

**THE PARADOX OF CORRUPTION AS ANTITHESIS TO ECONOMIC
DEVELOPMENT: DOES CORRUPTION UNDERMINE ECONOMIC
DEVELOPMENT IN INDONESIA AND CHINA AND WHY ARE THE
EXPERIENCES DIFFERENT IN EACH COUNTRY?**

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I. INTRODUCTION

The question of whether corruption is antithetical to economic development has been extensively researched and debated since the 1960s. This has occurred largely in connection with law and economic reform efforts directed by governmental development agencies and non-governmental organizations in Western¹ countries toward developing countries in Africa, South America, and Asia. More recently, interest in this question has been rejuvenated by China's dramatic economic growth (especially as contrasted with other states in political and economic transition), despite widespread corruption in that country. While nearly all participants in the debate appear to agree that corruption ultimately is antithetical to long-term economic development, the extent to which it positively or negatively affects economic development in the short term depends upon highly contextual factors. In different countries and regions of the world, factors of local culture and history, the nature of the state, the type of corruption and actors involved, and the political responses and motivations to curtail corruption all inform the answer to this question.

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¹ In this article, the terms "West" and "Western" are used in their contemporary, non-geographic sense as encompassing the Americas and Western Europe, as well as countries such as Australia and New Zealand which are geographically far from Western Europe and the U.S. but culturally still very "Western."

Two countries are considered in this article: Indonesia and China. These countries were chosen for discussion because both are rife with corruption, especially in public administration and, although both are in Asia, they represent very different cultures and political systems from each other. It is suggested in this article that corruption in Indonesia is a significant deterrent to economic development and is a problem which needs to be addressed more vigorously and eliminated by the Indonesian government. Corruption in Indonesia not only siphons-off and reallocates resources in a non-productive manner, it also discourages much-needed direct foreign investment. Paradoxically, corruption in China appears to be a useful State tool that actually encourages economic development in the short term, while creating less optimistic long-term prospects. Due, in part, to the nature of China's political system, corruption appears to advance economic development by slowing political reform while still allowing less disruptive market reforms. Accordingly, an analysis of corruption as it affects economic development in Indonesia and in China illustrates that the extent to which corruption is antithetical to economic development ultimately depends upon context.

II. WHAT IS CORRUPTION? DEFINITIONS AND CONCEPTS

Corruption evades definition. As has been said of beauty and obscenity, ironically, one could also say that corruption "lies in the eye of the beholder," and that, while we may not be able to define it, we "know it when we see it."² Moralists, for example, define corruption according to simple (and simplistic) terms of right and wrong action, akin to stealing or lying. This moralist definition often supposes that there is a universal moral code, usually a Western moral code or some idealized version of it. Moralists also may purport to incorporate prevailing local cultural norms which are likely to change from time to time.

On the other hand, some scholars avoid moral absolutes in defining corruption. They see such morality-based definitions as

² *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964). U.S. Supreme Court Justice Potter Stewart is oft-quoted for his statement in *Jacobellis* regarding what is obscene: "I shall not today attempt further to define the kinds of material I understand to be embraced . . . [b]ut I know it when I see it . . ." *Id.*

hypocritical.³ To them, definitions based on some supposed universal moral code are seen as ethnocentric, failing to take into account local cultures and norms. These scholars instead rely on more objective terms usually derived from economic or legal principles. They define corruption in terms of “the market” and diversion or (mis)allocation of scarce resources, or in terms of illegal practices which violate specific legal codes or administrative regulations.

Scholars further break down the concept of corruption into various subcategories according to the greater public interest or even public opinion. These scholars use a “litmus test” by which corruption is characterized (much like acceptable “white” lies versus unacceptable lies) as black, white or gray, according to whether the lie directly and immediately benefits the public as well as the corrupt actors.⁴ Thus, for example, a public official diverting public funds from an intended project is seen as less corrupt (white or gray corruption) if his action will benefit his constituency even if his noblesse is tainted by what he skims for himself. Still other scholars break down corruption into further typologies, such as quasi-corruption, pre-corruption, integrative corruption and disintegrative corruption, in an effort to “provide some systematic method of approaching so complex a phenomenon.”⁵

Each of these definitions and categories has its weaknesses. The problems with morality-based definitions have been summarized above. Legal codes often lag behind societal norms and may not be in sync with what is considered as corrupt conduct. Economic principles are somewhat subjective, generally free-market based, and tend to assume that there are vaguely different standards applicable to public officials in comparison with private business persons.⁶ Definitions

³ We apply different standards and definitions to ourselves, for example, when we buy tickets to a sold-out game from a scalper, or when we tip a *maitre d'* in order to jump the queue in a crowded restaurant.

⁴ Simcha B. Werner, *New Directions in the Study of Administrative Corruption*, Vol. 43 No. 2 PUB. ADMIN. R. 146, 147 (1983).

⁵ Kate Gillespie & Gwenn Okruhlik, *The Political Dimensions of Corruption Cleanups: A Framework for Analysis*, Vol. 24 No. 1 COMP. POL. 77, 79 (1991).

⁶ See, e.g., David Kennedy, *The International Anti-Corruption Campaign*, 14 CONN. J. INT'L L. 455, 455 (1999). Kennedy also notes that a further dimension to this double-standard is a First World vs. Third World bias. Practices characterized as corrupt when conducted by government officials in the Third

based upon concepts of public interest and public opinion are not only based upon highly transient judgments, but public interests and opinions are also extremely diverse and difficult to ferret out effectively. Moreover, even the best efforts to “eliminate moralizing rhetoric and stick to the more rational language of economic advantage or defense of a presumptively neutral and locally adopted rule of law,” may still suffer from “moral opprobrium” which unavoidably colors the discourse regarding corruption.⁷

Corruption in the context of Indonesia and China is even more difficult to define because attempts at definition risk further extending the express or implied issue of morality into a debate over Western values versus Asian values. Asian culture has been traditionally characterized by Western (Orientalist) writers as essentially “defective to the point of being immoral and corrupt”⁸ Asian legal culture, for example, may be demonized in the West as “immature, primitive, backward, subjective and irrational,” in contrast to Western laws which are seen as “developed, modern and advanced, objective and rational.”⁹ At the same time, some Asian leaders – especially Dr. Mahathir of Malaysia and Lee Kuan Yew of Singapore – have fallen back on a sort of “reverse Orientalism”¹⁰ in deflecting Western attempts to define and combat corruption in Asia. They argue that Asia has its own unique, and uniform, way of doing things and that Western attempts at reform are a neo-colonialist form of cultural imperialism.¹¹ This “Asian values” debate is beyond the scope of this article, but it is noted that any definition of corruption, especially as it pertains to Asia, is susceptible to criticism as being heavily biased in favor of Western ideology.

Probably the most widely-accepted definition of corruption often relied upon when discussing corruption in Asia, is the World

World may be no different than the accepted private practices of First World individuals and corporations. *Id.* at 458.

⁷ *Id.* at 458.

⁸ Tim Lindsey, *History Always Repeats? Corruption, Culture and “Asian Values,”* in *CORRUPTION IN ASIA: RETHINKING THE GOVERNANCE PARADIGM* 1, 1 (Tim Lindsey & Howard Dick, eds., 2002).

⁹ *Id.* at 2 (internal citations omitted).

¹⁰ *Id.* at 8.

¹¹ *Id.* at 9.

Bank definition of corruption as “the abuse of public office for private gain.”¹² That definition, while limited to the public administration arena (as opposed to corruption purely in the private sector), is useful to the following analysis of corruption in Indonesia and China. While it implicitly conceptualizes corruption in somewhat normative terms, essentially a violation of formal or legal norms,¹³ the World Bank definition does not imply any negative economic consequences of corruption. This is an especially important factor when considering the premise of this article that corruption in China may have some positive short-term effects on the Chinese economy, despite negative long-term effects. In practical terms, moreover, that definition extends over those areas of public corruption most frequently encountered in both Indonesia and China: bribery, extortion, patronage, nepotism, theft of state assets, and diversion of state revenues. It is the World Bank definition, therefore, which underlies the discussions in this article.

III. THE CULTURE OF CORRUPTION: INDONESIA AND CHINA COMPARED

In the 1960s, in conjunction with the law and development movement,¹⁴ it generally was accepted that corruption was “a usual

¹² WORLD BANK, *CORRUPTION AND ECONOMIC DEVELOPMENT, HELPING COUNTRIES COMBAT CORRUPTION: THE ROLE OF THE WORLD BANK* 8 (1997), <http://www1.worldbank.org/publicsector/anticorrupt/corruptn/corruptn.pdf>. Although a useful definition, there may be some conduct that falls outside the scope of this definition but which nevertheless would generally be considered corrupt. An abuse of public office, for example, might fall outside the scope of this definition if the abuse does not actually benefit the public official and instead benefits the public. Returning to an earlier example in this article, one can further question whether corruption exists when a public official fraudulently diverts funds from an intended project in another jurisdiction to benefit his own constituency. Morality and law-based definitions of corruption, and most economics-based definitions, would deem such action as corrupt.

¹³ Howard Dick, *Corruption and Good Governance: The New Frontier of Social Engineering*, in *CORRUPTION IN ASIA: RETHINKING THE GOVERNANCE PARADIGM* 71, 72 (Tim Lindsey & Howard Dick, eds., 2002).

¹⁴ The so-called law and development movement was largely spearheaded by U.S. law professors, sponsored by the U.S. government (USAID) and the Ford Foundation, who saw it as a way to stabilize various developing countries' economic and political systems; the experiment was first introduced in

and expected part of the national maturation process” in developing countries.¹⁵ Certain “corrupt” practices were attributed to the immature development of the rule of law in those countries. In fact, characterizing those practices as corrupt was seen as a West-centric imposition of Western values on indigenous practices (such as gift-giving or payment of tribute to authority figures). Conduct that might be “viewed as corruption in the West would be interpreted differently within the customs of emerging economies.”¹⁶ It was suggested that in developing countries there was simply “a gap between law (as imposed by western and alien standards) and accepted informal social norms (sanctioned by prevailing social ethics),” into which slipped the “folklore,” “climate,” or “way of life” of corruption.¹⁷

More recent scholars, however, assert that “the theoretical tenet that corruption is a dependant variable of development is false.”¹⁸ It generally is agreed today that corruption exists in all countries and in all societies, at all stages of economic and political development.¹⁹ Even in the United States, for example, “common wisdom . . . indicates that corruption has now become part of the

Africa, with resounding failure, and later in various forms in Asia and Latin America over a period of about ten years.

¹⁵ Werner, *supra* note 4, at 147.

¹⁶ Daniel Kaufman, *Corruption: The Facts*, 107 FOREIGN POL’Y 114, 115 (1997).

¹⁷ Werner, *supra* note 4, at 148 (internal comments added).

¹⁸ *Id.* at 148; *see also* Kaufman, *supra* note 16, at 114 (“In more recent times a revisionist view has held that corruption may not be inconsistent with development and at times may even foster it.”).

¹⁹ *See, e.g.*, Werner, *supra* note 4, at 148; Isaac Ehrlich & Francis T. Lui, *Bureaucratic Corruption and Endogenous Economic Growth*, 107(S6) J. POL. ECON. S270, S271 (Dec. 1999); Nora M. Rubin, *Notes and Comments; A Convergence of 1996 and 1997 Global Efforts to Curb Corruption and Bribery in International Business Transactions: The Legal Implications of the OECD Recommendations and Convention for the United States, Germany, and Switzerland*, 14 AM. U. INT’L L. REV. 257, 265-66 (1998); *but see* Peter W. Schroth, *American Law in a Time of Global Interdependence: U.S. National Reports to the XVIth International Congress of Comparative Law: Section V, The United States and the International Bribery Conventions*, 50 AM. J. COMP. L. 593, 619 (Fall 2002) (“There is a silly conventional wisdom that corruption is everywhere, only in different forms.”).

national lifestyle.”²⁰ It is said to be “endemic to United States politics, businesses, and social institutions.”²¹

Corruption is very different, however, in each country wherein it occurs. There are wide variations from one country to the next, both as to the degree to which it prevails and the nature of corrupt activity. As such, any analysis of corruption and its effects in different countries must examine the particular context of corruption in each country. Depending on the country involved, factors might include the local culture and history, nature of the state, type of corruption, actors involved, and political responses and motivation to curtail corruption (or not). These factors collectively form the culture of corruption in a given country. Significantly, the term “culture of corruption” is not used in this article in the same ethnocentric and apologetic sense it appeared in the law and development movement, especially as an effort to deflect criticisms of that movement’s failures.²² Rather, it is used in the sense that local context is an important factor in discussing corruption.

A. *The Culture of Corruption in Indonesia*

With respect to Indonesia, it has long been said that there is a “culture of corruption.”²³ In fact, with a diverse population of more than 240 million people²⁴ spread over an archipelagic state of 17,508

²⁰ Werner, *supra* note 4, at 148.

²¹ *Id.* According to a relatively recent World Bank study, “perceived corruption” may have “risen slightly during the 1990s in Western Europe and North America, but still, as of 1999, [it was indexed] at less than half of any other region and about one-third of the level in sub-Saharan Africa.” Schroth, *supra* note 19, at 622, note 141 (citing Lederman, Loayza & Reis Soares, *Accountability and Corruption: Political Institutions Matter*, WORLD BANK WORKING PAPER NO. 2708 (2001)).

²² See Lindsey, *supra* note 8, at 1.

²³ Gary Goodpaster, *Reflections on Corruption in Indonesia*, in CORRUPTION IN ASIA: RETHINKING THE GOVERNANCE PARADIGM 87, 87 (Tim Lindsey & Howard Dick, eds., 2002) (“Indonesia’s first vice-president, Mohammad Hatta, said this a long time ago, but it is often repeated . . .”).

²⁴ United States Central Intelligence Agency, The World Factbook, <http://www.cia.gov/cia/publications/factbook/geos/id.html> (last visited Sept. 10, 2006).

islands,²⁵ corruption may be Indonesia's predominant cultural common-denominator. The reasons for such widespread corruption are difficult to ascertain and somewhat controversial (particularly when so-called "Asian values" are invoked). Indonesia's political history, including recent efforts to accomplish greater government decentralization, may be the most important factor in shaping the current culture of corruption. Other contributing factors may include a certain sense of resignation or acquiescence by the average person in Indonesia (even in the midst of widespread calls to eradicate corruption). Further, there has been a lack of "staying power" by outside donor organizations, intermittently "ramping-up" their insistence for anti-corruption reforms, only to later lose momentum and interest.

Following centuries of Dutch colonialism, subsequent Japanese occupation during World War II, and a brief attempt after the war by the Dutch to regain control (prevented largely through intervention by the United States and Great Britain through the United Nations), Indonesia finally emerged as a "democracy" slightly more than fifty years ago. The country's first constitution (drafted in 1945) established a very basic framework of fundamental government institutions necessary for an effective legislature, executive, and judiciary.²⁶ Despite a "thin" rule of law,²⁷ however, that gave the appearance of democracy, Indonesia passed through a prolonged period of authoritarian rule that: "implicitly – sometimes explicitly – rejected the universalism of human rights as an innately Western concept that was alien to East Asia . . . [;] asserted the irrelevance of separation of powers[;] and elevated the state to a position of almost

²⁵ Republik Indonesia Portal Nasional, Posisi Geografis, http://www.indonesia.go.id/navigasiDetail.php?n_avId=1&content=0 (last visited Sept. 10, 2006).

²⁶ The 1945 Constitution of the Republic of Indonesia, especially Articles 2-17, 19-22E, and 24-25.

²⁷ A "thin" rule of law is characterized by certain procedures and fundamental institutions. This is in contrast to a "thick rule" of law, which is more substantive, tends to emphasize the importance of law, and may even include notions of "morality related to economic governance . . . regime type . . . and human rights." Erik G. Jensen, *The Rule of Law and Judicial Reform*, in *BEYOND COMMON KNOWLEDGE* 336, 339 (Erik G. Jensen & Thomas C. Heller, eds., 2003).

unchecked authority.”²⁸ Only after the fall of Soeharto’s “New Order” in 1998 (which spanned 32 years), did Indonesia finally commence “a formal constitutional transition from authoritarianism to a liberal representative democratic system, with a new institutional framework that would allow separation of powers,” in essence favoring a “historically weak, but now politically irresistible, Anglo-American ‘thick’ interpretation of rule of law.”²⁹

As suggested above, these political transitions from colonialism to authoritarianism to real democracy, coupled in turn with greater decentralization of the government (discussed below), were protracted catalysts for the pervasive culture of corruption in Indonesia today. It has been observed that “[c]olonization distorts relationships, destroys or petrifies institutions, and corrupts men and women, both colonizers and colonized.”³⁰ The authoritarian governments which replaced the colonial government, in turn, were firmly autocratic and the state operated virtually as a family enterprise for the benefit of the president, his family and friends. The Soeharto government, for example, was so corrupt that doing business in Indonesia necessarily involved a “complex web of corrupt deals and political payoffs,” generally tied to Soeharto’s family and cronies.³¹ Thus, corrupt practices and a sense that the state (and the bureaucratic machinery) was above the law not only continued, but became even more firmly entrenched in the wake of colonialism as relationships and institutions were further distorted.

Finally, with the end of the New Order and its authoritarian rule, Indonesia underwent a transition from an autocracy to a real democracy. The social and political disruption as Indonesia began reworking its fundamental institutions, however, continued to provide

²⁸ Tim Lindsey, *Indonesia: Devaluing Asian Values, Rewriting Rule of Law*, in *ASIAN DISCOURSES OF RULE OF LAW* 286, 286 (Randall Peerenboom, ed., 2004).

²⁹ *Id.* at 296.

³⁰ George J. Aditjondro, *Liberating Our Colonial Mindset* (Aug. 16, 1995), <http://www.hartfordhwp.com/archives/54b/034.html> (last visited Sept. 9, 2006) (paraphrasing ALBERT MEMMI, *THE COLONIZER AND THE COLONIZED* 217 (Earthscan Publications 1990) (1957)).

³¹ Jared Levinson, *Indonesia’s Odyssey: A Nation’s Long, Perilous Journey to the Rule of Law and Democracy*, 18 *ARIZ. J. INT’L & COMP. L.* 103, 112 (2001). Even Soeharto’s late wife, Siti, “was known as ‘Madame Ten Percent’, reflecting her share of all public contracts.” *Id.*

a fertile climate for corruption. Indeed, it has been observed generally that such transitional periods of “political modernization . . . [are] usually accompanied by increases in corruption.”³²

Decentralization of the government as part of this political transition has also exacerbated wide spread corruption. Over the past decade, Indonesia has moved somewhat haphazardly from the highly-centralized autocratic regime of Soeharto, through a period in the late 1990s of politically motivated (popularly mandated, and not always peaceful) demands for greater administrative and political autonomy at the regional level, and ultimately to a more carefully crafted decentralization of governmental (especially fiscal) authority to the provincial and local governments.³³ While this decentralization may be good for local fiscal autonomy and relieves the unnecessary burdens on the central government as it (inefficiently) has tried to administer programs across such a widely dispersed population, it also has created decentralized opportunities for corruption that previously did not exist at the provincial and local level in Indonesia. As provincial and local governments administer more programs and control more government funds and expenditures, local bureaucrats also now have opportunities for diversion of funds and “rent-seeking”³⁴ activities: primarily bribery and collection of excess “administrative” fees in connection with the performance of official duties.

Indeed, most of the corruption in Indonesia is in the nature of rent-seeking activities by government officials. Very low government salaries which encourage rent-seeking, together with a broad cultural

³² Andrei Shleifer & Robert W. Vishny, *Corruption*, Vol. 108 No. 3 Q. J. ECON. 599, 610 (1993).

³³ The most significant steps toward decentralization have been accomplished by Law Number 18/1997; Law Number 22/1999; Law Number 25/1999; Law Number 34/2000 (amending Law Number 18/1997); and, late in 2004, the enactment of Law Number 32/2004 and Law Number 33/2004, which replaced Law Number 22/1999 and Law Number 25/1999, respectively, regarding the authority of the central government (Undang-undang Nomor 18 Tahun 1997, Undang-undang Nomor 22 Tahun 1999, Undang-undang Nomor 25 Tahun 1999, Undang-undang Nomor 34 Tahun 2000, Undang-undang Nomor 32 Tahun 2004, and Undang-undang Nomor 33 Tahun 2004, respectively).

³⁴ DAVID KENNEDY, *THE DARK SIDES OF VIRTUE: REASSESSING INTERNATIONAL HUMANITARIANISM* 165 (2004). “Rent-seeking” is frequently used in literature to refer to “using power to extract a higher price than what would be possible in an arm’s length or freely competitive bargain.” *Id.*

“expectation that if anyone provides a service, there will some payment for it,”³⁵ combine to foster the culture of corruption. As one American scholar has observed, “[i]n a sense, the ordinary functions of government have been quietly “privatised” in what we would think of as perverse ways.”³⁶ And, where the top strata of the state and its bureaucracy set an example of corruption, corruption becomes part of the national culture. An editorial in the *Jakarta Post* recently explained:

[i]n a hierarchical society, such as Indonesia’s . . . norms and values are defined by those at the apex of the societal structure. If the public perceives their leaders as being able to get away with "murder", than the only logical conclusion is that such behavior is acceptable.³⁷

This has also been characterized as the “leader-follower spillover effect” of corruption: “left to itself, corruption will grow, ‘spilling over’ and affecting increasing portions of a given organization or society.”³⁸ As Niccolò Machiavelli cautioned a half-millennium ago, “what the prince does the many will also soon do – for in their eyes the prince is ever in view.”³⁹

Ironically, in the midst of this culture of corruption, the call for an end to “corruption, collusion, and nepotism” – *korupsi, kolusi dan nepotisme* (“KKN”) – has been a rallying cry throughout Indonesia for many years. The press devotes significant attention to the subject and there are frequent articles in the newspapers regarding

³⁵ Goodpaster, *supra* note 23, at 92.

³⁶ *Id.*

³⁷ Editorial, *Rooting Out Corruption*, JAKARTA POST (Indonesia), Apr. 13 2005, available at <http://www.anti.korupsi.org/eng/mod.php?mod=publisher&op=viewarticle&artid=429>.

³⁸ Werner, *supra* note 4, at 149. This theory appears to be adapted from basic principles of group dynamics.

³⁹ *Id.*

corruption and efforts to combat it in Indonesia.⁴⁰ Even the World Bank has moved beyond its earlier euphemistic reference to bureaucratic corruption in Indonesia as “common local practices,” and now expressly addresses the need to combat Indonesia’s corruption.⁴¹

Yet, there is also an air of resignation about corruption,⁴² which may be a product of its sheer magnitude in Indonesia. Corruption in Indonesia has long been “rampant throughout all levels of Indonesian society.”⁴³ As noted in a decision in 2005 by the Indonesian Constitutional Court (*Makhama Konstitusi*), corruption in Indonesia involves “almost all elements and strata in the three branches of the government – the executive, the legislative and judiciary, which colluded – directly or indirectly – to protect themselves, rather than checking one another in a complex democratic system of checks and balances.”⁴⁴ It has been observed that in Indonesia “[c]orruption colors every regime. Like an old tree, its strong roots spread everywhere. From the Old Order to the New Order to the Reform Order, corruption has continued In this republic, corruption is the child of every regime.”⁴⁵ As pointed out above in this article, the Soeharto government was so corrupt that doing business in Indonesia generally involved corrupt payments to Soeharto’s family and cronies. Likewise, subsequent presidents have been characterized by the Indonesian press as all having “waxed lyrically about eradicating corruption and launched high profile anticorruption campaigns,” yet until now they have “left office under

⁴⁰ See, e.g., Editorial, *supra* note 36; *infra* note 44; and Widoyoko, *infra* note 47.

⁴¹ DICK, *supra* note 13, at 71.

⁴² Levinson, *supra* note 31, at 121. Levinson recounts a meeting of business people in Jakarta for a World Bank survey, after which one business person “sadly” told him with respect to the meeting, “Nothing will come of it.” *Id.*

⁴³ *Id.* at 114.

⁴⁴ Ardimas Sasdi, *Govt Must Not Waver in its Battle Against Corruption*, JAKARTA POST (Indonesia), Mar. 16 2005, available at <http://www.antikorupsi.org/eng/mod.php?mod=publisher&op=viewarticle&artid=416>. As reported by Sasdi, the Constitutional Court ruled on February 17, 2005 that the Corruption Eradication Commission (“KPK”), lacks authority to address graft cases that arose before its establishment in 2003. *Id.*

⁴⁵ Levinson, *supra* note 31, at 113-14 (citing Editorial, *Corruption, The Child of Every Regime*, MEDIA INDONESIA (Indonesia), Feb. 23, 2001).

a cloud of suspicion of having facilitated, if not directly participated in, the misappropriation of state funds.”⁴⁶ In fact, the Indonesian press is not optimistic about current President Susilo Bambang Yudhoyono’s pledge to combat corruption either. It has been observed by the press that the “President inherited the same corrupt system that had been built up over decades,”⁴⁷ and that “[w]ith the lack of political will, corrupt legal system, inconsistency in law enforcement and a penchant for the good life, the possibility of success for the government’s anticorruption program is in fact slim.”⁴⁸ Even with some dramatic successes in combating corruption, the opinion in Indonesia remains that “we have been in this situation before – high profile case, big headlines, severe punishment, reprieve and back to business as usual.”⁴⁹ The culture of corruption in Indonesia persists despite reform efforts.

B. *The Culture of Corruption in China*

A relatively recent article by Chinese economist Shuntian Yao eloquently summarizes that:

[s]ome people hold the view that China’s corruption problems have their root deep in the Chinese culture. They argue that the Chinese people, as well as most of their counterparts in Asian countries, have a long tradition of placing personal connections above the law, and that this is the real source of corruption. They conclude that, no matter what political system China chooses, the corruption problem can never be avoided. Many CCP officials and business bigwigs

⁴⁶ Editorial, *supra* note 37.

⁴⁷ J. Danang Widoyoko, *Awaiting the results of SBY antigraft campaign*, JAKARTA POST (Indonesia), Oct. 20, 2005, available at <http://www.antikorupsi.org/eng/mod.php?mod=publisher&op=viewarticle&artid=452>.

⁴⁸ Sasdi, *supra* note 44.

⁴⁹ Editorial, *supra* note 37.

agree with this view, although they do not admit it in public. I have had discussions with several friends who are either CCP officials or very successful businessmen; all of them privately supported this view [sic]. They even argued that corruption was not too bad, and that if you could take advantage of it, it could work for you very efficiently, and that, after all, you had to accept it if you wanted to survive in China.⁵⁰

Yao disputes the “culture-root view,” however, as it applies to China.⁵¹ He maintains that the political system in combination with the legal system in China is the true root of corruption.⁵² To support this hypothesis, Yao draws on historical examples of the early Han and Tang Dynasties as periods with rule of law and no serious corruption. In contrast, Yao suggests, “the darkest periods in China’s history are all related to a corrupt political system and to the illegal behaviors of a tiny group of bigwigs or aristocrats who were protected by a fatuous and self-indulgent ruler.”⁵³ According to Yao, rather than a cultural phenomenon, corruption in China is merely a consequence of the faulty political system compounded by the faulty legal system.⁵⁴

It is suggested by this article that, although Yao and other scholars do not to admit it, there is indeed a culture of corruption in China. It is shaped, in part, by the political and legal systems, as well as by the economic systems, that Yao indicates are the sole cause of corruption. In addition to the factors mentioned previously in this

⁵⁰ Shuntian Yao, *Privilege and Corruption: The Problems of China’s Socialist Market Economy – New Perspectives on Transition Economics: Asia*, Vol. 61 No. 1 AM. J. OF ECON. & SOC. 279 (Jan. 2002).

⁵¹ *Id.*

⁵² *Id.* at 281-85.

⁵³ *Id.* at 282.

⁵⁴ *Id.* at 280-85.

article,⁵⁵ as generally coalescing into a culture of corruption in a given country, certain historical and sociopolitical factors found in China also combine to define and color the prevailing culture of corruption in that country. These include a centuries-old Confucian sense of strict hierarchy and order, and a tradition of tributary payments to government officials. They also include the long-standing traditions of *guanxi*, “whereby ‘personal connections’ among government officials and firm managers control the allocation of resources . . . [a] response, rooted in Chinese culture, to an underdeveloped system of property rights and contract law.”⁵⁶ Finally, the Chinese culture of corruption is also shaped by contemporary popular attitudes, the Communist nature (and interventionist stance) of the state, and the state’s response to corruption.⁵⁷

No one disputes that China is currently in a “dark period” of extensive and pervasive corruption, a “cancer of the Chinese society.”⁵⁸ Prominent journalists in China decry that “[c]orruption in China’s system reaches every level and can’t be solved”⁵⁹ and even ponder whether some aspects of corruption in China are “one hundred times worse even than that of Indonesia under Suharto’s ruling.”⁶⁰ It

⁵⁵ See *supra* pp. 2, 7-8.

⁵⁶ C. Simon Fan & Herschel I. Grossman, *Incentives and Corruption in Chinese Economic Reform* 3 (Mar. 2000), <http://www.anti-corr.ru/archive/Incentives%20and%20corruption%20in%20Chinese%20Economic%20Refor.m.pdf> (internal citations omitted) (last visited Sept. 10, 2006).

⁵⁷ See generally MARTIN STUART-FOX, *A SHORT HISTORY OF CHINA AND SOUTHEAST ASIA: TRIBUTE, TRADE AND INFLUENCE* 11-14, 20-22 (2003). The evolution and nature of Chinese culture itself and the impact of Confucianism on present-day issues facing China (a controversial and complex issue in itself) is well beyond the scope of this article. A good discussion of China’s cultural history, including the Confucian emphasis on hierarchy and order, and the tributary system that historically existed both within the Middle Kingdom and with its neighbors, is provided generally in Martin Stuart-Fox’s *A Short History of China and Southeast Asia: Tribute, Trade and Influence*. As noted above, other factors include popular local culture and history, the nature of the state, type of corruption, actors involved, and political responses and motivation to curtail corruption (or not). *Id.* at 6.

⁵⁸ Yao, *supra* note 50.

⁵⁹ Wang Fang & Wang Zhen, *Corruption Fuels China’s “Overheated” Economy*, THE EPOCH TIMES (P.R.C.), Jun. 17, 2004, www.theepochtimes.com/news/4-6-17/21997.html (last visited Sept. 10, 2006).

is reported by the media that “[c]orruption has long been rife in Chinese society, where government and party officials control access to business licenses and a host of other vital permits.”⁶¹ In that context, corruption “takes the form of rules, edicts and certificates, all requiring extra fees rather than blunt requests for money.”⁶²

Significantly, the Chinese culture of corruption appears to be cultivated and used surreptitiously by the Communist Party and the government to achieve their social, political and economic ends. Although the Chinese Communist Party Central Committee issued a 36-page policy paper in 2004 calling corruption “a life and death struggle” for the Party,⁶³ such statements appear to be, at best, mere window-dressing. For example, it has been observed that the Party has an incentive to allow corruption as an alternative to Western-style compensation and that the government may only selectively enforce laws that prohibit corrupt practices. Consistent with long-standing propaganda that “every Communist Party member is a selfless ‘public servant of the people,’” corruption allows the government to pay low salaries, but with the recognition that higher compensation will be earned through rent-seeking schemes by public officials.⁶⁴ In some ways, payment of bribes and administrative “facilitation” fees is analogous to, and perhaps more effectively and fairly administered than, performance-based bonuses paid in the West. Chengze Simon Fan and Herschel I. Grossman argue:

Corruption, whether in the form of
tanwu shouhui or *nuoyong gongkuan*,

⁶⁰ Hu Ping, *On Corruption with “Chinese Characteristics”*, ASSOCIATION FOR ASIAN RESEARCH, Sept. 30, 2002, <http://www.asianresearch.org/articles/939.html> (last visited Sept. 10, 2006).

⁶¹ Mary Hennock, *China’s graft: Tough talk, old message*, BBC NEWS ONLINE, Sept. 24, 2004, <http://news.bbc.co.uk/2/hi/asia-pacific/3693714.stm> (last visited Sept. 10, 2006).

⁶² *Id.*

⁶³ *See, e.g., id.; China Leaders Warn of Corruption*, BBC NEWS ONLINE, Sept. 27, 2004, <http://news.bbc.co.uk/2/hi/asia-pacific/3692530.stm> (last visited Sept. 10, 2006).

⁶⁴ Chengze Simon Fan & Herschel I. Grossman, *Entrepreneurial Graft in China*, PROVIDENCE J., May 3, 2001, at B5, available at http://www.econ.brown.edu/fac/Herschel_Grossman/papers/pdfs/chinaop.pdf.

mitigates the problem of measuring and monitoring economic performance because local officials who make the largest economic contribution are likely to be able to extract the largest fees or nepotistic favors or to have the most valuable property to appropriate. Also the compensation that local officials obtain through corruption, particularly in the form of bribery, is paid by local firms, which have the best information on the performance of local officials.⁶⁵

In addition, although Western-style explicitly-paid higher salaries and bonuses based on economic performance might benefit many public officials, there are also many Chinese officials who do not have any direct economic role and, therefore, would be bypassed by such rewards. As has been observed:

[a]n explicit system of material incentives and rewards for economic performance would undermine the political and social standing of those government officials and Party members who are not involved in economic activities. Because the Communist Party, like any political organization, is a potentially fragile coalition, jealousy and discontent, especially in the army, would threaten to destabilize and to undermine its cohesiveness.⁶⁶

Thus, rent-seeking and other corrupt activities by public officials become a compensation scheme that may, at least in the short run, benefit the Communist Party and the government despite their public pronouncements to the contrary. This phenomenon contributes significantly to the culture of corruption in China.

⁶⁵ *Id.*

⁶⁶ *Id.*

Notwithstanding the beneficial use of corruption as an incentive program for public officials, however, the Communist Party and the government do have an incentive to selectively prosecute some officials for corruption. When reports of major corruption crack-downs are published, it reflects well on the Communist Party both in China and abroad. In addition, selective prosecution of corruption furthers strong internal cohesiveness and absolute power by the Party and supports the Party's hierarchical structure. Where every official knows that another (especially a higher-ranking) official could successfully charge him with corruption, "lack of exposure is in effect special treatment for which the official gratefully exchanges his political support."⁶⁷ Public officials whose loyalty to the Party is questioned or who become too greedy can be reigned in. High-profile prosecutions do occur and the media does periodically tout the successes of government anti-corruption campaigns – such as a China News Service report that Beijing recovered as much as 700 million yuan (US\$84 million) in the first year of the government's campaign against corruption.⁶⁸ Finally, as discussed in the last section of this article, corruption needs to be tightly controlled, even if it is not fully discouraged by the Party. Ultimately, corruption is highly inefficient and disruptive to China's economy and causes quantifiable economic loss despite the country's growing economy.

Significantly, it is the manner in which the Chinese government has co-opted the culture of corruption in that country that distinguishes it from Indonesia and other countries that also experience a strong culture of corruption. In China and Indonesia alike, the governments insist that they are fighting corruption and trumpet their high-profile successes. The public and the press in both countries vociferously decry the state of corruption in public administration; but only in Indonesia does it appear that the government actually has an incentive to eliminate corruption.

Despite modest GDP growth in Indonesia, corruption significantly suppresses business investments and overall economic development. By contrast, China may benefit in the short-term from corruption. The following suggests that, although corruption in China poses a substantial cost to the economy in terms of inefficiencies and

⁶⁷ *Id.*

⁶⁸ *700 Million Yuan Recovered in One-year Campaign Against Corruption: Report*, PEOPLE'S DAILY (Oct. 31, 2001) (P.R.C.), http://english/200110/31/eng20011031_83587.html (last visited Sept. 10, 2006).

actual yuan lost, Chinese economic growth paradoxically continues to outpace every other economy in Asia.⁶⁹

IV. CORRUPTION AS ANTITHETICAL TO ECONOMIC DEVELOPMENT: INDONESIA AND CHINA COMPARED

Most people would agree that, as an ethical matter, most forms of corruption are undesirable. Moreover, as is noted in the discussions above, there is widespread lip service paid to the eradication of corruption. But, the question of whether fighting corruption should be a “true priority or merely a rhetorical one” remains hotly debated.⁷⁰ A great deal of ambiguity remains with respect to whether corruption is good, bad, or irrelevant for economic development,⁷¹ especially in countries like China that simultaneously have a vigorous economy and yet an entrenched culture of corruption.

Many scholars promoting “rule of law” as a development strategy enthusiastically embrace anti-corruption measures. Rather than a purely economics-based approach, these scholars look at the inter-relationships of investment, economic growth, and the strength of public institutions. They advocate the elimination of corruption “to avoid squandered resources, to promote security and predictability, to inspire confidence, eliminate price distortions and promote an efficient distribution of resources,”⁷² albeit in the interests of encouraging development. They further insist that “corruption somehow drains resources from the system as a whole – its costs are costs of transactions, not costs of the product or service purchased.”⁷³

⁶⁹ See, e.g., J.A.-MUND, N. BRANDT & S. HANSAKUL, CHINA-INDIA CHARTBOOK: CHINA & INDIA: A VISUAL ESSAY, DEUTSCHE BANK RESEARCH GLOBAL RISK ANALYSIS 24 (Oct. 10, 2005), http://www.dbresearch.com/PROD/DBR_INTERNET_DE-PROD/PROD000000000192108.pdf (last visited Sept. 10, 2006); People’s Daily, *ADB Revises Down East Asia’s Economic Growth for 2005* (August 9, 2005) (P.R.C.), http://english.people.com.cn/200508/09/eng20050809_201228.html (last visited Sept. 10, 2006).

⁷⁰ Kaufman, *supra* note 16, at 115.

⁷¹ *Id.*

⁷² Kennedy, *supra* note 34, at 163.

⁷³ *Id.*

If those transaction costs are removed, they believe, the whole economy improves. There is some ambiguity in their research, however, as to the separate effects of corruption vis-à-vis other factors contributing to poor quality public institutions.⁷⁴

Still other scholars, economists as well as non-economists, argue that corruption is actually beneficial to poor quality institutions. Corruption is viewed as the grease that makes the otherwise rigid machinery of government function smoothly. According to this “functionalist”⁷⁵ view, corruption promotes certain efficiencies. For example, in the case of competitive bidding for government contracts, where the highest bidder in *bribes* is awarded the contract, a certain “allocation efficiency is maintained, as only the lowest-cost firm can afford the largest bribe.”⁷⁶ In addition, according to the functionalists, corruption also encourages bureaucrats to work harder, acting as a sort of piece rate for government work. Moreover, it supposedly permits entrepreneurs to circumvent or at least navigate efficiently through an otherwise slow-moving and burdensome regulatory framework. So-called “speed money” paid to expedite administrative action or to reduce delay in public administration, has been demonstrated (using complex Nash equilibrium game theory) to actually reduce inefficiencies in public administration by speeding up the overall queue for services, thus minimizing waiting costs for everyone in the queue.⁷⁷ This is especially true in those countries with excessive bureaucratic regulations and discretion.⁷⁸ Samuel

⁷⁴ World Bank Report, *supra* note 12, at 15.

⁷⁵ Also referred to as “revisionist”, functionalism was largely a response arising in the 1960s to the moralist view. *See generally* Gillespie & Okruhlik, *supra* note 5, at 78. Function is the ultimate consideration; the end justifies the means. Functionalists have also characterized as “positive functions” the corrupt political machines and systems of patronage controlled by powerful political bosses, smuggling, black-marketing, usury, and even slavery and war, arguing that they fulfill “positive functions which are at the time not adequately fulfilled by other existing patterns and structures.” Edward Van Roy, *On the Theory of Corruption*, Vol. 19 No. 1 ECON. DEV. & CULTURAL CHANGE 86, 89 (1970).

⁷⁶ Pranab Bardhan, *Corruption and Development: A Review of Issues*, 35 J. ECON. LITERATURE 1320, 1322 (1997). It is irrelevant to allocation efficiency that an excess payment is going to the corrupt official instead of the public treasury.

⁷⁷ *Id.* at 1323.

Huntington has succinctly captured the essence of this argument, colorfully asserting that “[i]n terms of economic growth the only thing worse than a society with a rigid, over-centralized, dishonest bureaucracy is one with a rigid, over-centralized, *honest* bureaucracy.”⁷⁹

The flip side of the functionalist coin is “post-functionalism,” an approach that began in the 1970s in an attempt to rebut functionalism.⁸⁰ Warning that “academia, state and society must rouse themselves from the autonarcotic effects of the ‘functional corruption’ myth,”⁸¹ post-functionalists argue that corruption has dysfunctional consequences for the economy and society generally. They maintain that “corruption wastes revenues and resources that might be utilized elsewhere, erodes the trust and loyalty granted to political leaders by their followers, and solidifies inequities in the apportionment of goods in favor of certain strata of society.”⁸² In their view, corruption also stifles innovation, entrepreneurship, and both domestic and foreign productive investment. It also encourages even more excessive and discretionary regulation.⁸³ As for the “grease the machinery” argument, it has been observed that corrupt officials actually may be incentivized to “cause more administrative delays in order to attract more bribes.”⁸⁴ Such deliberate delays may also occur where public officials have no ability to speed up the process in any event, and they are instead bribed to slow down the process with respect to a payor’s competitors.⁸⁵ Finally, the post-

⁷⁸ See Paolo Mauro, *Corruption and Growth*, Vol. 110 No. 3 Q. J. ECON. 681 (1995).

⁷⁹ SAMUEL P. HUNTINGTON, POLITICAL ORDER IN CHANGING SOCIETIES 69 (1968) (emphasis added).

⁸⁰ Werner, *supra* note 4, at 147.

⁸¹ *Id.*

⁸² Gillespie & Okruhlik, *supra* note 5, at 79.

⁸³ See, e.g., Kaufman, *supra* note 16, at 116; Werner, *supra* note 4, at 149; Bardhan, *supra* note 76, at 1327-328.

⁸⁴ Bardhan, *supra* note 76, at 1323 (citing a study conducted in India).

⁸⁵ Kaufman, *supra* note 16, at 117. Kaufman cites an example in India where a “high-level civil servant who had been bribed could not process an

functionalists point to research which indicates that even where corruption has some short-term benefits to the economy, it still leads ultimately to dysfunction. In a number of countries studied, corruption has led to smuggling, black market economies, mass starvation, imposition of martial law, and the complete disintegration of economy and society, in general.⁸⁶ Moreover, corruption feeds upon itself, “blocking organizational change and societal reform . . . [and as reform consequently] becomes increasingly onerous to achieve, more corruption is fostered as a remedy to existing corruption.”⁸⁷

It is suggested in this article that both the functionalist and the post-functionalist positions have merit, depending upon the specific country under consideration. As the following discussions indicate, corruption in Indonesia appears to be a deterrent to more than modest economic growth and development. In China, on the other hand, credible research indicates that economic development continues to race forward, even though corruption’s inherent inefficiencies and misallocation of resources is costing the economy heavily and likely will be quite harmful in the long term.

A. *The Economic Impact of Corruption in Indonesia*

Despite the wide-spread culture of corruption in Indonesia, there has been relatively little research quantifying the economic impact. It is widely asserted that the “crony capitalism” and overall corruption of the Soeharto regime – thirty-two years of a dysfunctional “black state”⁸⁸ – was a root cause of Indonesia’s

approval any faster given the multiple bureaucrats involved in the process, yet [who] willingly offered his services to slow the approval process for rival companies.” *Id.*

⁸⁶ See Werner, *supra* note 4, at 148-49. It is interesting that functionalists counter-argue that corruption actually helps prevent violence and lawlessness in some circumstances. For example, functionalists argue that those who corrupt the police are more likely to identify with them and less prone to violence against them. *Id.* at 148. Similarly, others suggest that corruption may be an alternative to violence and point to periods in history, some quite recent, when groups who “had been killing each other to obtain power . . . substituted a system of patronage, bribery, and corruption for the previous method of bloodletting.” Bardhan, *supra* note 76, at 1328-329.

⁸⁷ Werner, *supra* note 4, at 149.

⁸⁸ Lindsey, *supra* note 8, at 15.

economic crisis in the late 1990s.⁸⁹ Moreover, the media has not been shy about proclaiming the dire economic consequences of corruption in Indonesia more recently. Headlines exclaim, “Investors desert Indonesia as rot of corruption sets in.”⁹⁰ It is reported that “[m]illions of Indonesians face poverty as investors continue to desert the country largely because of rampant corruption and collapsing infrastructure,”⁹¹ and that “[p]roblems with regional autonomy and increasing demands for bribes are further slowing Indonesia’s exports in a highly competitive regional market.”⁹² The media declares that “[t]he President must decide whether corruption eradication is part of economic recovery, the improvement of public services, the efficiency of the state budget or just about improving Indonesia’s rank in the Corruption Perception Index survey by [Transparency International]. Each option has its consequences and requirements.”⁹³ Moreover, in a recent survey, *Doing Business in Indonesia 2005*, the World Bank reportedly “confirmed that Indonesia is not attractive for foreign investors. To invest in Indonesia requires more time, more complex procedures and much more money, all because of corruption.”⁹⁴

Yet, while it generally is accepted that corruption is hurting the Indonesian economy, there is little empirical data specifically examining its effects. As such, this article looks at several key factors of corruption present in Indonesia that are regarded as hindering economic development. It is suggested that these factors, consistent with anecdotal evidence reported in the press and by several surveys

⁸⁹ See, e.g., Levinson, *supra* note 31, at 111.

⁹⁰ Matthew Moore, *Investors Desert Indonesia as Root of Corruption Sets In*, SYDNEY MORNING HERALD (Australia), Jan. 17, 2003, <http://www.smh.com.au/articles/2003/01/16/1042520724884.html?oneclick=true> (last visited Sept. 10, 2006).

⁹¹ *Id.*

⁹² Mudrajad Kuncoro, *Bribes, Regulatory Constraints, and Boosting Indonesian Exports*, JAKARTA POST (Indonesia), Dec. 5, 2004, available at <http://antikorupsi.org/eng/mod.php?mod=publisher&op=viewarticle&art id=247>.

⁹³ Widoyoko, *supra* note 47.

⁹⁴ *Id.*

conducted by the World Bank and organizations such as Transparency International, are in fact crippling the Indonesian economy.

Possibly the most significant factor antithetical to economic development in Indonesia is what has been characterized as a “shadow system”⁹⁵ or extralegal administrative system parallel to the official public administration. This shadow system was established especially during the thirty-two years of Soeharto’s New Order rule, and while not as all-encompassing as it was during that regime, vestiges of it remain. Business people still complain, for example, of corruption in the courts and the instability and unpredictability that this injects into business transactions.⁹⁶ The law is largely irrelevant in the face of powerful connections or money.⁹⁷ As a prominent scholar on Indonesia has observed, in the wake of Soeharto’s systematic co-option of all formal administrative institutions in Indonesia, “there is really nothing left to work with . . . there’s corruption everywhere.”⁹⁸ Even today:

[t]he result is a highly developed legal formalism (hard law) and public rhetoric; seemingly impenetrable and secretive politics; state sanctioned “corruption” and legal informality in practice (soft law norms); and apparent irrelevance and absurdity in the practice of law by reason of it being the interface between the two systems.⁹⁹

Apart from the political and legal consequences of such a shadow system, such pervasive corruption is also socially and economically parasitic and exploitive:

It is not a self-sufficient or stand-alone system but depends on co-existing

⁹⁵ Lindsey, *supra* note 8, at 15.

⁹⁶ Levinson, *supra* note 31, at 114.

⁹⁷ *Id.* at 115.

⁹⁸ *Id.* at 118 (quoting Professor Daniel Lev).

⁹⁹ Lindsey, *supra* note 8, at 15 (internal citations omitted).

economic and social systems, for example, on the agricultural economy; on markets or state enterprises; on the self-employed; on small and medium enterprises; on the informal or black economy operating outside, or on the contestable margins of, the law.¹⁰⁰

Corruption in Indonesia “interpenetrates these and other systems and lives off them.”¹⁰¹ It fails to produce any tangible socio-economic benefits and it is a highly inefficient use of resources. As one scholar notes, corruption in Indonesia “comprises essentially non-productive behaviours or behaviours excessively costly to the host. It does not, in economists’ terms, use resources efficiently nor give people the incentive to engage in productive activities.”¹⁰²

Significantly, it is likely that administrative corruption in Indonesia also undermines the country’s macroeconomic stability by siphoning off government revenues and encouraging excessive government spending. As noted in a World Bank report on corruption and economic development:

[t]his can happen through corruption in tax and customs departments, through debt incurred when the scrutiny of finance ministries and central banks is bypassed, through contracts that are awarded to high-cost bidders or without competitive tendering, and through the general erosion of expenditure control. Excessive debt may be incurred thorough “white elephant” investment projects that owe their origin, in part, to bribes. Macroeconomic stability may also be threatened by debt guarantees and other off-budget contingent liabilities agreed to in corrupt

¹⁰⁰ Goodpaster, *supra* note 23, at 90.

¹⁰¹ *Id.*

¹⁰² *Id.* at 91.

transactions without public scrutiny. It may also be threatened by fraud in financial institutions, leading to loss of confidence by savers, investors, and foreign exchange markets.¹⁰³

In similar fashion, the diverting of public resources for personal use (such as construction materials intended for public works used on private homes or even misappropriated and sold by public officials) also disrupts economic stability and growth in favor of non-productive resource allocations.¹⁰⁴

Perhaps the greatest effect of corruption on the Indonesian economy is both foreign and domestic investors' reluctance to invest in Indonesia. In much the same way that weeds crowd healthy plants out of a garden, widespread bribery and related rent-seeking by public officials "imply declining profitability on productive investments relative to rent-seeking investments, thus tending to crowd out the former."¹⁰⁵ Exacerbating this effect, in fact, increased rent-seeking makes further rent-seeking less costly relative to the cost of productive investment.¹⁰⁶ Moreover, as rent-seeking increases, entrepreneurial investment is particularly hard-hit. Compared to existing and static businesses, new or expanding businesses often are more at the mercy of public officials who issue licenses and permits. The costs of paying bribes to these officials, for example, can undermine the ability to predict start-up or expansion costs (essential for attracting or accurately allocating capital investment) and can disproportionately increase those costs.¹⁰⁷ Innovators and entrepreneurs may decide not even to enter the market because of moral compunctions over paying bribes, as well as a fear of getting caught.¹⁰⁸ This decline in competitiveness and diversity in the market also negatively affects the economic development overall.¹⁰⁹

¹⁰³ World Bank, *supra* note 12, at 18.

¹⁰⁴ Bardhan, *supra* note 76, at 1328.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*

¹⁰⁷ *See, e.g., id.* at 1328; World Bank, *supra* note 12, at 18.

The economic cost of corruption and a reluctance to invest has been the subject of a number of important studies focused on developing countries. International Monetary Fund economist Paolo Maoro, for example, found that “[t]he negative association between corruption and investment, as well as growth, is significant.”¹¹⁰ In one study, Maoro argues that “if a given country were to improve its corruption “grade” from 6 out of 10 to 8 out of 10, its investment-GDP ratio would rise by almost 4 percentage points and its annual growth of GDP per capita would rise by almost half a percentage point.”¹¹¹ A similar study by another IMF economist, Shang-Jin Wei, examined the effects of taxation and corruption on international direct investment from fourteen source countries to forty-five host countries. He concluded that an increase in corruption level in a host country would decrease foreign direct investment. Illustrating his conclusion, Wei points out that an increase in the corruption level of a relatively low-corruption country such as Singapore to that of a high corruption country such as Mexico “would have the same negative effect on inward FDI as raising the tax rate by eighteen to fifty percentage points, depending on the specification.”¹¹² While limited attention has been paid to how these factors specifically affect Indonesia’s economy, the considerable prevalence of rent-seeking by public officials in Indonesia¹¹³ indicates that these factors would adversely

¹⁰⁸ This may be particularly true not only for domestic investors, but especially for U.S. investors who are subject to U.S. law prohibiting payment of bribes to foreign officials and other foreign corrupt practices. *But see*, Rubin, *supra* note 19, at 268 (citing a study that implies that American investors “indulge in bribery practices to compete, and risk prosecution under United States law.”).

¹⁰⁹ See Susan Rose-Ackerman, *The Role of the World Bank in Controlling Corruption*, LAW & POL’Y INT’L BUS. 93, 97-98 (1997).

¹¹⁰ Maoro, *supra* note 78, at 683.

¹¹¹ Paolo Maoro, *The Effects of Corruption on Growth, Investment, and Government Expenditure: A Cross-Country Analysis*, in CORRUPTION AND THE GLOBAL ECONOMY 83, 91 (Kimberly Ann Elliott, ed., 1997). *See also*, Maoro, *supra* note 78, at 683.

¹¹² Shang-Jin Wei, *How Taxing is Corruption on International Investors?*, Vol. 82 No. 1 REV. ECON. & STATISTICS 1, 8, available at <http://www.nber.org/~wei/data/wei2000a/wei2000a.pdf>.

¹¹³ *See, e.g.*, Goodpaster, *supra* note 23, at 92-99.

affect the economy in that country.

B. *The Economic Impact of Corruption in China*

It is interesting that much of the recent impetus for quantitative analysis and the collection of empirical evidence on the effects of corruption on economic development has been propelled by the apparent success of the Chinese economy despite significant corruption. As Shang-Jin Wei points out at the beginning of his study, he was motivated to conduct his research because “China has rampant corruption according to various newspaper accounts as well as surveys of business executives. Yet, for every year in the last four, China has been the largest developing host of international investment. Even its FDI flow-to-GDP ratio has been among the highest among developing countries.”¹¹⁴ While the effects of corruption in other developing economies, such as Indonesia’s, appear to be directly and immediately antithetical to economic development and growth, China appears on the surface to present a paradox.

Contemporary conventional wisdom – especially as promulgated by scholars at the World Bank and others promoting (good) governance and its virtual doppel-ganger, anti-corruption efforts – insists that:

countries with stable government, predictable methods of changing laws, secure property rights and a strong judiciary enjoy higher rates of investment and growth than countries lacking such institutions. Indeed, a number of multiple-country empirical studies have shown that rule of law and enforceable property rights are positively correlated with growth.¹¹⁵

In addition, there is significant empirical evidence to suggest that corruption negatively correlates with economic development, such as

¹¹⁴ Wei, *supra* note 112, at 1.

¹¹⁵ Randall Peerenboom, *Seek Truth from Facts: An Empirical Study of Enforcement of Arbitral Awards in the PRC*, 49 AM. J. COMP. L. 249, 309 (2001).

the case of Indonesia. Yet in China, despite an apparent lack of rule of law and at least tacitly state-sanctioned (albeit somewhat controlled) administrative corruption, a present-day economic miracle appears to be continuing unabated. The reasons for this are complex. However, recent studies do indicate that corruption is negatively affecting economic development in China, despite the current growth.

Unlike other developing countries, China presents a unique set of circumstances. Much of the economic growth is “attributed to cultural factors, a distinct form of ‘Chinese capitalism,’ a *guanxi*-based rule of relationships, clientelism and corporatism.”¹¹⁶ Importantly, “[w]hat they all share in common is an emphasis on relationships as a substitute for rule of law.”¹¹⁷ However, corruption itself is also a significant factor fueling economic growth. As discussed previously in this article, it is suggested that the Chinese Communist Party uses corruption as a form of “bonus” or “incentive” program to encourage greater economic performance by public officials.¹¹⁸ Thus, public officials who work hard and contribute the most economically may also get the most back in bribes and “facilitation” fees. Public officials also are incentivized to undertake local development projects, and to attract both domestic and foreign investment in those projects, by the opportunity to benefit from corrupt payments they will receive.¹¹⁹ While misallocation of scarce resources and an incoherent distribution according to competing local interests, rather than fundamental market principles, may distort the economy in the long-run,¹²⁰ corruption does push the economy forward in the short run.

Partly as a result of enthusiastic economic development efforts by local officials who stand to gain from increased rent-seeking opportunities, and partly due to a “lemming effect” by foreign

¹¹⁶ *Id.* at 313-14.

¹¹⁷ *Id.* at 313-14.

¹¹⁸ *See supra* pp. 16-18.

¹¹⁹ Excessive debt, of course, is a concern as “white elephant” projects are undertaken solely for the benefit of corrupt officials.

¹²⁰ Concerns have been expressed in the press that the economy is expanding too quickly as a result of these projects, resulting in “a massive depletion of the nation’s assets” and *ad hoc* development and resource distribution. *See Fang & Zhen, supra* note 59.

investors, much of the economic growth in China is attributed to foreign investors who are flocking to invest there, despite the rampant corruption. In the past, many foreign investors lacked sufficient information with which to make a well-reasoned and informed decision about investing in China. They invested despite the risks and difficulties involved in navigating a corrupt and unpredictable landscape.¹²¹ But it has also been observed that ignorance, more recently, may not be the only excuse:

Eyes dazed by the (fictive) promise of a market of 1.3 billion captive consumers, foreign investors have been willing to discount or ignore the considerable risks of doing business in China . . . [Some of these] decisions have been driven not by any long term strategic plan but rather by organizational politics and dynamics. Even senior management of major multinational companies at times appears to have been swept up in the hype over the Pac-Rim century, and rushed to enter China simply because others were doing so . . . In other cases, lower level management saw China as a good place to advance their careers and aggressively pursued projects.¹²²

In addition to increased foreign investment, much of the economic growth in China is attributed to other factors unique to China. These clearly include short-term phenomena. Government programs promoting the “reallocation of labor from low to high productivity sectors, in particular from agriculture to manufacturing and services,” for example, figure prominently in promoting economic development.¹²³ Such short-term phenomena appear largely unaffected by corruption, although long-term productivity within each sector could suffer.

¹²¹ Peerenboom, *supra* note 115, at 310-12.

¹²² *Id.* at 311-12.

¹²³ *Id.* at 317.

The nature of the state and the nature of corruption in China are also important factors contributing to the proportionately more limited impact of corruption in China than in other countries. For example, building on a well-established institutional legacy, the Chinese state remains strong and well-disciplined as it progresses with economic reforms. The reforms are gradual and accomplished through existing state institutions controlled by the Communist Party.¹²⁴ Moreover, the “Chinese regime has not only preserved old mechanisms [for discipline] but also created new ones to deal with the prevention, discovery, and control of corruption.”¹²⁵ As such, it is able to effectively “limit the nature and impact of corruption.”¹²⁶

The nature of Chinese corruption itself is also an important factor mitigating the negative effects of corruption on economic development. It is significant that most of the corruption in China is in the form of rent-seeking and “profit-sharing”,¹²⁷ rather than outright theft of public money.¹²⁸ The potential positive short-term effects on the economy from rent-seeking, such as incentives for local economic development efforts, have been discussed above. Profit-sharing also is regarded as a type of corruption which “may be the least harmful and could even lead to good social results.”¹²⁹ With respect to the development of township and village enterprises, for example, it has been observed that exchanging profit shares for commercial privileges granted by local officials actually has helped the growth of those local enterprises.¹³⁰ Further, it has been observed that money derived from profit-sharing (and to a lesser extent from rent-seeking) is more likely to be reinvested in a country’s economy than is money derived from other types of corruption. Although there

¹²⁴ Yan Sun, *Reform, State, and Corruption: Is Corruption Less Destructive in China Than in Russia?* Vol. 32 No. 1 COMP. POL. 1, 5-6 (1999).

¹²⁵ *Id.* at 6.

¹²⁶ *Id.* at 2.

¹²⁷ Profit-sharing occurs where “nonstate actors pay government officials to induce favorable policies concerning, for example, capital for investment, land for expansion, and export quotas.” *Id.* at 12.

¹²⁸ *Id.* at 10-12.

¹²⁹ *Id.* at 12.

¹³⁰ *Id.* at 12.

is a lack of conclusive empirical evidence in this respect, reinvestment of corrupt money in the Chinese economy may serve to lessen capital losses incurred through corruption.

Despite the apparently more controlled and limited impact of corruption in China, particularly as compared with countries such as Indonesia, corruption is still seen as causing “prodigious economic losses for the country and its people.”¹³¹ The reduced economic output and inefficiencies that result from corruption in China are draining the Chinese economy.¹³² One of the first studies estimating total economic losses resulting from Chinese corruption over the period 1995-1998 indicated that it was 13.2-16.8 percent of GDP.¹³³ A further study based on official statistics examined ten specific areas of “systematic economic losses caused by corruption” in China.¹³⁴ It was estimated that for the period 1999-2001, the total economic losses “amounted to an annual average of 14.5-14.9 percent of GDP.”¹³⁵ Moreover, the author of both studies, Professor Angang Hu of Tsinghua University, acknowledged that, “[i]n reality, the forms of corruption are more than those listed, and the real losses are far beyond that . . . It is still an unknown economic ‘black hole.’”¹³⁶ As he summarizes:

China’s GDP accounts for over 10 percent of the world’s total, ranking second only after the United States. Up to the end of 2001, the GDP of China was approximately eight times of that of 1978 (7.9 times), which is one of the great wonders in human history (to create capital at the fastest speed).

¹³¹ Angang Hu, *Public Exposure of Economic Losses Resulting from Corruption*, 4 CHINA & WORLD ECON. 44, 44 (2002).

¹³² See, e.g., CHARLES WOLF, JR., ET AL., FAULT LINES IN CHINA’S ECONOMIC TERRAIN 32-33 (2003), available at http://www.rand.org/pubs/monograph_reports/MR1686/MR1686.pref.pdf

¹³³ *Id.* at 33.

¹³⁴ Hu, *supra* note 131, at 44.

¹³⁵ *Id.* at 44.

¹³⁶ *Id.* at 48.

However, as a result of the large amount of economic losses and illegal capital transfer, which is caused by prevalent and systematic corruption . . . the increase was much less than eightfold.”¹³⁷

Whereas corruption has not fully prevented economic development from occurring in China, the inefficiencies and nonproductive transfers of resources it creates, combined with lost investment opportunities, appear to be significantly hurting the Chinese economy. Indeed, as reflected by Professor Hu’s studies, “[i]t is not exaggerating to say that, China may very well be the country with the most enormous economic losses in the world caused by corruption.”¹³⁸

V. CONCLUDING THOUGHTS

The degree to which corruption is antithetical to economic development continues to be researched and debated, particularly as the unprecedented growth of China’s economy continues relatively unabated. It appears that virtually everyone agrees that corruption ultimately leads to institutional and administrative dysfunction and that it is antithetical to economic development in the long run. There is a great deal of debate, however, regarding whether it can benefit economic development in the short run. In considering the consequences of corruption in Indonesia and in China, it is apparent that whether – and the extent to which – corruption is antithetical to long-term and short-term economic development depends significantly upon contextual factors. These include the culture, political history, nature of the state and the corruption occurring, and the response by the state to administrative corruption. These also include less rational factors, such as those presently driving foreign investment in China despite rampant corruption.

In Indonesia, despite modest growth, corruption is holding back the economy and frightening away foreign investment. The government has no choice but to act aggressively to eliminate corruption. It is clearly antithetical to economic development in that country. In China, on the other hand, the economy is still hurtling

¹³⁷ *Id.*

¹³⁸ *Id.*

forward despite corruption. The state appears less eager to completely eliminate corruption, but instead it appears to be harnessing it in some positive ways. Corruption is very costly to the Chinese economy, however, especially considering estimated losses between 13.2 and 16.8 percent of GDP over a two to three year period. Although the position of China's public officials to less than vigorously combat corruption is consistent with the wisdom that "Thou shalt not muzzle the ox when he treadeth out the corn,"¹³⁹ there will eventually come a point at which China must stem its economic losses as a result of corruption. Despite China's enormous economic success, corruption is ultimately antithetical to the country's future economic development.

¹³⁹ Werner, *supra* note 4, at 150 (citing the late Israeli Prime Minister, Levi Eshkol, who once quoted *Deuteronomy* passage 25:4 when asked about corruption).