

## *From State Capture to Business Capture: Corruption or Maladministration?*

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### **Abstract**

Accountability is the key to good governance. In global administrative law, every policy made should be accountable. The given law should be accessible for public. When global financial crisis happened, many countries didn't have the necessary rules to solve problems arose. In Indonesia, the decision from government to bailout century bank is controversial as of right now. The need of comprehensive law in related to economic, political and social factor should be considered. Unfortunately, bailout policy can be seen in two ways: state capture or business capture. State capture for some countries is a form of corruption: less known but still very pervasive, found often but not exclusively in transition countries. Others called it business capture: the state unlawfully taking control and exercising undue influence over businesses. By comparing both, there's another characteristics emerge: maladministration. Administrative failure which hard to define but one always can find it exist in the exercise of good governance.

Keywords: state capture, business capture, corruption, maladministration

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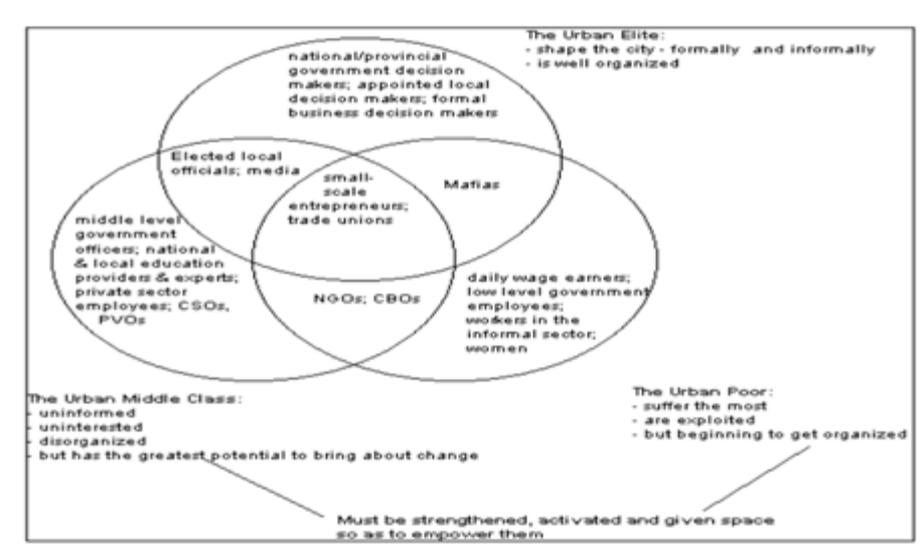
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## Introduction

Joel Hellman and Daniel Kaufmann said that in transition economies, corruption has taken on a new image—that of so-called oligarchs manipulating policy formation and even shaping the emerging rules of the game to their own very substantial advantage. They refer to this behaviour as state capture. Another definitions of ‘State capture’ is defined by Vesna Pesic as any group or social strata, external to the state, that seizes decisive influence over state institutions and policies for its own interests and against the public good. Teten Masduki , also have similar understanding that state capture is a policy that have been made to the advantage of entrepreneurs.

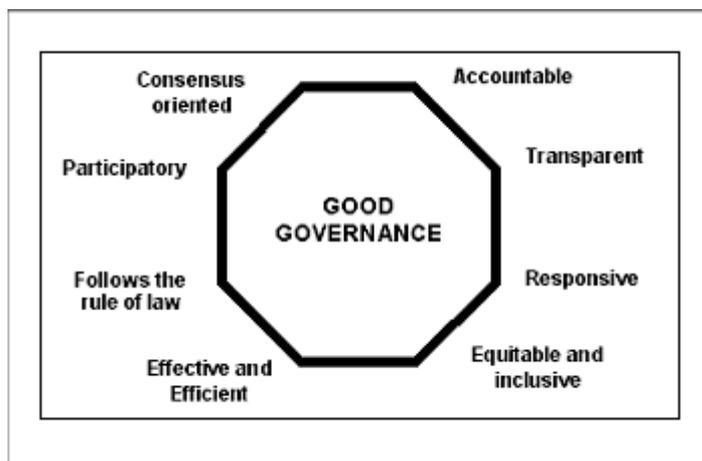
Anne Lugon-Moulin in understanding state capture said that it occurs when the ruling elite and/or powerful businessmen manipulate policy formation and influence the emerging rules of the game (including laws and economic regulations) to their own advantage. In recognizing the problem of state capture, Helmann and Kaufmann put their effort on the complex interactions between firms and the state. Particularly, they emphasize the importance of mechanisms through which firms seek to shape decisions taken by the state to gain specific advantages, often through the imposition of anticompetitive barriers that generate highly concentrated gains to selected powerful firms at a significant social cost. Accordingly, state capture has become not merely a symptom but also a fundamental cause of poor governance.

Since governance is the process of decision-making and the process by which decisions are implemented, government is only one of the actors in governance. All actors other than government and the military are grouped together as part of ‘civil society’. At the national level, informal decision-making structures such as ‘kitchen cabinets’ or informal advisors may exist. Such informal decision-making is often the result of corrupt practices or leads to corrupt practices. Figure 1 provides the interconnections between actors involved in urban governance:



Bad governance is being increasingly regarded as one of the root causes of all evil whereas major donors and international financial institutions are basing their aids and loans on the condition that reform ensure ‘good governance’ undertaken. Good governance has 8 major characteristics. It assures that corruption is minimized, the

view of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. Figure 2 specify the characteristics of good governance:



In the absence of access to government decision making through collective representatives, firms are compelled to seek informal, one-on-one relationships with individual state officials to represent their interests. A number of key writings on the topic suggest the roots of state capture extend from partial civil liberties, lack of transparency, competition and insecurity of property rights. The lack of transparency tends to go hand in hand with insufficient competition among firms and other constituencies to influence the state's deliberative processes. Fostering competition in the economy and in the marketplace for political influence is the main challenge in preventing and combating state capture.

## **Corruption**

Montinola and Jackman conducted cross-country study to find sources of corruption. Two arguments were initially advanced to explain the incidence of corruption in the newly sovereign states. The first took a cultural approach, suggesting that corruption stems from social norms that emphasize gift-giving and loyalty to family or clan, rather than the rule of law. The second explanation of corruption stimulated by events in the new states, a revisionist approach, attributed the phenomenon to a country's particular stage of development. Within the revisionist school, some scholars argued that corruption is efficiency-enhancing; it helps alleviate problems of capital formation and administrative inflexibility characteristic of modernizing economies.

With the popularity during the 1970s of neo-Marxist approaches to development issues, the debate on causes of corruption became irrelevant. Corruption was no longer a puzzle, but simply an inevitable by-product of capitalist democracy and an intrinsically corrupt international capitalist system in which lower-class groups are routinely and systematically exploited. By the 1980s, however, neo-Marxist analyses began to lose favour, as the gap between their predictions and observed patterns became increasingly conspicuous. An expanding number of so-called peripheral countries in Asia and Latin America, for example, were developing rapidly (instead of under developing), while socialist countries were performing much more poorly than expected.

Systematic Change	Major Political Effect	
East Germany	Argentina	Bangladesh
Liberia	Brazil	Burkina Faso
Mauritania	China	Colombia
Nicaragua	Gabon	Greece
Niger	India	Indonesia
Nigeria	Italy	Ivory Coast
Panama	Japan	Kenya
Philippines	Malaysia	Mali
Former Soviet Union	Mexico	Pakistan
Sierra Leone	Paraguay	Peru
Sudan	South Korea	Spain
Uganda	Tanzania	Thailand
	Venezuela	Zaire
	Zambia	

Figure 3. Linkages of corruption to systemic change and major political effect by country's since the mid-1970s

The argument that state intervention in the economy and weak political competition facilitate corruption appears to fit well with the experience of a number of developing countries. Moreover, Montinola and Jackman offer a fresh analysis of the sources of corruption. First, they hypothesize that more competitive political structures inhibit corruption. Second, their hypothesis focuses on the possible effects of government size. Specifically, they examine the proposition that larger governments generate more corruption. Finally, they examine the proposition that the incidence of corruption is lower in countries with higher levels of economic development.

Daron Acemoglu and Thierry Verdier in their research about the choice between market failures and corruption had developed a simple framework to analyze the links between government interventions and government failures. There are three basic assumptions:

1. Government intervention requires the use of agents ("bureaucrats" for short) to collect information, make decisions, and implement policies;
2. These bureaucrats are self-interested, and by virtue of their superior information, hard to monitor perfectly;
3. There is some heterogeneity among bureaucrats.

These three assumptions imply that when the market failure in question is important, the optimal allocation of resources will involve a certain degree of government intervention, accompanied by a large government bureaucracy, rents for public employees, misallocation of resources, and possibly, corruption. Acemoglu and Verdier used the above reasoning to produce result such as: because government intervention designed to correct, market failures requires the use of bureaucrats to make decisions, it will create opportunities for these employees to be corrupt and demand bribes.

Another result is that corruption should be observed as part of an optimal allocation when the market failure in question is important, and the fraction of "dishonest"

bureaucrats (those who are harder to detect when taking bribes) is relatively low. This result may suggest that situations where the majority of bureaucrats are corrupt, as in some less developed countries (LDCs) are harder to rationalize as "optimal" government intervention than instances of more occasional corruption in the country member of Organization for Economic Cooperation and Development (OECD).

The established link between government intervention and market failures have raised questions about the economics of corruption. Toke S. Aidt had made a distinction between four different analytic approaches to corruption. The categories are:

1. Efficient corruption: corruption arises to facilitate beneficial trade between agents that would not otherwise have been possible. It promotes allocative efficiency by allowing agents in the private sector to correct pre-existing government failures;
2. Corruption with a benevolent principal: corruption arises when a benevolent principal delegates decision making power to a non-benevolent agent. The level of corruption depends on the costs and benefits of designing optimal institutions;
3. Corruption with a non-benevolent principal: corruption arises because non benevolent government officials introduce inefficient policies in order to extract rents from the private sector. The level of corruption depends on the incentives embodied in existing institutions;
4. Self-reinforcing corruption: the reward to corruption depends on the incidence of corruption due to strategic complementarities. The level of corruption depends, for given institutions, on history.

Michael Johnston said that any assessment of the role of corruption in the world's economies must also address its political dimension. Parallel to Johnston's findings that corruption tends to accompany rapid political and economic change, he also said that corruption raised an important political question about the relationship between state and society and between wealth and power.

### **Maladministration**

Maladministration as Kenneth Wheare said is a very large subject; it occurs wherever social organisation exists. It is not confined to the operations of the government or state alone. It may be difficult to define but most believe that one could recognise an example of it, if one saw it. In a sense it all comes back to the meaning of 'administration' itself. If it includes within it a measure of rule-making and of adjudication, the notion of administration widens and in so doing the area in which maladministration can occur. If on the other hand the word has a narrower meaning, the meaning of maladministration is correspondingly confined.

Wheare argues that 'administration' as in wider sense. In the pursuit of maladministration, concepts of misconduct and negligence have been introduced. Misconduct has many shades of meaning as a deliberate dereliction of duty on the part of a person who knows that he is acting wrongfully and in the breach of duty. The relevant concept of negligence is a departure from the required standard of competence, whether it be by action or by failure to take action, though not every departure is necessarily negligence.

It is sometimes assumed that in identifying maladministration, one cannot question the rules, only the actions of those who are applying the rules. As a result, if an official is carrying out the rules or is acting strictly in accordance with them, then, no matter how unjust the results are for the citizen, no question of maladministration can arise. Wheare argue this point of view, such complaints are, in many cases, complaints both against bad administration and bad laws and it is the bad laws which have made possible and sometimes made obligatory the bad administration.

In defining public maladministration, Caiden said that the breakdowns of individual policies, programs and organizations do not constitute an indictment of a whole administrative systems. Studies of postcolonial administrations in several newly independent states had indicated that systemically sick administrations did exist, which caused the societies so badly to fail to develop and even deteriorate. Although individual administrative maladies have been identified for many centuries, no one has ever tried to combine it systemically.

The study of public administration as such has to await the spread of the institution of ombudsman from its native Scandinavia. Based on actual complaints investigated by the British version of the ombudsman, Geoffrey Marshall concluded that maladministration was both a matter of instinct and an acquired technique. A novel experiment was tried in the early 1970s at the Institute of Administration at the University of Ife, Nigeria. Factor analysis pointed to six leading causes of preventing initiative: corruption and lack of integrity; community conflict and aggression; inefficiency; sectarian conflict; misconduct and indiscipline; and bad authority relationships.

Although a formal definition of "maladministration" did not exist at the time the powers of the Ombudsman were first established, however, one has evolved through practice. The Ombudsman provided a preliminary definition in its 1995 Report to the European Parliament: "Maladministration occurs when a public body fails to act in accordance with a rule or principle which is binding upon it." Based on this definition, the Ombudsman considers it an instance of maladministration whenever an institution or a Community body does not respect the Treaty rules as they are contained in binding Community legislation, the rules and principles of law derived from decisions of the Court of Justice and the Court of First Instance, or fundamental human rights law.

This broad definition leads to significant overlap between investigations by the Ombudsman and investigations by the European Courts. The Treaty does not contain provisions detailing the activities that may be subject to investigation by the Ombudsman and the means of formulating complaints. This absence is significant, as it suggests that, contrary to the activities of judges under Article 230 of the Treaty, the Ombudsman is not limited in his examination of specific activities and wrongdoings. In other words, the Ombudsman does not render decisions that remedy the legal injury to the complainant, but formulates opinions aimed at encouraging amendments to the practices and rules applied by Community institutions.

In Indonesia, maladministration is a behaviour or illegal action, abuse of power, using authority contrary to the purpose of the authority given, including negligence or omission in doing public service by official and government which resulted in

material loss and/or immaterial to the individual and society. The wider definition of maladministration in Indonesia gave ombudsman the chance to take part in every maladministration cases including criminal, human rights, ethics and administrative cases. Accordingly, this resulted in the need to cooperate with other government bodies based on Memorandum Of Understanding (MOU).

### **Case Study**

The practices of state capture had invoked the party involved to find the solutions. Kaufmann is one of the leading researchers in these matters. His research basically made the basic ground for other research to be held. World Bank and the European Bank for Reconstruction and Development (EBRD) conducted joint initiative to form The Business Environment Survey (BEEPS). The results of the Business Environment and Enterprise Performance Survey 2002 do indeed show that there has been a decline in state capture -- a significant decline in some cases -- across the transition countries.

The countries where capture was most pronounced -- Russia, Ukraine, Azerbaijan, Moldova -- have seen the sharpest decline, while countries with more modest capture levels, for example in some south-eastern European countries, have remained more or less constant or experienced an increase in levels of capture. Meanwhile, the recently conducted research, has found that Putin paved the way for a new phenomenon of 'business capture' by state officials. Business capture constituted of dramatic increase in the formal state share ownership in certain strategically important sectors, such as petroleum, energy and media outlets.

Practitioners in Russia consistently highlight that there are two parallel processes taking place in Russia: state capture and business capture, as described by some, these two processes have been turned into the fusion of state + business by the elite, with former bureaucrats running businesses and business leaders holding or controlling political office. Amongst the key measures to address the situation are the introduction of conflict of interest, regulations, codes of conduct and wide-ranging transparency reforms. In addition, it has now been acknowledged by many that to galvanize Russia's public debate over corruption, it is vital to remove the sole responsibility for reform from government.

President Putin publicly challenged the leaders of the Union of Industrialists and Entrepreneurs (RSPP) to help "destroy the breeding ground for corruption". The association responded by creating a working group that will recommend administrative reform measures to the president, which will include reducing obstacles to business that provide the opportunity and incentive to engage in various forms of corruption, including state capture.

### **Practices**

In Indonesia, Susilo Bambang Yudhoyono, when elected as the sixth president of Indonesia, introduced the integrity pact for his cabinet. The candidate for ministry office must sign their signature that explained their commitment to avoid corruption according to code of conduct. This action might relate to history of Indonesia under regime Soeharto. Soeharto may never intend to give grief for Indonesia but alas after

ruling for almost 32 years, it had established as a corrupt regime. After that, Indonesia forced to embark on a comprehensive and unprecedented process of decentralisation, devolving almost overnight enormous responsibilities to regional, provincial and local governments. In spite of considerable achievements, the Indonesian decentralisation process continues to face major challenges of state capture by the local elites, a deeply entrenched patronage system and widespread petty and bureaucratic corruption.

Transparency International in accordance with Anti Corruption Resource Centre tries to fully understand the nature of corruption challenges at the local level. In query, they said that it is important to analyze the successes and failures of Indonesia's unprecedented decentralization process that transferred rapidly complete responsibility for most public services to the sub national level. The fast transition from a highly centralized to a largely decentralized system has created specific accountability challenges that significantly affect corruption risks at the local level.

Todung Mulya Lubis, senior advocate practising in Indonesia said that Lapindo's mud case in Sidoarjo is an example of state capture corruption. Activist for Indonesia International Transparency, Lubis surely know enough about corruption practices. Furthermore, he explained that state capture corruption happened if there's some party who gained benefits from government policy. Indication to the fact can be seen in this case when the party involved never taken the responsibility for the disaster. The policy endorsed by Indonesian government to take responsibility for Lapindo mud flow victims has illustrated how businesses may shift policy against public interests.

What makes state capture possible according to David Kupferschmidt from International IDEA is the existence of a well-organized and a well-funded interest, in the case of Indonesia is powerful business groups. Their control of large media groups, combined with weak law enforcement, contributes to establish a conducive environment to state capture. The Corruption Eradication Commission (KPK), who has been under constant attack from the police, attorney general office, and parliament members for the last couple of years, remains one of the last rampant against the impunity sought by state capturers.

The Indonesian political party system is characterized by a growing individualization of weak leadership, by the inability of political parties to identify the champion core of constituent groups and to articulate policy programs. In their press release, transparency international Indonesia concluded that the financing of local elections is the root of political corruption and state capture at the regional level. Besides its direct impact on state resources, it raises more fundamental issues related to political leadership, the strengthening of Indonesia's political party system, and public trust towards democracy.

When civil participation in local government is low, as it seems to be the case in most Indonesian provinces, there is a greater chance of interest groups and local elite capturing and directing resources towards their own priorities rather than towards poverty alleviation and improved service delivery. There are several types of state capture in Indonesia:

- Local Networks of Patronage
- Red Tape and Bribe Extortion

- Lack of Local Capacity
- Misuse of Local Public Resources
- Public Procurement
- Facilitation and Other Informal Payments
- Lack of Efficient Controls and Oversight Mechanisms
- Culture of Impunity

### **Lesson Learned**

The standard advice for combating corruption has traditionally focused on measures to address administrative corruption by reforming public administration and public finance management. Unfortunately, with the increasing recognition that the roots of corruption extend far beyond weaknesses in the capacity of government, the repertoire has been gradually expanding to target broader structural relationships, including the internal organization of the political system, relationships among core state institutions, the interactions between the state and firms, and the relationship between the state and civil society.

While there exists rampant corruption in the countries of the FSU and oligarchs in many countries have seized the lion's shares of State assets, the question arises as to who is capturing who. Is it a case of the State being captured by the private sector or a fusion of the State and the private sector? Putin already put it in quite a definite statement, "I only want to draw your attention straightaway to the fact that you have yourselves formed this very state, to a large extent through political and quasi-political structures under your control. So perhaps what one should do least of all is blame the mirror."

In East Asia, one key issue that emerged out of active state intervention in the economy to generate growth was extensive corruption. The main-stream view of the political economy of development is that corruption is an integral part of the political process, since the close links between state and capital are central to achieving rapid economic growth. Politicians in power provided business with a pro-growth regulatory regime and cheap capital. In return, business supplied politicians with monetary resources to preserve their grip on power. This barter of state-generated economic rents for funds created a tight alliance between ruling parties and business that transformed these nations into newly industrialised countries (NICs). Since much of the flow of money between business and politicians was either illegal or skirted the letter of the law, corruption was seen as a structural problem, that is an inevitable aspect of the developmental state.

The nature of the links between the state and big business in these East Asian countries indicates that the influence of capital over politics has increased appreciably following democratisation. The changing pattern in the balance of power between capital and the state in democratised countries is having a bearing on the flow of funds from business into politics. Political funding by business has contributed to a significant rise in the phenomenon of money politics, involving the use of funds in the political arena to secure control over the state so as to influence the form of distribution of state-generated rents. Since the links between politicians and capitalists heavily influence political contests, this brings into question the quality of democracy emerging in East Asia.

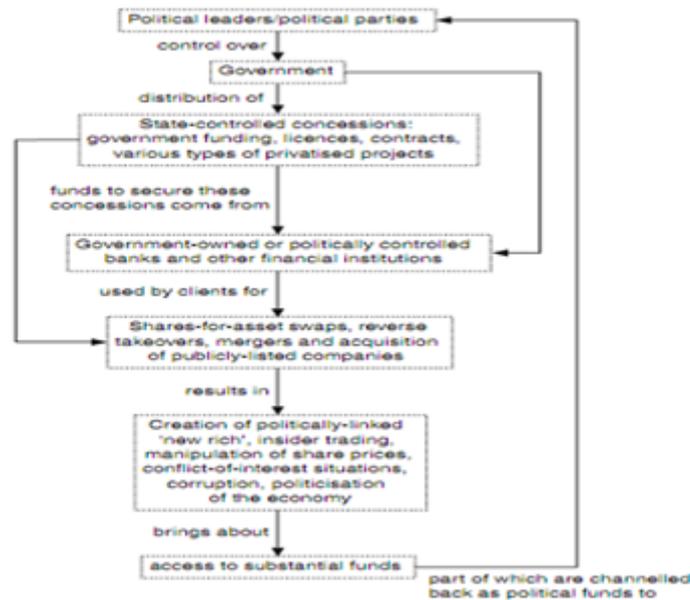


Figure 4: a model of the practice of the political business and the impact of the nexus between state and capital on the corporate and financial sectors as well as the political system.

In Indonesia, according to the anti-corruption act, any conduct by an individual or corporation which is either against the law and or abuse the power which may inflict losses to economy or national budget is considered as a corruption. The definition of corruption in the anti-corruption act is limited to misallocation of public money. Indeed, the coverage of offences in Indonesia anti-corruption act is narrower in comparison to that of the UN convention against corruption in 2003, though Indonesia is one of countries, which ratified it. The anti-corruption act does not cover corruption by private sector, moreover it does not taken into consideration that money politic is part of corruption. The latter is quite ironic since in Indonesian Criminal Code (KUHP) it is stated clearly that money politic is a criminal offence.

The main indicator of corruption in Indonesia is that whether or not such activity may inflict losses to the economy or the national budget. Ideally the estimation of losses in economy and national budget uses the economic approach by estimating both the explicit and the implicit costs of corruption. The common practice in Indonesia's judicial system is that the estimation of losses in economy or national budget due to corruption is limited to the explicit cost of corruption. The estimation of the losses has been conducted by prosecutors, who are obviously well versed in the area of law but they have limited knowledge in Economics. The estimation of explicit and implicit costs cannot be separated in every economic activity. In many cases, the explicit costs of a decision are overwhelmed by its implicit costs or implicit benefits.

Corruption can be seen as maladministration according to Ombudsman Indonesia. Where would also regard as falling within the scope of maladministration actions which were influenced by what is loosely described as bribery and corruption. In most cases this would amount to a form of illegality, but there can be examples where influence may be used to persuade officials either to act or not to act in an area where

they have discretion but where, though it might not be clear that illegality was involved, it could be urged that maladministration had occurred.

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