Could Corruption Derail Indonesia’s Economic Growth?

By Yohanes Sulaiman

As a developing country riddled with corruption at every level, Indonesia appears to defy expectations with consistently high growth rates in recent years. But this cannot last: sooner or later, corruption will stifle growth as more and more people demand their share and the costs of doing business rocket. It is only a matter of time.

By Hal Hill

Indonesia’s unexpected and stellar growth over four decades shows clearly that corruption does not have to be a barrier to a booming economy. The key is only allowing the ‘right’ sort of corruption: Small bribes that oil the wheels of commerce for everyone are less of a problem than high-profile scandals involving officials pocketing millions of dollars.
Corruption Harms Development? It’s Not That Simple
By Hal Hill

IT WAS WRITTEN OFF as a chronic economic dropout in the mid-1960s, but Indonesia has seen its living standards rise dramatically over the past four decades. It is one of the developing world’s stellar economies, with average per capita income rising about six-fold since 1970.

Yet its performance according to various indicators of governance quality, and particularly corruption, is certainly less than stellar. According to one widely reported yardstick, the annual Corruption Perceptions Index (CPI) prepared by the respected organization Transparency International (TI), Indonesia in 2011 scores just 3 on a scale up to 10, and it ranks 100th, in the bottom half of the 183 countries surveyed.

How can these two apparently contradictory facts — rapid economic development and high levels of corruption — be explained? Isn’t corruption by definition harmful to economic development, apart from being morally indefensible?

One explanation could be that the CPI is incorrect. It is admittedly a subjective measure, based on the perceptions of fickle and sometimes misinformed international investors, yet this is unlikely. Various other independent estimates reach broadly similar conclusions. For example, according to the comprehensive World Bank estimates in its Worldwide Governance Indicators project, Indonesia is typically placed in the third lowest decile on the Control of Corruption indicator.

A second response would be to assert that Indonesian economic development would have been more rapid still if there had been less corruption. This may be so, but the removal of corruption is clearly not a prerequisite for economic success. In the TI index, most of the lower-to-middle income Asian stars have similar scores and rankings to Indonesia. Take just three of them, all growing faster than Indonesia over the past decade: India has a score of 3.1 (and a ranking of 95), China 3.6 (75) and Vietnam 2.9 (112).

The third and most convincing explanation is that corruption and economic development can and do co-exist. That is, certain levels and types of corruption are not necessarily a barrier to rapid economic growth, especially in developing economies with weak institutions.

WHAT IS CORRUPTION?
To understand this argument, we first need to ask, what is corruption? The most widely accepted definition is the abuse of public office for personal gain. Indonesia has an acronym for the phenomenon that, like its slogan for political reform, reformasi, has spread beyond its borders to neighboring Malaysia and elsewhere. This is KKN, or korupsi, kolusi, nepotisme: corruption, collusion and nepotism. The term rightly includes not just straightforward bribes and other forms of malfeasance but also various forms of business and political malpractice, and selective favoritism in government projects and employment.

Economists have long argued that there is a fine line between “corruption” and “rent-seeking.” The latter practice refers to lobbying governments to adopt policies to favor particular vested interests, such as protection for a specific industry at the expense of others, or the location of infrastructure projects in marginal electorates. If a donation to a political party is the price for
A crucial distinction is between what may be termed ‘organized’ and ‘disorganized’ corruption. The former was a hallmark of the Suharto era, when the rules of the game were generally clear: who to pay, how much and for what results. Under the latter, which characterizes the post-Suharto democratic era, all three are uncertain, and therefore businesses are more likely to hold back on investment decisions.

Yew, also well known for his quip that, among Southeast Asian leaders, officially he had the highest salary but the lowest actual income.

Second, there have to be checks and balances on government — independent institutions such as anti-corruption commissions and audit agencies, a free press, parliamentary and democratic processes and a vigorous civil society. As the Indonesian experience since 1998 illustrates, these all take time to develop. The Corruption Eradication Commission (KPK) has had some notable successes, but its wings are now being clipped by a paralysed, fearful of its power, and its senior personnel have themselves become embroiled in controversy. Democracy has created space for dissent and exposure of criminality, but local and national legislatures have been as much part of the problem as the solution. The press is occasionally vigorous in its prosecution of corruption, but just as often subject to the vagaries of checkbook journalism and their proprietors’ interests.

Third, since the bureaucracy is at the heart of corruption, there needs to be radical civil service reform, in at least two respects. One is an overhaul of civil service conditions of employment. Salaries are hopelessly misaligned with the private sector and aid donors, especially at middle and senior levels, and thus there is an ever-present temptation to accept bribes. Increased and restructured salaries can be funded partly through massive bureaucratic reform over time, including the phasing out of endemic over-staffing. Halving the numbers and doubling the pay is a hallmark of the Suharto era, when the rules of the game were generally clear: who to pay, how much and for what results. Under the latter, which characterizes the post-Suharto democratic era, all three are uncertain, and therefore businesses are more likely to hold back on investment decisions.

First, clean government has to start at the top, with a clear commitment to probity. This has always been the mantra of Singapore’s Lee Kuan Yew, also well known for his quip that, among Southeast Asian leaders, officially he had the highest salary but the lowest actual income.

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Until her resignation in May 2010, the reformist finance minister Sri Mulyani Indrawati had started to implement such reforms, a fact that led to massive internal political roadblocks that
eventually caused her to leave for a senior position at the World Bank. In general, however, the absence of any significant civil service reform during the democratic era is striking, and it renders rather hollow the official pledges to tackle corruption.

The other major reform is regulatory simplification. Signatures are a license to print money — the more there are and the greater their complexity, the more scope there is for bureaucratic enrichment. Indonesia is well known for its regulatory complexity. For example, according to the World Bank’s Doing Business surveys, it is one of the most difficult countries in the world in which to start a business. Combine this with opaque procedures and poorly paid civil servants and the results are as predictable as the needed reforms are obvious.

Indonesia has plenty of egregious cases of corruption with a seemingly endless parade of colorful and sinister characters. In 2010 it was the remarkable case of rogue tax official Gayus Tambunan and his exploits. In 2011, it has been Muhammad Nazaruddin, a former treasurer of President Susilo Bambang Yudhoyono’s governing Democratic Party, who was allegedly caught accepting massive bribes from a contractor, fled the country and was later apprehended in Colombia and brought back. He has threatened — but has so far not delivered — to expose numerous senior officials caught up in the same racket.

Their behavior offends one’s moral sense of decency, and Indonesia would obviously be better off without them. These cases highlight the constant struggle to develop stronger checks and balances on government excesses. But it is important not to lose sight of the fact that countries can and have achieved rapid economic development in spite of corruption.

In fact, there is a strong and positive correlation between a country’s per capita GDP and its ranking in the TI Corruption Perceptions Index. An optimistic interpretation of this correlation is that over the course of economic development, institutions become stronger, political processes better reflect the will of the people and corruption gradually diminishes. But it’s a long-term process.

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