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# INDEPENDENCE OF BANK INDONESIA POST LAW NO. 4 OF 2023 ON DEVELOPMENT AND STRENGTHENING OF THE FINANCIAL SECTOR

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## Abstract

Economic conditions following the COVID-19 pandemic have impacted the financial sector's condition. Considering how vital the financial sector is for both the economy and people's lives, the government has enacted the Law on Development and the Strengthening of the Financial Sector (Law on P2SK), which amended and/or repealed several regulations related to the financial sector, including changes affecting Bank Indonesia. The Law on P2SK stipulates that Bank Indonesia is an independent state institution with the authority to carry out its mandate, free from interference from the government and/or other parties, except for some issues expressly regulated by this law. The phrase "except for certain matters which are expressly regulated by this law" means there is a potential threat to BI's independence. For this reason, it is necessary to study further the implications of the regulations in the P2SK Law on BI's independence. The benchmarks are institutional, organisational, political, and financial independence. The research method that was used was doctrinal. The results show that under the Law on P2SK, there is a change in the level of autonomy from the institutional, functional, and organisational standpoints. These changes will indeed affect BI's ability to achieve its goals.

**Keywords**: *independence, bank indonesia, central bank, financial sectors*

## I. INTRODUCTION

In developing countries such as Indonesia, which still rely on the banking sector to drive the economy forward, it is vital to maintain the banking sector's stability and prevent the deterioration of the national economy. Experience shows that a collapse in the banking sector would not only affect economic activity but would also affect people's welfare. This condition is caused by fluctuations in the banking sector, which can reduce the capital available to businesses. Of course, economic activity can always experience a decline that can increase the rate of inflation, which in time can affect the prices of goods and services on the market and reduce people's purchasing power. All of this results in a decline in people's welfare due to the difficulty in obtaining goods and services whose prices are increasing. In other words, the banking sector's stability is essential for the public good.

Regarding these conditions, it is necessary to have the highest public authority, namely the state, to maintain and stabilise the banking sector. For this reason, several institutions were formed: Bank Indonesia (BI) as the central bank, governed by Law No. 23 of 1999 on Bank Indonesia (hereinafter the "Law on BI"); [1] the Deposit Insurance Corporation (LPS) governed by Law No. 24 of 2004 on the Deposit Insurance Corporation (hereinafter the "Law on LPS").[2] As the institution that guarantees customer money; and the Financial Services Authority (OJK) as the regulatory and supervisory institution for banking and other financial sectors, regulated under Law No. 21 of 2011 on the Financial Services Authority (hereinafter the "Law on OJK").[3] This legal framework codifies the independence of these institutions.

Institutional independence is believed to be the key to maintaining financial sector stability. Several studies illustrate the correlation between institutional independence, economic stability, and public trust in the government.

This is especially true for central banks. Central bank independence became the primary focus for almost all countries worldwide, especially after the 1997/1998 currency (monetary) crisis. Before the crisis, central banks were not independent in many countries. This lack of independence was suspected as one of the leading causes of the rapid collapse of currency values and widespread economic collapse. The experiences also taught us that the independence of a state's central bank is one of the determining factors in its effectiveness in resolving banking crises. This is the basis for the IMF, which demanded the independence of a state's central banks as a "solution" for bailing out governments and resolving the financial crisis. Indonesia agreed to central bank independence as a condition for assistance from the IMF.[4]

In 2020, the world was shaken by the COVID-19 pandemic, which stifled economic activity by restricting people's movements and social interactions. With the economy weakened, the Indonesian government was forced to issue several policies to mitigate the worst impacts of the pandemic and simultaneously encourage the movement of the national economy. Law No. 4 of 2023 concerning Strengthening and Development of the Financial Sector (Law on P2SK) was enacted to maintain financial sector stability by amending and revoking several regulations in the financial sector. One of the institutions directly affected by the changes was Bank Indonesia.

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[1] Law on Bank Indonesia, No. 23, 1999 (Indonesia). (hereinafter Law on LPS).

[2] Law on the Deposit Insurance Corporation, No. 24 2004 (Indonesia).

[3] Law on the Financial Services Authority, No. 21, 2011 (Indonesia).

[4] J. Soedradjad Djiwandono, *Mengelola Bank Indonesia dalam Masa Krisis*, Pustaka LP3ES, 2001, 18.

Importantly, the Law on P2SK altered BI's status as an independent state institution in carrying out its duties and authority, free from Governmental interference and/or other parties, except for some issues expressly regulated in this law.[5] With this rule, however, BI is still independent, BI is now subject to more government oversight and intervention.

Every state today claims that its central bank has been granted independence. Several studies illustrate that independence has several levels or stages, the implementation of which differs in each state, with varying implications for the state's monetary and economic stability. With BI's independence currently curtailed in several respects, it is essential to examine further the impact of restricting BI's freedom, especially in achieving its objectives.

Several benchmarks are used to investigate the implications of these restrictions on BI's independence and achieve BI's objectives, namely institutionally, organisationally, politically, and financially. An overview of BI's level of independence and its implications for achieving BI's objectives is examined.

## II. CENTRAL BANK INDEPENDENCE

The role of central banks in various countries began with the function of issuing currency under the government's authority. As Bagehot states, the ability to convert currency into precious metals, especially gold, represents the most critical element in a monetary system. Hence, the effort to maintain the convertible system is the Bank of England's most important task.[6] In its development, the role of central banks expanded by becoming government bankers to manage government deposits, government debt repayments, and the state's foreign exchange reserves. The function of the central bank as the government banker in several countries makes the central bank a source of funding for the government to supplement budget deficiencies by purchasing government debt on the open market. However, supplementing the deficiencies that way is the same as printing more money, which makes said function no longer held independently by the central bank.[7] Following developments in the banking world, the role of the central bank has also been extended to become a banker for commercial banks, providing liquidity assistance and facilitating national payment (clearinghouse) systems. Since the liberalisation of banking worldwide, competition among banks has gotten fiercer, to the

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5 Law on Development and Strengthening of the Financial Sector, No. 4, 2023 (Indonesia), Art. 4, Paragraph 2.

6 Akhand Akhtar Hossain, *Bank Sentral dan Kebijakan Moneter di Asia-Pasifik*, Rajawali Press, 2010, 37-38.

7 *Ibid.*, 37-39.

point that banking conditions have become frailer and more vulnerable to national and international disturbances. For that matter, the central bank is required to support funds. The government delegates authority to support a state's development, which is attached to the central bank, among others, to spur economic growth through various credit distribution to the community, including alleviating poverty and controlling the business activity cycles.[8] As stated by Swinburne and Castello-Branco, as a result of the release of guaranteed convertibility of a state's currency into pure gold bars in a standard exchange rate system, the function of the central bank increases where the central bank is responsible for maintaining the value of money (external and internal) in line with the money printing, or treasury authority of the central bank.[9] The latest development in the role of the central bank is to become the guardian of the financial sector to maintain financial stability. The following are some examples of poor bank control and surveillance. The sudden high-risk loans have caused the following banks to fall into bankruptcy, banking in America (1991-1994), Norway (1988-1991), Sweden (1991-1993), Finland (1991-1994) poor management has caused banking crises in the following, Hungary (1993), Bulgaria (1995), and Russia (1998).[10] This additional role is intended to anticipate widespread financial instability, which has the potential to paralyse entire economies.[11] Not all of these roles are carried out by a central bank. The history of the formation and development of the central bank in that state influences the role of the state's central bank.[12]

Experts have different opinions regarding a central bank's essential functions and authority, as presented below. According to Hawtrey, the essential function of a central bank is its position as a last-resort loan provider.[13] This is different from Kisch and Elkin, who argue that the essential function of a central bank is to maintain the stability of monetary standards.[14] This opinion is in line with Lipjhart's opinion that "the most important task of central banks is the making of monetary policy - that is, the regulation of interest rates and the supply of money. Monetary policy has a direct effect on price stability and the control of inflation, and it indirectly, but also very strongly, affects levels of unemployment, economic growth, and fluctuations in the business cycle."[15]

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8 *Ibid.*, 39.

9 *Ibid.*, 37.

10 Frederic S. Mishkin, *The Economics of Money, Banking, and Financial Markets,* trans. Lana Soelistianingsih Salemba Empat, 2010, 279-284, 399-403.

11 *Ibid.*, 399-406.

12 Yuli Indrawati, "Risiko Fiskal Dalam Operasionalisasi Bank Indonesia dan Lembaga Penjamin Simpanan: Suatu Telaah Hukum, Ekonomi, dan Politik," PhD Diss. (Universitas Indonesia), 176.

13 Mishkin, *Economics of Money,* 399-406.

14 *Ibid.*, 399-406.

15 Arendt Lipjhart, *Pattern of Democracy: Government Forms and Performance in Thirty-Six Countries,* (Yale University Press, 1999), 233-234.

Regardless of the regulated roles and functions of the central bank, it is essential to ensure that it can carry out its duties and authority optimally so that economic stability can be achieved, and the state's economy can thrive.[16] Regarding the choice of roles and functions of central banks, history has exposed the following:

1. Latin American countries' unclear separation between monetary and fiscal authority triggered the economic crisis. These countries have tended towards expansionary fiscal policy, which has resulted in increasingly weak monetary discipline.[17]
2. The 1990s monetary crisis demonstrated that monetary stability is possible if the banking sector is healthy and the money supply is independent of banking conditions.[18]
3. In a central bank that is not independent, when the fiscal authority is dominant, the monetary authority cannot control the governmental budget deficit, so the money supply becomes endogenous.[19]
4. The greater the central bank's independence, the more effective monetary policy is in achieving stability targets and the more effective the macroeconomic management of a state will be.[20]

On the eve of election day, the government is keen to use fiscal and monetary instruments to sway the people's trust to support the ruling party with more votes. Thus, Sutan Remy recognised that granting central bank independence is intended to: (i) improve economic performance, especially in maintaining the stability of prices of goods and services through containing the inflation rate at the lowest possible level; (ii) avoid misuse of interest rate determination by the government for political interests; and (iii) prevent orders from the government to print money to cover budget deficits, which could result in uncontrolled inflation rates.[21]

Based on the inflation bias theory, price instability affects the economy through the purchasing power of a state's currency. Unstable prices increase uncertainty and create an unstable economy because people tend to be unsure of the actual value of their money, which has been devalued by inflation. To achieve price stability, an independent central bank is needed. An independent central bank provides public confidence that the central bank focuses more on inflation than output growth. A central bank becomes independent when it is free from political pressure or government intervention, including being free

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[16] Djiwandono, *Mengelola Bank Indonesia,* 267.
[17] *Ibid.*
[18] Zulfie Diane Zaini, *Independensi Bank Indonesia dan Penyelesaian Bank Bermasalah*, Keni Media, 2012, 123.
[19] *Ibid.*, 123.
[20] Djiwandono, *Mengelola Bank Indonesia,* 274.
[21] Maqdir Ismail, *Bank Indonesia dalam Perdebatan Politik dan Hukum*, Navila Idea, 2009.

from the government's ambition to increase *seignorage* by increasing the money supply further.[22]

Etymologically, independence in Indonesia means freedom from rule, sovereignty, and self-sustaining. In an institutional context, this means that everything within the institution is determined by itself, including financial and administrative governance, and in terms of decision-making, it is based on the interests of the institution itself in achieving the purpose of establishing the institution. This meaning is in line with the definition given in Webster's Dictionary, which defines independence as not governed by another, not requiring or relying on something or someone else, and/or not easily influenced.[23]

Several studies on the impact of central bank independence on the national economy show non-uniform results, as presented below. Research conducted by Rahmah shows that the central bank independence variable (CBI) and macroeconomic variables including economic growth (GDPG), inflation (CPI), exchange rate change (ER), freedom of business (FOB), balance of payments (BOP) have a significant effect on the financial systems stability within five ASEAN countries. The effects are different in some ways, where CBI, GDPG, and FDI have a considerable positive impact, while CPI, ER, FOB, and BOP have a significant negative impact. Likewise, research conducted by Cihak illustrates a significant positive relationship between CBI and financial stability. Herrero and Rio also obtained similar results using an annual data sample for 79 countries between 1970 and 1999, proving that higher CBI can reduce banking crises as a proxy for stability.[24]

This contrasts with research conducted by Haan, which was conducted with a sample of 80 countries between 1985 and 2005 and found a negative relationship between central bank independence and financial instability. Likewise, Klomp and Haan's research shows a significant negative relationship between central bank independence and financial instability in 90 countries. If we distinguish between political and economic independence, the results show that the negative relationship is caused primarily by politics and not economic independence.[25]

Apart from the pros and cons regarding the impact of central bank independence on financial sector stability, there is also research from Berger

[22] Yessy Andriani and Prasanna Gai, "The Effect of Central Bank Independence on Price Stability: The Case of Indonesia," *Bulletin of Monetary Economics and Banking* 15, no. 4, (2013): 368-369.

[23] Merriam-webster.com, "Independence," accessed April 12, 2025.

[24] Laili Puspia Rahmah, "Analisis Hubungan Independensi Bank Sentral dan Variabel Makroekonomi Terhadap Stabilitas Sistem Keuangan di ASEAN," Undergraduate Thesis. (Universitas Brawijaya), 1-14.

[25] *Ibid.*

and Kibmer that shows that central bank independence does not promote financial stability. Separating monetary policy from fiscal policy, employment, trade, or other policies is meaningless because all these policies are a part of the overall economic policy that influences each other within a country's financial system.[26]

Most countries worldwide proclaim that they have granted independence to their central banks. However, research conducted by Meyer shows that the level of central bank independence in each state is not consistent,[27] because it is influenced by the historical development of each state and the importance of the central bank in the consumer economy. Several approaches can be used to assess the level of central bank independence: political and economic independence, Institutional and functional independence, financial independence,[28] personnel independence,[29] and legal objectives.[30] The Grilli, Masciandaro, and Tabellini (GMT) index is a central bank independence index used to measure political and economic independence. [31]

Political independence uses parameters (i) relating to the procedures for appointing the Governor, his deputies and the members of the board of governors and (ii) relating to decisions by the board of governors and where they influence, whether internal or external influence, whether there is a government veto right or not, and whether there is a fixed salary for members.[32] The parameters used to assess a central bank's economic independence are monetary policies free from fiscal influences, particularly the government's interest in closing the budget deficit or maintaining its power.[33] institutional independence measures whether the central bank is subordinate to an institution in the government hierarchy. This institutional independence is in line with the independence of functions shown by decisions that are free from interference from any outside party in carrying out the duties and authority of the central bank.[34] To assess the central bank's independence from a financial perspective, the authority to determine its budget without the approval of

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[26] *Ibid.*

[27] Ismail, *Bank Indonesia*, 281.

[28] Baka wrote about bank central independency in *institutional independence, functional independence, and financial independence. Ibid.*, 281.

[29] Mboweni wrote about central bank independency in *functional independence, personnel independence, instrumental independence, and financial independence. Ibid.*, 38-39.

[30] Fraser and Meyer wrote about bank independency in *independence goal and instrumental independence. Ibid.*, 387.

[31] Grilli et al and Elgie wrote about bank central independence in *political independence and economic independence, Ibid.*, 38.

[32] *Ibid.*, 288.

[33] *Ibid.*

[34] *Ibid., 305.*

any party is used as a benchmark.[35] Meanwhile, personnel independence is assessed by the authority to hire and fire employees, salaries, and other benefits free from influence, especially avoiding employees with interconnected relationships with the government. In connection with the independence of legal objectives, a distinction is made between setting monetary policy targets and how to achieve those targets. Experts disagree regarding the independence of this legal objective. Some parties state that a central bank can be categorised as independent if it has the authority to set monetary policy targets and how to achieve them. However, there is also a view that does not view setting monetary policy targets as an independent assessment factor as long as the central bank is involved before the targets are set. The central bank is granted the authority to determine how to achieve the monetary policy targets.[36] In fact, the differentiation of authority over setting monetary policy targets and how to achieve them has implications for the parties responsible for failures in implementation. In the event of a separation of authority, each party is responsible according to their authority. The government is responsible for its targets, while the central bank is responsible for the means it chooses to achieve them. This is different if the goals and how to achieve them both fall under the central bank's authority.

Apart from this approach, there is the CWN index (Cukierman, Webb, and Neyapty),[37] which is also commonly used to measure the level of independence of a central bank. The index used is as follows.

1. The Chief Executive Officer (CEO) consists of:
    1. period of governance;
    2. dismissal of the central bank governor;
    3. authority to appoint the governor; and
    4. whether concurrent positions can be held.
2. Policy formulation consists of:
    1. who makes policy;
    2. involvement in final decisions; and
    3. the level of central bank participation in formulating the government budget.
3. Central bank objectives consist of determining whether the central bank has one goal (price stability) or multiple goals (price stability, growth, and unemployment).
4. Central bank lending limits to the government consist of:
    1. loan securitisation (advances and securities lending);

[35] *Ibid.*, 309.
[36] Meyer and Soemitro in Ismail, *Bank Indonesia*, 258-259.
[37] Andriani and Gai, "The Effect," 377.

2. central bank's authority to determine loan maturity;
3. loan interest rates; and
4. prohibition on buying government securities on the open market.

## III. DEVELOPMENT OF BANK INDONESIA INDEPENDENCE

The existence of a central bank in Indonesia after the independence of the Republic of Indonesia began in 1946 with the formation of Bank Negara Indonesia (BNI). Apart from functioning as a central bank, BNI also performs commercial activities. Furthermore, based on the results of the agreement between the Dutch government and the Indonesian government at the Round Table Conference of 1949, the function of the central bank was handed over to De Javasche Bank, De Javasche Bank represents the central bank founded by the Dutch government with operating territories in what was then the Dutch East Indies. BNI was made a development bank. Then, in 1951, De Javasche Bank was nationalised to become Bank Indonesia (BI) by Government Decree Number 118 of 1951 and codified by Law No. 11 of 1953 on Determining the Central Bank.

Central bank independence was first recognised in 1952 by Sjafruddin Prawiranegara when he was President of De Javasche Bank. According to him, the central bank needs independence to convince the public of the government's ability to maintain the stability and value of the fiat currency (the Indonesian Rupiah). The central bank must be a financier, not just a cashier for the government. The function of the central bank is to advise the government on financing, and the central bank can deny credit requests from the government based on the stable value of the rupiah. This information was based on Presidential reports and the Council of Commissioners of De Javasche Bank from 1951-1952.[38]

Law No. 11 of 1953 concerning the Principles of Central Banking was the first central bank regulation since Indonesia's independence. It regulates several aspects that indicate the central bank's independence, namely, institutionally (as a legal entity) determining how to achieve policy goals/targets (instrument independence).[39] The law further states that the central bank is a legal entity owned by the state that has the right to carry out tasks based on these laws.[40] To implement monetary policy, the bank has the right to create special reserves, as stated in Article 34, and the bank has the right to withdraw money from said reserves.[41] Article 7 States:

[38] Ismail, *Bank Indonesia*, 4.
[39] Law No. 11, 1953, Art. 7
[40] Law on the Determination of the Central Bank, No. 11 of 1953, (Indonesia), Art. 1 paragraph 2.
[41] Law No. 11, 1953, Art. 6.

1. The Bank is in charge of managing the value of Indonesian currency to benefit the people, nation, and in this matter, to ensure the value of the currency remains stable;
2. The bank is in charge of circulating currency in Indonesia, using banks and paper money, purchasing government-issued bonds in Indonesia, and making progress payments overseas;
3. The bank must develop healthy business from credit affairs and bank affairs in the Republic of Indonesia in general, from national credit and bank affairs specifically; and
4. The bank must monitor credit affairs.

Waiting the launch of a specific law concerning credit affairs with governmental regulations can be enforced by more laws for the bank to continue monitoring for the interest of paying ("solvability") and the continued financing ("liquidity") credit institutions, as well as paying credit in a healthy method based on the wisdom of the bank.

The relationship between BI and the government during that period is illustrated by the norms regarding: (i) the Monetary Board, which has the authority to determine policy objectives, board members, and financial reports;[42] (ii) BI's role as government cashier;[43] and (iii) BI's obligation to finance government needs. Article 19 states:

1. By not limiting what is stated in Article 16 and accordance with the first section of Article 15, the bank is obligated to follow the orders of the ministry of finance if it deems it vital to strengthen the Indonesian currency on an interim basis, by circulating sufficient money to the Republic of Indonesia, for as long as money in circulation is sufficient and allowed by the law;
2. The down payment outlined in Article 1 must not exceed 30% of the state income in the preceding yearly budget, at the time the government asks the bank for money;
3. The limit of said down payment as stated in Article 2 can only be exceeded with the approval of the People's Representative Council (DPR); and
4. The entire downpayment of Rp. 50.000.000 bears no interest, and in the public's interest, the bank can perform other jobs stated in this article.[44]

Art. 34 paragraph 5 of the Law on Central Bank states that from the profit that the bank has legitimised and has been set aside in the special reserve, the remaining funds of up to 20% are transferred to backup funds until the amount is equal to the capital of the bank. The remaining funds become part of the state treasury.

[42] Law No. 11, 1953, Arts. 21-23 and 34.
[43] Law No. 11, 1953, Art. 18.
[44] Law No. 11, 1953, Art.19:

In practice, BI's relationship with the government burdens BI and hinders its achievement of monetary stability. The duties of administering credit affairs accompany BI's responsibilities as a regulator and custodian of financial stability, supervising sound banking affairs, and as a development agent. BI even carries out development agent functions by providing credit directly to state-owned enterprises and foundations, primarily funded by the government and private companies, so only a small amount is allocated to financial and credit institutions. Apart from that, BI also provides credit for new businesses within the framework of the government's "Industrialisation Urgency Program," in the form of: (i) facilitating agricultural credit that supports increased food production and food self-sufficiency; (ii) helping small-scale businesses, ongoing and long-running businesses to increase productivity; and (iii) supporting efforts to increase foreign exchange earnings through exports, especially in the plantation sector.

In the 1960s, BI's function as a development agent was carried out as support for government projects, especially mandatory projects of a developmental and non-development nature, assisting indigenous businesses and state-owned enterprises, and increasing the capacity of government banks through liquidity credit. In 1966, Cabinet Presidium Instruction No. 15/EK/IN/10/66 concerning Policy Guidelines in the Credit Sector, which limits credit expansion and increases credit interest rates, ended up siphoning the money supply. To maintain economic stability, the President issued Presidential Instruction No. 39 of 1967, which stipulates credit classification based on development priorities, namely providing credit to BULOG, production of nine essential commodities, including agricultural production, export materials, and the crafts industry. Apart from that, during that period, the government carried out *sanering* (apportioning money) without the knowledge of the governor of BI.[45] In subsequent developments, the position of the Governor of BI was held by the Minister for Central Bank Affairs.[46] This happened because at that time, the concept of a single bank was the responsibility of the Ministry of Central Bank Affairs. Conditions during the enactment of Law No. 11 of 1953 reflect BI as a government tool.[47]

Along with changes in leadership in Indonesia came the enactment of Law No. 13 of 1968 concerning Central Banks. This law codifies the level of BI's independence. Institutionally, BI is regulated as the president's assistant in implementing monetary policy, whereas the Monetary Board determines the

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[45] Emergency Law (*UU Darurat*) No. 19 of 1950 concerning Regulations on Providing Pensions and *Onderstands* to Members of the Army., (Indonesia).

[46] M. Dawam Rahardjo, *Bank Indonesia dalam Kilasan Sejarah Bangsa,* Pustaka, LP3ES, 1995, 21.

[47] *Ibid.*

policy itself. The Monetary Board consists of the BI governor, the Minister of Finance, and the Minister of Trade. As the central bank, BI has tasks that include internal and external stability of the Rupiah to encourage smooth production and development, including monitoring the banking system. BI can provide loans to the government in amounts approved by the DPR. These loans are subject to an interest rate of 3% a year or at a rate to be determined by the monetary council. When the law was in force, part from acting as government cashier, the law BI played a role as (i) a development agent, (ii) a mobiliser for public funds, (iii) a supporter for development policies, (iv) a partner for encouraging the development of small businesses, and (v) a provider of special credit.

When there was an economic downturn due to a lack of available funds in the market, the government carried out financial deregulation by issuing the 1983 *Pakjun*, 1988 *Pakto*, and 1989 *Pakmar* policies, which increased the number of banks. Apart from that, in 1983, the Governor of BI entered the ranks of the government cabinet and was equal to a Minister. The President, therefore, controlled the policies that BI had to take. This made things difficult for BI when it submitted a request to revoke the business licenses of several problematic banks. The President rejected the requests for political reasons and to maintain the charade of public legitimacy. Institutionally, BI was very dependent on the government. This position created problems because BI found it difficult to realise its targets, which caused an increase in inflation. For example, from 1970 to 1984, the average annual inflation rate was 18 per cent. In fact, in 1972 and 1973, the inflation rates were 25.80, 30.63, and 40.03 per cent, respectively.

During this period using independence assessment indicators, BI was not independent politically because: (i) the appointment of governors and directors by the president was based on the recommendations of the monetary council and could be dismissed by the president during his term in office; (ii) directors were answerable to the government; and (iii) government commissioners supervised BI management and could attend board of directors' meetings.[48] Meanwhile, based on economic indicators, BI cannot be categorised as independent either because: (i) BI had multiple objectives in the form of (a) regulating, maintaining, and safeguarding the stability of the Rupiah's value, as well as (b) encouraging smooth production and development as well as expanding employment opportunities to improve people's living standards; (ii) the government set monetary policy; (iii) BI could provide credit to the government; and (iv) BI's annual budget was approved by the government.[49]

[48] Law on the Central Bank, No. 13, 1968 (Indonesia).
[49] Law No. 13, 1968.

After the monetary crisis in 1997/1998, with the collapse in the banking sector and the government needing international assistance, BI institutions were strengthened through the following policies: (1) BI's independence was demanded by the IMF as stated in the Letter of Intent II of January 15 1998, in point 22, where the Government promised that BI would be given autonomy in formulating and implementing monetary policy; (2) Presidential Decree No. 23 of 1998 that BI would determine and implement monetary policy; (3) People's Consultative Assembly (MPR) Decree No. XVI/MPR/1998 strengthened BI's independence; (4) the government formed a committee to draft an independent BI Law through Presidential Instruction No. 14 of 1998.

The transformation of BI's position was carried out during the BJ Habibie administration, where the Governor of BI was no longer included in the governmental cabinet. As an amendment to the 1945 Constitution, a new norm was created, which included BI's independence, namely Article 23D of the 1945 Constitution, which stipulates that the state has a central bank, the composition, position, authority, responsibilities, and independence of which are regulated by law. The research by University of Indonesia's Constitutional Law Legal Clinic (PSHTN UI) found that incorporating the central bank into a state's constitution has a specific meaning. Some countries (Germany, Sweden, and Finland) have found that inclusion in the constitution firms up the central bank's independence. In contrast, some countries such as Azerbaijan, Bosnia-Herzegovina, and the Czech Republic have significantly recovered, maintaining inflation rates and economic stability. Research conducted by Lipjhart and John Elster shows that incorporating the central bank into the constitution gives the bank legal authority to refuse political intervention.[50] To embody this, Law No. 23 of 1999 on Bank Indonesia was promulgated in an atmosphere of central bank independence that resonated globally worldwide. This law states explicitly, "Structurally, the position of Bank Indonesia does not fall under the auspices of the government but shares an equal position".[51] It is suspected that the lack of independence of the central bank is one of the factors strengthening the economic crisis in Asia and Latin America. Therefore, the independence provided in this law is very strong. BI is stipulated as an independent institution aiming to achieve and maintain stability in the rupiah's value. For this reason, BI implements monetary policy sustainably, consistently, and transparently and must consider the government's general policy in the economic sector. In this case, setting monetary targets must take into account the inflation rate set by the government. In the payment system, BI has full

[50] Ismail, *Bank Indonesia,* 198-196.

[51] Ayu Deviana, "Legal Protection of Bank Indonesia Financial Independence," *Journal of Central Banking Law and Institutions* 3, no. 2 (2024): 346.

authority to regulate and maintain the smooth running of the payment system. The government sets the targeted rate of inflation after coordinating with BI. BI is the only institution with the authority to issue and circulate currency and revoke, withdraw from circulation, and destroy currency. As a manifestation of BI's independence, the monetary council was abolished, and BI no longer plays a role as a development agent.

Independence is reinforced by the autonomy of the BI governor and members of the board of governors which is manifested in that governors: (i) cannot be dismissed during their terms of office unless they resign, are proven to have committed a crime, or are permanently absent; (ii) cannot be punished because of decisions taken as long as they are within the scope of their duties and authority; (iii) are free from outside influence because government representatives who attend the governor's meeting only have the right to speak, not the right to vote; and (iv) authorise the governor to make a final decision if a consensus is not reached at the meeting. However, the appointment of the governor and members of the board of governors must obtain approval from the DPR, so the position of BI leader still has a very political nuance because it was born from a political process that sometimes puts aside the values of professionalism and prioritises specific political interests.

As an example of the institution's economic independence, BI is prohibited from providing credit to the Government. Besides, BI no longer issues credit under the Indonesian Standard Industrial Classification (Klasifikasi Baku Lapangan Usaha Indonesia or KLBI). Banking credit is only extended by BI on a limited basis for lending within the framework of a last-resort lender, subject to strict requirements. The BI Governor also has the authority to determine BI's annual budget.

BI's independence was considered too strong during its development, with critics claiming that "[t]he actual independence of Bank Indonesia (in the Law No. 23 of 1999) is higher than legal independence in the meantime", [52] and it was deemed necessary to limit it. These restrictions were put into effect by Law No. 3 of 2004 on Amendment to Law No. 23 of 1999 on the Bank Indonesia. The changes made included: (i) BI's independence was only limited to "carrying out its duties and authority;" (ii) procedures for BI to achieve and maintain stability in the value of the Rupiah, namely by implementing monetary policies in a sustainable, consistent, and transparent manner by considering the government's general policy for the economic sector; (iii) the inflation rate targets are set by the government after coordinating with BI; (iv) providing emergency financing facilities, the funds for which are borne by the

[52] Muhamad Iksan and Tetsu Konishi, "Central Banking Independence and Policy Outcomes: A Trans-Boundary Comparison," *Journal of Central Banking Law and Institutions* 1, no. 3, (2022): 501.

government treasury (APBN); (v) there were alterations to the requirements and nomination procedures for members of the board of governors, the mechanism for nominating them, prohibitions on them, and their dismissal. Added to the requirements are integrity, morals, and high morals. As for the mechanism for appointment, deputies are assigned by the president on the recommendation of the governor; (vi) the DPR shall assess the performance of BI's duties and authority; (vii) BI must convey information to the public openly through the media regarding evaluations of the implementation of monetary policy in the previous year and monetary policy plans for the coming year. This information must also be conveyed to the president and the DPR; (viii) the budget shall be divided into the operational budget and the budget for monetary policy and other BI authority tasks. The DPR must first approve the operating budget, while the monetary policy budget only needs to be reported to the DPR; and (ix) a supervisory body was formed to supervise, increasing BI's accountability, independence, transparency, and credibility – not BI's performance.

Both Law No. 23 of 1999 and the amendments thereto, BI continues to play the role of government cash repository. In this case, BI certifies all accounts owned by the government. Besides that, BI also accepts foreign loans for and on behalf of the government and administers and settles the government's financial obligations to foreign parties.

Even though BI has the independence to achieve stable economic conditions, the synergy between BI and the Government is needed, including, among other things: (a) the government's obligation request BI's opinion and/or invite its representative to cabinet meetings to discuss related economic, banking, and financial issues, within BI's objectives or other issues that fall within BI's authority; (b) BI's obligation to provide opinions and considerations to the government regarding the Draft State Revenue and Expenditure Budget (RAPBN) and other policies related to BI's duties and authority; (c) the government's obligation to first consult with BI before issuing government backed bonds (Law No. 24 of 2002 on SUN); (d) The government can place its representatives with the right to speak without voting rights at meetings of the board of governors; (e) The government receives a share of the BI surplus; and (f) The government must cover BI's minimum capital shortfalls.

Several laws that affect BI's independence have been issued recently, namely Law No. 7 of 2011 concerning Currency and Government Regulation in Lieu of Law (Perppu) No. 1 of 2020 on Financial System Stability.

## IV. REGULATION OF BI'S AUTHORITY UNDER THE LAW ON P2SK

As a result of the decrease in the growth of the national economy due to the spread and expansion of the COVID-19 pandemic, the government issued regulations to strengthen financial authorities and related financial sector institutions, namely Law No. 4 of 2023 on Development and Strengthening of the Financial Sector (Law on P2SK). In general, the Law on P2SK regulates the following subjects.

1. Additional BI objectives. The law on P2SK, Chapter 5, Art. 9 amended Art. 7 on the Law on BI, clarifying that BI is responsible for stabilising the value of the Rupiah, maintaining the stability and reliability of payment systems, and contributing to a stable financial system in support of sustaining economic growth.
2. Mandates in furtherance of additional objectives. The Law on P2SK, Chapter 5, Art. 8(c) amended Art. 8, for managing and executing macro prudential policies.[53]
3. Limitations on BI independence through exceptions under the Law on P2SK. BI is a state body that is independent in performing its tasks and authorities, free from intervention by the government and/or other factions, except as strictly stated in this law.[54]
4. Elimination of the prohibition on BI purchasing government bonds. The law on P2SK allowed BI to purchase bonds on the open market on its behalf, except for short-term government bonds that BI needs for monetary policy.[55]

In several cases, BI's authority requires coordination with the Government, namely in terms of: (i) determining interest rates; (ii) executing other monetary policies; (iii) implementing policies for money market and foreign exchange market transactions (iv) taking actions related to currency, in the form of determining the Rupiah denomination, using of images of heroes/presidents, allocating raw materials, planning, printing, and culling, digital rupiah planning, and the destruction of withdrawn rupiah; and (v) purchasing of government bonds; and (vi) providing liquidity loans.

Regarding currency, which is still under BI's authority after the Currency Law and its amendments, includes: (a) determining the characteristics, design, and criteria for raw materials for currency printing; (b) determining the number of banknote series; (c) planning and determining the amount of money printed; (d) providing ~~of~~ the amount of Rupiah in circulation; (e) issuing digital rupiah;

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[53] Law on P2SK, Chapter 5, Art. 8(c).
[54] Law on P2SK, Chapter 5, Art. 4 paragraph 2.
[55] Law on P2SK, Chapter 5, Art. 4 paragraph 2.

(f) determining the validity period of the Rupiah; (g) developing procedures for circulating Rupiah; and (h) setting the criteria for reimbursement of revoked and withdrawn money.

BI's duties and authority concerning the handling and preventing financial sector crises under Law on P2SK includes the Law on P2SK, Chapter 5, Art. 4 paragraph 2 and Art. 276, which amended the Law on Prevention and Handling of the Financial Crises System (Law on PPKSK), specifically Art. 20 paragraph 1 and Art. 36A providing the authority to:[56]

1. Grant short-term liquidity loans or short-term liquidity financing based on Sharia principles to Systemic Banks or banks other than Systemic Banks;
2. Grant Special Liquidity Loans to Systemic Banks that experience liquidity difficulties and fail to meet the requirements for providing short-term liquidity loans or short-term liquidity financing based on Sharia principles guaranteed by the Government and based on the KSSK Decree;
3. Purchase long-term Government Debt Securities (bonds) and/or Government Sharia Securities on the primary market to address financial system problems that threaten the national economy, including Government Debt Securities and/or Government Sharia Securities issued for specific purposes, especially in the context of the 2019 Coronavirus (COVID-19) pandemic;
4. Purchase/*repo* (repurchase) state securities owned by the Deposit Insurance Corporation for handling solvency problems of Systemic and non-Systemic Banks;
5. Regulate the obligations for receiving and using foreign exchange for individuals, including provisions for the transfer, repatriation, and conversion of foreign exchange to maintain macroeconomic and financial system stability;
6. Provide corporations/private sector enterprises access to funding by *repoing* (through repurchase agreements) Government Debt Securities (bonds) or State Sharia Securities owned by corporations/private sector enterprises through banking transactions; and
7. Purchase long-term government debt securities and/or government Sharia securities on the primary market, intended as a government funding source. Funding sources for the government are used in the context of national economic recovery, including maintaining the continuity of state financial management, providing loans and additional capital to the Deposit Insurance Corporation, and funding for bank restructuring during times of crisis. Further provisions regarding the scheme and mechanism

[56] Law on P2SK, Chapter 5, Art. 4 paragraph 2. Art. 276.

for purchasing Government Debt Securities and/or Government Sharia Securities on the primary market are regulated jointly by the Minister of Finance and the Governor of BI by considering (a) market conditions for Government Debt Securities and/or Government Sharia Securities, (b) influence on inflation, and the type of Government Debt Securities and/or Government Sharia Securities.

## V. IMPLICATIONS OF REGULATING BI'S AUTHORITY UNDER THE LAW ON P2SK ON BI'S INDEPENDENCE AND ACHIEVING BI'S OBJECTIVES

The Law on P2SK describes changes to BI institutions in terms of objectives, duties, authority, and the relationship model between BI and the government. There has been a change in the relationship model between the government and BI, limiting BI's independence in carrying out its duties and authority to achieve its objectives as fully outlined in the Law. There are additional new norms which, from BI's perspective, affect the implementation of BI's policies and impose a burden on executing policy and managing finances and risks. Meanwhile, from the government's perspective, adding these new norms is a solution to several alternatives with the highest possibility of implementation and the lowest risk of disrupting the stability of the state budget.

The Law increased the coordination between BI and the government. From the government's perspective, the addition of coordination is intended to maintain the financial sector's stability while at the same time ensuring the achievement of monetary and fiscal policy targets and objectives. Fiscal policy success requires achieving monetary policy objectives because the financial sector supports economic growth. If economic growth is sustained, it immediately impacts the stability of the state budget and increases the chance of success in achieving state goals. If implementing the new norms is successful, then this is the choice of action with the least risk.

From BI's perspective, such conditions reduce BI's ability to function, requiring BI to have increased responsibilities (transfers of commitments from the state/government to BI), which, if not carried out carefully, could impede the achievement of BI's goals. In this case, BI should be free to implement these norms either as a whole or in part by basing the assessment on the success of achieving monetary policy targets and BI's financial risk burden (a win-win solution).

It would be best to suggest that these new arrangements are only subject to certain conditions, which are not always applicable. If economic conditions have improved and the state's fiscal condition is safe, then BI's independence should be restored to its pre-COVID state. Thus, in the long term, optimising the implementation of BI's duties and authority would further strengthen the stability of the value of the Rupiah, which would positively impact economic growth and fiscal sustainability.

Regarding international practices and the opinions of several experts, independence can be assessed through multiple aspects, namely institutional, organisational, political, and financial, each of which has multiple levels. Institutionally, BI remains a state institution whose independence is enshrined in the constitution (except as currently limited) and, as a legal entity, has its limited independence. This limitation is framed by "free interference, except for matters regulated in this law." These statutory exceptions are manifested in the pattern of coordinative relationships. Organisationally, BI still has the authority to regulate its internal affairs, including matters relating to employees, the code of ethics, and confidentiality. Politically, the current situation should be evaluated by popular sovereignty, control, accountability, and transparency which are reflected in several ways by political influence, namely in terms of the appointment of the BI Governor and BI board members being determined by political institutions, which, of course, makes BI subject to external influences.

Regarding budget oversight, the DPR's approval of the operational budget could reduce the budget and be inconsistent with BI's status as an independent legal entity. What must be taken into account is that the budget for implementing BI's duties and authority must also be considered in evaluating the implementation of BI's monetary policy to realise the optimal implementation of BI policy. The language of the P2SK Law implies the inclusion of political interests. Politics here should be by and for the people. Meanwhile, BI has limited financial independence because of the need for DPR approval for the operational budget, except that BI is given the authority to manage its assets (e.g., investments, write-offs, and collections).

The change in the legal relationship between BI and the government, which often tends to be government-leaning, raises concerns that there could be pressure from the government so that BI prioritises the government's interests. This is reflected in the addition of regulations whereby BI can purchase long-term government bonds on the primary market to handle financial system problems that endanger the national economy, including crisis conditions that impact decreasing financial sector performance or financial system crises. This rule is a change from the status quo, with a longstanding prohibition on open market operations under Law No. 23 of 1999. These regulatory changes mean transferring government responsibility to BI, which burdens BI's finances more. On the other hand, significant policy changes seem to be quick and easy solutions without considering the long-term consequences. If BI's finances decline to the point of reducing BI's minimum capital, the government is responsible for covering the capital shortfall to maintain the sustainability of the central bank. This would be a fiscal risk for the state, disrupting national budgetary sustainability. Therefore, applying the rules for purchasing long-term government bonds on the primary market requires further regulations that would significantly narrow the definition of the crisis conditions.

From a macro perspective, this additional authority would weaken BI. BI is the entity that bears the burden of duties and authority on behalf of other institutions (including the government). This responsibility goes beyond the duties that BI had previously borne. This arrangement will weaken the responsibility of other relevant authorities in the financial sector for their duties and responsibilities to maintain financial sector stability. A tiered accountability mechanism should be built, where the Financial Services Authority bears the primary responsibility. At the next level, the responsibility would be borne by the Deposit Insurance Agency and then by the government, which, in this case, would do so through BI purchasing state-issued bonds. Each authority must optimally lighten the burden on the state (BI) to maintain BI continuity and fiscal sustainability. This is very important to understand because BI sustainability is a must for creating monetary stability. Economic stability is impossible without monetary stability, as a lack thereof could lead to national instability and disrupt fiscal sustainability.

For this reason, there needs to be a mutual understanding and awareness of the final goal that we want and must achieve together, namely, achieving the state's overall goal, the welfare of the Indonesian society. What must be prioritised is the interests of the people. Therefore, though bearing their respective responsibilities, achieving BI's objectives is the main priority and becomes the basis for determining policies for carrying out BI's duties and authority.

Achieving the BI's objectives is the essence and purpose of forming a central bank. As a norm, BI aims to become a legal umbrella for all parties. Further research to explain norms regarding BI's duties and authority must refer to BI's objectives. To achieve this final goal, BI needs to set intermediate goals. These intermediate goals are flexible in accordance with conditions (needs and abilities) that do not deviate from the corridor for achieving the final goal. Suppose the government's interests are intended to advance the Indonesian economy and society (from a macro perspective) and not diminish the achievement of monetary policy objectives. In that case, the government's interests must be prioritised. Flexibility only results in delaying the time needed to achieve the final goal. Sharing the view that fiscal and monetary policies must work side by side has become a primary need. If there is domination, it will undoubtedly weaken the achievement of the objectives of one of the policies, namely, being dominated.

## VI. CONCLUDING REMARKS

Based on the analysis presented above, the following conclusions can be drawn. First, the government itself is tasked with implementing governance. Likewise, BI carries out governance according to its field of duties. BI's success in carrying out its duties is also the government's success because achieving BI's goals has a positive impact and is one of the determinants of the success of the government's fiscal policy. Second, the existence of the phrase "except for certain matters which are expressly regulated by this law" has changed the relationship between BI and the Government in some cases to become coordinative and no longer under the independence of BI. Besides, BI has limited independence regarding institutional, organisational, political, and financial parameters.

The degradation of BI's independence could hamper the achievement of BI's goals due to excessive burdens. Obstacles in achieving BI's goals affect the success of attaining national fiscal and economic policy goals. BI's responsibility is to purchase long-term government bonds on the primary market to handle financial system problems that put the national economy at risk, including crisis conditions that have an impact on decreasing financial sector performance and economic system crises that have the potential to weaken BI's finances. This responsibility goes beyond the duties that BI must bear. This arrangement would also undermine the responsibility of other relevant authorities in the financial sector for their duties and responsibilities to maintain financial sector stability. Excessive burdens that BI must bear also have the potential to create fiscal risks that the state would bear because if these burdens result in a shortage of BI capital, the Government is obliged to cover a shortfall (a fiscal "cliff").

Economic stability and fiscal sustainability can only be achieved if there is synergy between monetary and fiscal policies. The government plays the primary role in ensuring this synergy. For this reason, it is necessary to realise together that the boundaries of independence and coordination between the monetary and fiscal authorities must be established with the mandate only to achieve state goals and no other specific interests. BI must safeguard its independence so that only the people's interests are the basis and primary objective of every monetary policy. BI must be able to become an institution that only makes the people's interests its main goal - BI must be free from outside interests. The impact of a new law cannot be seen within months. It takes years, which is why further empirical research is required. To safeguard the people's interests, further research must be conducted to unravel the stage of BI's independence and the relationship between the Government and BI.

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