

# **Economic and Political Perspectives on the Bank Century Case**

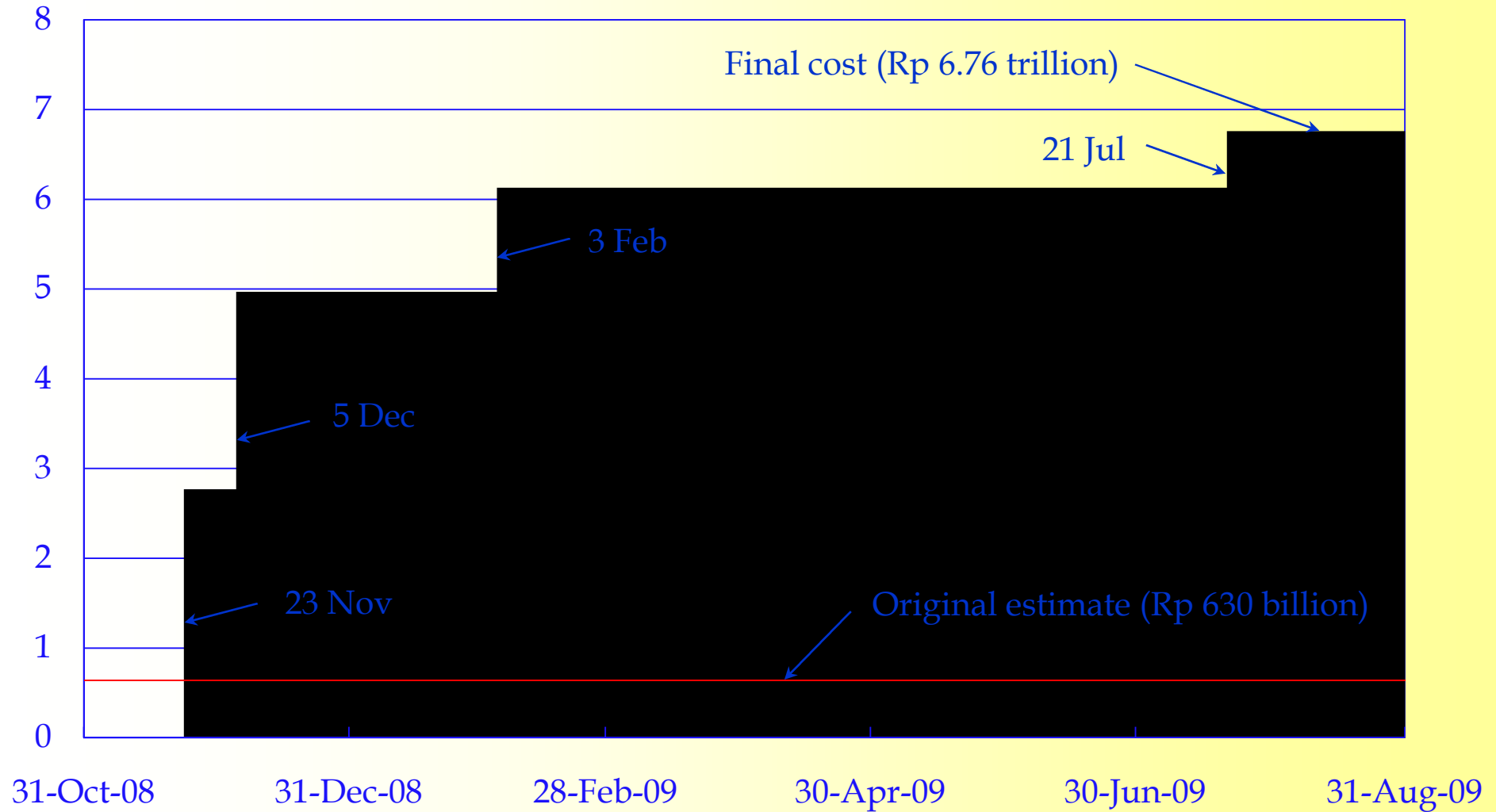
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# Why all the fuss by the DPR?

- The initial estimate of the cost of bailing out Bank Century was Rp630 billion (say, **\$US60 million**)
- The ultimate cost has been about Rp 6.8 trillion (say, **\$US700 million**)
  - 'A billion here, a billion there: pretty soon you're talking about real money' (old American proverb)
- But since when did the DPR care about spending (wasting?) money?
  - Happy with middle class/rich budget subsidies of \$US14 billion (= 20x)
- *DPR itself* enacted the law on deposit insurance/bank bailouts
  - But no thought of revising the law
- Central bank (BI) is *responsible to DPR* for failures of bank supervision
  - But no move to hold BI responsible for its abysmal performance in relation to Bank Century case
- The case was never about money or good governance

## Bank Century Bailout Cost (Rp trillion)



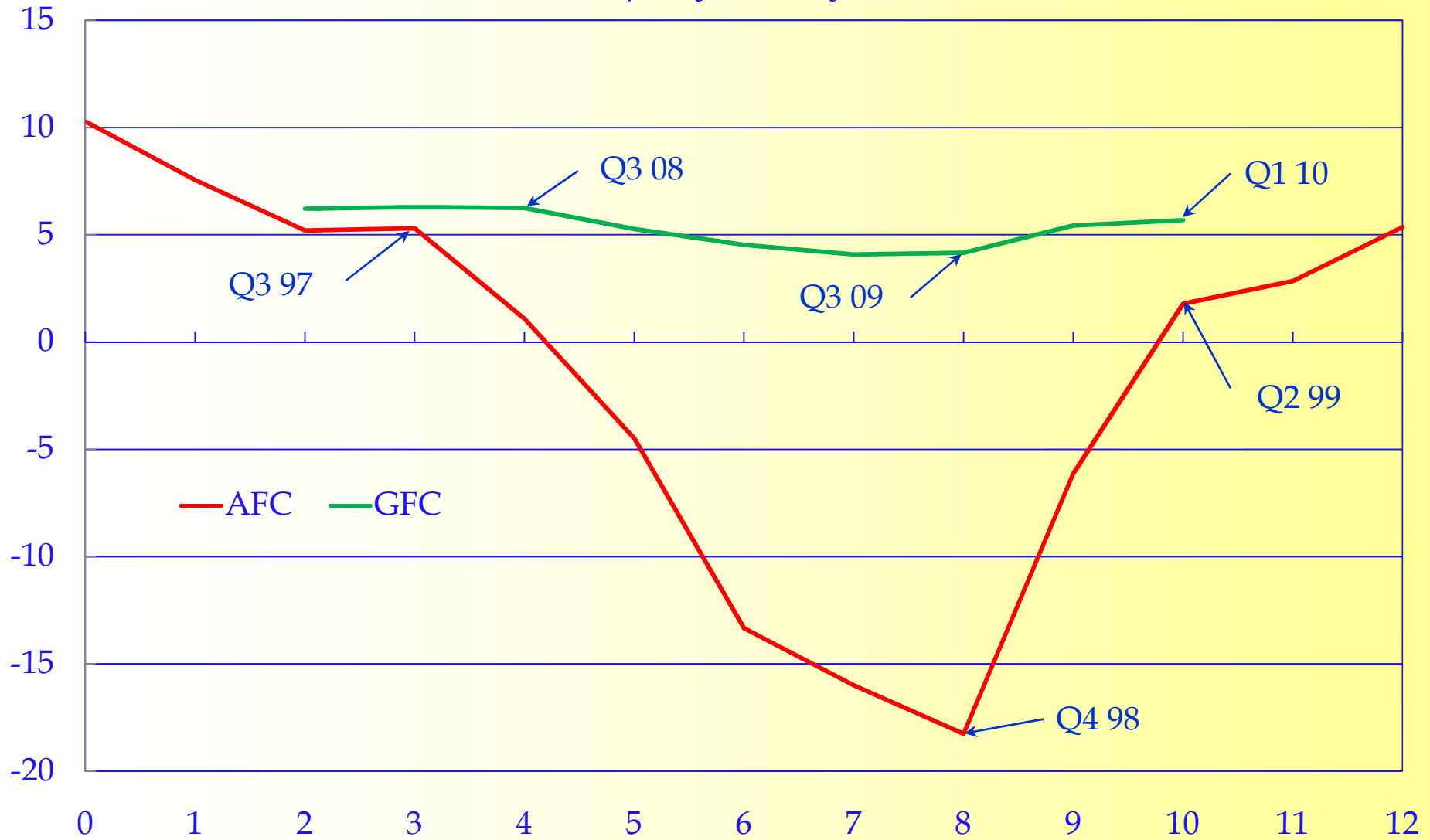
# Timeline for Bank Century

## Economic/political developments

## People developments

1997-98	Asian Financial Crisis: closure of 16 small banks causes runs on other larger ones; disastrous handling of crisis by government and BI; <u>GDP</u> declines 18% Y-O-Y to Q4 98	<b>Soeharto</b> out
26 Jul-99		<b>Anwar Nasution</b> appointed as Senior Deputy Governor of BI
27 Nov-01	Initial attempt to merge 3 (?) bad banks into one: <b>Bank Century</b> ; agreement in principle from BI, subject to various conditions	
25 Jul-04		<b>Anwar Nasution</b> leaves BI
2004	New law for handling failed banks through LPS; BI formalises policy intended to reduce number of banks and make them bigger on average, announcing its Indonesian Banking Architecture plan	
Oct-04		<b>SBY's</b> first cabinet contains <b>Aburizal Bakrie</b> as Economics Coordinating Minister; <b>Sri Mulyani Indrawati ('SMI')</b> as Planning Minister; <b>Boediono</b> (FinMin under Megawati) overlooked
6 Dec-04	At last the Bank Century merger is consummated, even though the pre-conditions have <i>not</i> been met	
Dec-04		<b>Anwar Nasution</b> becomes Head of Supreme Audit Agency (BPK)

## Impact of AFC & GFC on Indonesia's GDP Growth (% p.a. year-on-year)



## Composite Stock Price Index and Exchange Rate During AFC



# Timeline for Bank Century

## Economic/political developments

## People developments

Dec-05

**Bakrie** shifted to Menko Peoples' Welfare; **Boediono** takes his place as Menko Econs; **SMI** becomes Min of Finance

early 2006

**SMI** begins clean-up of corruption in MOF, including replacement of Directors General of Tax (**Hadi Purnomo**) and Customs

May-08

**Boediono** shifted to BI as Governor; **SMI** takes additional role as Menko Econs

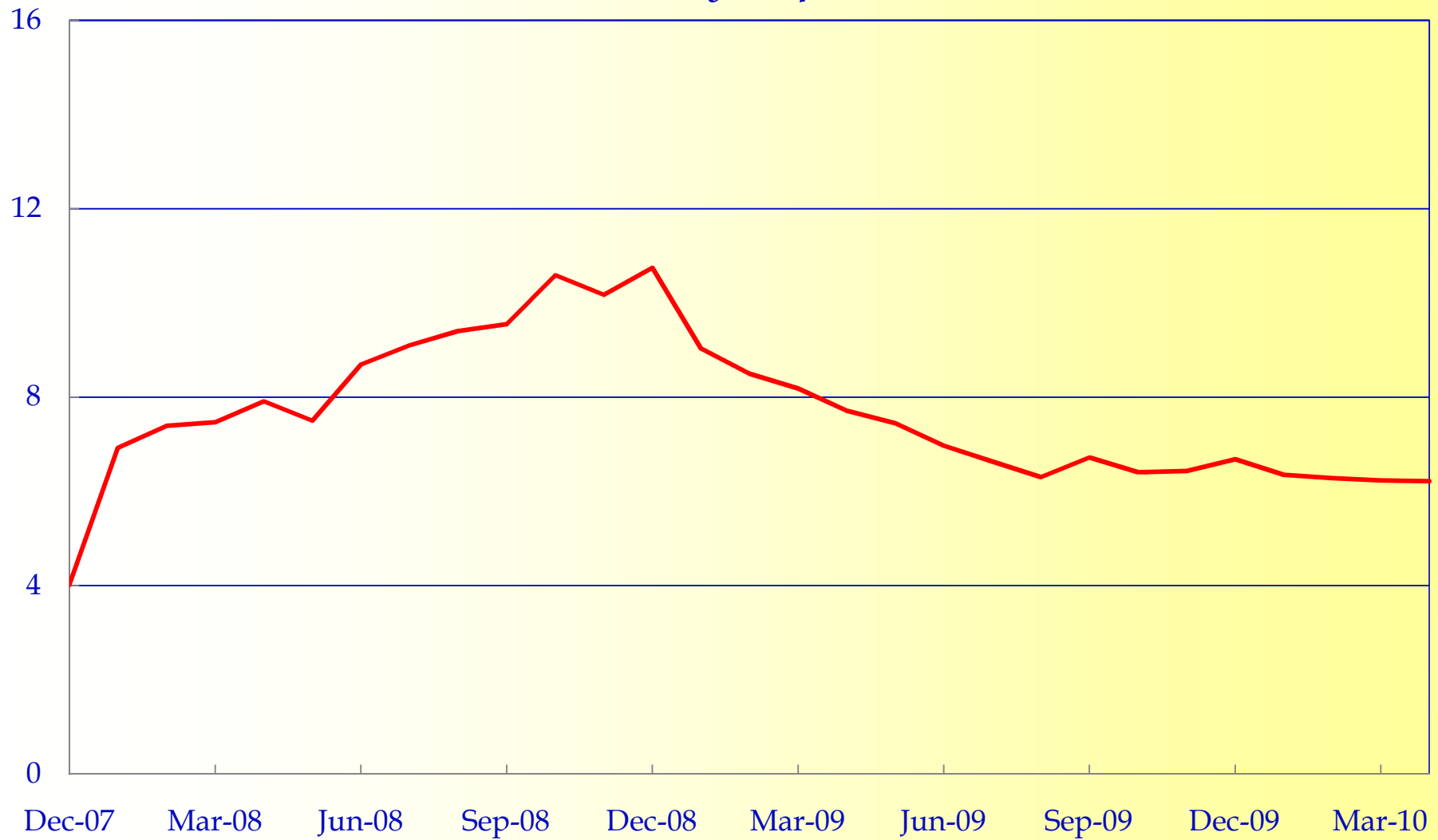
Sep-Oct 08 GFC begins to have an impact in Indonesia; money market rates rise significantly; Stock Exchange suffers big falls in share values

8-10 Oct 08 Stock Exchange closed after big falls

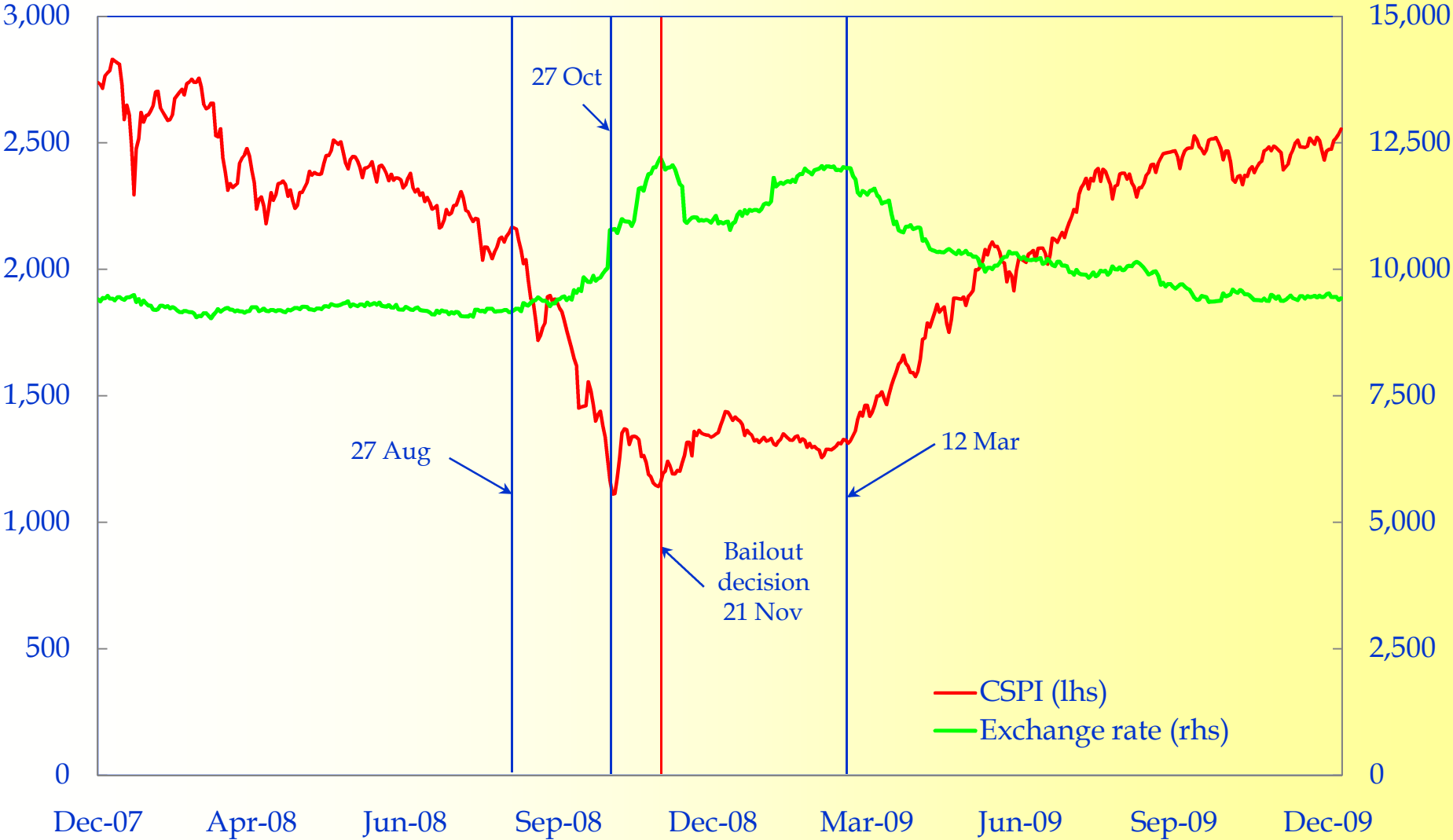
**Bakrie** tries to keep trading in some of his (listed) companies suspended because of negative impact on their value; **SMI** says no, and faces down **SBY** on this

Oct-08 Government increases size of guaranteed deposits (from Rp 100 million to Rp 2 billion) and introduces other emergency measures

## Interbank Interest Rates During GFC (7-day, % p.a.)



# Composite Stock Price Index and Exchange Rate in GFC



# Timeline for Bank Century

## Economic/political developments

## People developments

Oct-08	With no guarantee of <i>large</i> deposits, concerns about soundness of Bank Century lead to attempts at <u>large-scale withdrawals</u> (demonstrating the <u>conceptual weakness of LPS</u> ); capital inadequacy ignored by BI leads to liquidity problems	<b>Budi Sampoerna</b> (previous owner of Sampoerna cigarette manufacturer) is a big customer; his deposit split into multiple small deposits in names of Bank Century employees (presumably attempt at theft by <b>Tantular?</b> ); enlists support of a top cop ( <b>Susno Djuadji</b> ) to put pressure on bank to release his funds
14-18 Nov-08	BI makes a number of short-term loans to Bank Century to boost its liquidity (total value Rp 689 billion)	
21 Nov-08	<ul style="list-style-type: none"><li>•BI decides Bank Century is 'failed and systemically important', and hands problem to KSSK</li><li>•BI argues strongly that this is not the time to allow a bank to fail</li><li>•BI persuades KSSK that the cost will only be about \$60 million (Rp 630 billion)</li><li>•KSSK agrees and confirms BC is '<u>failed and systemically important</u>' and hands it to LPS for rehabilitation (= bailout)</li></ul>	<i>Note:</i> <b>Boediono</b> only BI Governor for about 5 months prior to this
May-09		<b>Boediono</b> becomes <b>SBY's</b> running mate and resigns from BI

## Size Distribution of Bank Deposits (all banks) (%, October 2008)

Size range Rp million	Cumulative totals	
	Number	Amount
< 100	97.7	18.4
100 < 200	98.7	25.0
200 < 1,000	99.8	44.9
1,000 < 2,000	99.9	52.8
<b>2,000 &lt; 5,000</b>	<b>100</b>	<b>61.5</b>
<b>&gt; 5,000</b>	<b>100</b>	<b>100</b>

# Inherent Conflicts in Deposit Guarantees and Insurance

## Objective I: Protect *depositors*

### Choices

all

small

### Problems

moral hazard

yes

bank run

yes

### Damage

economy

yes (?)

budget/'public purse'

yes

### Objective II: Protect *public*

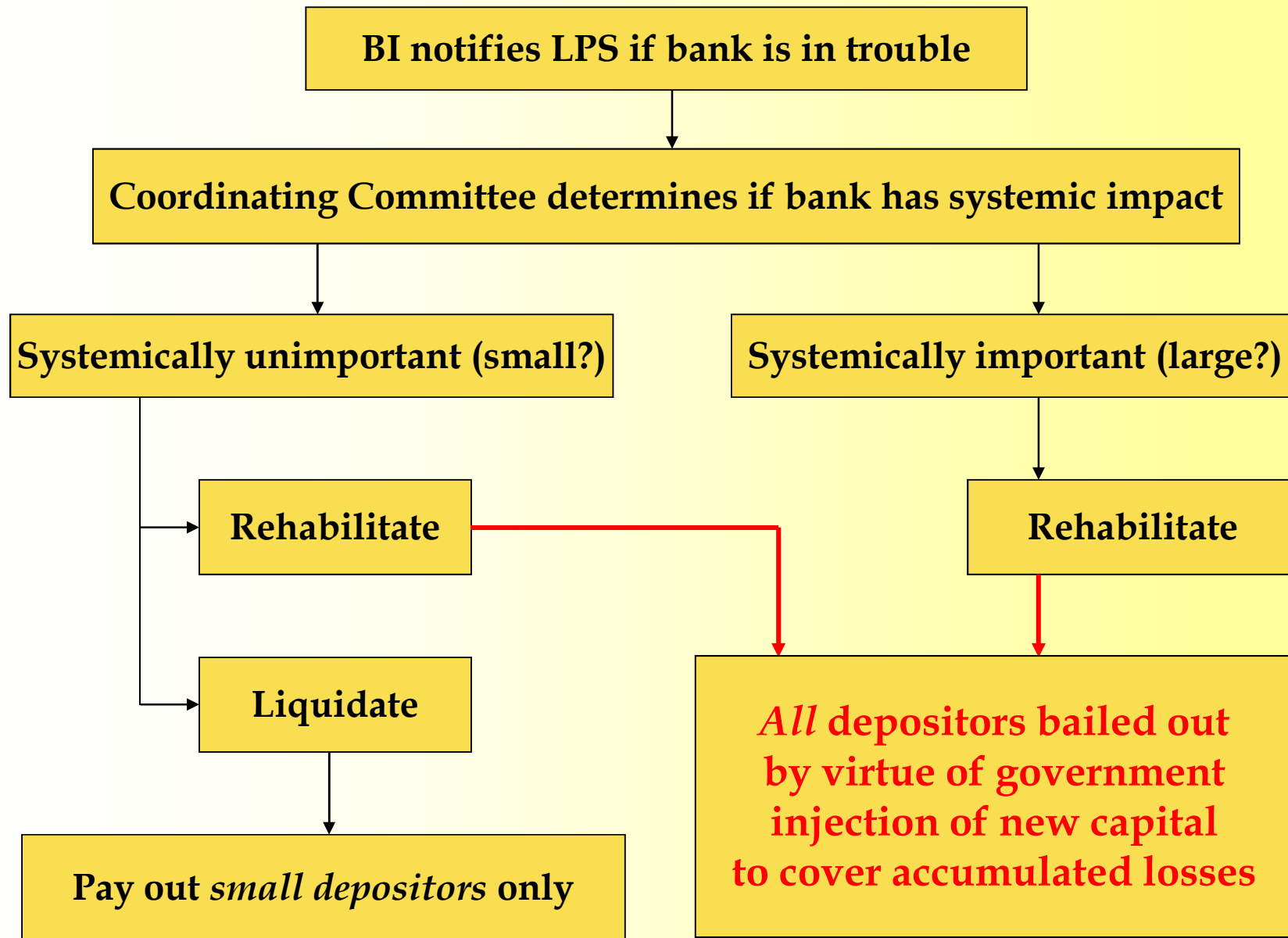
taxes up/services down

yes

loss of income/unemployment

yes (?)

# Dealing with Failed banks under LPS Law



# Timeline for Bank Century

## Economic/political developments

## People developments

1 Sep-09 DPR requests BPK to undertake investigative audit of the Bank Century case

22 Oct-09

SBY inaugurates cabinet for second term in office; **SMI** remains as MinFin, but is replaced as Menko Econs by **Hatta Rajasa**; **Bakrie** no longer in cabinet; soon becomes Chair of Golkar

Oct-09

**Anwar Nasution** completes term at BPK; replaced by **Hadi Purnomo** (ex MOF)

20 Nov-09 BPK's investigative audit handed to DPR

Dec-09 Special Committee of DPR ('*Pansus*') begins long 'investigation' of BC case, televised in full by **Bakrie's** TV station

Mar-10 *Pansus* decides by vote (on party lines) there are indications of wrongdoing, without any real evidence

May-10

**SMI** announces retirement as MinFin to take up high WB job; **SBY** congratulates her on this honour and makes no attempt to dissuade her

May-10

*Mission accomplished*: **Bakrie** appointed as 'Managing Chairman' of Coalition Joint Secretariat: '**Menko of Everything**'?

# Bank Century Case is Rich in Policy Issues

- Who runs government?
- Anti-corruption strategy
- Banking issues

# Who runs government?

- Executive or legislature?
- My own impression is that members of the DPR do not want to *oversee* the work of the government (i.e. to safeguard the interests of the general public), but to appropriate a great deal (too much?) of policy-making authority from the elected president and his cabinet
- That doesn't seem like a good way to run a democracy, but I leave this as an issue for my political scientist colleagues to consider...

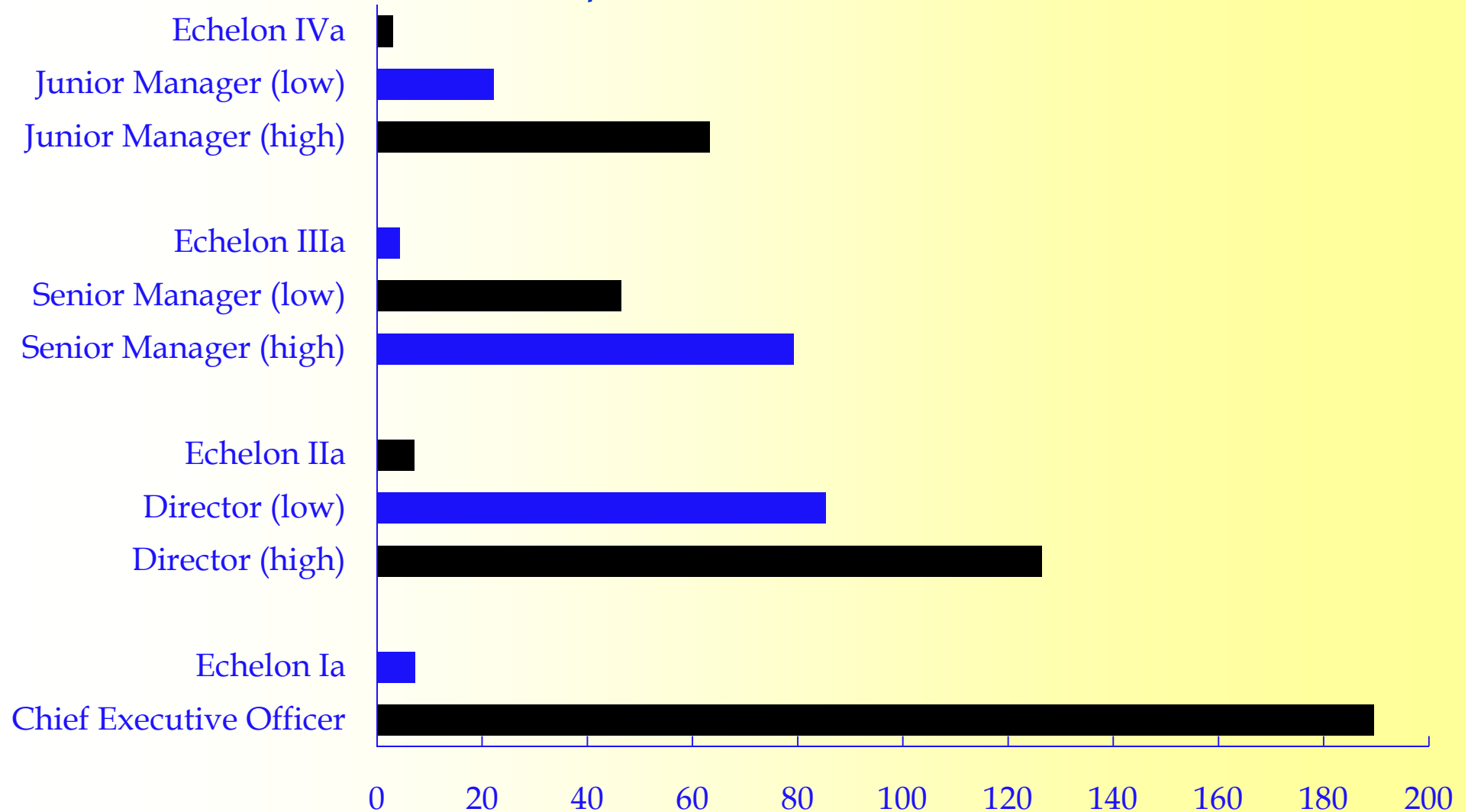
# Anti-corruption strategy

- Detection and punishment for wrongdoing
  - SBY's major focus: superficially successful
  - Essential part of good governance; works when corruption is relatively uncommon
  - Cannot succeed if corruption endemic (see *BIES* paper December 2005)
- Campaign against SMI/ Boediono is part of the great anti-corruption fightback
  - Police conspiracy (Susno Djuadji) against KPK
  - Appointment by DPR of Hadi Purnomo to head BPK
  - Watering down of KPK powers

# Anti-corruption strategy

- Alternative approach
  - SMI's pilot project in MOF (see *BIES* Survey August 2008)
- Rewards for doing right/performing well and penalties for doing wrong/performing badly
  - Aims at dealing with causes rather than symptoms
  - Market comparable salaries, combined with performance evaluation and competition for available positions

# Private and Public Sector Managerial Remuneration (Rp million/month)



Private sector remuneration data taken from a report in *SWA Magazine*, February 15–28, 2007, of a survey by the Hay Group.  
Public sector remuneration includes basic salary plus general and structural allowances.

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# Banking issues (1)

- How many banks?
  - BI thinks there are too many, ignoring the relevant evidence
    - Small banks performed better than large in AFC (*all* the big banks failed!) (see *Cato Journal* paper, 2002)
    - Small banks are in fact profitable; if not they will disappear as part of a natural market process
    - There are about 2,000 very small 'peoples' credit banks' (secondary banks) that are also profitable (since they provide a useful service)
  - And it thinks that merging banks makes them stronger
  - Bank Century case demonstrates the obvious reality
    - Combining 3 small bad banks creates 1 large bad bank...

# Banking issues (2)

- Who should regulate banks?
  - BI has always done so (poorly!), but strongly resists relinquishing this task
  - BI should never have agreed to the creation of Bank Century
- The Law on BI (23/1999) called for establishment of a prudential supervisory body for whole financial sector by **end 2002**
  - This target not met
- The revised Law on BI (3/2004) called for its establishment by **end 2010**
  - Seven months to go...
  - Bank Century was '*cacat sejak lahir*', and 'continuously violated the banking (prudential) regulations' without sanction from BI (Nasution)
  - DPR appears uninterested, even though BI's failure to deal with Bank Century and its predecessor banks is the root cause of the huge loss to LPS
  - No excuse for not closing these banks down long before GFC

# Preconditions for Establishment of Bank Century

- Report on examination of the 3 banks (21 Nov 2001):
  - Danpac: reasonably healthy
  - CIC & Pikko
    - Did not fulfill minimum 8% capital adequacy ratio (CAR) (standard requirement for all banks)
    - Bad management
    - Frequent violation of banking regulations including suspicion of criminal actions
- Board of Governors of BI meeting 27 Nov 2001
  - Agreement in principle to merger, subject to:
    - Increase capital of merged bank to minimum 8% CAR
    - Improve bank management
    - Avoid repetition of illegal actions (!)

# Preconditions for Establishment of Bank Century

- Board of Governors of BI meeting 16 April 2004
  - Despite *failure to accomplish any of the preconditions*, the agreement in principle was restated (with more explicit statements as to timetable and amount of new capital)
- A Deputy Governor of BI makes an internal note to the effect that the merger of the 3 banks is 'absolutely essential'
- Suggests BI should give at least two kinds of 'tolerance':
  - A major financial asset known to be bad should be classified as OK until the time it fell due, thus allowing the CAR requirement to be met
  - Fit and proper test of RAR should be postponed
- BI gives permission to proceed with the merger on 6 December 2004
  - Two unsound banks had been allowed to continue to operate for a further 3 years
  - None of the preconditions to put things right had been met
- All in all, a total abdication of BI's responsibilities as supervisor of the banking system

# Banking issues (3)

- How to deal with failed banks
  - In normal circumstances?
  - In circumstances of threatened/actual crisis?
- The LPS Law was an attempt to codify everything that was done in the banking crisis of 1997-98
  - But that approach cost the public \$50 billion (nearly half the output of the economy in one year)!
- A better approach? (see *BIES* paper April 2004)
- Two main criteria
  - Avoid moral hazard (and thus avoid losses to public as in Century case)
  - Keep payments mechanism operational
- Ensures that innocent bystanders do not pay for others' actions, by ensuring that capitalism works as intended in the case of banks
  - Losses borne first by owners, then by creditors
- Involves immediate conversion of deposits to equity, with demand deposits given priority

# The Bank Century Case Personalities

Sri Mulyani Indrawati	Minister of Finance; previously Chair of Bappenas
Boediono	Vice President; previously Governor of Bank Indonesia; previously Coordinating Minister for Economic Affairs; previously Minister of Finance (in Megawati Administration)
Aburizal Bakrie	Conglomerate owner; Chair of Golkar; previously Coordinating Minister for Peoples' Welfare; previously Coordinating Minister for Economic Affairs
Hatta Rajasa	Coordinating Minister for Economic Affairs
Sjahril Sabirin	Former Governor of Bank Indonesia
Burhanuddin Abdullah	Former Governor of Bank Indonesia
Anwar Nasution	Professor of Economics at UI; previously Chair of Supreme Audit Agency; previously Senior Deputy Governor of BI
Hadi Purnomo	Chair of Supreme Audit Agency; previously DirJen Pajak in MOF
Anton Tarihoran	Former Director of Bank Supervision at BI
Siti Fadrijah	Deputy Governor of BI in charge of Bank Supervision

# The Bank Century Case Personalities

Robert Tantular	Controlling shareholder in Bank Century and affiliated companies (and previously of Bank CIC)
Anton Tantular	Brother of Robert Tantular; owner of Antaboga Delta Sekuritas securities company/ownership vehicle for Bank Century
Theresia Dewi Tantular	Sister of Robert Tantular, formerly Head of Bank Notes Division at Bank Century
Rafat Ali Rizvi	Controlling shareholder in Chinkara Capital; Pakistani origin/UK citizen
Alwarraq Hesham Tallat	Controlling shareholder in Chinkara Capital/ became Deputy Commissioner of Bank Century; Saudi Arabian
Budi Sampoerna	Former owner of PT Hanjaya Mandala Sampoerna cigarette empire (sold to Phillip Morris in 2005 for \$2 billion); big depositor in Bank Century
Susno Duadji	Former National Police chief of detectives (implicated in conspiracy against KPK deputy commissioners); enlisted by Budi Sampoerna to help recover his investment

# The Bank Century Case Organisations

Bank Indonesia (BI)	Central Bank (responsible for bank supervision)
Ministry of Finance	(Minister chairs committee dealing with failed banks)
LPS	Deposit Guarantee Institution/Deposit Insurance Corporation
KSSK	Committee for Financial System Stability
Supreme Audit Agency (BPK)	(Reported various shortcomings in investigative audit)
DPR	House of Representatives
<i>Pansus</i>	Special Committee of DPR to investigate BC case
Golkar	Large 'coalition partner' in both SBY Administrations
Anti-Corruption Commission (KPK)	(Still investigating the case at <i>Pansus</i> request)
Bank Danpac	Rated sound in November 2001
Bank Pikko	Rated <i>unsound</i> in November 2001
Bank CIC	Owned by Tantular family; rated <i>unsound</i> in November 2001
Bank Century	New bank resulting from merger of Pikko, CIC and Danpac
Bank Mutiara	Rebadged Bank Century (after bailout)
Antaboga Delta Sekuritas	Securities company (unlicensed?) owned by Anton Tantular
Chinkara Capital/First Gulf Asia Holding	Investment vehicle owned by Rafat Ali Rizvi and Alwarraq Hesham Tallat

# Selected papers on relevant policy issues

- ‘Banking Collapse and Restructuring in Indonesia, 1997–2001’ (jointly, with George Fane), *Cato Journal*, 22 (2), 2002, pp. 277–95.
  - Discusses relative performance of small and large banks
- ‘Dealing with Bank System Failure: Indonesia, 1997–2003’, *Bulletin of Indonesian Economic Studies*, 40 (1), April 2004, pp. 95–116.
  - Discusses an alternative approach to dealing with failed banks
- ‘Indonesia’s New Deposit Guarantee Law’, *Bulletin of Indonesian Economic Studies*, 42 (1), 2006, pp. 59–78.
  - Provides critique of LPS approach
- ‘The Struggle to Regain Effective Government Under Democracy in Indonesia’, *Bulletin of Indonesian Economic Studies*, 41 (3), December 2005, pp. 367–86.
  - Discusses impossibility of combating corruption by punitive measures when it is endemic
- ‘Inadequate Budgets and Salaries as Instruments for Institutionalising Public Sector Corruption’, *South East Asian Research*, July 2008.
  - Explains the link between remuneration and endemic corruption