CORRUPTION AND ITS EFFECTS ON THE ECONOMY AND PUBLIC SECTORS

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ABSTRACT

Corruption is an ancient problem and its levels vary greatly across countries. Many factors contribute to corruption, including individual behavior, government organization, law enforcement, and weakness of controlling. The objectives of this study are to identify the social cost of corruption and investigate the impact of corruption on the public and economic sectors. A literature survey was conducted in this study. We figured out that corruption occurs not only at the central government level but also at the regional government level, along with regional autonomy. Corruption has affected economic growth, the level of GDP per capita, investment activity, international trade and price stability negatively. Corruption has also abused public budget to private or group interest.

Keywords: *Corruption, The Social Cost Of Corruption, Misallocation Of Resources.*

1. INTRODUCTION

Etymologically, the term 'corruption' comes from Latin term *'corrumpo*', which means 'to be rotten', 'to disintegrate', or 'to reduce value', and 'to become useless'. Today, corruption has become a global problem and no country in the world can escape from the threat of corruption (Chinenye Leo and Edet Patrick, 2010). Corruption is a multidimensional predicament in almost developing countries. The public sector is targeted by the state to serve the community to improve their welfare, but this sector is often targeted by corruptors to achieve their private goals. Ata and Arvas (2011) argued that corruption as an abuse of power in society is complex because it endangers the country's economy, politics, and socio-cultural structures, and damages public confidence, which impacts on people's lives.

Corruptors are different from other types of crime actors. They commonly come from high-income groups, possess a high level of education, and have various ages. They practice sophisticated techniques that are difficult to track. Corrupt actors always make use of their power to protect themselves from inspection to lower the level of detection. In Indonesia, the criminal act of corruption is regulated by the law. Based on the Law Number 31 the Year 1999 Article 2, what is called corruptor is anyone who violates the law to enrich themselves or other people or a corporation that can harm state finance or state economy, and they can be punished with life imprisonment or imprisonment a minimum of 4 (four) years and a maximum of 20 (twenty) years and a fine of at least IDR 200,000,000.00 (two hundred million rupiahs) and a maximum of IDR 1,000,000,000.00 (one billion rupiahs). In the case of corruption, as referred to in the article carried out in certain circumstances, capital punishment can be imposed.

In everyday life, the practice of criminal acts of corruption is often not realized by the perpetrators. For example, someone receives a payment from a company or agency officer by signing a receipt whose value is greater than the amount received. In this case, the person concerned is not guilty, by considering that the receipt is not related to its obligations, where money must be received on-demand, even though it results in the company or agency having to spend more money than it should. The excess payment is the right of the concerned officer. The above case fulfills the element of corruption, because who signs the receipt has made a deviation by giving false or incorrect information, the corruption benefits company officers, and this can harm the state's or company's financial condition.

Corruption takes place due to several factors, namely (1) the existence of opportunities, (2) a system of government and bureaucracy, (3) the absence of a strong system of control from the community, and (4) weak regulations. Corruption causes inefficiencies in the allocation of resources, and this will contribute to high social costs to hinder economic growth. Corruption crimes can also disrupt the public sector, such as reducing public facilities due to misallocations and increasing the cost of the community to obtain public services (bribes).

This study has endeavored to take stock of what is known about corruption in Indonesia by analyzing the causes of corruption, their impacts on the economy and public sector, and the complexities of reducing or eliminating them. It explores the following research questions: (1) What are the social benefits and social costs of corruption?; (2) What are the effects of corruption on the public sector and the economy?

1.1 Basic Theory of Corruption in Economics

In economics, two theories can explain corruption studies. The first is the theory of rent-seeking. The term "rent" refers to Adam Smith's classification of the factors of the return to production services. Wages are remuneration for labor, profits are for employers, while rent is a reward for assets. Problems arise when economic actors try to take rent from assets that are not theirs. The second theory is the superiors (principal-agent). The first party, boss or principal, has a desired final goal. To achieve that goal, the boss delegates the work to the subordinate (agent) with particular incentives or compensation. Superiors and subordinates here are not always synonymous with hierarchy in companies or organizations. In the context of government, for example, public officials and members of parliament are subordinates while voters (the people) are superiors.

In ideal conditions, the boss can monitor the performance of subordinates, and the ultimate goal set by the boss will be achieved without deviation. However, these ideal situations rarely occur. The cost of supervising subordinates at any time will be excessively high. Meanwhile, subordinates also have some personal interests they need to fulfill. This is "space" in which corruption can take place. Third parties can benefit by offering several rewards to subordinates to do the opposite of what the boss demands.

1.2 Corruption as Necessary Grease (Leff-Huntington)

$$H = h > l = l, \pi N < 1 < N$$

The price is p <1, to test H for T hours so that $\exp[-\lambda T](l - p) - \delta T = 0$. Corrupt bureaucrats sell places at l without passing the test because the test can reduce the profits derived from the buyer. It appears that only type H purchases. Efficiency increases due to corruption because this effort eliminates bureaucracy (red tape). Corruption is negatively related to bureaucracy in some countries (assuming that the actor is greedy).

1.3 Corruption as Extortion (Shleifer-Vishny)

$$N < 1, L > 0$$

Bureaucrats exploit the bureaucracy for charging illegal levies. In the selection process (testing), bureaucrats charge fees to candidates and the candidates pay a sum of money to pass the selection stage. Here, bureaucracy is positively correlated with corruption, by assuming greed and monopoly.

2. RESEARCH METHOD

To take stock of the existing knowledge about corruption, as well as their impacts on the economy and public sectors in Indonesia, a literature survey was conducted. This review focused primarily on the studies about the social cost of corruption and the social benefit of corruption, along with the impact of corruption on the public sector and economy. This paper uses a literature study by examining previous studies, such as scientific publications and books. In this paper, we examine thoroughly the dangers of corruption in life. To ensure that the information was up-to-date and relevant, we only included pertinent literature for further analysis.
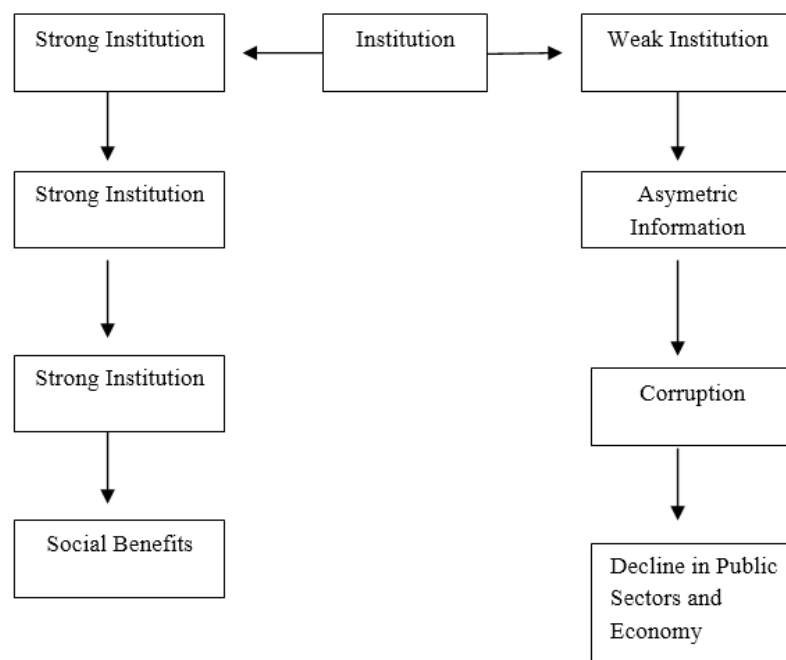
Figure 1. Framework

3. RESULTS AND DISCUSSION

3.1 Determinants of Economic Corruption

The economic theory introduces a term of "asymmetric information". This is the cause of corruption, which triggers moral hazard and adverse selection. However, corruption is a multidimensional problem, which is attributable to many factors.

Table 1. Determinants of corruption

Factors Underlying Corruption		
Economy	**Politics**	**Social and Culture**
Government size	Democracy	Ethnicity
Wage	Political competition	Religion
Economic growth	Freedom of the press	Education
Distribution of income and poverty	Political instability	Gender
Competition	Accountability	Culture
Transparency	Bureaucracy	Natural Resources
Economic freedom	Constitution	Ethics
Inflation	Proprietary Rights	Urbanization
Regulation		

Sources: Ata and Arvas, 2011

From the table above, it can be assumed that the lack of economic resources can instigate corruption. A country with high economic development, as well as a more even distribution of income, will lead to a lower level of corruption. Another cause of corruption is inflation. High inflation and variables contributing to it can reduce investment and economic growth. A strong institution and a virtuous belief in cultural values can reduce corruption.

3.2 Social and Economic Costs of Corruption

Corruption demands social and economic costs. This act creates unproductive behavior and reduces incentives. Economic costs of corruption cover explicit costs and implicit costs (opportunity costs). The former is the number of state losses due to corruption or the nominal amount taken by corruptors while the latter is the lost economic multipliers due to corruption, economic inefficiencies that lead to misallocation of resources, lowering the level of competition and increasing transaction costs.

Vazquez, et al. (2004) have mentioned that corruption reduces efficiency and increases prices for public services from several sources. Corruption in the fiscal sector in various forms reduces the funds available to support public goods and services. Corruption upsurges the costs of public services, as well as increases taxes. It damages the allocation of public resources. Moreover, it lowers the quality of public services.

Corruption generates more social costs due to the non-transparency and the presence of a protected network. This network weakens the legal and governmental functions, reduces government accountability, and lessens the effectiveness of government and public services. The involvement of the military, police, and prosecutors in smuggling, extortion, and other types of organized crimes indicates the weakness of the regulation that indeed should protect the community, and therefore, the biggest cost of corruption is a reduction in trust in the government.

3.3 Corruption Phenomena in Indonesia

Corruption has a major impact on economic development because of the high levels of distortion and inefficiency. According to Dreher and Herzfeld (2005), corruption puts a negative impact on economic growth, the level of GDP per capita, investment, international trade, and price stability. Impacts in the public sector take place in the form of distortion, diverting public investment into community projects that have more bribes, reducing the quality of government services and infrastructure, and adding pressure on the government budget.

Corruption also reduces the compliance of safety requirements of buildings, the environment, or other regulations. In the private sector, corruption increases costs due to losses from illegal payments and management fees in negotiations with corrupt officials. These distortions and inefficiencies ultimately lead to misallocations of resources and inhibition of growth.

Table 2. Trends in the enforcements of corruption crimes in 2018

No	Mode	Number of case	Percentage	Total state loss (IDR)
1	Mark up	76	16.74	541 billion
2	Budget misuse	68	14.98	455 billion
3	Fraud	62	13.66	441 billion
4	Fictitious report	59	13.00	160 billion
5	Bribery	51	11.23	-
6	Fictitious activities/projects	47	10.35	321 billion
7	Illegal levies	43	9.47	-
8	Abuse of authority	20	4.41	3.6 trillion
9	Budget cut	16	3.52	38.2 billion
10	Gratification	7	1.54	-
11	Extortion	2	0.44	-
12	Double budget	2	0.44	2.7 billion
13	Markdown	1	0.22	1.4 billion
TOTAL		454	100	5.6 trillion

Sources: Corruption Eradication Committee (KPK), 2018

The abuse of authority is carried out by the government officials, who have special authority, by issuing particular policies such as mayor's or regent's decisions or regulations, which usually allow them to collaborate with their colleagues/particular groups (despotism) or with their relatives (nepotism). Another type of abuse is pursuing certain goals and interests of particular groups or parties. This can also be a form of a group's support to an officer to occupy a strategic position in an executive board or a position that holds bureaucracy, in which later they will receive compensation for their actions. This practice is commonly called the cunning politics of reciprocation. This type of corruption is extremely precarious because, with this practice, all supporting elements have received compensation.

Table 3. Positions of corruption actors in 2018

No	Position	Number of suspects	Percentage
1	State Civil Apparatus (ASN)	375	38.82
2	Corporate	235	24.33
3	Chief/Member of the People's Representative Council (DPR)	127	13.15
4	Head of a village	102	10.56
5	Regent/Mayor/Governor	37	3.83
7	Director/Employee of State-Owned Enterprises (BUMN)	28	2.90
8	Village apparatus	22	2.28
10	Director/Employee of Regional-Owned Enterprises (BUMD)	15	1.55
11	Head/Member of Organization/Group	13	1.35
12	Headmaster	12	1.24
	TOTAL	966	100.00

Sources: Corruption Eradication Committee (KPK), 2018

The aforementioned losses are merely explicit costs attributable to the corruption practices. The more substantial problem is the implicit costs of corruption in Indonesia, the number of state losses due to the loss of economic multipliers, in which the corrupted money is not allocated to important sectors for economic development and this results in a misallocation of resources. This is the government's failure to carry out economic development and the distribution of the economy, as well as to hold a fair and credible judicial process.

4. CONCLUSIONS

Corruption occurs as a result of several factors, comprising the economic, political, and socio-cultural factors. Corruption does not only take place at the level of the central government but also at the level of the regional government, together with regional autonomy. The sources of corruption at regional levels are regional income, expenditure on apparatus, and expenditure on public service. Corruption gives a negative impact on the level of community welfare, which is obvious from the many economic multipliers losses that have caused a misallocation of resources.

In the public sector, corruption causes distortion, shifting public investment into community projects with more bribes, plummeting the quality of government services and infrastructure, and intensifying pressures on government budgets. Prevention is better than cure, meaning that a good state awareness and corruption education are required from an early age of an individual. An education system for students that teach morality, integrity, national and state awareness, and a strong religious foundation is necessary. An improvement in the firm legal system and credibility is also important to reduce acts of corruption in the future.

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