

THE FUTURE OF THE GLOBAL FINANCIAL ARCHITECTURE: INDONESIA'S PERSPECTIVES

Hekinus Manao
Deputy Minister of Finance of Indonesia

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1. Just about a decade ago, Indonesia was considered a basket case. Today, Indonesia has not only survived the catastrophic financial crisis and a political calamity in 1998, it has now turned into a stable democracy with a robust economy, says *The Economist*, in its 15-page report titled "A Golden Chance" of September 12, 2009 edition. Highlighting the success this country has made in the past decade, the London-based weekly reports that Indonesia has managed to achieve a remarkable turnaround in a relatively short period of time, and with its impressive growth, it can now be considered as a serious fast-growing emerging economy along with BRIC countries – Brazil, Russia, India, and China.
2. Nonetheless, the recent crisis that has spread globally has adversely magnified toward emerging economies, wherein Indonesia has not been an exception. This is a consequence of the increasing importance role of such emerging economies in the global economy through their increasing contribution in both international trading transactions and international financial activities. Therefore, the recent financial crisis has given an important lesson that in supporting global economic growth sustainability, the stability of global financial is an essential prerequisite to be maintained. Financial markets have become globally integrated and, consequently, problems in a market in one country have rapid contagious effects on other markets in other countries. Hence, it is urgently to find ways for regulators to exchange more relevant information across borders on a timely basis. It also should be viewed that with the systematically increasing role of emerging economies, it is becoming more important to have them actively involved in global financial stability issues, including the initiatives to establish global financial reform measures and new international cooperation schemes, to produce substantial benefits for the global financial systems. It is widely recognized, that facing the global financial crisis, countries around the world have struggled to prevent the fallout in financial markets from spilling over to the real sector. A wide range of policy measures have been adopted. However, we should take note that individual and uncoordinated actions lead to financial protectionism, which in turn would dampen the recovery of global financial markets. Global cooperation will therefore be beneficial to all countries, not only since it can prevent financial protectionism, but also since it may expedite the stabilization of the financial markets.
3. In the wake of the global financial tsunami, we have taken the view that to respond effectively we first had to understand that the crisis was not a stand-alone event. It was the cumulative effect of many years of macro, financial, and regulation policy choices – many of which were beyond our borders and beyond our control. In particular, the crisis shows us the limitation of the "invisible hands" in the real global economy, apparently in the demise of Lehman Brothers, Bear Sterns, and other major financial houses, and along with

them the hard earned savings of many millions of people. The balance sheets of financial institutions were under pressure due to dry up of liquidity, exchange rate volatility, increasing NPLs, and huge erosion of capital. This has triggered panic behavior due to increase risk perceptions globally. This in turn has victimized emerging countries due to capital outflow and increase risk perceptions. Their corporate and sovereign bond yields were pushed upward, and their local currencies and stock indexes were plunged. The crisis in the financial sector was then transmitted to the real sector. The disruption of credit channel has caused widespread economic downturn due to slower consumption and dropped global aggregate demand.

4. Moreover, the recent financial crisis has some distinctive features that might not allow the government to merely rely on conventional policies. In a normal time, the banking sector and its intermediary function have always been the focus of our attention. The central bank uses the monetary operations to affect market interest rates and thereby manipulating how the economy works. During this time of market failure, however, we need to expand the central bank intermediary function to offset the decline of banking sector intermediation, and some unconventional approach might be needed to cleanse the balance sheet of financial institutions.
5. To deal with efforts of renewal international cooperation between supervisory authorities and regulators, first of all we have to admit that there was a mismatch between regulation and innovation in global financial business. As we have witnessed from the crisis chapter, unregulated global financial markets had fueled irresponsible efforts to create financial innovations, many without proper value assessment. On the other hand, a long period of very loose monetary policy, under-assessment of risk, and persistent global imbalances, has provided ample liquidity that triggered the bubble in the financial sector. These factors combined with moral hazards of the financial managers and decision makers had created excessive risk taking behavior. When the bubble burst, the whole global financial systems were disrupted. Therefore, Indonesia has taken clear stance to overcome the pre-crisis flaws of the international financial systems through several policy measures. We basically agree to the vast majority of the Action Plan set out in the London Summit of G-20 on April 2, 2009, with some notable undertaking, including:
 - the extension of regulation and oversight coverage to all systematically important financial institutions and instruments, including hedge funds;
 - the strengthening mandates and the expansion of the Financial Stability Board (FSB);
 - the incorporation of host supervisors from EMEs in the supervisory college;
 - the call for tough regulatory and oversight to all credit rating agencies to ensure that they prevent unacceptable conflicts of interest;
 - the endorsement to implement compensation scheme to cut down some of the risky behavior;
 - the call for improved accounting standards, particularly in valuation and provisioning, and a harmonized set of high-quality accounting standards by the standard setters;
 - the commitment to remove obstacles for international exchange of bank information, including the adoption of OECD Tax Information Model; and
 - the initiative against non-cooperative jurisdictions.
6. We also strongly felt that we need changes to the global financial architecture. In our view, multilateral development banks should have filled the void left by the flights of funds to the U.S., Europe, and other developed countries. In this respect, international financial institutions have been reasonably expected to deliver stability as global public goods. They

appear, however, that while having the unique position, IFIs have fallen short of members' expectation with global stability being jeopardized, and the recurrence of future crisis might not be ruled out. Following is a detailed description of Indonesia's stance of reform measures most needed to restore legitimacy and policy scope of the International Financial Institutions (IFIs).

- All IMF country members should be treated evenhandedly. The issue of evenhandedness rises from the inability of IMF to convince developed countries on its policy recommendations. This asymmetry arises due to the fact that developed countries have no obligation to follow its advice since they are no longer borrowing countries. Nevertheless, we should not lose sight that the world economy now has been globalized and integrated with its spillover effects prevailing all over the world. Hence, there is urgency for the Fund to devise a mechanism to ensure that systematically important members be put under enhanced surveillance.
 - As the recent crisis putting the IMF and MDBs back to its lending business, the issue of adequacy of resources raises to the surface. As a member of the G-20 and as co-chair with France on the Working Group on multilateral development bank reform, Indonesia has pushed the case for a recapitalization of MDBs and RDBs. This resulted in a tripling of the ADB's capital, which was secured at the ADB Annual Meeting in Bali, May 2009. We also advanced the case for improved governance and quota arrangements.
 - The IMF has been equipped with a range of lending instruments, geared toward helping members coping with balance payment problems stemming from the current account. It also launched a new lending instrument in October 2008, the Short-term Liquidity Facility (SLF), in response to the crisis. However, the onerous conditionalities attached to the instruments has discourage members to make use the facilities. In addition, despite the efforts to improve its lending instruments, borrowing from the IMF is still perceived to be unfavorable due to the prevailing stigma associated with. In view of the facts, Indonesia has provided support to the proposals (i) to shorten the disbursement process, (ii) to provide credit line with no ex-post conditionalities, (iii) to differentiate the cost of borrowing (charges), wherein a lower rate may be charged to the use of fund by countries experiencing difficulties due to the spillover effect of the crisis, and (iv) to establish better communication strategy to avoid misconception that the new instrument may not be worth considering.
 - To regain its relevance, legitimacy, and credibility, the IMF should also reform its governance structure. The Fund apparently has paid no serious attention to issues surrounding governance considered essential by emerging markets and less developed countries. In this regard, we took the view that to fulfill its mandates in an efficient and effective way, the Fund should (i) improve the representation on the Executive Board, (ii) reduce the voting threshold on critical decision, and (iii) not confine selected Managing Director candidates from particular regions.
 - To produce early warning of macro-economic and financial risks and to address actions needed, the Fund should establish effective collaboration with the strengthening FSB.
7. Back home, each government should pay serious attention to do their domestic works. For Indonesia, learning from the 1997-1998 crisis, we have found this to trigger the overhaul of the financial sector. The current government has continued with fiscal and financial

reforms, including a massive program to reform the bureaucracy. We accelerated government spending, extended the provision of credit and lending instruments to SMEs, and supported the banking and capital market systems by increasing government funds and offered a limited deposit guarantee scheme. The Indonesian government took swift and determined action to ensure foreign exchange stability with two major swap facilities with China and Japan. In the forefront, the supervisory and enforcement capacity over financial institutions and capital markets have been strengthened. And the central bank in particular has systematically lowered the interest rates. In the area of monitoring, Indonesia maintains a firm position that credit rating agencies, fund managers, and those offering products such as hedge funds require our continued close monitoring. Thankfully that in the recently released government bond rating by Moodys, Indonesia has been improved to a better rate.

8. Admittedly, the Leaders Summit in Pittsburg on September 25, 2009, has come to a more optimistic view of global economy and financial condition. But despite some promising signs of recovery, the global economy is still fragile. Therefore, this is a time for the greatest need to work collectively and collaboratively. Regardless the pain brought by the financial crisis, world should take it as a golden opportunity to reform the global financial architecture. We must ensure the right balance between supports to market dynamism and product innovations in one hand and the need for highest standards of supervisory and regulation in the other hand. Also we should not forget to ensure even-handedness with the surveillance of developed and emerging economies as well. Moreover, world leaders should not only take credit for pulling the economy back from the brink, but also pledge to work together to build a new world order of tighter financial regulation and more inclusive global governance to protect the world from future meltdowns. The G-20 as a new emerging coalition in global economic order is facing high expectation to become the premier forum for international revolutionary breakthroughs to fix the imbalances and to tackle global economic issues in the future. In this respect, Indonesia as a member of the G-20 would particularly work with ASEAN countries to push through the global reform agenda.

Thank you.