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FIGHTING CORRUPTION AND PROMOTING COMPETITION

Contribution from Indonesia

-- Session I --

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FIGHTING CORRUPTION AND PROMOTING COMPETITION

-- Indonesia * --

1. Competition Enforcement for Corruption Eradication: Introduction

1. Corruption is a serious problem in Indonesia, even the eradication of the corruption has been becomes top priorities of the Government but kept increase despite of the policy reforms and regional autonomy era. It is not as simple as said to prevent corruption because the development of corruption in different countries vary according to the political, cultural, community legal awareness and the development of legal systems adopted by each country. From this fact it appears that the eradication of corruption in many countries, including in Indonesia is something crucial and multidimensional problems, this means that the eradication of corruption cannot be approached only from one kind of approach. However, every effort should be deployed, thoughts, and methods of the various life because corruption is not just a question of law violations, but also related to culture, economics, and politics.

2. According from our history, reformation has successfully resulted in a number of laws to stimulate democratic values in the fields of politics and economy followed by good, clean, transparent, and accountable government. Among others are laws on prohibition against monopolistic practices and unfair business competition and laws on corruption eradication. Ever since 1999, through the birth of Law No. 5 of 1999 concerning the Prohibition of Monopolistic Practices and Unfair Business Competition (“the Law”), Indonesia has declared that fair competition should be one of the principles to be accommodated for the economic development of the country. Therefore, it becomes a liability for the entire stakeholders (mainly enterprises and regulators) to accommodate and implement the values stipulated by the Law in carrying out its activities throughout the economic sector.

3. The obligation to accommodate the values of fair competition was not without cause. The setting is part of the nation's journey through various phases in the economic sector. Economic crisis in 1997 which brought down the economy of Indonesia, tells us the underlying fundamentals of how fragile the economic development and growth of Indonesia without proper competition policy in place.

4. At that time, based on that one of the main causes of all behavior that so many monopolistic practices and unfair business competition that characterizes the economic life of Indonesia. Various exclusive rights in it with ease, in various strategic sectors, were enjoyed by a handful of firms that have access to power. So we know that when a monopoly on the commodity flour, Pontianak Orange, cloves and a few others. While on the other hand, regulation by businesses also becomes a very strong color in Indonesian economic systems of the past. Arrangements by business actors in competition perspective cartels were legitimized through a variety of policies issued by the regulator. It was understandable given that patronage of politicians/bureaucracy to business operators. The result was, Indonesia was known as a country with high costs and fragile economic fundamentals at that time. The monetary crisis becomes evidence of the facts.

* This report is jointly prepared by Research Bureau and Foreign Cooperation Division. For further information, please contact us at international@kppu.go.id.

2. Corruption and competition in Indonesia

5. The issuance of law on corruption eradication in the year 1999 followed by establishment of anti-corruption body and special court on corruption indicates the state's commitment to accelerate corruption eradication. Since that issuance, Indonesia puts corruption as an extraordinary crime and the enforcement is deemed important to sustain better economic performance.

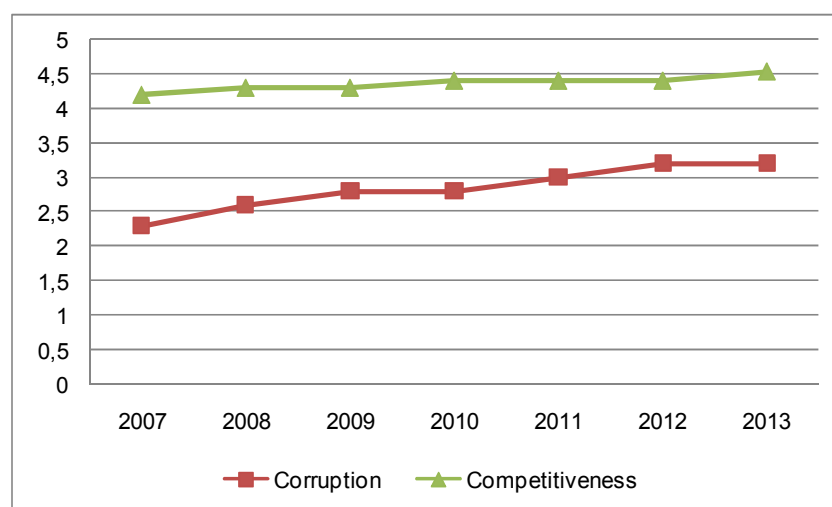
6. In the World Bank publication titled "*Redesigning the state to fight corruption*", Ross-Ackerman (1996) formulated a hypothesis that, in general, efforts to improve competitiveness would reduce the incentives for corruption. The foundation of the conceptual framework is the existence of illegal fees which are often found in conditions where competition is lacking (Celentani and Ganuza, 2001). Thus, conceptually there is some sort of causal relationship between corruption and the level of competition.

7. Simply put, models or parameters for testing the level of corruption is often represented by the form of bribery or illegal fee. In the context of government procurement of goods and services, providing a tangible form can bribe money back (kick-back) or a token of gratitude and come in the form of gratification. The question is, where business actors (the winning bidder) have the funds to provide various forms of bribery and other illegal fees? Answers may greatly vary. However, in a competition perspective, the presence of excessive pricing that result in abnormal profit may be one source of funds for the company to fund a range of activities related to the graft. This is consistent with the concept that in a low level of competition environment, businesses will have market power and potential for misuse of the power to earn abnormal profits. Like a nasty cycle, accumulation of abnormal profits will be a source of funding for businesses to continue to run the practice illegal fees and various other forms of bribery, especially with a view of ensuring corporate interest ahead in relation to various forms of regulation, policy and other conditions that may affect business activities. In these conditions, the potential for corruption is in the process of drafting regulations/policies as well as the discussions between the interest discussion groups (lobbyists) with policy makers.

8. From many literature, a significant relationship between the level of (potential) corruption with competitive climate can not be confirmed. It refers to the study Celentani and Ganuza (2001), Allen and Quin (2007). In fact, the results of Straub (2005) concluded that competition can indeed result in a welfare improvement, but it can only lead to an increase in corruption. Ambiguous condition is also seen when we compare the perception of corruption (CPI) and the data competitiveness (GCI) in Indonesia. It shows that the higher the CPI index, the lower the perception (or prevalence) on corruption, vice versa. Although there are fundamental flaws to the comparative method, but at least this gives us challenges to academic circles to describe more accurately about the relationship between corruption and level of competition.

9. As many developing countries, Indonesia does have some problems with corruption. The good news is, it tends to move in a positive manner as the following chart. Eventhough the changes of corruption (39%) is move beyond those competitiveness (7.8%) within the last seven years, it still indicated that corruption eradication in Indonesia moving toward a precise direction in supporting national economic development.

**Indonesia's Corruption and Competitiveness Index
Year 2007-2013**



Source: Transparency International and World Economic Forum, 2013 (adjusted)

3. Measures by Competition Law

10. Various measures of prevention and action have been taken by law enforcement agencies to overcome corruption, including anti-corruption agency, national police, and attorney general. However, as competition policy and law, it will not be successfully eradicated if it is dealt with by law enforcement agencies only, or let alone by anti-corruption institutions only.

11. Therefore, the competition law should be enforced also as efforts for corruption eradication, at least as efforts for corruption prevention. This is very possible as the potency of corruption with bigger scale may be attributable to business actors who have some funds from their profits, which are very potential to be granted as illegal fees or bribes or other forms to policy makers.

12. One of the characteristics of a government with high corruption level is strong relationship between those in power (government or political party) and business actors. Business actors who have access to power are usually provided with exclusive rights and other facilities with proportional compensation to the related officers. The business actors can then freely exploit consumers by excessive pricing in order to gain supernormal profits.

13. From the perspective of competition policy, however, excessive pricing that result in supernormal profits is one of potential sources of funds for companies to finance various corruption related activities. This is in line with the concept that in a condition where there is a lack of competition, business actors would have market power and be very potential to misuse such power to gain supernormal profits. Like a vicious circle, the accumulated supernormal profits will then become potential sources of funds for business actors to put illegal fees and other forms of bribery into practice, particularly with the objective to protect the interest of companies in the future from various regulations, policies and other provisions that may affect business operation. In such a condition, a potential corruption is begun in the formulating process of a regulation/policy and discussion between an interest group (lobbyists) and policy makers.

14. Researches that were conducted by several academicians showed that the relationship between competitiveness and corruption is not easy to conclude. Ross-Ackerman (1996) formulates a hypothesis that in general, various efforts to improve competitiveness would reduce incentives for corruption. The conceptual framework is based on illegal fees that are often found in a condition where there is a lack of

competition (Celentani and Ganuza, 2001). Straub (2005) concluded that competition can actually result in welfare improvement, but at the same time corruption may increase as well. It was plainly outlined that the level of corruption is often represented in the form of bribes and illegal fees. In connection with the procurement of goods and services for the government, a bribe may be in the form of a kickback and/or a token of gratitude in the form of gratification.

15. Own study on ASEAN countries by KPPU founded that there is a pattern that, the better the corruption index or rank of a state or region (less corruption), the better level of her competitiveness, or in simple term, lower corruption will support competitiveness of a nation or a region. I believe, there are numerous similar studies that support this finding. This can be explained that with tough climate of competitiveness, the business world must try hard to improve efficiency and competitiveness and avoid wasting. The profits gained are also reasonable instead of supernormal. As a result, the potency for corruption becomes lower. However, Indonesia shows an interesting finding where lower corruption is not merely higher Indonesian level of competitiveness. There is still other factors that affect both issues in Indonesia. This is, I believe, an interesting finding that will invite more researches to KPPU or other academicians in order to find best model or solution to synchronize competition policy, competitiveness, and corruption in Indonesia.

4. Competition Agency's Efforts for Corruption Prevention

16. In the framework of law enforcement, KPPU, the Indonesian Competition Authority that was established pursuant to Law No. 5/1999 has duties and authorities to prevent and take action against violation of law on competition and provide the government and related state agencies with recommendations and considerations.

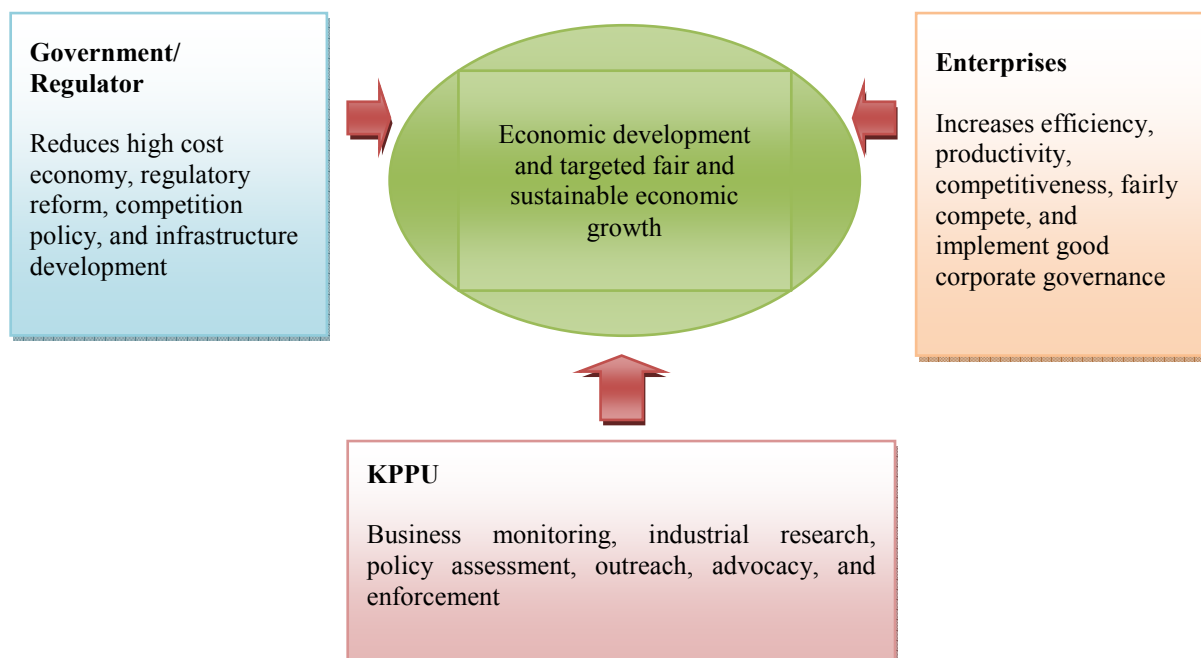
17. Within the eleven year period upon its establishment, KPPU has shown ever increasing outputs of law enforcement. The data shows that in terms of report handling, up to the first quarter of 2012, KPPU has received 1,253 (one thousand and two fifty three) reports from various regions. Last year only, the Commission received 219 (two hundred and nineteen) formal reports, where 83% (182 formal reports) related to potential bid rigging activities in public procurement. From those reports, 265 (two hundred and sixty five) of which is handled as case and follow formal legal proceeding at the Commission.

18. The relationship between the law on competition and corruption conduct in Indonesia lies on the application of prohibition against conspiracy in tender as referred to in Article 22 of Law No. 5/1999. In the Article, business actors are prohibited from committing tender conspiracy with other parties (including the government) in winning certain business actors. Vertical conspiracy between business actors and tender committees cannot be separated from corruption efforts. It is less impossible that if there are facilities from a tender committee (the government) to a certain business actor, it is without involving bribery or corruption.

19. It is the fact that potential for corruption would be higher if entrepreneurs have the ability to print supernormal profit. Super normal profits will usually result in market conditions that competition leads to imperfect, which occurs because of market distortions through policies). In this condition, enterprises will grow with significant market power. Market power may then be abused by the mark-up which lead to excessive, and the quantity may exploited.

20. Furthermore, through supernormal profits, enterprises have the ability to maintain that market through lobbying government officials, especially sector regulator in which firms are operated. This is consistent with the analysis of corruption based on the concept of rent seeking, which the authorities will be considered committing rent seeking (or corruption) when they use a "rate" on their authority to provide benefits (legal or illegal) to the client. Through such way that create chain of efforts to create super-normal profits that some part of it will become bribery or corruption, enjoyed by the officials with the power to make those arrangements.

21. As one of the pillars of national economy, the role and contribution of the Commission can be presented by the following scheme.



22. It can be seen that the Commission will make many efforts to encourage economic development. However, such achievement should also be supported by variety of regulatory and economic policy issued by the government and businesses behavior that promote efficiency, productivity, fair competition and also apply the principles of good corporate governance. In other words, the achievement of economic development will depend heavily on coordination and cooperation among the various parties involved in the national economic development.

23. In coping with corruption in public procurement through enforcement of law on business competition, KPPU uses several approaches. First is through cooperation with the Anti Corruption Commission. The cooperation is focused on exchange of data and information, joint socialization related to prevention of conspiracy in tenders, and delegation of conspiracy cases that involve corruption. With such cooperation, if KPPU finds that a government element is involved in a corruption, KPPU may delegate the corruption case to a more competent institution. In addition, KPPU would also recommend administrative actions against the officers concerned to those with higher position in their organization.

24. From advocacy side, most discussion topics in those activities include conspiracy in public procurement. In order to enhance understanding of the stakeholders that include the government, business actors, academicians, journalists, legal practitioners, and the public, KPPU conducts the activities of socialization and advocacy. The activities including mass media network development (journalist forum), competition forum development at national level, joint socialization between the parliament and the government, socialization of business competition in regions, formulation of advocacy subject matters, intensive socialization in media, joint socialization with judges, joint socialization with public institutions, discussion fora in Regional Representative Offices, and business competition seminars in regions.

25. On the corruption and collusion in public procurement, KPPU had conducted several advocacies, namely;

- By guaranteeing regulation or policy on licences, and procurement have adopt competition principles (openness, transparency, and non discrimination). This shown by high demand on consultation by bid committee and participant, including those in construction;
- Having allocation of concession and frequency allocation which should be provided through open dan competitive bidding (e.g. Presidential Decree No. 67/2005 on Fostering Infrastructure Development);
- In monitoring, the Commission will keep supervise the implementation of policies and regulations on licensing.

26. Experiences have shown that those approaches have not resulted in sufficient deterring effects, so that KPPU is currently putting another effort into the punishment of administrative sanctions to tender committees or principals. This is applied based on the definition of business actors in Law No. 5/1999, where in public procurement, a tender committee acts as the purchaser and therefore it can be classified as a business actor and imposed with sanctions.

27. In prevention efforts, various activities of business competition advocacy are always carried out. Those activities are conducted by publishing manual for prevention of conspiracy in tenders and holding various seminars and workshops with the government, business actors, and other stakeholders in regard of Law No. 5/1999 and particularly conspiracy in tenders.

28. Should there will be a violation, the Commission will focus on the collusive practices between bid participants, while the corruption aspects will be handed to independent authority enforcing corruption eradication or through attorney general.

5. Conclusion

29. Collusion and corruption in public procurement have become like a chronic and spreading disease in Indonesia. A variety of efforts have been put into corruption eradication. However, corruption cannot be eradicated by the enforcement of corruption law only. Corruption eradication has to be a national people's movement by involving all layers of the society, including through competition policies.

30. From the perspective of economics, the practices of monopoly and unfair business competition are very potential to fertilize collusion and corruption. Cartels, abuse of dominant positions, merger and acquisition, and other forms of conspiracy are conducted by business actors with expectation to gain supernormal profits. Despite only expectation, business actors would be please to provide any parties with some funds to realize it. Moreover, if a supernormal profit has ever been gained successfully, a quite big fund would be available to realize the next expectation, maintain profits or even make market expansion. As such, the relationship of corruption and unfair competition would form a vicious circle that is the longer the harder to break.

31. The enforcement of law on fair business competition would stimulate to realize the level playing field. Government policies and regulations would also put more attention on accessibility, treatment, equal opportunities for business actors without discrimination. The society would certainly be more prosperous in that they would be able to save their income and make rational choices in the market. Meanwhile, the business world would be able to grow big if the competition climate is healthier as competition would help promote efficiency, productivity, and competitiveness. Business actors would keep gaining profits but at reasonable and sustainable levels. Thereafter, with profits at reasonable levels, the smaller would be the potency for business actors to provide the related officials with kickbacks or bribes.