Paying bribes in Indonesia:
A survey of business corruption

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AUTHORS: Paul Kenny and Eve Warburton

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THE AUTHORS:

Paul Kenny is Professor in the Institute for Humanities and Social Sciences at the Australian Catholic University. He specializes in political economy and comparative politics. He received his PhD in political science from Yale University and has degrees in economics and political economy from Trinity College Dublin and the London School of Economics. Prior to joining the ACU, Professor Kenny worked at the Australian National University, where he was Associate Professor and Head of the Department of Political and Social Change.

Eve Warburton received her PhD from the Australian National University's Coral Bell School of Asia and Pacific Affairs. Her doctoral dissertation examined the political economy of resource nationalism, and in particular the role that domestic firms play in shaping nationalist policy trajectories. She is now finalising a book manuscript based on her dissertation, *Reclaiming What's Ours: A Political Economy of Resource Nationalism in Indonesia.* Eve's broader research interests include identity, representation, and the political economy of policymaking in young democracies. Her work focuses primarily on Asia, and especially Indonesia.

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Introduction

Corruption is a pervasive feature of Indonesia's contemporary political economy. In-depth studies and cross-national surveys alike emphasise the ubiquity of illicit fees and bribery across the public and private sectors, and in the everyday lives of Indonesians. Transparency International's Corruption Perceptions Index, which is based upon the views of experts and business people, gave Indonesia a score of 40 out of a possible 100 in 2019, where 100 is very clean. The score is an improvement on recent years, but reflects Indonesia's continued struggle to change deeply entrenched practices of rent-seeking, graft and bribery.

The term 'corruption' refers broadly to the misuse of public office for private gain. Such terminology suggests public sector actors to be the agents of corruption. However, the intensity and character of corruption depends to a substantial degree on the incentives and constraints on those on the other end of corrupt exchanges: people in the private sector. In this report, we examine corruption from the perspective of Indonesia's business people.

Leveraging an original survey of 672 Indonesian managers and business owners, we set out to explore how different sorts of companies experience corruption. We investigate patterns of corruption at different administrative levels and across each of Indonesia's major economic sectors — agriculture, mining, construction, manufacturing, and financial services. Like any survey on corruption, we expected some of our participants to be ambivalent about admitting to engaging in or observing illicit activity (social desirability bias). However, while we cannot be sure of the absolute number of firms truly exposed to corruption, the variation we uncover allows us to draw reliable and important inferences about differential patterns of corruption across firms and sectors.

Overall we find that about one third of companies have been asked to make illicit payments to state officials — but that figure varies substantially across sectors. For example, a *majority* of companies in the mining and construction sectors have received these sorts of requests, compared to a small minority in sectors such as finance and manufacturing. Across a range of similar measures, sectoral differences matter for how companies engage in and view informal flows of money. Mining and construction stand out as especially afflicted by corrupt practices. Firms in these sectors experience the most requests for bribes. But they are also more likely to alter their financial reports, which we suggest is because hiding costs and profits is easier for firms in extractive sectors and construction than most other sectors, allowing them to make back the losses incurred due to state extortion. This argument implies that attempts by Indonesian policymakers and international organisations to diagnose, measure, and reduce corruption could more efficiently focus their programs on specific problem sectors.

1. Background: firms and corruption in Indonesia

Corruption is a major global challenge. Recent estimates put the cost of corruption at more than 5 percent of global GDP (US$ 2.6 trillion) with over US$ 1 trillion paid in bribes annually. Corruption reduces economic productivity, deepens inequality, and may even harm human health (Fisman & Golden, 2017, pp. 83-120; Holmes, 2015, pp. 18-35). Corruption potentially includes a vast set of actions, ranging from the illegal to the immoral. As different forms of corruption are likely to have different causes, for the purposes of our investigation, we focus on corruption in the business sector, which primarily includes bribery and extortion over the terms of market access, regulations, and effective tax rates. Corruption excludes actions, however illegal, that do not involve at least one party acting in an official capacity (Holmes, 2015, pp. 14-16).

Corrupt exchanges have characterised state-business relations throughout Indonesian history, but became especially endemic during the New Order. Under Suharto, bureaucrats were encouraged to treat their office like a “franchise”, building networks of private sector clients and personal associates for whom they facilitated lucrative government contracts, import licenses, or opportunities to partner with foreign investors (McLeod, 2011). The rents from such transactions made senior state officials immensely wealthy; but rents were also channelled upwards through the bureaucratic hierarchy. For the business community, opportunity and success often required close and personal relationships with bureaucrats, ministers, or the president himself.

The pro-democracy movement that forced President Suharto’s resignation in 1998 demanded an end to corruption and cronyism, and the reforms that followed brought greater transparency to state-business relations. New anti-corruption NGOs proliferated in the early years of Indonesia’s democracy, new laws were passed, and independent watchdogs were set up to investigate illicit economic activities and the misuse of public funds. The Corruption Eradication Commission (Komisi Pemberantasan Korupsi, KPK) in particular has been a major actor in efforts to reduce corrupt behaviour among political and economic elites. The Commission's sting operations led to 1,152 arrests between 2004 and 2019. Of those arrested, 297 came from the private sector.

Yet corruption remains endemic to Indonesia's post-authoritarian political economy. Democracy and decentralisation did not reduce corruption to the extent that reformists had hoped; instead, the political transition reshaped prevailing patterns of rent seeking and extortion. In post-Suharto Indonesia, companies interact with multiple levels of government, and the delegation of authority for many business licenses and land-use permits to local executives opened up new opportunities for corrupt exchanges between the private sector, district-level bureaucrats, local security apparatus, and criminal entities. Competitive elections created new incentives for politicians to extract rents from the private sector too, as electoral campaigns became increasingly expensive (Muhtadi, 2019). The effects of corruption in democratic Indonesia have been especially pernicious in the natural resource sectors, where collusion between companies and local state officials led to an explosion in the number of mining and palm oil permits, quickening the pace of deforestation and land degradation, and prompting new and sometimes violent conflicts in resource-rich regions (Burgess, Hansen, Olken, Potapov, & Sieber, 2012).

In response, activists, NGOs and the KPK have launched a wide range of programs to combat corruption between the state and private sector. In the natural resource sectors, for example, the KPK launched a series of investigations into corrupt practices in the mining industry, and worked together with NGOs and local activists across the country to make data public on irregular mining licenses and environmental permits. The KPK also turned its attention to corruption at the subnational level. Under the Jokowi administration, the number of local leaders arrested by the KPK has spiked: during President Yudhoyono's decade in power, the KPK arrested 45 district leaders or their deputies; between 2015 and 2019 alone, the KPK sent 74 district leaders to prison.

In general, however, the Jokowi government has emphasised preventative rather than punitive measures in the fight against corruption. The most powerful illustration of the president's aversion to the punitive and often disruptive approach of the KPK came in late 2019, when he approved a set of legal revisions that weakened the watchdog's investigative powers. Instead, Jokowi's reform program has focused primarily on reducing the layers of red tape and bureaucratic obstacles for investors, which create delays and incentives for payoffs. As a result, Indonesia rose 19 positions in the World Bank's Ease of Doing Business survey between 2017 and 2018. In the survey we conducted for this study (described below), we also found that 65 percent of business representatives felt the current regulatory climate helped rather than hindered their firm's operations.

But when it comes to reducing corruption, the results of Jokowi's approach are mixed. Indonesia has improved steadily on Transparency International's Corruption Perceptions index, moving up from 137th place in the world in 2005 to 85th in 2019. On other sorts of measures, however, there appears to be have been little change. For example, the volume of reports that the KPK receives from the public each year regarding potentially corrupt behaviour has, overall, remained relatively stable since 2004. Businesses have mixed opinions on the trajectory of corruption too. In the 2017 World Economic Forum's Executive Opinion Survey, companies reported corruption to be *the* most significant challenge for their operations in Indonesia. Yet, in the World Bank's 2015 Enterprise survey (which draws on a larger sample but with a more limited sectoral reach) just 13 percent of business people stated that corruption was a major constraint on their firm's operations. Such wide-ranging assessments not only underscore the difficulties inherent in measuring corruption, but also suggest that companies in Indonesia experience corrupt exchanges in very different ways.

This report contributes to efforts to better understand the nature of corruption in contemporary Indonesia, and to develop appropriate remedies. It looks specifically at how businesses experience bribery and extortion, and how those experiences differ depending on the sector, firm type, and on the different actors with whom firms interact. To achieve these objectives, we conducted a survey of Indonesian business elites.

2. About the Survey

In collaboration with the Indonesian Survey Institute (Lembaga Survei Indonesia, LSI), we administered a face-to-face survey with 672 business representatives between July 2019 and February 2020. The sample frame was designed to reflect the structure of the Indonesian economy in terms of sectoral contributions, the geographic spread of economic activity, and the size of the firms operating in each sector. The sample, therefore, is representative of companies operating in nine provinces (DKI Jakarta, East Java, West Java, Central Java, Riau, East

Kalimantan, North Sumatra, Banten and South Sumatra) and across the largest economic sectors that together contribute to approximately 70 percent of Indonesia's GDP (agriculture, mining, construction, manufacturing, financial services, and retail trade). This level of sectoral representation is rare. Other business surveys, such as the World Bank's Enterprise Survey, exclude agriculture and mining, and in doing so leave out two major arenas of economic activity in Indonesia.

The survey combines original questions with some that have been asked before in previous studies, allowing us to make comparisons over time. In formulating the questions, we use indirect phrasing techniques, such that respondents could avoid admitting to participating in illegal activities, which is a common approach when conducting surveys about such sensitive topics. For example, our questions often ask respondents to offer their observations on the behavior of companies in their sector generally. These efforts produced a relatively strong response rate, and the data offer unique insight into the nature of corrupt exchanges in contemporary Indonesia.

3. Findings

We first examine firms' responses regarding their experience of corruption, and their perception of the prevalence of corruption in their sector. Specifically, we ask respondents (1) how frequently their firm has been asked to pay illicit fees or bribes, (2) how frequently they have paid illicit fees or bribes; and (3) how common it is for firms in their sector to pay illicit fees or bribes. Overall, some 33.2 percent of firms report that they have been asked to pay fees outside the official requirements (i.e., extortion, facilitation, or security money), 30.6 percent report having paid such fees, 35.7 percent believe such illicit fees are commonly paid by businesses in their sector. These figures are marginally higher than results reported in the World Bank's Enterprise Survey from 2015, where 30 percent of Indonesian firms (in the manufacturing, service and retail sectors) stated they had experienced at least one bribe payment request.

Notably, responses vary significantly by industry. Table 1 breaks down the results according to sector. The highest proportions of firms reporting being extorted, paying bribes, and believing the practice is common in their sector (columns 1 to 3) are found in the extractive industries (47.9, 42.7, 53.1 percent) and in construction (49.5, 44.2, and 51.6 percent), while the lowest proportion of firms is in the financial sector (17.0, 16.0, and 22.3 percent). It is worth noting that in most cases (trade and logistics being the exceptions), the perceived incidence of corruption is higher than the reported experience of corruption.

Table 1 Percentages of Firms Experiencing Corruption by Sector:

	Asked for bribe	Paid bribe	Bribery present in sector	Pay over 2.5 % in bribes	Alter financial reports
	(1)	(2)	(3)	(4)	(5)
Agriculture	28.9	26.7	30.0	7.8	8.9
Extraction	47.9	42.7	53.1	5.2	15.6
Manufacturing	32.7	27.6	36.7	5.1	8.2
Construction	49.5	44.2	51.6	11.6	16.8
Trade	25.0	23.0	25.0	2.0	5.0
Logistics	31.3	30.3	31.3	7.1	12.1
Finance	17.0	16.0	22.3	1.1	2.1
Total	**33.2**	**30.1**	**35.7**	**5.7**	**9.8**

To estimate the magnitude of the corruption problem, we also asked firms to estimate the percentage of their revenues that is taken up by illicit fees and costs (column 4). The proportion of missing responses was higher (7.4 percent) than for the question that simply asked for the frequency of firms making such payments (3.1 percent).[1] The responses are highly skewed with most firms responding that they paid nothing in such costs. The majority of firms in all sectors reported paying no unofficial fees or costs, but 5.7 percent reported paying more than 2.5 percent of their revenue in illicit costs. Firms in the construction are again much more likely to report paying over 2.5 percent of their revenue in bribes (11.6 percent) than firms in other sectors.

We next asked respondents whether firms in their sector ever manipulate financial reports (column 5). Very few companies responded that such practices were commonplace (9.8 percent overall, with a non-response rate of 4.0 percent). Again, however, variation across sectors is revealing. Responses ranged from highs of 16.8 percent in the construction sector and 15.6 percent in the extractive sector to a low of 2.1 percent in the financial sector.

Next we set out to get a sense of the regulatory burdens and other operational challenges experienced by firms in Indonesia. We asked respondents whether they thought that the rules and regulations related to their line of business make their firm's operations difficult, whether they thought that the implementation of rules in their sector is consistent, and whether the security conditions in their sector are safe (from theft, for example).

[1] We recoded N/A responses as 0 if respondents answered "never" to the question of how frequently they had made illicit payments (column 2 in Table 1).

Table 2. Percentages of Firms Reporting Regulatory/Security Difficulties by Sector

	Regulations difficult	Rule implementation inconsistent	Insecure
	(1)	(2)	(3)
Agriculture	35.6	30.0	11.1
Extraction	31.3	36.5	9.4
Processing	35.7	32.7	6.1
Construction	43.2	32.6	23.2
Trade	29.0	20.0	7.0
Logistics	30.3	21.2	6.1
Finance	20.2	8.5	2.1
Total	**32.1**	**25.9**	**9.2**

We found that 32.1 percent of firms report that regulations make their operations difficult, 25.9 percent that rules are applied inconsistently, and 9.2 percent that security is a problem for their business (only 3.6, 3.4, and 0.3 percent of responses were missing). Again, however, responses differ substantially across sectors (Table 2). Firms in the construction sector are much more likely than average to report difficulties due to regulation (43.2 percent) and insecurity (23.2 percent). There is less variation in perceptions of rule implementation, although firms in the financial sector are less likely to report issues than those in other sectors (8.5 percent).

The results reported here are raw percentages. It is possible that additional factors such as firms' size or profitability confound these relationships. That is, if firms in the mining sector are simply more profitable, then it would make sense for corrupt officials to target their activities in this sector. It is also possible that some local governments are more poorly run than others. In the academic paper that accompanies this report we run multivariate regression analyses that control, not only for additional firm characteristics, but also hold constant a firm's region (Kenny & Warburton, 2020). The sectoral differences persist even with these more robust modelling choices. We find that firms in extractive and construction industries are substantially more likely to report being asked for and to admit paying bribes to government officials.

These sectoral differences reflect, in many ways, global patterns of corruption. Mining and other resource extraction industries, especially in middle-income and developing countries, are particularly vulnerable to corrupt practices on the part of firms, politicians and bureaucrats. Analysts have long argued that natural monopolies, such as in petroleum oil extraction or timber logging, provide opportunities for rent extraction on the part of government agents (Ross, 2001). Additionally, all around the world, from developed to developing countries, construction sectors are notoriously corrupt and present state officials with opportunities for kickbacks and bribes (Reuter, 1987). In Indonesia, previous research has shown that construction and public infrastructure is especially prone to corruption (Aspinall & Van Klinken, 2011; Olken, 2007). The state issues crucial licenses and plays a substantial regulatory role in these sectors, making them more prone to rent-seeking on the part of state officials as well. Firms also benefit directly from engaging in corruption (access to licenses and permits, for example) and thus have strong incentives to invest in corrupt exchanges, especially in developing countries where autonomous judicial oversight is weak (Olken & Pande, 2012).

What our survey suggests, however, is that extractives and construction share another feature that has so far been overlooked in studies of corruption. The fact that firms in these two sectors are much more likely to alter their financial reports indicates that, potentially, hiding firm profits is easier and more common. Specifically, both the construction sector and natural resource industries are characterised by bespoke (as opposed to standardised) and uncertain inputs and outputs. This in turns make manipulating reports and hiding revenue from auditors much more viable. Firms in these sectors can thus 'make back' the losses incurred through bribery and extortion.

For example, Indonesian construction firms typically pay "arranger fees" to state officials on a project tendering committee, and to other individuals that can influence the tendering process, like local government leaders, parliamentarians and senior members of political parties (Aspinall & Van Klinken, 2011). Then, in order to "*menutup biaya*" or "make back" the losses associated with those illicit fees, firm managers will collude to inflate the costs of construction material, services from subcontractors, equipment and the like. Also common is the reporting of "*pekerjaan fiktif*" or "fictitious work", where a construction company pays subcontractors for incomplete or substandard work, or for the procurement of goods that were never used or were used in a smaller volume. An investigator with the KPK noted in an interview with the authors that monitoring and uncovering cost inflation for substandard work or incorrect volumes of concrete and other inputs is immensely difficult. Detecting fictitious work is more feasible, but the practice is so common it is almost impossible to police effectively across the sector.[2]

Similarly, mining inputs are often bespoke. Each mineral, oil or coal deposit is different, such that estimating and monitoring the real costs of constructing a mine in a given location is immensely difficult, making this phase of an extractive project ripe for financial manipulation (McPherson & MacSearraigh, 2007). Unreported production can then be diverted onto the black market beyond the purview of tax collectors. Such illicit production is difficult to uncover. But the Indonesian government estimates, for example, that some 30 to 40 million tons of unreported coal gets exported from the country's shores each year (Indonesia Investments, 2014). For these reasons, we suggest extractives and construction are more systematically targeted by state actors for extortion compared to other sectors of the Indonesian economy, in part because firms in these sectors can more easily conceal their true profits, and recover the costs associated with state extortion.

4. Investing in reform

Firms engage in corruption because paying bribes 'gets things done' in the short term. But research shows that the firms which pay bribes lose time, suffer greater inefficiencies, grow more slowly, invest less, and their profits suffer too (Svensson, 2005). And, especially for large global firms, bribery constitutes a serious legal risk. It follows that firms might be willing to invest in institutional remedies that can ease the financial burden associated with bribery.

Like most Indonesians, business people in our survey expressed immense trust toward the KPK as the (once) independent body tasked with investigating and prosecuting corruption cases. In our survey, over 85 percent stated they trust or very much trust this institution. So, we asked respondents whether they would be willing to increase their tax contribution if it meant that demands for informal payments would be eradicated via a program instigated by the KPK. Specifically, we gave respondents the following scenario:

[2] Interview with former KPK commissioner, 16 August 2020.

Imagine that the World Bank and the KPK are implementing a new program that aims to stop bribery and extortion between the private sector and government. Experts believe the program will succeed. However, to finance the program, the government needs to increase the corporate tax rate. How much additional corporate tax is your company willing to pay if bribery and extortion can be eliminated?

The non-response rate to this question was 14.9 percent. 32.3 percent of firms reported a willingness to pay some additional taxes to reduce corruption, while 52.8 were unwilling to pay anything. 14.3 percent were willing to pay less than 1 percent more, 7.4 percent were willing to pay between 1 and 2.5 percent more, and 10.6 percent were willing to pay more than 2.5 percent. There is some variation by sector. In Table 3, we convert the willingness to pay for reform into a binary variable, with any value above 0 reclassified as 1. Firms in the extractive (41.7 percent) and construction sectors (39.0 percent) are the most willing to pay some additional taxes towards reform. Notably, however, firms in the financial sector are also more likely to respond positively to this question (36.2 percent) even though they are the least likely to experience extortion in the first place.

Table 3: Percentages of Firms Willing to Increase Tax Burden for Corruption Reform

Sector	Willing to pay for reform
Agriculture	27.8
Extraction	41.7
Processing	24.5
Construction	39.0
Trade	24.0
Logistics	33.3
Finance	36.2
Total	**32.3**

5. Conclusion

This report makes two principal observations about the nature of corruption and state-business relations in Indonesia. First, our survey shows that in Indonesia the intensity of corruption varies from sector to sector. As in many parts of the world, Indonesia's construction and extractive sectors are especially prone to bribery requests from state officials. These two sectors alone accounted for almost 20 percent of Indonesia's GDP, and so the leakage of corporate profits has potentially broader economic implications for the Indonesian economy.

Importantly, firms in these sectors were also more likely to manipulate their financial reports and hide their true costs and profits. Qualitative evidence of how corrupt transactions operate in these sectors of Indonesia's economy substantiates our theorized mechanisms. We show how business in each sector is characterised by bespoke inputs and uncertain outputs, which are difficult to measure and monitor. As a result Indonesian firms in these sectors can and do routinely manipulate and conceal what they spend and what they produce. Certainly, companies in other industries would engage in similar tactics to try to avoid taxation by hiding portions of their profits. But construction and primary commodities — in particular extractives — are especially prone to predation by state actors because firms in these sectors can potentially hide their true revenues with greater ease.

What do these findings mean for measuring corruption generally, and for anti-corruption policy in contemporary Indonesia specifically? First, measuring corruption at the national scale, and making cross-country comparisons based on those state-level observations, might produce misleading characterisations of the nature of corruption in a country such as Indonesia. Transparency International's Corruption Perceptions Index and the Global Corruption Index by Global Risk Profile, for example, allocate states an overall score when it comes to the intensity of illicit economic activity. Empirical differences between economic sectors are usually lost in these aggregated indexes; yet such differences are potentially critical for designing appropriate anti-corruption interventions.

Second, our results suggest a role for more investment in sector-level monitoring agencies and watchdogs. As discussed at the opening of this report, the Jokowi government has, overall, chosen to pivot away from patrolling and punishing corruption, and instead emphasised preventative measures such as cutting red tape and improving permitting processes. Such interventions have probably reduced firms' exposure to bribery and rent-seeking. But the government's approach has also drawn much criticism. A new law introduced in late 2019, for example, reduces the investigatory powers of the KPK, and undermines the body's independence by bringing it under the auspices of a politically appointed supervisory body. This strategy, Jokowi hopes, will relieve investors and firms from the burden of bribery, while avoiding what he views as politically disruptive investigations by the independent watchdog.

Our data, on the other hand, suggest that firms would embrace more independent monitoring and enforcement. Indonesian business people trust the KPK, and in sectors most afflicted by corruption, firms are willing to invest in the work of an independent watchdog such as the KPK. Our results suggest, therefore, that Indonesia's anti-corruption interventions should *be designed at the sector level,* should be led by an independent KPK, and should engage with the major business actors in each sector.