Judul : Central Bank's New Mandate Follows Global Best Practice
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Halaman : 6

Central bank's new mandate follows global best practice

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The House of Representatives recently approved the omnibus bill on the development and strengthening of the financial sector so that it can optimally support the national economy amid the various challenges ahead such as pandemic, digital disruption, geopolitics and climate change.

The bill which amends 17 related laws will deepen and increase the efficiency of the financial sector, by 1) expanding coverage, products and investor base; (2) promoting long-term investment; (3) increasing competition to support efficiency; (4) strengthening risk mitigation; and (5) increasing investor and consumer protection.

One of the regulatory scopes of the financial-sector omnibus law is strengthening the authorities in the financial sector, which includes strengthening the central bank with three objectives: namely achieving stability of rupiah value, maintaining the payment system and participating in safeguarding financial-system stability in the framework of sustainable economic growth.

Thus, Bank Indonesia (BI) will have one additional objective with the ultimate goal of sustainable economic growth. The Bank for International Settlement (BIS) survey of 47 central banks after the 2009 global financial crisis found that it is very normal for a central bank to have more than one objective like this. Based on the survey, the objectives of the central bank consist of (i) monetary policy; (ii) financial-system stability; (iii) employment, growth and welfare; (iv) supporting government policies; and (v) achieving profits.

This multi-objective model is also in line with Joseph E. Stiglitz' recommendations in 2014 to achieve sustainable economic growth. Monetary policy should not focus solely on price stability. Most of the central banks in the world, however, emphasize the goal of price stability, either as a single objective with sub-objectives, or parallel to other objectives. Countries that include not only stability but also economic growth or other development targets in the central bank's mission are South Korea, the United Kingdom and Japan.

The choice of such a model, in which the stability of the rupiah is in line with other objectives, is also justifiable, although it is not very widely applied. It is justifiable because it does not put too much emphasis on price stability because it is feared that there will be an "inflation nutter" phenomenon, which happens when the central bank only focuses on controlling prices even in the short term, so that it adopts policies that lead to large fluctuations in output.

This model is similar to the United States Federal Reserve system and the Federal Open Market Committee, which have the goal of maintaining long-run growth of the monetary and credit aggregates commensurate with the economy's long-run potential to increase production, so as to effectively promote the goals of maximum unemployment, stable prices and moderate long-term interest rates.

However, there are concerns about this model, namely the potential for an over-expansionary policy to occur. To mitigate such a risk, the roles and interrelationships of BI's objectives/tasks in the economy and the real sector need to be defined specifically. It should not overlap with other authorities' mandate, such as the development of micro, small and medium enterprises (MSMEs), which is under the jurisdiction of the government.

Although it is confirmed in the literature that there is no trade-off between the goal of price stability and economic growth in the long term because price stability encourages economic growth, in the short term, price stability can conflict with other macroeconomic objectives. Therefore, the phrase "in the framework of sustainable economic growth" is very important as an overriding objective.

In theory, inflation that follows the long-term path is needed by the economy. By adhering to this principle, the central bank will, at any given time, aim to close not only the inflation gap but also the output gap. In this case the financial-sector omnibus brings us closer to the best practices of central banks in the world such as the US.

Antara/Hafidz Mubarak A

Done deal: Finance Minister Sri Mulyani Indrawati (*left*) submits the final draft of the omnibus bill on the financial sector to House of Representatives Speaker Puan Maharani during a plenary session in Jakarta on Dec. 15. The House passed the bill into law.

Next, the omnibus financial-sector law provides a specific clause that BI's task will include participating in safeguarding financial-system stability. This is important because it follows the practice of central banks' post-global financial-crisis reform where around 20 percent of 146 BIS-surveyed central-bank laws begin to state explicit objectives related to financial-system stability.

One of the important meanings in the explicitness of this goal is that there is equality in the task of price stability by helping to maintain financial-system stability. This strengthens the function of BI in participating in maintaining financial-system stability. Learning from the experience of crises including pandemic, this is an important milestone along with improving regulatory governance since the crisis has been carried out by Indonesia for more than 10 years including through the Financial Services Authority (OJK) Law and the financial-system safety-net law.

The mandate to maintain financial-system stability is shared with many institutions. Currently, there are four institutions that are mandated to maintain the financial-system stability, namely the Finance Ministry, BI, the OJK and the Deposit Insurance Corporation (LPS). The "participating" clause is emphasized to show that BI is not the only one who has this mandate, and every authority that receives a mandate carries it out with the authority it does have.

The new law also emphasizes the task of establishing and implementing macro-prudential policies in order to help maintain financial stability as a whole and not just for banks like its current mandate based on OJK Law. Based on literature, macroprudential policy aims to limit systemic risk and procyclicality that can have a significant negative impact on the economy as a whole. Thus, macro-prudential mandate for the whole financial sector including its related regulation and supervision affirmation at BI is getting closer to best practices.

The financial-sector omnibus law also ensures that macro-prudential policies are carried out in close coordination with other authorities. Coordination in the context of managing banking-sector problems, for example, is required specifically between the authorities of macro-prudential, micro-prudential and bank resolution.

Lastly, the law also complements BI's authority in managing financial crises, such as purchasing government bonds on the primary market. This authority is set with clear rules using the BI-government joint decree. The rules include that it can only be done under crisis conditions. Crisis status is set by the President based on the recommendation of the Financial System Stability Committee (KSSK), which also includes BI. KSSK remains the coordination platform when it comes to financial-system stability issues.

The financial-sector omnibus law reiterates that BI is an independent state institution. Board of Governor candidates may not serve as administrators or members of a political party. In addition, the Bank Indonesia Supervision Body (BSBI) is also strengthened by regulating its supervisory scope to include institutional and operational budgets of BI.