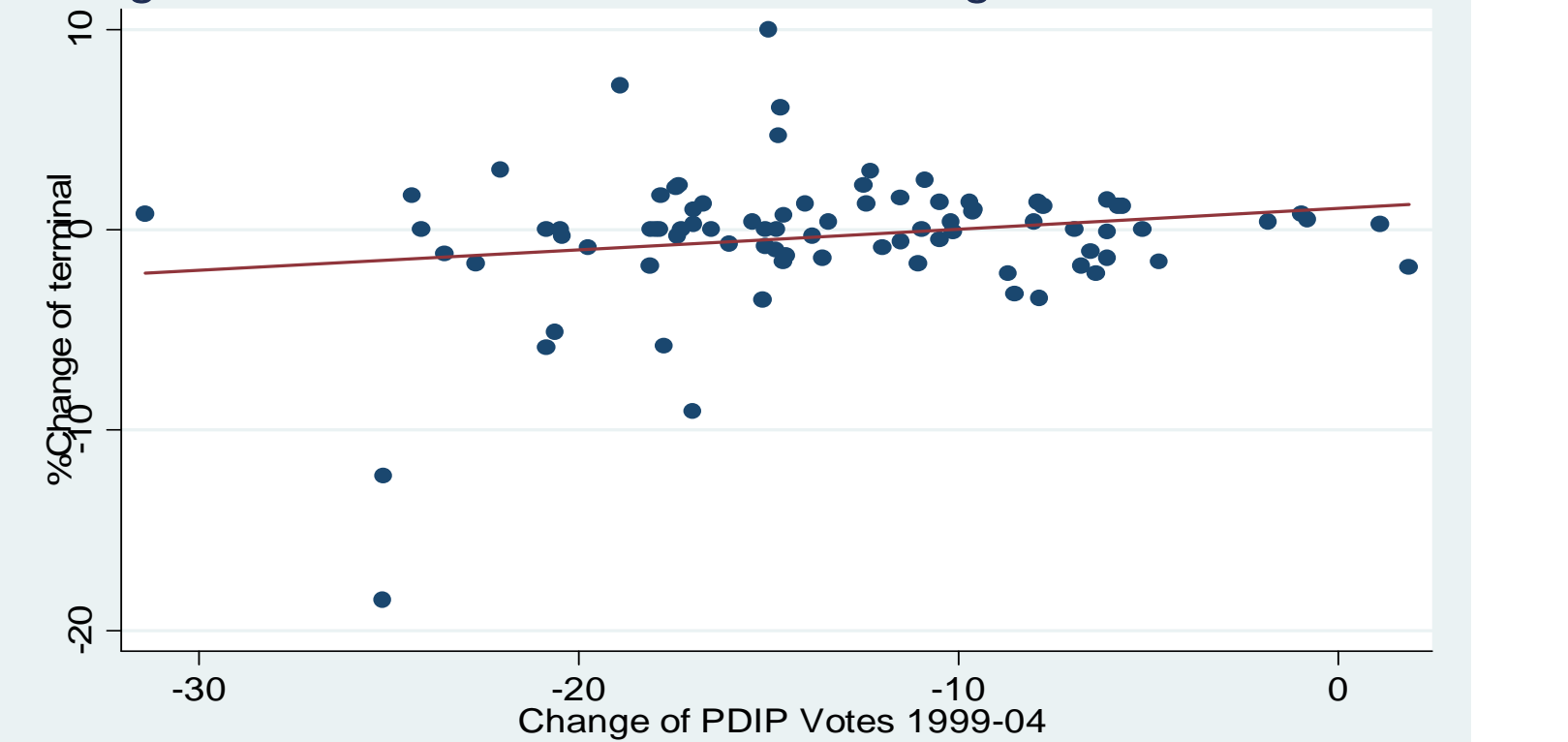
Bus terminals and votes

Change of terminal 2000-2003 and Change of GOLKAR votes 1999-04



Bus terminals and votes

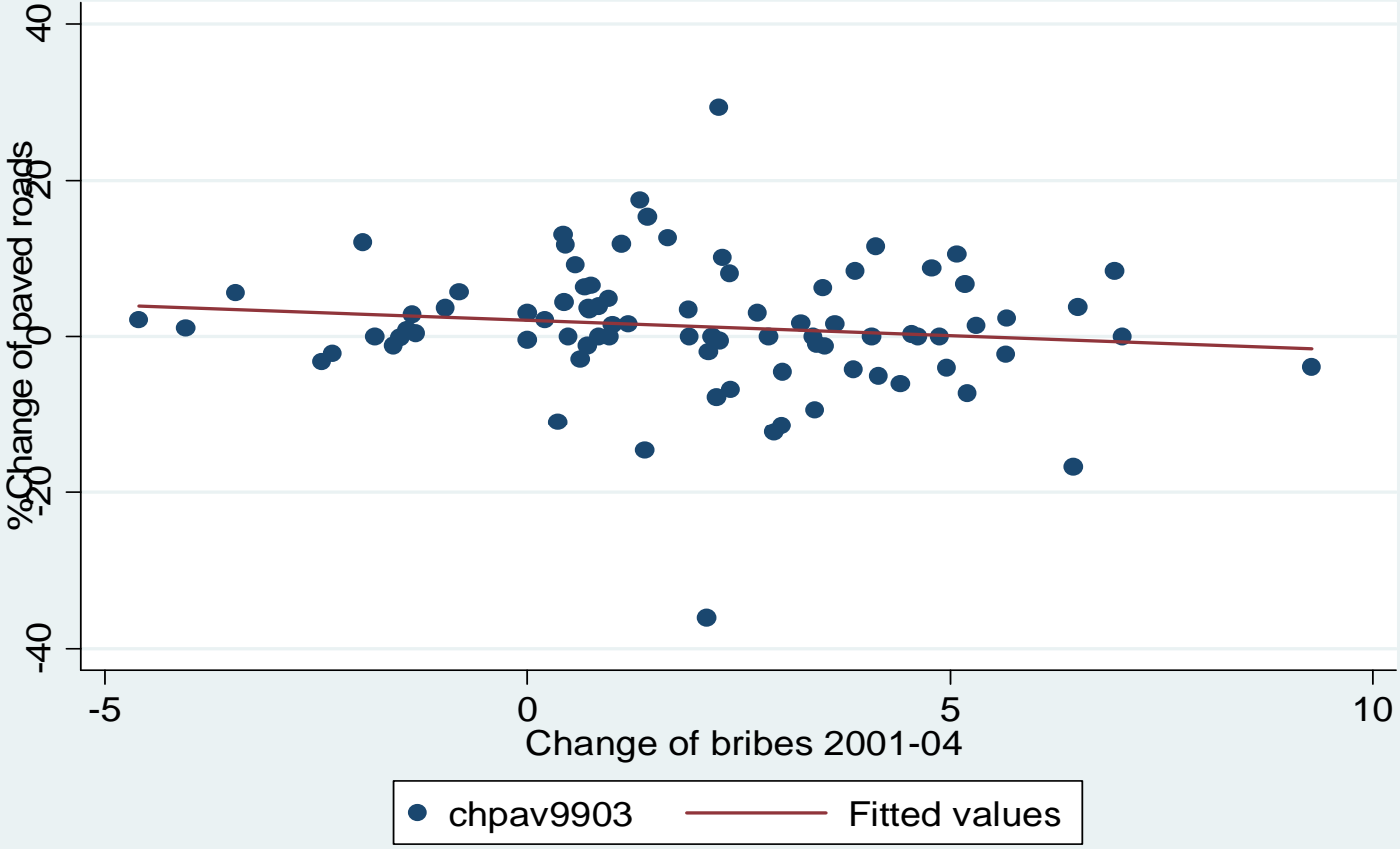
Change of terminal 2000-2003 and Change of PDIP votes 1999-04



● chtr9903 — Fitted values

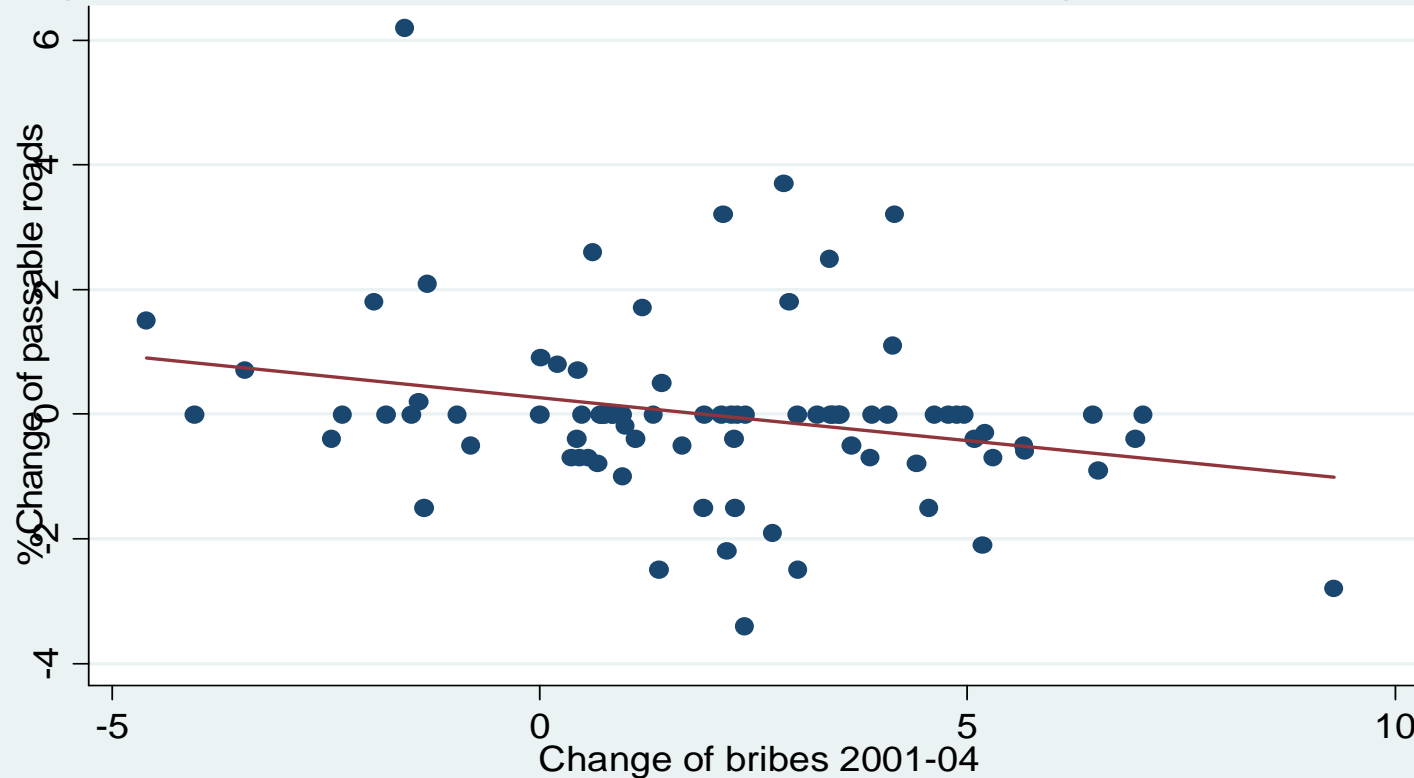
More corruption means poorer infrastructure

Change of paved roads 2000-2003 and Change of bribes 2001-2004



More corruption means poorer infrastructure

Change of passable roads 2000-2003 and Change of bribes 2001-2004



● chpas9903 — Fitted values

Challenges at the National Level

- But due to short-term horizon “self-correcting mechanism” alone may not be enough to control political parties’ corruption
- Establishing transparent campaign finance systems that could contribute to good governance more effectively in the long run
 - by providing resources for competitive party politics
 - encouraging popular participation in that process,

Final Remarks

- Anti corruption drive, democratization and economic competition (both international and local) have the potential to reduce corruption
- but to be effective the long-rung they must be accompanied by sweeping reforms in the judicial system, the civil service and political finance
- A respected enforcement agency like KPK must continue to function without intervention from politicians