# The Regulation of Foreign Ownership of National Banks in Indonesia and Its Impact on National Development

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***Abstract*— International agreements make Indonesia liberalize the financial sector. As a result, foreign ownership of national banks in Indonesia has dominated the shares of banks that have gone public. Even though market mechanisms should be the key to healthy competition in liberalizing national bank ownership in Indonesia, the readiness of local investors to compete with foreign investors still needs to be improved. This research aims to show the impact of the foreign monopoly on national banks' ownership to achieve long-term national development targets. This research uses normative juridical research methods with a conceptual and statutory approach. As an analytical tool, Richard Posner's antitrust theory will show the negative impact of the national banks' liberalization in Indonesia. This policy will impact the stability and future development of the national financial sector. The result shows that the liberalization policy at least brought about (1) domination of foreign ownership, (2) lack of ability of domestic investors to compete with foreign investors, (3) there needs to be an evaluation of the motivation of foreign investors in Indonesia, (4) dominance in determining the direction of national bank policy is in the hands of foreign investors, (5) there need to be adjustments to standards that can ensure that investor policies are in line with the direction of Indonesian national policy. Thus, this research can provide a new perspective in looking at the direction of economic sector liberalization policies that are fair to all Indonesian people.**

***Keywords*— Banking Ownership, Economic Analysis of Law, International Agreement, Liberalization.**

## I. INTRODUCTION

This article evaluates the effectiveness of the national bank ownership liberalization policy in Indonesia. The government's decision to open opportunities for foreign investors to own majority shares in Indonesia's banking system certainly impacts national economic development targets. *Banking liberalization* is a policy made by the government as a form of Indonesia's seriousness in fulfilling the results of international agreements. For this reason, this policy needs to be evaluated because the dominance of foreign ownership of national banks in Indonesia is currently relatively high. Based on these considerations, this study was created to examine the legal issues related to the low percentage of local ownership in shares of national banks in Indonesia. The research was conducted using normative juridical methods. A statutory approach is used to analyze the legal umbrella that underlies foreign ownership limits for banks in Indonesia.[1]

The conceptual approach in this research was carried out using the economic analysis of law (EAL) theory perspective proposed by Posner. This theory can provide a complete picture of the rationality of the policies that should be made. To produce an effective policy, the government needs to consider the elements such as value,


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utility, and efficiency contained in the substance of the regulation. Pareto efficiency will be the basis for rationality in choosing the desired benefit distribution model. To achieve Pareto optimality conditions, the government must evaluate whether the policy of liberalizing foreign ownership in national bank shares in Indonesia will potentially create a monopoly in the financial sector. Posner does not entirely see that monopoly is a bad thing. However, it is related to the aim of providing maximum prosperity to the Indonesian people, which can be illustrated through the distributive justice model in the Pareto optimality concept. In that case, the opportunity for foreigners to dominate the share ownership of national banks in Indonesia certainly needs to be evaluated.

Harold Levitt and Kenichi Ohmae view that globalization and establishing international legal systems would lead to the integration of markets in a world without borders, offering boundless economic wealth. free trade was then used to unify the world's economic systems. Efforts are needed from countries that are members of the free trade community to open up space for the entry of various commodities and foreign investment to achieve these conditions. However, the liberalization of the financial system resulted in member countries relinquishing sovereignty over their national legal authorities as they were compelled to adhere to the terms of international agreements they had previously entered into.[2] One of the organizers responsible for overseeing and managing the free trade process is the World Trade Organization (WTO).[3] Singapore, Malaysia, the Philippines, Thailand, Brunei Darussalam, Vietnam, Myanmar, Laos, and Cambodia also built regional cooperation under the auspices of ASEAN.[4] The recognition of ASEAN as a Regional Trade Agreement (RTA) or Free Trade Area (FTA) is expected to support global economic integration. However, The collective GDP of ASEAN member countries in 2022 stands at US$ 3.6 trillion, making it the fourth largest globally.[5]

Responding to changes in global economic patterns, Indonesia has actively issued policies supporting financial liberalization, especially in the banking sector. The global economic crisis that occurred at the end of 1990 has made the process of financial liberalization increasingly intensive in various countries in the world. In line with this policy, Indonesia also chose the same option through a Letter of Intent (LoI) in the agreement with the IMF. Based on this agreement, the Indonesian government must lift the limit on foreign ownership of banks that have gone public. Apart from that, the banking liberalization process in Indonesia is also contained in the Conditional Initial Offer (CIO) in response to the General Agreement on Trade in Services (GATS). The banking industry is 1 of 5 sectors that oversees 68 transaction activities, but this sector has been liberalized based on the CIO provided by Indonesia.

In this case, one aspect that has quite a significant influence is the government's statement, which allows foreigners to do several things, such as owning shares of up to 99% in national banks or opening branch offices in big cities in Indonesia. To support their business activities, the government also opens up opportunities to temporarily employ foreign experts and does not impose taxes on horizontal business activities. Finally, according to the provisions of international agreements under the free trade model, the Indonesian government can no longer implement national treatment.[6] Consequently, this regulation positioned Indonesia as an ASEAN nation that implemented the most liberal principle in governing the banking industry. According to this strategy, Indonesia aims to have a minimum of 106 companies offering public banking services by 2022. Out of them, at least 30 private banks will have foreign ownership.

From this data, when the government does not protect local investors, this policy will open up opportunities for foreigners to monopolize domestic banking shares. If we refer to the antitrust theory put forward by Posner, monopoly can occasionally be erroneous when it has the potential to yield a more favorable influence on economic growth. However, which groups will benefit from these economic activities needs to be considered. As a state administrator who should make policies that can improve the welfare of all Indonesian society, the government needs to consider aspects of distributive justice based on the logic of utilitarianism. A study needs to be carried out to see the effectiveness of financial sector liberalization policies based on the perspective of EAL theory. This study aims to answer legal issues regarding the potential for financial liberalization policies and the anticipation that needs to be taken to deal with the dominance of foreign investment.

The analysis will be presented in several sub-topics. First, the explanation of the economic analysis from the law perspective will provide an overview of the urgency of distributive justice to achieve Pareto optimal conditions. This study will be presented in a sub entitled 'Perspective of economic analysis of law in providing justice for the wider community.' Second, the next section of this study will specifically discuss the financial liberalization policies implemented by the Indonesian government. The results of this presentation will become material for analysis of the effectiveness of the liberalization process on the prosperity of Indonesian society. The results of the analysis will show the extent to which the government's role is needed in limiting foreign ownership of domestic bank shares in Indonesia. This analysis will be presented in the sub entitled 'Liberalization of banking ownership in Indonesia: challenges to effectiveness in achieving distributive justice.'

## II. RESEARCH METHOD

The normative juridical research model is the standard for scientific testing in this study.[9] A legislative approach is used to look at the substance of the series of regulations used by the Indonesian government to regulate share ownership limits for national banks in Indonesia. A conceptual approach is used to provide a foundation for the legal arguments that will be made. The theory used as part of the conceptual approach of this study is an economic analysis of law theory proposed by Richard Posner. The analysis process will be carried out using a deduction model. The study results are presented in descriptive and prescriptive form.[10]

## III. FINDINGS AND DISCUSSION

The thoughts produced by Richard Posner have provided many perspectives in the study of law. One of the perspectives used by Posner to see the effectiveness of implementing a policy is economic principles. Departing from the logic of utilitarianism put forward by Bentham,[7] Posner presupposes that humans would persist in their efforts to maximize the gains they acquire. This necessity then needs to be supported by rational choice methods that can support the achievement of a condition that can bring happiness. This logic is then seen as having similarities with the point of view of economic theory.

In classical economic logic, humans want more than what is available. This desire will then bring human rationality to maximize the profits that can be obtained. As a rational maximizer,[8] Humans will select the optimal alternative to maximize the profits they acquire. Dissatisfaction that continues to arise within a person and the desire to continue to get something more than what he has obtained is a condition that will affect a person's rationality in acting. Success in achieving the things he desires then leads to situations that make him happy.

For this reason, Posner believes that law can be an economic tool used to maximize a person's happiness. The effectiveness of implementing the legal system can be assessed from its impact on community welfare. Nevertheless, Posner emphasized that the value of justice is critical in legal studies, so EAL must still be able to promote the principles of distributive justice.

The development of legal science, which continues to be influenced by various scientific disciplines, also changes how we view aspects of justice for society. Gender justice, ecological justice, inter-species justice, and the values of distributive, substantive, and procedural justice have made a difference in achieving the goals. In this study, distributive justice is a perspective that is specifically needed to ensure that everyone will receive the same benefits. This concept is under the objectives of the utilitarian view, which wants to bring the most significant benefit that can create the highest happiness for many people. This view then brings an understanding that the law can be effective when it can bring justice to all society without exception. However, the law must uphold the principle of equality before the law.[9]

It was chosen considering that the analysis of this study relies on the values contained in the Constitution in force in Indonesia. In particular, the Constitution of Indonesia has mandated that the government can run the economic system by considering the impact of prosperity that can be provided to all Indonesian people. Thus, it is clear that the fundamental essence of the value of justice contained in the Constitution is related to the concept of distributive justice. Distributive justice, used as a basis for consideration in this study, is closely related to elements in EAL theory to show whether a policy has been deemed capable of demonstrating high effectiveness in the implementation process. From the perspective of EAL theory, effective law must consider the value, utility, and efficiency contained in its substance. So, financial liberalization policies must also bring distributive justice to Indonesian society. The highest happiness will be obtained when the community gains prosperity from implementing these policies.

In order to see the effectiveness of implementing financial liberalization policies, an analysis needs to be carried out on the three elements of EAL proposed by Posner. The first element in EAL theory relates to efficiency. Concerning the distributive justice model to be realized through financial liberalization policies, the efficiency of these norms will be based on Pareto Efficiency standards. The concept of efficiency postulated by Vifredo Pareto sees that the measure of realized efficiency can be seen in two ways: Pareto optimality and superiority.[10] The condition of Pareto optimality is a form of efficiency that can share profits at the same level for everyone. By understanding Pareto's optimality, all individuals will attain equal happiness levels. Meanwhile, in Pareto superiority, the acquisition of enjoyment is not distributed evenly. In this concept, at least one individual experience a higher degree of happiness than others. In this case, the target who will gain benefits and pleasure should be reflected in the alignments that exist in the substance of the law.[11]

Second, the promised utility is a condition that can produce benefits for the legal subject. These benefits can direct people's lives to be more prosperous. With the hope of guaranteeing a better life, happiness can be realized when these policies run effectively. In other words, the measurement used to determine utility standards lies in the objectives of formulating a policy and the ability of the policies created to achieve these objectives. This condition must then be taken into consideration in the policy-making process. If the policy cannot work according to the expected goals, it would be better if it is changed or revoked.[8]

Third, essential elements in a policy are closely related to its values. Posner describes that value as something significant. This can be in the form of desires or desires that humans have. The value fought for in a policy can be monetary or non-monetary. Thus, the policies formulated are a form of struggle to achieve satisfaction. An analysis of the characteristics brought by the policy can be carried out to determine the values contained in the regulation. Calculating the values obtained will provide an idea of the advantages or disadvantages a particular person or group will experience. In this study, the values of distributive justice are expected to be realized through financial liberalization policies, especially those implemented in the banking sector in Indonesia.

The Indonesian Banking Law has regulated limits on domestic bank share ownership. Indonesian Citizens (WNI), Indonesian Legal Entities (BHI), Foreign Citizens (WNA), and Foreign Legal Entities (BHA) can directly or indirectly buy shares sold by the bank. Indirect purchases can be made through the stock exchange. After the banking liberalization process was carried out in 1998, the government abolished the article regulating ownership limits for domestic bank shares. This policy also makes Indonesia the most liberal country in the Asian region. Liberalization of the economy, especially the banking sector, was the policy chosen by the government to deal with the monetary crisis that occurred at the end of 1990. With the opportunity to participate in free trade, the government intends to support this potential by providing open facilities in the banking sector.

The government's seriousness in realizing this policy can be seen in government regulations (PP), which regulate the purchase of commercial bank shares, and regulations from the financial services authority (POJK) regarding commercial banks. Under these provisions, foreigners and BHA can buy up to 99% of domestic bank shares. Due to the regulations used by the Indonesian government to liberalize the financial sector, this study was carried out to see the effectiveness of implementing these policies. If we look at historical factors, the liberalization process in Indonesia is the result of international agreements that have been made. Apart from that, the global economic crisis at the end of the 1990s made Indonesia decide to increase the value of incoming investment to maintain national financial stability. The rationality underlying Indonesia's participation in a series of international agreements that want to establish a free trade mechanism can be seen through the opinions of Harold Levitt and Kenichi Ohmae, who view that the phenomena of globalization and the establishment of an international legal system would lead to the integration of markets in a world without borders, offering boundless prosperity.

As stated in EAL theory, humans are rational maximizers. So, it will become ordinary if countries dare join the World Trade Network. Moreover, the Indonesian Constitution also mandates the government that national economic policies must bring society the greatest prosperity. These principles can then be translated as a goal to be achieved and simultaneously become a prerequisite for realizing happiness for every Indonesian citizen. Thus, the fundamental nature of the goals achieved through economic liberalization policies has been discovered. Further analysis was carried out on the suitability between the substance of the domestic bank ownership liberalization policy and the EAL elements.

First, the government's policy to liberalize domestic bank share ownership by foreign investors can show that the values of capitalism are being fought. In the view of capitalism, the government can take steps that are considered capable of improving the economic system. This value is a tool to achieve maximum prosperity for the people. With the global shift caused by globalization, the government must be able to follow developments in world policy. The Indonesian government then welcomed this phenomenon by entering into international agreements and offering the concept of liberalization in the banking sector. With the approved LoI and CIO, Indonesia has brought this country towards the gate of open access to foreign investors who wish to own shares in national banks in Indonesia.[12]

This value has been well summarized in a series of regulations created by the government to open up opportunities for foreigners to invest in domestic bank shares. Currently, foreign investors have been able to control 39 banks operating in Indonesia. Of this number, there are 32 national private banks whose share ownership is dominated by foreign investors and seven foreign bank branch offices operating in Indonesia. This condition shows that the government has successfully attracted foreign investors to invest their capital in Indonesia's banking sector. Of the total IDR 10,932 trillion in bank assets in Indonesia, foreign investors have contributed IDR 2,944 trillion or the equivalent of 26.9% of total banking assets in Indonesia. Several countries that dominate ownership of domestic banks are Japan, South Korea, and Singapore.

Second, the substance of the ownership liberalization policy for national banks in Indonesia must be examined concerning its utility aspect. Based on the values and goals to be achieved, the government is targeting benefits by increasing economic stability. The government hoped these benefits would face the crisis at the end of the 1990s. Currently, the financial crisis no longer occurs in Indonesia, but this does not mean that the policy of liberalizing domestic bank ownership will be immediately revoked. This policy continues with considerations relating to the basis of international agreements that have been agreed. Referring to the agreement in the CIO, which has been approved by the Indonesian government, of course, regulations at the national level must adapt to the contents of this international agreement.

One of the rules that must be obeyed in the international agreement made by Indonesia is the willingness of all member countries to continue improving the country's liberalization process. This provision is a limitation for the Indonesian government, which has implemented full liberalization for foreign investors to own bank shares in Indonesia. Due to the existence of these regulations, the economic benefits obtained from the increase in foreign investors investing capital in the banking sector can continue to increase. KasikornBank from Thailand recently provided an additional cash injection of IDR 3 trillion to fulfill the rights issue mechanism and increase its ownership stake in Maspion Bank. Due to the additional capital value, Maspion Bank shares are now officially dominated by foreign ownership. Thus, regarding benefits, the banking sector liberalization policy has opened up opportunities for foreign investment and increased the possibility of improving the quality of banking services. The ease of investment the Indonesian government offers can attract foreign investors to raise capital for the domestic banking sector.

Third, the policy of liberalizing national bank ownership towards foreign investors needs to be studied from an efficiency perspective. Based on a theoretical review of the efficiency aspect in EAL and its relation to distributive justice, the benefits obtained from the liberalization policy of the banking sector. The benefits of economic stability that can be obtained from the ease of investment are only intended for foreign investors. Although the government did not limit local investors' ownership of domestic bank shares, the government offered no protection. Apart from facilitating foreign investment, the government should create the 'Pareto optimal conditions' for local investors. The benefits of increased prosperity and economic stability typically only directly impact foreign investors and the banks they acquire. Meanwhile, local investors with limited financial strength will struggle to compete with foreign investors.

As proof, 75% of Singaporean banks have controlled more than 90% of the share ownership in national banks. This condition is undoubtedly very unfavorable for the strength of local investors if they are forced to compete freely with foreign investors. If we refer to the antitrust law theory put forward by Posner, monopolies implemented by corporations should not be contested if genuine competition fails to yield a more favorable outcome than the monopoly itself. In this case, if the government does not protect local investors, the monopoly of foreign ownership of banking shares in Indonesia will continue to increase.[13] Even though the beneficial value of monopoly activities can contribute more to the stability of the national economic system and boost development in the financial sector, the value of distributive justice, which should be the main principle of this policy, needs to be addressed. Suppose the government needs to review this policy. In that case, the government will gradually hamper local investors' ability to experience the positive impact of the economic liberalization process in the banking sector. In other words, 'Pareto superiority' is a condition that will be formed if the government does not create regulations that can strengthen the position of domestic investors. Foreign investors and the banks they acquire will be the only side to feel economic profits and benefits that can increase welfare.[6]

However, when foreign investors dominate domestic bank share ownership, the government must also be prepared for the consequences of this condition. The dominance of share ownership can indicate that all policies carried out by the bank will run following the decisions of the majority shareholder and, in this case, are in the hands of foreign investors. Meanwhile, the government will undoubtedly have limitations in controlling decisions taken by foreign investors. The government still needs to prepare a mechanism to ensure that foreign investors who dominate share ownership in domestic banks must be willing and actively contribute to the national development goals the government wants to achieve.

## IV. CONCLUSION

The research results show that the liberalization policy that has been implemented has at least had an impact on the emergence of foreign ownership domination of national bank shares in Indonesia lack of ability of domestic investors to compete with foreign investors; there is a need to evaluate the motivation of foreign investors in Indonesia; the dominance of determining the direction of national bank policy is in the hands of foreign investors; There needs to be an adjustment to standards that can ensure that investor policies are in line with the direction of Indonesian national policy. Thus, this research can provide a new perspective in looking at the direction of economic sector liberalization policies that are fair to all Indonesian people. For this reason, it is necessary to revise the laws and regulations governing national bank ownership in Indonesia so that local investors have a stronger position.

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