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COLLUSION AND CORRUPTION IN PUBLIC PROCUREMENT

Contribution from Indonesia

-- Session V --

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COLLUSION AND CORRUPTION IN PUBLIC PROCUREMENT

-- Indonesia --

1. Introduction

1. Corruption has become a chronic problem in Indonesia and kept mushrooming in spite of the reformation and regional autonomy era. Practices of collusion and nepotism towards corruption have also expanded and involved central and regional public officials, business actors, and the public. Corruption is not only related to business activities that regulate licensing, concessions, procurement, *et cetera*, but has expanded to such other matters as the handling of resident identity cards, driver's licenses, travelling documents, and the like.

2. A number of efforts have been put to eradicate corruption in Indonesia, particularly since 1998, when the waves of reformation began to roll on. A variety of social organisations have kept growing and actively demanding corruption eradication. Apart from its shortcomings, 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 general election, laws on prohibition against monopolistic practices and unfair business competition, and laws on corruption eradication.

3. However, those efforts are still not enough. Corruption practices that have been systemic and deeply rooted in Indonesia require more serious, systematic, simultaneous, and co-ordinated eradication efforts. Corruption eradication has to be a national People's Movement by involving all elements and layers of the society. Both the system and the actors have to be good. Without exception, efforts for law enforcement on competition have to bring about positive impacts to efforts for corruption eradication. At least, with law enforcement on competition, the climate of fairer business competition will grow, so that business actors will be encouraged to set more competitive prices with nearly normal/reasonable level of profit. With smaller profit, the potency of corruption will also be reduced.

4. From the perspective of the development of the economic system, the position of business competition is very strategic in that it is an essential need of the nation. Indonesian founding fathers have inherited *Pancasila*¹ and the Constitution of 1945 as constitutional grounds for living as a nation and a state. Therefore, Indonesia's economic system must be source from Indonesia's own national constitution, not from various theories, let alone from the constitutions of other nations. According to *Pancasila* and the Constitution of 1945, the objective of economic development is to realise a just and prosperous (affluent) society in addition to a distributive mechanism of economic resources that is also regulated in more detail in Article 33 of the Constitution of 1945.

5. It is explicitly stated that a state can control or at least intervene market mechanism if it is related to specific business lines that are important for the state and the people. Control in any form, however, is

¹ Consists of five key elements, namely (1) Believe in the one end only God; (2) Just and Civilized humanity; (3) The unity of Indonesia; (4) Democratic life led by wisdom of thoughts in deliberation amongst representatives of the people; (5) Achieving social justice for all the people of Indonesia.

basically very limited, as the state must be able to show that the people's prosperity would improve. Otherwise, the state's intervention can be abusive and distortive, thereby increasing burden/hardship on the people. Therefore, Indonesia's constitution provides enough room for the market mechanism to allocate economic resources. In line with the development of globalisation, the demand towards market economy system is unavoidable.

6. Theoretically, negative impacts of market economy can be corrected by the state's intervention. However, it may be complicated if the state concerned is included as one of the states most infiltrated by corruption in the world.

7. In Indonesia's case, it is important to understand its history to understand how why corruption is such a large issue and how the drive for improvements and reform have emerged. In the past, Indonesian economy had been developed in centralistic manner for more than 30 years and not based on economic democracy as outlined in *Pancasila* and the Constitution of 1945. Through centralised policies, a very small number of business actors had gained extraordinary benefits, especially those who were close to policy makers. Finally, the economic structure became more unbalanced, where 20% of business actors controlled more than 80% of economic assets, whereas the remaining 80% of business actors competed to obtain the remaining assets that were less than 20%. As a result, with monetary crisis beginning in Thailand in mid-1997, the economy that had been built for more than 30 years was ruined.

8. The reformation has rolled on massively since 1998. It has put *Pancasila* and the Constitution of 1945 to be understood more progressively with the spirit to affirm democratic principles in the fields of politics and economy as well as good, clean, and accountable government. The law on business competition was one of the solutions being offered at that time.

2. Business Competition and Corruption Eradication

9. Corruption has been one of the biggest enemies of Indonesia. The issuance of law on corruption eradication, Anti-Corruption Court, and the establishment of anti-corruption institutions indicates the state's commitment to accelerate corruption eradication. In this case, various measures of prevention and action have been taken by law enforcement agencies. However, corruption will not be successfully eradicated if it is dealt with by law enforcement agencies only, let alone by anti-corruption institutions only.

10. Therefore, the law on business competition 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.

11. One of the characteristics of a government with high corruption level is strong relationship between those in power 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.

12. It is through these supernormal profits that business actors are able to set aside some quite big funds potential for corruption practices in order to maintain status quo or even business expansion. As such, those rogue officers will be stronger and richer by the grants of related business actors. Policies and regulations are used as tools to enrich themselves and maintain their power. It goes on with win-win principle to be a vicious circle that is not easy to break.

13. Based on survey results, corruption level in Indonesia always relatively ranks as one of the highest in the world. The result of a Transparency International (TI)'s survey in 2009 showed that Indonesia was ranked the 111th (with index of 2.8) out of 180 states. Indonesia is part of the ASEAN grouping of South East Asian countries and initiatives associated with its membership of this organisation is important for the country's further development. Several other ASEAN states were much better with Singapore in the 3rd rank (with index of 9.2), Malaysia in the 56th rank (with index of 4.5), and Thailand in the 84th (with index of 3.4).

14. The following table also describes the ranks of competitiveness in terms of several ASEAN member states. With regard to corruption index, we know that Indonesia's competitiveness index ranked the 55th (with index of 4.25), far below Singapore that ranked the 5th (with index of 5.53), Malaysia that ranked the 21st (with index of 5.04), and Thailand that ranked the 34th (with index of 4.6).

15. At a glance, there is a pattern that the better the corruption rank of a state, the better its competitive rank. 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.

Table 1. Comparison of Corruption and Competitiveness Indices in 2009

States	Corruption		Competitiveness	
	Index	Rank out of 180 states	Index	Rank out of 134 states
Singapore	9.2	3	5.53	5
Malaysia	4.5	56	5.04	21
Thailand	3.4	84	4.6	34
Brunei	5.5	39	4.54	39
Indonesia	2.8	111	4.25	55
Vietnam	2.7	120	4.1	70
Philippines	2.4	139	4.09	71

Source: Processed from various sources.

16. In connection with the matter mentioned above, in a World Bank's publication titled "*Redesigning the State to Fight Corruption*", 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).

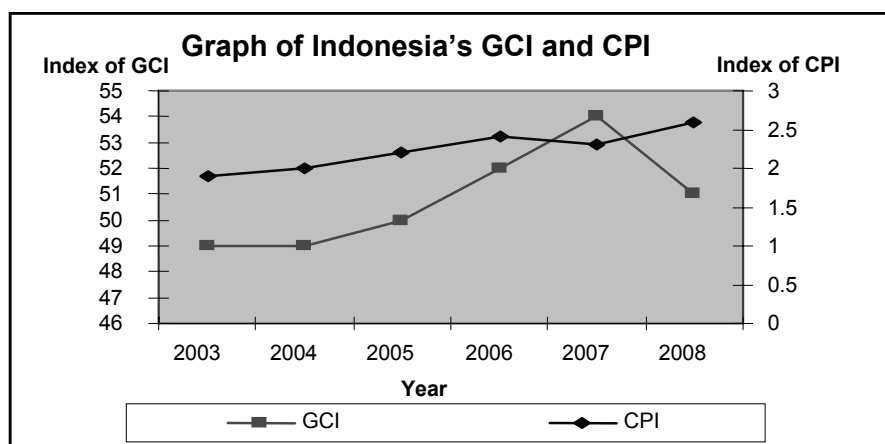
17. A model is plainly outlined that the level of corruption is often represented in the form of bribes and illegal fees. In connection with the procurement of goods and services for the government, a bribe may be in the form of a kickback and/or a token of gratitude in the form of gratification. The question is: How can business actors (tender winners) have enough funds to provide various forms of bribe and other legal fees? The answers may vary.

18. From the perspective of business competition, however, excessive pricing that results 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. Market power can come either from the dominance of individual firms or collectively through a collusive arrangement. 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.

19. Based on some literature, significant relationships between (potential) corruption and competition climate cannot be confirmed yet. Admittedly, various factors that affect competition conduct may be different from those that affect corruption conduct. Therefore, there is not always correlation between competition index and corruption index.

20. Research that was conducted by Celentani and Ganuza (2001) and Allen and Qian (2007) showed that the relationship between competitiveness and corruption is not easy to comprehensively explain. Moreover, the research of Straub (2005) concluded that competition can actually result in welfare improvement, but at the same time corruption may increase as well. Such an ambiguous condition may also be perceived when we compare corruption perception data (CPI) and competitiveness data (GCI) in Indonesia as follows:



21. The above CPI graph shows that the higher the CPI index, the lower the corruption perception (prevalence); on the contrary, GCI index shows that the lower the index, the higher is the competition.

22. The above graph shows that during the period of 2003-2006, Indonesia's CPI and GCI increased, implying that the corruption level was declining but at the same time the competitiveness was weakening. Negative relationship (as expected between corruption and competitiveness) was only perceived a little in 2007-2008 where there was increasing competitiveness in line with decreasing corruption perception.

23. Several other researches have tried to describe the relationship through parameters that affect corruption level and competitiveness level such as the number of business actors who participate in bidding process (Celentani and Ganuza, 2001) and in the procurement of goods and services for the government (Allen and Qian, 2007). The pattern of goods and services procurement for the government was chosen in that it is one of vulnerable points for interaction between government officials and business actors that is tinged by corruption practices.

24. In spite of ambiguity in the relationship pattern, this at least constitutes a future challenge for researchers and academicians to explain the relationship between the level of corruption and the competition climate more accurately.

3. Business Competition Supervisory Commission (*KPPU*) and Efforts for Corruption Prevention in Public Procurement

25. In the framework of law enforcement, *KPPU* of the Republic of Indonesia 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.

26. Notwithstanding various constraints, *KPPU* has made a variety of efforts to enforce the law on competition in Indonesia. Moreover, with its relatively young age (9 years), a UN institution, i.e. UNCTAD, has granted an award as appreciation to *KPPU* for its relatively good performance and effectiveness.

27. Within the nine-year period upon its establishment, *KPPU* has shown ever increasing outputs of law enforcement. The data shows that in terms of report handling, *KPPU* received two types of report, i.e. 2,824 written reports and written information; whereas in this year of 2009, up to the second week of December, *KPPU* has received 730 reports from various regions. Those reports consist of 201 written reports and 529 written information, meaning there is an increase compared to last year's 707 reports.

28. From the perspective of alleged articles being reported, the reports that go to *KPPU* were still dominated by reports about tender conspiracy, i.e. 84% or 169 out of 201 written reports. In the last three years, the types of report have tended to be more various. This shows that the public has been more aware that *KPPU* is not an institution that only supervises tender conspiracy. This is evident from reports on merger, consolidation, acquisition, share ownership, dual position, monopsony, closed agreement, and so on.

29. Meanwhile, in terms of case handling, during the period from January up to the second week of December 2009, *KPPU* has handled 33 cases, covering 28 cases originating from reports of the public and 5 initiative cases. As at December 2009, *KPPU* is handling 20 cases that are still in investigation stage.

30. 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.

31. The main idea of the corruption in the procurement process is agreeing that the bid committee arranges conditions or specifications for a certain bid participant to win, in which the bid committee shall guarantees to all the conspirators that the person they have agreed should win a bid actually is awarded that bid. In some case, the collusion involving several bid participants and the bid committee. This pseudo-competition (cartel) is hard to manage, especially when not involving the certainty for the loser to get a subcontract from the bid winner. One way to ensure this cartel succeeds is that when any of the colluding bidders tries to cheat on the cartel by putting in a lower price, the bid committee will tell the other members of the cartel or even find a reason to award the contract to the person who the conspirators agreed would be the winner, such as revising the requirement and evaluation criteria.

**Box 1. Example of collusive tender Cases:
Case of Vertical and Horizontal Conspiracy in a Shares and Bonds Tender**

PT. A, acting as a financial advisor on behalf of X, and B, announced in 2 newspapers that it would sell B's entire shareholding in C and the entire bonds issued by B and X. The sale of C's shares and bonds were done through a tender with a sales process in accordance with the provisions made in the Procedure for the Submission of Bids, which included sale structure, binding bid, submission of bids and selection of the winning bidder and closing of the transaction. Among the criteria of tender participant were that it was a partner, or principal, or a subsidiary of a partner including a colleague of a subsidiary, a car distribution company, other auto companies and financial advisor or in essence they had to be bona fide companies.

The implementation of tender for the sale of shares by PT. A did not follow the implementation schedule of the tender for the sale of C's shares made by X as intended in the TOR. PT. A invited 135 companies but only 16 companies signed the confidentiality agreement as required by the procedure. Afterwards, the companies that submitted final bid documents and then participated in the tender were D, E and F. D was finally declared as the winner of the divestment tender.

In this case of sale of shares by tender there is a vertical and horizontal conspiracy, because it involved the owner, the work owner, and the tender participant. Based on its investigation, KPPU discovered that the conspiracy in this case was done by conducting adjustments, comparing tender documents prior to submission, the creation of a pseudo-competition, and the granting of an exclusive chance to a certain tender participant by committing various acts that violated the stipulated procedures.

The indication or signs of conspiracy in the above case came from these discoveries:

- The implementation schedule of the sale of shares tender was very short, namely 14 days, while the tender was related to huge sums of money and a complex company structure;
- There were similar tender documents among the tender participants, namely in the choice of words, the form of the letter, and the syntax on the cover letter;
- There were almost similar bidding prices submitted by two tender participants, namely F and E. The value only differs 5% from the highest bidding price submitted by D;
- There was an effort by two tender participants, namely PT ASI and D, to compare the tender documents before submitting the final bid documents. The matter was discovered following the similarities in the choice of words, the form of the letter, and the syntax in the cover letter submitted during the final bid;
- There was an effort to create a pseudo-competition following the discovery that a tender participant, E, did not seriously attempt to complete and meet the requirements asked by the selling party as included in the procedures for the submission of bid;
- There was an effort to give an exclusive chance to a certain tender participant by committing various violations on the stipulated tender procedure. One of them is by giving a time extension of the final bid submission window and there were no objections on the extension by the punctual tender participants. In addition, it was also discovered that the tender committee had accepted a tender participant that did not meet the requirements stipulated in the procedures of the submission of bid, among them were that it was not invited, it never sent a letter of interest and warranty letter, and it did not sign the confidentiality agreement.

32. In coping with corruption in public procurement through enforcement of law on business competition, *KPPU* uses several approaches. Firstly, through co-operation with the Anti Corruption Commission. Law in Indonesia mandates the anti corruption commission, the police, and the attorney general's office to co-ordinate in preventing and taking action against corruption conduct. Since corruption may also be related to the enforcement of the said Article 22, *KPPU* has initiated a formal co-operation with the institution. The co-operation is focused on exchange of data and information, joint socialisation related to prevention of conspiracy in tenders, and delegation of conspiracy cases that involve corruption.

With such co-operation, 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 organisation.

**Box 2. Co-operation between the KPPU and
the Corruption Eradication Commission**

Co-operation between the Corruption Eradication Commission (KPK) and the Commission for the Supervision of Businesses Competition (KPPU) was agreed on February 6th 2006. The co-operation is aimed to build co-ordination within the nation's supervisory institution, understanding that there is a correlation within corruption practices and unfair businesses competition, especially those related to tender conspiracies. The scope of co-operation were involving inter institution access on data, information, and co-ordination related to respective case findings. If there is indication of corruption in any cases handled by KPPU, then KPPU could apprehended the corruption aspect to the KPK, while KPPU continues with the collusion aspect and vice versa.

During the implementation, KPPU apprehended several big cases involving corruption. One of the biggest is a bid rigging case for an auction of Very-large Crude Carrier (VLCC) which involving one of the State-owned Enterprises in Indonesia. While, the KPK once apprehended a bid rigging case on the procurement of helicopter by Indonesian Police. Apart from law enforcement, the co-operation also established precaution activities through joint dissemination programme to the national stakeholder on the tender conspiracy.

33. From advocacy side, most discussion topics in those activities include conspiracy in public tenders. In order to enhance understanding of the stakeholders that include the government, business actors, academicians, journalists, legal practitioners, and the public, *KPPU* conducts advocacy activities through dissemination programmes for the stakeholders. Throughout the year of 2009, the dissemination is more intensive than that of the previous years. There are 78 activities including mass media network development (journalist forum), competition forum development at national level, joint workshop between the parliament and the government, seminar for business competition in regions, formulation of advocacy subject matters, intensive public education in media, joint workshop with judges, joint workshop with public institutions, discussion fora in Regional Representative Offices, and business competition seminars in regions. Throughout this year, there are 1,916 participants who have participated in the activities held by *KPPU*. They include journalists, academicians, business actors, the government, the parliament, judges, and the public. Most discussion topics in those activities include conspiracy in public procurement.

34. Experience has 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.

35. This might be different by practice in other countries such developed country. The idea that not to frighten the tender committee, but to educate them to comply with competition law and assisting us in supervising bid participants and other member of the bid committee or principal not to breach the law. Therefore in the guideline published by the *KPPU*, several cartel indications are mentioned as a warning sign to the related parties. Other government institutions also published their own publication in detecting misconduct and corruption on public procurement.

36. 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.

Box 3. Guideline on the Prohibition of Tender Conspiracy

The guideline defines tenders as the bids submitted to contract certain work, for the procurement of goods or the provision of services. This article does not mention any number of parties submitting bids (either by several business actors or by one business actor in case of direct appointment/selection). Such definition of tender includes bids submitted (1) to contract or carry out a certain work, (2) to procure goods and or services, (3) to purchase goods and or services, and (4) to sell goods and or services. Based on the aforementioned definition, the basic scope of the application of Article 22 of Law No. 5/1999 shall be tenders or bids that can be submitted through Open Procurement, Limited Procurement, Public Auction, and Limited Auction. Based on this basic scope, direct selection and direct appointment that constitute parts of tender process is also included in the application of Article 22 of Law No. 5/1999.

Conspiracy in tenders in the Guideline is classified into three categories, namely horizontal conspiracy (amongst business actors), vertical conspiracy (between the tender committee and business actor) and combination of vertical and horizontal conspiracy.

In order to discover the existence of a conspiracy in a tender, the Guideline explains various indications of conspiracy in a tender. These indications ranged from planning activity until the contract implementation. However, the Guideline also views that an Investigation Team or the Commission Council of KPPU must still prove the form or manner of the conspiracy or the existence of conspiracy through an investigation.

4. Closing

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

38. From the perspective of economics, the practices of monopoly and unfair business competition are very potential to fertilise collusion and corruption. Cartels, misuse of dominant positions, merger and acquisition, and other forms of anti competitive behaviour are conducted by business actors with expectation to gain supernormal profits. In bid rigging case, the supernormal profits could be expected by the bid participants and or the bid committee who guarantee certain bid participant to get the contract.

39. Despite only expectation to win a tender, business actors would be please to provide any parties (other bid participants and or bid committee) with some funds to realise it. Moreover, if a supernormal profit has ever been gained through a mark-up in contract value, a quite significant funding would be available to ensure their winning on the next procurement, maintain profits or even make their market expansion. As such, the relationship of corruption and unfair competition would form a vicious circle that is all the longer the harder to break.

40. The enforcement of law on fair business competition contributes to realising the aim of obtaining a 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 significantly 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 limited to reasonable levels, business actors would have less ability to provide kickbacks or bribes to dishonest officials.