



## OXFORD ANALYTICA

**INDONESIA**

**MONETARY TRANSPARENCY**

**Country Report 2006**

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# INDONESIA



## COMPLIANCE RATINGS

<i>Monetary transparency</i>	2006	2005	2004	2003
Clarity of roles	●●●●	●●●●	●●●	●●●
Open decision process	●●●●	●●●●	●●●●	●●●●
Availability of information	●●●●	●●●●	●●●●	●●●
Central bank accountability	●●●	●●●	●●●	●●●
<b>Score</b>	<b>3.75</b>	<b>3.75</b>	<b>3.50</b>	<b>3.25</b>

## OUTLOOK & COMMENTARY

The central bank of Indonesia, Bank Indonesia (BI), has made a number of improvements to monetary policy transparency during 2006. Having implemented inflation targeting in 2005, it has sought to improve the framework by establishing an inflation monitoring team that brings together senior officials from government departments and BI. This is expected to strengthen overall coordination, so that the inflation target becomes a credible and achievable joint objective.

In order to improve its external communications, BI officials are discussing the public release of the minutes of Board of Governors meetings. BI has been taking steps to enhance bank supervision in accordance with the Basel Core principles, and implementation of Basel II is expected to commence in 2008. It has also removed the blanket guarantee on deposits, and in March 2007 the maximum coverage will be limited to 100 million Indonesian rupiah.

A Bank Indonesia Supervisory Board (BISB) has been established to assist the legislature in overseeing the functioning of BI officials, which will improve the governance of BI. However, the establishment of a separate Financial Services Authority Institution, which would have improved the quality of bank supervision, appears unlikely. BI can improve its transparency by divesting its commercial interests in a number of its financial subsidiaries, as well as by strengthening bank supervision to forestall future crises.

## EXECUTIVE SUMMARY

### 3.75 Compliance in progress

The central bank of Indonesia, BI, has made improvements to monetary policy transparency during 2006. In 2005, BI implemented a new monetary policy framework consistent with the inflation-targeting scheme. To improve the functioning of the scheme, an inflation monitoring team has now been set up that brings together senior officials from a number of Ministries including Finance, Energy and Transportation, the National Development Planning Agency, Economic Planning as well as officials from BI. The Bank hopes that the team will help to establish public credibility for its inflation targeting credentials, so that over time inflation expectations become forward looking.

As part of efforts to improve transparency, BI is considering whether to make public the minutes from meetings of its Board of Governors, the body responsible for formulating and implementing monetary policy.

A Bank Indonesia Supervisory Board (BISB) has now been established, as has been required under Bank Indonesia Law No.2/2004. The main task of the BISB is to assist the legislature in conducting its surveillance of BI's accountability, independence, transparency and credibility. Its role is related to the good governance of the central bank, and it has no input into monetary policy. Nevertheless, the BISB has yet to receive clear terms of reference or a budget allocation.

BI is strengthening bank supervision in accordance with the 25 Basel Core Principles. Basel II will be implemented in phases commencing in 2008, and the process is expected to be completed by 2010. In July 2006, BI enacted regulations concerning commercial bank period reports which set out requirements for timely and comprehensive reporting to BI. Further changes to information requirements are expected in accordance with Basel II implementation.

Under Bank Indonesia Law No. 3/2004, most of BI's banking supervision responsibilities were to be transferred to a new institution, the Financial Services Authority Institution (FSAI). However, discussions about the establishment of FSAI appear to be fading, and BI looks likely to retain its banking supervision activities. The target for the transfer of responsibilities has been officially shifted to 2010.

A new deposit insurance agency, the Indonesia Deposit Insurance Corporation (LPS), became effective in September 2005. By March 2007 the size of deposits to be guaranteed by LPS will fall from the current 1 billion Indonesian rupiah to 100 million (10,000 US dollars). LPS now also handles the resolution and closure of failed banks.

Indonesia's overall score is unchanged from last year.

## 1. CLARITY OF ROLES, RESPONSIBILITIES, AND OBJECTIVES OF CENTRAL BANKS

●●●● Compliance in progress

### The objectives and institutional framework of monetary policy

#### Central bank objectives and responsibilities

The objectives of Indonesia's central bank -- Bank Indonesia (BI), a separate legal entity from the government -- are specified in the Central Bank Act (CBA, Law No. 23/1999) and amendments to the CBA as established by BI Law No. 3/2004. The sole function of BI under the 1999 law was to maintain domestic price stability. The 2004 amendments establish that BI has three roles: (1) price stability, (2) regulation and supervision of the banking industry until the new Financial Services Authority Institution (FSAI) is established, at the latest in 2010, and (3) lender of last resort facility.<sup>1</sup>

BI implemented an inflation-targeting framework in 2005. BI Law No. 3/2004 specifies that the central bank will conduct monetary policy to achieve an inflation target as determined by the government in consultation with BI. The central bank can decide which policies to set, in order to achieve the inflation target -- so both the central bank and the government have responsibility for inflation.

BI is also empowered by the CBA to prescribe and implement monetary policy, regulate and safeguard the adequate operation of the payments system, and exercise banking supervision functions.<sup>2</sup> The law authorises the use of several monetary policy instruments, including open market operations and the setting of both the interest rates and the minimum reserve requirements.

The CBA was enacted at a time when BI was under negative scrutiny because of the collapse of the banking sector in Indonesia, and when it was felt that BI's monetary policy and banking supervision responsibilities should be separated. Under the CBA, most of BI's banking supervision responsibilities are to be transferred to a new institution, the Financial Services Authority Institution (FSAI), along with those currently exercised by the Ministry of Finance (MoF) and the Capital Markets Supervisory Agency (Bapepam). This transfer was originally set to take place by the end of 2002, although the BI was expected to retain some broad regulatory powers. However, that deadline was missed, and the legislation chartering the FSAI remains under debate among legislators, the government and BI, as it appears that the establishment of the FSAI is a far more difficult task than first envisaged. BI Law No. 3/2004 set a delayed deadline of 2010 for the establishment of the FSAI. The MoF does not have the capacity or the budget to set up an FSAI, while BI does have the capacity in terms of human resources but is reluctant to relinquish its role of banking supervision. The new institution will require funding from the government, and it remains uncertain how many resources the government will allocate to it in the medium term, and from which revenue sources. At present, it appears that discussions on setting up the FSAI are fading, as the original momentum for change stemming from the late 1990s slows down.<sup>3</sup>

#### Operational autonomy

The CBA establishes that BI is fully autonomous in formulating and implementing monetary policy. External actors are strictly prohibited from interfering with BI's implementation of its tasks. Moreover, BI has the duty to refuse or disregard any attempt at interference in any form by any party. In order to further assure its independence, the CBA confers on BI a special position within the civil structure of the Republic of Indonesia. In May 2003, BI Governor

Burhanuddin Abdullah was sworn into office for a term of office to run from 2003 to 2008. This was the first time since BI's independence that the House of Representatives (DPR) had elected the central bank governor, instead of his being 'handpicked' by the president.

As required by BI Law No.2/2004, a Bank Indonesia Supervisory Board (BISB) has been established by a Presidential Decree issued in 2005, although clear terms of reference and a budget for the BISB have yet to be agreed. The main task of the BISB is to assist the legislature in conducting its surveillance of BI's accountability, independence, transparency and credibility. The Board consists of five members (one chairman and four members) who only deal with BI administrative and budgetary issues; they are not authorised to engage directly in policy, so the principle of BI independence in terms of formulating and implementing monetary policy is still intact. It has not been decided whether the budget for their salaries will come from the DPR, the executive or BI, but in the meantime they are being funded by BI.<sup>4</sup> The State Audit Agency (BPK) will remain responsible for auditing BI, and for presenting these audits bi-annually to the DPR. Some commentators have repeatedly stated their concern over the possibility of politicisation of the BISB.<sup>5</sup>

## **Institutional relationship between monetary and fiscal operations**

Coordination between the central bank and government usually takes place in a cabinet session on economic, banking and financial issues related to the duties of the central bank. On such occasions, the government may request BI's opinion on a policy matter. In addition, BI can also provide input to the government regarding the state budget and other policies relating to its duties and responsibilities. Government officials may attend the BI Board of Governors meetings, but have no voting rights.<sup>6</sup>

The aggregate reconciliation of monetary and fiscal accounts between the MoF and BI is undertaken only once a year, three to four months after the end of the fiscal year. From 2006 onwards, authorities have been expected to reconcile the accounts every quarter.<sup>7</sup>

### **Lending to government**

As set out in Article 56 of the CBA, the central bank is barred from providing any credit to the government and is no longer involved in financing development programmes or any type of government-directed spending. Information on the amounts and terms of overdrafts to the government, and on deposits of the government with BI, is disclosed on the BI website (in English and Indonesian).<sup>8</sup> The same information can be found in the *Indonesian Financial Statistics*, published monthly by BI and released on its website, and in the IMF's monthly *International Financial Statistics* (IFS).

Under the amendments to the CBA, BI is allowed to purchase short-term (no longer than one year) SUN (government bonds) in the primary market with a view to controlling the monetary aggregates. The medium-term and long-term SUN can only be purchased in the secondary markets. These provisions are intended to ensure that the budget deficit is not financed by the central bank.

### **Central bank involvement in the rest of the economy**

BI is authorised by the CBA to hold equity in entities such as clearing agencies, rating agencies and bank deposit guarantee agencies, only if it is deemed necessary for the implementation of its tasks. Approval from the DPR is needed for investment in other types of institution. BI currently holds equity in a number of financial institutions, including PT Bahana Pembinaan Usaha Indonesia, PT Askrido, and Indover Bank in the Netherlands. By law, BI should have divested interests in these institutions during 2001, but this was not fulfilled. The CBA was then amended in 2004, which extended the deadline for divesting its commercial interests by January 2009. According to

commentators, all of Indover Bank's non-performing loans have been restructured and absorbed by BI. Despite this, BI has been unable to find suitable buyers, as the offers from prospective buyers have been too low to be acceptable. The DPR has to approve the sale price before a sale goes ahead.<sup>9</sup>

### **Central bank profit allocation**

Under Article 62 of the CBA, 30% of central bank profits must be placed in the Special Purpose Reserves account, and the rest of the surplus must be accumulated as a General Reserve account such that the total amount of capital and the General Reserves reaches 10% of all monetary liabilities. The rest of the surplus is distributed to the government.<sup>10</sup> Information on central bank profits, contained in surplus and deficit reports, is prepared and distributed internally. This information is gradually being made publicly available on BI's website.<sup>11</sup>

### **Agency roles performed by the central bank on behalf of the government**

BI's agency roles for the government are stipulated in the CBA. Chapters VIII and IX cover all the categories stipulated in the IMF code, including BI's role as account holder of the government, manager of foreign exchange and domestic debt, and adviser to the government on economic and financial policies.

All regulations regarding BI's role in debt management are disseminated via the *Government Gazette*. Legislation and regulations are publicly available in Bahasa Indonesia; the availability of legislation and regulations in English has improved markedly in the past two years.<sup>12</sup>

## 2. OPEN PROCESS FOR FORMULATING AND REPORTING MONETARY POLICY DECISIONS

●●●● Compliance in progress

### The framework, instruments, and targets of monetary policy

#### Framework and monetary targets

BI has focused on maintaining price stability with a floating foreign exchange rate system. Previously, the central bank used base money as its operational target and set monthly base money targets. In July 2005, BI implemented a new monetary policy framework consistent with an inflation-targeting scheme. The new framework has four fundamental elements: the use of a BI reference rate as an operational target; a forward-looking monetary policy decision process; a more transparent communication strategy; and enhanced policy coordination with the government. These efforts are aimed at enhancing the effectiveness of monetary policy and achieving price stability.<sup>13</sup>

According to the Central Bank Act, the inflation target is set by the MoF in consultation with BI. Following coordination between the MoF and BI, in September 2004 the MoF issued Decree No. 339/KMK.011/2004 setting out inflation targets for 2005, 2006, and 2007 as follows: 6%, 5.5%, and 5% with an uncertainty band of +/-1%. These targets were subsequently revised in March 2006 to 8%, 6% and 5% with an uncertainty band of +/-1%. The MoF and BI have established an inflation monitoring team, made up of senior officials from MoF, BI, the Ministry of Transportation and the Ministry of Energy and Mineral Resources. The team's objective is to discuss the impact of government policy on inflation.<sup>14</sup> Its tasks include evaluation of sources and potential for inflationary pressure and the impact of this pressure on achievement of the inflation target, recommending policy choices that support achievement of the inflation target, and disseminating public information on the inflation target and actions to be taken for achievement of the target. The establishment of the inflation monitoring team is expected to strengthen overall coordination between the monetary authority and the government, so that the inflation target becomes a credible, achievable joint objective.<sup>15</sup>

In determining its monetary policy, BI uses the published consumer price index (CPI) as its target, even though the impact of BI policy is only limited to core or underlying inflation. The main reason for using CPI as the target is that the public understanding of CPI is better than core inflation. According to commentators, public understanding of the concept of core inflation is limited, and gaining public credibility for monetary policy is very important. The central bank anticipates that as it gains credibility over time, inflation expectations will be more forward looking.<sup>16</sup>

In an effort to provide clearer information to the financial system regarding the goals of, and changes in, BI's monetary policy and the future money supply, the central bank now targets changes in the interest rate of its short-term debt certificates (SBI 1 month), rather than base money, through the BI Rate. The central bank may also intervene in the foreign exchange markets to help absorb liquidity and minimise excessive exchange rate fluctuations.<sup>17</sup>

In January 2005, BI eliminated its overnight rupiah placement facility for commercial banks, which had been established to allow Indonesian banks to place excess liquidity with the central bank. BI eliminated this facility in response to concerns that its initial purpose of absorbing excess temporary monetary liquidity in the financial markets was no longer necessary given the stabilisation of the Indonesian financial system. Indonesian banks are still allowed to place excess liquidity with BI in seven-day time deposits, known as Bank Indonesia Deposit facilities

(FASBIs). However, owing to pressure on the rupiah, BI reopened its overnight rupiah placement facility at the end of August 2005 to absorb excess liquidity in the market.

### **Monetary instruments**

The CBA authorises the central bank to set monetary targets by taking into account the determined inflation rate target, relying on instruments such as open market operations on the rupiah and the foreign exchange money market, the setting of discount rates and the BI reference rate, the setting of the statutory reserve requirements, and/or regulation of credit or financing.<sup>18</sup> The 30-day SBI rate is the key intermediate target.

BI's monetary instruments largely consist of fortnightly auctions of SBIs (usually with one-month to three-month maturity), as well as currency sterilisation to absorb excess liquidity in the economy and reduce exchange rate volatility. In an effort to help stabilise the exchange rate, BI banned rupiah margin trading against all foreign currencies from 15 September 2005.<sup>19</sup>

Press releases are used to explain the main considerations underlying BI's monetary policy decisions. Additionally, when SBIs are auctioned every two weeks the news of the interest rate goes to financial press coverage systems and is disseminated to the markets.

## **The monetary policy-making body**

### **Monetary board**

The CBA specifies the structure, composition and functions of the Board of Governors. As the bank's highest decision-making forum, the Board of Governors is charged with the formulation and implementation of monetary policy and meets at least once a month. Criteria for the selection of board members, rules on the conduct of meetings, and rules for voting and decision-making are also stipulated in the CBA. According to BI Law No. 3/2004, the governor of the central bank can, for the first time, be selected from candidates outside BI and no longer has to be a BI officer.

The BI Board of Governors consists of a governor, a senior deputy governor, and at least four (with a maximum of seven) deputy governors. The governor and the senior deputy governor are nominated and appointed by the president, with approval from the DPR. The deputy governors are nominated by the BI governor and appointed by the president, with prior approval of the DPR. Board members are appointed for five-year terms, and may be reappointed to the same position for no more than one subsequent term. The Board of Governors is fully responsible for implementing the tasks and authorities of Bank Indonesia.<sup>20</sup>

### **Advance meeting schedule**

In 2005, BI published for the first time an advance meeting schedule for Board of Governors meetings.<sup>21</sup> As stipulated in Article 43 of the CBA and amended by Law No. 3/2004, BI is required to hold monthly Board of Governors' meetings in order to stipulate general policies in the monetary sector.

The Board of Governors traditionally convenes every Tuesday to assess the economic situation, policy objectives and any developments in previous months. The monthly meetings are followed by the issuing of a press release on the same day which explains to the public the assessment of the economy and reasons for policy decisions. All market participants, including the government, have information about the meeting schedule, the framework of policy, and the background of the decision.<sup>22</sup>

The quarterly meetings in April, July and October also assess the corresponding previous quarter, while the meeting in January focuses on the previous fiscal year. The quarterly meetings are followed by the publication of a quarterly report and data in the same month as the meeting. Summary minutes of the board's meetings are released on the same day, and are also disclosed in the BI's Monthly, Quarterly and Annual Reports. A press release is also issued. The Board of Governors is currently debating whether to release the minutes of its meetings to the public.<sup>23</sup>

## **Public statements on monetary policy**

### **Periodic publications**

BI discloses changes to the setting of monetary policy instruments on its press release webpage as well as through its *Monthly Review on Economy, Monetary Policy and Banking*, and the *Bank Indonesia Annual Report*. BI discloses its monetary policy objectives and policy considerations to the public by publishing summaries of BI board meetings. In addition, the results of BI board meetings are also disseminated through press conferences and are included in supplementary and quarterly reports. All of this information is available on BI's website.

The quarterly *Monetary Policy Report*, prepared within the context of the need for increased transparency and accountability, is part of the inflation-targeting framework launched in July 2005.<sup>24</sup> It incorporates the content that publications such as the quarterly *Economic, Monetary and Banking Developments: Future Policy Directions* reports included. The *Monetary Policy Report* examines current economic conditions, the exchange rate and inflation, monetary policy and banking sector policies. Economic forecasts and indications of future policy directions are also set out. In its chapter on 'Monetary Developments', the *Bank Indonesia Annual Report* includes similar information without the prospective emphasis, as well as a summary of monetary developments from the previous year. In addition, periodic press statements are released on matters relating to monetary policy.

Publications available in English are: *Indonesian Economic Monetary Statistics* (weekly), *Indonesian Financial Statistics* (monthly), *Monetary Policy Review* (monthly), *Monetary Policy Report* (quarterly), *Financial Stability Review* (annual), *Economic Report on Indonesia* (annual), *Indonesian Banking Booklet* (annual).<sup>25</sup>

### **Public hearings**

Under the supervisory function of the DPR, the central bank is required by law to submit a quarterly progress report on the implementation of its duties and responsibilities. BI officials have regular meetings with key policymakers (at least once every three months) to discuss BI's decisions and the direction of monetary policy. In particular, they meet regularly with the legislature's Commission IX (overseeing financial issues) and with the Coordinating Ministry of the Economy.

## **Regulations on data reporting by financial institutions to the central bank**

The CBA establishes BI's right to request data, information and reports from financial institutions. A summary of banking regulation is included in the *Bank Indonesia Annual Report* as part of the appendices. The report usually has a special chapter on 'Banks and Other Financial Institutions', where policies and information on banking policies, commercial banks and other financial institutions are reported. BI's website publishes consolidated statements of the banking sector.

BI is currently trying to speed up its efforts to employ risk-based banking supervision in accordance with the 25 Basel Core Principles. Basel II will be implemented in phases commencing in 2008 and is expected to be fully implemented by 2010. There are expected to be further reporting requirements for banks in line with Basel II.<sup>26</sup>

On 10 July 2006, Bank Indonesia enacted Regulation Number 8/12/PBI/2006 concerning Commercial Bank Periodic Reports, in order to support the obtaining of accurate, complete, and timely information. The data coverage required includes data concerning third party funds, weekly balance sheet items, violations or excess of legal lending limit, loan restructuring, minimum capital requirements after calculating market risk, core depositors and debtors, and sensitivity to market risk.<sup>27</sup>

After BI issued 'Know Your Customers' regulations (No. 3/2001) in June 2001, requiring banks to report suspicious transactions, the legislature passed the Anti-Money Laundering Law (No. 15/2002) in March 2002, which was later amended in 2003. The legislation outlines measures to control attempts to hide illegally amassed funds. In March 2002, BI issued Regulation No. 4/2/PBI/2002 requiring non-financial institutions to report their foreign exchange transactions with offshore parties to the central bank. Foreign exchange flows by companies with total assets of, or an annual sales turnover of at least 100 billion Indonesian rupiah are subject to the regulation. These requirements supplement data on foreign exchange flows already furnished by banks and non-bank financial institutions.

The Anti-Money Laundering Law also established the independent Centre for Financial Transaction Analysis and Reporting (PPATK), which submits its findings to the Attorney General's Office (AGO) and the Corruption Eradication Commission (KPK). By law, the PPATK should remain free from political intervention, responsible only to the legislature, and it is vested with the authority to investigate finance companies and persons suspected of being involved in money laundering crimes. The PPATK has sound investigative skills, and it has made arrangements to cooperate on investigations with Bapepam, BI, certain directorates of the MoF, the national police and the AGO. As a result of these efforts, Indonesia was removed from the Financial Action Task Force's 'blacklist' of non-cooperative countries and territories on 11 February 2005.<sup>28</sup>

Within BI, a new Directorate of Banking Investigation and Mediation has been formed in 2006 to deal with disputes and arbitration between commercial banks and BI. There is also a Financial Stability Forum (FSF) comprising senior officials from BI and the MoF to oversee problems and failures in the financial system. The latter was set up as a consequence of the financial sector safety net regulations.<sup>29</sup>

### 3. PUBLIC AVAILABILITY OF INFORMATION ON MONETARY POLICY

●●●● Compliance in progress

#### Release of central bank data

Indonesia subscribes to the IMF Special Data Dissemination Standard (SDDS), and the country meets specifications for coverage, periodicity, and timeliness of data related to the analytical accounts of the central bank and the banking sector as a whole. Information on the analytical accounts of the central bank is provided on a weekly basis (four times per month), and no later than two weeks after the end of the reference week.<sup>30</sup> Weekly released data on Indonesia's aggregate open market transactions can be found on the Monetary Indicators page of BI's website.<sup>31</sup> Moreover, BI publishes the monthly bulletin *Indonesian Financial Statistics*.<sup>32</sup>

An advance release calendar -- giving one-quarter prior notice of the approximate release dates, and later a one-week prior notification of the precise release dates -- is disseminated on the IMF's Dissemination Standards Bulletin Board.<sup>33</sup> The advance release calendar is updated monthly.

Information on foreign exchange reserves is available on the BI website. The website also discloses BI's claims on deposit money banks, domestic credit to the public sector, domestic credit to the private sector, gross foreign assets, and gross foreign liabilities. BI's website also publishes information on reserve money, currency in circulation, commercial banks' demand deposits at BI, and non-bank private sector demand deposits. In 2005, BI made efforts to report data on mutual funds (Reksadana) that issue deposit-like liabilities that have hitherto been excluded from the scope of monetary statistics. Central bank staff also started working in 2005 with the MoF's Directorate General of Financial Institutions (the supervisory agency for non-bank financial institutions) to begin data compilation on finance companies.<sup>34</sup> This has been followed in 2006 by insurance companies' data, with data from pension funds and mutual funds due to be compiled in 2007. BI receives regular reports on finance and insurance companies through the MoF, and these are which is used to compile data.<sup>35</sup> Some of these data are published by BI in the *Financial Stability Review*.<sup>36</sup>

As part of its inflation-targeting effort, BI conducts research on asset price inflation as well as on consumption, purchasing power and capacity utilisation. However, these series are not publicly and regularly available.<sup>37</sup>

#### The central bank balance sheet

BI publishes data based on its accounting records on a weekly basis, and no later than two weeks after the end of the reference week. The data are released simultaneously to all interested parties through BI's website, and are subsequently published in the *Weekly Report* and in the monthly bulletin *Indonesian Financial Statistics*. In addition, the central bank publicly discloses its balance sheet as part of the annual financial statement. The annual statements for 1998 to 2005 are available on the website. BI also releases information on the central bank's monetary operations.

BI is required to submit its annual financial statement to the State Audit Agency (BPK) for auditing, the result of which is reported to the DPR. The audited balance sheet and surplus/deficit statement are announced to the public.

## Lender of last resort

A financial safety net team, with members drawn from BI and the MoF, designed a policy framework for lender of last resort operations in 2004, which included legal provisions, operational rules and technical guidelines.<sup>38</sup> The framework elaborates the lender of last resort and deposit insurance policies. According to the regulations, BI can provide short-term financing facilities for banks undergoing liquidity difficulties due to cash flow mismatches. Additionally, it can also provide emergency liquidity assistance for banks undergoing financial difficulties that have systemic impact and the potential to cause a crisis in the financial system, with funding provided by the government. BI and MoF have signed a Memorandum of Understanding regarding the provision of emergency liquidity assistance.<sup>39</sup> The regulation of the mechanism for emergency liquidity assistance for systemic banks was issued by the MoF on 30 December 2005 (PMK No. 136/PMK.05/2005) and by BI on 3 January 2006 (PBI No. 8/1/2006).<sup>40</sup>

As part of the policy framework for financial safety nets, a deposit insurance agency, the Indonesia Deposit Insurance Corporation (LPS) became effective in September 2005. Prior to this, a blanket guarantee by the government for all bank deposits had been in place since 1998 in response to the banking and economic crisis, which led to large contingent liabilities for the government. This is now being phased out, and by March 2007 the size of deposits to be guaranteed by LPS will fall from the current 1 billion Indonesian rupiah to 100 million (10,000 US dollars).<sup>41</sup> LPS also handles the resolution and closure of failed banks.

## Public information services

According to the CBA, BI must disclose monetary information to the public.<sup>42</sup> Public information services are comprehensive and include such publications as BI's *Annual Report* and the *Financial Report*, quarterly publications on economic, monetary and banking developments, and monthly reviews on monetary policy. In 1998, BI established a Communications Bureau in the Office of the Governor to relay information to the press and other stakeholders.<sup>43</sup>

BI maintains public information services both through its own website and through the IMF's SDDS site. This includes timely access to a variety of publications, including the *Monetary Policy Reports*. Moreover, the *Monthly Review on the Economy, Monetary Policy, and Banking* provides information on the central bank base money, its liquidity credit and support, open market operations, and the country's foreign exchange assets. Interviews with senior officials and progress reports on banking and monetary policy are also posted on the site. While not all documents are available in English, BI's website has greatly improved and today is one of the most informative and best-maintained Indonesian government websites. The website also consists of an interactive question and answer format that explains key policy issues to members of the public. At the same time, information on BI's website is now being updated on a regular basis.

BI's Investor Information and Enquiries (IIE) website is designed to provide complete and accurate information about economic, financial and banking conditions in Indonesia, as well as investment rules, regulations, and other information relevant for supporting investment decisions in Indonesia. The site is also intended to establish a communication channel with investors and to counter incorrect or negative information about the country's financial markets. Since 2002, the IIE website has grown and now offers a variety of documents on topics such as fiscal sustainability, financial sector restructuring and banking regulation.<sup>44</sup>

## 4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY BY THE CENTRAL BANK

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### Accountability before a designated public authority

The CBA requires that BI must always adhere to principles of accountability and transparency in implementing its duties, authorities and budget. BI is committed to strengthening its internal management through good governance. Significantly, the MoF Decree No. 339/KMK.011/2004 establishes that, whenever there is deviation between the actual and the target range of inflation, senior officers of the government and BI must explain to the parliament the reasons for such a deviation, and the measures that they expect to take to steer inflation back into the target.

In accordance with the CBA, BI's Board of Governors must regularly appear before legislative committees to explain the conduct of monetary policy, its objectives, its performance in reaching those objectives, and other general issues involving the state of the economy. The board also liaises frequently with other governmental bodies, such as the president, the MoF, and the Ministries of Trade and Industry.

BI must submit its annual report, the *Bank Indonesia Annual Report*, which examines its monetary policy for the previous year and presents policies and targets for the coming year, to the legislature, the president, and media.<sup>45</sup> Quarterly and requested reports are also submitted to the legislature. BI's internal operations budget should now be approved by the DPR according to BI Law No. 3/2004.

### Financial statement

#### Audited financial statement

BI's financial statements can be found in the *Bank Indonesia Financial Report*. The presentation of the Annual Financial Statements of Bank Indonesia for the year 2005 was in accordance with the Circular Letter of Bank Indonesia Number 5/65/INTERN dated December 20, 2003 concerning the Financial Statements of Bank Indonesia. The accounting policies adopted by Bank Indonesia are regulated in Bank Indonesia Financial Accounting Guidance (PAKBI). PAKBI conforms with the Indonesian Financial Accounting Standards (SAK), International Accounting Standards (IAS), and best practices in other central banks, as well as the agreements among Bank Indonesia, BPK and the Financial Accounting Standards Board of the Indonesian Institute of Accountants (IAI).<sup>46</sup>

#### External and internal audit

The BPK audits and discloses its results to the public. The BPK is constitutionally independent from the government in the conduct of its activities, and the State Audit Law 15/2006 passed on 30 October 2006 has significantly increased its financial and operational independence. Cases of abuse and misuse of resources are noted in the BPK reports, which are submitted to the AGO and the police for further action. Although the onus is on these latter institutions to pursue criminal investigations, some commentators noted that these have become much more effective since the formation of the Coordinating Team for Combating Corruption (Timtastipikor) in April 2005.<sup>47</sup> The Internal Audit Directorate (DPI) audits all of BI's departments and agencies, as well as its representative offices abroad. These are performance as well as financial audits.

In the past, the BPK has acknowledged the need to continue strengthening BI's audit processes, but did not want to recruit an independent accounting firm to carry out this work.<sup>48</sup> In an effort to institutionalise additional accountability measures, BI Law No. 3/2004 created the Bank Indonesia Supervisory Board (BISB), with members appointed by the DPR. The main task of the BISB is to assist the DPR in conducting its surveillance of BI's accountability, independence, transparency and credibility. This surveillance function covers the assessment of the BI annual financial report, BI's operational and investment budget, and internal decision-making processes unconnected to monetary policy.

## Conduct of officials

The CBA prohibits members of the Board of Governors from having any direct or indirect interests in any enterprises, from holding any other position concurrently in other entities except where their tasks require them to hold such a position, and from holding membership or a management position in a political party.<sup>49</sup> Article 71 specifies the penalties to be imposed should a BI official illegally disclose confidential information, while Article 72 authorises the Board of Governors to impose sanctions on employees who fail to perform their obligations.

The CBA establishes that employees of BI are appointed and removed by the Board of Governors. Article 45 provides legal protections for officials and staff in the conduct of their official duties. The governor, the senior deputy governor, and any other BI official cannot be punished for decisions taken or policies implemented in accordance with the tasks and authority as prescribed in the CBA, as long as these policies are conducted in good faith.

The State Finance Law of 2003 has strengthened standards for the conduct of public servants. In particular, Article 35 makes government officials personally responsible for state funds under their control. Under the law, officials will face jail terms for embezzlement and mismanagement, and they will be forced to personally reimburse the state for any misused or embezzled public money. The law makes all civil servants subject to equal punishment for the same fiscal crime, regardless of rank. Although the law does not provide for a clear enforcement mechanism, the implementing regulations and the State Treasury Law of 2003 have gradually addressed the issue of proper enforcement. The State Treasury Law provides officials at both central and local levels with detailed rules governing the use and administration of state funds, establishes penalties and sanctions for violations by state treasurers, and contains clear stipulations on the settlement of government financial losses caused by mismanagement or corruption.

## INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following individuals during a visit to Indonesia between 6 and 10 November 2006:

### Ministry of Finance (MoF)

#### 8 November 2006

Boediarso Teguh Widodo	Director	State Budget Planning
Agung Widiadi	Economist	State Budget Planning

### Central Bank of Indonesia

#### 7 November 2006

Suhaedi	Senior Economist	Monetary Policy Bureau
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### Department of Taxation

#### 9 November 2006

Erwin Silitonga	Director	
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## ADDITIONAL INTERVIEWS

#### 6 November 2006

Anwar Nasution	Director	State Audit Agency (BPK)
I Gusti Agung Rai	Member	State Audit Agency (BPK)

#### 9 November 2006

Stephen Schwartz	Senior Resident Representative	IMF
Ian Lienert	Senior Economist	IMF

#### 10 November 2006

Rajiv Sondhi	Senior Financial Management Specialist	World Bank
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## NOTES

- <sup>1</sup> See Central Bank Act (hereinafter CBA), No. 23/1999 at: [www.bi.go.id/web/en/Tentang+BI/UU+BI/UU23-1999/](http://www.bi.go.id/web/en/Tentang+BI/UU+BI/UU23-1999/) and Amendment to the CBA, No. 3/2004 at: [www.bi.go.id/web/en/Tentang+BI/UU+BI/UU3-2004/](http://www.bi.go.id/web/en/Tentang+BI/UU+BI/UU3-2004/)
- <sup>2</sup> Article 8, CBA.
- <sup>3</sup> Interviews in Indonesia, 6-10 November 2006.
- <sup>4</sup> Interviews in Indonesia, 6-10 November 2006.
- <sup>5</sup> Interviews in Indonesia, 4-6 October 2004 and 14-17 November 2005. See also: “BI opposes plan to set up supervisory board”, *The Jakarta Post*, 18 September 2003. In 2003, BI Governor Burhanuddin Abdullah stated: “The intention of setting up the [Supervisory] Board is good, but what happens in Indonesia is that good intentions are usually transformed into something bad by particular vested interests”. There is an ongoing debate on whether BISB’s powers and authority should be expanded.
- <sup>6</sup> See Chapter VIII of the CBA.
- <sup>7</sup> *Indonesia: Report on Observance of Standards and Codes – Fiscal Transparency Module*, IMF, September 2006
- <sup>8</sup> See Monetary Indicators, Bank Indonesia at: [www.bi.go.id/web/en/Indikator+Moneter+dan+Perbankan/Indikator+Moneter/](http://www.bi.go.id/web/en/Indikator+Moneter+dan+Perbankan/Indikator+Moneter/)
- <sup>9</sup> Interviews in Indonesia, 6-10 November 2006.
- <sup>10</sup> Article 62, CBA.
- <sup>11</sup> See “Laporan Keuangan Tahunan Bank Indonesia” (in Bahasa Indonesia only) at: [www.bi.go.id/web/id/Riset+Survey+Dan+Publikasi/Publikasi/](http://www.bi.go.id/web/id/Riset+Survey+Dan+Publikasi/Publikasi/)
- <sup>12</sup> Interviews in Indonesia, 14-17 November 2005.
- <sup>13</sup> Interviews in Indonesia, 14-17 November 2005.
- <sup>14</sup> Interviews in Indonesia, 6-10 November 2006. According to BI, there are three components of inflation in Indonesia, the most important of which is core inflation. The other two are food price inflation and inflation due to government regulations.
- <sup>15</sup> Inflation Targeting Framework, BI, at: [www.bi.go.id/web/en/Tinjauan+Kebijakan/Inflation+Targeting/](http://www.bi.go.id/web/en/Tinjauan+Kebijakan/Inflation+Targeting/)
- <sup>16</sup> Interviews in Indonesia, 6-10 November 2006.
- <sup>17</sup> “*Foreign Exchange Intervention and Policy: Bank Indonesia Experiences 1997-October 2004*”, BIS Papers No. 24 at: [www.bis.org/publ/bppdf/bispap24o.pdf](http://www.bis.org/publ/bppdf/bispap24o.pdf)
- <sup>18</sup> Article 10, CBA.
- <sup>19</sup> Interviews in Indonesia, 14-17 November 2005. Margin trading allows investors to put up only a fraction of the amount they wish to trade while using borrowed funds to leverage the operations.
- <sup>20</sup> The Board of Governors, Bank Indonesia, at: [www.bi.go.id/web/en/Tentang+BI/Profile+DG/](http://www.bi.go.id/web/en/Tentang+BI/Profile+DG/)
- <sup>21</sup> See “Tentative Schedule of 2005 Monthly Board of Governors’ Meetings (RDG)” at: [www.bi.go.id/web/en/Pengumuman/Board+of+Governors+meeting+05.htm](http://www.bi.go.id/web/en/Pengumuman/Board+of+Governors+meeting+05.htm)
- <sup>22</sup> Interviews in Indonesia, 6-10 November 2006
- <sup>23</sup> Interviews in Indonesia, 6-10 November 2006.
- <sup>24</sup> See “Monetary Policy Report” at: [www.bi.go.id/web/en/Riset+Survey+Dan+Publikasi/Publikasi/](http://www.bi.go.id/web/en/Riset+Survey+Dan+Publikasi/Publikasi/)
- <sup>25</sup> For a list of Bank Indonesia publications available in English, go to: <http://www.bi.go.id/web/en/Riset+Survey+Dan+Publikasi/Publikasi/>
- <sup>26</sup> Interviews in Indonesia, 6-10 November 2006. Also see: ‘Indonesia’s banking industry: progress to date’ by Dr. Miranda S. Goeltom, BIS Paper No. 28, December 2005, at: [www.bis.org/publ/bppdf/bispap28o.pdf](http://www.bis.org/publ/bppdf/bispap28o.pdf)
- <sup>27</sup> Bank Indonesia Regulation Number 8/12/PBI/2006 at: [www.bi.go.id/NR/rdonlyres/07AD0FA5-B11A-498B-9D5B-85CCF948D5C4/4323/pbi\\_81206\\_eng.pdf](http://www.bi.go.id/NR/rdonlyres/07AD0FA5-B11A-498B-9D5B-85CCF948D5C4/4323/pbi_81206_eng.pdf)
- <sup>28</sup> Interviews in Indonesia, 14-17 November 2005.
- <sup>29</sup> Interviews in Indonesia, 6-10 November 2006. The government and BI formulated a policy framework for financial safety nets covering the role, liability and coordinating mechanism of each related institution in this area, namely, BI, MoF, supervisory authorities, and the Deposit Insurance Company.
- <sup>30</sup> Analytical accounts of the central bank, provided by Indonesia as a subscriber to SDDS at: <http://dsbb.imf.org>
- <sup>31</sup> Bank Indonesia Monetary Indicators at: [www.bi.go.id/web/en/Indikator+Moneter+dan+Perbankan/Indikator+Moneter/](http://www.bi.go.id/web/en/Indikator+Moneter+dan+Perbankan/Indikator+Moneter/)
- <sup>32</sup> Indonesian Financial Statistics, Bank Indonesia, at: [www.bi.go.id/web/en/Riset+Survey+Dan+Publikasi/Publikasi/Indonesian+Financial+Statistics/seki\\_1006.htm](http://www.bi.go.id/web/en/Riset+Survey+Dan+Publikasi/Publikasi/Indonesian+Financial+Statistics/seki_1006.htm)
- <sup>33</sup> Dissemination Standards Bulletin Board at: <http://dsbb.imf.org>

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<sup>34</sup> Interviews in Indonesia, 14-17 November 2005. See also: “Indonesia: Report on the Observance of Standards and Codes - Data Module, Response by the Authorities, and Detailed Assessments Using the Data Quality Assessment Framework”, 28 July 2005, at: [www.imf.org/external/pubs/ft/scr/2005/cr05255.pdf](http://www.imf.org/external/pubs/ft/scr/2005/cr05255.pdf)

<sup>35</sup> Interviews in Indonesia, 6-10 November 2006.

<sup>36</sup> Financial Stability Review, Bank Indonesia, at:

[www.bi.go.id/web/en/Riset+Survey+Dan+Publikasi/Publikasi/Financial+Stability+Review/Financial+Stability+Review++No.6++March+2005.htm](http://www.bi.go.id/web/en/Riset+Survey+Dan+Publikasi/Publikasi/Financial+Stability+Review/Financial+Stability+Review++No.6++March+2005.htm)

<sup>37</sup> Interviews in Indonesia, 6-10 November 2006.

<sup>38</sup> “Economic Policy Package Pre- and Post-IMF Program”, Coordinating Ministry of Economic Affairs, p.II-5, 2004.

<sup>39</sup> “Indonesia’s banking industry: progress to date”, Dr. Miranda S. Goeltom, BIS Papers No. 28, December 2005.

<sup>40</sup> “Banking Sector Overview”, Bank Indonesia, at: [www.bi.go.id/NR/rdonlyres/786D21E8-BB27-4A79-B157-EAD041D52C29/3597/BankingSectorOverview.pdf](http://www.bi.go.id/NR/rdonlyres/786D21E8-BB27-4A79-B157-EAD041D52C29/3597/BankingSectorOverview.pdf)

<sup>41</sup> Interviews in Indonesia, 6-10 November 2006.

<sup>42</sup> Article 58, CBA.

<sup>43</sup> Interviews in Indonesia, 4-6 October 2004.

<sup>44</sup> Bank Indonesia Investor Relations Unit at: [www.bi.go.id/web/en/Info+Penting/IRU\\_NEW/](http://www.bi.go.id/web/en/Info+Penting/IRU_NEW/)

<sup>45</sup> Following CBA provisions, Article 58.

<sup>46</sup> Annual Financial Statements, Bank Indonesia, 2005.

<sup>47</sup> Interviews in Indonesia, 14-17 November 2005. Timastipikor pools the resources of the BPK, the police, the AGO, the Centre for Financial Transaction Analysis and Reporting (PPATK) and others to investigate criminal activities.

<sup>48</sup> The IMF, “Indonesia: Eleventh Review Under the Extended Arrangement – Staff Report; and Press Release on the Executive Board Discussion”, January 2004.

<sup>49</sup> Article 47, CBA.