Journal of Indonesian Economy and Business
Volume 24, Number 2, 2009, 163 – 176

THE POLITICS OF BANKING:
GLOBALISATION AND DOMESTIC POLICY CHANGE

Widigdo Sukarman

Universitas Gadjah Mada, Indonesia
(w_sukarman@yahoo.com)

ABSTRACT

The current article aims to elaborate on the history of bank policy modifications as a response towards economic and financial change, mainly due to globalisation. The central status of banks in the economy causes a need for the government to protect it in many forms that differ from one country to another. Bank policy makers that are closed or esoteric and are short-lived must be opened up to be able to receive long term ideas. The process is also marked intensively with competing interests between other actors of the government.

Keywords: *esoteric, globalisation, segmentation, deregulation, problem of coordination.*

INTRODUCTION

Banks play a central position in the economy, especially considering that they provide liquidity to the economy. It is because of its great importance that governments engage in great efforts to protect banks from the forces that may result in its instability. Protection from competitors that may lead to bank failure frequently come in form of business segmentation or size restrictions, and may be applied when banks were relatively uncomplicated, as was the case in the 1970s where savings were limited, the Euro market had not grown yet, and financial innovations such as derivatives have not developed. From the XVII century until the early 1970s, banking operation and financial systems were simple and conservative. Bankers consisted of closed up communities as not much of the public were aware of the banking system. In England, the operation of commercial banks, financial houses, financial cooperatives and securities companies were limited to their market segments, therefore disallowing open competition to take place. Bankers had the liberty to create banking policies without public monitoring and government interventions, a process in policy-making known to be esoteric in nature (Moran, 1986).

Esoteric politics refers to one of the approaches in analyzing policy making processes within the banking sector, as implemented by Moran (1986) and Coleman (1996). Esoteric policy making is defined as the process by which policy making is dominated by a group of "insiders" (internal) of which these parties acquire access to relevant knowledge upon a particular matter. In other words, esoteric may be understood as being much more private, technical, and informal in nature. In contrast, exoterism implies the opposite, whereby policies are determined by external parties. The knowledge acquired by these external parties upon relevant matters are deemed inferior compared to the esoteric group. In banking policy making, it is the bankers themselves that constitute the esoteric groups, while the exoteric group is represented by actors in the government, coming from different departments, as well as economic analysts or journalists that are referred to as the attentive public.

Moran's studies (1986) demonstrate the competing interests of bank policy making in England. The early stages of its progress were marked by esoteric banking policy, whereby processes of bank policy making were restricted to the banks. External parties, including parliament and the department of finance (Exchequer) did not intervene much with banking policies. Bank monitoring of which ideally be performed by a monitoring body, or central banks were only conducted by means of formality (pro forma) unless such conditions were met that required such actions to take place. However economic changes in the 1970s due to financial globalisation urged the need for external intervention, originating from several parties including the executive branch. This had became particularly evident when the Conservative Party under the leadership of Margaret Thatcher assumed victory in the 1979 elections, of which adhered to neoliberalisme ideals and desires to open up esoteric politics. The periods under prime minster Thatcher were marked by liberalisation in various economic sectors.

Mildly in contrast with Moran's studies, Coleman (1995) studied examples from France, Germany, United States, England and Canada to conclude that bank policy making remains esoteric in nature, but in a novel fashion. Complexities within new regulations and the technical rationale that were built had rather created a new broader esoteric community comprising of several parties outside the banking system. These parties were also aware of the banking system and were enabled to participate in the process of policy making. The parties consisted of financial institution professionals, and government representatives from the central bank or department of finance, because in reality- suggested Coleman - the execution of predetermined strategies requires coordination of actions from the limited number of professionals mentioned above, and may even include other institutions such as financial service authorities, deposit insurance, and also other related financial associations. In sum, Coleman argued that due to the larger competing interests involved in banking, a broader policy community is formed consisting of policy makers and executors of those banking policies.

URGES TO OPEN UP ESOTERISM

The 1970s was marked by the attack of esoterism in banking and financial services. The financial market and London finance experienced heightened changes, originating from the rapid rise of the Euro market, the flood of petrodollars, rise in participation of credit provision by large banks and the United State's security firms that avoided U.S. control, and lead to the change of domestic policy understanding. The Bretton Woods Agreement regulating international monetary systems to prevent short term capital flow had collapsed, gold standards were abandoned by the U.S. in 1971 and in 1973 the currency remained to be replaced by flexible exchange rates.

U.S. initiatives to reduce control over capital flow lead to the rapid globalisation of the financial system and was reinforced by the advance of information and technology. Failure of the Keynesian demand management model insisted that several governments shift to adopt neoliberal and monetarism doctrines within their financial system. The reduced roles of commercial banks in the U.S. due to their defeat against non-bank financial institutions that had the freedom of pricing, and the banking crisis striking numerous countries in this period caused public unrest and eventually forcing governments to review their banking policies.

EXPERIENCE IN ENGLAND

Following the collapse of several prominent banks in UK in the early 1820s, parliament eventually relaxed laws regulating bank ownership by allowing bank establishment to be conducted through the merge of bank shares, also known as *joint stock banking*. Examples of such actions include the establishment of the Bank of England which had been practiced with similar methods 200 years ago). The concept of *joint stock banking*, enables bank owners to distribute the risks between the bank owners themselves. This policy, of which occurred simultaneously with the industrial revolution, periods of enhanced quality of transportation and rapid communication devices, lead to the very significant growth of national banks in England.

Although English banks have already broaden their network in the national scope, their services remain restricted to three segmented groups, namely: "High Street" Clearing Bank, Merchant Bank and other financial institutions for example the Building Society.

Following the end of World War II, three fundamental advances resulted in the change of esoterism in English banking. First, an event occurring in the 1950s when the English government eventually began to relax restrictions of financial product service offers. For the first time, this had lead English Banks to offer new products including guarantee cards, cheques, and Automatic Teller Machines (ATM) practiced by the Royal Bank of Scotland.

Second, an event occurring in 1968-1970 when the English government approved policies to merge banks. This policy effectively resulted in the emergence of the *the big five* in the banking sector, of which contradicted with principles of bank size restrictions that were previously embraced. The third event occurred in 1971 when the English government once again encouraged banks to elevate competition by offering several broad services to its depositors. This lead English banks to offer products including savings, credit cards, personal savings, modernised ATM functions, and mortgage.

The largest change in the English financial system, in matters of services, occurred when parliament eventually approved the abolishment of restrictions on capital accumulation by non-bank financial institutions (referred to as the building society). Prior to this event, building societies were prohibited to accumulate funds and give mortgage credits to its members. By abolishing these restrictions, capital accumulation and products offered by financial institutions became indistinguishable. The division between banks and building societies became vague and had even lead to the merge of these two institutions (for example Lloyds Bank and Trust Savings Bank to become Lloyds TSB), an example of decompartmentation of financial services.

EXPERIENCE IN UNITED STATES

The banking crisis in United States in 1929 that had devastated the U.S. banking system and lead the world to a recession for one decade, lead macro-policy makers to reconsider the effectiveness of the free banking system: Whether banks would remain to be privileged in regulating themselves, therefore prioritizing self interest and putting national interests in second priority. The Bretton Woods Conference in 1946 presented an intense battle between policy think tanks, represented by John Maynard Keynes, insisting for regulation of interstate financial sectors, against White who represented the international bankers of Wall Street, who, as opposed to Keynes, urged for full freedom. When eventually the arguments of Keynes assumed victory, the win was supported by the U.S. government (Cerny, 1998), because the U.S. government remained uneasy to U.S. banks, of whom were suspected to cause the 1929 banking crisis. When the U.S.

government issued several banking laws in the the New Deal policy package, implying bank laws referring to the Glass-Steagall Act 1933 that highly regulates banking activities, banking became a heavily-regulated industry, and bank politics became very esoteric in nature.

Other developments occurring following the cease of World War II, was the raise of society income, resulting in heightened savings in banks, and therefore enabling application for credits to fund their homes. Banks developed to become institutions that served the broader society, not only the affluent. Based on experiences of the 1929 crisis, depositors remained fearful of their savings that may be wiped out in case of another banking crisis. In this case, bankers must be monitored, and banking must be open for public monitoring.

The particular matter had emerged when economic experts succeeded in providing sound explanations with their theories of *principal-agency problem*, *adverse selection* and *moral hazard* (see Akerloff, 1970; Lelland & Pyle, 1997; Stiglitz & Weiss, 1981; Diamond & Dybvig,1983). Moreover, theories related to *trust*, distinguishing banking sectors with real sectors, *contagion effect* and *systemic risk* further clarified that banking industries were much more vulnerable towards the dangers of the payment system or national economics compared to the real sector. Banks must become the *domain* in *public policy* (Dewatripont & Tirole, 1993; Davis, 1995).

Pressures from globalisation that had elevated competition begun to influence the U.S. banks in the 1960s. Commercial banks were no longer capable of competing with non-bank financial companies and therefore lead to considerable increased interest rates. As a consequence, lobbies emerged to end the Glass-Steagall restrictions. The abolishment of these restrictions were also due to aggressive lobbying to Congress from investment banks, commercial banks, and policy makers that demanded reforms in banking policies. Desires to reform banking policies gave way for the government to broaden commercial banking activities that had previously been restricted. Commercial banks were permitted to issue numerous municipal revenue bonds (1968), manage mutual funds (1974), public retail brokerage (1982), and most importantly, started to develop transactions of derivatives, one of which included mortgage backed securities (1987). The progress of market securities and derivative transactions demonstrated that the U.S. had interests to increase domestic liquidity, mainly in response to the advances in the international financial system as well as to assist progress of U.S. companies. The need for liquidity became much more evident when the U.S. Federal Reserve, on September 1990, permitted J.P Morgan, a New York commercial bank, to issue and assist the issuing of company stock. By this policy, the need of companies for liquidity became relatively much easier to fulfill compared to when the U.S. restricted the issuing of securities.

EXPERIENCE IN FRANCE

In the 1960s, France followed the state-led economy doctrine or *dirigisme* where banking policies were stressed in market stability, purposive segmentation to stimulate government industrial policy through the government, and protection from foreign forces. Government policies to encourage industries of priority was implemented by ownership of large commercial banks, therefore allowing the government to seize control over banks in allocating credit to the industrial sector that had became a priority. Because the capital market had not begun to flourish, the French economy centered on credit allocation following the directions of government policies known as *d'Economie endettement* or overdraft economy (Loriaux, 1991). This was characterised by the availability of credit ceiling, and the availability of credit allocated to a particular sector as well as the availability of interest ceiling.

In the late 1970s, the French economy shifted from an overdraft economy to a market economy with capital markets playing a dominant role. This perspective became much more evident in 1979 when the *Mayoux Commission* reported financial problems encountered by small-middle scale businesses, leading a number of the committee members to prepare the *Eight Plan* that had aspired the need to adapt to the new international financial system. This shift demonstrated a reduction towards intermediary roles of the banks, abrogation of government laws towards interest rates and credit, reduction of market segmentation, and desires to open up to international markets and foreign companies. The strategy of liberalisation started to be established and implemented. It had contained five basic elements: incentives to build intensive competition in the financial sector, promotion of universal banking and modernisation of regulatory structures.

In 1984 the French government issued a bank policy package that places all banks, whatever their status, under the same regulation. This policy became the starting point of a range of policies to erase credit specialisation policies and lead to the deregulation of the banking system. *Saving banks* (Caisse d'épargne) under the status of *co-operative banks*, are presently equal with Crédit Agricol, and in the year 2002, *mutual banks* became a member of the French Banking Association (Fédération bancaire française or FBF). As a consequence of credit liberalisation, all institutions competed in the domestic market under the same laws, and with practices that were entirely unrestricted.

Later on in 1987, under the government Chirac, a number of large banks were privatised including Societe Generale, Credit Commercial de France, Paribas and Suez. A year later the Caisse Nationale de Credit Agricole became a *mutual bank*. Privatisation followed in 1993 to the BNP and Credit Lyonnais in 1999. This process of denationalisation ended with the privatisation of Bank Hervet in 2001, and with the sale of 10% state shares in Credit Lyonnais in 2002. Eventually, new banks that were privatised had to deal with deteriorating economic trends. As a result, the financial crisis that reached its peak in 1997-1998, devastated Crédit Foncier, Crédit Lyonnais, CIC and most devastated by the crisis was Societe Marseillaise de Credit.

In France, esoterism of banking politics tended to be oriented towards a broad form of esoterism following the Coleman model. This was due to specific factors, referring to the bureaucrats in several government institutions as well as the origins of the central banks of which came from the same elite school. As a consequence, problems of coordination were absent from the process of decision making between departments.

EXPERIENCE IN GERMANY

Following the 2nd world war, German banking policies were strongly protectionist because of the influence of the bank collapse in Word War I that had lead to broad consequences. Efforts to protect depositors in dealing with the bank's failure was conducted by protecting banks from excessive competition. Policies in 1967, determined the limits of interest rates for deposits (*interest ceiling*) and provided barriers for entry of new financial institutions or the establishment of new branches (Oberbeck & Baethge, 1989). The authority of the German banks required that banks restrict loans in order to maintain the capital adequacy level in a secure position.

Germany has a long tradition of strong ties between banks and large corporations, also known as *bank-centered finance.* Apart from the contribution of its credit, large banks in Germany were also known to be shareholders of companies. This occurred because tax upon high capital gain resulted in the expensive sales of shares to banks. Banks were therefore more likely to hold shares in a company in the long term and as a result, banks must maintain fine relations with the clients of the corporation.

The second characteristic of the German banking system is the strong federal character. The influence and role of the banks in Germany vary and much is determined by the *federal state* (Herrigel, 1998; Deeg, 1999). Governments obtain large shares in regional banks and use the credit of these banks to promote interests of small-middle scale businesses in their regions. Even in Nordrhein-Westfalen, where large businesses dominate the local economy, the state bank (WestLB) and s*aving bank* support acquisition technology and R&D of small business by giving a subsidised interest rate (Deeg, 1999). It is not surprising that private banks became unhappy with the "*profit padding*" of state banks since they created an unfair profit. This conflict is likely to expand when large companies seek cheaper and flexible funding from abroad, therefore leaving the large private banks.

In the 1970s, domestic political pressure along with external pressure from globalisation and deregulation trends of the financial system resulted in a change of the German banking policy framework. The federal government applied significant changes in amending the Banking Laws that were approved by the parliament in 1976. In November 1974, as a response to criticism demanding German banks to become more responsive towards the development of the international financial system, an investigation commission was established in the banking sector, known as the Gebler Commission. This commission consisted of 11 members representing private banks, savings banks, private cooperatives, academicians, as well as banking monitors, to review whether the German banking system needs to move to a universal banking system segmented between banks and capital markets.

Entering the year 1990, the federal government's desire to create a universal banking system became obvious when the government legalised the law on the money market therefore approving the issue of money market securities. This step enabled company bonds to be issued and investment funds progressed extensively resulting in the shift of the German banking system from before 1970, of which was highly protected and segmented, to a liberalised financial system that no longer differentiated between banking operations and the capital markets. The German government also permitted the admission of foreign banks to fund development due to limited domestic liquidity. The limited abilities of the domestic market for liquidity, and the high demand of capital lead the German government to strengthen the bond market to draw larger liquidity.

BANKING POLICIES IN INDONESIA

Indonesia had for centuries became a colonial state of the Netherlands and was followed by Japanese colonialism that had applied a war economy. Success to eventually gain independence in 1945, inherited a colonial economic and financial system. Available production factors were destroyed by the war. Domestic production was stagnant as they were unable to meet demands, export of raw material had almost fully collapsed, the agricultural sector was stagnant and eventually lead to rice imports. These situations resulted in devastatingly low levels of state revenue and high inflation rates. Economic recovery mainly focused in suppressing inflation rates and these anti inflation policies proceeded to become a consistent government policy. However the policy was proved ineffective because firstly, the supply side had not recovered yet, second, fiscal policies were experiencing deficit.

This period was also marked by Indonesia's efforts to seek a suitable political system, deciding whether to become a full democracy in order to convince Western countries that Indonesia was not a product of Japanese fascism, or whether to become a partial democracy that will not fully comply with the western democracy system. Choices to determine the political system, of which remained to be encapsulated by hate for all matters related to colonialism, will determine the economic and financial system chosen by Indonesia.

In the early stages of independence, Indonesia nationalised a number of Netherland Banks and companies of which largely affected the people's livelihood, for example electrical companies, train companies and people's credit bank of which later became BRI. In 1946 the government established BNI to become a central bank, replacing De Javasche Bank, a commercial semi-Netherlands of which its tasks is to become a bank of circulation to issue money as a legal tender. Some pragmatic groups did not approve of BNI as a bank of circulation and preferred to continue with the roles of De Javasche Bank because DJB had experience in its field. One of these dissenting figures include Sjafruddin Prawiranegara, who ironically became the first governor when the government nationalised De Javasche Bank to Bank Indonesia (BI) in 1953.

In 1949 the Circular Desk Conference (Konferensi Meja Bundar-KMB) was held where Netherlands finally acknowledged Indonesia's independence or in the words of the Netherlands – submitting independence to Indonesia – but with the condition that Netherland Banks and companies remain to operate in performing their tasks to secure the interests of Netherlands. De Javasche Bank was forced to be accepted as a bank of circulation and BNI changed to become a commercial bank, although this became very disappointing for the parties aspiring a central bank established by a sovereign Indonesian government. Netherland-owned banks were allowed to continue their tasks of which were to ensure that war compensation be paid by Indonesia. To this day, bank policy making follows the colonial pattern.

In the periods 1950-1959, Indonesia experimented with political systems and tried the parliamentary democracy. This time of democracy was marked with rapid and repeated cabinet change therefore disallowing continuous progress of development Programmes to proceed. When the president Soekarno eventually rescinded the KMB in 1951, one of the political initiatives was to nationalize the De Javasche Bank to become BI. Nationalisation is political in the sense of being a sign of Indonesian sovereignty and economic in the sense that it may maintain the economic interests of Indonesia. Sjafruddin Prawiranegara of whom was former minster of finance, was assigned to become the first governor, where he had laid the main foundations of Indonesian banking policy. He declared that the position of BI is equal and not under the government. The opinions of the central bank in directing Indonesian economic development may differ from opinions of the government. The central bank views that agricultural sectors must be enhanced, in contrast to the minister of finance who considers the enhancement of the industrial sector to be of larger priority.

Sjafruddin suggested that a Monetary Board (PP No.11/1953) be established as a means to ease coordination. Although the minister of finance will hold the position Head of the Board, and the minster of trade as well as the Central Bank governor will become members, this does not imply that the central bank will simply submit to the demands of government actors. The purpose of the coordination does not always proceed as it should because within the process of policy making in Indonesia's banking system, the Monetary Board frequently is used by the government to open up Central Bank esoterism. Moreover, possibilities of government actors to abandon coordination all together with other actors may occur. This occasion had taken place in 1958, when the minister of finance implemented devaluation without consulting with BI, resulting in the resignation of Loekman Hakim, as a sign of protest, who was currently assigned as BI governor.

The role of the central bank is required in providing funds, in advance, to the government to implement deficit financing in the 1950s. The stance of the Bank Indonesia governor Sjafruddin Prawiranegara, of whom distanced himself from the government rather than becoming a government tool, had proved detrimental to the government's position. The government therefore went through great efforts to influence Bank Indonesia to coordinate management of state finance. The conflicts between government actors and Bank Indonesia began in the 1950s and continued persistently to maintain principles of a balanced state finance management while the government was forced to conduct deficit financing.

Eventually, government intervention succeeded through the government banking reorganisation under Jusuf Muda, as the BI governor, who was also appointed to become the Minister of the Central Bank. Under "*Musyawarah Bank Berdjoang Sabang-Merauke*" implemented in 1964, a Bank doctrine was produced as a foundation for banks to execute their roles in the final phases of the revolution. The basic idea of the doctrine was "*Panca Sakti Bank Berdjoang*" stressing that banks are tools of the revolution, as opposed to mere profit seeking financial institutions. As a consequence of the of *Bank Berdjoang* conceptions, adjustments were applied to the tasks of the general government banks, therefore enabling efficient management of state economic conditions. For this reason, tasks were divided between general banks and government banks to serve particular economic sectors. Within economical politics, the concept of *Bank Berjoang* was to integrate and segment the bank's operations in a particular business field so that it does not compete with each other, and so that allocation of government funding channels to the sectors intended to be developed, a characteristic known as economic *dirigisme* as applied in France (discussed in previous section).

On April 11 1965, the President Soekarno, under his political mandate, in front of the MPRS General Assembly, stated that the Indonesian banking structure, as providers of funds to government projects, will gradually be directed to a single Banking system. Under this system, government monetary and banking policies are able to be executed effectively, efficiently, and directed for the success of the government's Programmes of struggle.

Table 1. Government Expenditures, Revenue, and Deficits
(Billion Rp.)

Year	Expenditures Reported	Revenue Reported	Actual Revenue	Budgetary Deficit
1952	13.5	9.2	7.9	4.3
1953	12	9.7	9.5	2.3
1954	12	8.4	8.6	3.6
1955	12.4	10.3	9.9	2.1
1956	18	15.7	14	2.3

Source: Bank Indonesia

Table 2. Credit Sources of State Enterprises 1959-1965 (Billion rupiah)

Year	Credit Providers: Bank Indonesia	Credit Providers: Other Government Banks	Percentage of Shares From BI
(1)	(2)	(3)	(2):[(4)+(3)]
1959	7.2	0.2	99%
1960	7.3	3.4	70%
1961	12.8	2.6	88%
1962	20.6	6.6	75%
1963	41	9.8	80%
1964	82.2	50.3	62%
1965	334.4	194.6	63%

Source: Bank Indonesia

From the table above it is apparent that the government's urge to control the Central Banks and other government banks has a logical basis because of the lack of funding for development. At the time, foreign capital had not yet existed due to the unstable economic conditions for foreign investment admission, and because of the nationalist economic-political stance of the government that is anti-foreigner. Moreover, government revenue from tax was inadequate so that government budget deficit was paid in advance.

Before establishing the *Bank Tunggal* (Single Bank), the government integrated general banks and government owned saving banks in advance. This integration was gradually implemented through Presidential decree No. 8/1965,4 June 1965. In the same date, integration was also conducted to the Farmer and Fisherman Cooperative Bank (*Bank Koperasi Tani dan Nelayan)* into BI and was later followed on 21 June 1965 with the integration of State General Bank (*Bank Umum Negara)*, State Savings Bank (*Bank Tabungan Negara)* and Indonesian State Bank (*Bank Negara Indonesia)* into BI. The establishment of the Bank Tunggal had taken effect in 27 July 1965 through Presidential Decree No. 17/1965 of which refers to the Indonesia constitution (UUD 1945) and doctrines of the Indonesia revolution. The banks were named Bank Negara Indonesia and became a state owned bank that performed circulation banking activities of the central and general banks. Furthermore, under the Ministerial Decree Letter of Matters Concerning Central Bank No. 65/UBS/65, 30 July 1965, BI was blended together into *Bank Negara Indonesia*. This decree took effect in 17 August 1965.

The process of appointing the BI governor to become a minister to facilitate the integration of banks clearly indicates that BI esoterism had been opened up by government political interests. Powers of exoterism had then took great control over the banking world. However, because in reality, economic development funds were less prioritised compared to interests in combating regional rebellions and fund political projects, therefore prior development plans were unable to be actualised, hyperinflation took place that further suppressed the state's economy, people's distrust to the government declined, and eventually lead to the government's fall.

BANK POLICY ESOTERISM 1966-1983

Depressed banking conditions were inherited to the New Order government. Initiatives to improve conditions of the banks became some kind of urgent homework. BI Governor, Radius Prawiro and his substitute Rachmat Saleh tried very hard to maintain the bank's health as one of the ways to suppress inflation. The total numbers of banks were reduced and bank capital structure was strengthened, by demanding that private banks merge and not issue permits to establish new private banks in 1974. Government banks were implicitly guaranteed by the government when those banks were incapable of fulfilling their bonds. In other words barrier of entry had taken place in banking. Until 1988, the total number of banks that had operated included 1 central bank, 7 state owned banks (5 commercial banks, 1 development bank, and 1 savings bank), 27 regional banks, 10 foreign branch offices, and 68 private national banks.

Furthermore, BI was returned as a central banks with its basic functions of monetary control, supervision, and guiding banks as well as the field of payment traffic. The tasks of BI was even expanded as an agent of development in order to push national development. In addition, BI was also given right of monopoly to issue money and coins. Within this period, esoterism was evident in policy making, because BI had been granted broad liberties to improve the conditions of banks, while interventions from the Department of Finance became relatively low. Coordination problems within the Monetary Board between BI and department of Trade frequently occurred in managing foreign exchange.

This situation had quickly reversed when domestic savings became inadequate to fund development (Sumarlin, 1990:2-6), meanwhile large global capital flow was unable to be used since Indonesia had a closed economic structure. Discourse related to economic and banking liberalisation had emerged, and was enthusiastically responded by the government by issuing the June Policy Package 1983 (Pakjun 1983) and followed by Pakto (October Policy Package) 1988.

The reactivation of the capital market on 10 August 1977 had caused capital accumulation to occur beyond the banks, of which was previously the single source of funding. The policies of banking liberalisation and capital markets mentioned above, have succeeded in significantly increasing capital accumulation through the capital market as displayed in table 2. This is caused by capital flow from affluent nations that seek larger profit in developing countries when their own economies experience recession. However it may be added that starting from 1996, outward cash flow had returned to the countries of origin since their economies began to improve. This example of capital outflow became one of the causes of the 1997 crisis.

Table 3. Capital Accumulation through the Capital Market

(Billion rupiah)

Year	Equity funds	Bond funds	Total
1977	2.6	0	2.6
1978	3.3	0	3.3
1979	20.56	0	20.56
1980	37.06	0	37.06
1981	45.78	0	45.78
1982	95.4	0	95.4
1983	117.21	114.72	231.93
1984	131.44	194.72	326.16
1985	131.98	354.72	486.7
1986	132.75	404.72	537.47
1987	133.16	535.72	668.88
1988	156.05	855.72	1011.77

Source : Capital Market Statistics No. 20
Sub section BAPEPAM statistics

BANKING POLICY ESOTERISM POST PAKTO 1988

Banking liberalisation through the October package in 1988 became one of the turning points in Indonesian banking history, because this policy had succeeded in spectacularly pushing economic growth during the decades of 1990. On the other hand, this was also believed to be the main cause of the economic vulnerability that became a precondition to the 1997 crisis (Hill, 1999:114). The *Pakto* Policy 1988 was a consequence of the strong demand to liberalize the banking sector as suggested by the World Bank and IMF, meanwhile Indonesia had needed much more domestic and foreign funds for development.

When liberalisation was implemented in 1983, once again problem of coordination had occurred between Department of Finance and

BI, particularly concerning which body should regulate and monitor financial institutions, not excluding banks. Competing interests between the two bodies occur because of matters related to field of tasks, authorities and responsibilities, in addition to the fact that each follow their own state model and benchmarks. The department of finance uses the Mexican model, and the central bank uses the Netherlands and Japanese model. To settle these conflicting interests, in 1985 it was agreed that bank monitoring remained in the hands of BI, while Non-Bank Financial Institutions (*Lembaga Keuangan Bukan Bank-LKBB*) where transferred to the Department of Finance (Sukarman, 2003:200). Based on these experiences of conflict between Department of Finance and BI, therefore, ever since Development Cabinet VI (*Kabinet Pembangunan VI*), when the head of J.B. Sumarlin was assigned to become Minister of Finance, he appointed Deputy Head of Bappenas, Adrianus Mooy as the BI governor of whom was regarded to have the ability in reducing problem of coordination when bank liberalisation in 1988 was being implemented. (Cole & Slade, 1996: 333).[1]The appointment of the central bank governor was frequently viewed as a signal of the direction of future banking policies (Maxfield, 1997).

BANKING ESOTERISM POST ECONOMIC CRISIS

Society's views upon arranging banking policies were divided into two different groups. The first group, demanded broader bank transparency. The other group insisted on limited bank transparency, implying that banks are bodies of which its liberties must be protected from its clients. These conflicting perspectives continued to dynamically interact in achieving compromise.

Other contradicting perspectives were also proposed related to matters of central bank transparency. Political progress in affluent nations in the 1980s raised discourses addressing the need for central bank independence, free from government intervention, or in other words, intervention from authorities. This independence is required to ensure that central banking policies are oriented to the long term goals meanwhile government policies are commonly short term. Furthermore, this issue of independence was not debated much and only developed among academicians and politician, mainly discussing the degree of Central Bank independence. Based on a survey carried out by a number of economists to measure the degree of independence, it was discovered that from a scale of 0 to 1,00, *Bundesbank* had the highest independence rate of 0,84 and the New Zealand central bank had the lowest of 0,24 (Bernhard, 2002).

The degree of central bank independence will follow its own political system. In an exoteric government environment, the question frequently arose as to whether the banks independence implies the return to banking esoterism. When banks and other financial institutions improve transparency, will the central bank change to become an isolated institution immune from public transparency?

Bernhard (2002) suggested three formal aspects that defined the central bank's independence. The first aspect is control towards monetary policy instruments. There is a difference between "goals" with "instruments to achieve those goals". Fischer (1995) used the differentiation to distinguish between goal independence referring to the central banks' capacity to determine the final outcome of monetary policy, and instrument independence referring to the degree of autonomy of the central bank to choose the necessary "boosting tools" in monetary policy, including prohibitions to fund deficits in the budget.

[1] The Pakto 1988 was viewed to be implemented in a rush, for a policy as monumental as it was, no academic documents related to its implementation was found (interview with Fachry Ali, et al with Achyar Ilyas, 3 February 2003), similar to Moran on negotiations between IMF and Bank of England.

Within its capacity to maintain price stability, independence is largely implying the choice and determination of policy instruments (instruments of independence) rather than independence to determine the final outcome (goal independence). The final outcome is to achieve price stability and this requires government coordination.

The second aspect making the central bank independent is the procedures in determining the management of the Central Bank. Central Bank Independence is demonstrated from regulations that prohibit the government to directly determine the composition of the Central Banks' management. Selection is carried out by other bodies for instance parliament. Third, the capacity of the government to "sanction" the Central Bank by various means, for example by dismissing management, disapproving policies and budget reduction. For independent Central Banks, should they file those actions, it must go through amendment in the Bank Central Law of which is very costly.

Bernhard (2002) eventually concluded that based on the above definition, independence does not refer to something static but rather dynamic, in accordance with external and internal conditions that may change the Central Bank's status.

CONCLUSIONS

Progress of banking in a number of countries demonstrate a shift from esoteric to exoteric patterns, mainly ever since the emergence of globalisation. Before the 1970s, banking policies tended to be segmented and protectionist, by protecting banks through prudent regulations and avoiding banks from excessive competition. Within this stage, banking policies were largely esoteric in nature. Urges to open up esoterism strengthened especially because of the need to increase funding resources by opening up to foreign investment and strengthening the capital market. This was almost certain to occur as every country needed more domestic and foreign funds to fund development. This strong need for liquidity caused segmentation policies and protectionism to be erased and policies moved towards deregulation of the financial system and universal banking that expanded banking activities. Banks were no longer restricted of merely accumulating and distributing funds, however they were able to have access to the securities market, and were even active in the transaction of derivatives.

In Indonesia, ever since independence until the present, the pendulum of banking policies remain to swing from esoterism to exoterism. Real conflicts that have recently occurred involve BI's independence and the establishment of OJK. Ideas to actualize BI independence is enacted by Law No.23/1999 about BI, of which was amended with Law No.3/2004.

By having this law, the pendulums of banking policies return to its esoteric form. BI's position in becoming independent entitles larger autonomy in managing the banking sector. Such situations allow BI to apply increasingly comprehensive prudential regulations to the Indonesian Banking Architects (*Arsitektur Perbankan Indonesia*-API) and Indonesian Financial System Architects (*Arsitektur Sistem Keuangan Indonesia*-ASKI). However the government's intentions to establish OJK, no later than 2010, may imply that policy makers and bank monitoring will switch positions. This may seem plausible because by definition, should BI gain full independence in performing monetary policies, therefore bank monitoring must be released, as was done in England, Australia, and South Korea.

The question that remains is whether BI's absolute independence is the right choice for Indonesia of which is still developing, different to the German model that has been applied by European Union countries? Second, whether OJK may perform its tasks efficiently without creating problems of coordination with BI of which remains to be a Lender of the Last Resort (LoLR) in dealing with bank failure?

The first question must be answered by studying other countries who have implemented central bank independence: Does absolute or partial independence suit Indonesia best? This implies that efficiency and effectiveness of BI performance in supporting economic development must become a priority. Establishment of the Indonesian Bank Supervision Body (*Badan Supervisi Bank Indonesia*-BSBI) based on Law No. 3 /2004 Verse 85 is one of the efforts to overcome existing weaknesses, although to clarify the tasks of BSBI, it requires an amendment of the current law as well as its elaborations.

OJK is established based on international experience where banking activities, insurance, pension funds and capital markets have not been firmly been differentiated. Because of this, monitoring towards financial institutions must be integrated. The tasks of OJK is to integrate monitoring that was previously conducted by BI, Department of Finance and Bapepam, which will surely not be easy since different methods of monitoring, working culture, and staffing system are present. Therefore, in order to perform tasks of monitoring and regulation in the future, there is a lot of home work to be done. Potential problems including problems of coordination with BI must be anticipated. And finally, based on conventional wisdom, each pragmatic-based policy decision must be monitored so that interventions may be applied for its own betterment, whether based on faulty designs or external factors that require changes to those regulations.

REFERENCES

Benhard, W., 2002. *Banking on Reform*. Ann Arbor: The University of Michigan Press.

Cerny, Phillip, 1993. *Finance and World Politics: Markets, Regimes and States in the Post-hegemonic Era*, Edward Elgar, Vermont.

Coleman, W. D., 1996. *Financial Services, Globalisation and Domestic Policy Change*: *A Comparison of North America and The European Union*, Hampshire: Macmillan Press.

Cole, David C. and Betty F. Slade, 1996. *Building a Modern Financial System*: *The Indonesian Experience*. Cambridge: University Press, New York.

Davis, E., Philip, 1995. *Debt Financial Fragility and Systemic Risk*. Oxford University Press.

Deeg, R., 1999. *Finance Capitalism Unveiled: Banks and the German Political Economy.* Ann Arbor: The University of Michigan Press.

Edward, R. Franklin, 1996. *The New Finance-Regulation & Financial Stability.* Washington DC: American Enterprise Institute.

Herrigel, Gary, 1998. *Industrial Constructions: The Sources of German Industrial Power.* New York: Cambridge University Press.

Hill, Hal, 1999. *The Indonesian Economy in Crisis*: *Causes, Consequences, and Lessons*. Singapore: ISEAS.

Moena, I. N., 1984. "Hampir Semua Negara Menjerit Karena Reagan" [Almost Every Country Scream Because of Reagan], *Prisma*, No. 7/Tahun XIII.

Maxfield, S., 1997. *Gatekeepers of Growth-The International Political Economy of Central Banking In Developing Countries*. New Jersey: Princenton University Press.

Moran, M., 1986. *The Politics of Banking*. 2nd edition. London: The Macmillan Press Ltd.

Nasution, A., 1990. *Tinjauan Ekonomi atas Dampak Paket Deregulasi Tahun 1988 pada Sistem Keuangan Indonesia* [Economy Review on Deregulation

Package Year 1988]: PAU UI and Gramedia. Jakarta

Oberbeck, H, and Baethge, M., 1989. “Computer and Pinstripes: Financial Institutions,” in *Industry and Politics in West Germany*. Edited by Peter Katzenstein. Ithaca: Cornel University Press, 275-303.

Perbanas, 1974. *“Perkembangan Situasi dan Masalah-masalah Perbankan Nasional Swasta di Indonesia 1973/1974”* [Situation and National Private Banking Problem in Indonesia 1973/ 1974]. Perbanas. Jakarta.

Rachbini, D. J, 2001. *Ekonomi Politik Utang* [The Political Economy of Debt]. Ghalia, Jakarta

Rahardjo, M., S. Mahasin., J. Didik., M. Rachbini., M. Masmimar., S. Eko Budi, and P. Widiyanto, 1995. *Bank Indonesia dalam kilasan sejarah bangsa LP3ES* [Indonesia Bank in Indonesian History Glance]. Jakarta

Rosenbluth, Frances and Ross Schaap, 2009. *The Domestic Politics of Financial Globalisation*. Oktober 15. http://www.yale.edu/leitner/pdf/2000-07.pdf.

Sukarman, W., 2003. *“Liberalisasi: Ekonomi-Politik Perbankan Masa Orde Baru”* [Liberalisation: Banking Economy-Politic in Orde Baru Area], Unpublished Dissertation, Post-Graduate Programme. Yogyakarta: GMU.

Sumarlin, J.B., 1990. *“Dana Pembangunan dan Deregulasi Ekonomi Indonesia”* [Development Fund and Indonesia Economy Deregulation] in Sjahrir, *Fund Mobilisation in Deregulation Era*. Jakarta: Yayasan Padi dan Kapas.