LEGAL ROLE ON BANKING CRISIS RESOLUTION IN INDONESIA: AN ANALYTIC NETWORK PROCESS APPROACH

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ABSTRACT

In late 1997, Indonesia's economy after many years of uninterrupted growth was shocked by a severe crisis. The banking crisis, which ensued, was proved as the most severe in East Asia and one of the most costly crises in the last quarter of the 20th century. The crises were mainly derived from the foreign capital problems and exacerbated by the political transition during the period. The impacts of the crisis, to some extend, still exist. Some even argued that in fact the crises are not over yet.

This paper focuses specifically on the legal role of the banking crisis resolution in Indonesia. It was assumed that all the programs implemented by the Indonesian Government, as part of the banking crisis resolution, could not help banks recover immediately because of lack of legal role. The legal role in general is represented by three factors, i.e. structure, substance, and legal culture. By using the Analytical Network Process approach, this paper came to a finding that banking crisis resolution in Indonesia was not effective, since it was lacking mostly on sufficient structure and legal culture. Legal substances as represented by acts, policies, and regulations issued by the government are shown necessary but not sufficient in resolving the banking crisis in Indonesia.

1. Background

The Asian crisis especially in Indonesia has caused considerable losses in many aspects of developments and welfare, including in the economic performance. Starting at a currency crisis in Thailand, it has rapidly spread into neighboring countries and had transformed into banking crisis and even into multi-dimensional crisis in Indonesia. Many have tried to explain on why Indonesia should experience such a deep and very adverse crisis, especially in the banking sector. From economic perspectives, many believe that the banking crisis in Indonesia was also originated from the vulnerability of the banking system itself as indicated by insufficient capital, lack of good corporate government, coupled with weak supervision and regulations amid economic boom in the mid 1990's and rapid international financial integration which further amplified the inherent vulnerabilities in Indonesia's banking system . (*WTO Trade Policy Review*, 1999, Enoch, et. al., 2001, Feldstein, 2003, Pangestu, 2003).

It became apparent that such weaknesses emerged when the government of Indonesia was trying to resolve the crisis. While weaknesses in the legal regulatory framework and lack of law enforcement due to combination of weak capacity and capability of bank supervisors, were acknowledged. Other factor such as corruption and political interference of favored owners close to the centre of power had added to the complexity of the problem (Djiwandono, 1999, Pangestu, 2003). Furthermore, lack of coordination and consensus on how to cope with these complex problems among various governmental department and agencies has caused the implementation of many policies taken were delayed or even reversed, resulting a very slow progress in overcoming the crisis.

Looking from legal perspectives, law reform in the banking sector was expected to become a panacea for resolving the crisis and simultaneously preventing the emergence of future problems in the banking sector. However, the result of the legal reform in this sphere was not up to the expected outcomes. One major constraint or impediment facing the legal reform in Indonesia is due to relatively low-level of understanding the benefit of legal importance. Other factors contributed to this disappointment were the low level of commitment and lack understanding by various stakeholders. At the end, instead of becoming the problem solver, many believe that the law has been blamed as one of the major obstacles in resolving the crisis, with a weak legal infrastructure and weak regulatory performance. (Syahdeini, 1999, Rajagukguk, 2004)

There are many studies and research focusing on banking crisis resolution including what has happened in Indonesia. Unfortunately, the literature is rather limited on the role of legal reform in Indonesia. This research therefore is intended to enrich various studies on the banking crisis in Indonesia, viewed from the legal role utilizing the Analytic Network Process (ANP) approach. This approach is applied by taking into account its supremacy in quantifying qualitative data or in the form of perception.

2. Banking Crisis Resolution in Indonesia: An Overview

Facing the banking crisis, the Indonesian Government has conducted several programs to overcome the impact. The programs can be classified into three main programs, namely[1] 1) Crisis containment programs consisting of Exit Policy Program, Bank Indonesia Liquidity Support Program, and Blanket Guarantee Program; 2) Restructuring programs consisting of the Indonesian Banking Restructuring Agency (IBRA) Incorporation Program, Assets Management Program, Acquisition, Merger and Consolidation Program, and Bank Recapitalization Program; and 3) Strengthening programs consisting of Credit Restructuring Program and Financial Safety Net Program.

During the crisis containment period, the Indonesian Government issued Bank Indonesia Liquidity Support and Blanket Guarantee Program. Bank Indonesia Liquidity Support Program, which is known as BLBI, is the central bank's fund intended to advance liquidity needs to banks in order to avoid the continuing bank's failure facing systemic financial problem. The rupiah

[1] Hereinafter only two program groups will be discussed, namely the handling group and the restructuring group.

depreciation, coupled with high interest rates and off-shore loans had caused domestic liquidity reserve to decline drastically, prompting the central bank to provide its liquidity. When banks experienced bank run or systematic massive withdrawal of savings, Bank Indonesia acted as lender of last resort try to overcome systemic crisis in order to save national payment system (Enoch et. al., 2001).

Blanket guarantee program was issued by The Indonesian Government to prevent a further slide and to restore public confidence in the banking system. This program covered all commercial bank's liabilities (rupiah and foreign currency), including both depositors and creditors. It was an interim measure pending the establishment of the Deposit Insurance Agency. Prior to this, the Indonesian Government had ever provided deposit guarantee to particular bank's failure up to Rp. 20 million, which were regarded as inadequate by depositors, triggered them to withdrew their savings from the private banks and transfer them to state banks, foreign banks or banks overseas. This capital flight reduced the public's confidence in the Indonesian banking system.

Bank restructuring was marked by the Bank Recapitalization Program as an effort to strengthen the banks' capital. In this program, Indonesian Government strengthened capital of appropriate banks to operate by issuing government bonds. The total government bond issuance has reached around Rp.400 trillion, a total of huge amount of Indonesian Government's domestic debt which has never been existing during the three previous decades. Similarly to blanket guarantee program, the issue discussed in this program is mainly related to the large amount of fiscal burden.

The Indonesian Banking Restructuring Agency (IBRA) Incorporation Program was assigned mainly to restructure banks through taking over their management, recovering bad asset, providing guarantee. In addition, IBRA has to coordinate with Bank Indonesia in executing other crisis resolution programs. The agency was established temporarily to restructure the banking system due to the crisis as set forth in the Banking Law Number 10 of 1998.

Merger, Acquisition and Consolidation, which was also included in restructuring programs, was meant not only to reduce the number of unsound banks but also to decrease the number of banks as a whole.

3. Why the Banking Crisis Resolution in Indonesia did not work effectively: A Legal Analysis Using ANP Approach.

3.1. Logical Framework

A profound study on law dysfunction (law-based failure) confirmed by Norton (1998) is principally needed to respond to various problems that may have caused the legal system not to function well. Meanwhile, Friedman (1984) suggested that how a legal system is applied in an economy may be observed from the interaction of three factors referred to as structure (institutionalization), substance (rules) and legal culture (opinion or understanding of the agents, users and policy authorities).

Structure in the study of the legal system includes institutionalization created by the legal system. Referring to the economic and political theory on institutionalization, Rachbini (2002) stated that in the context of the banking crisis in Indonesia, structure may serve as the basis for explaining the causes of the crisis arising from the weaknesses of the institutional function of the banking system. In the banking crisis resolution, referred to as structure, includes the institutions that become the authorities and issue regulations and supervise well functioning of the banking system as well as other institutions relating to the duty of the crisis resolution.

Substance includes everything contained in the regulations that may have either positive or negative implications (Rachbini, 2004). In the context of the banking crisis resolution, substance includes regulations and policies relating to licensing, business activities and bank dissolution.

Legal culture includes who and how that determine effectiveness of substance and structure in a legal system. In legal culture, there is a theory that differentiates between formal law and law in action. Formal law means a set of norms or rules contained in the legislation or in legal cases, whereas law in action is the law applied or implemented by the parties, lawyers and courts (Glazebrook, 1999). In Asian countries, it is frequently mentioned that tradition or culture is largely influential in application of the law, for instance mutual interest is prioritized over individual rights. Furthermore, it is largely expressed that in order to understand implementation of legislation in Asian countries, it is essential to understand the traditional norms, customs, religion, moral behavior and value underlying such legislation. In the banking crisis resolution, an example of legal culture would be the customs and behavior of the banks and their apparatuses in carrying out banking operations and the culture that can affect the smoothness or success of banking restructuring, such as the practices of corruption, collusion and cronyism.

Interaction of these three factors will represent the legal system in a country. Contemplating interaction of the three factors of the legal system may provide an illustration of the legal role on a certain issues, such as the ineffective banking crisis resolution.

Referring to the definition of each factor as described above, legal role in the banking crisis resolution in Indonesia may be assessed by utilizing the indicators as follows:

1. Structure

From legal structure perspective, a program or policy on the banking crisis resolution is considered strong if it has or is supported by:

1. legal basis for establishment that provides legality of the program and the relevant institutions;
2. legal basis for authority that provides clarity of the authority coverage of each institution involved in the program/policy;
3. work hierarchy and mechanism that provide clarity on how the program or policy can be implemented by the relevant institutions;
4. Adequate of supporting regulations that facilitate the relevant institutions to execute the policy pursuant to their right.

2. Substance

From legal substance perspective, a program or policy is considered strong if the legal products serving as the bases for the program or policy have or are supported by:

1. adequate philosophical elements
2. scientific considerations
3. economic considerations
4. clear objectives or targets
5. conformity to higher basic laws
6. compliance with legal drafting norms

3. Legal Culture

From legal culture perspective, a program or policy is considered strong if its implementation has or is supported by:

1. a strong political will or commitment of the relevant institutions;
2. a profound understanding of regulations by all relevant parties involved in the program or policy implementation;
3. consistency in the program/policy implementation by each institution;
4. no crony-capitalism indication in the program/policy implementation
5. principles of competition and openness in the program/policy implementation;
6. professional integrity in all parties involved in the program or policy implementation;
7. legal awareness of all parties;
8. Law-enforcement efforts for all supporting the program/policy implementation.

By using the analytical concept of the role of law by Friedman, the logical framework of an ANP approach to analyze the legal role of the Indonesian banking crisis resolution can be set up as seen in figure 1 (appendix 1).

Figure 1 indicates that analysis of the role of law is conducted on all the policies and programs for containing and restructuring the banking crisis, namely BLBI, exit policy, blanket guarantee, IBRA incorporation, merger and acquisition, assets management, and banking recapitalization. Evaluation of weight and role in all the policies/programs is based on the evaluation or perception of each indicator in legal factor.

According to the ANP approach framework developed above, the analysis of legal role in this study are limited to the assessment of the strength and weakness of legal role in each banking crisis resolution programs in Indonesia. However, this study was not aimed to measure the capacity of legal aspects in accelerating or delaying the banking crisis resolution program.

Furthermore, this study is not yet capable to insert legal aspects as part of institutions as endogenous variables in evaluating the process of banking crisis resolution[2].

3.2. Data Gathering and Processing Procedures

Data used in this study are collected from the legal and banking experts directly involved in containing and restructuring banking crisis in Indonesia from 1997 to 1999. They are gathered from in-depth interviews with the experts who were legal banking scholars, central bankers, corporate lawyers, government officials, international financial observers, former financial authorities, as the resource persons, and then reconfirmed through focus group discussions attended by different experts.

Data were processed by using super decision software, in which the comparative weights of inter-policy, inter-indicator, inter-alternative (strength and weakness) were justified by considering the results of in-depth interviews and focus group discussions.

3.3. ANP Results

In analyzing the legal role on the banking crisis resolution by using the ANP approach the first step to do is determining the weight of the role of each program or policy applied by the government. Findings from in-depth interviews have indicated that the containment programs are essential and should be prioritized by the government in order to rescue banks from loosing confidence any further. In this regard, exit policy, liquidity support, and blanket guarantee programs should be prioritized compared to any other program. The accomplishment of banking crisis resolution will mostly be depended on the completion of those three programs.

As second priority was the recapitalization program within the bank restructuring stage which is actually a program intended to improve the bank's capital after securing banks from failing. Furthermore, it would be followed by IBRA incorporating, assets management, and as final step is merger, acquisition and consolidation program.

Results of weighing the role of each program for banking crisis resolution are as follows:

Table 1

Weights of Roles of Crisis Resolution Programs

Program	BLBI	Exit Policy	Blanket Guarantee	IBRA	Asset Management	Merger – Acquisition	Recapi-talization
Weight of role	0.2138	0.5139	0.1173	0.0326	0.0326	0.0251	0.0646

Source: primary data, processed

After obtaining the weight of role of each program as described above, we use the same result from in-depth interviews to calculate value of each legal factor for each program as follows:

[2] The role of institution is growing more crucial in the policy analysis as pointed out by the New Institutional Economics (NIE) approach. NIE is an approach that "criticizes" or improves the Neo-Classical Economics (NCE) approach. NIE suspects the equilibrium condition as a focus of NCE in reality cannot be achieved. According to NIE, a policy that has been optimum in terms of NCE can be ineffective if the institutional condition, among others the legal aspect, formal or informal is not sufficiently supportive.

Table 2
Values of Strengths and Weaknesses of Legal Factors of Banking Crisis Resolution Programs

Program	Values (ANP Results)					
	Structure		Substance		Legal Culture	
	Strength	Weakness	Strength	Weakness	Strength	Weakness
1. BLBI	0.5917	0.4083	0.7583	0.2417	0.1677	0.8323
2. Exit Policy	0.4167	0.5833	0.8000	0.2000	0.1250	0.8750
3. Blanket Guarantee	0.6625	0.3375	0.8000	0.2000	0.1375	0.8625
4. IBRA Incorporation	0.4833	0.5167	0.8333	0.1667	0.1302	0.8698
5. Assets Management	0.4833	0.5167	0.8000	0.2000	0.1250	0.8750
6. Merger-Acquisition	0.6833	0.3167	0.8000	0.2000	0.5208	0.4792
7. Bank Recapitalization	0.5250	0.4750	0.8000	0.2000	0.4375	0.5625
Synthesized **Strength = 0.3522 ; Weakness= 0.6478**						

Source: Primary Data, Processed

Table 2 indicates that legal culture is the main weakness occurring in nearly all of the banking crisis resolution programs in Indonesia. Weak legal culture is reflected in:

1. Lack of political will or strong commitments of the government and the relevant institutions to resolve the banking crisis as reflected particularly in the cases of bank liquidation and IBRA incorporation.
2. Lack of understanding of the detail regulations by all parties involved in the program or policy implementation as indicated by the fact that IBRA lost most of the cases brought before the courts. The ineffectiveness of IBRA's authority is largely caused by the lack of understanding of the policy underlying on its incorporation.
3. Lack of consistency in program implementation by each institution. This is particularly revealed in IBRA establishment, in which its policy focus is inconsistent in following the interest of the regime.
4. Indicated presence of crony-capitalism in the program implementation as revealed in the exit policy case, particularly in connection with bank liquidation policy in November 1997, where Bank Andromeda, which was initially included in the liquidation but then was excluded.
5. Lack of professional integrity in all of the parties involved in the program or policy implementation. This was specifically conspicuous in all programs.
6. Lack of legal awareness of all parties particularly in resolving IBRA's cases.
7. Lack of law enforcement efforts for all supporting program implementation.

Slightly similar to legal culture, nearly all of the programs showed weaknesses on the structure. This is particularly indicated by unclear hierarchy inter-institutions. In this case weaknesses also indicated by lack or even nonexistent implementation procedures and incomplete supporting regulations. Consequently this resulted into ineffective programs implementation.

Unlike legal culture and structure, substance as indicated in table 2 is the strengthening (supporting) factor for all the banking crisis resolution programs. The existence of knowledge-based consideration, a clear target, harmonization among regulations represented the strength of substance in all programs.

Although there was a strong substance as a supporting legal factor, there were too many weaknesses in the legal culture and structure, that lead to a conclusion of weak legal role on the banking crisis resolution programs in Indonesia. ANP results indicate that weaknesses of the crisis resolution programs reach 64 percent, whereas the strengths reach only 36 percent.

4. Conclusion

From results of the literature studies and based on the expert opinions who involved during the banking crisis resolution process in Indonesia, we may conclude:

1. The banking crisis in Indonesia, which was triggered by the lost of confidence to the government, was largely caused by inaccurate policies applied by the government in overcoming the currency crisis.
2. The most priority in banking crisis resolution program should be exit policy, liquidity support and blanket guarantee. These three programs determined the government's success or failure in accomplishing or accelerating the banking crisis resolution.
3. The main weaknesses was legal culture. It was occurring in nearly all the banking crisis resolution programs in Indonesia. Factors indicating weaknesses are lack of the government's political will to resolve the crisis (reflected in the inconsistent policies), lack of legislation understanding, crony-capitalism, and low professional integrity.
4. The other weaknesses was structure. This weakness, which showed in nearly all of the programs,. was caused by unclear hierarchy inter-institutions, lack or even nonexistent implementation procedures and incomplete supporting regulations.

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APPENDIX 1

Picture 4.1

ANP Approach Framework

Analysis of Legal Roles in Banking Crisis Resolution in Indonesia