

# **The political economy of corruption in Indonesia**

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Despite the emergence of free and competitive elections, significant governance problems persist in Indonesia. By some measures, perceptions of corruption have actually deteriorated since the Suharto regime. These perceptions are subject to multiple sources of bias that render interpretation difficult. Still, the smoke – perceptions of corruption – is indicative that corruption fires are still burning. It is indicative as well that the quality of government decisions and services must also be suffering, whether in health and education or law enforcement and financial regulation, since corruption is routinely associated with deficient government performance. This report presents an attempt to unravel the puzzle of corruption in Indonesia, puzzling because the perceptions of corruption in Indonesia remain far above those in other democracies, and puzzling as well because high levels of corruption persist despite the increased electoral leverage that the general public has over the government officials who can control corruption.

Many observers argue that there is no puzzle: Indonesian democracy operates within a clientelist environment that provides few incentives for political decision makers to attack corruption or to improve government performance more generally. This report endorses that view, but extends it in several ways that are critical for the design of policy. First, discussions of the role of clientelism in Indonesia generally do not account for these alternative causes of corruption; the analysis that follows does this. As numerous analyses of corruption around the world have observed, corruption is exacerbated by numerous factors, ranging from poverty to the shape of formal political institutions to the time horizons of political leaders.

Second, this report points to specific reasons for the prevalence of clientelism in Indonesia. These have to do with the inability of political competitors in Indonesia to make credible pre-election promises to voters on any issues but two: the provision of private or narrowly targeted goods and services, and promises related to a candidate's or party's stance on the spectrum from purely secular to strongly Islamist. The first set of promises are at the core of clientelist political relationships, but are because of that credible only to a few voters – these are the voters with whom political competitors have had long personal associations that make the promises credible. The second set of promises are credible to more voters, but limit the extent to which electoral competition can drive elected officials to improve the provision of public services, the efficiency and equity of government spending, or the extent of corruption.

Third, by explicitly addressing the role of formal institutions and the nature of clientelist political relationships, the analysis in this report generates insights about the implications for corruption of different political and electoral reforms are the subject of ongoing debates in Indonesia. For example, the expectation of some advocates is that reforms such as plurality voting should make political decision makers more responsive to voters; one might imagine that responsiveness to voters would have implications for corruption. The report discusses the case for and against these reforms in the context of corruption and clientelism.

Two points are taken for granted in the report. First, vested or special interests play a key role in the pervasiveness and persistence of corruption. Second, the only sustainable solutions to corruption emerge when elected legislative and executive branch officials embrace them. Political enthusiasm to curb rent-seeking and corrupt behavior by politicians

and public officials waxes when corruption dominates the electoral calculations of voters and wanes when voters' attention is on other matters. If politicians see little political gain to attacking corruption, it is unrealistic to expect the public administration to sustain an effective anti-corruption program.

The analysis in this report therefore focuses on the incentives of elected officials in order to answer the following questions: What are the characteristics of the political economy of Indonesia that make vested interests particularly influential, relative to other democracies? Why has their pernicious influence persisted in the transition from autocracy to democracy? And why have the two most powerful groups of Indonesians in the Suharto era, the military and the conglomerates, retained substantial influence in the democratic era?

This report also relies strongly on a methodology that is somewhat unusual in the examination of corruption and its causes. Many discussions of corruption and clientelism in Indonesia – and in other countries – focus on the peculiarities of each country. To some extent, of course, it is undeniable that each country has unique characteristics that must be taken into account in understanding corruption and designing reforms that reduce corruption. It turns out, however, that most analyses of this type end up discussing many of the same features of countries, and that some of these can be quantified and systematically compared from country to country.

By statistically comparing such characteristics as income, levels of ethnic tension, political institutions, and the years that countries have held competitive elections, the analysis in this report gains some leverage in making somewhat more precise projections about some the relative contribution of each to corruption outcomes. For example, the extent to which the age of the Indonesian democracy, the large size and population of the country, its income, or the status of relations between ethnic groups cause corruption can all be quantified to a reasonable degree. Since policy recommendations should differ depending on which of these is the predominant cause of corruption, it is crucial to establish the relative importance of each. The cross-country statistical methodology provides a convenient and plausible way to do this. Still, the specific characteristics of Indonesia are considered in detail throughout the analysis.

The evidence presented below on the political economy of corruption in Indonesia relies on both cross-country statistical comparisons and specific information from interviews and other sources in Indonesia. The evidence suggests that corruption is strongly related to four characteristics of Indonesian democracy that make it susceptible to corruption.

- First, the under-development of democratic institutions and the corresponding prevalence of “clientelism” weaken electoral discipline on political decision makers. Indonesian democracy can be said to date only from the 1999 elections, not enough time for the political process to mature and for clientelist motivations in politics to be displaced.
- Second, the time horizons of most politicians, particularly legislators, have shortened since the Suharto era. Until the end of the Suharto era, few key decision makers, beginning with Suharto himself, expected to lose power in the near future. With the advent of democracy and the still unsettled nature of electoral institutions, legislators and even the highest party leaders confront a higher probability of losing power.
- Third, decision making has not only splintered since *Reformasi*, but responsibilities are

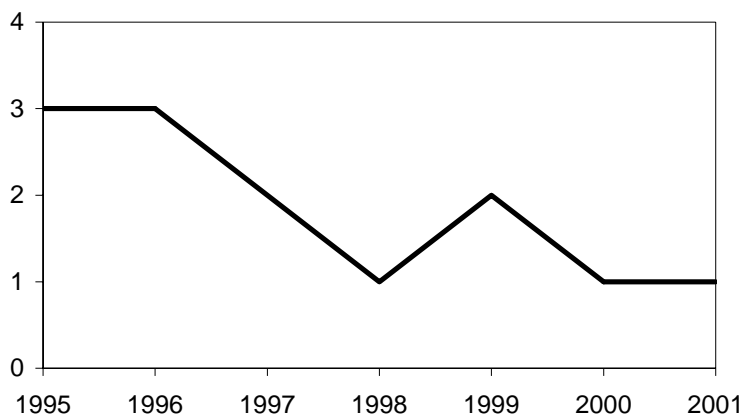
diffuse and opaque from the point of view of voters. Voters are less able to hold individual parties or legislators responsible for outcomes, leaving parties and legislators with fewer incentives than similarly situated legislators in more developed democracies to rein in corrupt behavior by government officials.

### **Perceptions of corruption in Indonesia since the return of democracy**

The discussion in this report relies on both cross-country analyses of corruption and information from Indonesia specifically. These tend to coincide in claiming that corruption in Indonesia is as pervasive as or even worse than it was under Suharto. One example of this comes from Political Risk Service's *International Country Risk Guide*, which contains the corruption indicator with the widest country coverage over the longest time period. The ICRG consists of ratings on elements of the investment climate in countries ranging from the rule of law and contract enforcement to corruption and bureaucratic quality. These ratings are generally sold to foreign investors, but in addition have been used in many academic studies of the determinants of economic growth and investment across countries. The corruption indicator in *International Country Risk Guide* is a variable coded from 0 to 6, with 6 representing *least* corruption. For more recent years, corruption ratings from Transparency International are also taken into account.

From these data, it is clear that the general perception of Indonesia is that the effect of corruption on business has grown worse since the transition to democracy. Figure 1 provides evidence from one foreign investor risk advisory service of the evolution of corruption in Indonesia since 1995. It indicates that perceptions have deteriorated, consistent with the opinions of nearly every close observer of private sector activity and of every private firm with whom interviews were conducted for this report.

**Figure 1: The Evolution of Corruption Perceptions, Indonesia, 1995 - 2001**



Note: Political Risk Services Corruption Index, 0 – 6 scale, higher implies less corruption.

These data must be interpreted with care since most subjective corruption indicators and opinions tell us not that the incentives of government actors to be corrupt have increased, which is the subject of this report, or that the extent of corrupt decision making by government has increased. Instead, they tell us that the negative effects of corrupt behavior on business and investment decisions have increased. In fact, the Suharto era was likely one in which government incentives to be corrupt were very high, the value of corrupt

transactions enormous, but the effect on business decisions somewhat less.

In the Suharto era, businesses believed that if they paid a \$1,000,000 bribe they would get a high return on their investment because the underlying agreement that they could enter a market, enjoy a monopoly, or be exempt from particular regulations was credible and the rents that the monopoly or regulatory privilege delivered were high. Since Suharto, the rents available have fallen, as has the the credibility of corrupt transactions. Even if officials were now demanding a smaller bribe in exchange for the same entry or regulatory privileges, firms are be less likely to believe that the transaction is credible. They might therefore perceive greater damage to the firm from a bribe of only \$100,000 than the much larger bribe during the Suharto era.

### ***Changing rules of the game regarding corruption in Indonesia***

The credibility of corrupt deals has fallen for two reasons: deals struck while Suharto was in power are being called into question; and current deals are proving to be unreliable. In some cases, changes in the rules of the game have been for the better, but would be regarded as negative for incumbent private sector firms (causing a deterioration in their perceptions of corruption). For example, all those firms that had stable arrangements with the Suharto government are now faced with the collapse of those arrangements. In some cases, this collapse is warranted: for the hugely privileged cronies, the transfers that occurred under the large bank bailouts in the late 1990s were the last significant rents that they received from the state. Many observers report that they now have to pay a stream of bribes to politicians to minimize the prosecutorial effort to recoup BLBI losses. Importantly, those bribes are not expanding the scope of rent-seeking, as would have been the case earlier, but slowing the decline in rents.

In other cases, the collapse of the rules is unwarranted and highly damaging, both for the private sector and for Indonesia as a whole, as the notorious Manulife case demonstrates. Here, a Canadian insurance company whose Indonesian subsidiary is the largest private insurance company in the country has been subjected to severe harassment, including assaults on the wife of the highest ranking expatriate company officer and the jailing of company officers, including a months-long stay in the Jakarta city jail for the highest ranking Indonesia officer of the company.

The company entered the Indonesian market under the Suharto rules of the game, with a local partner. The economic upheaval threatened the local partner with bankruptcy in many of its ventures and it was forced to auction off its stake in Manulife-Indonesia, an auction that Manulife itself won. The former local partner has teamed with police, judges and prosecutors to attempt to extort millions from Manulife with transparently illegitimate claims of fraud against the Canadian company, threats that are ongoing and unresolved. For example, despite the huge damage the case has done to Indonesia's image among foreign investors, the prosecutor's office persistently refused to issue a notification clearing Manulife, thereby permitting continuing harassment by government officials. None of this would have occurred under the Suharto regime, precisely because the regime would have recognized instantly that such attacks on a multinational would drastically reduce its ability to collect rents in any future agreements with multinationals.

Other, more recent cases of the breakdown in the rules of the game emerge from the energy sector. The long-established and largest mine on the east coast of Borneo, PT Kaltim

Prime Coal, a joint venture of BP PLC and Rio Tinto PLC, is required to offer a 51 percent stake in the mine to local joint venture partners. Some of the same local players are involved as under the Suharto regime. For example, a nephew of the founder of the Salim Group has formed close ties with the provincial government of East Kalimantan and is seeking to force Kaltim to sell the stake to the nephew's company, using court action in Jakarta to sequester the mine's assets until the issue is resolved.<sup>1</sup>

While corruption incentives of key political actors may not have increased, there is no evidence that they have declined. At the same time, there are two key differences from the Suharto era: first, the rules are changing on a large and established investment; second, the players are shifting and unstable – for example, the provincial government is now an important player, and there is no central authority that can clearly push back its claims; third, the way in which the new players seem to operate does not seem to reflect the “rule of law”.<sup>2</sup>

Independent power production was a rich source of rents under the Suharto regime, with the Indonesian government agreeing to extremely lucrative take or pay contracts with the IPPs. Here, as well, is substantial evidence about the changing rules of the game, but arguably towards better rules, even if incumbent private sector participants find them damaging. With the economic crisis, the government lost its ability to pay for the output of the IPPs at exaggerated contracted rates; with the departure of Suharto, the local joint venture partners who were meant to ensure the credibility of these contracts were no longer useful. In 1998, therefore, the government suspended approximately \$16 billion worth of generation projects, contracted with 27 independent power producers. Since then, seven have renegotiated their contracts, four have dropped the projects entirely, with another two likely to do so, but several have sued for damages. Among the more notorious examples of those that have sued for damages is Karaha Bodas, 10 percent owned by the son of a Suharto vice president (Sudharmono) and 80 percent owned by American partners. This company has succeeded in freezing over \$100 million of US-based assets of Pertamina in satisfaction of claims against Pertamina for \$261 million because of the suspension of a geothermal project.<sup>3</sup>

The reluctance of the Indonesian government to fulfill these contracts is understandable, given the questionable circumstances under which the contracts were negotiated. At the same time, though, foreign investors perceive the abrogation of the contracts as a threat to the rule of law in the country, contributing to perceptions of increased corruption. Strictly speaking, the IPP-Suharto government agreements are binding

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<sup>1</sup> On July 31, 2002 as this report was concluded, the *Wall Street Journal* reported that the provincial government had accepted a settlement with the central government and the foreign investors, in which the foreign investors would sell a 31 percent stake in the company to the provincial government, and had dropped its court case. However, Indonesian news sources reported on August 1, 2002 that the provincial government had rejected this settlement.

<sup>2</sup> Details from *The Wall Street Journal Online*, April 9, 2002, “Foreign Investors in Indonesia Battle Lawsuits and Corruption,” by Timothy Mapes and Tom Wright.

<sup>3</sup> Details from *Far Eastern Economic Review*, “In Contempt: A foreign firm gains ground in court case”, April 18, 2002, reported in castleasia website, [www.castleasia.com/headlines/berita.php3?ID=880](http://www.castleasia.com/headlines/berita.php3?ID=880) and the *Jakarta Post*, “IPPs committed to renew deals,” April 2, 2002, from [www.corfina.com/financial\\_news/april\\_02/april\\_2\\_02.htm](http://www.corfina.com/financial_news/april_02/april_2_02.htm).

on post-Suharto governments, and multiple international courts and arbitrators have so ruled. Because each of these disputes is almost surely accompanied by demands for informal payments from the IPPs to facilitate their case before Indonesian authorities, it then becomes clear why perceptions of corruption have deteriorated.

### ***Publicity and perceptions of corruption***

Independent of political incentives to engage in corrupt acts, perceptions of corruption may have also deteriorated because of greater public knowledge of those acts. Since *Reformasi*, the press has been unleashed, and reporting on corrupt deals is far more prevalent than under Suharto, where a tight lid was kept on the exposure of illicit deals involving the Suharto family and cronies. New innovations, such as the Audit of the Wealth of Public Officials and the Ombudsman have also increased awareness of corruption.

At the same time, political competitors now find it convenient to use the threat of corruption prosecutions to gain political advantage. An awareness of this has led politicians to bring new cases of corruption to light, and has led judges to exercise greater oversight than was previously the case. The judges who recently ruled against Manulife in one of the many legal turns in that story are being investigated for corruption by another panel of judges. The sale of assets by IBRA, the repository of assets transferred from liquidated banks, has been slow and contentious because of newly emergent checks and balances in the system, in which competing political actors resist policy decisions that might result in disproportionate rents flowing to competitors. The slow but persistent attention paid to the diversion of Bulog funds for Golkar campaign activities, to the Indonesian army's role in the violence of East Timor, are also evidence of a new, albeit politicized attitude towards deviations from the rule of law.

These are all positive steps that would have been impossible under Suharto. The impact of these changes on actual corruption is unclear, however, and they provide sparse evidence that a sea change in the political incentives of politicians to fight corruption has occurred. There is, certainly, no evidence of a sustained and widespread change in the judiciary or the public administration either with respect to corrupt practices or the predictability of regulatory decisions and the rule of law. Nor have these changes yet convinced investors or Indonesians generally that a new, stable set of rules of the game have replaced the old, leaving perceptions of corruption unchanged or worse.

### ***Using corruption perceptions as an indicator of government incentives to fight corruption***

Changing rules of the game and increased publicity surrounding corruption provide two explanations for the sharp deterioration in corruption perceptions recorded in Figure 1. The analysis here, though, employs the corruption assessments underlying Figure 1 to track the incentives of elected officials to fight corruption, rather than to measure the impact of corruption on business behavior. There are two justifications for this. First, although corruption perceptions are a noisy and unreliable way to measure small changes in the incentives of public officials, they do convey meaningful information about large changes. An easy way to see this is to ask what corruption perceptions would be if public officials had no incentives whatsoever to undertake or to tolerate corrupt acts. In this case, there would

be no corruption, and corruption perceptions would have to mirror corruption incentives.

Second, though, one of the underlying reasons for the changing rules of the game should be expected to change political incentives, as well. The shortened horizons of political decision makers since the emergence of competitive elections have not only disrupted the credibility of corrupt agreements. They have also increased the incentives of decision makers to make larger corrupt demands in the present rather than postpone them until the, now more uncertain, future.

### Free elections and corruption

One puzzle that motivates this analysis is continued high corruption incentives despite the introduction of free elections. Corruption universally implies rent-seeking by public officials at the expense of the general public. The public confronts lower costs of disciplining such officials when elections are free than when there are no elections. All else equal, then (though it rarely is), corruption should therefore fall in the presence of free elections.

In fact, the evidence suggests that it does. Figure 2 shows that corruption is almost one point higher, on a six point scale, in countries with less than fully competitive legislative elections.<sup>4</sup> Of course, this relationship could arise for many spurious reasons. Democracies, for example, tend to be richer than non-democracies. However, even controlling for numerous other possible explanations of corruption, ranging from income and “neighbor” effects to colonial heritage, land area and demographic characteristics, the competitiveness of either legislative or executive elections are a significant contributor to cleaner government.<sup>5</sup>

Under Suharto, elections to the DPR were moderately competitive. However, the method of election of the President was not at all competitive. The electors were the members of the MPR, which included the DPR plus many others, whom Suharto essentially chose himself. In 1997, therefore, the competitiveness of executive elections in Indonesia is assessed as two. The regime change in Indonesia shifted executive elections to the most competitive category, or seven. Using estimates of the effect of electoral competitiveness on corruption that control for the many other influences noted above, one would have expected that corruption would have improved with the introduction of free elections in Indonesia by

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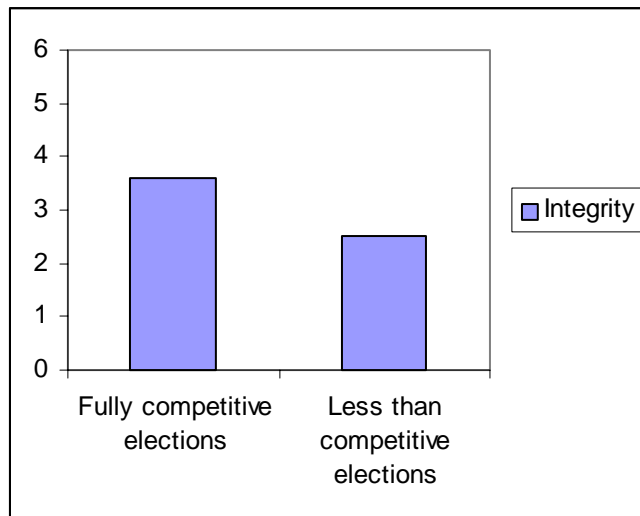
<sup>4</sup> That is, almost one standard deviation. The magnitude of the effect drops somewhat when one takes into account country per capita incomes, but is still very significant (a change from less than fully competitive to fully competitive elections increases integrity in government by 0.59 points on the six point scale). Fully competitive elections are those for which the legislative index of electoral competitiveness, from the *Database of Political Institutions*, equals seven, the highest score, given to countries in which there are multiple parties or candidates competing and none gets more than 75 percent of the vote.

<sup>5</sup> In a regression on 113 countries, using only 1997 values, yielded:  $corruption = (.000049 * \mathbf{GDP/capita}) + (-5.63e-08 * \mathbf{land\ area}) + (-5.98e-10 * \mathbf{total\ population}) + (.51 * \mathbf{fraction\ of\ the\ population\ under\ the\ age\ of\ 16}) + (-.91 * \mathbf{fraction\ of\ population\ of\ working\ age}) + (.0025 * \mathbf{colonial\ heritage}) + (\text{effects of Africa, Mideast, East Asia, Latin America, South Asia and Eastern European continent dummies}) + (.06 * \mathbf{ethnic\ tensions, a\ 0-6\ variable\ from\ Political\ Risk\ Services}) + (.14 * \mathbf{executive\ index\ of\ electoral\ competitiveness})$ ,  $R^2 = .51$ , bold-faced variables significant at .10 or less. Results are insensitive to the use of a much larger sample covering the years 1982 – 1997, with either an OLS or fixed effects specification.



0.7 on a six point scale, or one-half of a standard deviation. Even taking into account that ethnic tensions also increased in the period following free elections, falling from three to two on the Political Risk Services 0 – 6 ethnic tensions scale, the experience of other countries suggests that Indonesia should have exhibited a marked decline in corruption with the emergence of democracy.

**Figure 2. Integrity in government and competitive elections, 1997**



Note: Fully competitive elections are those for which the legislative index of electoral competitiveness, from the *Database of Political Institutions*, equals its highest score, seven, given to countries in which there are multiple parties or candidates competing and none gets more than 75 percent of the seats in the legislature. 90 countries had fully competitive elections; 35 had less than fully competitive elections in 1997. Integrity is measured using the corruption indicator of Political Risk Services *International Country Risk Guide*, where the highest score (least corruption) is 6, and the lowest (most corruption) is zero.

That there has been no notable change in corruption or corruption incentives suggests either that the Suharto autocracy was much less corrupt than the average non-democratic system, or that the post-Suharto democracy has been more corrupt. Each of these possibilities is examined in the following sections. In these, the specific determinants of corruption incentives in non-authoritarian and democratic countries are examined.

### **Corruption in authoritarian governments**

Unlike the average democratic government, the dynamics of electoral competition and the formal institutions of political decision making matter less in authoritarian governments. Instead, incentives regarding corruption are more directly related to the role of corruption in retaining support, the extent to which the military acts without restraint, the popular support of the authoritarian leader and, related to all of these, the time horizon of authoritarian leaders and whether they expect to be thrown out of office sooner rather than later. In each of these, Indonesia seems to have been unusual, with a single leader with a long tenure in office and with strong connections to the military.

Many relevant characteristics of dictatorships cannot be easily assessed, nor their relative contribution to corruption weighed. However, several can. In particular, data is

available to examine the contributions to corrupt outcomes of the longevity of authoritarian leaders in office, the role of the armed forces in the government of a country and the extent to which authoritarian leaders confront pressures to move towards more democratic forms of government, as seen by whether they permit competitive legislative elections, can also be weighed. Each of these is relevant in the case of Indonesia, since the Suharto regime was characterized by the unusual duration of the authoritarian leader, the close relationship of the leader with the military, and the willingness to allow a legislative body to exist, for which elections were nearly competitive.

The longevity of a leader in office captures numerous effects, not necessarily moving in the same direction. Clague, et al. (1995) show that past tenure in office bears a significant relationship to future tenure: a leader who has been in office for a longer period of time is therefore likely to have a longer horizon. The longer a leader's horizon, the less likely the leader is to extract excessive rents in the near term or to renege on corrupt agreements since the costs of such actions will be borne by the leader in the future, in the form of reduced investment and rents. However, long tenure in office also captures the extent to which a leader has consolidated power and is able to extract funds without restraint.<sup>6</sup>

The influence of the military in an authoritarian government is also unclear, *a priori*. If the military is dedicated to self-aggrandizement, then if the head of government and the defense minister are both from the military suggests that corruption should be unbridled. On the other hand, a disciplined military operating outside of an authoritarian civilian government might constitute a check on corrupt behavior by the government.

Finally, we would expect that multiple, non-political characteristics of countries to affect corruption outcomes. For example, one might expect the effects of political variables to be mediated by the wealth of a country and whether it is primarily rural or urban. Activities such as vote-buying that are frequently associated with corruption are more attractive political strategies when voters are poor. The poor may also be less informed about political alternatives and the contributions of individual candidates and parties to policy outcomes that affect them. This raises the demand for candidate and party financing to "inform" such uninformed voters, financing that is obtained from special interests in exchange for favors. Authoritarian leaders are not immune from these incentives, however. The more popular they are, the more difficult it is for armed opponents to mobilize support against them. It is easier for an authoritarian leader to secure support with small transfers to individuals in poorer countries. Independent of their political regime poorer countries should therefore exhibit more corruption.

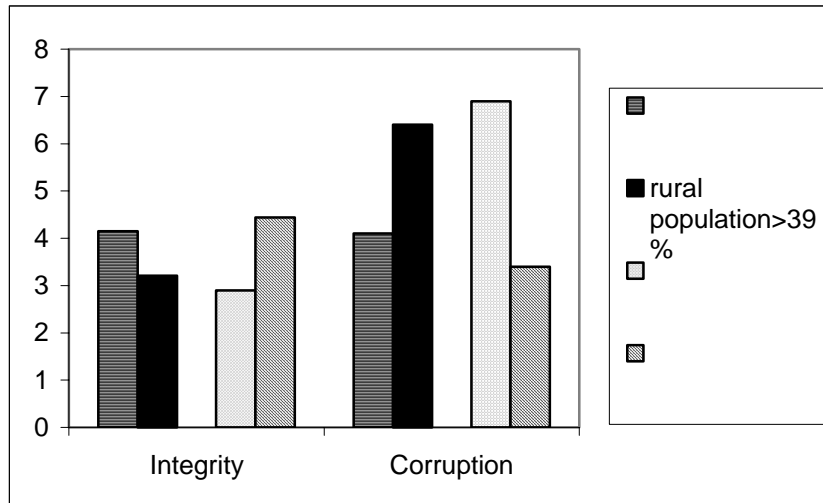
Rural voters, for their part, are likely to be more isolated. In democracies, this means that it is more costly for them to vote, so to mobilize their rural supporters candidates must expend more resources. Second, campaigns themselves – creating supporters – are more expensive. More expensive elections lead candidates to make deals with special interests: campaign finance in exchange for policy concessions. Finally, because of their dispersion, rural voters are less likely to be presented with multiple credible candidates than are urban voters. Politics may be less competitive in rural areas, therefore, further exacerbating corruption. Authoritarian leaders, for their part, are typically more successful in rural areas;

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<sup>6</sup> This suggests that one allow for the effects of tenure in office to be non-linear (as in  $\beta_1 \text{tenure} + \beta_2 \text{tenure}^2$ ), such that initially, additional years in office worsen corruption, and only later do they improve it.

Suharto himself spent considerable resources on transfers to rural residents in Indonesia.

**Figure 3: The rural-urban divide and income affect integrity and corruption**



Note: Integrity is Political Risk Service's corruption measure (higher is less corrupt); Corruption is from Transparency International. The countries were divided so approximately one half (40 countries in each half) were above and below the thresholds given in the legend.

The simple correlations in Figure 3 provide support for both of these arguments. Using either of two corruption ratings, poor countries are significantly more corrupt than rich countries. Similarly, countries in which a higher proportion of the population is classified as living in rural areas seem to offer more fertile ground for corruption. Indonesia is therefore vulnerable to corruption since it is both poorer and substantially more rural than average.

Statistically controlling for all of these influences, institutional and non-institutional and political and non-political, reveals that years in office has a significant effect, first worsening and then improving corruption outcomes in authoritarian governments. This can be seen in the first two rows of Table 1. Military control of government has a significantly negative effect on corruption (military control, on average, is associated with corruption that is 0.51 worse than it otherwise would be on a six point scale), as do ethnic tensions (a one unit worsening of ethnic tensions leads to a .22 increase in corruption).<sup>7</sup> The non-political variables, though, related to the demographic, geographic and income characteristics of countries, exhibit little significant impact on corruption. This is important for reform purposes, since it suggests that there is nothing inevitable about high levels of corruption.

<sup>7</sup> Using a procedure that controls for fixed effects, which eliminates the effects of omitted, country-specific characteristics that are constant through time, the *tenure in office* results remain unchanged; the competitiveness of legislative elections becomes much more significant and the significance of the military variable drops. The latter effect is doubtless due to the considerable intra-country turmoil that typically emerges when military governments replace or are replaced by civilian and/or democratic governments.

**Table 1: Determinants of corruption in non-democracies**

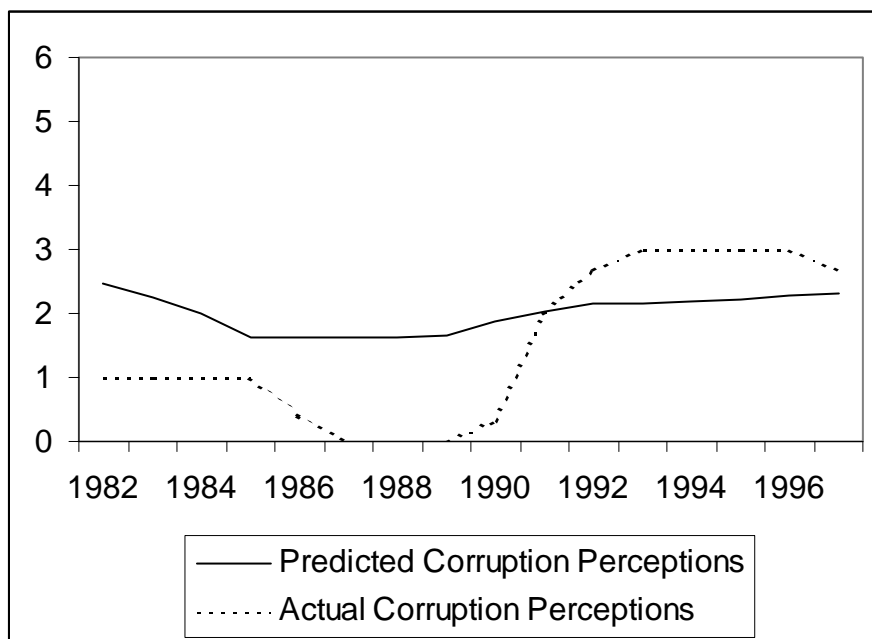
Dependent variable: Corruption (Political Risk Services)	
<b><i>Tenure in office</i></b>	<b>-.057 (.10)</b>
<b><i>Tenure in office</i><sup>2</sup></b>	<b>.0013 (.17)</b>
<b><i>Head of government and defense minister from the military (1 – 0)</i></b>	<b>-.51 (.03)</b>
<i>Competitiveness of Legislative Elections (1 – 7)</i>	.028 (.55)
<i>Ethnic tensions (0 – 6)</i>	.22 (.003)
<i>Income/capita (PPP-adjusted, times 10,000)</i>	.11 (.78)
<i>Land area (times 1,000,000)</i>	.11 (.35)
<i>Total population (times 1,000,000)</i>	-.0012 (.26)
<i>Percent population rural</i>	-.36 (.66)
<i>Percent population young</i>	-2.04 (.39)
<i>Percent population working age</i>	1.46 (.61)
<i>Colonial Heritage</i> <sup>8</sup>	
R <sup>2</sup>	.37
Number of observations/countries	717 / 77

Note: Only countries for which executive elections were non-competitive or non-existent (less than 7 on the EIEC scale) are included. The number in parentheses indicates the probability that the coefficient is actually zero (the lower the number, the more reliable the estimated coefficient). The regression also includes regional dummy variables; the East Asia dummy variable is significant and positive – East Asian countries are perceived to be less corrupt than one would expect, given the other measurable characteristics of these countries. Coefficients were estimated using ordinary least squares. Clustering is used, so that intra-country observations are not considered independent of each other. Political data from the Database on Political Institutions; data on corruption from Political Risk Services. The PRS corruption variable goes from zero to six.

Figure 4 compares the levels of corruption predicted from the model in Table 1 with the actual corruption perceptions recorded by Political Risk Services over the period 1982 – 1997. The comparison reveals, first, that the prediction is reasonable. Although predicted corruption is sometimes higher and sometimes lower than corruption perceptions, at no point does it reveal extremely corrupt behavior when corruption was in fact modest or low levels of corruption when in fact corruption was high.

<sup>8</sup> Colonial heritage: 1 = Great Britain; 2 = France; 3=Spain; 4 = Netherlands; 5 = Portugal; 6 = Belgium; 7 = Japan; 8 = Italy; 9 = South Africa; 10 = USA. This variable is a control only and provides no information on the costs of one colonial heritage or another. The estimated coefficient can, however, be interpreted as meaning that countries that have been colonized are more corrupt than those that have not. A different formulation that distinguishes Dutch colonial heritage from all others shows that the Dutch colonial legacy is not significantly different from others in its consequences for corruption.

**Figure 4: Predicted vs. actual perceptions of corruption in Indonesia**



Note: Predicted corruption based on the values of corruption predicted from the estimates in Table 2.

The instability of the actual corruption measure relative to the predicted corruption measure in Figure 4 also serves as a reminder that corruption perceptions are likely to be volatile even if underlying political incentives to be corrupt are not. In particular, as the earlier discussion emphasizes, firm perceptions about the impact of corruption on its business decisions depend on general business conditions and on the credibility of corrupt arrangements. Each of these can change more frequently and oscillate more widely than the incentives of public officials to engage in or tolerate corrupt acts. The predicted corruption perceptions in Figure 4 may therefore track quite well the precise issue of concern in this report: the incentives of political actors to tolerate corruption.

### **Corruption in democracies**

The key issue in democratic countries is: under what conditions do voters find it advantageous to vote against politicians who tolerate corruption? This is not a question that concerns authoritarian governments. The answer to the question depends on a number of institutions and conditions. Under many circumstances, in fact, voters tolerate corrupt politicians. In countries where more of these circumstances are present, the introduction of free elections has a more modest effect on the incentives of political leaders with respect to corruption.

Cross-country evidence and analysis suggests that among the most important possible determinants of political incentives regarding corruption are the ability of political competitors to make credible promises to voters prior to elections; the issues upon which they can make credible promises; the electoral laws under which political competition takes place; and the type of government, parliamentary or presidential, that countries have. The

logic behind each of these is examined below, with some simple illustrative comparisons of corruption under different levels of credibility and different political institutions. However, these comparisons do not control for the many non-political determinants of corruption nor the inter-relationships among the non-political determinants. These are taken into account subsequently.

### ***Clientelism and the credibility of political promises prior to elections***

If voters do not believe any of the promises that political competitors make prior to elections – that is, if politicians can freely renege on their pre-electoral promises to voters – then elections lose much of their force as a device for disciplining corrupt politicians. If, for example, no challenger to a sitting politician can credibly promise to provide better and less corrupt public services prior to the election, then incumbents are freer to provide lower quality services and to tolerate higher levels of corruption.<sup>9</sup> The credibility of political competitors is therefore a crucial parameter to consider in the analysis of the political economy of corruption.

In no country are political competitors either fully credible or fully non-credible. Instead, only some of their promises are credible, and only to some voters. In more mature and successful democracies, most voters believe the promises of most political competitors. Republicans and Democrats in the United States or the Labor and Conservative parties in the United Kingdom can credibly claim to voters that they have competing stances on numerous issues ranging from tax cuts, immigration, and education to the role of the private sector in the economy, trade policy and religious issues. Competition prior to the election for all votes is therefore fierce. Upon entering office, successful candidates/parties are confronted with the necessity of fulfilling those promises (since a credible party can always beat a non-credible party, and by not fulfilling promises, politicians lose credibility). The political price of corruption is higher since corruption undermines their ability to make good on pre-electoral promises to voters.

In countries characterized by clientelism, on the other hand, credibility is narrowly circumscribed. Politicians (who might be called “patrons”) are credible only to some voters (“clients”) with whom they have a history of personal exchange. Such personal contacts can extend only to a minority of all voters, though. At the same time the nature of these relationships demands that politicians promise private or very narrow public goods (such as jobs or localized infrastructure projects) to their clients, rather than broad access to high quality public services, such as education. Promises about “higher quality education”, for example, are neither made nor expected. Instead, education promises would more likely relate to the construction of school buildings in specific locales.

An important characteristic of most clientelist systems is that “clients” generally have only one political patron and do not believe the promises of multiple patrons. This means that political competitors are not forced to compete for votes with pre-electoral promises to the same voters. It is enough for a patron to promise client-voters just enough to ensure that they turn out to vote, since once they turn out they have no incentive to vote for anyone but the patron. The absence of significant pre-electoral promises means that politicians in clientelist systems have substantial scope for post-election corruption. Clientelist political

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<sup>9</sup> For more on this point, see Persson and Tabellini (2000), Chapters 8 and 9.

competition therefore does less to restrain corruption.<sup>10</sup>

Elections in Indonesia have significant clientelist characteristics. This is in part for historical reasons. The elections that took place under Suharto, particularly at the local level, were non-ideological and depended on the exchange of specific benefits between candidates and voters. Hüsken (1994) looked at elections for village headman in 1988-89 and found them to be non-ideological and inordinately expensive, as candidates attempted to use money to establish credible relationships with voters. At the same time, these elections were highly competitive: multiple candidates competed against each other and incumbents – some from wealthy families that had produced village headmen for many years – occasionally lost. His evidence is especially helpful in showing that highly competitive elections in clientelist settings need not produce unambiguously better outcomes for all voters.

As institutions, parties in Indonesia have little credibility with voters and voter support for candidates of particular parties is largely conditioned by their opinion of the person at the top of the party. Party activists and candidates are generally those with the strongest personal relationship with the party leader rather than, as in more developed democracies, those who are most committed to the party ideology. The ability of the PDI-P to attract voters, for example, depends heavily on the leadership role of President Megawati; the strength of the PAN rests on the fact that Amien Rais is the party leader; the PKB's appeal to voters depends on Adurrahman Wahid's continued influence in party affairs.

Party leaders can only convey a limited array of promises to voters. In 1999, voters believed that President Megawati was a credible voice for democracy, but not for any specific set of public policies other than opposition to the New Order. In fact, the PDI-P conveyed little information about its proposed policies, as one might expect if such information would not have been taken seriously by voters. This is generically true: many observers note that political parties put out little information that would allow voters to distinguish them with respect to the major issues of the day, ranging from economic policy to their stance on separatists. In systems where political parties are not credible, we would not expect significant differences in party platform, since these are not convincing to voters in any case.

Only on the issue of Islam can voters reliably distinguish parties prior to the election. The largest Islamic party – the PPP – is strongly identified with this stance, while the PDI-P is well-known as a more secular party. However, voters can deduce little from a party's location on the secular-religious spectrum about its position on other public policy issues.

Golkar is the least ideological party, sitting in the middle of the secular – religious spectrum and having, for obvious reasons, no credibility as a party of political reform. Consistent with the clientelist model of politics, Golkar has the most well-developed network and best understanding of the need to deliver private benefits to voters to improve electoral chances. Its support in the 1999 election reflects this: most strongly outside of Jakarta and outside of Java, where clientelist political dynamics are most prominent.<sup>11</sup>

Prior to elections, therefore, Indonesian voters can distinguish parties and their

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<sup>10</sup> See Keefer (2002) for an extended presentation of this argument.

<sup>11</sup> Although Golkar was most successful in the least urban *kecamatan*, though, research by Kevin Evans suggests that within those voting districts they were more successful in the more urban areas.

candidates in only two ways. First, all voters can reliably distinguish whether a party is secular or Islamicist, or something in between. That is, they can believe that public policy decisions related to religion will be much different if they vote for the Partai Keadilan (Justice Party) than if they vote for the PDI-P, which has strong secular, even anti-Islamicist elements. However, voters can, prior to the election, reach no further conclusions about policy differences they could expect between such parties and the parties do not, in turn, articulate clear alternative positions on issues ranging from privatization, fighting corruption and trade liberalization to education. Second, some voters are able to believe the particularistic promises made by some candidates or party leaders. These are the voters that have a personal connection with candidates or party leaders.<sup>12</sup> Finally, voters who are indifferent to the religious dimension of politics and do not expect to benefit from clientelist relationships with political party leaders or candidates will also be indifferent to the parties prior to the election.<sup>13</sup>

It is easy to foresee the implications for corruption of this type of political competition. Voters who are motivated by the sectarian dimension of politics to the exclusion of all else will vote accordingly, in Indonesia as in any other country in the world. For such voters, it is irrelevant that political parties in Indonesia are not credible with respect to other dimensions of public policy, such as corruption; such voters will also prefer an corrupt Islamicist or strongly secular party to a less corrupt party that is neither. These voters, though, constitute a small minority of all voters.

A second group of voters benefit from clientelist promises. These voters, also, will always prefer the corrupt party or politician whose clientelist promises they believe over the non-corrupt party or politician whose promises they do not believe. This is rational: corruption is paid for by all Indonesians, while “clientelist” voters alone are the beneficiaries of the transfers they receive from corrupt politicians.

If party leaders competed for the same clients, clientelism could actually lead to a reduction in corruption, since corruption would undermine a party’s competitive position relative to these voters. However, competing party leaders are typically not credible to the same constituencies. For example, the residents of Bali believe President Megawati’s promises regarding the distribution of benefits to Bali, but not necessarily those of Golkar, just as the residents of Sulawesi trust the promises of certain Golkar officials, but not necessarily those of President Megawati. Voters interested in receiving targeted transfers from government have few alternatives but to support PDI-P or Golkar, respectively, even if performance overall is low and corruption remains high.

The majority of voters benefit neither from clientelist promises nor care more about

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<sup>12</sup> If the connection is direct, then loyalty to the party leader will be extremely high. However, even the fact that a party’s leader comes from the province of the voter can tip the scales in favor of that party leader, simply because in a clientelist system local ties imply a network of personal exchange that lends greater credibility to such a leader than to any competitor. In particular, relationships can also be mediated by, for example, village “patrons” with whom village voters have a history of personal exchange and who in turn have a history of personal exchange with the candidate or party official of some party – such as the party leader who comes from the very province where the village leaders are located.

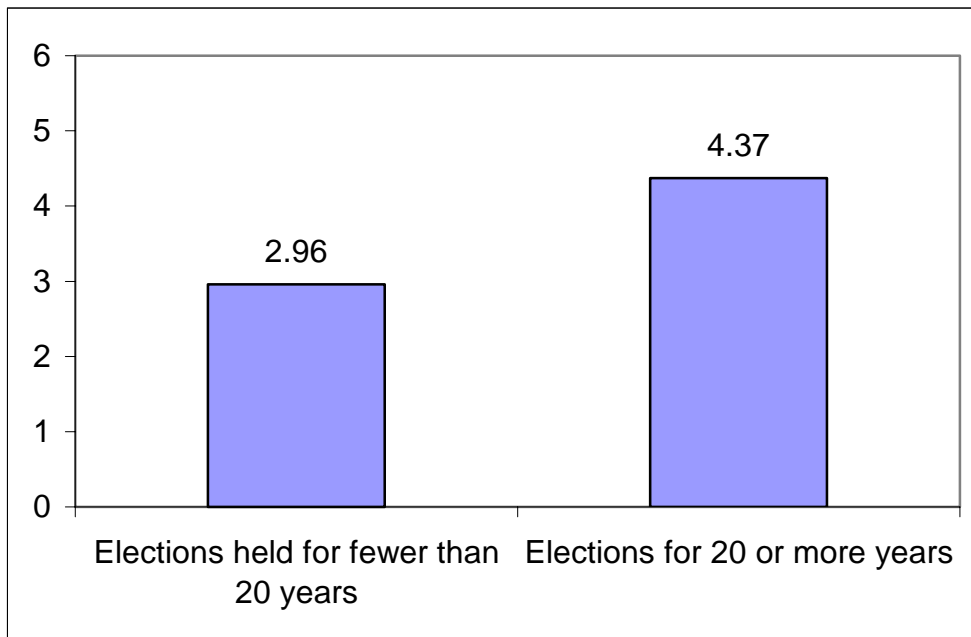
<sup>13</sup> They might, however, still vote if they are given a pre-electoral inducement to do so (e.g., vote-buying).



other aspects of public policy although they may not be indifferent to the religious dimension. Such voters can only exercise an *ex post* judgement regarding political performance: if incumbent performance falls below some benchmark set by these voters, they can vote against them no matter who the incumbent is. Taken together, then, the electoral system provides incumbents with considerable leeway to avoid any serious attack on corruption in the public sector.

It is unsurprising that parties would not be credible in such a young democracy as Indonesia's, and that credibility is slow in developing. First, parties have no policy reputations, except with respect to religion. Second, voter uncertainty about who is responsible for particular policy outcomes – resulting from voter ignorance about the new mechanics of the institutions of Indonesian democracy and inexperience and error in the operation of those mechanics by the new political leadership – means that even in office, parties have a difficult time establishing a reputation.

**Figure 5: Number of years elections continuously held and the extent of corruption, 1997.**



Note: Number of years elections held is from the Database on Political Institutions. Political Risk Services is the source of the corruption indicator (higher scores mean less corruption). Similar results emerge from using Transparency International data. Only countries that are rated seven (out of seven) on the Legislative and Executive Indices of Electoral Competitiveness in the DPI are considered (there are 42 countries below and 41 above the 20 year threshold).

One approximate way to assess party credibility over a broad array of issues is to look at the number of years that countries have continuously held competitive elections. The argument is simple: parties have a greater opportunity to develop a reputation for fulfilling broad policy promises the more often elections are held. The process is not inevitable, but because it is much more difficult in newly emerging democracies than in established democracies, the variable is a reasonable way to judge the effects of party credibility in pre-electoral competition on corruption. Corruption should therefore be higher in “younger” democracies than in more established democracies. Figure 5 shows

that, on average, this is precisely the case. In countries with competitive elections, corruption is significantly higher in countries where elections are a more recent phenomenon.

### ***Electoral laws***

A heated debate is underway in Indonesia, at least in civil society, about reforms to the country's strongly proportional electoral system. Currently, voters must choose between competing slates of candidates; the composition of the slates is determined by party leaders. Voters may not express a preference for candidates within the slate. District magnitudes (the number of legislative seats per electoral district, the province or *provinsi*) are large, averaging approximately 17, but as many as 82 in Jawa Barat. Although each *kabupaten* is guaranteed a seat, voters see only a list for the whole *provinsi*. Party leaders make assignments of candidates to *kabupatens* after the election. After the last election, to ensure that candidates most loyal to party leaders received seats in the legislature, parties even shuffled candidates among *provinsis*; so that candidates appearing on the party slate of one *provinsi* ended up representing a different *provinsi*. In fact and in law, then, Indonesia exhibits the strongest possible party-based electoral system, one that is both highly proportional (because of large district magnitudes) and that offers candidates no incentive to develop a personal constituency (because of complete party control over candidate selection).

Complaints about the current system focus on the lack of responsiveness of politicians to constituency needs. In fact, in sharp contrast to other parliamentary democracies (e.g., Pakistan or India) that employ plurality electoral rules with single member voting districts, Indonesian legislators seem to exert considerably less effort to receive or deliver benefits to constituents. This is precisely what one would expect from its strongly party-oriented system. Unfortunately, parties are not perceived as responsive, either. This is also unsurprising, however, when parties are young and party platforms are neither well-known nor credible to voters. Nevertheless, it is obviously unsatisfactory from the point of view of voters.

To remedy this, reform advocates argue that voters should be able to select candidates directly, thereby at least increasing candidate incentives to be attentive to voter concerns. The alternatives under consideration range from the German, in which some candidates are elected in single-member plurality districts and others from party lists, to the preference voting system in use in Australia. They all have in common a shift towards candidate-based rather than party-centered electoral competition, with small district magnitudes and plurality voting for candidates rather than parties.

The outcome of this debate has implications for the incentives of politicians to control corruption. However, whether candidate- or party-based systems offer stronger incentives to political decision makers to combat corruption turns on a number of assumptions. If political parties are fully credible, then Persson and Tabellini (2000, pp 206-215) conclude that party-based systems (closed-list proportional representation) are more likely to lead to corrupt behavior by politicians.<sup>14</sup> Party list voting makes it difficult for

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<sup>14</sup> Their theoretical argument is subtle. In systems with credible parties and plurality/small district voting, parties focus all of their efforts on swing districts, where the most voters are indifferent between the ideologies of the competing parties; it is not worthwhile for parties to pursue swing

voters to hold individual corrupt politicians to account. If, though, it is parties (e.g., party leaders) who authorize corrupt decisions, this argument no longer applies. In fact, Myerson (1993) argues that large district magnitudes, which are one aspect of proportional systems, should dampen corruption.<sup>15</sup>

Importantly, though, the conclusions in each of these analyses depends on the assumption that parties can make credible promises to voters. If parties are not credible, as in Persson and Tabellini (2000, 234-239), then rents/corruption are actually *higher* in plurality voting systems with small district magnitudes than they are in proportional systems.<sup>16</sup> Since the lack of party credibility is a significant feature of Indonesian politics, this prediction about the effect of electoral institutions seems to be the most plausible.

Like the theory, the evidence is mixed. Looking only at simple averages, corruption is somewhat lower in countries with proportional representation electoral systems. Figure 6 shows that on average, in countries with functional institutions (relatively high levels of political freedom as assessed by *Freedom House*), corruption is lower and integrity is higher in countries with more proportional electoral systems and larger district magnitudes. The same breakdown is evident if one looks only at countries with competitive elections, as in Figure 5. Controlling for other factors, Persson, Tabellini and Trebbi (2001) find that proportional systems, on balance, are *more* corrupt. They conclude that the insulation from voter pressures that party list systems give to corrupt candidates, which exacerbates corruption, outweighs the greater opportunity that systems with large district magnitudes give to voters

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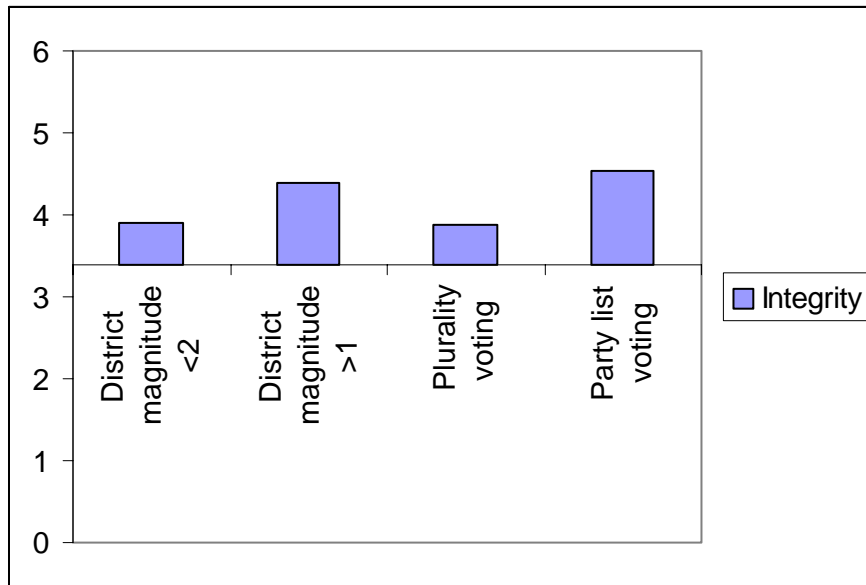
voters in districts where swing voters are a small fraction of all voters, most of whom are strongly committed to one or the other party for ideological reasons. Competition in swing districts is therefore fierce: the party that wins is essentially the one that promises the most targeted spending to the swing district. In particular, then, parties that indulge in significant rent-seeking (corruption) at the expense of providing narrow public goods to swing districts can be defeated by parties that engage in less rent-seeking. In proportional systems, in contrast, the votes of all indifferent voters matter, including those who are in “core” voting groups that, in majoritarian systems, are ignored. The vote cost of a dollar of rent-seeking is lower in the proportional system, since it is spread over more of these swing voters. Consequently, more corruption/rent-seeking takes place.

<sup>15</sup> When district magnitudes are small, voters who decide to cast their ballots for new, non-corrupt parties and candidates risk being entirely unrepresented, since the probability that those parties or candidates will win one of the few seats available in a district is low. When district magnitudes are large, this risk to voters is lower, and anti-corruption parties can enter the political arena more easily. Specifically in the Indonesian case, and despite protests of its representatives to the contrary, small anti-corruption parties such as *Keadilan* would likely not win as many seats under majoritarian voting rules.

<sup>16</sup> In non-credible systems, voters cannot distinguish candidates and parties. Although candidates and parties may try to differentiate themselves through their campaign promises, since those promises are not credible, the effort fails. Since voters cannot reliably distinguish the future performance of incumbents and challengers, the best they can do is set an implicit threshold of performance for incumbents: incumbents that meet the threshold get re-elected, and those that do not are rejected. However, since candidates only need to win a majority of votes, voters must compete among themselves in setting that threshold. Voters who set too high a threshold take the risk that incumbents will target resources to other voters who set a lower threshold. This competition is fiercer in majoritarian systems, where candidates only have to win 51 percent of the votes in 51 percent of the voting districts to control the government. They need twice as many votes in proportional systems: 51 percent of all votes.

to choose less corrupt parties, which mitigates corruption. The more elaborate statistical evidence presented below is, however, supportive of the results in Figure 6: plurality elections tend to encourage corruption. This is not surprising: electoral systems that ask voters to choose individual candidates are most compatible with clientelist forms of political competition, where credibility is based on individual rather than party characteristics.

**Figure 6: Integrity across electoral systems**



Note: District magnitude (the number of seats in a legislative district) less than two, and plurality voting, are two different indicators of majoritarian systems. Information on both is from the *Database of Political Institutions*. Only countries rated as relative free or better (political freedoms less than 2.5 on the *Freedom House* scale of political freedom) were considered, to ensure that the electoral laws were “relevant”. Eighteen countries had district magnitudes less than two, and 29 countries had district magnitudes of two or greater. 24 countries had plurality elections, 23 did not. Similar results are found using the Persson and Tabellini corruption indicator from *Transparency International* and their measure of majoritarianism.

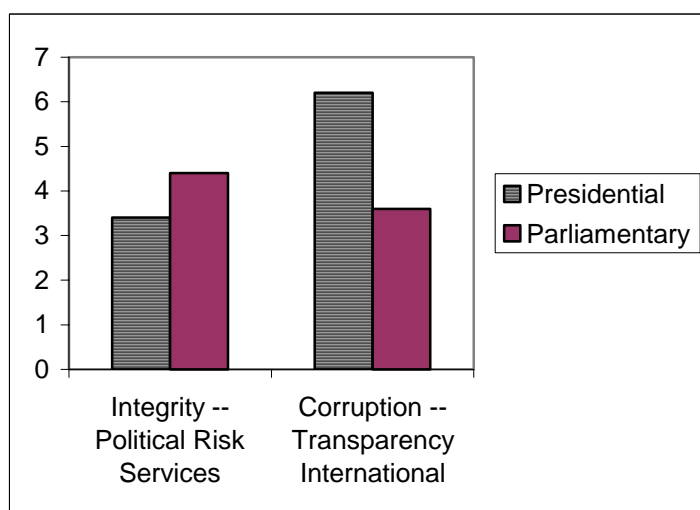
Much of the impetus for electoral reform stems from the behavior of parties during the 1999 elections. Many parties in the last elections filled their party slates with candidates unknown to local voters, but loyal to the party leadership. Parties essentially asked citizens to vote only on the basis of the identity of the party leader. This strategy is not likely to be politically sustainable. In a system in which clientelist pressures matter most, a winning strategy – even with proportional representation – is to fill party lists with candidates from the voting district who have a well-established network of “patron-client” relationships. Such slates will, in the future, be decisive in determining the vote shares of competing parties whose leaders command roughly the same level of national support.

### ***Regime type***

Whether countries are parliamentary or presidential has also been found to have an effect on the extent of corruption in a country. Again, these findings are highly relevant for Indonesia, particularly since it has an exceptional constitutional arrangement, in which the executive is chosen by and can be easily removed by the MPR, unlike presidential systems of

government. The key institutional dimension that varies across parliamentary and presidential systems is the extent to which a single individual or party leader can make all-or-nothing legislative proposals to other government decision makers. When an individual or political party has this power, the size of government and corruption both tend to be greater. The logic is more straightforward than in the electoral analysis: if a single individual or party can make an all-or-nothing offer to other political participants, they have less leverage to resist efforts by the strong individual to accumulate significant rents – to be corrupt. If they try to resist, the strong individual can simply reduce their share of the fiscal pie and give it to another participant who is more cooperative.

**Figure 7: Regime type and integrity/corruption in government**



Note: A higher score on the integrity measure (called a corruption measure by PRS) indicates less corruption; a higher score on the TI measure indicates more corruption. There are 32 and 34 parliamentary countries, respectively, for the Political Risk Services and Transparency International measures; and 31 and 33 countries, respectively, that are presidential. Countries were included only if they exhibited competitive elections, a seven on the seven-point scale of the Legislative Index of Competitive Elections (LIEC), from the Database on Political Institutions.

In most presidential systems (apart from the United States), the legislature can only consider budget proposals that are submitted by the president, and the legislature confronts restrictions on its ability to amend those proposals.<sup>17</sup> Presidential agenda control in most presidential countries is independent of whether the president's party has majority control of the legislature or not. If their party has majority control of parliament, prime ministers are also able to make all-or-nothing offers to the legislature, so we would expect little difference between such parliamentary systems and presidential systems.<sup>18</sup> However, prime ministers at the head of a coalition government cannot make all-or-nothing proposals without the

<sup>17</sup> The president in the Dominican Republic, Chile, or Peru, for example, can make budget proposals to the legislature that the legislature can only reduce, or cannot amend at all. This reduces the separation of powers that is critical to the low-corruption result in presidential systems.

<sup>18</sup> Of course, prime ministers also frequently confront dissident back-benchers from their own party. The presumption is, however, that it is more costly for back-benchers to leave the party and bring down the government than it is for coalition partners to withdraw from the coalition.

approval of coalition partners. Given the prevalence of parliamentary systems in which governments are coalitions, and the similar prevalence of presidential systems that grant the president substantial influence over spending, we would expect parliamentary systems to be less corrupt.

Figure 7 demonstrates that, across countries, corruption does indeed seem to be greater in presidential systems. Moreover, though not shown, this difference is strongest when comparing systems where the chief executive's party lacks a majority in the legislature, consistent with the discussion above. In a more elaborate analysis, Lederman, Loayza and Reis Soares (2001) also find that parliamentary systems exhibit *less* corruption than presidential systems.

Suharto obviously controlled fiscal policy, an arrangement that was consistent with high levels of corruption. However, the current institutions of Indonesian policy making mark a significant change from the past, and resemble most closely a parliamentary system with a coalition government; such an institutional setting is predicted to discourage corruption. Change in the institutions of government decision making therefore does not explain the reported increase in perceptions of corruption since the end of the Suharto regime.

### ***Sorting out the determinants of corruption in democracies***

Just as in the analysis of corruption in non-democracies, the many determinants of corruption in democracy are unlikely to be independent of each other. Table 2 presents the results of a more careful examination of determinants of corruption, taking into account the many and multi-directional influences omitted in the simple comparisons above. Several important conclusions emerge from the analysis. The most relevant to Indonesia, perhaps, is that the more credible are politicians, as approximated by the number of years that elections have been continuously held in a country, the lower is corruption. After 35 years of continuous elections, the impact of corruption on investors is a full point less on the Political Risk Services scale (running from zero to six, with six meaning corruption is lowest).

This credibility effect seems to be offset when the electoral system is plurality-based: according to the data used here, a move from proportional representation to plurality voting rules results in a .44 increase in corruption (recalling that a negative coefficient implies an increase in corruption). These results, as intimated previously, argue against a change in electoral rules towards a plurality-based system, at least with respect to their effect on corruption.<sup>19</sup> Other features of the institutional environment seem to matter less: large or small district magnitudes matter less, as does whether a system is parliamentary or presidential.

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<sup>19</sup> The striking results on the electoral system, as well as on the years of continuous elections, remain even if all OECD countries are excluded from the sample. That is, the results are not driven by long-lived European and North American democracies.

**Table 2: Determinants of corruption in democracies**

Dependent variable: Corruption (Political Risk Services)	
<b><i>Number of continuous years competitive elections held</i></b>	<b>.028 (.000)</b>
<b><i>Electoral system (Plurality = 1, Proportional Representation = 0)</i></b>	<b>-.44 (.006)</b>
<i>District magnitude</i>	.002 (.23)
<i>Regime type (Presidential = 0, Semi-presidential = 1, Parliamentary = 2)</i>	-.05 (.58)
<i>Years in office of executive</i>	-.045 (.05)
<i>Head of government and defense minister from the military (1 – 0)</i>	-.40 (.49)
<i>Ethnic tensions (0 – 6)</i>	.15 (.002)
<i>Income/capita (PPP-adjusted, times 10,000)</i>	-.27 (.07)
<i>Land area (times 1,000,000)</i>	.0047 (.90)
<i>Total population (times 1,000,000)</i>	-.00024 (.62)
<i>Percent population rural</i>	-.966 (.09)
<i>Percent population young</i>	1.68 (.05)
<i>Percent population working age</i>	.74 (.86)
<i>Colonial Heritage</i> <sup>20</sup>	.031 (.59)
R <sup>2</sup>	.74
Number of observations/countries	745 / 82

Note: Only countries with competitive elections (seven on the *EIEC* and *LIEC* scales) are included. The number in parentheses indicates the probability that the coefficient is actually zero (the lower the number, the more reliable the estimated coefficient). The regression also includes regional dummy variables; the East Asia dummy variable is significant and positive – East Asian countries are perceived to be less corrupt than one would expect, given the other measurable characteristics of these countries. Coefficients were estimated using ordinary least squares. Clustering is used, so that intra-country observations are not considered independent of each other. Political data from the Database on Political Institutions; data on corruption from Political Risk Services. The PRS corruption variable goes from zero to six.

Continuous control of the executive by a single person has a significantly deleterious effect on corruption. Corruption is half a point higher in countries where the executive has been in office for 20 years rather than 10 years. This captures the fact that just because

<sup>20</sup> See note to Colonial heritage in Table 1.

countries allow multiple parties to compete in elections does not mean that electoral competition is itself free from manipulation that is difficult to capture in statistical comparisons. Where the incumbent controls access to the media or uses public resources for campaigning, one would expect greater incumbent longevity, less real competition, and greater corruption. Unsurprisingly, finally, ethnic tensions undermine the integrity of government. Recalling that, like the corruption measure, higher scores on the ethnic tensions measure are “better”, and imply less ethnic tension, a one point increase in ethnic tension eliminates the benefits of almost seven years of elections.

As with Table 1, the coefficient estimates reported in Table 2 can be used to generate a “predicted” corruption score for Indonesia since Suharto. Political Risk Services assessed corruption in Indonesia in 2000, the first full year of the new Indonesian democracy, at 1.92, the average of 12 monthly corruption assessments. Predicted corruption in that year, derived from Table 2, was somewhat less, approximately 3.5 in 2000. There are two explanations for the discrepancy. First, the predicted incentives to engage in corrupt acts fell in the direction we would anticipate from the Suharto era to the democratic era (from 2.3 under Suharto in 1997 to 3.5 under democracy). At the same time, the impact of corruption on business was greater in 2000 (so that measured corruption in Indonesia was 1.92 in 2000, worse than the 2.7 recorded in 1997).

Several factors influence these divergent tendencies. On the one hand, the economic environment is less stable and presents fewer lucrative opportunities than it did under Suharto; corruption is therefore more likely to be undermining the economic justification for doing business. On the other hand, the horizons of political decision makers, holding constant the political costs of corruption, are shorter. This hurts the reliability of corrupt agreements, reducing their value to investors.

A third explanation for the divergence between predicted and actual corruption values in 2000, however, is simply that the cross-country analysis fails to reveal some idiosyncratic aspects of political competition in the Indonesian democracy that are not captured in the cross-country statistical analysis. One of these is the complicated structure of political decision making in Indonesia, which makes the solution to corruption more of a “public good” than it is in many other countries and creates difficulties for voters who seek to hold one party or another responsible for corrupt practices. Another is the horizons of political leaders referred to already. A third is the way in which parties compete for voters who are indifferent – voters who are neither the beneficiaries of clientelist promises nor strongly committed to the most secular or most Islamist strains in Indonesian politics. These are the subject of the next section.

### **Additional obstacles to fighting corruption in democratic Indonesia**

The additional obstacles to battling corruption in Indonesia, beyond those captured in the cross-country analysis, are at least three-fold. First, the politics of coalition building in Indonesia have undermined incentives to fight corruption. Second, the short horizons of politicians have weakened anti-corruption resolve. And finally, efforts by political competitors to bring voters to the polls who are entirely neutral (who do not believe the pre-electoral promises of any party) are expensive and increase tolerance for corruption when it is linked to campaign success.



## ***Coalition formation and the fight against corruption in Indonesia***

As in many parliamentary and quasi-parliamentary systems, legislation in Indonesia requires the consent of multiple coalition partners. The president's party, PDI-P, controls only 30 percent of the seats in the DPR, and must pass legislation either with the support of Golkar, the party of the Suharto regime, or with a coalition of Islamic parties. The coalition formation process in Indonesia allows politicians to more easily disclaim or minimize their responsibility for persistent corruption.

Multiple decision makers is not always problematic. For instance, multiple government decision makers are less likely to suddenly expropriate investors, so that the policy environment under multiple decision makers may be more conducive to investment and economic growth.<sup>21</sup> The salutary effect of multiple decision makers in Indonesia is offset, however, by the fact that coalitions are opaque and change from issue to issue, making it difficult for voters to hold particular parties or individuals responsible for policy outcomes.

Coalition governments are well-known throughout the world and are characteristic of many successful countries. However, in most such countries, membership in a coalition implies endorsement and shared responsibility for the decisions that a government has taken. Departure from a coalition can even mean new elections if it brings down a government, putting the legislative seats of the departing coalition members at risk. Similarly, membership in a party implies the endorsement of the ideological characteristics of that party, making movements to other parties more difficult. This makes it easier for party leaders to enforce party discipline, such that a party's membership in a coalition implies that a party's legislators will vote with the coalition.

These conditions do not hold in Indonesia. First, unlike many parliamentary democracies (though not all), Indonesia has no vote of confidence procedure, in which the president could force new legislative elections if her proposals were voted down.<sup>22</sup> In addition, there is a low vote threshold (the minimum fraction of votes a party must achieve in order to take seats in the legislature) and a large district magnitude (the number of legislative seats within a single electoral constituency), making it relatively easy for individuals to start new parties. The effect of the low vote threshold is exacerbated because it takes effect only in the next election. Finally, all of the foregoing arguments about the lack of credible differentiation among political parties reduces the costs of moving among parties, further undermining party discipline.<sup>23</sup> The consequence of this is that on every issue, the president must undertake non-transparent negotiations with individual legislators to achieve

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<sup>21</sup> The information that underlies much of the analysis of this report demonstrates this point, as well. Among 54 countries in 1997 with competitive elections and at least four key decision making individuals, parties or branches of government, the average rule of law rating from Political Risk Services was 4.7. Among the 36 countries for which the number of key decision makers was less than four, the rule of law rating was almost one standard deviation less, or 3.8.

<sup>22</sup> Daniel Diermeier and Timothy J. Feddersen (1998) demonstrate different determinants of government cohesion, such as the vote of confidence, all of which are missing in Indonesia.

<sup>23</sup> Significant movements among parties are not observed, yet, in Indonesia. However, if all players are adjusting to the rules of the political game, one would not expect to observe waves of party-switching.

some sort of policy movement.

Two outcomes this interpretation of the role of coalition formation in Indonesian politics. One is that President Megawati's cabinet has had representatives from all five of the largest political parties. This is an unusual arrangement in countries characterized by coalition governments, precisely because competing parties do not usually want to be held responsible for the policy decisions of their opponents. However, when membership on the cabinet implies little about support for government policies, voters cannot take cabinet membership as a cue about which parties to hold responsible for government performance.

More tellingly, perhaps, is the example of one district where local elections were held in which the PDI-P legislative majority elected a governor from one of the Islamic parties, spurning its own candidate. This clearly shows that coalition building occurred at the level of the individual legislator. Since individual legislators are more motivated by narrow than national interests, and since voters can more easily assign responsibility for broad corruption problems to parties and presidents than to individual legislators, the effect of coalition-building and weak party discipline in Indonesia is to dampen the political incentives to fight corruption.

### ***The short horizons of elected officials in Indonesia***

The short horizons of Indonesian political parties is an additional important factor in the worsening of corruption and rule of law perceptions in the country. Given short political horizons, elected officials stand to gain little from any investment they make today in improving the rule of law. Their short horizons are not due to democracy, *per se*, but to the fact that the Indonesian democracy is young and its rules are evolving.

With respect to the evolution of rules, parties in Indonesia will have significant incentives in the next election to change their party slates, leaving many incumbent legislators without a place on the party list. Approximately 70 percent of current DPR members lived in Jakarta prior to the 1999 elections, and had lived there for some time. Most of these were unknown to the constituencies in which they appeared on their party's list. Since the 1999 elections, voters have regularly complained that legislator contacts with their local constituencies have been sparse. In the next election, parties that place individuals on their party slates with personal relationships with local voters will therefore have an advantage over parties that do not. In the last elections, most parties had difficulties fielding candidates of any kind; by the time of the next elections, though, their choices should be greater. Some current legislators are likely to be displaced by legislators with stronger personal connections to the regions where they appear on the list.<sup>24</sup>

Decentralization exacerbates this trend. Local governors and legislators are increasingly controlling the resources flowing to their jurisdictions, both from the central government and, even more importantly, from mineral and timber resources in their jurisdictions. District offices of national political parties are therefore more likely to have

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<sup>24</sup> There are some circumstances where voter choices are ambiguous, however: a party with a nationally popular leader, which voters in a region expect will get the most support nationally, may do well in that region even with a candidate list full of strangers. However, voters are unlikely to believe that only party has a chance of winning the elections, creating an electoral payoff to those parties of finding regionally appealing candidates.

independent sources of financing, and to wield increasing authority in national political party decisions. This again jeopardizes the positions of current legislators not from the provinces. Finally, electoral reform, should it come to pass, will also be deeply prejudicial to incumbents. In particular, any electoral rules that increase candidate accountability to constituents, such as single member districts, would severely disadvantage candidates with no active connection to the district.

Apart from all of these factors, legislative life is simply quite risky in Indonesia in relation to other democracies. A corruption scandal has already brought down the two most recent presidents and one party leader – and, implicitly, all of the party members allied with these people. There is nothing to suggest that such outcomes cannot spread to other prominent politicians and their backers.

Voter disillusion also creates significant risks. Because they are not able to choose between credible political parties, voters in Indonesia may be reduced to using crude rules in deciding whether to re-elect an incumbent or not. They might decide that incumbency itself is a problem, voting against all incumbents. In fact, voter mistrust is high, and such an outcome (rejecting all incumbents, no matter what) is a possibility that materially increases the risk that incumbent legislators attach to their futures.

Evidence from Hungary shows that voters with less political trust are, indeed, less likely to re-elect incumbents, even when economic performance is good, and certainly much more so when it is bad.<sup>25</sup> Hungary is obviously not Indonesia, but it is a new democracy and its higher income and education levels mean that, if anything, the phenomena identified in Hungary are more likely to emerge in Indonesia. Among those Hungarian voters who thought that the economic situation of the country had improved, 69.8 percent of the voters lacking political trust still intended to vote against the incumbent governing coalition, while only 36.2 percent of the voters who exhibited high political trust expressed this intention. These findings are robust to controls for personal finances, age, employment, income and education (Duch 2001). A lack of voter information – again, a common characteristic of all young democracies, and more so where, as in Indonesia, income and education levels are relatively low – exacerbates this sense of uncertainty on the part of incumbent legislators.<sup>26</sup> Among Hungarian respondents who believed that the economy had improved, but who had *low* political knowledge, 59.7 percent were likely to vote against incumbents. Among those respondents who believed that the economy had improved but who had *high* political

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<sup>25</sup> Trust in this case was measured by survey responses to four questions: 1) How often do you feel that you can trust the government to do the right thing? 2) How do you think the people working for the government use the money of the taxpayers? 3) In your opinion the government . . . is run by a small number of people who are looking out for themselves, or is run for the benefit of the whole nation? 4) In your opinion, the government includes . . . a lot of dishonest people, some dishonest people, or no dishonest people at all?”

<sup>26</sup> In fact, the problems of information should be more acute in Indonesia since Hungary exhibits at least three characteristics that should boost the political information of the average voter. Purchasing power adjusted incomes per capita in Hungary are four times those in Indonesia. Educational levels also much higher: in 1995 gross secondary school enrollment in Hungary was 97.8 percent, compared to 51.5 percent in Indonesia. Finally, the fraction of the population living in rural areas is almost twice as high in Indonesia (59 percent) as in Hungary (36 percent).

knowledge, only 44.8 were likely to vote against the incumbent (Duch 2001).<sup>27</sup>

### ***Money and politics***

Where political parties are not credible and voters are relatively uninformed about parties and candidates, money plays a bigger role in political competition. At the extreme, money is needed for vote-buying: to buy support and to persuade voters to go to the polls. Where politicians need more money, they tend to show more deference to the interests of those who can supply money, and who benefit from special privilege that, in the limit, degenerates into corruption.

Vote buying is particularly expensive in Indonesia because parties are poorly organized (except for Golkar, in some rural areas) and so cannot easily track whether those whose votes are bought actually vote in the appropriate way. In the Philippines, a country where political parties are similarly underdeveloped, one preliminary survey found only 38 percent of poor voters who accepted money voted for the candidate, or roster of candidates, on whose behalf the money was offered. Of that 38 percent, one in five said they would have voted the same way had they not been offered anything (Shaffer, p. 15).

Still, although expensive (perhaps only one dollar out of every three spent on vote buying seems to make a difference), vote buying has a number of advantages as a political strategy relative to expending political capital on broad public good provision. The voters know exactly who provided the money for the vote, and are thus more likely to give full credit to the candidate. Vote-buying can also allow candidates to initiate clientelist relations with an expanded group of voters. Even with a one out of three success rate, therefore, the persuasiveness of vote-buying is likely to be greater than expending the same amount of resources on public goods that benefit all Indonesians.

A growing literature has also shown that the presence of uninformed voters gives politicians a larger incentive to collect money to spend on informing voters.<sup>28</sup> Voters in Indonesia have certainly not been well-informed about political candidates and parties – party slates in the last election were full of candidates unknown to voters. Under these circumstances, parties raise money from special interests to persuade uninformed voters.

Local elections during the Suharto era again illustrate fundamental aspects of political competition in Indonesia. Hüsken (1994) showed that ideology mattered little in contests for village headman and that the campaigns were correspondingly expensive. Money bought votes, but also assistants to act as “canvassers”, months of offering free meals to passers-by, and loans – probably never to be repaid. Several dozen candidates surveyed said they spent from 8 – 50 thousand dollars, for a job paying 50 – 80 dollars. Some losers had to sell land and houses, or went bankrupt.

The underlying rationale for expensive elections remains the same today as it was for

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<sup>27</sup> Levels of political information were assessed based on the interviewer assessment of respondent's general level of information about politics and respondent answers to two questions, one about the composition of the governing coalition; and the other about the party responsible for unemployment policy in the coalition.

<sup>28</sup> Baron (1994), for example, analyzes political incentives when candidates can use money to increase the probability that uninformed voters will vote for them.

these village elections under the *New Order*. Ideological differences between candidates continue to be immaterial. The ability of candidates to direct benefits to one group of voters rather than another continues to be key. And elections continue to have a relatively modest impact on corruption: corrupt officials were in fact kicked out, but this seems to have only encouraged winning *lurabs* to increase their corruption rather than to moderate it. This is exactly what one would expect under competitive elections when candidates cannot make credible promises about their future actions.<sup>29</sup>

### ***Other elements explaining Indonesian corruption that are not captured in the cross-country comparison***

Two other elements of the Indonesian democracy deserves mention and are not well captured in cross-country comparisons. One is the role of latent or actual violence. All observers note that the chief political parties have gangs allied with them. President Wahid's gang, *Banser*, was a force during his term, and the threat of unleashing the group in street demonstrations was an important weapon for him as he waged his campaign to remain in office. Such groups require funding, further raising the costs of political competition.

A second, only partially taken into account, is the role of the military. The military has extensive economic interests and at the same time is the guarantor of the integrity of the Indonesian state, a priority for most political parties, or at least an objective that none dare repudiate. These two characteristics go together: a large portion of military financing comes from off-budget sources. These off-budget resources are difficult to track, which is naturally preferable to the military and at the same time complicate its attitude towards fighting corruption. The exceptional influence of the military, more pervasive than in most countries identified in the cross-country comparison, and its strong reliance on off-budget sources of finance both help to explain the divergence between predicted and actual corruption scores in Table 2.

### **Implications for corruption reform**

There are, in sum, a multitude of reasons that explain the persistence of corruption in Indonesia despite the introduction of political competition, and many of these can be quantified in relation to the experiences of other countries. Many of these may dissipate as elections become a more regular and predictable feature of the political landscape. One way to see this is that, for countries that have been democracies for fewer than 10 years, the perceived corruption levels are typically much higher – by 0.8 points on the six point corruption scale – than the corruption levels that one would predict based on the results in Table 1. Simply put, countries in transition to democracy are systematically more vulnerable to corruption than more developed democracies.

Still, corruption, and the public policy problems that it creates, are a serious short run concern. In the short and medium term, then, steps can and should be taken both to ensure that the long-run development of democracy is favorable, but also to crack down on

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<sup>29</sup> While it might have been the case that elite families in earlier days would have had a reputation for performance or malfeasance, elections in the years in which they dominated the village headman positions – to the extent that there were elections – were not as competitive, making the issue moot.

corruption generally and to make clear the new rules of the game that are in place. The fact that some transition countries (if the minority) are able to do better than expected with regard to corruption provides some reason to believe that such efforts could be productive.

The following therefore outlines some ways to think about reform in the short and medium term. The reform suggestions merely constitute ways to think about reform rather than the final word on what will work in Indonesia, however.

### ***Political reform***

The single element of the Indonesian democracy that seems to matter most to corruption (and other policy) outcomes is the lack of credibility of political parties regarding many of the most pressing issues of public policy. This is a difficult problem to address in the short term. Short term reforms can be implemented, however, that increase the transparency of coalition formation and the ability of voters to hold parties accountable for poor policy outcomes. Such reforms should make the decision of a party to join a coalition more transparent and politically meaningful, and to increase the costs to party members of exiting one party to join or form another. The first set of reforms makes it easier for voters to hold parties accountable; the second set links party legislators more closely to the success of the party, by making it more difficult to join or start a new party. If parties are more accountable to voters, then reforms to link legislators more strongly to parties should make them more sensitive to voter concerns, as well.

#### *Party discipline and accountable coalitions*

With respect to coalition formation, the MPR at the end of 2001 already undertook a series of reforms that make it more difficult for the MPR to remove the president. It is not, in and of itself, problematic that a legislature can remove the executive. This is an inherent characteristic of parliamentary systems and is possible as well in most presidential systems. However, legislators in Indonesia have faced fewer costs than in most parliamentary systems when they have sought to remove the president. In contrast to the experience of legislators in many parliamentary systems, removal of the president did not oblige the government to hold new elections. In addition, for all of the reasons stated above, legislators tend to have narrow and more private interests rather than broader public interests in mind when they evaluate the performance of a president. The effect of easy removal of the president, then, has been to make the president more receptive to the narrow demands of legislators.

Constitutional changes adopted by the MPR at the end of 2001 have alleviated this problem somewhat. These changes require that the MPR only dismiss the president for specified reasons, a decision that is then confirmed by a new Constitutional Court. Because the MPR can reverse these constitutional changes as easily as it could, previously, reject a sitting president, this does not necessarily represent a constitutional sea change. The MPR can always reverse the constitutional changes if it wishes to reject a president.

At the same time, the change does little to increase the political responsibility of parties that join the presidential coalition because it removes policy failures from the list of acceptable reasons for removing the president – unlike all parliamentary systems. It therefore does not improve the ability of voters to monitor coalition partners.

An additional reform under consideration actively discourages party discipline.

Under this option, the Upper House would be composed only of non-party individuals. It is far better, and more typical among successful democracies, to allow parties to compete for seats in all chambers of the legislature.

To improve coalition accountability, the introduction of a vote of confidence could be considered. Under confidence procedures, the president can respond to cabinet or legislative opposition by bringing her initiatives to a vote of confidence which, if it fails, triggers new elections. Such a vote would force parties to take responsibility for major policy issues in a way that voters could track.

Strengthened party discipline may also be important to improving the accountability of parties to voters. More effective vote thresholds are the main institutional instrument available to do this. The point is not to preclude competitive entry by new political parties, only to ensure that those parties are a serious political alternative for voters. There are two types of entry barriers currently in place in Indonesia. First, there are vote thresholds that parties must meet. These, however, are low and apply only to the subsequent electoral cycle, making them essentially meaningless. Second, parties are required to have organizations in half of the districts and subdistricts of half of the provinces. This is an important barrier to entry. Observers insist that starting a new party is an expensive proposition. Such money-intensive organizational barriers to entry, though, generate perverse incentives. They reward party entrepreneurs who are most willing and able to raise money to set up party organizations, and penalize party entrepreneurs who might be popular among voters but less able to raise money. A better requirement, which would favor popular but “poor” new parties and be more consistent with the design of requirements in other countries, would be to set as a requirement that a party’s candidates could win seats in the legislature only if the party won five percent of the vote in at least half of the provinces and at least five percent nationally.

Stronger party discipline has no effect on legislators who have strong personal ties to the party leader; such legislators can do no better in any other party than their own and are automatically “disciplined.” However, for legislators without such ties, the specific attributes of a party and its likely success in government become much more relevant when it is difficult for them to leave the party subsequently. By not being able to insure themselves as easily against voter displeasure with their party, they are more likely to insist on policy stances by their party that are favored by voters.

Still, party discipline can have perverse effects that should be taken into account. In a highly clientelist environment, it is straightforward for party leaders to make private arrangements with dissidents among their party caucus. Strong party discipline can also cement the position of possibly corrupt party leaders or of cross-party elite cartels, such as those that have bedeviled some long-lived South American democracies. However, mitigating these objections, such problems are visible already in Indonesian politics and it is not clear that meaningful voter thresholds will worsen them. In addition, the strongly proportional electoral system that Indonesia exhibits, with average district magnitudes of 18.5, does more to offset the clientelist impulse than Colombia’s electoral system, where district magnitudes are much smaller, on average only five.

*Electoral rules and incentives to fight corruption*

The other major institutional change under discussion, the move to plurality voting,

is at least as likely to increase corruption as reduce it. The evidence in Table 2 suggests that this would increase corruption. At best, because of the pervasive influence of clientelism, switching to a different mode of voting may have only a small effect one way or the other.

The principal obstacle to the success of plurality voting as a device for fighting corruption is that individual legislators have even less reason than party leaders to pursue policies that improve outcomes for all Indonesians. The plurality rule would imply a formal institutional overlay that reinforced the non-institutional, clientelist structure of politics already in existence. A useful compromise would be a mixed system along German lines, where half of the legislators are selected from single member districts and half from off of party lists; or a restricted open list system, where voters could express a preference for candidates within a party list, but could not express a preference for candidates on different parties' lists. These systems retain some of the incentives for parties to develop distinct policy stances, while increasing legislator accountability to individual voters, which is certainly missing now. The other advantage of mixed systems is to offset any collusive efforts by party elites.

### ***Policy reform***

Absent significant developments in the political dynamics of the country, policies intended specifically to lay the groundwork for a full-fledged attack on corruption in Indonesia are unlikely to succeed. They will be implemented much as current policies are implemented. For example, the focus of public and government attention with respect to corruption has been associated with significant cases, such as the Central Bank governor accused of illegally releasing the BLBI funds, or the Speaker of the House, accused of diverting *Bulog* funds to Golkar political activities. These are notable cases, but the underlying strategy of reform through prosecution of isolated and personalized cases is unlikely to trigger a widespread change in behavior.

The 1998 formation of the Joint Investigative Team was widely regarded as an important innovation, and its aggressive attacks on corrupt behavior, reaching targets on the Supreme Court, were a striking departure from past practice. However, the group was immediately exposed to serious pressures, both informal and formal, and even violent. It was soon forced to disband. While its dissolution is usually tied to the defensive actions of the Supreme Court, which directly was the case, it is clear as well that a multitude of governmental actions could have protected the JIT from Supreme Court decisions. For example, the laws that allowed three justices to sue the JIT for defamation of character and to arrest the chief witness against them could have been modified by the president and legislature, or the actions of the Supreme Court could have been loudly protested by all other branches of government. That none of this came to pass suggests that the environment was not supportive of enforcement reforms.

Despite the frustrating early experience, the proposed Anti-Corruption Commission provides another opportunity to revive the vigorous anti-corruption activities exhibited by the JIT. Its approval and active role will indicate a significant change in political incentives with respect to the control of corruption. As the experience of the JIT indicated, however, the key to success of the Anti-Corruption Commission will not only be its legal strength and funding independence, but also active political support to remove other legal obstacles, such as modification of the anti-defamation laws that undermined the JIT.



Additional reforms that are likely to be at least as important are those that strip away the rationale for corruption. For example, a former minister of the Ministry of Trade and Industry said that the Ministry continues to regulate through the issuance of licenses, even after rules were changed to introduce registration (requiring no ministry approval) and *ex post* regulation of registered firms. Absent any demonstrable social benefit, such regulations should be suspended or *ex ante* licensing requirements changed to *ex post* regulation. This is but one of many examples of government regulations that, though potentially well-intended, serve only to abet corruption and to foster insecurity in the investment climate.

### ***Collective Action***

Small- and medium-sized businesses now complain that their competitiveness is undermined by uncontrolled extortionary demands by public officials, and claim that these demands are worse than under Suharto. The earlier discussion suggests that the demands may be much smaller, in monetary terms, but their effect on business may be worse. Regardless, some have refused to submit to these demands and, essentially, called the bluff of the officials making them. This has proven to be an effective strategy: most demanders of bribes are much less powerful than they used to be. It is no longer a case of the entire Indonesian government, with Suharto sitting at the top, demanding ten or more percent of every project. Instead, lower level officials, acting independently of the highest levels of government and of each other, and party leaders, also acting independently of each other, are making these demands, either for personal enrichment or to fund political campaigns.

The lack of coordination among the demanders of bribes, though, presents an opportunity for collectively organized small and medium-sized businesses. Together, they could resist extortionate demands much more easily than under the Suharto government. However, the basis for such collective action does not yet exist. One possible form of such action: a federation of businesses that each contributed money into a common defense fund, which would then be used to fight bribe-demanding officials in court or in the media, and to hire private security to protect federation members against more violent demands. Such a strategy was worth little in the Suharto era because corruption was a means to obtain competitive advantage; this is much less the case now.

Again, though, the realities of collective action in Indonesia do not make this an easy solution. The ethnic composition of small and medium-sized business-owners is likely to be skewed towards minority ethnic groups; at the same time, even when confronted by significant private security and high-priced legal help, demanders of bribes can still exert substantial and violent pressure on extortion victims, as the Manulife case has demonstrated.

### **Conclusion**

As an emerging democracy with a history of clientelist politics, Indonesia confronts significant obstacles to attacking the problem of corruption. Still, there are many countries confronting similar obstacles that have succeeded in narrowing the scope of the problem. This report identifies the main obstacles to fighting corruption that emerge from the dynamics of political competition in the country, particularly the lack of credibility of political parties regarding most issues of public policy. Credibility is difficult to generate in a short period of time. However, institutional reforms such as the introduction of a vote of

confidence, the use of minimum vote thresholds rather than organizational requirements as a condition of entry for new parties, and steps to facilitate the collective action of extortion victims are potentially important initiatives that might dampen corruption incentives in the short run.

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