

On the Problem of Indonesia's Financial Stability: Harnessing the Central Bank Independence

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Bank Indonesia (BI) legally received an independent status in 1999. It experienced a long period of being influenced by the government. Generally, the endeavor to achieve the independence is on the right track. BI tends to adopt monetary independence. However it must be understood that the statutory independence is not a condition of being free and totally independent of the government (or free from political matters). It should be seen as a simply separation of public function which calls for a peer to peer dialogue and mutual coordination and information sharing between them, because there will be no total independence for any central bank in this world. This paper also tries to observe the relationship between the independence and the implementation of the open market operation, even though it is understood that both stand on different pillars. This paper found that the relationship between the independence and the open market operation in Indonesia have a close and a reciprocal relationship. The improvement in the hemisphere of the open market operations inevitably influences the effectiveness of the central bank independence. The open market operations are the significant tools of the monetary policy. What is interesting is that the role of the Central Bank Certificates (Sertifikat Bank Indonesia – SBI) overwhelms the monetary instruments, and influences the aggregate of Indonesian financial structure. The investigation on the SBI as the primary monetary means is the heart of the observation on the open market operations. It is observed that the main problem of the financial market lies on the excessive role of the SBI. Although recently the government has also started to issue the government securities (Surat Berharga Negara – SBN), but it has not been broadly used as a monetary means. The SBI is now undermining the commitment to the independence, and spoiling the banking intermediary function. The intermediary is undermined as banks prefer the SBI rather than overcoming the lending risk. As results, real sector financing is slowing and sound banking system is decreasing. Albeit these problems, the SBI is playing an important role in the financial structure. The results of the study suggest that: a. the open market operations must be well reoriented to mainly transact the SBN in the long run; b. to achieve central bank independence a peer to peer dialogue and mutual coordination and information sharing between the government and BI are inevitable ways; and c. present condition is not an appropriate time to significantly decrease the amount of the SBI, but

the SBN should gradually play a significant role as a promising candidate of the monetary instrument; and d. intermediation problem must be put as a priority to be resolved.

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