Chapter 5
Policy Transformation in the Indonesian Central Bank

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ABSTRACT

The achievement of Bank Indonesia's vision, namely, to become the leading digital central bank that makes a real contribution to the national economy and is the best among emerging market countries for advanced Indonesia, is supported by the implementation of Bank Indonesia's comprehensive transformation. The transformation carried out is Bank Indonesia's response to facing various future challenges that could affect the achievement of its vision and mission. Bank Indonesia's policy transformation was carried out through strengthening the policy mix in order to carry out the mandate of the Law to maintain the stability of the value of the Rupiah (inflation and exchange rate), contributing to maintaining financial system stability, as well as encouraging sustainable economic growth, as well as strengthening each area of monetary policy, macroprudential, payment systems and policy support. Institutional transformation is carried out to improve superior performance based on effective, efficient and governance (2EG) performance so that Bank Indonesia's mandate can be carried out credibly.

1. HISTORY OF CENTRAL BANK IN INDONESIA

The Bank of Indonesia which is the central bank in Indonesia, plays a pivotal role in maintaining financial stability, fostering economic growth and implementing sound monetary policies. Over the years, the bank has undergone several transformative changes to adapt to dynamic economic landscapes and emerging challenges. The history of the Bank of Indonesia is closely intertwined with Indonesia's struggle for independence and its subsequent economic development. Here is a brief overview the history of Bank of Indonesia (Warjiyo & Juhro, 2019):

Ducth Colonial Period. Prior to Indonesia's independence, the Dutch East Indies (now Indonesia) was under Dutch colonial rule. The colonial administration established "De Javasche Bank" in 1828, which served as a central bank and commercial bank.

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Japanese Occupation. During world war II, Japan occupied Indonesia and De Javasche Bank was dissolved. The Japanese administration introduced a new currency system and established the "Dai Nippon Syu Kin" as the central bank.

Post-Independence Period. After the Indonesia declared its independence in 1945, the country had to build its own financial institutions. In 1951, there was strong pressure to establish a central bank as a form of the economic sovereignty of the Republic of Indonesia. Therefore, the Government decided to form a De Javasche Bank Nationalization Committee. The nationalization process was carried out through the purchase of De Javasche Bank shares by the Indonesian Government, with an amount reaching 97%. The Indonesian government on July 1 1953 issued Law No.11 of 1953 concerning the Principles of Bank Indonesia, which replaced DJB Wet of 1922. Since July 1, 1953 Bank Indonesia was officially established as the Central Bank of the Republic of Indonesia.

Bank Indonesia (BI)'s task is not only as a circulation bank, but also as a commercial bank through providing credit. At this time, there was a Monetary Council (DM) which was tasked with determining monetary policy. The monetary council is chaired by the Minister of Finance with members being the Governor of BI and the Minister of Trade. Furthermore, BI is tasked with implementing monetary policy that has been determined by the Monetary Board.

Period of Political and Economic Challenges. In 1968, the Indonesian Government issued Law no. 13 of 1968 concerning Bank Indonesia. This law restores BI's duties as the Central Bank of the Republic of Indonesia. One of the articles in this law also stipulates that Bank Indonesia no longer has the function of distributing commercial credit, but acts as a development agent and holder of state treasury.

Financial Reforms. The monetary crisis that occurred in Asia prompted BI to take policy steps to overcome the crisis, such as implementing a floating exchange rate policy for the exchange rate, closing problematic banks, and restructuring unhealthy banks. During this reform period, Law No. 23 of 1999 concerning Bank Indonesia was issued, Bank Indonesia was designated as an independent Central Bank.

This law sets out the sole objective of Bank Indonesia, namely achieving and maintaining stability in the value of the Rupiah, and eliminates the aim of being a development agent. Since this period, Bank Indonesia has implemented a monetary policy regime with an inflation targeting framework. In the ITF framework, Bank Indonesia's credibility is assessed by its ability to achieve the inflation target set by the Government.

In 2004, the House of Representatives passed Law No.3 of 2004 concerning Amendments to Law No.23 of 1999 concerning Bank Indonesia. This law contains confirmation of the independent position of the central bank, improving the regulation of duties and authorities, and structuring BI's supervisory function.

Then in 2009, the House of Representatives passed Law No. 6 of 2009 concerning the Stipulation of Government Regulations in Lieu of Law No. 2 of 2008 concerning the Second Amendment to Law No. 23/1999 concerning Bank Indonesia into Law. This law clarifies and emphasizes BI's role in its function as lender of last resort.

The Establishment of Financial Service Authority. In 2011, the House of Representatives passed Law No. 21 of 2011 concerning the Financial Services Authority (OJK) which transferred the function of banking regulation and supervision from Bank Indonesia to the OJK. This law divides the scope of microprudential regulation and supervision of financial institutions under the authority of the OJK, while macroprudential regulation and supervision is the responsibility of BI with the aim of financial system stability. The transfer of bank supervision from Bank Indonesia to OJK was officially carried out on January 1 2014.

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