Stealing From the People

16 Studies on Corruption in Indonesia

Book 3

Foreign Aid, Bussines, and State Enterprises: Counting the Cost

Editor of English Edition
Richard Holloway

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First Printing : January 2002

Published by the Aksara Foundation on behalf of
the Partnership for Governance Reform in Indonesia

Cover Design by the Aksara Foundation incorporating (with permission) Firman Ichsan's photograph of Dolorosa Sinaga's statue "Waiting for Godot"

This book is published in both English and Bahasa Indonesia. The Indonesian title is "Mencuri Uang Rakyat". The contents of both are largerly the same, except where adjustments were made in recognition of the different readership, language idioms, and editing styles. The Indonesian edition is the definitive edition.

Publishing Data for the Indonesian National Library

Stealing from the People – 16 Studies of Corruption in Indonesia/Editor, Richard Holloway - Jakarta: Aksara Foundation, 2002, 4 volumes, 18 cms.

Contents: 1. Corruption - from top to bottom. 2. The Big Feast: soldier, judge, banker, civil servant. 3. Foreign Aid, Business, and State Enterprise: counting the cost. 4. The Clamp Down: in search of a new paradigm

Book 1: Corruption - From Top to Bottom

ISBN: (for complete set) 979-3093-05-6

ISBN: (for Book 1) 979-3093-06-4

"Stealing from the People"

Foreward to the English Edition

Stealing from the People is published by the Partnership for Government Reform in Indonesia. The Partnership's aim is to promote and support a program of governance reform. The Partnership is governed by a Board consisting of senior government officials, private entrepreneurs, and Indonesian citizens who have a clear perception of the meaning and purpose of good governance. The World Bank, the United Nations Development Program (UNDP), and the Asian Development Bank are both founders and members of the Partnership.

The purpose of publishing the book ***Stealing from the People*** is to present the Indonesian public with a collection of research reports about how corruption has come about, spread, and held hostage the entire social fabric of the Indonesian nation. The book also aims at convincing the deeply concerned community of reform minded citizens in the country that somewhere, behind a mountain of hard and smart work, there is hope for salvaging the nation.

The editorial concept of the book emerged from the ranks of the Partnership. The editors wish to thank Ms. Merly Khouw, a consultant to the Partnership, for the selection of authors, and her persistent drive for precision, detail, and accuracy. Most of the reports were written in Indonesian and have been translated into English. It is not an easy task and the Partnership is grateful for the work done by translators and editors, particularly Michael Soldner, who understood that each language carries with it its own syntax and idiom which would result in distortion of intended meaning if translated literally.

The book's cover represents the work of Dolorosa Sinaga, an Indonesian sculptor who has generously permitted the Partnership to feature the fruits of her creativity at the front of this most important book. To the Partnership, Dolorosa Sinaga's sculpture symbolizes the resolve and the desperation of Indonesias's poor waiting for justice. Finally the editors thank Mr. Khateeb Sarwar Lateef, Senior Adviser to the World Bank in Indonesia and Ms. Sri Urip, Executive Director of the Partnership for their accessability and wise counsel.

The book is up to date until April 2001. The findings, interpretations and conclusions are those of the authors of each report and do not necessarily reflect the views of the Partnership. Neither the Partnership, the members of the Governing Board, the organisations or governments they represent, nor their affiliated organizations may be held responsible for the accuracy of the facts and data in this publication, or any consequence whatever resulting from their use.

Richard Holloway

Editor of the English Edition

Jakarta, January 02

“Stealing from the People” - Introduction

By Nono Anwar Makarim

The 16 essays in the 4 volumes of ***Stealing from the People*** report on research conducted by the authors. The book is about what people have always suspected, but didn’t know precisely. How did they steal from the people? From the presidential palace to military headquarters, from state enterprise to national development planning boards, from foreign aid projects to courts of justice, from banks to political parties, entire sectors were examined. The result was a picture of systemic corruption. It is corruption conducted in an institutional and organized manner, covering all political and economic sectors. Highly placed government authorities cooperate with private businessmen, local government bureaucracies, customs, and the state security apparatus in order to maintain and develop the art of stealing.

The constant theme emerging from the studies is that the government must be controlled, that control cannot be done by government alone, and that those most entitled to exercise such control are the corruption’s victims – who are the entire citizenry of Indonesia. A warning that also arises from the 16 studies is that news about corruption in the media is not about some distant crime occurring to some other person removed from ourselves. It is, in reality, a prior notice to everybody that a bill is on the way to pay for the luxury of the few.

Stealing from the People cautions that isolated measures are not enough to begin making a dent in the armour of corruption. Setting up anti-corruption task forces and watchdogs only won’t do. When political pressure is strong, governments normally succeed in deflating tension by feigning serious attempts at dealing with corruption. Most of the time they get busy setting up commissions. In 1997, in Kenya, the government established 4 anti-corruption commissions within the span of one year. There was no significant improvement in the situation. During the rule of President Suharto no less than 5 anti-corruption committees were installed. In 1970, at the time of establishing No.2 in this series, Suharto even pledged to lead the fight against corruption himself. One of the cruel ironies of the anti-corruption efforts during the New Order era is that the country managed to gain a prominent seat among the most corrupt countries in the world.

Simply jailing the culprits won't do either. Pursuing corrupt officials, even in countries where the legal system has a tradition of working more or less effectively, has not produced the desired results. In the 80s and 90s waves of successful prosecutions and convictions of corrupt officials swept through the bureaucracies of India, Bangladesh and Pakistan. Soon thereafter, their replacements were doing the very same things for which their predecessors had been jailed. Law enforcement as a single anti-corruption policy tool in a broken down legal system such as we find in Indonesia is disastrous for two reasons. It is ineffective and it erodes what little social trust remains in society. Officials accused of corruption are interrogated, held in detention, milked by investigating officers, prosecuted and then set free by the courts. Arrests made by investigating officers against present or former government officials leave the general public cold. People already know what the outcomes of the arrests will be.

The 16 research papers warn that, unless law enforcement and anti-corruption commissions are accompanied by other policy reforms, efforts to reduce and eventually eradicate the most flagrant forms of corruption are doomed at birth. Such policies include institutional reform of the bureaucracy, the reduction of the public sector, privatization of state enterprises, and the launching of successive campaigns to raise public awareness of the evil corruption generates. The proposed policies may have big sounding names, but at closer inspection contain down to earth prescriptions. Institutional reform of the bureaucracy, for instance, calls for fit and proper criteria to be met by people joining the bureaucracy, and similar criteria for people to be promoted. The ethos of selfless service to the public, no matter how far removed from reality, must be inculcated and restored to each government agency in order for its members to regain their self-respect. Law enforcement, the punishment of those found guilty of violating the laws, is not merely a retributive measure, but aims at resurrecting the basic moral code of right and wrong. It should correct the disproportionate adulation of rich government officials and promote the embarrassment of association with persons whose wealth was accumulated by corrupt means.

The reduction of the public sector should not be seen as a capitulation of selfless public service to rapacious plunder by cut-throat capitalist monopolies. It is but a serious effort to reduce the space of corrupt activities and, sometimes, even to increase public gain. An example of this would be the take-over of Indonesian customs functions by a Swiss-based surveyor company. Government income increased, and the increase served as an indication of what, in the past, would be lost to corruption. The same goes for the privatization of state enterprises. Protests against these measures are cloaked in nationalistic jargon. In reality it is but a political mask hiding the fear of losing resources from which to finance patron-client relations and political loyalties.

Finally, there is the need for sustained campaigns to broaden the pressure faults and include both domestic and foreign fronts in demanding a stop to the plunder of citizens. Foreign pressure is much needed in a power structure dominated by a bureaucratic polity bent on protecting the status quo. If threatened, the system either resorts to sabotage through inaction, as we see today – or violence, as we saw in the past. This is why domestic pressure is not enough to bring forth significant results. An important phase of the campaign should stress the issue that good governance is not a sell-out of the national interest. On the contrary, corruption is such a sell-out. Stealing is bad. It does not matter whether the thief is Indonesian or foreign.

Introduction to Volume 3

Foreign Aid, Bussiness and State Enterprise

Counting the Cost

The third volume in this four part series on corruption in Indonesia deals with the way in which corruption sucks people into its grasp. When corruption is pervasive and expected, and when corruptors seem immune to prosecution, then more and more people join those already practising corrupt behaviour.

Mohammed Ikhsan first of all tries to estimate the economic cost of corruption along several macroeconomic indicators including economic growth, domestic investment and foreign investment. He points out that since corruption is an illegal activity, there is no direct estimate of the cost of corruption on the economy and the empirical problems of measuring corruption stem from unclear definitions of the phenomenon. This paper limits the definition of corruption to the World Bank's definition of "the use of public power for private gain".

Measuring corruption has traditionally relied on perception indices developed by business risk organizations and the international NGO, Transparency International (TI). Such corruption perception indices have been shown to be empirically robust, and this is because all these indices have very strong correlations to each other. As Mohammed Ikhsan points out, however, there are significant differences when the corruption ratios of two countries are directly compared, thus affecting the estimation of the economic cost of corruption.

Utilizing an augmented growth model, the study has found that corruption has cost Indonesia's economic growth and investment significantly. This method consists of using growth and investment equations to generate corruption parameters which are then used to assess the macroeconomic impact of upgrades in a country's level on a corruption perception index to a better or lower score. The difference between the hypothetical level and the actual level reflects the cost of corruption to the economy. The study finds ratio would have been higher than its current level. Similarly, if Indonesia could reduce its corruption level to that of Singapore, its ability to attract foreign direct investment would be equivalent to a 10% subsidy. Corruption has also meant a deterioration in the quality of capital inflows to Indonesia as it is dominated by short-term debt rather than foreign direct investment.

Mohammed Ikhsan shows that corruption undermines the performance of the Indonesian economy by (a) lowering levels of domestic and foreign investment; (b) distorting public expenditures and investments and deteriorating physical infrastructure; (c) lowering public revenues and lessening provision for the rule of law: and (d) hurting the poor as result of reduced economic growth which in turn derives from increased corruption.

Paul McCarthy looks, in the second chapter at the role foreign aid has played in stimulating or supporting corruption. He points out that the leakage of money from projects funded through the Indonesian government's "Development Budget" is common knowledge. Projects supported through development loans are particularly vulnerable to corruption.

By examining the history of corruption within foreign aid projects, with a particular focus on Indonesia's three largest development creditors: the Government of Japan, the World Bank and the Asia Development Bank, and by examining the factors that affect rates of corruption from one project to another, Paul McCarthy demonstrates that leakage rates are more complex than the popular notion that 30% of all foreign aid funding finds its way into the pockets of corrupt civil servants and contractors and he offers a description of the elaborate system of corruption and how leakage typically occurs within aid projects.

Mr. McCarthy points out that while longstanding observers of the Indonesian foreign aid scene are convinced of the correlation between the increase in Overseas Development Assistance (ODA) and the rise of corruption, and that there is a perception that KKN (corruption, collusion and nepotism) took off primarily as a result of the emergence of external donor agencies and their foreign aid packages, a closer analysis suggests that there is no direct causal effect. The stage was already set in terms of a pre-established set of well-practiced KKN mechanisms before this capital influx. More over, the increase in aid flows would not have taken place in the absence of the economic and geo-political conditions that had stimulated the increase in private investment in the first place. In this sense, foreign aid was less a precursor to, than a consequence of pro-Western economic growth and political stability. In this sense, foreign aid was less a precursor to, than a consequence of pro-Western economic growth and political stability.

The author provides an analysis as to why key donor agencies, despite a widespread awareness of corruption patterns, either ignored or took inadequate action to prevent leakage of funds from within the projects they were supporting. The paper looks at how Indonesian public and private sector officials managed to circumvent virtually every anti-corruption initiative put forward by donors.

An examination of the current foreign aid scenario is undertaken: whether or not corruption is decreasing as it falls under an ever brighter public spotlight, the enhanced measures donors are taking to safeguard their development investments and whether they are likely to be effective. Finally, Mr. McCarthy offers brief suggestions as to what more needs to be done in the ongoing battle.

In the third chapter of this book, Nasir Tamara discusses corruption in the Indonesian private sector. He briefly reviews the business and entrepreneurial class in Indonesia in the colonial and pre-independence period and then then moves to focus on the corrupt practices that have taken place within the private sector since Independence. Although corruption also occurs in small and medium scale businesses, the emphasis is on the conglomerates which became large with help from the state through the influence big companies have on the national and regional economy.

Nasir Tamara divides his chapter into three parts. The first part discusses the relationship between the government and private business sector and details how the corporate model of government in the Orde Baru cooperated with the western world in controlling policies to build a strong private sector on the basis of political stability and economic growth. The impact was that the private sector greatly depended on the government which caused certain corrupt practices to occur.

The second part describes how parts of the private sector developed into conglomerates under the New Order. It elaborates on the corrupt practices of conglomerates in carrying out their business, and includes some case examples involving state-owned enterprises as well as national and international corporations alleged or proven of corrupt practices. These cases include the State Oil Company Pertamina, the State Electricity Company (PLN), the State Logistics Agency (Bulog), Department of Mines and Energy, Freeport, Balongan, the Timor "national car" project, Lippo, the Capital Market Supervisory Board (Bappepam), Clove Marketing and Buffer Stock Agency (BPPC), Cimacan land case and Tapos animal husbandry case, and the Indonesian educational Television (TPI) among others.

The third part describes the destruction and re-embodiment of conglomerates in the Era of Reform and their continuing corrupt practices. This section analyzes how corruption practices still in fact continue in an era of democracy with all of its freedoms and the various laws and regulations that have been issued. It also discusses how such corrupt practice works and who benefits from them. Nasir Tamara closes with a look at how far corruption has become part of the Indonesian business culture and the appropriate remedies for such corrupt practices.

Ahmad D. Habir, in the fourth chapter, looks at corruption and state enterprises where there is a common public assumption that corruption is the rule rather than the exception. Dr. Tamara agrees that corruption in the state enterprise sector is systemic and his paper reviews the roots of state enterprise corruption in Indonesia and the implications for reform. Emphasising the need for a historical perspective in understanding corruption in state enterpreises, Nasir Tamara looks at state enterprise development from the colonial period, through the early independence period, the period of State Sector expansion, the Suharto New Order years, the early reform process and then into the 80s and 90s reform processes. Two cases are provided of state enterprises with good governance practices PT Tambang Timah and PT Rekayasa Industri.

The implication for reforming a patronage and crony-based system is that a political system that is based on the maintenance of political power through distributing spoils to clients and cronies has to be dismantled. Since the well-being of patrons, clients and cronies are dependent on the survival of a patronage regime, any change to the regime will be opposed. It is therefore unlikely that reform can occur without a shift in the regime. The shift itself has to be accompanied by a shift in the aim of politics from distribution of spoils to distribution of public services. Any such shift will of necessity be a long-term process, given the need for developing a credible system of law that would ensure the rule of law.

On a more macro stale, Nasir Tamara points out that supervision of state enterprises has shifted between the Finance Ministry and the technical ministries depending on the relative political strengths of the ministries as they struggle to control state enterprise resources. Supervision has also been shared between the Finance and technical ministries at times when political power has been balanced. Recently, a separate ministry with sole responsibility for state enterprise supervision was established, only to be dissolved after a few years of existence.

The reform process has therefore been piecemeal and ad hoc rather than systematic and strategic. The reasons lie in the historical development of the state enterprise sector as a national source of political power rather than as business entities. Nasir Tamara points out that those opposed to past reform directions include the economic nationalists and also those who view state enterprises as governmental instruments for achieving economic and political objectives.

Richard Holloway

Contents

Corruption in Indonesia's State Owned Enterprises

By *Ahmad D. Habir*

Measuring the Economic Cost of Corruption in Indonesia

By *Mohamad Ikhsan*[1]

Editors Note:

This paper contains tenns more familiar to *econometricians than the general public*

ABSTRACT

The main objective of this paper is to estimate the economic cost of corruption along several macroeconomic indicators including economic growth, domestic investment and foreign investment. Since corruption represents illegal activities, there is no way to directly estimate those costs for the economy. Utilizing the augmented growth model we found that corruption has had significant costs for Indonesia's economic growth and investment. If Indonesia could

[1] The author would like to express his appreciation to Dr. Vikram Nehru for his constructive review. But any errors and responsibilities belong to the author.

reduce its corruption level to a comparable country -for example Malaysia, the per capita PPP income could have been 5 times higher than the current level. With a higher growth rate, Indonesia could actually cut its level of poverty by 4,2 percent in rural and 1.3 percent In urban areas. Corruption has also meant a deterioration in the quality of capital inflows to Indonesia since its composition with corruption tends to be dominated by short flows rather than foreign direct investment.

INTRODUCTION

Studies on corruption during recent years have attracted the attention of policy makers and development practitioners around the globe. Since there is no universally accepted indicator that measures corrupt practice, it is less clear how models can capture empirical information about corruption.

The empirical problems of corruption measurement originate with unclear definitions of the phenomenon of corruption. Klitgaard (1998) defines corruption as a result of weak state management that exists when individuals and organizations have monopoly power over a good or services, discretion over making decisions, limited or no accountability, and low levels of income. The World Bank (1997) defines corruption as the "abuse of the public office for private interest". This definition seems to mean that corruption can only exist in public office, but we know it can also exist in the private sector. We will follow, however, the World Bank's definition limiting us to public sector abuses. Corruption is also, of course, a problem of good governance.

Many authors agree that corruption is a "bad thing" but in the literature we find two competing views on the effect that corruption has on the economy. The first view is that corruption increases economic growth for a variety of reasons and this argued by some authors like Leff (1964) and Huttington (1968). They say that corruption

- Acts as speed money ,which enables entrepreneurs to avoid delays. Lui (1985) using game theory shows that bribing strategies form a "Nash equilibrium in a non-cooperative game". He suggests that corruption minimizes waiting costs there by reducing inefficiencies in public administration.
- Reduces market distortions related to the poor pay structure in the bureaucracy, which

does not motivate civil servants to work properly and efficiently (Rose-Ackerman 1998), May actually-improve economic welfare by offering opportunities for black marketeering and smuggling (Bardhan, 1997)

- May increase efficiency if the private sector is more efficient in allocating resources than the public sector through its tax structure.

On the other hand, there are vast theoretical works and empirical evidence, which show that corruption is harmful to economic development. A great number of empirical studies show the many ways that corruption may weaken the economic performance of a particular country because corruption can:

- Lower levels of domestic and foreign investment (Mauro, 1997 and Wei, 1997)
- Distort enterprise development and growth of the unofficial economy (Johnson, Kaufmann, and Zoido-Lobadon, 1999)
- Distort public expenditures and investments and deteriorate physical infrastructure (Tanzi and Davoodi, 1997)
- Lower public revenues and make less provision of the rule of law as a public good (Johnson, Kaufmann, and Zoido-Lobadon, 1999)
- Hurt the poor (Rose-Ackermann, 1997)

The list above is not alway relevant to Indonesia, particularly in the past. Even though Indonesia has been categorized and recognized as a country where corruption has been and is practiced extensively and intensively, its investment ratio to GDP was comparable to East Asian countries and was high compared to Latin American countries whose index of perceived corruption was relatively better than Indonesia. Similarly, Indonesia was relatively successful in combating poverty across its regions during 1970s right up to the crisis period of 1997.

Given those two competing views on the impact of corruption on the economy, the purpose of this paper is empirically to scrutinize the impact of corruption on the macro variables of economic growth, private investment, and foreign direct investment -and together to assess the impact of corruption on the poor in Indonesia.

The paper is organized as follows: In the next section, we discuss the issue of the measurement of corruption. Following that we look at the estimated costs of corruption and the impact of corruption on Indonesia's economy -which is the heart of the matter, and finally, we summarize our findings in the last section.

MEASURING CORRUPTION

There are two important things that we need to clarify before attempting any estimate of the economic costs of corruption in Indonesia. First, we need to agree on the definition of corruption. As said before we are following the World Bank's defInition of the abuse of power for private gains. This definition is quite broad: it can involve not only public officials who legally grant monopoly power in governing the country, but also private sector officials who misuse the special privileges granted to them for their special interests. We can, however, see the difference between this and political corruption and/ or bribes between private sector actors.

It is almost impossible to obtain information on corruption and its effect on the whole economy for several reasons: first, because it is in the nature of corruption to be secret and illegal; and second, the variation in definitions of corruption across countries is quite large -in some countries, for instance, giving a gift to a public official is common practice and acceptable, while in another country this practice is considered corrupt.

The second issue is related to corruption indicators or measures. As argued by Wei (19971, corruption is difficult to quantify, although "you know it when you see it". When we try to quantify the magnitude of corruption, we find that we have to rely on measures of perception of corruption. There are several organizations that conduct survey-based measures of corruption perception. Among others are:

Business International Index (BII)

Their index is based on surveys of experts' and consultants' perception of corruption practice in several countries. It ranks countries from one to ten, according to "the degree to which business transactions involve corruption or questionable payments". This survey was terminated in 1983.

International Country Risk Guide Index (ICRG).

This index is produced annually by Political Risk Service -a private investment risk company. As in BII, this index is also based on experts' opinions and perceptions of the demand of public official for special payment and other illegal payments.

Global Competitiveness Report Index: (GCR)

This is based on firm managers' perception of corruption practice in anyone particular country. The GCR corruption index for a particular country is the average of all respondents' rating for that country;

Transparency International index (TI):

This index has been produced by a International NGO, Transparency International since 1995 and is based on a weighted average of approximately ten surveys of varying coverage. It ranks countries on a one- ten scale.

Samples of the indices are given in Table 1 and Table 2 (which are at the end). Additionally, in Figure 1 we present the development of Indonesia's position in Transparency International's corruption index over the last 15 years even though the figures before 1996 may not be directly comparable to the years after since they were produced by different surveys.

As has been shown in many empirical studies, applying any perception index is practically robust in the sense that plugging any particular index into any corruption equation seems not to produce any change in the magnitude of the estimates. All corruption perception indices have very strong correlation with each other. But one will find a significant difference when (directly) comparing the ratio of a corruption perception index of two countries with each other. For example, if one applies a TI index of Indonesia and Singapore and compares it with the ratio of the ICRG, one would find that a TI index has a bigger gap (index of two countries) than the Index of the ICRG. A TI index will produce a 5 point differential while the ICRG's will give about a 2-3 point differential. This, of course, will affect our estimation of the economic costs of corruption in Indonesia.

ESTIMATION OF ECONOMIC COST OF CORRUPTION IN INDONESIA

As depicted in both Table 1 and 2 and in Figures 1 and 2, corruption practices in Indonesia are consistently high compared to other countries in the world. Figures 1 and 2 indeed show that the practices tend to intensify over time -particularly during the 1990s even though we had already moved towards becoming a more politically transparent country. This implies that a moderate reduction in corruption should produce a significant impact on economic performance.

In order to quantify the magnitude of the impact of corruption on economic indicators like growth or investment or other social indicators, one would normally apply a time series econometric analysis. But as implicitly mentioned above, problems of data availability and consistency constrain us in carrying out such econometric analysis. Alternatively, one may follow a growth augmented model a la Barro (1985)2. This approach has been pioneered by Mauro (1995)[2] and expanded by Wei (1997) , Rahman et.al (2000). In general, Barro's framework correlates the dependent variable in question to two other types of variable: the initial level of state variables and a vector policy variable chosen by government and/ or private agents.

In practice we need a two step approach in order to estimate the cost of corruption in a particular country. In the first step, we need to carry out estimations across countires to see the

[2] There is another option to measure economic; cost of corruption i.e., one may use the findings of the internal audit agency (BPKP) or the State Audit Agency (BPK) on the illegal or misuse practices of the state budget and combine it as a rough estimate of cost of corruption in Indonesia. An anecdotal fIgure comes up to a 30 percent of state budget has been corrupted in Indonesia. This figure then can be used to calculate the implied Incremental Capital Output Ratio in order to estimate the economic costs of corruption in Indonesia. For example, if the investment ratio is about 20 percent of the GDP and the ICOR can be reduced about 30 percent lower then the implied economic growth is 5.7 percent compared to 4 percent in the corrupted environment. This approach has serious drawbacks. First, the 30 percent misuse practice comes from the anecdotal figure and is very difficult to verify it. Second, the ICOR itself is a poor indicator of aggregate efficiency. It tends to increase as the economy grows and diversifies. Third, the corruption practice will not only affect the way we handle the economic activities but also will affect the decision of investors to choose the location or the mode of production. Thus, the corruption practice will affect the ex ante variables.

relationship between corruption and growth, and between corruption and investment. For- mally, we can write the growth or investment equations as follows:

Growth model:

g = a+ b 1 (initial level of GDP per capita) + b2 (initial quantity of human capital)+ b3 initial quality of human capital + b4 (corruption)+ wX' + q (Z; Z e Z') + e

Investment Model: I/GDP = d+g1 (initial level of GDP per capita) + g2 (initial quantity of human capital)+ g3 initial quality of human capital + g4 (corruption)+ mX' + q (Z; Z e Z) + e

where g and I/GDP are average annual economic growth and the investment to GDP ratio, respectively, X' is a vector of regional dummies, 2 is a vector of policy and country characteristics and e is the error term.

Once corruption parameters (b4 and g4) are obtained, we then use them to assess the macroeconomic impact of corruption if one particular country can upgrade its corruption perception index to a higher level of corruption. The difference between the hypothetical level and the actual level may reflect the cost of corruption to the economy. The advantage of this approach is that findings can be further used to assess the impact of corruption to - for example - the poor. Given the growth elasticity of a poverty index, one may easily calculate the impact of losing the opportunity to grow due to corrupt practices and the incidence of poverty.

For this paper, I will utilize the empirical work done by Rahman.et.al (2000) to identify the corruption parameter. There are two reasons to follow their work. First, this cross section equation was done using the current data including Indonesia as one of the sample. Reestimating a new cross section growth equation would not give any significant improvement to our study. Secondly, compared to the previous work done by Mauro, in addition to the first reason above, this cross section equation is more reliable for several arguments. Rahman et.al (2000) has augmented their equation by incorporating several combinations of variables that may explain the differences of growth across countries. They also have tried to estimate those regressions using various econometric techniques not only a standard ordinary least square but also others like instrumental variable technique. Rahman et.al also applied a more comparable corruption index from ICRG than the one (discontinued) used by Mauro (1985).[3] Their model is also extended with regional dummy variables in an attempt to take account of various region specific effects (i.e., the intercept heterogeneity in the regional context). This strategy in turn is expected to reduce the extent potential omitted variable bias. The results of growth or invest- ment regressions for various specifications are presented in Table 4-5. As shown in those Tables, the sign of the coefficient for the corruption variable is positive as expected and marginally significant at 5 confidence level, controlling for a country's initial conditions and geographic, demographic and policy characteristics. The detailed interpretation of the econometric results will be discussed in the sections below.

ON DOMESTIC INVESTMENT

We hypothesize that corruption will reduce the investment level. There are many ways corruption would reduce the investment level. First, it will directly increase transaction and investment costs. The ballooning in project costs would have been started before the project is realized. The investors would need to pay some money to get an investment approval.[4] After the project is realized and becoming operational, the producer still needs to pay several other costs including bribery costs. Our latest industrial survey shows that that cost consists of about 5-20 percent of total output of medium and large manufacturing sectors (Box 1). Those numbers would be higher since many of illegal payments would have been included in transportation costs[5].

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[3] In his published paper, Mauro explained that his indices obtained by a hand collecting of hard printing at the B1 office in New York. It is not clear whether the methodology used is consistent over times.

[4] A LPEM's study (1994) found that even though the government has abolished any costs for obtaining investment licenses, the investor still need to pay about Rp. 5-30 million per license.

[5] For example Kompas newspaper found that textile and garment exporters have to spend about Rp. 125-200 thousand per container when transported goods from their factory to the port. The manufacturers have also to pay a substantial money to clear custom procedures.

How much do the firms pay for illegal payment?

The answer for that question is difficult because lack of factual information. There are several (potential) sources of information about illegal payment paid by the firms in one particular country. The most important source is its annual industrial survey. The survey usually asks the detailed description of costs paid by the firm from labor, energy, and tax payments to other costs. The illegal costs paid by a particular firm in the Indonesia's annual survey is aggregated into other costs item including interest cost, gift, royalties, management fees, promotion and advertising cost, travel cost, research and development cost, training costs, representation costs and other costs. We suspect that the Indonesian firms book illegal payment either as "gift costs" or "other costs".

Unfortunately, since 1998 BPS has not produced any disaggregated information of the "other costs". Instead, the BPS grouped all those costs into "other costs". This classification will not enable us to assess the illegal payment paid by the firm anymore. The other weakness of using the industrial survey is that it only consists of large and medium manufacturing companies. There actually is another source of information, which can be used to estimate those illegal costs, i.e., the 1997 World Bank's Survey on competitiveness. From that survey, one can assess illegal costs more accurately paid by the firms in particular country. Unfortunately, Indonesia -even though has been classified as a high corruption country -was excluded from the survey.

With those constraints, the 1997's industrial survey revealed that on average the manufacturing pay about 5-25 percent of total output for other costs including illegal payments.

One recent study by Kuncoro (2000) shows that bribery costs significantly affect the decision made by the investor when choosing the location. This evidence was applied for all sub-sectors in manufacturing sector. Second, it will create uncertainties both on revenue and expenditure streams, which make it difficult for the investors to calculate the exact net present value of a particular project. By increased uncertainties, the investor may refuse to invest even though he or she knows that project can produce a positive outcome. Third, corruption also reduces the quality of infrastructures, which in turn will affect the business environment in that country (Tanzi and Davoodi, 1997 and look at the next section for further explanation).

As mentioned above, in order to illustrate the impact of corruption practice in Indonesia, we utilize the empirical work of Rahman, Risonko and Kapoor (2000). They show that an improvement of 1 unit of ICRG corruption index will increase the investment ratio by 1.63-1.97 percentage point depend on the specification of the investment model being used. Thus, in Graph 2 we present the impact on investment ratio if we can reach several levels (perception) of corruption in some comparable countries. Here we pick Malaysia, Chile and Korea as comparable countries. For example we can reach a Malaysia's level of corruption-which means 1.27 point increase in corruption index -then our investment ratio would have been 2.1-2.5 percentage point higher than its current level. Similarly, if we were able to reach a Korea's level of corruption, our investment ratio would have been at an average of 34 percent of GDP during 1990-1997 or about 4 percent higher than the actual level. Given those achievements and an assumed 4 of ICOR, this means our growth rate would be 1 percentage point higher compared to the actual figure during 1990-97 period.[6]

That assessment is also consistent with other study by the DRI (2001), which shows the probability of losing investment in Indonesia due to corruption is high or about 60 percent (see figure 4). According to that study, Indonesia is the worst among the East Asia countries or just better than Myanmar and Russia.

ON FOREIGN DIRECT INVESTMENT AND COMPOSITION OF CAPITAL INFLOWS

Corruption is bad for both international direct investors and creditors. Corrupt borrowing countries are more likely to default, or to nationalize the assets of foreign direct investors.

There are numerous studies that show evidences of the negative impact of corruption on foreign direct investment. First, Rahman, et.al (2000)'s study which shows that the impact of corruption is statistically significant for a foreign investor. For one unit increase in corruption

[6]Theoretically, improvement in corruption would not only increase the investment ratio but also improve the efficiency of investment. Thus, the ICOR level would have been lowered if we were able to educe corruption practices and hence a higher growth rate.

perception index will lead to 1 percentage point reduction in foreign investment ratio to GDP. Taking that point of estimation one may find that Indonesia would have attracted foreign investment ratio to the GDP by 1.27 percentage point if we were able to improve our perception index on corruption to Malaysia's level. Second, Wei (1997) found that the point estimates of foreign direct investment on corruption and host country marginal tax rate is -0.09 and -1,92, respectively. Again using those point estimates and the BI index presented in Table 1, one will find that if Indonesia was able to reduce its corruption level to that of Singapore, its effect on attracting foreign investment would be the same as reducing its marginal corporate tax rate by 40 percentage point. [9.5-1)-x0.09/(0.01x1.92)] This, in other words and other things being equal, means Indonesia would need to give a 10 percent subsidy to attract foreign direct investment at the Singapore's level of FDI.

Third, another recent Wei (2000) study found also that the FDI -depressing effect of corruption is significant not only statistically but also economically. A one step increase in the TI corruption index is associated with a 20 percent reduction in inward FDI. If Indonesia (TI index in 1998 is 8) was able to reduce its corruption to Singapore's (TI index value of 0.9) or Malaysia' s (TI index of 5.3) level, the FDI in Indonesia would have been rose by 310 percent and 71 percent respectively.

Interestingly, this study also shows that corruption also will change the composition of capital inflows. A country with a high corruption practice would be characterized by a lower FDI but a high debt ratio. Table 10 depicts that New Zealand and Singapore which perceived as countries with low corruption have a relatively low loan/FDI and portfolio/ FDI ratios in one hand and in the other hand, Indonesia and Thailand which perceived as high corrupt countries have a relative high loan/FDI and portfolio /FDI ratios.

The figure above is supported by the econometric evidence produced by Wei (2000), which shows that the effect of corruption on the composition of capital inflows is robust across different definition or measures of corruption and different econometric specification.

There are at two economic explanations for that effect (Wei, 2000). First, FDIs are more likely to be exploited by local corrupt officials ex post than foreign loans. Among international investors, foreign direct investors may have informational advantage over international portfolio investors. They can station their manager in the host country and gather information about the economy of that particular country. However, the existence of corruption could lessen that advantage. The need for international investors to pay bribery and deal with extortion by corrupt officials is more likely to increase with the frequency and the extent of their interaction with local bureaucrats. It is obvious that international investors tend to have more interaction than do international portfolio managers. Furthermore, FDI also involves greater sunk cost than bank loans. Once investment is realised and when the local corrupt officials demand bribery, it is obviously that the international investors would have a weaker bargaining position towards those bureaucrats compared to their counterparts in international portfolios and loans. It is clear then corruption would be more detrimental to FDI than other forms of capital flows.

The other reasons for that feature is related to the fact that this current international financial architecture is more likely to produce moral hazard behavior by the portfolio or loan flows than FDI. The evidence during the crisis -from the Mexican and Asian Crisis - show that the international community mobilizes a large amount of funds to these countries to prevent or at least to minimize the systemic massive default on bank loans. The concrete example is shown by the evidence of international portfolio made by the Peregrine -an international portfolio investors stationed in Hong Kong -to a bad reputation Indonesia company Steady Save with- out any proper and adequate evaluations and supervisions only because of the President Commissioner of that firm is Siti Hardianti Rukmana, a daughter of President Soeharto. This some - how explains why capital flows still migrate to one particular country despite its reputation on corruption practice. While on the other hand, there is no such protection program for the FDI.

The question next, why do we have to worry about that composition of capital flows? This composition of capital inflows is an important explanation of the existence of crony capitalism and its responsibility for the onset and or the depth of the economic crises in particularly country. (Wei, 2000). Several studies like Frankel and Rose (1996), Raveled and Sachs (1998) and Rodrik and Velasco (1999) have shown that the composition of international capital inflows is correlated to with incidence of currency crises. Specifically, the lower share of FDI in capital inflows or the higher the short- term debt to reserve ratio, the higher probability of that particular country may run into a currency crisis.

ON ECONOMIC GROWTH

If domestic and foreign investments were greatly hindered by corruption practice, one would think that it would also reduce the economic growth rate. To show that impact for Indo- nesia's case we will apply two different empirical studies, which directly relate corruption and economic growth. First, we reiterate our exercise with the corruption parameter obtained from Rahman, et.al (2000) work. Second, we check our exercise of Rahman et.al is empirical works with another recent study by Kaufmann, et.al (2000) to produce a robust estimate. By doing that exercise, we would be able to calculate the economic costs of corruption in terms of percent- age of Gross National Product (GNP).

Referring to Rahman et. al' s econometric results, the point estimate of corruption on economic growth is 0.51-0.66. This means that anyone point improvement in corruption per- ception index in one particular country will result, ceteris paribus, in a 0.51 to 0.66 percentage point increase in per capita GNP growth. Again, applying these parameter estimates to compa- rable countries like Malaysia and Korea, we will fmd that Indonesia's GDP growth rate over 1990-97 would have been higher by 0.83 percentage point [(0.66 x 4-2.73)] and 1.20 percent- age point if Indonesia was able to reduce its corruption level to those of Malaysia or Korea, respectively. Using the fact that Indonesia's actual average growth rate over the same period is 6.4%, its per capita income by 1997 could have been more than 6 to 8% higher if the level of corruption equals to those of Malaysia and Korea, respectively only for the period of 1990-97. Interestingly, referring to the column 2 in the Table 3, one point improvement in perception corruption index equals to a quarter percentage point increase in gross secondary school enrollment rate.

A recent study produced by Kaufmann et.al indeed shows a bigger cost of corruption on the economy. Three estimate points derived to link corruption and per capita income is about 0.977 (for the first full sample definition), to 0.990 (for the other full sample definition) and 1.192 (for the developing countries only). That study also was able to produce a composite corruption index ranging from -2.3 (the worst) to 2.3 (the best). Using that index and again using Malaysia as a benchmark and the full sample regression, one would find that that Indonesia's per capita income could have been 1.5 times higher in 1995 if we were able to reach and keep the corruption level as that of Malaysia. This means the Indonesia's PPP per capita income could have been $ (PPP) 3620 instead of $ (PPP) 2497.

How would corruption have cost Indonesia's economy so much? There are several robust explanations on that effect. First, as mentioned above, the opportunity loss of domestic investment in term of per capita growth "is about 1 percentage point. Some of them may be also explained bya reduction of FDI, ex ante, owing to corruption practices.

Second, there were also some quality effects of investment both from domestic and foreign investors in the sense that risky investors have crowded the good investors out. This, referring to the new growth theory, will reduce the total factor productivity effect in Indonesia, and which in turn will reduce the long term steady state per capita growth rate.7

Third, corruption also would reduce the quality of infrastructure, which in turn would raise the transaction costs and reduce the competitiveness of private sector in the global market. A study by Tanzi and Davoodi (1997) revealed this evidence for five indicators of quality of infrastructures (roads, power outages, telecommunication faults, water losses, the use of diesel in railways). Countries with high corruption do tend to have poor quality of infrastructure. Another important finding of this study is that the reduction of quality infrastructure occurs through public investment. There are many ways of producing that result. First, when the approval of public infrastructure projects comes to be much influenced by corrupt and high level officials, the whole decision progress is distorted where those connected to this decision making process would tend to chose the firms which care about kickbacks (bribes). Thus, the projects are chosen exclusively for their bribe-generating capacity, not for the productivity. This evidence, which is demonstrated by Tanzi and Davoodi (1997), supports a positive relationship between corruption and public investment ratio. A high public investment creates opportunities for manipulations by dishonest officials. This practice is common in Indonesia. Two of indonesia's

7 Assuming a Cobb-Douglass production function and a constant labor and capital growth rate and fixed share of capital, the long-run steady state per capita growth rate is total factor productivity divided by share of labor. Thus, any increases in total factor productivity either from technical progress, or improvement in labor or capital productivity will have a positive effect on long term per capita growth rate.

8 This anecdotal evidence mentioned by them in several occasions and it has became a public knowledge and reference.

prominent economists, Dr. Soemitro Djojohadikusomo and Dr. Emil Salim8 have predicted that there was at least 30 percent mark-up on government investment expenditure in Indonesia.9 Second, Tanzi and Davoodi's study also shows that a high corruption country is associated with low operation and maintenance expenditures, which also reduce the productivity of public expenditure that lead to poor quality of infrastructure.

Fourth, another study by Mauro (1997) also shows that corruption tends to reduce social expenditures including health and education because they offer less scope for rent seeking. This again will constrain the potential growth of output since according a new growth theory and experiences of industrial and newly industrial countries, human capital plays an important role not only in the growth process, but also in reducing income inequality (Birdsall, 2000). The evidence is also valid for Indonesia where the social expenditures are less than the average of those in developed or newly industrial countries, i.e., percent compared to percent of developed and newly industrial countries.

Fifth, Johnson, Kaufmann, and Zoido-Lobaton (1998) also demonstrate that corruption reduces tax revenue, mainly through the growth of the unofficial economy. Overburdened by red tape and associated rent seeking in the official economy, firms move to the unofficial economy and fewer taxes. Such reduced tax revenue is associated with lower provision key public goods, such as rule of law and lower incentive for public official, further increasing the unofficial economy and incentive to corrupt. This evidence, is supported by Van Rijckeghem and Weder (1997)., which demonstrated a negative relationship between the ratio public and private incentive and corruption.

In short, we have shown that corruption practices have cost Indonesia's ability to expand its economy from 0.81- 1.2 percentage points. Nothing that the costs of corruption tend to accelerate owing to both the compounding effect and the deterioration in Indonesia's performance in attacking corruption practices.

9 It is common for a research institute to provide "kick-back" about 20-30% to government official in order to win the bIdding process. Some of them will. go to the budget office to smooth the payment stream.

ON THE POOR

The poor would be also affected by corruption and poverty might become persistent through corruption. The latter occurs because usually the poor do not have any money to bribe government officials and have less an access to the political arena. Rose-Ackerman (1998) specifically lists several channels that make the poor to be hurt by corruption: (i) they will receive a lower level of social service; (ii) infrastructure investment will be biased against projects that aid the poor; (iii) the poor may face a regressive tax; (iv) the poor are disadvantaged in selling their agricultural products; (v) the ability to escape poverty using indigenous, small and medium enterprise is diminished. Again, that is evident for the case of Indonesia. Many of government expenditures tend to be anti-poor in the sense that subsidies - which were intended to be distributed to the poor- are consumed by the rich. A concrete example of that is the fuel subsidy where about 70-90 percent is going to the rich.

We may quantify the impact of corruption to the poor. As explained before, using the elasticity of poverty index to growth of about 1.53 (for rural area) and 0.53 (for urban area) [10] then an additional increase in the GDP per capita growth or its equivalent with 2.41 percentage point (0.81 % + 1.61 % of population growth) in GDPgrowth could cut the poverty incidence 3.7 percent and 1.3 percent in rural and urban areas in one particular year, respectively.

WHERE DOES THE MONEY GO?

If the leakages are so high, where did the corruption money go? It could go to capital flight or still be circulated in Indonesia through the banking sector (and it might possibly be used to finance other rent seeking activities). One rough estimate shows that about US$ 45- 70 billion were transferred abroad through capital flight. [11] If some of it was used domestically and efficiently, it could have produced an additional growth rate depending on how the money would be spent.

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[10] Warr, Peter, Poverty Reduction and Economic Growth: Asian Experience, a paper presented at the Asia and Pacific Forum on Poverty organized by the Asian Development Bank, February 2001

[11] Ikhsan (1989) showed about US$12-20 billion capital flew from Indonesia during 1970-1987. He suspected that money is related to corruption practices. Recently he updated his previous calculation and found that capital flight has accumulated to US$ 45-70 billion during 1970-1999.

CONCLUSION

This report reveals that the economic costs of corruption in Indonesia are very high. These costs not only undermine economic growth but also poverty reduction and they deteriorate income distribution. Our estimates show that per capita income of Indonesia could have reached 1.5 times higher than the current value if we were able to clean up our economy to Malaysia's level of corruption.

There are many ways that corruption undermines the performance of Indonesia's economy i.e.,

- Lower levels of domestic and foreign investment (Mauro, 1997 and Wei, 1997). We would achieve about a two-percentage point of investment ratio higher if we could reduce our corruption practices to a Malaysia level.
- Distorted public expenditures and investments and deteriorating physical infrastructure (Tanzi and Davoodi, 1997). Corruption in the public sector not only marks up the cost of providing one unit of public good and service, but also reduces the quality of that good and service.
- Lower public revenues and less provision of the rule of law as a public good (Johnson, Kaufmann, and Zoido-Lobadon, 1999).
- Hurts the poor (Rose-Ackermann, 1997). Poverty studies for Indonesia -for example Warr (2000)- have demonstrated the importance of economic growth for poverty reduction. Reduction of economic growth by an increase in corruption practices will obviously hurt the poor particularly during a crisis period.

In addition, by a weaker assumption, we were able to show that the costs of delays in combating corruption are also very high and tend to be accelerated. Therefore it is very crucial and important for the government to take a concrete and massive action against corruption if the government wants to build a better foundation for a new economic development.

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Table 1. Corruption Rating Selected

	BI	TI97	ICRG97
Asia			
Singapore	1	2.34	1.77
Hong Kong	3	3.72	2.17
Jepang	2.25	4.43	2.96
Taiwan	4.25	5.98	4.60
Malaysia	5	5.99	5.67
Korea Selatan	5.25	6.71	6.20
Thailand	9.5	2.34	1.77
Phlipines	6.5	7.95	7.94
Cina	n.a	8.12	5.86
India	5.75	8.25	7.30
Indonesia	9.5	8.28	7.94
Pakistan	7	8.47	n.a
Bangladesh	7	9.20	n.a
Non-Asia			
Canada	1	1.90	2.37
United Kingdom	1.75	2.72	1.93
Germany	1.5	2.77	2.61
United States	1	3.39	2.41
France	1	4.34	3.51
Mexico	7.75	8.34	6.24
Kenya	6.5	8.70	n.a
Colombia	6.5	8.77	7.41
Russia	n.a	8.73	7.61
Nigeria	8	9.24	n.a

Source: Wei 1998

Table 2. ICRG corruption index, 1991-1997 average*

Country Name	Average ICRG Corruption Index 1991-1997 [1/]	Ranking [/2]
Albania	3.43	69
Algeria	3.15	59-60
Angola	2.91	34
Argentina	3.18	61
Australia	5.00	107-112
Austria	4.92	104-105
Bahrain	3.74	78
Bangladesh	1.76	6
Belgium	4.63	96
Bolivia	2.56	24
Botswana	3.36	67
Brazil	3.40	68
Brunei	4.44	94
Bulgaria	4.14	89
Burkina Faso	3.08	57
Cameroon	2.94	37
Canada	6.00	118-123
Chile	3.26	66
China	3.57	73-75
Colombia	2.72	27
Congo Rep.	3.01	52
Costa Rica	5.00	107-112
Cote d'Ivoire	3.55	72
Cuba	2.96	38-39
Cyprus	4.73	97
Czech Republic	4.38	91-92
Denmark	6.00	118-123
Dominican Rep.	3.19	62
Ecuador	3.12	58
Egypt, Arab, Rep.	3.00	41-51
El Salvador	2.83	32
Ethiopia	2.09	17
Finland	6.00	118-123
France	5.04	113
Gabon	1.05	2
Gambia, The	3.21	63
Ghana	3.06	54-55
Greece	5.00	107-112
Guatemala	2.43	22
Guinea	3.92	82
Guinea-Bissau	2.00	15-Sep
Guyana	2.11	18
Haiti	1.67	5
Hondoras	2.00	15-Sep
Hong Kong, China	4.94	106
Hungary	5.00	107-112
Iceland	6.00	118-123
India	2.71	26
Indonesia	2.73	28
Iran Islamic Rep.	3.57	73-75
Iraq	1.03	1
Ireland	4.83	98
Israel	4.87	101
Italy	3.54	70-71
Jamaica	2.67	25
Japan	4.92	104-105
Jordan	3.86	79-81
Kenya	2.96	38-39
Korea, Rep.	4.55	95
Kuwait	2.80	31
Lebanon	2.39	21
Libya	3.86	79-81
Luxemburg	5.82	117
Madagascar	4.00	84-88
Malawi	3.06	54-55
Malaysia	4.00	84-88
Mali	2.49	23
Malta	3.97	83

Country Name	Average ICRG Corruption Index 1991-1997 [1/]	Ranking [/2]
Mexico	2.84	33
Mongolia	4.00	84-88
Morrocco	3.00	41-51
Mozambique	4.00	84-88
Myanmar	1.83	7-8
Namibia	4.41	93
Netherland	6.00	118-123
New Zealand	5.79	114-116
Nicaragua	4.85	99-100
Niger	2.93	36
Nigeria	2.00	15 Sep
Norway	5.79	114-116
Oman	3.00	41-51
pakistan	2.13	19
Panama	2.00	15 Sep
Papua New Guinea	3.05	53
Paraguay	2.02	16
Peru	3.00	41-51
Philipines	2.79	29-30
Poland	5.00	107-112
Portugal	4.88	102
Qatar	2.00	15 Sep
Romania	3.73	77
Russian Federation	3.07	56
Saudi Arabia	2.00	15 Sep
Senegal	3.00	41-51
Sierra Leone	1.44	3
Singapore	4.00	84-88

Country Name	Average ICRG Corruption Index 1991-1997 [1/]	Ranking [/2]
Slovak Republik	4.18	90
somalia	1.51	4
South Africa	5.00	107-112
Spain	4.38	91-92
Sri Lanka	3.23	64
Sudan	1.83	7-8
Suriname	3.00	41-51
Sweden	6.00	118-123
Switzerland	5.79	114-116
Syirian Arab Republik	3.57	73-75
Taiwan, China	3.86	79-81
Tanzania	3.70	76
thailand	2.99	40
Togo	2.00	9-15
Trinidad and Tobago	3.00	41-51
Tunisia	3.00	41-51
Turkey	3.15	59-60
Uganda	2.79	29-30
United Arab Emirates	2.14	20
United Kingdom	4.91	103
United States	4.85	99-100
Uruguay	3.00	41-51
Venezuelz	3.00	41-51
Vietnam	2.92	35
Yemen, Rep.	3.00	41-51
Zambia	3.24	65
Zimbabwe	3.54	70-71

*Only countries where data was available for all the underlining years are presented in this annex. 1991-1997, the magnitude of the IGAG index for all countries in this sample was between 1 and 6.

1/ Annual average was calculated in two steps: (i) monthly values were averaged for each of the years; (ii) annual values were averaged to obtain annual average IGAG corruption index.

2/ If values of average IGAG corruption index were equal for several countries then these countries were assigned to the same interval., i.e. Uruguay and Venezuela both belong to 41-51 ranking interval. Higher ranking means that corruption is a lesser issue.

Source: Rachman, et,al (2002)

Table 3. Quality of public Governance and the Composition of Capital Inflows

	New Zealand	Singapore	Thailand	Indonesia
Corruption	0.60	0.90	7.00	8.50
(Ti Index)	(less corrupt)		(more corrupt)	
Loan/FDI	0.11	0.44	5.77	0.61
Portfolio/FDI	0.07	0.09	1.76	0.95
Loan	920,000,000	10,500,000,000	2,500,000,000	2,790,000,000
Portfolio	610,000,000	2,200,000,000	761,000,000	4,390,000,000
FDI	8,400,000,000	23,600,000,000	432,000,000	4,610,000,000

Source: Wei, 1999 dan Author

Table 4: Impact of corruption on growth in per capita GNP, 1990-97

Variabel Dependen	Base model	Model 1	Model 2	Model 3	Model 4	Model 5
Variabel Dependen: Angka Pertumbuhan rata-rata per tahun, 1990-97						
Log of GNP per capita, 1985	-0.48	-1.31**	-1.14**	-1.08**	-0.88*	-1.11**
	(0.96)	(2.73)	(2.23)	(2.17)	(1.76)	(2.26)
Gross secondary school enrollment ratio, 1985	5.33**	3.58**	2.76	2.76	2.38	2.39
	(2.29)	(2.12)	(1.56)	(1.58)	(1.41)	(1.44)
Pupil/teacher ratio in secondary school, 1985	-0.03	-0.08**	-0.07*	-0.07**	-0.07*	-0.06*
	(1.36)	(2.67)	(1.9)	(1.88)	(1.85)	(1.78)
Gross domestic investment-GDP ratio, average for 1990-1997			-0.14**	-0.15**	-0.16**	-0.15**
			(2.71)	(2.83)	(3.02)	(2.89)
ICRG corruption index value, average for 1991-1997		-0.66**	-0.63**	-0.56**	-0.61**	-0.51**
		(1.93)	(2.19)	(2.07)	(2.25)	(1.82)
Government consumption as % of GDP, average 1990-1997					-0.08**	
					(2.04)	
Average annual population growth rate, 1990-1997						-0.31
						(1.27)
South East Asia	3.23**	4.25**	2.35**	2.12**	1.62**	2.04**
	(3.96)	(5.94)	(2.73)	(2.48)	(1.99)	(2.41)
Latin America	0.90*	1.78	1.51*	1.35**	0.94	1.27*
	(1.67)	(2.84)	(2.66)	(2.43)	(1.56)	(2.29)
Middle East & North Africa	0.63	1.14*	0.43			
	(0.98)	(1.67)	(0.67)			
South Asia	2.10**	2.02**	2.02**	1.91*	1.59**	1.69**
	(3.1)	(2.3)	(2.78)	(2.68)	(2.37)	(2.35)
Constant	3.67	8.65**	4.76	4.44	4.09	5.55
	(0.98)	(2.32)	(1.09)	(1.03)	(0.95)	(1.23)
Adjusted R^2	0.23	0.31	0.42	0.42	0.44	0.43
# of observations	90	79	78	78	78	78

Note : Angka-angka dalam tanda kurung adalah heteroskedasticity consistent White standart error based t-statistics.**Signifikan pada level5%; *Signifikan pada level 10%. Tepatnya, indeks ini signifikan pada level 5.8%

Table 5: Impact of corruption on gross domestic investment/GNP, 1990-97

Departement variables: gross domestic investment - GDP ratio, average for 1990 -1997

Dependent Variable : average annual growth rate, 1990-1997				
Dependent Variable	**Base model**	**Model 1**	**Model 2**	**Model 3**
Gross of GNP per capita	0.50	- 0.35	-0.60	0.70
	(0.35)	(0.31)	(0.49)	(0.65)
Gross secondary school enrollment	6.03	3.09	2.66	
ratio, 1985	(1.34)	(0.70)	(0.55)	
Pupil/teacher ratio in secondary school,	0.02	0.06		0.17
1985	(0.24)	(0.56)		(1.11)
Distance	0.39	0.28	0.26	0.26
	(1.22)	(0.87)	(0.84)	(0.78)
ICRG corruption index value,		1.97**	1.92**	1.63*
average for 1993-1997		(2.30)	(2.51)	(1.86)
South East Asia	13.51**	14.20**	14.69**	12.87**
	(5.38)	(5.86)	(6.33)	(4.59)
Latin America	1.27	3.39**	3.36**	2.94
	(0.70)	(2.03)	(1.93)	(1.53)
Middle East & North Africa	7.03**	8.78**	8.81 **	7.88**
	(3.90)	(4.89)	(5.08)	(4.06)
South Asia	4.08**	5.03**	5.04**	4.67**
	(2.38)	(2.44)	(2.74)	(2.07)
Constant	8.28	.71	12.29	1.89
	(0.76)	(0.90)	(1.30)	(0.19)
Adjusted R2	0.49	0.54	0.52	0.44
# of observations		63	69	65

Catatan: Angka-angka dalam tanda kurung adalah heteroskedasticity consistent white standard error based t-statitics. **Signifikan pada level 10 % ; *Signifikan pada level 5 %. Tepatnya, indeks ini signifikan pada level 5.8%

Source : Rahman (2000)

Figure 1: Indonesia; Corruption Perception Index, 1988-2000
(Source: Transparency International)

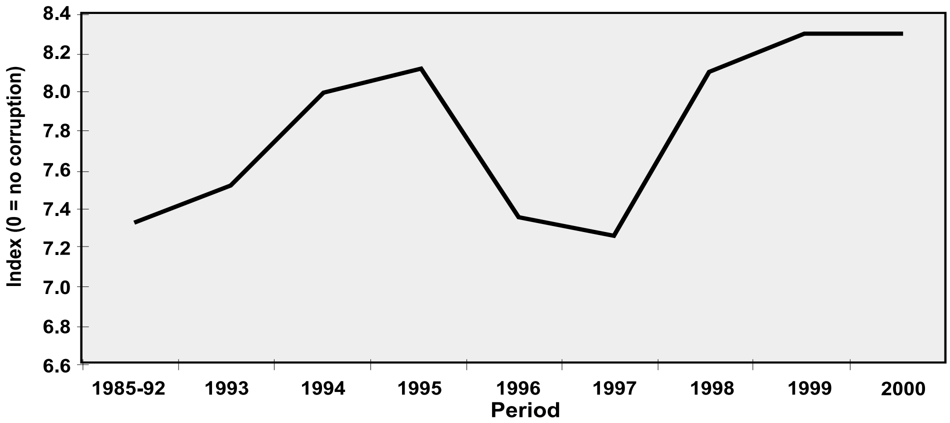


Figure 2: Overall Corruption Over Time
(Selected Countries; ICRG Index, rescaled 0-10)

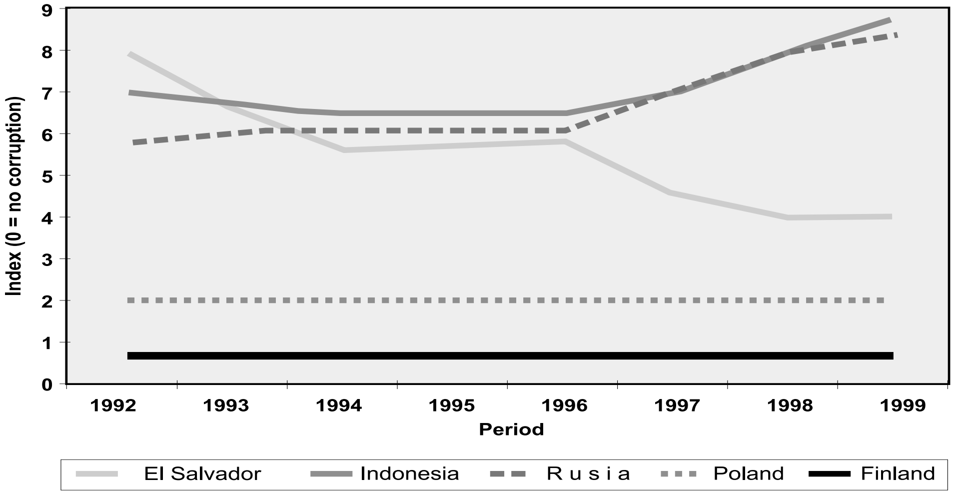


Figure 3: Probability of Losing Investment Due to Corruption

(For FDI, within a 5-year period. Source SP/DRI, 2000, Selected Countries Preliminary)

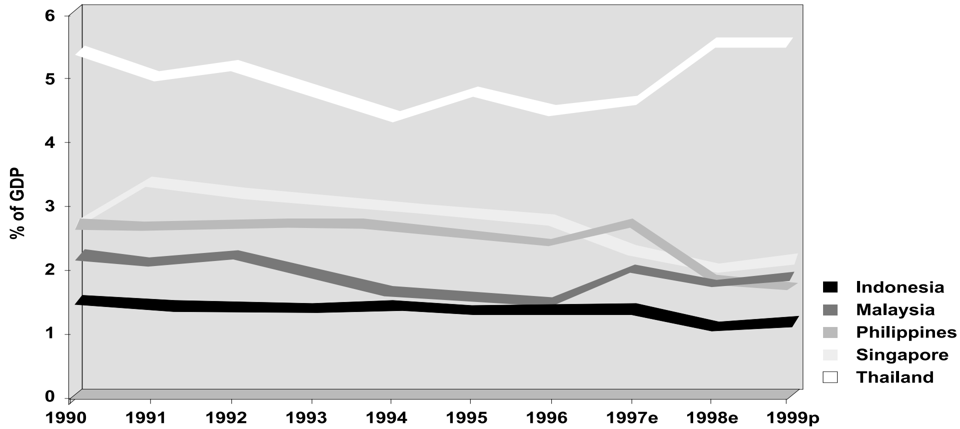


Figure 4: Indonesia: Investment-GDP Ratio and Corruption Level

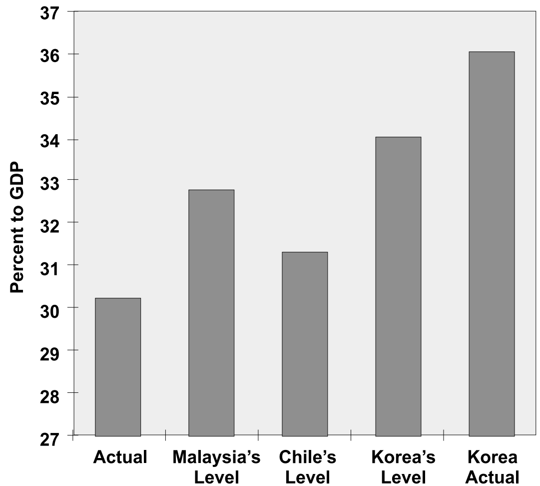
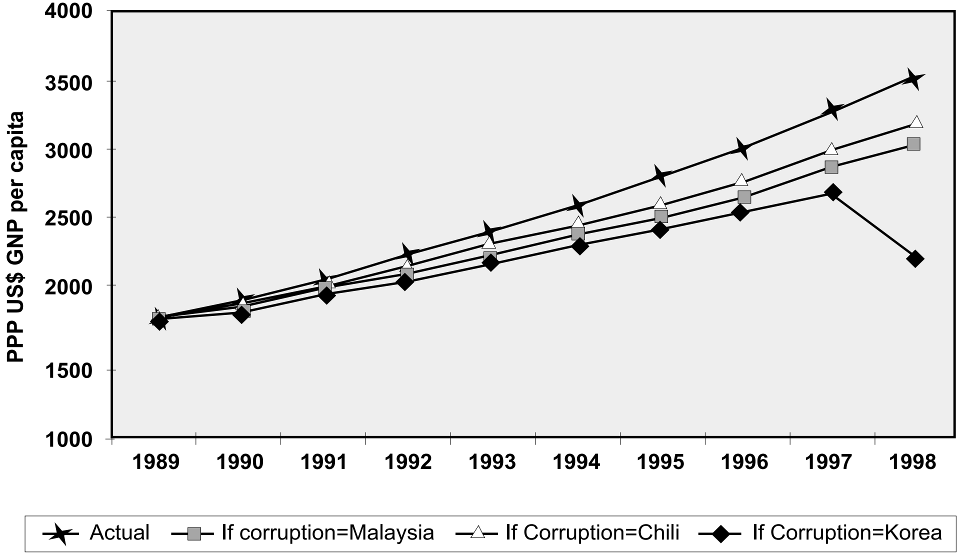


Figure 5: Indonesia's Per Capita PPP GNP and Corruption Level



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Corruption in Indonesia's Foreign Aid Programs:

Naivety, Complamency and Complicity within Donor agency

By *Paul Mcarthy*

THE MORE THINGS CHANGE, THE MORE THEY STAY THE SAME

"...Indonesian student organizations took to *the streets* to *protest corruption in their government... Special troops from the Army handled the immediate challenge, but as a longer term palliative the .President appointed a special Commission.. .For several months the Commission held hearings in executive session and sifted through charges and evidence pertaining* to *corrupt practices while the press, students and national political figures expressed their own views. Subsequently, in his annual Independence Day speech* to *the nation, the President reviewed the recommendations of the Commission and boldly stated*

that, "There should no longer be any doubts about it. I myself will lead the fight against corruption." This personal statement partially succeeded in defusing the issue, enabling the regime to *turn* its *resources away from short-run political problems and back* to *longer-run economic policy considerations. But given the pervasive nature of the problem, corruption* is *certain* to *be a recurring issue".* [1]

This will sound familiar to anyone tracking Indonesian current events. In fact, it refers to student-led demonstrations that took place in January 1970, more than three decades ago. Despite then - President Suharto's 1970 pledge - to the first of a series of ineffective anti-graft Commissions -corruption is both a recurrent theme and an enduring legacy that continues to plague Indonesian society.

By most historical accounts, corruption has been entrenched in Indonesia for four centuries with the situation becoming increasingly institutionalized under both Dutch colonial rule and the Japanese occupation. While there may have been something of a respite in the more blatant forms of corruption in newly independent Indonesia, the inception of Guided Democracy in 1959 further weakened the already shaky independent judiciary and enabled familiar patterns of corruption and patronage to re-emerge in a more pervasive manner than ever.

"With most (legal) controls removed, government offices extorted money wherever they could from anybody in possession of it. It was then that prosecutors, later judges and finally advocates began to *use their offices* as *money making machines, and the bureaucracy followed suit.* "[2]

By the time the New Order government was able to consolidate its power in the late 1960s, it was able to take advantage of "a weak legal system and, closely related, a rich tradition of corruption, nepotism, smuggling and patronage."[3] President Suharto facilitated the web of corruption by developing a triumvirate of complementary interests within the competing elites of

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[1] Smith, Theodore M, "Corruption, Tradition and Change", Unpublished mimeograph, 1970.

[2] Interview and email correspondence with Dr. Daniel Lev, Professor Emeritus, Department of Political Science, University of Washington, October 2000-March 2001.

[3] Schwarz, Adam, "A Nation in Waiting: Indonesia's Search for Stability", St. Leonard's, Australia: Allen & Unwin, 1999, pg. 3.

the armed forces, the business community and the government:

> “. ..*It soon became clear that the elimination of corruption was not a central priority of the government. corruption merely became more institutionalized, with the army officers and their (usually Chinese) business cohorts being the chief beneficiaries. ..For his part, Soeharto had sealed his hold over the armed forces by bringing the art of patronage* to *new levels and wasn't about* to *dispense with the tools of the trade.* “[4]

In economic terms, however, the effects of corruption, collusion and nepotism (or KKN, as it is known from its Indonesian acronym) began to have a marked impact around 1970, with the rise of two concurrent trends:

- the influx of direct foreign investment in support of for-profit ventures in business and industry; and,
- the influx of external development resources - in the form of both grants and loans to the. Government - as part of foreign aid packages to the staunchly anti - Communist New Order government.

For the most part, both public and private sector investments showed strong economic and developmental returns. But the aid and investment resource flow also enabled an increasingly avaricious business/military elite and a rapidly expanding Government bureaucracy to tap into an already well-developed network of corruption and collusion. As Prof. Daniel Lev describes it:

> *“...By the early 1970s, money was pouring in, the World Bank and the International Monetary Fund were in place, and KKN began* to *evolve quickly, skyrocketing as investment returns proved rewarding. For many foreign companies, returns more than covered costs, including corruption. Very big companies could avoid substantial payments because their power gave them influence directly* to *the President, but others put up with*

[4] Ibid, pg. 33. The Schwarz book provides a detailed analysis of how corruption became increasingly pervasive through the so-called system of crony-capitalism”. (See Chapters 2 through 6 of this book.)

extraordinary payments or *commissions because ultimately it was worth it".5*

Many longstanding observers of the Indonesian foreign aid scene are convinced of the correlation between the increase in Overseas Development Assistance (ODA) and the rise of corruption. There is a perception that KKN took off primarily as a result of the emergence of external donor agencies and their foreign aid packages. A closer analysis, however, would suggest that there is no direct causal effect. The stage was already set in terms of a pre-established set of well-practiced KKN mechanisms before this capital influx. Moreover, the increase in aid flows would not have taken place in the absence of the economic and geo - political conditions that had stimulated the increase in private investment in the first place. In this sense, foreign aid was less a precursor to than a consequence of pro-Western economic growth and political stability .

ASSESSING THE DAMAGE -THE SCOPE FOR KKN WITHIN FOREIGN AID PROGRAMMING

Foreign aid remains an important source of budget revenue for the Indonesian government. Although aid had dropped substantially, as a revenue percentage, from the mid-70s through the mid-90s, it has remained an important budget figure because of the relatively flexible nature in which it can be applied. It has become even more important with the onset of the economic crisis in 1997 especially when viewed against the backdrop of falling non-oil domestic revenues. The national budget for Fiscal Year 1998/99, for instance, projected foreign aid to be fully 30% of the total anticipated revenue.[6]

As the proportion of aid has risen, so too has the relative percentage of loan versus grant ODA financing. In the 2001 budget, fully 80% of aid commitments (US$4.2 outofa$5 billion overall aid package) were in the form of loans pledged to the Government of Indonesia. Of that development lending, an overwhelming 96% is expected from three main sources: the World Bank, the Asia Development Bank and the Japanese government.

5 Interviews and email correspondence with Prof. Daniel Lev, op.cit.

6 Source: World Bank data and interview with Bert Hofman, Economist, World Bank/Jakarta.

It comes as a surprise to many Westerners that, in terms of KKN, ODA funding is treated much the same as any other source of capital. By and large, Indonesians treat private and public investment - whether foreign or domestic - as part and parcel of the same thing. The fact that a large portion of foreign aid is disbursed in much the same way and for many of the same objectives as private investment capital - usually through an already corruption-riddled pro- curement system -serves to blur any distinction that might have been made. In a society where corruption has become so pervasive, there is no compelling moral argument that might serve to protect foreign aid programming any more than other sources of investments. The idea that foreign aid should receive special protection from KKN because it is intended to "reduce poverty" is too abstract for many and too easily ignored by most.

RATING THE DONOR AGENCIES

Like any other source of public revenue in Indonesia, small or large, foreign aid funding has been regularly victimized by KKN. The fact that the largest portion of the foreign aid budget - more than 80% in 1999 -comes in the form of loans to the Government of Indonesia (GOI), which eventually has to be repaid by Indonesian citizens, has not served as any sort of moral disincentive. If anything, ODA loans are more susceptible to corruption because they are typically large-scale, decentralized, and support activities - especially large infrastructure projects with multiple tenders -where KKN practices are already well-established. For this reason, this paper focuses primarily on the programs financed by Indonesia's three largest aid creditors: the Japan Bank for International Cooperation (JBIC)[7], the Asia Development Bank and the World Bank. [8]

[7] Two separate Japanese agencies, the Overseas Economic Cooperation Fund (OECF) and the Japan Export-Import Bank (JEXIM) were amalgamated to form the Japan Bank for Intemational Cooperation (JBIC) in 2000.

[8] Because documentation from World Bank sources is more readily accessible than from JBIC or the ADB, many of the projects sited in this paper refer to World Bank-funded initiatives. This also reflects the author's long-standing association with the World Bank and the fact that he was a member of the WB's Anti-Corruption Mission that took place in September 1998. The preponderance of quotes from World Bank staff or documents is not meant to imply that corruption is worse in WB projects than those of other donors. As noted in the paper, evidence suggests this is not necessarily the case.

While empirical data is impossible to ascertain, an informal survey conducted among veteran consultants9 indicated corruption has been historically most prevalent within projects financed under loan agreements with the Japanese. Box 1 provides a more in-depth analysis of the correlation between the Japanese aid program and KKN. Asia Development Bank (ADB) projects come a close second in perceived rates of corruption - with the World Bank not far behind. Because of a preponderance of infrastructure projects, a high level of Japanese influence and allegedly less-thall-stringent supervision practices, ADB-financed activities are perceived be generally more susceptible to KKN than World Bank projects but most consultants agreed that, overall, there was not a substantive difference between the *two.* There is some difference of opinion in perceptions of historical versus current corruption patterns among the three major donors. A number of the consultants surveyed felt there has been a decrease of corruption, albeit not a marked one, in Japanese and World Bank projects. There was a consensus that all three agencies -with the World Bank taking the lead -are confronting the issue more seriously but that GOI efforts to follow suit lag far behind.

Apart from the Japanese, most other bilateral donors10 provide assistance in the form of grants rather than loans. These projects are generally perceived to be less affected by KKN than loan-financed projects. Bilateral grants tend to be smaller in size (and hence less "profitable"

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9 A number of long-time consultants, both Indonesian and expatriate, were interviewed in February and March 2001, during the course of conducting research for this paper. Strikingly similar responses to a number of standardized interview questions indicated a broad consensus on key KKN issues. While many of the consultants were willing -and even eager -to share their views, most did not wish, for obvious reasons, to have their comments publicly sited in this paper. To protect these sources from any possible retribution, infonnation gathered from these interviews is occasionally summarized under the auspices of an "informal survey". Direct quotations from the interviewed consultants are cited as "Confidential interviews".

10 Relatively little information was uncovered regarding projects funded by the United Nations. In part, this is due to the fact that the UNDP and many other UN agencies have not been programatically operational for an extended period.

Box 1 -Corruption within the Japanese Aid Program

The monolithic nature of Japan's aid agencies and problems of obtaining up to date information on Japanese programming makes it difficult to form a clear picture of corruption within Japanese projects. The following analysis is based on confidential interviews with three sources: an Indonesian consultant who has worked on two previous Japanese aid projects in Sulawesi, and two Japanese citizens long-time residents of Indonesia, who are familiar with the inner workings of Japanese aid.

Based on a synthesis of their views and experience, a number of key factors enabling the relatively high level of corruption in Japanese-funded aid projects could be identified:

Pressure to Disburse: A very high proportion of the Japanese aid program is based on project loans. Given its weak domestic constituency (both politically and among a mostly indifferent public), the Japanese government needs to continue to make loans in order to justify the existence of its foreign aid program. With the poor credit ratings of sub-Saharan African countries, a weak lending history in Latin America, political sensitivities with China and an embargo on lending to India (as a consequence of India's nuclear policies), Indonesia has become a hugely important client for JBIC. This makes the Japanese less willing to risk offending GOI officials by raising the discomfiting topic of corruption.

Pressure to Recover Loans: The extent of Japanese development lending has led to the situation where the Japanese -who are currently owed roughly $40 billion of the currently outstanding total of $70 billion in development debt -is now the largest external creditor for Indonesian public spending. Growing concerns about public and parliamentary calls for debt relief has JBIC increasingly nervous. They need to recover their loans on a timely basis. The fragility of the Japanese economy means that any default or moratorium on Indonesian debt repayments could have substantial fiscal repercussions for Japan. Once again, the result is a reluctance to press Indonesians on KKN matters.

A Focus on Infrastructure: A large share of Japanese aid projects focus on precisely the type of large- scale infrastructure-based projects -gas pipelines, electrification, road and dam construction -that are most prone to KKN. Of note is the fact that the Miyazawa Plan, established in 1998 as a means of helping Asian nations recover from the economic crisis (and represented nearly 70% of the Japanese portion of the aid budget to Indonesia in Fiscal Year 2000), focuses almost entirely on quick-disbursing low interest-and hence highly attractive –infrastructural loans.

Poor Supervision: Sources describe project monitoring and supervision as "totally inadequate". Noting the fact that there are fewer than 50 professional staff at the JBIC office in Jakar1a ostensibly charged with monitoring an active portfolio of more than 150 projects, weak supervision was sited as a significant contributing factor to project-based KKN.

A Profit Orientation: There is an implicit understanding in Japan that financial profits from the implementation of development projects can and should be maximized. Although restrictions requiring the contracting of Japanese aid projects to Japanese firms were formally removed more than a decade ago, close ties remain between Japanese public sector agencies and private sector contractors that tend to perpetuate the involvement of favored firms in aid project implementation. A longstanding pattern of collaboration (some say collusion) between these favored firms and Indonesian private sector contracting networks allegedly ensures the stability of profits arising from aid implementation.

Non-Intervention in Domestic Affairs: A longstanding Japanese government policy of non-intervention in the domestic or political affairs of other countries has only just begun to change.[11] Critics feel that this policy has provided Japanese aid officials with a built-in excuse not to push Indonesians too hard on allegations of corruption.

Cultural Attitudes towards Corruption: Most important of all are attitudinal factors. In a country where the "the system itself is seriously tainted by corruption"[12], consultants were unanimous in asserting the view that the Japanese are generally more tolerant of more prepared to accept widely-known patterns of corruption. The concern in the post-Suharto era is not about a looming crackdown on KKN, but rather heightened confusion over exactly who and how many people need to be paid off in order for business to function "smoothly".

While efforts are allegedly happening between the scenes, there is scant public evidence that the Japanese are endeavoring to deal with corruption issues within their projects or to reform their overall aid effort. Except for the large international donor for a such as the WB-chaired Consultative Group on Indonesia (CGI), Japanese aid officials seldom turn up for multi-donor sectoral meetings on issues such as poverty and anti-corruption. This "policy of practiced, self-imposed isolation" (as one bilateral donor representative described it) may be gradually but on the front be painfully slow.

[11] The Japanese government was, for instance, the key backer of a UNDP-led voter education and election monitoring effort covering the crucial June 1999 national elections.

[12] Excerpted from the February/2001 "Perceptions of Corruption Index" produced by the Hong Kong- based Political and Risk Consultancy. Taken from the PERC website at <www.asiarisk.com>

from the corruptor's point of view) and subject to relatively closer scrutiny by the donors. They are often implemented by foreign-based private sector firms or NGOs that are more directly accountable to the donor agency than to a GOI counterpart. This makes it comparatively difficult to ensnare project managers in the KKN web. Bilateral donors also have the wherewithal to shift their resources away from sectors where corruption is particularly rife. According to a former senior staff member, USAID largely moved away from infrastructure projects in the late 1980s -thereby cutting off the Ministry of Public Works, one of the most notoriously corrupt GOI agencies, from a significant source of illicit revenue. The move was made as a result of widespread allegations of corruption and the intimidation of several staff and consultants who had attempted to expose corrupt practices. [13] In a similar move, Australian aid programming has shifted away from project funding towards specialized technical assistance which can be better protected from the vicissitudes of KKN. Although such protection can never be fully guaranteed, bilateral donor vigilance has had some impact: "It is really difficult to get their hands on some of those [bilateral] projects", commented a BAPPENAS consultant. "Sometimes it's just not worth the trouble."[14]

HOW MUCH DISAPPEARS?

What everyone wants to know is exactly how much money is typically skimmed off foreign aid projects into the pockets of corrupt bureaucrats and contractors. In recent years, the figure of 30% has been mentioned so widely that is now widely accepted as a given. But as with virtually all data on KKN, such calculations are more impressionistic than empirical. The magical 30% figure oversimplifies what is a very complex situation. In reality, there is no "average leakage rate" that can adequately capture the scope of corruption in ODA projects. With the situation varying from one project to another, donor staff, consultants and even Indonesian civil servants themselves can, at best, only provide estimates of what takes place.

[13] Interview with Peter Gajewski, former Chief Economist for USAID at their Jakarta office; February 2001.

[14] Confidential interview, February 2001.

An initial effort to quantify the scope of aid-related corruption was undertaken by the World Bank in 1997. Findings were summarized in a memorandum -subsequently leaked to the media -with the explosive conclusion that:

> "... *In aggregate, we estimate that at least 20-30% of GOI development budget funds are diverted through informal payments* to *GOI staff and politicians, and there* is *no basis* to *claim a smaller "leakage" for Bank projects as our controls have little practical effect on the methods generally used".* [15]

It was precisely this estimate that allowed many foreign aid pundits and critics of the World Bank to seize upon the higher estimate and claim a 30% leakage rate as fact. This despite the note of caution expressed in the same memo that suggested:

> *"the complexity and variability in the patterns of diversion have* to *date frustrated any attempt* to *more precisely quantify or analyse the problem."*[16]

Nonetheless, this was the most frank admission to date of the significant levels of corruption in donor-funded projects. The leaking of the so-called Dice memo - combined with the radically changing socio-political environment in 1998 - sparked the most significant ever anti- corruption action on the part of major donors. Subsequent public pressure, nationally and internationally (including interventions from the US Congress) forced donors to acknowledge the seriousness of the situation and renewed cries for a national strategy that would eradicate KKN.[17]

Nonetheless, while it is tempting to assign percentage-based figures to the level of corruption, none of them can be empirically verified. What can be assumed is that both the scope and the methods of KKN vary widely among and within projects in accordance with three key factors:

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[15] "Summary of RSI Staff Views Regarding the Problem of 'Leakage' from World Bank Project Budgets", intemal World Bank memorandum. This memo, compiled by Steven Dice, the former Urban Sector coordinator for the World Bank, office in Jakarta, was drafted in October 1997. It did not become public until July, 1998.

[16] Ibid.

[17] ADB officials likewise estimated, based on information from their own aid consultants, that an average of 15-20% of project resources was siphoned off as a result of KKN, but also acknowledged that this could easily range as high as 40% in some projects. Source: Confidential interviews; February March 2001.

- the number, type and location of GOI agencies involved in project implementation;
- the level and quality of actual- as differentiated from designed -project monitoring and supervision; and,
- the quality of the donor's and the Government's fiduciary controls.

"WET" AND "DRY" -IMPLEMENTING AGENCIES WITHIN THE GOI

Although it is not the intention of this paper to examine priorities for civil service reform in Indonesia, the level of corruption in a given project is determined, to a considerable extent, by the GOI line agency designated responsible for its implementation. [18]

It should be borne in mind, however, that. longstanding GOI budgeting practices - whereby an agency's projected revenue is divided into a "routine" budget and "development budget"[19] has led to a systematic abuse of foreign aid revenue. Many GOI agencies would be bankrupt were it not possible to divert income from ODA projects to cover budget shortfalls. The budget process simply assumes the continuation of such systemic diversions thereby promoting interagency competition (and furthering illegal kickbacks among Ministries) over who will be named responsible for ODA project implementation. As such -and as differentiated from outright criminal activity for embezzlement and misappropriation of project funds for personal gain - many Indonesians do not consider such practices as "real" corruption.

Not with standing competing perceptions of criminality, foreign aid projects are widely viewed by civil servants, as one expatriate consultant called them "galleons of gold" due to the relative ease with which a large share of project funds can be illegally extracted. Ministries and other GOI line agencies have developed apparently well-deserved reputations for being either more or less corruptor, to use popular slang, *"basah"* (wet) or *"kering"* (dry). Such reputations are

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[18] Much of the data in this section is based on a still confidential report on Civil Service reform undertaken by the World Bank, in collaboration with the ADB, in March 2000.

[19] The "routine" costs come from GOI sources and are budgeted in Rupiah but cover only "subsistence- level wages for civil servants and grossly inadequate operations and implementation overheads" for implementing agencies. The "Development budget" is based on projected revenue to be received from external sources, including foreign aid projects. Source: "Summary of RSI Staff Views Regarding the Problem of 'Leakage' from World Bank Project Budgets".

already well established among those involved in the business of foreign aid. Several donors have included detailed rankings of "wet and dry" implementing agencies in confidential reports with the Ministries of Public Works and Home Affairs usually topping the lists.[20]

Some donors are tempted not to hold Indonesian civil servants accountable for widespread corruption within ODA projects on the grounds that they have been caught up in a system which requires them to be in constant search of supplemental income. Indonesians themselves, increasingly aware of the comparatively exorbitant salaries and benefits earned by expatriates working for donor agencies and aid projects, seek to rationalize KKN by portraying it as a means of narrowing the gap between foreigners and Indonesians who are performing similar roles.

The fact is, however, that competition for "wet" employment remains fierce. Both senior and junior civil servants frequently engage in "buying" positions associated with donor-supported projects. Intense peer pressure ensures that details surrounding the KKN web are rarely disclosed outside the line agency itself. That colleagues who have successfully "purchased" such positions may be subject to demands of income support from both higher and lower officials in their agency, makes it more acceptable to use KKN practices to recover the costs of their initial job- buying investment.

PROJECT SUPERVISION

All foreign aid projects formally encompass a monitoring component, but the standards of financial and management supervision tend to vary widely according to institutional requirements as well as the project manager's level of interest and propensity for vigilance.

A widely circulated World Bank booklet entitled "The Project Cycle", notes the legal requirement to monitor projects:

> ". . .*The Bank* is *required by* its *Articles of Agreement [effectively the World Bank constitution]* to *make arrangements* to *(ensure that the proceeds of any loan are used only for the*

[20] For example, a still unpublished World Bank report (dated March 2000) included an Annex titled, "Wet, Moderate and Dry Agencies -Assumptions and Sources' listing 53 GOI ministries, departments, and state-owned enterprises according to the supposed degree of corruption within these bodies.

purposes for which the loan was granted.' While this 'watchdog' function has been and remains important, the main purpose of supervision is *to help ensure that projects achieve their development objectives and, in particular, to work with the bo"owers in identifying and dealing with problems that arise during implementation.* "[21]

But the same document, in its section describing the "Implementation and Supervision" phase, admits that project supervision is "the least glamorous part of project work" and acknowledges that

"Once a loan for a particular project is *signed, attention in the borrowing country shifts* to *new projects that are coming along."*[22]

The same attitude seems to have prevailed, until recently, within the three major donor agencies. As one civil engineering consultant commented, with reference to the allegedly lax standards of Japanese supervision,

"Once the loan agreement is *signed, [the Japanese] just wants* to *wash their hands from anything else* to *do with it. They've told me, this* is *a loan. The Indonesian government will have* to *pay* it *back so it is up to them to monitor how it is spent"*[23]

The sheer logistics and expense of monitoring and auditing a large number of projects, many of them being implemented in remote areas, makes effective supervision a daunting task. Inevitably, compromises are made. As an ADB spokesperson remarked,

"We would need a huge office, a much greater monitoring budget and a large number of staff to do *proper supervision. ..All we can really hope* to do is *a random sampling of project reviews.* "[24]

Any significant problems uncovered in the course of such reviews are turned over to the Quality Control Unit -which is based not in Jakarta but at ADB headquarters in Manila.

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[21] Baum, Warren C. "The Project Cycle" The World Bank: Washington DC, 1996 (Original edition, 1982), pg. 8
[22] Ibid, pg. 7.
[23] Confidential interview; Jakarta, February 2001.
[24] Interview with ADB staff based in Jakarta; March 2001.

Out in the provinces, supervision that is carried out by Jakarta-based bureaucrats can seem haphazard at best. One consultant described an ADB-funded water supply project in Kalimantan (the RWSS project) as being typical of the pattern of supervision that enabled widespread corruption:

> *"There was just no oversight from [the ADB office in] Jakarta. In the two years I was associated with it, the project manager never once visited a village water site. Sure he came* to *[the provincial capital] once in a while, but he only met with Government officials, never with any of the supposed beneficiaries".*

As a result, the consultant estimated that up to 70% of project funding was leaked or otherwise wasted.

> *"What would have cost a capable and credible NGO Rp.* 30 *million* to *build was costing the project an average of Rp. 100 million per village. ..It wasn't just outright corruption but poor quality control, bad materials. There was just no incentive* to *save.* "[25]

That many project managers are actually based in distant Manila, Tokyo or Washington is not lost on the Indonesia-based personnel (most of all the Indonesians themselves):

> *"Many of our staff, particularly HQ TMs [Task Managers] are viewed as ignorant* or *uncaring (as in 'they don't really want* to *know') of local practices and thus subject* to *being misled* or *deceived rather easily.* »[26]

IMPOSING FIDUCIARY CONTROLS

In terms of fiduciary controls, the donor's major tools are financial progress reports and audits. Neither have proved especially effective. Persons skilled in the ways and means of Indonesian KKN have long been able to avoid leaving a paper trail. Given the rampant

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[25] Confidential interview; Jakarta, February 2001.

[26] "Summary of RSI Staff Views Regarding the Problem of 'Leakage' from World Bank Project Budgets"; internal World Bank memorandum, October 1997.

falsification of invoices and manipulation of billing rates, financial progress reports for most projects are "not worth the paper they are written on" according to many consultants. They are submitted mainly as a means of meeting the donor's formal requirements and securing the release of the next tranche of funds.

Problems with audits are similarly widespread, as acknowledged by the World Bank's 1998 internal report: *"We cannot rely on probity of audits from BPKB (Government internal audit agency) and local associates of international audit firms.* "[27] Yet donors have repeatedly yielded to the Government's insistence in two critical areas of fiduciary responsibility:

that only the GOI audit bureau (known by its Indonesian acronym of BPKP) can be responsible for conducting audits of aid projects financed by loans to the Government; and, that contractor's books are not included as part of BPKP audits.

As with their typically superficial efforts to supervise projects, GOIs attempts to impose fiduciary controls have been feeble at best and, in many cases, have provided additional opportunities for corruption. Such is the case with the audit bureau where, for many years, a clean audit has been effectively for sale. As one consultant described it:

> " *..BPKP is a joke. They look for mistakes* so *that they can then confront the miscreant and obtain payments for not including the offending items in their audit. The only* times *BPKP finds and then reports inconsistencies are when the offending party refuses to pay them off* "[28]

Previous attempts to broaden audit efforts beyond the BPKP have been bogged down not only by GOI resistance but also by debate over who would pay the costs of truly independent audits. On occasion, the ADB and the World Bank do insist on conducting post -procurement audits and so-called "Management Letters" are issued when wrongdoing is uncovered. This can result in specific actions -re-tendering, cancellations of some project components, the

[27] "Options to Reduce Negative Impact from Corruption on Bank-Financed Activities" Internal World Bank memorandum from Jane Loos, Regional Manager, EAPCO to Jean-Michel Severino, Vice President for East Asia & the Pacific; October 19, 1998.

[28] Sourc:e: Confidential correspondence with an expatriate engineering consultant.

blacklisting of some contracting firms and the like -but such actions address the symptoms of KKN rather than the root causes. Moreover, this type of follow up on every project is time consuming and expensive -an argument not lost on senior management. The World Bank's Articles of Agreement, for instance, specifically require that matters of economy and efficiency be taken into account during the course of carrying out its fiduciary responsibilities. As a well-known World Bank critic has pointed out:

> "... *One argument worthy of careful consideration* is *that tighter supervision* is *expensive, and that reaching a high degree of certainty that Bank funds are not being stolen could be even more costly to the Bank and* its *clients than the resources currently being lost. (You're always balancing efficiency against stopping leakage,' a senior Bank official points out".*[29]

The bottom line, however is that, given the endemic and sophisticated nature of KKN in Indonesia, even the best supervised projects that are subject to a donor's strictest possible fiduciary controls, will not be spared the scourge of corruption. For the foreseeable future, it is a matter of limiting corruption within a foreign aid project portfolio rather than eliminating it.

WHERE DOES THE MONEY GO?

Volumes could be written about the ingenuity surrounding many of the methods that have become part of Indonesia's ever more sophisticated system ofKKN. Not surprisingly, very little has ever been put on paper- though many a scheme has entered the realm of Ministerial lore. From fake advertisements to the establishment of shell contracting firms, from bait -and-switch project staffing to ghost conferences[30], tactics have ranged from the clever to the ridiculous.

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[29] Winters, Jeffrey A. "Criminal Debt in the Indonesian Context" Academic paper prepared for the INFID conference; July 2000. Prof. Winters is a well-known -many would say strident -critic of the World Bank. An appendix to this paper entitled "Project Supervision in Theoty and in Practice" quotes extensively from World Bank staff on the shortfalls of supervision and auditing of World Bank projects.

[30] The ghost conference is a particularly legendary incident. The Government agency implementing a WB-funded agriculture project "went so far as to create a ghost conference at a hillside resort complete with posters and banners, evaluation sheets, and discussion papers. The conference was charged to the project, including accommodations, transport, and per diem payments for a large number of staff" -none of whom actually attended anything. (Source: "The Anti-Corruption Handbook", World Bank, 1999)

The East Asia Environment and Social Development Unit of the World Bank recently put together a handbook for WB project managers with guidelines and useful tips on how to prevent corruption in their projects or to weed it out when it does occur .[31] It highlights lessons learned from actual incidents of corruption in previous WB projects -a high proportion of which are, alas, from Indonesia.

What is surprising is that so much corruption, collusion and outright embezzlement could go officially undetected even though projects were still deemed to have met the financial controls put into place by donors. As one donor report pointed out:

> ".. *.Despite apparent compliance with World Bank guidelines and documentation requirements for procurement, disbursement, supervision and audits, there is significant leakage from Bank funds.* "[32]

Drawing on interviews with donor staff and consultants as well as internal donor reports[33], most fund leakage can be traced back to a number of key steps in the project development and implementation cycle:

Pre-Project Payments

Before a project even becomes eligible for funding, initial payments from the sponsoring GOI agency are required to ensure the project receives a an allocation during the annual budgeting process. These off-record fees are normally paid to BAPPENAS (the national planning agency) with additional payment to BAPPEDA (regional planning bodies) for some local/ provincial projects. For projects seeking foreign donor funding, an additional payment to BAPPENAS is required in

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[31] "The Anti-Corruption Handbook., EASES Discussion Paper Series. The World Bank: Washington DC, 1999.

[32] "Options to Reduce Negative Impact from Corruption on Bank-Financed Activities. Internal World Bank memorandum, op.cit.

[33] Much of this information is drawn from annexes to two World Bank reports: "Standard Methods of Funds Diversion and Kickbacks. was prepared by an engineering consultant for the WB's resident Principal Socio-Economist in March 2000. Additionally, the so-called Dice memo attached a separate note called "Typology of Informal Pauents in GOI Development Projects (including World Bank Funded Investments).

order for the project to be listed in the so-called Blue Book, from which donors are intended to select the projects they wish to support. Once approved, a payment to the Ministry of Finance -typically 1-2% of the overall project budget -is needed before the budget (called the DIP) will be released. Local governments usually have to make another kickback to the Ministry of Home Affairs if the project has a component supported by internally raised revenue. In sum, consultants estimate that 5-8% of total project funds are effectively pre-committed merely to ensure GOI project approval and budget allocations.

Contract Bidding and Awarding

The most extensive series of kickbacks takes place during the bidding and awarding of project contracts. Bearing in mind that large projects may involve hundreds of different sub- contracts, considerable leakage -anywhere from 5-30% of total funding according to consultant estimates -can occur during this period. Without going into exhaustive detail of the methods used, there are three key stages where most of the leakage occurs:

- Short-listing of eligible contractors -In line with the Government's set of complex procurement rules, each project has a consultant selection committee (normally comprised of civil servants from relevant line agencies) which awards the contracts, ostensibly according to an objective rating system determined on the quality of bids and the personnel to be assigned to the project. Just to be "pre-qualified" for participation in the tender –there by improving their chances of appearing on the short-list -contractors ,must make covert payments to one or more members of the selection committee.[34]

[34] Selection committee members usually have a pre-determined means of sharing such payoffs. Complications sometimes arise when more contractors make pre-qualification payments (typically 0.5 to 1% of the total contract amount) than there are places on the short-list. In other words, "...making a payment does not necessarily mean that you are assured of being short-listed. On the other hand, not making a payment may well insure that you are not short-listed. Once the short-list is developed, it may be modified one or more times as additional payments are made by prospective bidders who did not make the initial list." Source: "Standard Methods of Fund Diversions and Kickbacks" Internal World Bank report; March 2000.

- Consultant Selection -Tenders are generally awarded in one of two ways. Either there is a "winner take all" process involving a de facto auction among the short -listed bidders with the highest bribe being awarded the entire contract. Or, when eligible bidders wish to leave nothing to chance, they meet -typically with the full knowledge and/ or participation of a member of the selection committee and the GOI project manager (referred to as the Pimpro) -to decide in advance who will win the bid. Such collusion is commonplace with profit-sharing assured by an informal rotation system among the larger consulting firms, often overseen by GAPINSI, the national contractor's association. The winner would also pay a set amount (usually 1-2% of the bid) to the "unsuccessful" firms who, in order to meet GOI procurement rules, had submitted pro forma "losing" bids.
- Contract Signing and Transfer of Funds -Once the selection is confirmed, additional payments are extracted by the contract signatory (signing authority varies according to the size of the contract[35]) and of the Pimpro. These kickbacks are perceived to be the most highly variable in the entire procurement system with examples ranging from 0 to 35% of contract value. In general, international firms pay less than domestic ones. Once the contract is finally signed, the transfer of funds is far from automatic, with the treasurer's office of the Ministry of Finance (and/ or its provincial counterpart) expecting payment for the requisite sign-off. Even then, fund transfers are frequently delayed and contractors forced to pre-finance implementation costs so that the Ministry can earn additional interest by holding onto project funds.

Project Implementation

Once implementation finally begins, contractors still face a myriad of unofficial payments in order to secure reimbursement of their costs. The processing of invoices, the approval of

[35] Before the collapse of the rupiah, the Pimpro could approve direct appointments or limited tenders for contracts valued at up to Rp. 50 million -a direct incentive to split up larger projects into many small contracts. The Bupati had signing authority for up to Rp. 5 billion, while. the relevant Minister or Governor signed contracts between Rp. 5 and Rp. 10 billion. Beyond that, authority was vested in the Coordinating Minister for Finance and Economics. Source: "Standard Methods of Funds Diversion and Kickbacks".

project financial and progress reports, the acceptance of personnel substitutions and recurrent fund transfers all require facilitation payments in order for the project to proceed. For private sector contractors there is the business of tax payments to be "negotiated" -or more commonly evaded. As already noted, "mistakes" discovered in the course of interim financial audits and reviews by provincial or Ministerial inspectorates can almost always be "fixed" with the proper payoff.

Other corruption-related problems invariably affect projects depending upon the nature and location of activities. Demands for political "contributions" are commonplace -formerly to the Golkar party machinery, currently to a confusing network of party politicians and legislators. Projects involving land acquisition and resettlement are particularly susceptible to fraud - up to 80% leakage of funds allocated for land acquisition has been reported.[36] Poverty reduction projects that involve direct financial transfers to villages (such as the Inpres Desa Tertinggal project) using GOI channels frequently have a large share of designated funds skimmed off by corrupt officials at both the central, provincial and village levels.[37] It seems clear that projects implemented through local governments in rural areas, usually via the Ministry of Home Affairs or one of its agencies, are undoubtedly subject to higher levels of KKN:

> *"It is clear that the accumulation of such demands weighs most heavily on projects executed at local government level, where GOI controls are weakest and staff are least willing* to *question instructions of superiors.* "[38]

While it is impossible to accurately calculate the "average" cost of corruption during project

[36] Source: "Typology of Informal Payments in GOI Development Projects", This memo describes how this happens:" ,either by production of falsified documents showing higher amounts than actually paid or by use of 'middlemen' to aquire [sic] land at a low price for resale to GOI at inflated values,"

[37] A World Bank report on the anti-corruption efforts in the Kecamatan Development Project (still under preparation at the time this paper was written) cited a WB study from 1999 that found that less than 50% of the resources allocated for the IDT program were actually received at the village, Even then, an average of 15% was received in cash and much of the in-kind contribution was deemed to be of inferior quality,

[38] Summary of RSI Staff Views Regarding the Problem of Leakage from World Bank Project Budgets", op,cit,

implementation, it surprises some observers that anything gets done at all. In other developing countries, notably in sub-Saharan Africa, funds for aid projects are routinely looted in their entirety, without any attempt to construct what is called for in the project plan. As the Dice memo observes,

> *"Unlike Corrupt practices [elsewhere], the GOI system still expects an acceptable project outcome / result and peer pressures and scrutiny by others in the system tend to limit incomes.* "[39]

But despite the intricate system of illegal payoffs, the majority of contracting firms implementing foreign-funded development projects in Indonesia still manage to turn a handy profit. They do so, of course, by covering the costs of KKN within the budgets of winning contracts. Box 2 describes some of the clever means typically used by contractors to ensure a healthy profit margin.

Consulting firms who cannot or will not play by the KKN "rules" typically find themselves out of the running for further business or out of business altogether. In the case of a large World Bank water supply and sanitation project, for instance, a large international NGO, CARE International Indonesia, was squeezed out of further implementation contracts when it refused to pay the increasing demands from provincial Selection Committees. This occurred, in the words of one project consultant, *"even when [CARE's] performance was agreed by all* to *have been the best of any consultant in the project".*[40]

[39] Ibid.

[40] Confidential interview with former project consultant.

Box 2 - Ensuring a "Win-Win Scenario"

On rare occasions, demand for kickbacks during the tendering and implementation of foreign aid contracts have become so excessive, contractors have simply run out of funds before being able to complete the project to even minimal standards. But an informal system of checks and balances usually makes this kind of situation avoidable. It ensures that, not only will contractors recoup the costs of kickbacks, but both they and their counterparts in the GOI implementing agency will enjoy a reasonable profit from their "investments". In this,: sense, collaborating on ODA projects becomes a "Win-Win" scenario for private contractors and GOI civil servants alike.

There are three main inter-related ways of ensuring a profit:

1. Budget Manipulation - What is actually presented and accepted as the agreed budget for a given contract: is rarely what is actually covered. Over-design matched with over-pricing is common. Most typically, budgets are knowingly over-inflated, often with the full knowledge of the Consultant Selection Committee. This takes place on both a large scale (where, for instance, the agreed price per village to design or build a water supply system may be only 30-40% of what is actually paid) and a smaller scale with specific line items -particularly so-called "soft" expenditures that are difficult to audit such as Technical Assistance, travel and training41 -being budgeted at high rates but implemented cheaply or not at all. When the Government introduced a new means of contract tendering (via a Presidential Decision known as Keppres 16/1994[42]) ostensibly to reduce collusion among contractors, it included set billing rates for project staff and some types of equipment. These rules were quickly circumvented either by falsifying Curriculum Vitae of personnel (to show more work experience and receive a higher billing rate), by switching agreed to project personnel with less qualified staff earning lower wages or simply by paying lower salaries than those in the agreed-upon budget. The "savings" are, of course, not returned to the project but pocketed, usually by pre-arranged agreement, by the contractors and GOI counterparts.
2. Falsifying Invoices -To corroborate the system of budget manipulations, an intricate - though not necessarily sophisticated -means of creating false invoices and receipts is required. This often involves nothing more than drawing up fake receipts and either forging or paying for the requisite signature. (A long-time consultant told me that the

director's office of every consulting firm she had ever worked for in Indonesia had a glass table equipped with a light underneath the table for the sole purpose of forging signatures.[43]), In the business of being reimbursed for project expenditures -real or otherwise -nearly everything can be falsified: time sheets, travel authorizations[44], hotel and per diem receipts, training courses, the number and names of project beneficiaries. The list seems to be endless.

3. Compromising on Project Materials and Equipment -Substituting sub-standard equipment or materials is a regular means of enhancing profit. It is common, for instance, to supply motorcycles or used cars instead of the new vehicles agreed to -and paid for -in the project budget. Even when the full amounts for materials line items are disbursed, kickbacks from suppliers are the norm rather than the exception. Large numbers of crumbling school buildings, useless water supply systems and decrepit roads, many of them constructed with foreign aid loans or grants, are testimony to the chronic practices of short- sacking cement, substituting cheap pipes or using inferior construction equipment or supplies.

Not everyone comes out a winner in the "Win-Win" scenario. Not only do donors not receive their "money's worth" when such a significant portion of their funding is waylaid, Indonesian communities themselves are the ones who lose the most when projects produce inferior results or poor services. It is no wonder that, among the rank and file, many Indonesians have no desire to see their villages or their neighborhoods "participate" in any of the GOI's so-called development projects.

[41] As one report stated: "Making money on project-flrianced training is a time-honored tradition here.. and rewarding for the creative consultant or Pegawai Negri. There are several good reasons for this: Nearly all donors strongly support the need for training (who could object to the need for 'institutional capacity building' [and) it is relatively difficult to closely monitor the inputs and outputs of training." Source: Annex to WB report entitied "Standard Methods of Funds Diversions and Kickbacks", op.cit.

[42] Subsequently replaced last year by Keppres 18/2000, though most observers feel the new rules represent only a marginal improvement in terms of fighting KKN.

[43] Confidential interview, February, 2001.

[44] A particularly common ruse used by Civil Servants, said to be still commonplace, is that of double billing for project monitoring expenses. GOI staff cover actual costs -travel, hotel, per diems -from within thetr own agency's budget but also bill the contracting firm for the same charges. To maximize their profit, they frequentiy cash in plane tickets, opting instead to travel by much cheaper train or bus. (Source: Confidential interviews with Indonesian consultants and former civil servants.)

TURNING A BLIND EYE -WHAT DONORS KNOW AND WHEN THEY KNEW IT

To put it bluntly, any Indonesia-based employee of a donor organization who denies knowledge of widespread corruption and collusion within the development sector is either woefully naive or wholly disingenuous. That being said, none of the people interviewed for this paper could point to cases where donor agency staff were proven to have been directly involved cases of KKN within aid projects. (There was vague talk of long past incidents but this seemed to be more in the realm of gossip than reality.) So while donor agency staff are sometimes perceived as naive or complacent, direct complicity does not appear to be a serious problem.

But few deny having been aware of the broad extent of corruption. In a caustic expose called" Anatomy of a Bank Job", a former ADB employee describes how consistently corruption was ignored in a range of ADB projects in South-East Asia during the course of his (abruptly terminated) career .[45] As one long-time World Bank staff member put it,

> *"Everyone knows the [KKN] situation, pretty much from the moment they set foot in this country, if not before hand. And the local [Indonesian] staff know a lot more than [the expatriates] do.* "[46]

Orientations for incoming staff-usually once the formal briefings were concluded -invariably included "horror stories" detailing the pervasiveness of KKN within private and public sector activities. During the Suharto era the pun about "Madame Tien Per Cent" was particularly popular, even if it had to be expressed in hushed tones.

There is ample evidence to suggest that donors have been aware of the nature and general scope of ODA corruption for many years. As far back as the mid-1970s, not long after they reestablished operations in the country, major donors were expressing concern about corruption:

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[45] Nelson, Peter. "Anatomy of a Bank Job" Nelson International Limited: Dar es Salaam, 1995.
[46] As with the foreign aid consultants interviewed for this study, donor agency staff generally declined to speak on the record. Unless explicit permission was given, quotations sited from these sources were not for public attribution.

> *"From as early as 1973, when the then [World] Bank President, Robert McNamara, raised with Suharto the need to tackle corruption, senior Bank officials repeatedly warned the Government of the consequences to the economy officials to deal with the problem. "*[47]

In a book documenting the first half-century of its work, the World Bank is seen to have "clearly had the [corruption] issue in view from the beginning of its renewed relationship with the country." The authors quote a memo from the then WB Country Director where in the World Bank President, during a 1979 visit, is reported to have told GOI Ministers and Presiden Suharto, in separate meetings, that

> *"it was also necessary to maintain the emphasis on reducing corruption... this was much talked about and the world had the impression, rightly or wrongly, that [corruption] was greater in Indonesia than in any but perhaps one other country. "*[48]

The Japanese were likewise complaining about the level of corruption:

> *"Everything is very unclear here: taxation" procedures, restrictions. It is often necessary to do things under the table. In China there is corruption but not so much. Here it is everywhere. It's hard to calculate business costs when invisible costs come up again and again".* [49]

But for nearly three decades, the issue was raised mostly politely and mostly behind closed doors. Publicly, donors and GOI officials continued to be evasive. During the Suharto era, few dared to air such dirty laundry in the open. Ordinary citizens were essentially powerless to expose KKN. NGOs who raised corruption issues in public felt they were effectively stonewalled

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[47] "The World Bank's Anti-Corruption Efforts in Indonesia", unpublished memorandum, June 18, 1999.

[48] Taken from "Criminal Debt in the Indonesian Context", Jeffrey Winters, Associate Professor for Political Economy, Northwestern University. This paper was prepared for the INFID Seminar on Indonesia's Foreign Debt in July 2000. The excerpt used here is from the book by Devesh, Kapur, et.al, The World Bank: Its First Half Century" Washington DC: Brookings Institution Press, 1997.

[49] Source: Schawrz, Adam; op.cit. pg. 158. This quote is attributed to a 1992 interview with Mr. Tomiyasu Nakamura, the director of general affairs at the Jakarta office of the Japan External Trade Organization.

by donors and risked intimidation by the Government's security apparatus. [50]

On the rare occasion when persistent allegations of corruption could not be quelled, the overt reaction -on the part of both donors and Indonesian officials -was frequently one of righteous indignation. Following a spate of negative media stories during the waning years of Suharto's rule, for instance, a press release from the World Bank simply denied media reports of routine leakage in World Bank-funded projects. It quoted the Vice President for East Asia and the Pacific as stating that such allegations were *«demonstrably untrue",* and added, *«We know exactly ifjhere our money* is *going. We* do *not tolerate corruption in our programs".* [51]

Privately, nearly every consultant and staff member employed by donor agencies acknowl- edged an awareness of typical KKN practices within procurement, budgeting and financial transfers related to development projects. They issued continual warnings to their Indonesian counterparts and took occasional preemptive action by canceling procurement tenders or declining to renew certain sub-contractors, but such action did little to curb the ever-increasing KKN.

IGNORING THE WARNINGS

The fact of the matter is that the vast majority of Indonesian government officials routinely ignored or paid lip service to repeated warnings from donor agencies. The question is begged as to why donors allowed their warnings to be so blatantly ignored -and why there were no consequences in terms of ODA levels.

The answers lie in the complex geo-political and economic realities of New Order Indonesia. Most aid observers site multiple reasons for the lack of concerted donor action on KKN issues:

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[50] The advocacy consortium, INFID, conducted a study on a number of power supply projects funded by the ADB, the World Bank and the German Export/Import Bank in 1993/94. When they raised environmental and KKN concerns with the relevant donors they were informed that these were issues for which the GOI implementing agency (in this case, PLN, the parastatal overseeing energy supply) had sole responsibility. Source: Interviews with former INFID staff.

[51] Press Release No. 98/1426/EAP, The World Bank, July 28, 1997.

- during the cold war era, Indonesia under Suharto was most certainly seen as a bulwark against Communism. It was simply not worth rocking the political boat by pushing for action on matters of corruption;
- when it came to development lending, Indonesia was an important -and hence powerful- client of the Japanese and the multilaterals. Continued lending was good for all parties and yielded a relationship that had an element of mutual economic interdependency. As a Director General in the Ministry of Finance commented at a 1995 reception, *"TheADB and the World Bank need Indonesia more than Indonesia needs them."*[52]
- Indonesia has a long history of rejecting -often vigorously and vociferously -real and perceived intervention in its domestic affairs. In the past, the Government was not afraid to back up its protests with action, as the Dutch discovered in 1992 when their air program was unceremoniously shut down. According to Dutch officials, this action yielded nary a word of protest from other donors. It did, however, make donors considerably more docile when it came to Gonfronting GOI on matters of corruption, human rights and other sensitive issues.
- strong and consistent economic growth allowed many donors to turn a blind eye toKKN. There were real advancements in poverty alleviation for the better part of three decades. Some aid officials have acknowledged that it was easy to be, as WB President James Wolfensohn put it, *"caught up in the enthusiasm of Indonesia".* For multilateral donors, the rapid pace of development made Indonesia the *"jewel in the crown"*[53] and provided a convenient excuse to overlook some of the more prominent patterns of corruption;
- there was also the "embarrassment factor". Many project managers simply did not want to acknowledge corruption in their projects because it would make them look bad. Within organizations where there is traditionally a strong pressure to disburse funds, project

[52] Personal recollection of the author.

[53] Kapur et. al, use this same term iri their book "The World Bank: Its First Half Century", op.cit. They note that Suharto was aware of the fact that "Indonesia was the presidentially designated jewel in the Bank's operational crown" that allowed the Indonesian leader to "make no trace of a response to the demarche on corruption."

cancellations or delays, regardless of how legitimate the grounds may have been, were not conducive to career advancement;

- with most Western nations having historically experienced extended periods of high corruption -America during the era of robber barons, for example -a number of senior donor agency staff felt that this was a natural phase of Indonesian development. As Dan Lev speculated, key donors *"took the view that corruption was a natural part of the process of change, that in the end 'economic development' would lead* to *a 'modem' society, democratically guided by a well off middle class. The model for this kind of thinking was the European and North American experience,* or *rather the myth of it".*[54]

Whatever rationalizations were used, the majority of donor agencies calculated -quite consciously according to many staff members -that, overall, *"even when corruption was factored in, [their projects] were still worthwhile investments".*[55]

The bottom line is that for most donors, at least during the New Order period, corruption was simply a tacitly accepted -if distasteful- part of doing business. Those who didn't like it could pack up and leave. None did.[56]

THE INDONESIAN CASE FOR THE DEFENSE

Indonesian officials, meanwhile, did not sit idly by when development projects came under fire. They did their part to deflect or defuse corruption allegations. When pressed, they frequently countered with a three-tier defense strategy of their own. The most typical response was one of "*Di mana buktinya?"("Where's the proof?")* Given the well-known weaknesses of the Indonesian legal system and the endemic collusion that reaches all corners of the judicial

[54] Email correspondence with Prof. Daniel Lev; op.cit.
[55] Confidential interview with a World Bank task manager; March 2001.
[56] Some donors will point out that they cut back their levels of development assistance as a result of corruption. But this rationale was rarely made public -more frequently, it was stated that economic advances in Indonesia was simply making aid reduction more viable.

network, attempts to provide legally viable proof of KKN within development projects is a complicated and difficult task. The risk of being sued by persons who were themselves being accused of corruption was a real one as was the possibility of being tied up in endless and expensive court proceedings. These prospects made donors understandably reluctant to pursue such channels.

When this wasn't enough to waylay accusers, Government officials sometimes invoked the sovereignty card, at least in terms of ODA that came in the form of loans. By claiming that projects were ultimately being financed with Indonesian money, the project managers at some donor agencies were occasionally convinced to overlook KKN practices on the grounds that, one way or the other, the entire loan would eventually be paid back.

Lastly, a shadowy but sophisticated network of organized thugs (known locally as preman), loosely controlled by political and military authorities, made it possible to physically intimidate anyone suspected of exposing KKN within development projects (ironically, this also applied to anyone whose demands for increased payoffs became too far out of line with "accepted practices".) While such intimidation was rarely used against donor agency staff, they were a genuine threat to project consultants and junior officials further reinforcing a culture of silence and enabling corruption to sink its roots even deeper into foreign aid programming.

CORRUPTION IN THE SPOTLIGHT -KKN AFTER THE FALL OF SUHARTO

As with everything else in Indonesia, the sudden downfall of the New Order regime allowed new light to be shed on political, social and economic realities that had long gone officially unreported. The lid was blown off the corruption "industry" virtually overnight. Within days of Suharto's resignation, the now famous acronym KKN was on the lips of nearly every becak driver and petty trader throughout the archipelago. It didn't stop at the street level, reaching into government offices, private sector boardrooms and the hallways of every donor agency in town. What could barely be uttered for nearly three decades, now became a distinctly serious (and popular) topic of conversation. The newly unencumbered media, a host of Civil Society organizations -both new and old -and dozens of aspiring politicians seized upon the opportunity to expose everything they knew about KKN.

Donor agencies came under increasing pressure to do something about corruption, both within their own projects and as part of a larger governance reform agenda. Ironically, it took "leakage" of another sort to spark the most significant anti-corruption action ever taken by donor agencies in Indonesia. When the previously mentioned World Bank memo entitled "Summary of RSI Staff Views Regarding the Problem of 'Leakage' from World Bank Project Budgets" was leaked to the media [57], the resulting pressure on the World Bank -and vicariously on other donor agencies whose activities had all been subject to the same sort of KKN practices -was enormous.[58]

Within days, public and press attacks -many exaggerated and not all of them accurate - pilloried the World Bank (unfairly, many observers agree, since the state of play was much the same among other major donors) for its alleged duplicity. A Washington Times editorial was typical:

> *"Indeed, the World Bank has spent a generation utterly uninterested in the corruption that plundered many of its billion-dollar loans. In an eye-opening expose of the bank's decades-long relationship with Indonesia and the Suharto clan, during which time the World Bank lent Indonesia* $25 *billion, the Wall Street Journal recently reported how the Indonesian government repeatedly bullied the World Bank into hyping the Indonesian economy and ignoring its pervasive corruption Indonesian used the rose-colored reports from the Bank* to *stifle criticism and* to *obtain solid credit ratings, which attracted billions of dollars of foreign investment, much of which fled the moment it became clear that Indonesia's solid fundamentals were anything but".*[59]

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[57] The so-called Dice Memo (named after its principle author) was written in October 1997 but leaked to the media some nine months later. The initial press story "World Bank Memo Depicts Diverted Funds, Corruption in Jakarta" appeared on the front page of the Asian Wall Street Journal on July 19, 1998.

[58] Several observers made an interesting point on the Dice memo during interviews for this paper. While entirely rhetorical at this stage, the question is begged as to what action donors would have taken had this memo not found its way, however surreptitiously, into the public domain. Or was the trend towards stronger anti-corruption actions inevitable even without exposure from the memo?

[59] "Deep shoveling in the World Bank cleanup" Washington Times (editorial page); July 23, 1998.

Amidst much collective hand wringing, donor talk shifted, however belatedly, to how the tide could be turned in the battle against corruption. In a response to increased media pressure, the same World Bank Vice-President who had earlier denied the existence of corruption within WB-funded projects wrote:

> *"The campaign against corruption is a major part of our dialogue with the Government ...[and] with Indonesian civil society as a whole, at a time when there is an unprecedented opportunity to engage in open and spirited debate. This is happening against a background where there is an awareness that corruption in Indonesia is so deeply entrenched that it will require many years of reform - including major changes in the way the civil service conducts business.* "[60]

Without a trace of irony, senior GOI officials -new and old -joined the cause. In a letter "to the World Bank's Country Director, dated 21 August 1998, Ginandjar Kartasasmita, then State Coordinating Minister for Economy, Finance and Industry (himself now facing trial on corruption-related charges) wrote candidly:

> *"The people of Indonesia as well as international observers including the World Bank have long been concerned over growing problem [sic] of KKN. With recent changes in the political environment the Government is now in a position to attack KKN issues head-on.*
>
> *You will recall that you and I began working on new ways to combat corruption in the public sector when I was still Minister of Planning. We had started to discuss new approaches to reducing corruption in government and donor-financed development projects just before Indonesia's financial crisis broke last August. As the financial crisis deepened, our focus shifted form [sic] general issues of corruption to specific KKN issues including those associated with government -protected monopolies and leakages that occur as funds are transferred through multiple levels of government... it is now time to return to the*

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[60] This is taken from a memo dated August 20, 1998 from VP Jean-Michel Severino to all WB staff working on Indonesia. The memo contained a draft WB response to the Wall Street Journal article that was published the previous month.

broader issue of how to formulate a strategy for creating an environment in which KKN cannot survive. ..I would be grateful if the World Bank would assist Minister Hartarto {then Coordinating Minister of Adminstrative Refonn} and the Government as we seek ways of curbing KKN practices once and for all. "[61]

This letter set into motion a rapid and multi-pronged series of actions by major donors, kicked off by a high-profile World Bank mission. Clearly, the rules of the game in terms of public disclosure had changed and it was suddenly fashionable for donors to acknowledge high levels of corruption and to indicate what they intended to do about it.

During the entire period of the WB mission and for several weeks thereafter, newspaper headlines in Indonesia[62] focussed on the crisis of corruption and warned of the dire consequences the country would face if the problem was not immediately brought under control. While the Aide Memoire resulting from this mission was more circumspect, couching its findings in guarded terms, it clearly recognized the problem:

> *"This systemic corruption is alleged to affect virtually all development projects, including World Bank and other donor~1anced investment. It should be emphasized that the mission did not seek to evaluate any allegations, and had not capacity or mandate to do so. Equally, and for the same reasons, it did not seek to assess quantitatively the scale of corruption, or the financial or economic losses entailed".* [63]

The Aide Memoire went on to note growing concern about aid efforts:

> *"Confidence has been eroded that public and private funds, Indonesian and foreign, mobilized for development programs are indeed well spent for the intended purposes, with*

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[61] Letter faxed from Minister Ginandjar to Dennis de Tray, former World Bank Country Director for Indonesia; August 21, 1998.

[62] Within the space of a few days, front page coverage in the Jakarta Post included headlines such as "Fight against graft 'key to RI recovery' " (September 21, 1998) and "Corruption threatens continued aid: WB" (September 24, 1998).

[63] Quoted from "Combating Corruption in Indonesia: Aide Memoire of the World Bank Team, September 13-20, 1998".

effective results. A further concern of the mission was that, in the face of the national economic and social crisis, corruption could become much worse in the period ahead."[64]

Notwithstanding its cautionary tone, the World Bank team did recommend urgent action on a number of fronts:

- fencing off the high-priority social safety net programs by *"publicly declaring them to be of the highest national importance and 'untouchable'' by delay or conuption";*
- making immediate progress on transparency and information including concrete action on *"freedom of information"* and *"whistleblower protection"* legislation; and,
- initiating *"an irreversible process to define and advance with a national anti-corruption strategy"* that would strongly consider the establishment of a Governance Reform Task Force or Commission[65]

Publicly, senior Government officials went along with the Mission's recommendations whole - heartedly, pledging to rout out all manner of corruption. *"The government will protect those who come forward to report corruption cases against retribution",* said Minister Hartarto at a press conference during the WB mission.[66] Privately, however, many civil servants groused that they were being attacked unfairly at a point of great political and economic vulnerability. They resented what they perceived as a donor attempt to induce GOI subservience -a sort of "kicking us while we are down" phenomenon, as one senior official put it.[67] In a curious manner, this gave way to the sentiment that donor recommendations on KKN need not be taken too seriously. Civil Society observers also viewed the process with a strong degree of skepticism. As Rizal Ramli put it (long before he became a key Cabinet Minister):

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[64] Ibid.

[65] These are three of the key recommendations as excerpted from the Aide Memoire.

[66] Quoted in "WB sets up teams to address corruption in RI". The Jakarta Post, September 16, 1998. Interestingly the article went on to say that Hartarto had added that the government "would also protect the rights of those accused" of corruption.

[67] Some of these observations are the personal recollections of the author who was a member of this World Bank mission.

" It is naive to expect an internal team to investigate corruption cases in a transparent and objective manner."[68]

With the benefit of hindsight, it seems safe to say that this WB Mission - along with subsequent ones and the exhortations of numerous visits, reports and recommendations from other donors -had little practical effect on KKN within or outside of foreign aid projects.

While the level of public exposure of corruption had changed, the ground rules underpinning the elaborate KKN network had not. The tables may have turned insofar as the WE, the Japanese and the ADB were now critical players on the Indonesian economic scene, but this did not automatically portend any change in behavior.

The problem with raising the profile of KKN was that it simultaneously raised public expectations that concrete action was actually going to take place. When, in the event, nothing much happened in concrete terms, rising public cynicism became an important factor in contributing to the social and political crisis that plagues Indonesia to this day.

TOO LITTLE, TOO LATE: WHY PAST ANTI-CORRUPTION INITIATIVES HAVE NOT WORKED

Why did it take the donor community so long to make a concerted effort to combat corruption within foreign aid programming? If donor agency staff clearly had some idea that all of this was taking place within the projects they oversee, why were they seemingly incapable of doing something about it?

The answers are multifold but what does seem clear is that despite the devastating economic effects of corruption as proven by their own considerable research, donors consistently failed to develop an effective anti-corruption strategy. Acknowledging the crux of the problem, a 1998 World Bank report acknowledged:

> *"Our mission confirms earlier reports on corruption in Indonesia: that* it is *pervasive, institutionalized, and a significant deterrent to overall growth of the economy and effectiveness of the Bank's assistance".*[69]

[68] Jakarta Post article of 16 September, 1998; op.cit.

Historically, donor efforts have failed to have any marked impact upon the pervasive system of corruption and collusion. Because open discussion of KKN was taboo during the Suharto era, many donor agencies have tended to limit their anti-corruption efforts to defensive rather than offensive actions. Attempts are frequently made to tighten internal controls rather than trying to prove wrong doing. None of the donor staff interviewed during the course of this study, for instance, could recall any attempt to use lawsuits or other legal means -even in the most egregious cases -to recover project funds that had found their way into Government or contractor pockets. While the vagaries of what legally constitutes a burden of proof in a massively corrupt judicial system makes such reluctance understandable, it does serve to further the culture of impunity that serves as a major obstacle to combating KKN.

With few exceptions, measures put into place by donors have not been very effective in stemming the losses. Some of them have been half-hearted in nature and thus not taken very seriously (by donors and GOI officials alike), but most have fallen victim to the truly ingenious -and remarkably resilient -web of Indonesian KKN.

The blacklisting of supposedly corrupt Indonesian consulting firms or individuals was one of the means intended to limit KKN. But it has been implemented both too cautiously (donors tend to be justifiably mindful of being caught up in the legal tangle of lawsuits and counter-suits), and too haphazardly. Until recently, major donors neither publicized nor shared their blacklists. Moreover, the ease with which consulting firms can change their names or otherwise create new legal entities to carry on their work is noteworthy. *"They are like hydras"*, one expatriate consultant remarked. *"Cut off the head of one and within weeks, there's another in its place. Same people, only the names have changed.* "[70] Donors have often proved less than vigilant in updating their blacklists, a task further complicated when procurement and contract tendering is broken down on a regional basis. A major World Bank water supply project, for instance, blacklisted one of the country's largest engineering firms on the basis of poor performance and alleged corruption in Maluku, only to discover that the very same firm had been awarded

[69] .Options to Reduce Negative Impact from Corruption on Bank-Financed Activities"; internal World Bank memorandum from Jane Loos to VP Jean-Michel Severino, op.cit.

[70] Confidential interview with former consultant to BAPPENAS.

(by a provincially-based assessment committee) the implementation contract for the same project in another province less than two months later.

It seems safe to assume that current Indonesian leadership cannot be counted on to resolve the KKN pandemic. Courageous though many CiVil Society organizations and journalists may have been in exposing many cases, both prominent and commonplace, such exposure has hardly curbed the widespread abuse of public funds for private purposes. As this paper has already pointed out, mechanisms put into place by Government bureaucrats to control corruption have historically tended to become part of the problem rather than part of the solution.

ROOM FOR HOPE? THE CURRENT CONTEXT

This is a proverbial "Good news / Bad news" saga. The good news is that donors are at- tacking the problem of corruption more vigorously than ever. More project and policy information is being made public and disseminated to a wider audience. Project supervision is receiving a larger share of the budget and is being carried out more seriously. Indonesian staff working for donor organizations have detected a more serious attitude on the part of project managers in terms of their procurement and management oversight. There has been greater donor collaboration, particularly between the ADB and the World Bank, on anti-corruption measures. They are, for instance, jointly pressuring the Government to establish a "National Public Procurement Bureau" intended to overcome many of the problems associated with the decentralized tendering process.[71] Audits are being carried out with greater diligence and are being scrutinized more carefully than in the past. There is some evidence that the GOI audit bureau is gradually improving its ways. Corruption hotlines and internal investigation units have been established and even vague hints of project-based KKN are being checked out thoroughly. All of this is bound to have some effect in reducing corruption even if it is too soon to quantify the impact of these measures.

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[71] In August 2000, the WB and the ADB completed a "Country Procurement Assessment Report (CPAR)" that contained detailed information and a comprehensive set of recommendations on how the GOI needs to improve its procurement systems. This is now serving as the blueprint against which Indonesia's willingness to reform is being measured.

The bad news is that neither the public nor the private sectors in Indonesia are following suit. Anti-corruption commissions and taskforces, most of them seriously under-budgeted have been formed but effective action has not been taken. Evidence suggests that:

> *"not only have grand and mid-level corruption continued, but that the problem* is *worse than ever. Habit, opportunities for those new* to *the feeding chain, and money politics are reasons. The breakdown of authoritarian rule, which in some sense controlled and di- rected this corruption,* is *another"*[72]

Foreign aid consultants surveyed for this paper were divided in their views. One noted that several of the most notoriously corrupt GOI project administrators had been marginalized in recent months and that contract tendering was being undertaken in a comparatively clean and transparent manner. But most others contended that it is *"business as usual"* in most Government and contractor offices. The rapid turnover of senior civil servants (Echelon I and II) over the past two years was seen to be a contributing factor to *"the increased rapaciousness of the system"* as an IMF consultant put it. Increasingly, parliamentary and political party officials are endeavouring to get in on the action. There is little doubt that competing post-New Order political factions have replaced a more clearly defined political patronage system thereby forcing influence seekers to spread illegal payments more widely. Indonesian consultants, for instance, reported widespread rumors of *"rivers of money flowing* to *the DPR"* to prevent the passage of unfavorable legislation.[73]

Some consultants report that many civil servants in advantageous *"wet"* positions are worried that a crackdown on corruption might actually begin.to show results. Although the evidence is primarily anecdotal, this concern is allegedly leading to a heightened incidence of KKN in some projects as corrupt Civil Servants and contractors grab what they can while it is

[72] "Reflections on Corruption in Indonesia" by Prof. Gary Goodmaster, University of California Law School. Quoted from Van Zorge Report, March 2001.

[73] Quotes are taken from a series of confidential interviews, conducted in February and March 200 I, with expatriate and Indonesian consultants providing technical assistance to various donor-funded projects and seconded to GOI line ministries or private-sector consulting firms.

still possible to do so. An additional concern expressed by donor staff and consultants is that decentralization legislation could water down the potential impact of new anti-corruption measures and create a plethora of "mini-Suhartos" each with their own regional fiefdoms and network of cronies.

Objective observers, assessing the corruption issue from a mainly business perspective, have noted little improvement -a veritable recipe for continued pessimism. The Political and Economic Risk Consultancy, for instance, still rates Indonesia as the second most corrupt country in Asia in its annual "Perception of Corruption Index" survey. [74]

The question is begged, in light of this depressing lack of progress on the KKN front, as to what it would take for donors to wield the largest sanction they have at their disposal -a discontinuation of aid? Civil Society critics of the multilateral donor organizations have been advocating just such a moratorium for several years. Yet for most major foreign aid donors, particularly those involved in loan financing, even a temporary suspension of their aid programs is, as an ADB staff member noted, *"almost inconceivable".*[75] Specific projects can and have been cancelled but the ADB indicated that the most significant sanction they could foresee might be a sectoral suspension of aid.

Given the fragile state of the Indonesian economy and the increased importance of foreign aid in reducing the GOI budget deficit, economists warn of the potentially dire macro-economic consequences of an aid moratorium. More importantly perhaps, the continued disbursement of aid -albeit with the noble intention of reducing poverty -is the raison d 'etre of many donor organizations. To suspend aid would not only risk losing any policy influence on the Indonesian government, it could also make aid agencies largely irrelevant. There is also concern it

[74] "Asian crisis does not spur anti-graft fight: Survey", The Jakarta Post, March 7, 2001. The PERC survey noted that Indonesia's change over the past year was negligible -from 9.88 in 2000 to 9.50 this year, on a scale of 1 to 10 with 10 representing "most corrupt". More significantly, Indonesia's rating fell from a 7.30 in 1995.

[75] To be fair, the World Bank -with the ADB following suit -did suspend disbursements on adjustment lending programs (but not on on going projects) following the Bank Bali corruption scandal in 1999. But this was due as much to concernover "money politics" during a national election campaign as it was to corruption-related concerns.

could jeopardize the willingness of the Indonesian government to repay outstanding development loans. It would seem that the Indonesian government does not take the possibility of an aid suspension seriously. As Sebastian Pompe, an IMF consultant on legal reform, pointed out,

> *"The Indonesians continue* to *rely on the belief that the West will bail them out on geopolitical grounds, no matter how bad KKN remains.*" [76]

BETTER LATE THAN NEVER -WHAT NEEDS TO BE DONE?

Much of the information contained in this report will be all too familiar to those who have been involved in the design or implementation of foreign aid projects in Indonesia. They will also be familiar with the many extensive lists of recommendations on how to battle corruption that have arisen from numerous donor missions.

Like other revenue sources, foreign aid programming will continue to be undermined by KKN. Progress on the anti-corruption front is likely to remain painfully slow, and public cynicism about prospective action high, as long as the three interwoven components that mcilitate the KKN network remain largely unchanged:

- a civil service system that recruits and remunerates its employees on subsistence terms and conditions with the full expectation that they will have to supplement their basic wages and allowances to earn a decent living;
- a legal and judicial system where judges and law enforcement officers, often by their own admission have *"poor moral integrity* "[77] , where decisions can essentially be bought and where credible sanctions are so lacking, anyone with financial resources can act with virtual impunity; and,
- most critically, a value system that has been warped after forty years of abuse to the point where anyone in a position of even nominal authority has become *"inured and enamored"*

[76] Interview with Sebastian Pompe, Resident Legal Counsel, International Monetary Fund; Jakarta, March 2001.

[77] This was the term used by a newly appointed justice, Artidjo Alkostar, at the launching of a Civil Society organization called Indonesia Judicial Watch. Quoted in "Real actiops needed to thwart corruption: Experts", The Jakarta Post; 16 January, 2001.

of the additional incomes provided by corruption. For many, it is no longer a matter of corruption but of a hak, a right, a prerogative. "[78]

It is the latter that represents the major challenge -attitudinal change always being the most difficult to accomplish. Unless and until these three factors underpinning corruption are dealt with by Indonesians -in the public, private and civic sectors -KKN is likely to remain endemic. But to conclude that the battle against KKN must be led by Indonesians is a truism bordering on trite. While donor agencies alone cannot turn the tide, they should not abdicate their responsibilities. Donors need to remain engaged in two critical ways:

- by remaining ever vigilant in safeguarding their own projects from corruption and applying real sanctions when evidence of KKN is uncovered; and,
- by retaining and even increasing pressure - using both carrot and stick -for tangible policy improvements in good governance, including specific measures and mechanisms to counter corruption.

In terms of project safeguards, the many anti-corruption missions mounted by donors in the past three years have produced reams of recommendations that, if applied seriously, can and will provide a much more solid technical layer of protection for project initiatives. Combined with investigative mechanisms such as the World Bank's new Corruption Fraud and Investigation Unit and a greater willingness to actually apply sanctions, progress is being made, however gradual.

What has been lacking in many of the donor-led anti-corruption overviews is the need to involve citizens themselves -both the communities intended to benefit from aid projects and through Civil Society at large (NGOs, academic institutes, mass-based movement, watchdog agencies, and independent think tanks) -in anti-corruption efforts.

In particular, donors need to improve community and Civil Society participation by build- ing in three recurrent themes within project design [79]:

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[78] Email correspondence with Professor Daniel Lev; February 2001.

[79] These themes are based upon efforts to combat corruption in the World Bank-funded Kecamatan Development Project and are outlined in the draft paper "KDP and Corruption".

Improve public access to information

Indonesian civil servants have an *"endemic tendency* to *avoid sharing [project] information, or limiting its access only* to *officials and elites.* "80 Increasing project transparency is directly correlated to greater accountability over the use of public funds. Donors need to make a stronger effort to ensure that financial information, decision making mechanisms, and contract procurement is made accessible to the public and, especially, to the project beneficiaries. Subjecting project information to public scrutiny enables community self-monitoring. This should be complemented by independent monitoring undertaken by credible Civil Society organizations. Donors need to build the resources and the specific mechanisms for both types of monitoring into project design.

Simplify project transactions

The sheer complexity of financial and procurement-related transactions that typically sur- round foreign aid programming has provided a shield that has served to protect rather than expose the KKN web that has systematically drained a considerable portion of ODA funding. To the extent possible, decision-making over the allocation and use of project resources needs to be pushed down to the sub-district or village level, at least for community development programs that focus on poverty reduction.

Investigate complaints

By not responding in an effective and timely manner to allegations of corruption within aid projects, donors have effectively fuelled KKN. Projects need to incorporate credible com- plaints resolutions mechanisms that will result in the application of appropriate sanctions when investigations turn up proof of corruption. Equally important, those making complaints also need to be protected from reprisals.

80 Ibid.

But even if more effective measures to reduce corruption within aid programming are adopted, the overall governance framework that facilitates KKN will run counter to project -specific measures. At this macro-level, remedying corruption will be a long and often lonely battle. Cold comfort though it may be, Indonesians should be aware that many *“developed”* countries went through similar periods and eventually evolved away from patters of systematic corruption.[81]

No matter how discouraging, donors need to stay engaged on this broader front. In the absence of donor-led pressure, pro-reform leaders who are genuinely interested in combating KKN are left with little ammunition beyond moral platitudes.

Although there may be limited room for optimism, some observers do detect gradual movement in the right direction:

> *“The donor demand for good governance, the negotiated letters of intent, the reviews, the granting or withholding of tranches dependent on the fulfillment of promises, creates a substantial selection pressure in the Indonesian environment.. .there is movement in the right direction. There may be no stunning conversion, no mass baptisms in the anti- comlption faith, but there is change that would not have occurred otherwise. “* [82]

The saga continues.

[81] The United States, for example, is said to have experienced a half-century of endemic corruption and patronage between 1870 and 1920. Source: Reflections on Corruption in Indonesia” by Prof. Gary Goodmaster, University of California Law School. Article in Van Zorge Report, March 2001.

[82] Ibid.

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Corruption in the Indonesia's Private Sector

By *Nasir Namara*

INTRODUCTION: THE COLONIAL PERIOD

There is a strong perception in the international community that the Republic of Indonesia is one of the most corrupt U.N. member countries, and not without good cause; Indonesia is ranked 96th out of 99 countries surveyed in the 1999 Perception Index on Corruption issued by Transparency International. Corruption is also a cause for frequent complaints from the World Bank, the international business community, and liberal *free market* economists. Twenty years into former President Soeharto's *New* OrderregiIne an Australian researcher wrote:

> *Corruption constitutes a sizeable leakage of funds that may potentially be more constructively invested. At the same time it imposes substantial costs and frustrations on investors, particularly in strategic departments such as Customs and the Capital Investment Coordinating Board (BKPM) itself; where 'charges' of*

up to 20 percent of projected investment have reportedly been made for investment licenses. Corruption also constitutes a major obstacle to an effective tax-gathering system, an indispensable feature of any attempt to increase domestic non-oil revenues.

In real terms, corruption has haunted the entire spectrum of Indonesian society - communities, the government, business circles, educators and civil society. Some have said that corruption has become a part of Indonesian culture. This corruption has resulted in significant economic losses to the country as is evident from the current collapse of the Indonesian economy. Since the fall of the New Order regime, the cost of corruption has been estimated at 30 percent of the annual State Revenue and Expenditure Budget (APBN).

Corruption is defined here as conduct that violates regulations or laws, is conducted deliberately and is designed to gain illicit profits for entrepreneurs. The kinds of illegal acts governed by the term include bribery, the payment of money and valuable goods to bureaucrats, the presentation of excessive souvenirs to civil servants, mark-ups of project budgets, or the imposition of pressure or influence on other parties through the power of money or authority.

During the colonial period corruption occurred in the government and private sectors usually by employing middlemen, typically ethnic Chinese businessman, who acted as brokers between the Dutch military and the indigenous Indonesian people. *The role of the ethnic Chinese* as *brokers was exploited by the Dutch, not just because of their skills but also because of the social structure that enabled* them to *take on such a role* (Sartono: page 80).

Other brokers -lower down the totem pole -were the indigenous local authorities, separate from the leaders of the Indonesians of Chinese descent, who were given monopoly and business concessions as well as the right to conduct tax collection and force labor. These people become *lords* and formed the upper classes that governed the destiny of the commoners. The *lords* were given official positions equal to that of Governor; official positions equivalent to Major, Captain or Lieutenant were awarded to the ethnic Chinese.

At the time the privileges of ethnic Chinese middlemen were revoked -when the state assumed the collection of taxes, the management of pawnshops, and the control of the opium trade -the opportunities for corruption within the bureaucracy of the colonial government seemed to disappear.

The pre-colonial feudal relationship, that has since become part of the Javanese social system, is one where the people yield unconditionally to the authority of the officials appointed by the king. This was a system employed by the colonial administration as a method to control the general populace by using brokers and middlemen. This relationship was not easily terminated when Indonesia achieved independence. Authority within a feudal society is unlimited and unquestionable, and no distinction is made between private and professional needs. According to an Indonesian historian, in the times of the traditional Javanese kingdom *any person making a request from an official was obligated* to *contribute a commission.*

The rise of Indonesian entrepreneurs during the colonial period is attributable to their close relationship with and political subjection to the governing authority as, *only those individuals who left their fate* to *the company (VOC)* or *who plundered it from within* were *able to build considerable fortunes, a* state *of affairs as valid for the Dutch* as *for* other *inhabitants of the town (Batavia), the Chinese included.* Such was the situation in Java before the 1800s according to a European historian.

Dutch, British, American, Japanese and other European enterprises controlled the economic sector. Economic activity, which had previously been confined to rice cultivation, expanded to commodities for export such as sugar and coffee and subsequently tobacco and rubber. Not long afterward, tin mining; oil exploration and manufacturing were introduced requiring investment capital from foreign countries other than Holland. Economic growth and prosperity in the Dutch-Indies also prompted the emergence of a relatively large class of private sector entrepreneurs mainly dominated by foreigners and ethnic Chinese.

Indigenous entrepreneurs were relatively inactive during this period, especially when the Regents and ruling classes were put on the colonial payroll and their lands placed under the control of the colonial government. As such, the accumulation of capital by land did was nearly unheard of in the Dutch-Indies. It can be easily assumed that the causal factor in this modus operandi was to keep the indigenous populace from fostering political aspirations against their colonial masters.

> *According to history, the Filipino, Javanese and Malay people had merchant classes. What happened to these merchant classes? The European colonists eliminated them. This*

elimination process began at the beginning of the 16th century with the arrival of the Portuguese (Alatas: 1988 *page* 255).

Dutch monopolistic practices in the sale and purchase of commodities caused the disappearance of the *independent, high level, and international indigenous trader.* The Dutch assumed their functions as traders. *Other significant changes made by the Dutch - which contradicted the development of strong indigenous trader classes - included the change in authority and the role of the indigenous leaders* to *one of suppliers and supervisors of Dutch interests. Dutch companies used the local authorities and royal families simply* as *means* to *an end* (Idem: page 274).

One successful ethnic Chinese trader, Oei Tiong Ham (1866-1924), was born in Semarang and built the first conglomerate in SouthEast Asia, which operated for three quarters of the 19th century. With a modernly managed business, he expanded his commercial empire to Singapore, Malaysia, China, England, the Philippines, Thailand, Hong Kong, India and the Netherlands. At the same time, Nitisemito, an ethnic Javanese entrepreneur also met with great success in the kretek or clove cigarette business eventually becoming recognized as the King of Clove Cigarettes. Both these men also knew each other (Nitisemito: page 90).

Beginning with sugar production, Oei Tiong Ham established numerous peripheral businesses and before long his company became a conglomerate that controlled several upstream and downstream industries in various countries. His businesses, which operated for nearly a century in Indonesia, were confiscated when President Sukarno's anti-capitalist, nationalist- socialist regime took power (8). Such an economic imbalance did not go unnoticed by indigenous entrepreneurs who subsequently established the Islamic Trade Union, later called simply the Islamic Union, which boasted such prominent members as H. Samanhudi; Raden Mas Tirtoadisoeljo and H. Omar Said Tjokroaminoto.

To date, a great many Indonesians still live in rural regions under strong influences of feudalism, tradition and history. In these areas education is limited as is exposure to democratic concepts, therefore modern ideas regarding national organization and governance are not yet widely espoused.

A historical perspective is required to understand the problem of corruption in Indonesia. As historian Fernand Braudel once said, business is a *subset of* a *greater set,* and the most important elements of the greater set are the policies, attitudes and attention of the government to the business sector, to what extent freedom and assistance are given, and lastly the correlation between governmental political policy and business policy.

In this paper, I will examine the problem of corruption in the Indonesian private sector. For the sake of brevity, this paper will broadly analyze corruption, as it has existed since Indonesia became a sovereign nation, free of the colonization of the Dutch. This period of independence began according to the Indonesian people on 17 August 1945, although the Dutch and the United Nations only recognized the independent Republic of Indonesia in 1949.

However, the models cited herewith are based on events that took place following the emergence of the *New Order* (1966-1998) under President Soeharto's administration, which was followed by the *Reform Era* under Presidents B.J. Habibie (1998-1999) and Abdurraman Wahid (1999-). Although corruption also occurs in small and medium scale businesses, however because of their impact on the national and regional economy, the models examined focus on the businesses malpractices of conglomerates that for the most part became such with assistance from the state.

This seems viable as for the most part the companies that form conglomerates have entered both the local capital markets (the Jakarta and Surabaya bourses), and the international capital markets (The New York, London, Singapore and other exchanges). Hence they have engaged in commerce that mobilizes public or corporate funds in Indonesia or abroad, an activity that requires transparency,countability and public control through independent agencies or a perfect market mechanism.

In principal, as is generally the case abroad, before a company conducts an Initial Public Offering (IPO), the performance and financial status of said company must be examined by an international public accountant company, such as one of the internationally recognized *Big Five* namely, Price Waterhouse Coopers, Arthur Andersen, Ernst & Young, KPMG & Peat Marwick, and Deloitte & Touche. That company must then be approved by the Capital Market Supervisory Board (Bapepam) before being traded in the capital markets. Thereafter, in theory, so long as such a company is still listed, it will be under the supervision of the management of the relevant capital markets.

I have divided this study into three parts, excluding the prologue and epilogue. The first part discusses the relationship between the government and the private business sector. In the first part, I explain in detail how a government of a corporate nature cooperates with the western world in controlling its policies to build a strong private sector under an iron fist on the basis of the need for political stability and economic growth. The impact of this is that the private sector becomes greatly interdependent on the government so as to allow for certain corrupt practices.

The topic of the second part is how the Indonesian private sector became a virtual conglomerate under the *New Order.* This part elaborates on the corrupt practices of conglomerates. I discuss several cases of corruption involving state-owned enterprises, institutions, departments as well as national and international private sector companies such as, Pertamina, the State Electricity Company (PLN), the State Logistic Agency (Bulog), the Department of Mines and Energy, Freeport, Balongan, the Timor national car project, Lippo Group, the Capital Market Supervisory Board (Bappepam), the Clove Marketing and Buffer Stock Agency (BPPC), Tapos animal husbandry, Indonesian Educational Television (TPI), the Cimacan land case and others.

The third part pertains to the destruction and re-embodiment of conglomerates and their corrupt practices in the *Reform Era.* Here it is analyzed how corruption is propagated in the current era of *democracy* with all its freedoms and the various laws and regulations that have been issued to protect them, and who stands to benefit from such corruption.

With a historical and sociological method of analysis, it is expected that a comprehensive description regarding the details, anatomy and the entire problem of corruption in Indonesia can be obtained. To what extent corruption has become part of the Indonesian business culture must be determined as a diagnosis, after which the appropriate remedy must be prepared and administered. A study as brief as this is not sufficient to provide a complete picture of the corruption phenomenon in the Indonesian private sector, nevertheless it will at least offer an overall critical description of the matter.

THE GOVERNMENT AND THE INDONESIAN BUSINESS SECTOR

The Soekarno Years: 1945-1965

Since Indonesia gained its independence, various administrations have made numerous economic policies for this new country within the framework of a democratic state. Although the principles of these economic policies are essentially structured to preserve capitalist economic policy or market-oriented economic policy with all of its variations as exercised by the Dutch colonists, they are still dependent upon certain economic conditions either under crisis or in prosperity.

International social experts are of the view that the economic and political transformation of Europe occurred due to the existence of a strong capitalist group. Such transformation was initiated with the advancement of the trading sector and further expanded by means of industrialization. Once the capitalists held sway, they succeeded in toppling the aristocratic authorities and in the long run established a developed capitalist system, which produced a political democracy. *But this process did not take place, on the whole, in the Third World. In the case of Indonesia, the indigenous trading class has always been too weak economically for it to aspire to become the dominant political force, while the Chinese, a minority, have not been able to turn their economic strength into political power* (Crouch in Chandler: page 41).

The national Government prior to the era of guided democracy (17 August 1945 -1959) lacked educated and skillful national economists but still hoped to meet public expectations, and after a struggle to realize economic gains instituted several special policies to assist indigenous traders as a counterbalance for the special positions held by the Dutch, other foreign entities and the ethnic Chinese during the period of colonization. For example, by means of a *Fortress Program* that provided various indigenous entrepreneurs with numerous facilities, such as, import licenses, financial loans and fiscal facilities. These policies produced a number of successful indigenous entrepreneurs namely: Rachman Tamin, Wahab Affan, Omar Tusin, Pardede, R. Rudjito, Agoes Dasaad, H. Sjamsoeddin, Usman Zahiruddin, Herling Laoh, Soedarpo Sastrosatomo, Ir. Sosrohadikoesoemo, H.A. Ghani Aziz, Sidi Tando, Fritz Eman, Moh. Tabrani, Hashim Ning, Djohan and Djohor, Soetan Sjahsam, R. Mardanus, Eddy Kowara, R.M. Kusmuljono and the Indonesian Batik Cooperative Association (GKBI).

With all its shortcomings, the Indonesian government has over the years attempted to build a national economy that is open to international markets, speculators and investors. Major interruptions to this economic development process took place during President Soekarno's nationalist administration (1959 -1966), which adopted a socialistic economy that was decidedly anti-capitalist and anti-ethnic Chinese. At that time, the state's intervention in economic management, which was previously quite considerable but in a more substantial manner so as to enable the private sector during the transitional phase to continue to grow, became more comprehensive as the central government took over all principal private companies and transformed them into State Enterprises (PN) that formed the basis for the modern day Indonesian state owned enterpnse (BUMN) sector.

After the nationalization of the large multinationals (Dutch in 1957; British in 1963; U.S. in 1965), the owners, managers and professionals within those companies were expelled from or voluntarily evacuated Indonesia and were replaced by inexperienced and incapable staff directly appointed by the government, many from within the Indonesian military. Moreover, when Soekarno adopted a military confrontation policy against the also recently independent Malaysia, the Indonesian business sector suffered further.

The state of Indonesia's economy during the Soekarno era, particularly towards the end of his time in power, rapidly declined. The private sector stagnated and inflation skyrocketed to the point that in many regions the inhabitants stopped using the Rupiah, as its value could not be consistently depended on.

Various commercial concessions were also awarded to businessmen who were close to the president. The most successful Indonesian businessmen at that time were Aoes Dasad, R.M. Notohamiprodjo, H.A. Ghany Aziz, Rahman Tamin, OmarTusin, Soedarpo Sastrosatomo, Panggabean, Titiheru, Markam, Ir .Amjnuddin, Hashim Ning, Moh. Tabrani, Wahab Affan, Pardede, Bram Tambunan, Suwarma, Aslam, and Mardanus. Several of these were later imprisoned on charges of corruption. Of the above names, the most prominent was Agoes Dasaad. He was later accused of corruption for allegedly influencing the Indonesian Air Force (AURI) to purchase aircraft from Lockheed. The commissions and special payments disbursed by Lockheed had amounted to USD 152.000.

The fall of Soekarno was also marked by the collapse of the business interests of those who were close to him. Accusations of corruption against the men.oers of this elite group were processed and their companies subsequently confiscated. The accused were some of the President's closest associates, such as, Dasaad -who had been a friend to Soekarno since his release from the Sukamiskin prison in 1929, and Hasyim Ning -who was used by then general Soeharto to influence Soekarno in his favor (Alamsjah: page 167).

The most significant corruption case brought to court involved a high-ranking official, Yusuf Muda Dalam, the former Minister of the Central Bank. He was found guilty on four counts: 1) the issuance of import licenses to several companies valued at USD 270 million by means of *deferred payment;* 2) The furnishing of *special loans* amounting to IDR 338 billion; 3) The manipulation of IDR 97 billion of the *Revolution Fund,* which was lent to the companies of his best friends; and 4) The embezzlement of IDR 4 billion from the same fund (13). In stating his case, the prosecutor alluded that the defendant's abuse of power and authority had *deeply impacted Indonesian society, the economy in particular, and had resulted in widening the rift between social circles with vested interests and the majority of Indonesians who were fixed/ nominal producers and whose incomes had never afforded them a proper standard of living, thus forcing them* to *think, behave and act in contradiction* to *prevailing norms* (Nasution: page 285).

The downfall of this former minister was followed by the collapse of the power of the President who not long after received a memorandum from the *Gotong Royong* House of Representatives (DPRGR) with regard to his accountability and management issued by the Special Session of the Provisional People's Consultative Assembly. Soekarno was accused of being responsible for the decline of the economy and large-scale corruption due to his issuance of Presidential Instruction no. 18/1964 concerning the Special Deferred Payment (DPC) license, which was a special license granted to official agencies, private companies or individuals, for and on behalf of, the state agency to make offshore loans.

The DPRGR Memorandum stated that: *The issuance of DPC licenses which were transferred by means of cultivating the Revolution Fund did not fulfill* its *objectives due* to *the disorder of its administration which placed no control on the revenues and expenses of such funds, either in Rupiah or foreign currency.* Examples of such mismanagement included the following.

1. The determination of the amount funds for collection as a favor for granting the DPC license was vague and depended entirely on the whims of President Soekarno or former Minister of the Central Bank, Yusuf Muda Dalam.
2. Some individuals were subjected to mandatory deposits for such a fund, while others were exempt from paying mandatory deposits in the absence of any objective basis for the granting of such dispensation.
3. The payments of such funds were sometimes made to banks or received directly by President Soekarno himself.
4. The expenses paid out of the funds were disbursed in a disorderly manner subject to the caprices of the President (Nasution, page 327).

The Provisional People's Consultative Assembly (MPRS) chaired by General A.H. Nasution, after conveying other various considerations finally rendered the decision to 1) Revoke President Soekarno's mandate who, according to the DPRGR, was proven guilty of corruption, and to appoint a replacement pursuant to article 3 of MPRS Decree no. XV /MPRS/ 1966; and 2) to instruct the Judiciary to examine, investigate and prosecute the case (Idem, page 329). The Court further sentenced Yusuf Muda Dalam to death. Whereas Soekarno, not long after the Special Session of the MPRS was convened, with Presidential Order of 11 March 1966 (Supersemar) signed by him, transferred his power in full, as President, to Lieutenant General Soeharto.

Upon Soekarno's ouster in 1965, a Dutch scholar stated his views regarding corruption in Indonesia: *First we must* consider *that the forms of post-war corruption often concealed the inheritance of the traditional social structure. The heads of villages, for example, remained unsalaried, which forced them* to *survive off the contributions of village residents where a pan of such contributions was legal and another pan illegal. The substructure of patrimonial bu- reaucracy still influenced other parts of society, whereas the traditional family relationship was continually in conflict with modem concepts of morality regarding public problems* (W.F. Wertheim: page 125).

The Will to Eradicate Corruption in the *New Order*

When Soeharto assumed power, together with the economists who supported the ideals of the *New Order,* he implemented a new liberal economic policy in order to modernize the country. With a strong will to eradicate corruption, economic matters began to hold sway over politics and as such the political system that had inhibited personal freedom under the Soekarno government was continued. The newly formed government made economic recovery a top priority and was aided by the international capitalist network.

The economy and in fact the entire business sector of government was placed under the strict control of technocrats who were assisted by anti-communist western countries through bilateral or multilateral cooperation with their representative financial institutions such as the World Bank, the International Monetary Fund (IMF), and the Asian Development Bank (ADB).

The vision of a corporate country is one where the control of both political and economic power are in the hands of a central government that provides select business entities with the required strategy, technology, network, fiscal policy, funding and market access. However, cracks in this system appear if such sweeping powers are not held by a pluralist and independent state authority, as public officials then function as both the owners of the state and the managers of the economy, due to their exclusive control over capital resources.

There are three sectors in which stability is maintained and preserved between themselves. The fIrst is the state business sector that comprises state owned enterprises (BUMN), the service bureau and National Enterprises. The second sector is the private sector, while the third is made up of cooperatives, and is further related to the management of Small and Medium Scale Businesses (UKM).

The view of the *New Order* government was that it could do no wrong and that the President held absolute power. This is evidenced by the unlimited terms of office available to President Soeharto who was in power for 32 years. The sheer length of time that he held office is one causal factor that contributed to the upsurge in corruption and the creation of a culture rooted in corruption, collusion and nepotism.

Soeharto first became interested in commerce when he obtained a business in cooperation with Liem Soei Liong while serving as military chairman in Semarang. Liem Soei Liong later formed the country's first conglomerate, and set the blueprint for the New Order entrepreneur. At the outset of the *New Order,* the President's wife, Tien Soeharto, became involved in the construction of the Indonesia in Miniature Park (TMII), a project that drew a great deal of criticism, as it was alleged to have involved corruption.

Although commercially inclined, President Soeharto still made no effort to increase the income of civil servants and military personnel to levels on par with the private sector. This disparity exists to this day based on the government's claim that it possesses insufficient financial resources to remedy the situation. This behavior is believed to be rooted in regal Javanese tradition where high-level public officials were not paid by the King but were permitted to collect tribute and drive their constituents into forced labor to the financial benefit of the public officials concerned -two practices not deemed as corruption or extortion.

What occurred in the *New Order* mirrors this tradition as civil servants abused their power in the licensing and supervisory fields, for instance, to extort unofficial payments from entrepreneurs and other private persons in need of the various facilities and permits under the control of said civil servants. This practice has since become widespread and habitual, creating the *New Order* culture of corruption that endures to this day.

In 1971 a certain German scholar described the connection between Indonesiar, culture and corruption as the *basic morality of the Javanese people,* who use familial norms in all aspects of their daily lives, including in governance, which are structured into hierarchies,mutual assistance norms, deliberation and mutual cooperation norms. Mutual assistance refers to a demand of support for the village, for example in the event of death where refusal is not permitted. He wrote, *government teachers were not paid sufficient salaries and were supported by their students' parents. They were permitted* to *sell writing books and* to *collect graduation money and* so *forth Institutional employees sold application forms, and in traditional markets, one ounce equaled* 80 *grams, as the price per ounce had been determined. There were contri butions and deductions everywhere.*

He further stated *that anyone who held an important position had to care for many people as subordinates expected that their superior show his status. In order to carry out their* *duties such superiors relied upon smooth incomes. What are the limits of a system that* is *based on subjective-hierarchy morality? Is it still of a supportive/ communal nature, when bribery, exploitation and corruption are the norm? It is clear that overindulgent people, who take more than they are entitled* to *for their status and obligations, are bad people. Yet it is worse if they are stingy and prioritize only themselves. Their main obligation is* to *care for their dependants.*

The scholar concludes that, *such norms are most important, whatever the source of income may be. Thus corruption is quickly becoming part of Indonesian culture* as *the distinction between corruption and mutual assistance becomes increasingly vague in a society too extensive* to *supervise itself (Niels* Mulder: page 37-38). This mentality, according to the author, is a result of the fact that the Indonesian people as a whole are more traditional than modern. So long as no changes are made, it will continue to be impossible to establish the rule of law, as to do so society at large must possess the ability to think in an objective and modern fashion.

If the entrepreneurs within such a traditional culture wish to succeed, the rules of the game must be followed. They must have the will to engage in bribery, pay commissions, give gifts and provide shares to officials. If they do not, then their commercial survival is doomed. Therefore, in order to learn about corruption in the Indonesian private sector, we must acquaint: ourselves with the major entrepreneurs, the companies that they own, and the regimes under which they operate.

The *New* Order regime, though led by many educated technocrats, did not establish regulations or initiate preventative measures to deter bureaucrats and entrepreneurs from corrupt business practices. This reflects the fact that the principle of clean governance, which is based on laws that are consistently enforced, was not adopted in the day-to-day state administration.

Attempts to Eliminate Corruption

Endeavors to eliminate corruption were carried out under the *New Order* administration as is evident by the establishment of the Corruptjon EradicationTeam (TPK), Commission IV, the Law and Order Operation (Opstib. 1977) and the Anti-Corruption Committee, among others. Such initiatives however always tended to focus on the aspects of repression such as more legal charges and harsher punishments.

Commission IV, for example, concludes in its report that there are three causes of the pervasiveness of corruption, the primary one being insufficient salaries, which force civil servants to engage in corruption and abuse of power for financial gain. The Commission recommends that the government impose severe sanctions against offending parties, and that effective regulations be put in place and an Anti-Corruption Law enacted.

The shortcomings in the effort to eradicate corruption also lie with the fact that no attention has been given to public education on the subject explaining the effects of corruption and the negative impact it has on the economy and society in general. In addition, no concerted effort has been made to weed out the legal loopholes that encourage corrupt practices. Of the foregoing three primary causes of corruption namely, low wages, and the lack of preventative education and law enforcement, the latter receives the most attention.

Domestic and International Sources of Capital in the *New Order* Era

The rise of the *New Order* also meant the demise of businessmen linked to the *Old Order,* a term used to identify Soekarno's administration under Guided Democracy, and the naissance of those businessmen close to the emerging center of power, such as, Liem Soei Liong or William Soeryadjaya with his PT. Astra, a company that thrived under orders received from the government for wheat, automotive parts and other commodities.

Foreign Capital Investment companies (PMA) became the government's priority. The arrival of foreign firms was expected to propel economic growth as they brought in financing, technology, market and management capability as well as international work ethos and quality standards. At the birth of the *New Order,* nearly all technology components were imported, but with the advent of the PMA the government succeeded in substituting many technology imports enabling it to conserve foreign exchange.

The textile industry was the sector to attract foreign investment, particularly from Japan. Many factories were built to meet international and domestic consumption requirements. The significant growth of the textile industry also created the export oriented garment industry producing clothing under license of international houses of fashion. Many large Indonesian companies and conglomerates had their beginnings in the textile industry, such as Texmaco and Indorayon.

Various policies beneficial to PMA's were implemented, such as tax exemptions, land provisions, licensing and other competitive facilities. However, they were obligated to enter into cooperation with local companies in the form of a joint venture. Seeking a domestic partner is not an easy thing to do, particularly among indigenous entrepreneurs, as their businesses are generally small, lacking in capital and only in possession of localized networks and experience.

It is under such circumstances that subjective selections are carried out for those parties appointed to become partners of foreign investors. The pattern during the New Order was to provide projects to companies owned by or engaged with the families of officials closely linked to Soeharto, or who first received information on the eminent business venture.

The *New Order* also obtained capital from significant offshore loans provided with low interest rates and long – term payment schemes by western countries and Japan to finance reparation "and the construction of new infrastructure, such as roads, bridges, ports, ships, aircrafts, airports, satellites, telecommunication, electricity and weaponry.

A total of USD 282.2 million in financial aid was disbursed between April 1966 to September 1968. President Nixon, the first United States President to visit Indonesia (28/7/1969), became a symbol of western support for governments opposed to the communist ideology and diplomatically distant from communist states. Nixon promised to provide full support to Indonesia in their effort to achieve economic recovery when he declared, *The people of the United States wish* to *share with you this adventure in progress* (Jones: page 409).

In addition to the above, domestic funding was obtained from the management of natural resources industries- mining, oil and gas, forestry and plantations -as well as from income tax and excise duty. The oil boom that took place in the early 70s increased government revenues considerably. Unfortunately though, the increased resources were disbursed by the government to assist its preferred entrepreneurs like Arifin Panigoro and Ponco Sutowo, the son of the President Director of Pertamina, Ibnu Sutowo.

Case Study One: Corruption in Pertamina

Pertamina as an oil and gas company appears a kind of state monopoly, but is in reality no more than a cash cow to be milked by the ruling parties to finance their personal or political agendas. For this purpose, Pertamina was granted special status and its management placed under the direct supervision of the President. All decisions pertaining to management such as the appointment of Directors require the approval of the President. Consequently, Pertamina, which is not managed transparently, has since its founding been a hotbed of corruption, collusion and nepotism.

When the Pertamina corruption scandal broke it shocked the national economy. Pertamina was drowning in a USD 10.5 billion debt. In reference to the massive debt the company's founding director, Ibnu Sutowo commented, *Pertamina utilized such loans to build, among others, the Krakatau Steel factory and Bina Graha. Pertamina also financed sporting events in the provinces and built sports stadiums like the one in Palembang in a number of other cities. Pertamina executed these activities at the request of President Soeharto* (M. Karma: page 267).

The truth of the matter is however that Pertamina's ranks were filled with corruptors. Even the company's treasurer, Ahmad Thahir, embezzled USD 80 million in corporate funds. Com- mission IV, comprising four respected national figures, namely Wilopo, Kasimo, Johannes and A.Cokroaminoto and former Vice President of the Republic of Indonesia, M. Hatta as advisor, released two reports on corruption in Pertamina during the Commission's five months in operation in addition to reports on Bulog, the forestry industry, the Attorney General's Office and other state administration matters.

Ibnu Sutowo denied the allegations of corruption leveled against him, claimipg that he was wealthy before his appointment as President Director of Pertamina. He stated that the President had dismissed him in 1976 because; *I had rejected a proposal from Soeharto for a business venture that I believed was wrong.* Ibnu Sutowo also admitted that he was afraid to go against the President's wishes saying, *If I disclosed these openly to the public, I might disappear or at the least, the well being of my children would be jeopardized* (Jakarta Post: 4/5/ 1999)

Ibnu Sutowo did not try to deny the fact that large-scale corruption took place in the company of which he was the director. When rumors of corruption in Pertamina surfaced, Mr. Sutowo explained that, *Such corryption must indeed be eradicated. But unfortunately, it* is *present at every level of society. Should we stop working because of that? Of course not. Therefore, build something first, and later work to fix or clean it (M.* Karma: page 242).

Case Study Two: The Salim Group and Bulog

Aside from Pertamina, the State Logistic Agency (Bulog) is a source of state project funding that is very important to the private sector. Ethnic Chinese businessmen who were close to President Soeharto, such as Liem Soei Liong, founder of the Salim Group, were given concessions to trade as suppliers to the state, and in partnership with Bulog supplied the government with basic commodities and materials.

With regard to how he first became acquainted with former President Soeharto Liem Soei Liong writes: I made *Pak Harto* 's *acquaintance in the 1950s in Semarang. When I first met him, he had not yet been made a Diponegoro Commander, and although I actively supplied his military district, I don't recall his exact rank at the time -colonel perhaps?* Two years after Soeharto came to power, Liem was granted a monopoly on the import of cloves from Zanzibar and Madagascar, which enabled him to raise large amounts of capital for the expansion of his company into Indonesia's first conglomerate.

Bulog as a government procurement agency of basic commodities -rice, sugar and the like -is also sorely mismanaged. Those appointed as chairmen are without fail people who are close to the President. The selection of Bulog's private commercial partners is made according to the arbiter's criteria and typically comprises companies with connections to the Presidential Palace. Several corruption scandals involving Bulog have recently surfaced, the most notable being the cases of the former Chairman of Bulog, Beddu Amang, and his Deputy, Sapuan, and that of the Regional Chairman of the State Logistic Agency (Kadolog), Budiadji, in Kalimantan.

Case Study Three: Bob Hasan and the Forestry Industry

Forests are an extraordinary source of money. Those close to the seat of power often exploit large-scale forest clearings, as does the commercial arm of the military and government administration figures. Uncontrolled concessions are given to manage extensive forestry territories and under the management of these unscrupulous parties, many concessions are subsequently sold to private entrepreneurs or foreign joint-venture companies from Taiwan, Japan, Korea or Malaysia. Various cases of corruption within the industry have recently come to light, the most recent being the Bob Hasan case.

The mining business is also very lucrative but requires large amounts of start up capital and certain technical skills. Hence, the government has granted concessions in this industry to foreign companies such as U.S. based Freeport, which was the first company to utilize the Law on Foreign Capital Investment (PMA), in Apri1196 7. Freeport was later accused of corruption, collusion and nepotism (KKN) in seeking the extension of its contract to the benefit of Ginanjar and his closest associates namely, Aburizal Bakrie, Bob Hasan and A. Latief (who became the Minister of Manpower after the fall of the *New Order* regime and who was later accused of involvement in the Social Security [JAMSOSTEK] corruption scandal).

Case Study Four: MNC Mining Companies

Soeharto's children were themselves very interested in the mining industry and fought over it as in the case of the Busang scandal, which also involved Canada. Aside from Pertamina, the oil and gas sector, which had been dominated by U.S. oil giants since the colonial period, continued under largely American management, even though exploration concessions were awarded to several multinationals such as the French oil company Total. Not many private entrepreneurs are involved in this sector that is also rife with corruption. U.S. oil giant Exxon allegedly bribed government officials in order to secure the construction of an oil refinery in Cilacap.

Julius Tahija -a former officer in the Dutch military who joined the Indonesian Army (TNI), conducts business with Freeport, is the former owner of Bank Niaga, and was also the Managing Director of Caltex Indonesia for many years (until 1997) -stated that ,corruption is deeply entrenched within the developing world. This prominent figure, who fosters close relationships with many multinationals, became the bridge between the international business community, the *New Order regime* and the Indonesian business community.

On the problem of corruption in Indonesia, he once wrote: *When joined Caltex many westerners assumed that all businesses in Asia were corrupt. Some said Indonesia was moving quickly in that direction. More than a few Americans embraced corruption because it was expected. My first experience with this came shortly after Caltex placed* me *in a senior management position. An official from aforeign company approached* me *and said that he was prepared* to *pay the usual commission.* He *assumed I expected a kickback* (213-214).

Ethnic Discrimination: Indigenous versus Ethnic Chinese

In the *New Order,* as in the *Old Order,* the colonial tradition of discrimination in political affairs and ethnic identity, particularly concerning the culture and language of the Chinese minority continued. For public officials it was deemed beneficial to cooperate with ethnic Chinese financiers, as they held liquid financial resources and had access to the Asian business network; they also had no political power whatsoever and as such could be easily blackmailed.

Competition between indigenous entrepreneurs and their ethnic Chinese counterparts was still strong. Each entrepreneur had a *patron,* however, the *patron of patrons* was of course President Soeharto. Before long a crystallization of the private business sector took place. Prominent indigenous businessmen joined the Indonesian Chamber of Commerce and Industry (KADIN), which was chaired for many years by Sukamdani Sahid Gitasardjono, a well-known businessman from Solo with blood ties to the wife of the President and a good relationship with his ethnic Chinese colleagues. Sukamdani Sahid Gitasardjono was unofficially assigned by the government to explore the possibility of reopening diplomatic ties with the People's Republic of China (PRC), which had been severed in 1965. Salim, speaking on the behalf of the ethnic Chinese business community, once said, *Mr. Kamdani* is *one of a minority of indigenous Indonesians who is willing* to *be close* to *us and* to *understand, accept, and embrace us.*

The ethnic Chinese came together in the Prasetya Mulya Group with such prominent figures as Liem Soe Liong and Sofyan Wanandi. They met regularly to assist each other. This group was a private and exclusive one that created a sense of social envy. The government under the auspices of the Association of Young Indonesian Businessmen (HIPMI) brought young indigenous entrepreneurs together. Successful indigenous business figures were appointed chairman such as the former National Chainnan of Hipmi, Aburizal Bakrie. Under his management, the crystallization between the indigenous and ethnic Chinese entrepreneurs became even more apparent.

Ginanjar as Patron of Indigenous Entrepreneurs

The role of Ginanjar Kartasasmita, a nationalist who awarded numerous projects to indigenous businessmen during his term of office as Junior Minister of Domestic Production Procurement, cannot be overlooked. In fact, as a result of his efforts many young indigenous entrepreneurs profited to such a degree that they later become prominent businessmen, such as Aburizal Bakrie, A. Latiefwho was once the Minister of Manpower, Fahmi Idris, Sugeng Saryadi, Arifin Panigoro, Yusuf Kalla and Fadel Muhammad.

Small and medium scale businesses (UKM) were not made apriority. However, in order to assist UKMs, the government advised the Kadin and Prasetya Mulya groups to establish a partnership and conduct a policy of assistance. In reality though, small-scale businesses that were recipients of support were for the most part companies owned and established by the conglomerates. This ensured that the funding contributed was recycled back into the conglomerates; while at the same time their public image received a needed boost.

A new opportunity for corruption arose when the government issued a regulation stipulating that each BUMN must set aside 5 percent of its profit to be used in stimulating the small- scale business sector. In reality however, the Boards of Directors and Commissioners embezzled these funds due to the low level of control over such funds. A common practice that sprung up as a result was the use of such funds to establish private companies.

Once again cooperation became a special focus. A new department was established with the authority to issue policies and distribute funds for the development of the small-scale business sector. However, no significant progress was achieved in this sector during the 32-year *New Order* era as most of the existing funds simply vanished into the deep pockets of the management of the cooperatives or were channeled into dummy cooperatives.

PRIVATE SECTOR CORRUPTION IN THE *NEW ORDER*

Widespread Corruption

An Australian economist who had been a supporter of the economic policies of the *New Order* administration, when the regime passed the 16-year mark realized that corruption in Indonesia had become a serious problem. He wrote: *Upper management must give more serious attention* to *the corruption problem and the need* to *eradicate corruption by conducting strict public appointment. Every few years, efforts* to *eliminate* or *at least* to *repress corruption are implemented, the latest and the most energetic effort being the Opstib (Law and Order Operation) campaign, which began in July* 1977. *However, none of these efforts have been consistently executed. In fact, the Opstib initiative fizzled out after only a couple years.* The *public* is *now convinced that their leaders lack the will* to *eradicate corruption while the need* to do so *has become all the more urgent* (Arndt: page 127,128).

The more the capital, the more the corruption. Competition to obtain such capital by various means, including KKN, is greater between offshore capital and domestic capital. There is also fierce competition between the private sector, state owned enterprises (BUMN) and Cooperatives; between indigenous businessmen and ethnic Chinese businessmen; and even amongst foreign investors.

Cases of corruption, not only within the private sector, are quite well documented and discussed both domestically and overseas. Accusations pertaining to former President Soeharto and his children, former President B.J. Habibie and his family, former ministers and officials such as former Minister of Finance Ali Wardhana, former Minister of Finance Sumarlin, former Minister of Mines and Energy Ginanjar Kartasasmita, former chairman of the State Logistic Agency Beddu Amang and a number of private sector businessmen are widespread. Many investigations into such alleged cases of corruption under the *New Order* are currently underway.

Government officials are experts in a wide variety of corrupt practices however, according to research conducted by a certain economist two primary methods are utilized. The *first* is *the direct embezzlement of state funds by way of divesting state assets. The second* is *referred* to *as tax corruption (unofficial taxes levied on the public, popularly referred* to *as illegal collection in its various forms and processes). These two practices form the source of the bulk of corruption revenue, a term applied to income resulting from the corrupt practices of government officials* (Arief: page 143).

Soeharto's Take On Money And Power

Before discussing the corruption issue any further, it might be interesting to examine Soeharto's personal views on power and state property. When Soeharto became President he felt as though he was saving Indonesia from the *Old Order* that was backed by the Indonesian Communist Party. It is the culture of the ethnic group to which Soeharto belongs, that a conqueror that wins through violence has absolute characteristics. Although he held the democratic position of President, he modeled his government after ancient Javanese monarchies, which were ruled by commoners with military expertise who became kings through conflict.

As a conqueror, he used the upper classes to create *an environment where those who controlled the people also controlled the economic sector by means of bribery and nepotism* (Ong: page 83). Soeharto did not understand the principles of democratic governance pursuant to which corruption is illegal and harshly condemned. While visiting Mecca in 1991 on a religious pilgrimage Soeharto was quoted as saying: *It is not* as *though there* is *no election mechanism or system at all, I am the State, just* as *King Louis XIV was.*

It is important to understand this psyche, as similar patterns emerged during the Bruneigate aud Buloggate cases involving President Abdurrahman Wahid, who also espouses the same view. Nevertheless in the opinion of many, including management professional Tantri Abeng, the traditional management style of Soeharto was successful due to *the universa! charactenstics of high level leadership that are strengthened by honesty, professional integrity (bloko) and loyalty* (Abeng: page 240).

Elite circles in Indonesia are of the view that there is no guarantee that a clean government equals a thriving economy, citing the high levels of development and corruption in the PRC and Korea. Therefore, it is widely held that corruption should be tolerated so long as it is not exces-sive. *As a CEO, Mr. Soeharto twice transformed a massive organization, namely, the nation of Indonesia: first from an underdeveloped country* to *a relatively developed and well-*

managed one; then again from a low to a middle-income nation (Abeng: page 231).

Though a controversial figure, Soeharto valued social harmony and balanced principles. In the economic sector, he required harmonious and mutually beneficial relationships between state owned enterprises, cooperatives and the private sector. At the outset of the *New Order* many of Soeharto's closest civilian and military associates had private sector interests. His close friends in the military included Soejono Humardani, Sofjar, Soerjo, Alamsjah, Ahmad Tirtosudiro, Suhardiman, while his civilian business associates were Liem Soei Liong Probosutedjo (his step- brother); his children also became entrepreneurs.

State Owned Enterprises, Cooperatives and the Private Sector

State owned enterprises and cooperatives are instruments of the government to develop a strong state business sector in order to better control the private sector. Both sectors are highly valued and carefully maintained. Investments that cannot be made by the private sector due to their prohibitive costs and unprofitable nature are made by the state. This policy relieves the private sector of shouldering high business investment costs.

The relationship between these sectors is not always smooth as plenty of competition and conflict occurs in addition to corruption. The relatively stable relationship these sectors have enjoyed for so many years is thought to be largely due to external forces such as the Mafia. The Mafia's unfair practices and criminal activities are very much related to the use of violence, insider trading, sex, narcotics, money laundering and capital outflow to overseas countries.

Businessmen who establish monopolies and oligopolies in violation of governing regulations are largely responsible for the current state of the Indonesian economy and business sector, which are spiraling out of control. This condition has also resulted in negative social conditioning and behavioral patterns such as failure to fulfil ones obligations like the repayment of debts.

Many conglomerates have been declared bankrupt or placed under the management of the Indonesian Bank Restructuring Agency (IBRA), but the lifestyles of their owners have not changed as they have already accumulated assets *sufficient for seven generations.* These men do not give even a second thought to the injury that their actions have caused the

Indonesian economy or the mass pauperization and high level of unemployment that has resulted from the failure of their enterprises.

Loyalty to the government, and especially to its chief executive President Soeharto, was required if one hoped to succeed in the *New Order.* Any opposition was met with sanction as in the case of Ali Sadikin, the leader of Petition 50, whose business failed shortly thereafter or the case of William Soeryadjaya, who after he started financing the business interests of the Nahdatul Ulama political group was expelled from the management of the very company that he himself established.

Under Soeharto's leadership, military officers and personnel were also granted various business concessions. Before certain regulations were issued, the monopoly held by the government in the commercial licensing field was looked on as a good opportunity for the accumulation of wealth by those with no business experience or instincts, as such licenses were for the most part sold to private businessmen.

As previously explained, the *New Order* government almost entirely determined who would or would not become successful in business. However, a process of natural selection also took place. Those entrepreneurs capable of successfully lobbying government officials often became key players in the Indonesian private sector due to the various facilities provided them by the state. Such skills were also the primary consideration of international investors and multinationals in selecting local partners, as access to state assistance coupled with foreign capital, technology and management skills was the formula for commercial success under the *New Order.*

Sukamdani, a fonner civil servant with the Department of Home Affairs, responded to accusations (from Richard Robison and Yahya Muhairnin) that he had developed as a businessman due to the facilities granted him by the government by explaining thus:

> *On 1 April 1969, when the first Five- Year Development Program (Pelita) commenced, the government through the Bank of Indonesia introduced an Investment Credit Scheme par- ticularly to indigenous entrepreneurs, in order to boost Indonesia's economic growth The government offered loans at the low interest rate of 12 percent and with flexible requirements governing the availability of equity (only 25 percent), and many indigenous businessmen, including myself; took advantage of these facilities.*

Any company that competed with or criticized the business interests of the Cendana family -so named after the street where the Soeharto family lived -was dealt with. Aburizal Bakrie, founder of the Bakrie Conglomerate, and Arifin Panigoro for instance were commercially isolated. They were fortunate to have founded organizations supported by the government and they managed to acquire guarantees from several senior ministers to keep their businesses afloat.

From the time of the *New Order* until today, the ambiguity of the laws and regulations governing KKN, transparency, and imprudent cooperation with international companies and basic corrupt practices such as bribery, price manipulation, monopolies, and oligopolies have enabled many guilty parties to continue to operate beyond the arm of the law. Various corruption cases were indeed brought to court in the *New Order* era but these rarely ended in more than a slap on the wrist of the offenders. Those who were imprisoned later were at the generosity of the powers that be, only incarcerated for very short periods of time. Not long after Abdurrahman Wahid assumed the presidency, a business associate of Soeharto, Bob Hasan was sent to prison. However, the son of former President Soeharto, Tommy Soeharto, whose arrest was ordered by the court, managed to escape the officers sent to serve the arrest warrant.

Cooperation Between Public Officials And The Business Community

Most successful Indonesian businessmen became so owing to massive government projects. Information regarding such projects has been disseminated by ministers and other prominent public officials engaged in the field of planning and infrastructure development.

At the beginning of the *New Order,* development planning in Indonesia took place in five-year cycles (The Five-Year Development Program), each constituting a part of a long-term 25-year cycle. Such economic development planning was initially carried out and coordinated by the National Development Planning Agency (Bappenas), which is mostly managed by U. S. educated technocrats. Bappenas also employs consultants, both local and international, instead of relying on the advice and assistance of agencies within the First Level region (Regional Development Agency). As such Bappenas plays a significant role in the national economy. For the last 32 years, no development projects could proceed without the *blue book* and the approval of the Bappenas bureaucrats. Over such a lengthy period, throughout which the leadership of the agency was held by a select group of very powelful individuals, the opportunities for corruption were quite remarkable. Several scandals involving Bappenas have erupted in the era of reform resulting in a loss of credibility and the agency's being *downgraded* by the international community .

Developments in the field of technology are planned and coordinated by Bappenas and then delivered to the Agency for the Assessment and Application of Technology (BPPT) formerly under the leadership of the Minister of Research and Technology, B.J.Habibie, who chaired the agency for 20 years. This same ministerial position is responsible for nine strategic industries under the umbrella of the Strategic Industries Supervisory Agency (BPIS) that is largely involved in the development of aircraft, ships, weaponry ,and transportation.

The power of the BPPTand BPIS under the New Order grew parallel to B.J. Habibie's rise in power. All purchases of weaponry, aircraft, and battleships, for the military had to be approved by the BPPT. One interesting case occurred when B.J .Habibie approved the importation of East German war ships for the Navy. The *Tempo* magazine criticized this decision and was immediately shut down by Soeharto.

Nearly all mammoth projects such as the establishment of the flight industry (IPTN) in Bandung and the shipbuilding industry in Surabaya (PT. PAL) were positioned under the umbrella of the BPIS and were all accomplished by the transfer of technology to Indonesia. Each of these industries also involved armies of private sector businessmen and numerous instances of malpractice and corruption.

Most Indonesian entrepreneurs at the beginning of the *New Order* operated small and medium-scale enterprises much like traditional cottage industries. However these same entrepreneurs, often by hook and by crook, were awarded a variety of large-scale projects far beyond their experience and management capability. However due to the government's protective policies, local entrepreneurs were able to successfully bid for not only the projects but also for overseas financing usually in the form of loans.

IGGI-CGI, The World Bank, The IMF and Foreign Banks

Every year the Indonesian Government seeks development funding by negotiating new debts with bilateral and multilateral donors through an organization called the Inter Government Group for Indonesia (IGGI), also known as the Consortium of Governments for Indonesia (CG I). Until the downfall of Soeharto, the loan process itself was easy because the World Bank and IMF had always supported and praised Indonesia as the best student of the institutions due to their success in developing the country.

In the said period, conglomerates easily received loans for various projects. Proposals for new projects always included a banker and a fund manager who prepared the fund. In addition, conglomerates often received offers from multinationals, bankers and fund managers to aid in the execution of large-scale projects. These conglomerates operated in a continual state of development euphoria, and the principles of prudence and integrity were lost in a sea of readily accessible foreign capital.

As mentioned above, Indonesian conglomerates were initially headed up by entrepreneurs of high birth or by first generation businessmen. These individuals experienced a massive infusion of wealth and power within a relatively short period of time (1966-1998) and were not mentally prepared to cope with it. They, of course, had both their weaknesses and strengths. Those of high birth did not possess the business sense, abilities, commercial network, or tenacity of the traditional merchants. They did however have access to information and political clout that enabled them to obtain licenses for industries reserved for government bureaucrats. The entrepreneurs from business families were able to establish successful enterprises on very little capital, and made ideal partners. However, during the New Order not many entrepreneurs of high birth met with success as they were beaten back by the professional business community itself.

After agreeing to enter into a joint ventur, a company is established. Ideally the family members of a high birth entrepreneur or a government official are given large numbers of shares without any obligation to contribute capital and are placed in non-active positions as Directors or Commissioners. They are also paid salaries and receive allowances. Their main function is to use their influence to obtain projects.

After a project has been obtained, funding must be obtained. Prior to the banking deregu- lation, five large state banks namely BNI'46, BBD, BDN, BRI and Bapindo controlled the bank- ing sector. Once again, the easiest way to obtain credit was with a combination of the patronage of an influential official and bribe money for the relevant officials.

Once the necessary capital is acquired, a consulting firm or project management compa- nies are sought out. If the required technology is simple in nature, such as in the construction of roads, bridges and low-rise buildings, a local company is usually sufficient. However, for projects utilizing large amounts of capital and complex technology, coope.ration with foreign companies is generally required. The primary company, void of capital, then receives fees and commissions as well as capital gains through mark-ups of the project's value.

Other loopholes used to acquire profits include exploiting the opportunity of a high priced economy along with illegal collections and commissions on each transaction. This cycle contin- ues until a sufficiently large capital base is formed and the relevant entrepreneur is able to obtain substantial *economic scale.* After conducting business in this fashion for 15 years or so, many Indonesian entrepreneurs become large and independent. They then proceed to expand into conglomerates by taking on projects outside their field of expertise.

One entrepreneur who is also a former minister wrote: *Bureaucratic alliances and a busi- ness community that is based on the concept of guided cultivation are acceptable and deemed positive because in the end they will create a continually growing group of entrepreneurs. A concrete example* is *the cultivation of entrepreneurs from lower economic classes and the efforts made* to *increase domestic production that have succeeded in providing opportunities for the development and growth of national entrepreneurs* (Abeng: page 87-88).

Globalization and Indonesia's Conglomerates

The increasing prominence of the Indonesian conglomerate coincided with the emergence of an international economic trend in the United States and Europe in favor of free trade. It began with the Uruguay Circle and continued with the creation of the World Trade Organization (WTO) and the establishment of new economic and political cooperative organizations beyond ASEAN such as APEC.

At the same time, the Government of Indonesia was suffering from a shortage of funds to manage various projects that it had initiated. In light of this, the trend toward the deregulation and privatization of various economic and business sectors that had previously been controlled exclusively by the state began. Increased international pressure was also put on the government with respect to free trade, human rights, environmental and democratization issues. In many ways the private sector profited from these developments, especially as attention was turned toward the President's family and inner circle that typically represented the greatest competitive threat to the private sector. Conglomerates began to obtain access to profitable business opportunities that had historically been monopolized by the families of the President and other government officials. The government's diminishing role created the opportunity for private sector conglomerates to dictate their own, more profitable, working agendas independent of blackmail and political pressure.

Creative entrepreneurs formed conglomerates owning and managing businesses across the commercial spectrum. The absence of an Anti Monopoly Law and laws protecting small and medium scale enterprises enabled the conglomerates to freely enter industry sectors. Two sectors in particular that experienced incredible growth almost simultaneously were the banking sector and the property sector. Banking deregulation made it easy to establish and own a private bank.

The property sector grew rapidly due to an increase in demand for housing, office buildings, factories and industrial estates. Corruption practices such as the falsification of licenses, and the speculation and seizure of traditional lands bought cheaply and resold at high profit were widespread. In order to purchase land at low prices, corruption in the form of the usage of state instruments or the employment of hoodlums to intimidate owners into selling was commonplace.

With the deregulation and restructuring of the economy, the government fmally allowed for the funds of private parties, domestic or international, to be invested in companies through the stock exchange. The creation of a stock exchange in the absence of adequate laws and supervisory instruments to combat corruption can only result in the exchange being used as a place for economic manipulation and *insider trading.* In addition to these malpractices, opportunities also exist for the manipulation of corporate information by bribing audit agencies to give problematic companies a clean bill of health.

The Luxurious Lifestyles of the Conglomerate Kings

Previously small time entrepreneurs, after transforming their enterprises into conglomerates also quickly adopted jetsetter lifestyles. They built skyscrapers for offices and apartments in the Golden Triangle (Sudirman, Thamrin, Rasuna Said), with borrowed money. They purchased or constructed luxurious homes in elite residential areas in Menteng, Kebayoran, Pondok Indah, Permata Hijau and Kemang. They began to buy private planes and helicopters, yachts, islands, and villas both in Indonesia and abroad. They sent their children to be educated overseas. Family occasions like weddings and birthdays became extravaganzas held in the ball- rooms of five-star hotels and attended by thousands. Their circle of influence and power drew the attention of the public as they came to symbolize the repressive *New Order.* President Soeharto frequently invited these businessmen to gather at his farm in Tapos or his properties in Bali. They were also called upon to sponsor national development, sporting events, social functions and the construction of educational and religious facilities.

It is no secret that conglomerate leaders also lent their assistance to civil and military officials. Large financial gifts were given in the event of promotions, birthdays and other occasions and gifts in the form of luxury cars, houses, diamonds, expensive watches, international travel, and tuition for overseas studies became commonplace. Never before in the history *of* the Republic of Indonesia had such luxury, wealth, and arrogance been displayed so grandly. A cultural shift occurred, from the former psyche where people valued hard work and civil service, to an obsession with the pursuit of personal wealth through manipulation, speculation and corruption.

New Order entrepreneurs generally regarded their employees not as partners, but more as production tools to be exploited at a minimal expense. With the support of the government and state agencies, labor or employment suits always ended in favor of the conglomerates. Moreover, the All-Indonesian Workers Union (SPSI), as the sole representative of the local working classes, was positioned under the patronage of the government.

Realizing the importance of the media as the most effective way to shape public opinion, many conglomerates and their CEO's (Ciputra, Sukamdani, Tommy Winata, Bimantara, Peter Sondakh, Tutut Soeharto, Lippo and the Bakrie Group) entered the printed and electronic media industry. By controlling the media, their public image was strengthened, and they gained the ability to redirect negative public sentiment.

The chairman of Kadin, Aburizal Bakrie, in an effort to counter public criticism, established an institution called the Institution for Indonesian Business Ethics Development (LSPEU). Its purpose was to promote business ethics among Indonesian businessmen. True to its found- ing precepts this institution soon developed into a moral authority capable of influencing changes and minimizing the plague of KKN.

Various scandals have exploded onto the headlines of various international media and have become the topic of numerous studies and publications. However, up until the demise of the *New Order,* serious attention was rarely given to the issue of corruption, as many such scandals were settled and disappeared from public view almost as quickly as they had appeared. The close relationship between the entrepreneurs and the ruling classes was established to their mutual benefit and as such each party was obligated to protect the interests of the other.

Some of the scandals of recent years have involved corruption of unsurpassed proportions for example when 30 percent of the World Bank stimulus package disappeared into the coffers of several key government officials; or when Lippo illegally contributed USD 1 million to President Clinton's campaign. Others include the Bogasari and Indofood wheat flour and noodle industry cases, and the financial malpractice scandal in Pertamina.

Additionally, rumors of numerous economic conspiracies have surfaced such as: 1) the linking of Bakrie and A. Latief to Freeport along with Ginan jar; 2) the cooperation between PT. Dharmala and World Bank subsidiary, IFC in Manulife insurance; 3) the partnership between Bulog and PT. Goro that represented a partnership between Tommy Soeharto and Ricardo Gelael; 4) the case of the national car program; 5) the monopolization of the clove industry through the Clove Marketing and Buffer Stock Agency (BPPC); 6) the sale of East Timorese coffee; 7) gold mining in Bushang, Kalimantan; 8) the book procurement of the Department of Education and Culture; 9) the extortion of female employees' salaries; 10) the procurement of tax-free luxury cars; 11) the oil refinery in Balongan, again involving Ginanjar; 12) the destruction and mapping of the forest by Bob Hasan; 13) the expropriation of farmland in Cimacan and Tapos for a golf course and plantation; 14) the Bank Bali scandal; and 15) the Buloggate and Bruneigate scandals.

The Fall of Soeharto and the Disintegration of the Conglomerates

In the summer of 1997, the Asian economic recession began in Thailand and quickly swept across Korea, the Philippines, Malaysia, and Indonesia. The regional crisis that for the most part has since been contained in other South East Asian Nations has become a total economic and political meltdown that is threatening the integrity of the Republic of Indonesia.

In May 1998, after 32 years in power, President Soeharto resigned amid a fury of pro-democracy demonstrations and anarchy. Large sections of Jakarta were destroyed in the ensuing melee and cases of extreme violence, such as the rape of ethnic Chinese women and the abduction of pro-democracy students and opposition activists by pro-Soeharto forces were reported.

After his downfall, the totalitarian leader's involvement in corrupt business practices that provided financial benefits to him personally, his children, his extended family and his associates became more obvious. A new acronym was introduced into the Indonesian vocabulary- KKN: Korupsi, Kolusi dan Nepotisme (corruption, collusion and nepotism). Several investigations into the assets of the Soeharto family were published, the most notable being Time magazine's estimate that Soeharto during his tenure as President amassed a personal fortune in excess of USD 30 billion. After the *Time* report was released Soeharto sued the magazine, but the District Court ruled against the former President.

As was the case with his predecessor, Soeharto fell due to dirty money, although President Soekarno was also accused by the Special Session of the Provisional People's Consultative Assembly to have damaged the morality of the nation with his numerous female companions. Attorney General Soejono C. Atmonegoro, after submitting a three-volume report to President B.J. Habibie, Soeharto's successor, concluded that it was appropriate to name the former president as a suspect of corruption. Five hours after his conclusion was stated Soejono was sacked and replaced by A.M. Ghalib.

Allegations of corruption filed by the Attorney General's Office against Soeharto stemmed primarily from the audit of seven foundations of which he was chainnan, particularly Supersemar, Amal Bhakti Muslim Pancasila (ABMP), Dana Abadi Karya Bhakti (Dakab), Dharma Bakti Sosial (Dharmais), Trikora and Dana Gotong Royong. The total combined assets of these foundations were estimated at IDR 4 trillion and were scattered across deposits, shares and loans, however only IDR 2.5 trillion was ever recovered (Forum: 14/12/1998).

Yayasan Supersemar had ID R 1.2 trillion worth of funds, but utilized only 16 percent for education and spent over IDR 1 trillion to purchase land in Citeureup, shares in Indocement and PT. Citra Marga Nusaphala, award grants to Bank Duta, and dispense loans to PT. Kiani Lestari, PT. Kiani Sakti, PT. Granadi, PT. Sempati Air, PT. Kemgas Tama and PT. Nusamba Group. Another foundation, Yayasan Dharmais, lent IDR 1.1 trillion to Soeharto's cronies in PT. Kiani Kertas, PT. Barito Pasific and Bank Ifi in addition to purchasing stocks in Bank Duta, Bank Muamalat, PT. Sempati, Indocement, PT. Citra Marga Nusaphala and PT. Nusamba.

Thus the conglomerates disintegrated when their patron Soeharto fell from power, triggering the bankruptcy of the Indonesian economy. Almost all of the country's largest conglomerates are also its largest debtors and are linked to Soeharto and his family's business network. Interestingly though, the majority of them are owned by ethnic Chinese businessmen in contrast with the Soekarno regime under which the country's most prominent businessmen were indigenous. Unlike his predecessor, Soeharto was [mally brought to Court. However, due to health reasons he never stood trial and moreover was even acquitted by the District Court. Ironically, the state was burdened with the cost of treatment for the former dictator. All the while, his best friend, Bob Hasan was arrested and jailed on account of his embezzlement of state funds in the amount of USD 87 million from the Department of Forestry for the purpose of aerial forestry mapping conducted by his company PT. Mapindo.

Indonesia's Economic Ruin

Indonesia's economy, supported by KKN, became a fragile *bubble economy* that burst in 1997. Over a relatively short period, the country's entire private sector collapsed, and the conglomerates listed on the stock exchange went belly-up and were seized by the Indonesian Bank Restructuring Agency (IBRA) that at one point held an estimated 80 percent of the total national assets. Unfortunately, most of the assets of the conglomerates held by IBRA are nearly worth- less, as any valuable assets are still held by the owners of the conglomerates.

After the collapse of the *New Order,* many conglomerates relocated overseas waiting for a more advantageous time to return. The installation of B.J. Habibie as President reassured them that the policies and practices of the *New* Orderwould continue, and many of those conglomerates were appointed by Habibie as roving ambassadors or were given other strategic positions to encourage the return of foreign capital to Indonesia.

The economic and political crisis of the late 90s caused a flight of foreign investment. Since then the World Bank and the IMF have become increasingly critical of the Indonesian Government, which has not served to inspire investor confidence. Foreign banks are also pressuring Indonesian companies to settle their outstanding debts, and various debt-restructuring negotiations have been held. It has however proven difficult for local companies to settle their foreign currency (usually U.S. Dollars) debts, as most corporate revenue is Rupiah dominated, a currency that has dropped 5 fold from its pre-crisis level. Any foreign companies currently operating in Indonesia have been doing so for many years, and almost no new foreign investment has entered the country since the outset of the crisis, to the further detriment of the economy.

Despite the crisis conglomerate executives have continued to maintain their opulent life- styles funded by money stashed not in Indonesian banks but in private offshore financial insti- tutions or traded in the capital markets of neighboring countries like Singapore, Hong Kong, Australia and China.

Cracks are beginning to appear in IBRA, which has the mandate to settle the debts of the conglomerates. Widespread allegations of corruption in IBRA have emerged, as have rumors of political jockeying and conspiracies concocted by the agency and the conglomerates to settle the problems of the same in ways that are detrimental to the state but beneficial to the conglomerates. Aside from this, a great deal has been said about the incompetence of IBRA's professionals and their inability to handle the technical and non-technical matters they are faced with. Indeed, IBRA is progressing very slowly: sales of assets have been very time consuming and have often been executed at below or above the market price.

Several companies that should have been allowed to fold have been defended by BPPN such as Texmaco and Candra Asri. Whereas the sale of some assets have been laden with controversy such as the sale of Salim's plantation to Guthrie of Malaysia. Also of note is the fact in every dispute thus far the conglomerates have always managed to wiggle out of legal suits. Every bankruptcy petition filed against them has failed as if the conglomerates have some kind of legal immunity.

What Went Wrong with the Indonesian Economy?

What went so terribly wrong to prompt the simultanepus fall of Soeharto and of the economy? Did not the *New Order,* over its 32 years in power, make economic development its primary objective? There are four schools of thought that attempt to answer the million-dollar question -what went wrong?

The first is of the opinion that Indonesia's *traditional* culture impeded the emergence of successful economic development (cultural psychological approach). The second utilizes the We her theory concerning bureaucracy that is rational and patrimonial deeming that Indonesia is located within the second circle where bureaucracy possesses absolute power, is not reined in by opposition and holds onto control by distributing economic opportunities to various competing economic groups (domestic structural approach).

The third holds the opinion that the under development of Indonesia is due to its dependence on imperial powers where foreign capitalists control exportable commodities such as mining and plantations. This dependency has only worsened since developing nations began to import goods and technology from more developed countries (dependence approach). The perspective of the fourth and mal school of thought is that the most revolutionary force at work in the Third World today is not communism or socialism but capitalism. In Indonesia a transformation has taken place due to the massive accumulation of capital derived from foreign investment, oil and foreign aid. This transformation is stimulated by the government to reinforce the country and the domestic capitalist class, which in turn effects changes in speculative trading putting conglomerates in control of up and downstream production (dependence-development approach).

CONGLOMERATES AND CORRUPTION IN THE ERA OF REFORM

The Habibie Administration

When appointed President, B.J. Habibie faced the very difficult task of reconstructing the economy and upholding the legal foundation of democracy in Indonesia. Endeavors to eradicate KKN posed the greatest challenge. *corruption, collusion and nepotism,* said Habibie, *exist due to the cooperation between the ruling party and the private and or state enterprise sectors to the detriment of the public. What* is *intended by the eradication of KKN is the realization of a national economy that is efficient and a government apparatus that serves the interests of the people* (BJH: page 23). Despite his anti-KKN declaration however, the Habibie administration was also rife with corruption.

In a patrimonial society, the relationship between politics and commerce is a very close one B.J. Habibie, who was already positioned inside the *New Order* circle of power found it impossible to distance himself from it. He was also a close associate of many prominent indigenous and ethnic Chinese entrepreneurs such as Eka Tjipta Wijaya, the owner of the Sinar Mas Group. These relationships were evident in various projects he executed when head of the Agency for the Assessment and Application of Technology (BPPT) and the IPTN, and consequently allegations of corruption were also leveled against him.

Each new era in government creates its own breed of wealthy people. The naissance of a political power is always accompanied by the appearance of new entrepreneurs usually friends and confidants of the new regime's rulers. During his brief I8-month tenure as President, oddly enough no new conglomerates or fabulously wealthy appeared on the scene. However, the entrepreneurs of the Soeharto era continued to playa major role in the economy and began to forge ties with the new President.

One such individual was Baramuli, who like Habibie was a native of South Sulawesi. This entrepreneur -who was once the Chairman of the Supreme Advisory Council, a high-ranking official in the Department of Internal Affairs, the Governor of North Sulawesi, and High Prosecutor -after his retirement in 1974 went on to become a successful entrepreneur and member of House of Representatives Commission VII representing Golkar.

It was also Baramuli who had uncovered the corruption case involving Eddy Tamsil who through his company, Golden Key, misappropriated' a USD 430 million loan from Bapindo that fell due and payable in November 1993. The loan, that together with outstanding interest payments totaled USD 650 million, could not be repaid and Eddy Tamsil along with several former directors ofBapindo was imprisoned. Not long after though, with the help of an insider Eddy Tamsil succeeded in escaping from Cipinang prison. All the while, Admiral Sudomo and former Minister of Finance Prof. J .B. Sumarlin who were also suspected of involvement in the massive fraud were untouched.

The historical irony is that this former crusader against corruption who uncovered a financial scandal and managed to jail the guilty parties was later alleged to be not only involved in but in fact the mastermind of the IDR 904.6 billion Bank Bali scandal. This along with the East Timor settlement case was detrimental to the country and destroyed the President's chances for reelection. Both scandals involved people close to Habibie, the palace and the Golkar party, such as the entrepreneur Manimarem from Texmaco, who was then Treasurer of Golkar; Djoko Tjandra, a hotelier and former Minister of State Owned Enterprises (BUMN); and Tanri Abeng, the former President Director of the Bakrie Group. However, despite strong evidence of guilt, the court ruled to acquit the defendants in the Bank Bali case.

In July 1999, the government disclosed that there were 27,865 confirmed cases of corruption to date that had cost the state IDR 1.9 trillion in losses. Interestingly this amount was far smaller than Bank Indonesia's liquidity aid that was quoted at IDR 150 trillion. Corruption was taking place in every department and involved their private sector partners. However, no follow up to this announcement was ever made.

During Habibie's administration, the laws guaranteeing democracy in Indonesia through freedom of press, freedom to associate, freedom of speech and many others were upheld and the government also succeeded in holding perhaps the most transparent General Election in its history (under international supervision). Theoretically, using Weber's theory, President B.J. Habibie was the only Indonesian President to date that was modem and rational enough to form and administer a clean government. However the facts indicate otherwise, this may be because he was in power only for 18 months.

The Administration of Abdurrahman Wahid

B.J. Habibie's successor, Abdurrahman Wahid, when viewed from his cultural background, education, and political experience appears to be a President who is comfortable working within the framework of the patrimonial system. In observing his government for the past 18 months, it seems to be taking that very approach. As such, efforts to establish a bureaucracy that is rational and under the law must be consistent as it is impossible to establish a capitalist industry without the laws and policies required to build a legal infrastructure that is rational and predictable.

The Attorney General's Office, under the Wahid administration, examined 1,040 corruption cases in the year 2000; 256 of these have been concluded, and 290 brought to Court 79.31 percent of which have been ruled upon by the courts. The losses incurred by the state as a direct result of corruption are estimated at IDR 3.29 trillion (USD 329 million) while a paltry IDR 1.9 billion has been returned (Jakarta Post: 4/4/01).

Prior to being elected President, Abdurrahman Wahid was a public figure that openly defended the rights of ethnic minorities. When he came to power, he eliminated official discrimination against the ethnic Chinese. As such the Chinese cultural identity, art and language were legalized. Hence, theoretically in the eyes of the law there is now no difference between ethnic Chinese Indonesians and their indigenous co-citizens.

This official change in attitude is expected to signal a new era of friendship between the ethnic Chinese minority and indigenous Indonesians. Equality in the legal and political arena will create greater openness, trust, and tolerance between the two groups that have had a problematic relationship since the colonial era. The ethnic Chinese will begin to feel a part of the nation, which is expected to give way to a greater sense of social, economic and moral responsibility that may in turn further contribute to the eradication of KKN.

In 1999, the House of Representatives of the Republic of Indonesia issued two Laws directly related to corruption, namely the Law on the Establishment of a State Administration that is Clean and Free from Corruption (Law no.28 /1999), and the Law Concerning the Eradication of the Criminal Act of Corruption (Lawno.31/ 1999). The latter states the need to establish a Commission for the Eradication of Corruption in Indonesia that is independent of political interference and state power by its direct accountability to the House of Representatives, the courts and the public.

However, at the time this paper was written, the said Anti Corruption Commission was still not yet established, as the Bill of Law (ROO) concerning The Anti Corruption Commission was not finalized. Although the Preparation Team for the Establishment of the Anti Corruption Commission, chaired by Prof. Romli Atmasasmita, has long since been established the commission is not expected to be functioning before August 2001.

Plans have also been made to establish anti corruption courts in each provincial capital to examine cases pertaining to the criminal act of corruption. In the meantime, similar courts may also be established at the Regency level. In principle, each case must be decided within 90 days and in the event of an appeal the case must be concluded 30 days later. At the final appellate stage, the case must be ruled upon within 60 days. While such corruption courts are yet to be established, the falsification of the establishment one such court in North Sulawesi occurred in early 2001.

In order to prevent corruption, Law no.28/99 requires the establishment of an Examining Committee on the Wealth of State Administrators (KPKPN). The objective of this committee is to examine the wealth reports filed by state officials and community figures that become state administrators. This Commission is even authorized to investigate anyone suspected to have obtained their wealth inappropriately. The House of Representatives submitted 45 names for investigation during its July 2000 session, 25 of which were approved by the President.

The KPKPN, chaired by Jusuf Syakir, has begun to publish the wealth of government officials. What is interesting to note is that President Abdurrahman Wahid has accumulated over half of his personal wealth since taking office. Thus far, the preparation committee for the

Anti Corruption Committee (KAK), which will later become an independent agency, has not accomplished a great deal. The Committee has encountered many obstacles from the government itself in performing its duties that-have resulted in the failure of numerous investigations and other initiatives. In addition, the' commission members have not received sufficient public support, as people are still afraid to report occurrences of corruption. This is because the confidentiality of the reporting process cannot be guaranteed, which makes reporting parties vulnerable to threats from the accused. By the same token, insufficient incentives are offered for such information.

There are also serious concerns that when an investigation is assigned to the police or the Attorney General's Office they are unable to appropriately prosecute the case, as corruption is also prevalent in these institutions. Conflicts of interest, and a power struggle between the Commission, the police force and the Attorney General's Office have rendered the eradication effort incapacitated. Cooperation and the rule of law are required to achieve a reasonable level of synergy and coordination.

Another contributing factor to the failure of the Commission is that it is centralized in nature. It would be more effective if chapters of the commission were established on the provincial and regency levels by the said provinces and regencies themselves in conjunction with the Law on Regional Autonomy. Such a decentralization and expansion of the Commission's network would solidify its authority and maximize its effectiveness.

It seems that a flexible attitude towards punishment is also required. For example, is it really unnecessary to imprison a guilty party if the proceeds of his crime are returned? Should lengthy investigations be conducted into past cases of corruption or should attention and resources be turned to more recent cases? When anti corruption measures are ready to be put in place, obstacles in the form of difficulty in recruiting anti corruption officers who possess technical capabilities in investigating and proving corruption often arise, which is why international efforts conducted on a cooperative basis are required.

The proponents of corruption are individuals who possess resources such as funding, political affiliations and teams of legal advocates as well as a strong survival instinct, all of which have contributed to their continuing success and ability to evade prosecution.

The Economic and Political Arena at Present

The Indonesian economy has only worsened during the past 18 months of Wahid's government. Although inflation was temporarily suppressed, the Rupiah has fallen hard against the U.S. Dollar, while the Jakarta and Surabaya bourses continue to take a beating. IBRA's sales of assets are progressing very slowly and the privatization of state owned enterprises has come to a halt. Foreign investors are standoffish and the country's economic infrastructure remains unattended to and continues to crumble from day to day.

At the same time, the political and security situation in the country is rapidly deteriorating. Separatist movements have gained momentum in Aceh and Irian J aya and have begun to crop up elsewhere (Riau). Religious conflicts, such as in South Maluku, and ethnic conflicts, as in Kalimantan, persist; and while regional autonomy has strengthened, the power of the central government has begun to disintegrate. In addition, several new regulations have been issued in various region based on Laws mandated by the House of Representatives that are contradictory in their essence.

Although economic activity has slowed considerably, small and medium export-based firms, especially of agricultural products such as coffee and clove, remain afloat. Government subsidies for oil and gas have prompted many unscrupulous opportunists to smuggle Refined Fuel Oil (BBM) out of the country. The same applies to opportunities to import luxury items and working capital without paying the applicable taxes.

Many conglomerates have successfully lobbied the government for assistance by way of loans and debt rescheduling or restructuring. The most recent example of this is the case of Texmaco bosses, Sinivasan and Prajogo Pangestu. Other conglomerates that were bankrupted (and exiled) by Soeharto have returned to Indonesia by way of their affiliation with the new regime, and several New Order conglomerates have began clawing their way back to power.

Reform era conglomerates have turned out to be very strong, tenacious and capable of constructing impenetrable defenses against prosecution. Some of the major conglomerates have even gone so far as to establish relationships with the President and powerful cabinet members to ensure their legal immunity despite evidence of corruption. These conglomerates have proved capable of removing high-level government officials who oppose them.

In this era of reform, the nature of corruption has changed as it has become increasingly difficult for the government to openly award monopolies ~d dubious facilities to their preferred entrepreneurs, as was the case in the New Order. Despite this, the government has implicitly condoned such practices as no effort has been made on its behalf to break up existing monopolies.

Money Politics and Corruption

In recent years, several new and old faces have and become major players in the Indonesian private sector, but still the corrupt practices of the New Order continue to persist. Corruption remains unabated despite the fact that the recent Decrees of the People's Consultative Assembly are extraordinarily harsh with respect to corruption. One bright light is that as a result of increased democracy, freedom of press and competition between political parties, the public has become more informed of the back door money politics taking place in the halls of power.

The corruption that used to center mainly around the Palace and the offices of Governors and Regents has been decentralized fmding its way into the House of Representatives and the Regional Legislative Councils. Political parties who in the past were unable to adequately fi- nance their activities are now able to do so due to their newfound cooperation with private entrepreneurs. Political parties now compete with one another for sources of funding by placing their members into lucrative cash cow departments or by cooperating with residual New Order elements.

Major changes in terms of the scale and means of corruption are also taking place. The scale of such transactions began to diminish at the outset of the monetary crisis. Previously Soeharto and his accomplices in Golkar had cornered the market in government corruption, but today corrupt transactions can only succeed if they are executed in collaboration with a large number of political forces. Also in light of greater regional autonomy, such opportunists must lobby Regional Legislative Councils in order to obtain lucrative projects and concessions. Corruption is often justified to finance political activities that contribute to democracy, and money politics have become a new strain of corruption that is difficult to eradicate.

When political parties invest too much into the acquisition of funding without giving thought as to how far they are willing to go achieve their aims, then such corruption becomes even more difficult to eradicate. Public accountability is almost non-existent, with the exception of the organization of a new General Election, and reform initiatives have been blocked at every turn by political interests.

The public outcry against corruption is still insufficient as reported by the Indonesian Corruption Watch (ICW), an NGO that specializes in monitoring corruption, and the Joint Team for the Eradication of the Criminal Act of Corruption (TGPPKI) that was established by the government under the leadership of former Supreme Court Judge Andi Andojo Soetjipto who subsequently resigned in frustration. Although the ICW has continued its efforts to pressure the government, by for example, proposing that the leaders of state enterprises and the law enforcement apparatus be replaced completely, the NGO believes that only through public empowerment will the war against corruption be won.

According to the ICW, corruption is difficult to eradicate because the political elite lack the will to do so as they themselves are interested primarily in financing their private political agendas, an activity that requires the use of corrupt practices. Ironically, reports of corruption that have been released by the ICW and handed over to the Attorney General's Office have been misused by elements in the legal system to extort the parties accused by the ICW. As such, none of the reports generated by the ICW have resulted in the prosecution of the guilty parties and the orgy of corruption continues.

The President, Buloggate and Bruneigate

President Abdurrahman Wahid has himself been accused of corruption by the House of Representatives with regard to the Buloggate and Bruneigate scandals, which have resulted in the issuance of Memorandums I and II, and talk of impeachment proceedings in the Special Session of the People's Consultative Assembly in August 2001 should the President's response be deemed unsatisfactory.

The President's attitude towards the Memorandums can only be defmed as indifferent. What is interesting is his inability to differentiate the public and private aspects of his actions, an essential if one hopes to administer a government that is free of corruption. For example, should the USD 2 million in aid from Sultan Brunei be considered a personal gift to Mr. Wahid? Shouldn't limitations be put on the value of such gifts to the chief executive? In explaining this situation the President concluded that

> *the funds from the Sultan Brunei did not constitute aid to the state, but merely a personal tithe or donation from the family of the Sultan that was delivered to Mr. An Wowor and Mr. H. Masnuh.*

In the case of the Yanatera Bulog fund case, the President responded,

> *can a person, after being investigated and named us a possible suspect, be considered* to *have violated state policy*?

Aside from these two cases, the President has also been rumored to have brokered deals with Tommy Soeharto and the leaders of other conglomerates now under investigation by the Attorney General's Office. Allegations of corruption have also been leveled against many of his former ministers such as the Minister of Forestry Nur Machmudi and the Secretary General of his Department.

Those in power seem to no longer have any ethics or the will to differentiate personal assets and public assets. Although state officials are sworn into office under the Al Qur'an or the Holy Bible, promising to shun corruption, *they* in practice do the exact opposite. I believe that from a very early age, the public must be taught the principles of transparent state administration and good governance.

In contrast to his predecessors, once Abdurrahman Wahid found himself in a corner he began to get tough on corruption, and arrested 10 of the most corrupt *New Order* figures in March 2001. To boost his credibility, he also appointed the courageous, hardworking and honest Bacharuddin Lopa, as Minister of Justice of the Republic of Indonesia. At the same time, the President also threatened to sack Attorney General Marzuki Darusman should he fail to put forth a greater effort to eradicate corruption. Prominent *New* Order businessman Bob Hasan was imprisoned and later transferred to the notorious Nusa Kambangan prison as a warning to others. Despite these developments though, fugitive Tommy Soeharto remains at large.

The conglomerates' bad image during the era of Reform has caused a fury of reactions: *Why* is *it that all the blame* is *being laid on the conglomerates? Haven't high-ranking government and military officials planned and participated in many acts of KKN and all somehow managed* to *escape prosecution?* Several fonner officials and state enterprises are now in the [mal stages of investigation, while score of others wait their turn. Many in the public however, believe that the President's concerted anti corruption drive is merely intended to draw attention away from himself.

CONCLUSION

Since the time of the colonial economy of the Dutch-Indies corruption has been an integral part of the commercial process. The accumulation of capital through foreign investment and increased domestic economic activity has resulted in an equal increase of corrupt practices. However, international pressure towards Indonesia to eradicate corruption is growing in line with the integration of the Indonesian economy with the global economy.

Corruption in first world countries is considered a serious crime and deemed to be a major obstacle to economic development. However, in Indonesia the local culture has fostered a perception of corruption as an acceptable and necessary evil, although this is slowly changing with influence from the West.

The biggest obstacle to the eradication of corruption appears to be the government itself as it is the state that is mandated to issue and implement regulations, and laws concerning corruption. It is also the responsibility of the state to educate the public concerning the negative impact of corruption.

There is also a lack of a sense of morality and personal responsibility among state administrators in addition to, of course, the absence of a system capable of deterring people from engaging in acts of corruption. When the government of a country becomes incapable of eliminating corruption, it is time for the public to step up to the task and play an active role in the supervision of the government and the monitoring of corruption.

Corruption in the private sector originates from the legitimate desire to realize profits. Since the Indonesian economy is for the most part still controlled by state bureaucrats, the role of the public in the growth and development of the private sector is vital. Entrepreneurs are obligated to establish cooperation between the private sector, state enterprises and cooperatives, and to provide assistance to small scale and medium scale businesses. Under the New Order they were also expected to contribute funds to select political parties and institutions that supported the continuity of the regime.

For the last half-century, adherence to the law and its implementation has been insufficient so as to create loopholes in the systems that condone corrupt practices. These loopholes are still in existence today despite repeated efforts to do away with them such as by the establishment of the Anti Corruption Committee and other similar organizations.

Many high-ranking officials of the New Order and Reform Governments continue to engage in corruption as they have for years. In Indonesia the feudal mentality is such that subordinates instinctively imitate the behavior of their superiors. This has spawned an entire working class of corrupt frontline staff and lower-level employees who feel justified in engaging in extortion, embezzlement and corruption due to the standard set by their superiors. It is clear that the morality and ethics of the nation's leadership and bureaucracy must be evaluated. However, it is my view that such efforts will only succeed if civil servants and military personnel receive ad- equate wages, comparable with their private sector counterparts, as this would eliminate the necessity to engage in corruption.

Early on in the *New Order* regime, the government utilized the paradigms of stability and economic development to pressure private sector entrepreneurs with money politics or violence. However, in the 1980s the international community adopted a new paradigm that placed democratization as the primary requirement for market economy globalization, which affected changes in the *modus operandi* of many regimes including the *New Order.*

Indonesia began to open its market to compete for international capital. However, the Indonesian experience in this regard became a classic case of, too *much* too *soon* as the country was not sufficiently developed to compete globally. The 1997 economic meltdown led to the demise of the *New Order* and ushered in a new era of crisis. This had a devastating effect on a private sector that had always been greatly dependent on the State as in the late 90s the warring factions of the bankrupted Indonesian government could do no more than seize the assets of the ailing private sector conglomerates under IBRA. However, the deeply rooted relationship between the state and the private sector has hampered IBRA's efforts to acquire and sell the assets of the said conglomerates.

Entrepreneurs guilty of corruption and of causing losses to the state should be arrested and prosecuted for their crimes. The government however, lacks the will to do so and the judicial system is incompetent creating yet another impediment to the eradication of corruption. Judicial corruption involves not only judges and prosecutors, but also solicitors, notaries and case brokers. Cases often go simply to the highest bidder. Control of judicial institutions is weak or non-existent, and judicial personnel lack the integrity befitting of their vocation, making them vulnerable to the influence of external parties through bribery, money politics and corruption.

The quality of judges is also questionable, as the brightest minds in Indonesian law faculties generally prefer to seek employment with private companies and multinationals, while their less endowed colleagues opt to enter the judiciary. Hence, their technical abilities in judging increasingly complex cases concerning technology and globalization are doubtful. This circumstance has resulted in the establishment of Judicial Watch Indonesia (JWI) under the leadership of To dung Mulya Lubis, a renowned solicitor. Despite its noble aspirations, the long-term effectiveness of this organization remains to be seen.

The World Bank, during the 10th session of the CGI in Tokyo (October 2000) stated: *the Indonesian legal system, from the judges down,* is *viewed* as *fundamentally corrupt, whilst prosecutors are considered facilitators of extortion and bribery.* The main obstacle to eradicating judicial corruption is that the mechanisms designed to do so, namely law enforcement, and preventative education, have not been effectively implemented. The independent Anti Corruption Commission and the Commission to Examine the Wealth of State Administrators are also yet to show any concrete results.

Ironically, in the midst of all the endeavors to prosecute corruption cases, there are still those entrepreneurs who have remained unscathed, and who have even appeared to be proponents of the struggle against corruption. Although few in number, these individuals survived the downfall of the *New Order* and succeeded in forging cooperation with the new regime, a condition made possible by the needs of political parties to fund their political agendas.

Businessmen are known to be tenacious, creative and imaginative as competing for profit and eliminating their rivals is the essence of their existence. As such, they willingly subject themselves to the rules of the game that are deemed to be fair and that have no detrimental effects on their interests. By the same token, if the rules of the game call for bribery, malpractice and professional misconduct many have no choice but to comply, while some go so far as to pursue and create opportunities for such coITUption.

Society as a whole must commit itself to the eradication of coITUption and must seek out the assistance of the international community in doing so. If eradication efforts are not made a top national priority and given the attention and resources they warrant, Indonesia will only sink deeper into th-e quagmire of venality, and any attempt to rebuild the nation's economy will be doomed to failure.

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Corruption and State Enterprises in Indonesia

By *Ahmad D. Habir*

INTRODUCTION

There are currently 176 state enterprises under the management of the Directorate General for State Owned Enterprises (DGSOE), the Ministry of Finance. These state owned enterprises comprise a range of industries including financial services, insurance, construction, engineering, toll roads, manufacturing (including cement, paper, and textiles), pharmaceuticals, trading and distribution, tourism, industrial estates, telecommunications, airlines, airports, ports, electric power, steel, shipbuilding, shipping, mining, plantations, fertilizer, fisheries, and forestry. They vary in size from large, national monopolies and public infrastructure enterprises to relatively small service companies. In addition to these 176 state enterprises, the DGSOE manages the state's minority shareholdings in 19 primarily privately owned enterprises.

EXAMPLES OF CORRUPTION IN STATE ENTERPRISES

Prior to 1990, within one large state owned mining enterprise in particular, it was customary to supplement the low salary scale with so-called *uang daging* or *uang rokok,* a system that was practiced at all organizational levels. These supplementary funds were derived from systemic corruption that included markups on large projects, over invoicing, deposits of funds in transit and others.

Promotions were also bought and paid for. Regular contributions were made to Golkar; select government officials received funding for international travel, and a slush fund *-rekening* A -was accumulated for unexpected funding requirements. Employees would often clock in, then go about their private activities and return to the office only to clock out before going home. [1]

Oil companies with production sharing agreements with Pertamina needed the approval of Pertamina for personnel changes. These companies were extorted for such items as work permits, promotions, and organizational changes. These cases of extortion however were dwarfed by the institutionalized costs of procurement for capital and non-capital goods for operations, which required both the approval of Pertamina and the Coordinating Minister of the Economy (EKUIN) for large expenditures. This approval requirement was regulated by Presidential Decision 14A that has since undergone various revisions.

For any project, all purchasing is tendered. However, Pertamina and the Ministry reserve the right to change the final tender award. Therefore, the subcontractors pursuing the tenders ignore the oil contractor and instead bribe the relevant officials of Pertamina and the EKUIN in order to secure the contract. Until only recently ,the companies awarded particularly large contracts tended to be those of the close associates and children of former President Soeharto, and much of the funding that accumulated in the EKUIN was funneled to Golkar.

Based on comparisons made by several oil companies, it has been estimated that the costs of capital goods in Indonesia are 30 percent higher than those in the Gulf of Mexico. Many in the

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[1]Confidential interview, 26 March 2001

oil industry have argued that the costs would drop to a more acceptable level if the regulation requiring the approval of Pertamina and the government was done away with.[2]

An audit conducted by Price Waterhouse Coopers (PWC) that was leaked to the public in July 1999, reported that in fiscal years 1996/ 1997 and 1997/ 1998 Pertamina had unaccounted financial losses of USD 6.5 billion or IDR 45.5 trillion (IDR 7000/ USD). These losses had occurred in the Central Office (USD 2.4 billion), the Exploration and Production Directorate (USD 2.2 billion), Pension Funds (USD 0.7 billion), Shipping and Ports (USD 0.4 billion), Refining (USD 0.3 billion) and the Foreign Contractors Development Board, or Badan Pembinaan Pengusahaan Kontraktor Asing, BPPKA (USD 0.1 billion) (Kompas: 12 July 1999).

The above figure was later revised to between USD 3.9 and 4.7 billion depending on how exploration costs were calculated (Kompas: 11 October 1999). The contributing factors to the losses were cited as political intervention, and the overextended discretional approval process. The names of management members and government officials thought to be involved were not mentioned, as this was not the purpose of the audit. According to Priyo Budi Santoso, a member of Parliamentary Commission V, the revelation of corruption in Pertamina did not come as a surprise, as it only served to confirm public knowledge. Mr. Santoso also noted that the audit was restricted to two fiscal years and would have been far more scathing had the audit period been lengthened.

The above cases illustrate the five forms of corruption that categorized by Morgan in order of severity: Bribery, Theft, Distortion, Patronage and Cronyism. These are not mutually exclusive and can be intenlated. Bribery, theft and distortion occur under weak management systems and can be eliminated through the strengthening of such systems. The main aim of patronage and crony based systems is to maintain political power through the distribution of spoils. Solving the corruption problem requires creating a government management system that is transparent and that holds officials accountable for their actions, a solution that also requires a strong system of law -Indonesia has neither.

[2] Confidential interview with former CEO of Oil Company. 2 April 2001

In Indonesia, the corruption practiced in state-owned enterprises involves each of the five forms, underlying the difficulties in reforming the sector. There is no doubt as to whether or not corrupt practices are fostered in state-owned enterprises, as based on past and current publicized cases, it is almost common knowledge that corruption within state-owned enterprises is the rule rather than the exception. While this is unfair to the many who are working professionally in the sector, it is nonetheless easy to conclude that corruption in this sector is systemic. This paper will examine the roots of corruption in Indonesia's state-owned enterprises and its implications on reform, as it would be foolish to go about conceiving combatant strategies with- out a clear historical perspective.

THE DEVELOPMENT OF THE INDONESIAN STATE ENTERPRISE

The Colonial Period

The development of state enterprises in Indonesia dates back to the Dutch colonial period when the colonial government established about twenty state enterprises in such key sectors as railways, seaports, pawnshops, printing, publishing, electricity, and drinking water during the late nineteenth and early twentieth centuries. In 1925, these enterprises came under the Indies Treasury law of 1864, which put them under the direct supervision of ministerial departments. Operating under this law was, among others, the Balai Pustaka Publishing Company, the State Water Company, the State Bus Transportation Company and the State Electricity Company.

In 1927, a regulation governing state enterprises was issued which brought other state enterprises under the nominal supervision of the Finance Ministry. In contrast to those companies operating under the treasury law, companies under the new regulation had to use cost accounting principles in their operations and had to pay interest on capital received from the government. However, their budgets were still controlled by the respective technical ministries that retained operational control.

Such companies included: Jawatan Penggadaian (State Pawnshop), Perusahaan Garam dan Soda Negeri (Salt and Soda), Pusat Perkebunan Negara (Plantations) Percetakan Negara (State Printing), Jawatan PTT (Post, Telegraph and Telephone), Jawatan Kereta Api (Railways), the Surabaya Port Authority, and the Bangka Tin Mining Company. Tne strong governmental control of state enterprises under these two regulations would continue after Indonesia gained independence and the ownership of the companies was transferred to the new Indonesian government.

The Early Independence Period (1945-1957)

After independence, economic policy makers, influenced by socialist ideas and imbued with strong nationalist sentiments against foreign and Chinese domination of the economy, began to negotiate and implement the nationalization of several Dutch enterprises, such as the Java Bank, which became Bank Indonesia (the central bank) in 1953, and Garuda Indonesian Airways, in 1954. However, a concerted drive towards nationalization was considered as not feasible due to a shortage of funds for compensation and the lack of qualified local managers to replace their foreign counterparts. The new Indonesian government also established a number of other state enterprises in such areas as banking (Bank Negara-1946), trade (Central Trading Corporation-1947 and Usindo-1956), industry (Semen Gresik-1953) and tourism (Natour-1957).

In the early 1950s, the main thrust of government economic policy was directed toward the creation and expansion of a national (indigenous) business sector through cheap and accessible credit as well as exclusive import licenses to displace foreign and Chinese dominance of the economy. To facilitate this Benteng (Fortress) Program, the government established the Bank Industri Negara (Industrial State Bank) as an industrial development corporation that provided loans to industrial and commercial firms.

This led to the inadvertent expansion of the state sector when the government acquired a number of companies unable to repay their loans. Because by law state banks could not own shares of private companies, defaulting companies were changed into state enterprises, as was the case with PN. Iglas (glass), PN. Intirub (tires), and PN. Gaja Motor (car assembly). In 1961, Bank Industri Negara became Bank Pembangunan Indonesia (Bapindo) and its subsidiaries were transferred to the relevant technical ministries.

These attempts at developing indigenous entrepreneurs for the most part failed, except in the rarest of cases. Abuses resulted in disillusionment and the shifting of funding and emphasis to the development of a strong state enterprise sector that could effectively compete with foreign and Chinese companies. Despite the existence of a number of important state enterprises, the economy was still dominated by private (mainly Dutch) foreign firms, which had returned since 1950, and to a lesser extent, by Chinese businesses.

The State Sector Expansion (1957-1966)

The turning point in the development of the state sector came as a result of the failure of the United Nations to pass a resolution calling upon the Dutch to negotiate a settlement of the Irian issue on 29 November 1957. After unions began taking over Dutch companies, the army ordered the nationalization of all Dutch enterprises in Indonesia on 10 December 1957. Nearly 600 Dutch companies were formally nationalized, almost half of them being plantations, over a hundred industrial and mining companies and the remainder trading, financial, communications, gas and electric, and construction firms. This marked the beginning of the institutionalization of the military as a major economic force as it now had independent resources for patron- age. Along with this came the mismanagement and corruption that was later to become institutionalized as well.

With the issuance of Law no. 19/1960 on 30 Apri11960, all nationalized companies were given Perusahaan Negara (PN) status. Under this law, ownership was not in the form of shares, thus preventing any private participation. The law also marked the beginning of a pattern of governmental control that would plague the management of the state enterprise sector in the future.

Law no. 19/ 1960 was a victory for the many government officials -heads of newly created government agencies -seeking to increase the number of enterprises under their control. It rigidly defined all state enterprises in relation to each other and the sectors of the economy in which they operated. Under the Law, enterprises with similar functions were placed under the supervision of a General Management Board (Badan Pimpinan Umum-BPU). The BPUs in a sector would in turn be placed under a government department subject to the control of the minister. For example, the eight large vertically integrated trading houses were broken up into individual trading, production, marketing and ancillary service units. Each group of enterprises thus divided was then placed under the supervision of the appropriate government Ministry; in this case, the Ministry of Trade, the Ministry of Industry and the Ministry of Agriculture respectively. In some cases, BPUs created a dual management problem when assigned the operational management of state enterprises under their jurisdiction.

Inevitably, the competitive advantages enjoyed by these companies through vertical integration and the business relationships built in the past were lost. Other factors like inexperienced management and staff and the deteriorating economy, contributed to the weakening of the state enterprise sector. Profitable enterprises became cash cows for their ministries while less successful enterprises were unable to receive adequate working capital. Patronage was the rule and overstaffed enterprises became high cost operations that suffered losses and survived only through government subsidies, protected markets and monopoly rights.

Political and economic instability in the country, the former culminating in the 1965 coup attempt and the latter marked by hyperinflation, very low levels of trade, almost zero foreign exchange reserves, and a domestic manufacturing sector operating at only 20-30 percent capacity, led to President Sukarno's downfall and the handover of power to President Soeharto's New Order government in 1966.

The New Order Years

Consolidation and Attempted State Enterprise Reform

Economic policy making in this period, influenced by a group of internationally trained economists from the University of Indonesia, moved toward economic reforms that included the rationalization of the notorious state enterprise sector. Article 40 of MPR Resolution no. 23/ 1966 stipulated that the government, in its economic role, must emphasize the supervision of the economy and not the control of economic activities. To accomplish this, the resolution stated the importance of the debureaucratization of the supervisory system and the decentralization of the management of state enterprises.

Initially, a number of nationalized state enterprises were returned to their former owners, a great many state employees were dismissed, and a special team under the Minister of Labor, Dr. Awaludin Djamin (a police general), was established to review and bring order to the stateenterprise sector. The review led to the reclassification of state enterprises from Perusahaan Negara (PN) status to Ministry Agencies (Perjan) operating as public services and financed by the government budget; Public Corporations (Perum) wholly government owned, and not divided into shares but expected to generate sufficient income to finance their operations; and finally, Public State Companies (Persero) -limited liability companies whose shares were owned wholly or partly by the Ministry of Finance representing the government. The majority of the two hundred-odd official state enterprises then in existence were organized under this last category and expected to operate as profit -oriented ventures under the same legal provisions governing private limited liability companies.

A number of key state enterprises remained outside of this structure. Pertamina, the national oil company, was governed under its own law (Law no. 8/1971). The company was controlled exclusively by its first President Director, Ibnu Sutowo, almost as a personal fiefdom, dispensing patronage and answerable only to the President. Another important autonomous state entity not included in the official listing of state enterprises was the National Logistic Agency (Bulog), which was established by Presidential Instruction no. 11/1969 as a special government agency headed by a Chairman directly responsible to the President. State banks were also to be governed by their own law (Law no. 14/1967).

In late 1969, corruption became a national issue and public pressure forced the President to appoint a commission to investigate various charges that, among others, were directed at state enterprises, including Pertamina and Bulog. The Presidential Inquiry Commission, otherwise known as the Commission of Four reported that the situation was critical and urged priority attention to a number of prominent cases, including foreign exchange scandals, the Ministry of Religion's management of the Islamic pilgrimage, the forestry directorate and CV. Waringin, a trading firm whose directors included Liem Sioe Liong, a long time associate of the President, and Sudwikatmono, the President's foster brother. In addition, the commission submitted two detailed reports concerning Pertamina and Bulog.

President Soeharto largely ignored the report and its recommendations, which included placing Pertamina under the control of the Ministry of Finance. This was not surprising since Pertamina represented on a larger scale, the general use of state enterprises as a source of political patronage. Because the Ministry of Finance did not control it, it was easy for the oil company to withhold a significant portion of its revenue for extra budgetary purposes, in particular the channeling of funds to key constituents of the regime, such as the military.

The Early Reform Process

In the early 1970s, the initiative to curb the excesses of the state sector came from the Ministry of Finance, in particular its Minister, Prof. Ali Wardhana, as well as Bappenas, which was then headed by Prof. Widjojo Nitisastro. The strategy was to separate the state enterprises from their respective ministries and to place them under the direct control of the Ministry of Finance, which already had noln;illal control as formal shareholder. Under Goverment Regulation Substitution Law no. 1/69, most of the state enterprises under the control of other departments were to be transformed to Persero and a directorate for state enterprise development was established to safeguard the interests of the sole shareholder. Teams were set up to evaluate the enterprises and prepare them for their transition to Persero status with the help of the Harvard Advisory Group, which worked mainly through the Ministry of Finance and Bappenas. During the transition, ministries were reluctant to relinquish the control of their state enterprises to the Ministry of Finance because it exposed the enterprises to external evaluation. One of the first steps towards transparency taken by the Ministry of Finance was to prohibit the payment of management fees made by the state enterprises to their technical ministries to supplement their budgets. While the Ministry of Finance could prohibit the more obvious of such payments, in practice it was difficult to control the numerous unofficial payments requested by and paid to technical ministries.

Opposition from the technical ministries became more manifest when the program began to implement performance incentives to increase revenues for the Ministry of Finance. The plan involved al replacing all non-monetary payments to management such as cars, housing, and bags of rice with cash payments; b) offering monthly salaries roughly equivalent to USD 1.000 to managers of the larger trading, manufacturing and agricultural products companies; and t:1 offering one month's extra income as a bonus to those enterprises who exceeded their predetermined sales and profit targets.

The incentive program met With unexpected success when many companies achieved the sales and profit targets for the year Within less than 6 months. This suggested that substantial cash flows had not been accounted for in the past. The reform program was strongly opposed by many state enterprise managers, particularly high ranking military officers, who protested the abolition and cashing out of their fringe benefits as well as the requirement to achieve targets. In response to the protests, the cabinet decided to discontinue the program.

Protests from the technical ministries also led to the amendment of Presidential Instruction no. 11/1973, which had been issued to strengthen the control of the Ministry of Finance over state enterprises but instead served to weaken it. The regulation had originally given authority to the Finance Minister, who represented the government as the shareholder, to appoint both the commissioners and directors of state owned companies.

In light of the said protests, the amended regulation stipulated that in addition to supervising and advising technical operations, the technical ministries were given the sole authority to nominate candidates for the positions of commissioners and directors. The Finance Minister was granted veto power in the selection of candidates and could only request the nomination of new candidates in the event of a disagreement. Because the commissioners and directors were nominated by and were in reality representatives of the technical ministry, these ministries controlled the day-to-day operations and the policies of the state enterprises.

This cumbersome dual command structure, exacerbated in practice by the influences of other government and extra-official agencies, either relegated managers of state enterprises to department bureaucrats or paradoxically created conditions in which managers operated with- out any control whatsoever.

This reversal occurred because the threat to the technical ministries' control over the state enterprises and their extra-budgetary funding undermined the fundamental patronage base of the regime. During this period, the military still had control of many state enterprises, including the largest, Pertamina, Timah (the tin mining company), and Bulog. These were just some of the larger ones on which the military and the technical ministries depended to supplement their budgets.

The recovery of the Indonesian economy in the late 1960s and the early 1970s was led by growth in the oil sector. Towards the end of 1973 moves towards further rationalization were swept aside as the oil boom provided an incentive to return to inward-looking, nationalistic economic policies. The government used its increased (oil) revenues to initiate a massive industrial sector investment program, which included the basic metals sector, principally in the form of the Krakatau Steel complex and the Asahan Aluminum smelter; the chemical industry, in particular three large fertilizer complexes in West Java, East Kalimantan and South Sumatra; LNG and oil refining; and a range of other industrial activities such as the manufacture of paper and cement, and the assembly and manufacture of aircraft.

Pertamina under Ibnu Sutowo had become a large conglomerate that in addition to its petroleum business also included a tanker fleet, a steel plant, office buildings, a tourist resort, a fertilizer factory, an airline, and several rice plantations.

Three ideological predispositions supported the political legitimacy of Pertamina, and by extension, the rest of the state enterprise sector. One was the perceived necessity to build a strong indigenous pribumi business sector (pribumi-ism). Another was the assumption that only large companies that could take advantage Of.the economy could sustain the initial losses associated with developing infantile industries (industrialism). The last was that large national conglomerates could prevent the penetration of exploitative multinational corporations (economic nationalism).

THE PERTAMINA CRISIS

In the face of president Soeharto's reluctance to act against Pertamina and its excesses as documented by the Commission of Four, technocrats utilized external pressure in the form of a standby agreement with the International Monetary Fund in 1972. The standby agreement called for a ceiling of USD14 million on medium-term external borrowing for 1972-73. The technocrats then successfully bid for a presidential decree requiring state enterprises to obtain the approval of the Finance Minister and the Governor of Bank Indonesia before negotiating medium and long-term-loans to finance capital expenditures. When oil revenues began to decline in the latter half of 1974, Pertamina defaulted on a short-term USD 40 million loan that forced the government to assume the company's liabilities to ensure Indonesia's continued access to the international financial market.

After the Oil Boom

The near financial collapse of Pertamina in 1975 provided the opportunity for the technocrats to return to power in light of their management of the crisis, however general dissatisfaction with the overall performance of state enterprises persisted as further financial losses were reported in the press. MP, Rachmat Muljomiseno, a former trade minister, spoke for many when he called for a management audit of state enterprises in response to the increasing public and parliamentary criticism. He added that state enterprises were becoming breeding grounds for foul play, mismanagement, manipulation, fraud and corruption propagated by insiders and other groups, both organized and not (Sinar Harapan: 3 March 1980).

The struggle between the Ministry of Finance and the technical ministries for control of the state enterprise sector has continued to the present. The intent, for example, of Government Regulation no. 3/ 1983 when it was drafted was to strengthen the oversight of the Ministry of Finance and to prevent interference from the technical ministries. However, the regulation still did not govern Pertamina and the state banks, which were instead governed by special laws, and eventually the technical ministries succeeded in attenuating the regulation such that it reinforced the dual command structure.

The decline in the price of oil between 1982-1986 resulted in a sharp decline in government revenue. The government responded by imposing austerity measures, by expanding non- oil domestic revenues, and by promoting non-oil exports. Included in the budget cuts were the allocations for capital participation in state enterprises. At the same time, the operating surpluses of state enterprises in key sectors such as plantations and mining had declined in the early 1980s, while public utility companies operated at a loss. In this context, the state enterprise sector again became a target of reform.

THE REFORM PROCESS IN THE 1980s AND 1990s

As Indonesia's growth rate fell in the early 80s, the government responded by tightening monetary policy, restricting imports, promoting exports and cutting public investment programs, including capital participation in state enterprises. The mid-80s saw a public debate over the costs versus benefits of privatization as a route to reforming state enterprises.

Presidential Instruction no. 5/1988, classified state enterprises into categories of very healthy, healthy, less healthy or unhealthy based on several financial criteria. This was followed by two regulations from the Finance Minister in 1989, Decisions 740 / KMK. 00 / 1989 and 741 / KMK.001 1989. The first outlined possible actions to be taken to improve the performance of state enterprises. These actions included: a) a change in the legal status of state enterprises (to limited liability status); b) operational cooperation and management contracts with third par- ties; c) consolidation or mergers; d) fragmentation; e) public stock offerings; f) direct placement to outside parties g) joint ventures; or h) liquidation. The second regulation required that all state enterprises submit a five-year corporate plan and an annual budget plan to ensure better control by management and the government.

In Apri11990, a private placement was made when 70 percent of PT. Intirub, an unprofitable state tire company, was sold to PT. Bimantara Citra, the large conglomerate owned by Bambang Trihatmodjo, a son of President Soeharto. PT. Bimantara then sold 32.5 percent of its share to PT. Astra International, then the country's second largest conglomerate. The closed nature of the sale drew criticism from some parliamentary members and the press but did not prevent it.

The continuing deregulation encouraged an upturn in the Indonesian economy beginning in the late 80s that in turn led to a slow down in the reform process, several factors contributing. One was the fear that privatization would only benefit Chinese Indonesian business groups or the President's extended family. Another was the increasing opposition from the technical ministries, at least one of which succeeded. This was the establishment of the Strategic Industry Board (Badan Pengelola Industri Strategis), which grouped ten key state enterprises under the control of the then Minister of Research and Technology, B.J. Habibie. Economic improvement also lessened the sense of crisis that had prompted the reform movement in the first place.

In the mid 1990s, the government raised nearly USD 4.3 billion through IPOs, and the sale of minority share packages to strategic investors in six major enterprises including two telecommunication companies (PT. Indosat and PT. Telkom), one bank (PT. BNI), two mining companies (PT. Tambang Timah and PT. Aneka Tambang) and one cement company (PT. Semen Gresik). A large portion of the proceeds was reinvested into the enterprises for capital expenditures and expansion.

Prior to 1998, state enterprises were formally under the control of the Ministry of. Finance as shareholder. In early 1998, the government established the Ministry of State Owned Enterprises, which assumed the respqnsibility of the Ministry of Finance with regard to state enterprises and was mandated to restructure, improve the profitability of and accelerate the privatization of the 144 state enterprises in its portfolio.

The aims of the new ministry were to:

- Generate revenues for the state budget through privatization and increases in dividends and taxes through increased profitability .
- Enhance the performance of state enterprises through better corporate governance, greater operating efficiency, and improved service.
- Improve the valve of state enterprises with new technology, modem management skills, and access to markets and financing.
- Attract foreign investment into state enterprises to also improve market confidence and attract longer- term investment into the Indonesian economy.
- Diversify the ownership of state enterprises.

In early 1998, under an agreement with the IMF, the government chose 12 major state enterprises for partial privatization by March 1999. Target revenues of USD 1.5 billion were slated for the sale of stakes via tender and public offerings in the following sectors: telecommunications, mining, cement, air and sea ports, toll roads, steel and plantations. By the target date, only five of the privatization transactions were completed, and had generated more than USD 1 billion in gross revenues for the state budget. The five involved four state enterprises of the original list of 12 plus PT Indofood Sukses Makmur Tbk, in which the government was a minority shareholder.

The transactions were as follows:

- Cemex, the Mexican multinational cement company, invested USD 122.1 million in PT. Semen Gresik. Cemex also purchased shares in PT. Semen Gresik.
- The Jakarta container terminal was sold (51 percent with the government holding a golden share) for USD 215 million.
- The Surabaya container terminal (49 percent) was sold for USD 175 million.
- 9.62 percent of shares in Pf. Telkom shares were sold on the Jakarta Stock Exchange for USD 409 million.
- The 10.18 percent government minority shareholding in Pf. Indofood was sold' through the Jakarta Stock Exchange for USD 115 million.

From the original list of the 12 state enterprises to be privatized, those yet to be privatised were the country's largest plantation company, the Jakarta airport operator, the international telecommunication company and a multi-mineral mining company. All are currently undergoing restructuring prior to sale.

By mid 2000, governed by an additional agreement with the IMF, the government identified nine major state enterprises for partial privatization and one in the trading sector for liquidation by December 2000. The target for the sale of these enterprises in the mining, cement, airports, steel, plantation, fertilizer, surveyor and pharmaceutical sectors was a total of IDR 6.5 trillion. However, by the end of December 2000, none of the nine transactions were completed, due in part to the cabinet reshuffle of August 2000 in which the government dissolved the Ministry for State Owned Enterprises as state enterprise shareholder and re-established the Directorate General for State Owned Enterprises under the Ministry of Finance as state enterprise shareholder in December 2000.

The ministry had had three ministers, Tanri Abeng of the Golkar Party, Laksamana Sukardi of the PDI -P, who when Adurrahman Wahid became President in 2000 was replaced in short order by Rozy Munir of the PKB/NU. The liquidation of the ministry and the return of the supervision of state enterprises to the Ministry of Finance was a clear indication that the struggle to control state enterprises for political and financial gain was set to continue.

In early 2001, still under the IMF agreement of the previous year, the government identified 16 state enterprises for privatization by December 2001. Revenues of IDR 6.5 trillion were to be realized from the sale of shares through tender or IPOs in two pharmaceutical companies, and other companies in the plantation, fertilizer, surveyor, hotel, trading, steel, and telecommunications sectors. By April 2001, only one privatization transaction had been completed, which generated IDR 150 billion in gross revenues.

The implications of the history of state enterprise reform as described is that major structural changes in the political and economic spheres are needed before the sector can shed its perceived role as a cash cow for the financial and political interests of those in power. However, despite the many obstacles to reform, a few successful cases have shown the possibility of at least minimizing corruption through good corporate governance, even within a governmental patronage structure.

On 31 May 2000, the guidelines for implementing good corporate governance in state enterprises were issued under a Ministerial Decree. A number of state enterprises were selected as test cases to implement the guidelines as stipulated, namely PT. PLN (national electricity company), PT. Timah (tin mining), PT. Jasa Marga (Toll Road), PT. Pelni (shipping) and PT. PN. VIII (plantation)

The following cases describe the experiences of one the test cases, PT. Timah. The other case, that of PT. Rekayasa Industri, although not one of the pilot state enterprises is still an interesting example of a leadership driven organizational change, which incorporated good governance.

Case One: PT. Tambang Timah[4]

PT. Tambang Timah is an example of a state enterprise that has transformed itself from a near bankrupt, traditional patronage-based company into an efficient, public company. It would be useful to examine the restructuring process as experienced by Timah to determine what methods can be applied in the restructuring of other Indonesian state enterprises.

Timah's restructuring process began in 1990 when its new President Director, Dr. Kuntoro Mangkusubroto realized that the company was on the verge of bankruptcy. Production equipment was old and ill maintained. Financial reporting was a mix of uncoordinated systems. Overheads were high and morale was low. There was a large gap between the remuneration and benefits dispensed to operational staff and management: Corru ption, collusion and nepotism were rampant, and to make matters worse, at the time the international price of tin was in a slump resulting in a production cost per ton in excess of the selling price.

Even in this obviously desperate situation however, most of the existing management of the company were unaware of its true gravity. Most employees remained convinced that the past prosperity of company would continue. There were also many vested interests that were actively opposed to both the concept of change and restructuring and its subsequent implementation, which was long and arduous.

The Restructuring Process

On the whole, the process emphasized action and minimized conceptual discussions. The factors most contributory to the successful restructuring of the company are cited as, among others:

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[4].The case is based on Gede Rake, Restrukturisasi Sebagai Landasan Penerapan Good Corporate Governance Di PT Timah Tbk (Restructuring as the basis for implementing good corporate governance in PT Timah). presented at the Implementing Good Corporate Governance in PT Timah Seminar, 9 November 2000, Jakarta. Prof. Gede Rake was a consultant to Timah at the start of the restructuring effort.

- The ability of the leadership to view the problem in its widest scope, both internal and external, in order to estimate the risks involved and the sequence of actions required.
- The ability of the leadership to take the risks associated with massive changes and the controversies they engendered.
- The ability of the leadership to instill in the employees of Timah not only an awareness of the need for drastic change, but also a sense of urgency in the rate of change. To do this, it was essential to provide accurate information regarding the state of the company at all levels.
- The concurrent implementation of cultural and structural change. The cultural change included changing the values and attitudes of employees. The structural changes included changes to management and fmancial systems (for example: the establishment of electronic banking within the company to reduce the number of misusing fund transfers), and to the organizational structure.
- The identification of the supporters of the restructuring effort and their use to positively influence others. This was very important, as within the ranks there were those who openly opposed the restructuring, those who quietly opposed it, those who were skeptical and doubtful, those who accepted it conditionally, and those who accepted it passively.
- The ability of the leadership to gain the support of external parties. One major dilemma faced by the company was the need to lay offlarge numbers of employees, a move that was opposed by both the employees and the regional government. The company therefore lobbied the Parliament, the Ministry of Mining and Energy, the Ministry of Finance, and political parties for support of its layoff policy.
- The ability of the leadership to articulate and communicate its new vision and values in a way acceptable to the company's employees. The leadership communicated these inten- sively, not only verbally but also through their behavior. Some examples are the *3K Kebersamaan, Keterbukaan dan Kebersihan (Togetherness, Openness and Cleanliness)* and the *PTPRS Percaya, Terbuka, Positif, Rasional dan Sadar Biaya (Belief, Transparency, Positivism, Rationalism and Cost Consciousness).*

- The development of a corporate culture through action. For example, moving the head office from Jakarta to Pangkalpinang not only reduced overhead but was also seen by employees as a symbolic gesture of the solidarity of the management with the employees. Other aspects included egalitarian uniforms and access to company facilities and infor- mal social events, which were greatly appreciated by the employees.
- The commitment of the leadership to the transformation of the company, which set a positive example to the employees.

The Results

Since the restructuring began in 1990, the company has been transformed both structurally and culturally. It has increased its competitiveness and today is one of the biggest tin mining companies in the world with one of the lowest costs. It was also the first Indonesian company to be listed on the London Stock Exchange. Its management system and corporate culture has made it relatively free of corruption.

Case Two: PT. Rekayasa Industri [5]

The Government of the Republic of Indonesia, in order to develop the nation's engineering and large-scale construction capabilities established PT. Rekayasa Industri on 12 August 1981. Unti11994 Rekayasa had a captive market working solely on government projects and acting as the government's arm in the execution of those projects. However, as more companies entered the market, Rekayasa began to feel competitive pressure for projects.

The need for a more professional approach to project management became painfully apparent when in 1994, the largest project in the company's history at the time was mismanaged, inflicting heavy losses on the company and creating a corporate debt that exceeded the sum total of all its assets. The financial position of the battered Rekayasa was so poor that the government was prepared to liquidate the company. However many within government were

[5] Based on research conducted in September 2000.

convinced that a government-owned engineering and const ruction company for use in large industrial plants was strategically necessary. So instead of closing Rekayasa down, the government replaced the management team and granted its new CEO, Mr. Hari Suparto, unlimited authority to do whatever was necessary to revitalize the company.

The company's new management faced a daunting task -its overall market was shrinking as chemical and petrochemical companies were not increasing production capacity or constructing new plants; Rekayasa was not competitive in other markets such as oil, gas, and power plants; the company's products and services were ill defined; its business processes were not standardized: there were no human resource or information management systems in place; and finally, the company had accumulated losses of IDR 24 billion.

Since its change in management, Rekayasa has become one of the largest and most dependable engineering, procurement and construction (EPC) companies in Indonesia. The management demonstrates a commitment to excellence through its detailed project management services, engineering, stringent quality controls and the application of state of the art engineering technologies. Despite the regional monetary crisis, Rekayasa in 1998 realized sales of IDR 608 billion with profits of IDR 80 billion, and established itself as an industry leader.

Rekayasa has also since streamlined its organization, which now consists of its Board of Directors, and separate Engineering, Procurement and Project Management, Finance and Business Infrastructure Divisions, and its Business Development Division which comprises Profit Center Contracting Units, a Marketing &Technology Unit, an International Strategic Alliance Unit and Strategic Business Units.

The scope of the company's EPC business includes cement, mineral, power, oil and gas, pulp and paper, and chemical and petrochemical plants in addition to feasibility studies and plant maintenance. Since the Company's participation in the construction of the Iskandar Muda Fertilizer Plant, East Kalimantan Fertilizer III and the full EPC project, Pupuk Sriwidjaja -1B Plant in 1989/1990, its growth and competence in EPC has been stimulated through cooperation with a number of leading international corporations. In the cement industry, one of its initial core businesses, Rekayasa has completed the Tuban I, II, III and Tonasa IV plants that have a combined total capacity of over 4 million tons of cement annually.

Rekayasa penetrated the international market with two projects in Malaysia, the ASEAN Bintulu fertilizer plant and a lube oil blending plant. It has also diversified into piping, electrical and instrument engineering works for the Musi pulp and paper project as well as various optimization and de- bottlenecking projects for LNG plants in East Kalimantan. Two other milestone achievements were its successful bids for the EPC services for the world's largest geothermal project and Indonesia's first granulated urea project. A major emphasis in Rekayasa is quality management, as reflected in efficiency, cost effectiveness and profitability. Its primary objective is to become a competitive international player. One stepping stone in the achievement of this objective was its receipt of the ISO 9001 Standard for Quality Management and Quality Assurance certification received in 1996 from Lloyds Register Quality Assurance.

The company's highly educated corps of engineers is an asset that has worked to the advantage of the company in the changes that it has undergone. Suparto was convinced that empowerment, delegation, and participation, with minimal intervention from upper-level management were essential. Middle-level management and employees, who had long hoped for such changes, readily accepted this approach and helped to ensure that the restructuring took place promptly and smoothly

The strategic steps taken began with a SWOT analysis and continued with the execution of radical changes (relative to the previous regime) starting from a zero- point base. These were a) defining the company's mission, vision, objectives and goals; b) establishing an organizational structure and human resource system; c) redefining business processes; d) determining criteria and standards; e) measuring performance; and f) implementing a management information system.

An Emphasis on Human Resource Management

To accelerate the process of change, several internal restructuring initiatives were simultaneously implemented in 1995.

Increases In Compensation

Suparto believed capable employees in a high technology company to be primary assets.

Therefore, to increase productivity, management had to show confidence in its people by offering them competitive compensation, despite the company's unfavorable financial position and government guidelines for state enterprise salaries that compare unfavorably to private sector salaries.

Establishing a Knowledge-based Compensation System

Because of the rapid development of the high-tech characteristics of Rekayasa's business, heavy emphasis was placed on human resources in order to keep abreast. Criteria for levels of knowledge, problem solving ability, and accountability became minimum requirements for personnel rankings. To be promoted, an examination team would examine a candidate. Salary levels would be adjusted based on the results of work evaluations.

After the implementation of company rankings based on minimum requirements, knowledge gaps can be identified between what one should know and what one actually knows. To close the gaps, Rekayasa developed a training program covering a) fields of specialty; b) project management; c) general management; and d) personal development (leadership, achievement motivation, teamwork etc.).

Internal Development Projects

Task forces were created to develop and implement business infrastructure like human resource management systems, information management systems, and accounting systems. With the exception of the accounting system that was developed with the help of consultants, all other systems were developed internally and this later served as the embryo of a learning organization. Financial pressures encouraged such internal organizational learning, as tbere were limited funds available for third party consultants.

The human resource management system took approximately six months to develop and another six months to implement. Positive results were almost immediate as the ratio of operational to non-operational activities improved from 1: 1 to 2: 1. The development of the information management system created a faster means of communication. It was also aimed at increasing efficiency, as Rekayasa became a paperless company through intranet communication.

Rekayasa has also committed itself to organizational transparency and it reveals every aspect of its operation and organization over its intranet and as such information like Mr. Suparto's daily objectives as well as the current cash flow position of the company is available to all employees.

- Rekayasa is consciously striving to become an effective learning organization by:
- Learning from employees' on the job experiences, by, for instance, organizing weekly lunch discussions where different project participants share their experiences (both successes and failures) and learn to justify their actions as their colleagues query them. Discussions also take place over Rekayasa's internal intranet network.
- Organizing weekly Friday sessions where members who have attended outside seminars / workshops share their newly gained knowledge with others in the organization.
- Monthly management meetings that provide company updates to all its key staff members. These meetings also provide a forum where questions are raise and action plans are reviewed.

CONCLUSIONS

The implication of reforming a patronage and crony-based system is the dismantling of a political system that is based on the maintenance of political power through distributing spoils to clients and cronies. Since the well being of patrons, clients and cronies is dependent on the survival of the regime, any change to it will be opposed. It is therefore nigh impossible for genuine reform to occur without a shift in the regime. Such a shift must itself be accompanied by a shift in the aim of politics -from the distribution of spoils to public service. Any such shift will of necessity be a long-term process, given the need for developing a credible system of law that can ensure the rule of law.

Within this framework, the process of reform in the state enterprise sector, as witnessed in the two successful cases cited above, provides a basis for policies to minimize or prevent corruption in the said sector.

Corruption in state enterprises was one of the key issues leading to policies on state enterprise reform. The above review of state enterprise reform shows that, over the years a wide range of policy tools have been used. These have included restructuring, mergers, joint operations and privatization using public stock offerings and direct placements. In recent years, the privatization aspect has been an important and sometimes controversial part of the IMF program for an Indonesian economic recovery. Some policies have also attempted performance accountability, such as the classification of state enterprises into categories based on certain financial criteria, as well as the introduction of monitoring tools common in the private sector, such as corporate plans and yearly budget plans. More recently, the government has tried to encourage good corporate governance on a more systematic basis.

On a macro scale, the supervision of state enterprises has shifted between the Finance Ministry and the technical ministries depending on the relative political strengths of the ministries as they struggle to control the resources of the state enterprises. Supervision has also been shared between the Finance and technical ministries at times when political power was balanced. Recently, a separate ministry with the sole responsibility of state enterprise supervision was established and then dissolved after only a few years in existence.

The reform process has therefore been more piecemeal and ad hoc rather than systematic and strategic: the reasons for this lie in the historical development of the state enterprise sector as a national source of political power rather than as a consortium of business entities. Those opposed to past reform directions include the economic nationalists who are ideologically predisposed against any move towards a more competitive and market-oriented system. Opposition can also be found with those parties who view state enterprises as instruments to achieve government objectives, such as stabilizing prices, providing employment, promoting regional development, and controlling strategic areas. These and others may also share the view of state enterprises as a necessary counterweight to a private sector dominated by Chinese Indonesian businesses and foreign investment.

Reform, and in particular privatization, is also met with opposition from miriistries that benefit financially from the state enterprises they control, senior bureaucrats who receive additional income by sitting on the Boards of Commissioners (Dewan Komisaris), senior managers of state enterprises who fear that their positions would be threatened, private enterprises which might lose their favored status with state enterprises for obtaining contracts, and political parties looking to state enterprises for regular contributions to their coffers.

POLICY RECOMMENDATIONS

For the above reasons, effective reforms imply the need for a clean break from past practices. Such policies could include:

1. Reinstating an independent ministry or agency with responsibility for restructuring and privatizing state enterprises.
2. Developing good corporate governance in state enterprises. This includes merit-based recruitment and promotion systems, in government agencies and state enterprises (Boards of Directors and Commissioners included) to insulate the companies from political interference. Credible financial controls and appropriate wage and salary levels must also be established.
3. A master plan for privation with political support from the government, including parliament. Such privatization should be implemented in a competitive environment. Selling state enterprises to the private sector would remove much of the political and administrative interference from ministries. Partial divestiture would be less effective. Private placements should be transparent to prevent favoritism. Borrowing from experiences in Bulgaria, Panama and Ecuador, a group of experts can be fonned, in the Indonesian case by the Indonesian Transparency Society for example, to evaluate whether or not the privatization process is conducted in compliance with the law and to assess its transparency.
4. Reducing discretionary authority at both the industry and enterprise level. In the first instance, for example, contractor oil companies should not have to receive approval from Pertamina to purchase equipment. In the second, removing the need for approvals by using electronic banking, as in the case of PT. Timah.
5. Contracting services from private companies, either national or foreign that were fonnerly provided by state agencies or enterprises. For example, SGS, the Swiss surveyor company, has been contracted by the Indonesian government to take over the function of the notoriously corrupt customs department.
6. Monitoring by independent and reputable civil society groups such as the Indonesian Corruption Watch, Masyarakat Transparensi Indonesia and others. Units specializing in

state enterprises could be established in such organizations, ora specialized center focus- ing on state enterprises could be set up.

7. Devising public rankings of state enterprise on good corporate governance criteria to pres- sure government and management to perform better. Rating agencies such as Pefindo should issue the ratings.
8. Auditing by external auditors.
9. Training of the members of the Bo'ards of Commissioners and Directors on internationally accepted good governance practices.
10. Implementing the anti-monopoly and bankruptcy laws.
11. The development of a strong judiciary system is a requisite for the elimination of corruption.

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