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Economic Globalization and Systemic Risks to Indonesian Banking Stability

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Abstract

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Economic globalization has significantly increased international market integration through trade, investment, and cross-border capital flows. This phenomenon has facilitated the entry of Multinational Corporations (MNCs) into developing countries such as Indonesia, strengthening capital inflows and technology transfer. However, it also presents challenges, including inequality and intense competition with domestic firms. The Indonesian banking sector, as the backbone of financial intermediation, exhibits notable vulnerability to external shocks, particularly during the COVID-19 pandemic, which amplified credit risks and pressured profitability. Systemic banking risk demonstrates a two-way relationship with macroeconomic conditions: economic downturns increase the potential for non-performing loans, while banking instability can further weaken the economy through credit freezes and asset price declines. The role of foreign investors is ambivalent; they enhance stability by providing capital and expertise, yet pose a significant risk of sudden capital outflows. This study employs a literature review method to examine globalization dynamics, the role of MNCs, systemic risk, and foreign investors in safeguarding the resilience of Indonesian banking.

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1. Introduction

Economic globalization is one of the most influential phenomena in the modern international financial landscape. The deepening integration of markets allows the flow of trade, investment, and capital to move more quickly across countries, creating growth opportunities for the world economy while increasing the vulnerability of developing nations to unpredictable global dynamics (Guedhami et al., 2022). Indonesia, as one of the largest economies in Southeast Asia, cannot detach itself from the significant complexity caused by this globalization process. The presence of Multinational Corporations (MNCs) expands industrial capacity through technology transfer, managerial skill shifts, and capital injection into the domestic system. However, on the other hand, the penetration of MNCs also increases the intensity of inter-firm competition and strengthens dependence on foreign capital, which has implications for national economic sovereignty (Fernandez & Joseph, 2020).

In the context of banking, globalization presents challenges that are far more complex than those in the real sector. Indonesian banking now functions not only as a provider of domestic credit but also as a primary channel for integration with the global financial system. This condition makes the stability of domestic banking highly vulnerable to external changes. International shocks such as the 2008 global financial crisis and the COVID-19 pandemic are clear evidence of how international capital flows can rapidly affect the stability of the national banking sector. Empirical studies confirm that systemic risk in banking has a close reciprocal relationship with macroeconomic conditions. Economic weakening generally increases the non-performing loan (NPL) ratio, while instability in the banking sector can worsen economic weakening through liquidity restrictions, credit freezing, and a decline in public trust in the financial system (Wang et al., 2021).

Additionally, the phenomenon of financial distress is an increasingly relevant issue to be examined within the framework of banking stability. Profitability pressures arising from the pandemic, the acceleration of digitalization, and global geopolitical uncertainty have led to an increased risk of distress not only in the non-financial corporate sector but also in banking institutions. Some recent studies emphasize that financial distress often serves as an early indicator of potential banking crises. This is especially true in developing countries where the financial market structure is still fragile, with high dependence on the banking sector as the primary source of financing (Valerio Roncagliolo & Villamonte Blas, 2022).

The role of foreign investors in Indonesia's financial sector is also dual. On one hand, foreign direct and portfolio investments can strengthen domestic liquidity, encourage the adoption of modern governance practices, improve bank efficiency, and support credit expansion to the productive sector. However, on the other hand, an excessive reliance on foreign capital flows can lead to serious vulnerabilities when a sudden capital outflow occurs. This condition is often triggered by changes in global monetary policy, such as interest rate hikes in developed countries, or by geopolitical instability that creates investor uncertainty (Devereux & Yu, 2020). The "sudden stop" phenomenon that has affected various emerging markets serves as an important warning that the presence of foreign capital is not always synonymous with long-term stability.

Given these dynamics, it is important to examine more deeply how economic globalization, the presence of MNCs, banking systemic risk, financial distress, and the role of foreign investors interact within the Indonesian context. This article uses a literature review approach to examine the results of recent research, with a focal point on their implications for the stability of the national banking sector. Through this literature analysis, this study attempts to answer the main question of to what extent globalization and financial integration are able to strengthen the resilience of Indonesian banking, or, conversely, weaken it by increasing external vulnerabilities.

2. Literature Review

2.1. Economic Globalization, MNCs, and Banking

Globalization has paved the way for the widespread entry of multinational corporations into various countries, including Indonesia. These companies bring advantages in the form of large capital, more advanced technology, and modern governance practices that are often considered more efficient than local standards. In the Indonesian context, the rapid increase in Foreign Direct Investment (FDI) over the last two decades has made a significant contribution to the development of the banking industry's capacity. The presence of this FDI not only strengthens bank capital but also expands the ability of financial institutions to provide a more diverse range of financial products and services. However, it should be noted that the increase in FDI also increases the banking sector's dependence on external conditions, making domestic stability more vulnerable to global dynamics (Fernandez & Joseph, 2020).

Academic literature also shows that the presence of multinational corporations often widens the gap between domestic and foreign companies. Foreign banks with the support of international networks are often better able to attract large corporate clients and international investors. This situation creates pressure on domestic banks to increase efficiency, improve risk management, and adopt digital innovation in financing services. This increasingly tight competition forces national banks to adapt more quickly to avoid losing market share. Thus, globalization brings opportunities in the form of modernization and efficiency, but at the same time presents structural challenges for domestic banking (Iqbal et al., 2023).

2.2. Systemic Risk, Financial Distress, and Foreign Investors

Systemic risk in the banking sector is closely linked to the dynamics of periodic macroeconomic cycles. A study by Wang et al. (2021) shows that fluctuations in macroeconomic conditions, whether in the form of economic growth slowdown, rising inflation, or exchange rate volatility, can directly affect banking stability. This impact is reflected in the increase in non-performing loans (NPLs) and rising uncertainty in the financial market. When credit quality declines, banks will face liquidity pressures, a decrease in profitability, and even the potential for a decline in trust from depositors. In addition to macro factors, financial distress in the non-financial corporate sector has also been shown to be an additional trigger for banking risk.

Companies that are unable to meet their financial obligations have the potential to add to the NPL burden that banks must bear. As explained by Widowati et al. (2021), the failure of a company to pay is directly related to the vulnerability of the bank that is its creditor. Therefore, the symbiotic relationship between the corporate and banking sectors requires stricter supervision of the financial health of both parties. The role of foreign investors also adds another dimension to stability. Their presence can strengthen the financial system through additional capital, diversification, and the implementation of more advanced governance standards. However, the risk of a sudden capital outflow remains a significant threat. Devereux & Yu (2020) affirm that global financial integration actually increases the volatility of capital flows, especially in emerging markets like Indonesia, which are vulnerable to external shocks.

3. Methods

This study uses the literature review method as the primary approach to analyzing the issues raised. This method was chosen because it can provide a more comprehensive understanding through the examination of academic articles, scientific journals, reference books, and research reports relevant to the issues of economic globalization, the existence of multinational corporations (MNCs), systemic risk in banking, the phenomenon of financial distress, and the strategic role of foreign investors in the context of the Indonesian economy. Thus, the study does not rely on a single type of source but integrates various academic perspectives to obtain a more complete picture.

The literature used is primarily focused on scientific publications after 2020. This focus is aimed at ensuring that the data, arguments, and findings analyzed remain relevant to current global dynamics, including developments after the COVID-19 pandemic, which had a significant impact on the financial sector. Nevertheless, some classic studies published before this period were still included because they have strong relevance in providing a conceptual and historical foundation, as well as enriching the academic discussion being built. By combining contemporary and classic literature, this study aims to produce an analysis that is both comprehensive and contextual.

The literature review method allows the researcher to identify patterns, causal relationships, and trends that have emerged in previous studies. This approach also helps to find research gaps that are still open, especially in explaining the link between economic globalization and the stability of the banking sector in developing countries like Indonesia. The analysis is not conducted quantitatively but uses a qualitative approach with an emphasis on in-depth interpretation. Each finding from the literature is compared and linked to find consistent common threads, as well as to identify areas of inconsistency that open up opportunities for further study. All data analyzed in this study are secondary, so the validity of the information is highly dependent on the credibility of the sources used. Therefore, the study only refers to internationally and nationally reputed journals, articles that have gone through a peer-reviewed process, and officially recognized academic reports. With this strategy, the study seeks to maintain the accuracy of the analysis and produce a scientifically accountable contribution.

4. Results

Economic globalization has brought a very significant transformation to Indonesia's financial and banking structure. The deepening integration with the international financial system not only strengthens Indonesia's position as part of the global supply chain but also places the national banking sector in a strategic yet vulnerable position. On one hand, global connectivity provides access to foreign capital, the latest financial technology, and more modern governance standards. On the other hand, more intensive integration actually increases the Indonesian economy's dependence on external dynamics that are often difficult to predict. The literature results affirm that globalization has an ambivalent impact: strengthening the capacity for growth and modernization of the financial system, but at the same time increasing the systemic risk inherent in the domestic banking sector. Thus, globalization is like a double-edged sword that must be faced with a mature strategy of adaptation and regulation.

The role of multinational corporations (MNCs) in the globalization process is very prominent. In Indonesia, MNCs not only function as international business actors but also as a dominant contributor to Foreign Direct Investment (FDI). This FDI flow encourages the growth of various strategic sectors, including banking, which is the backbone of financing economic activities. The presence of MNCs ultimately requires a domestic financial system that is more efficient, transparent, and capable of providing large-scale financing. These demands force domestic banks to transform, among other things, by increasing competitiveness through digital innovation, implementing stricter corporate governance principles, and operational efficiency oriented towards international practices (Fernandez & Joseph, 2020). In other words, the penetration of MNCs acts as a catalyst for the modernization of the Indonesian banking system.

However, another consequence that arises is the increasingly tight competition between domestic and foreign companies. The presence of MNCs with large capital strength and global networks creates pressure on domestic corporations, including access to funding sources. This situation creates a serious challenge for domestic banks to be able to provide credit services with a healthy level of competition. As a result, national banks must not only strengthen liquidity and efficiency but also innovate in financial products to attract large corporate clients and the general public. The competition that arises from MNC penetration is what then increases the banking sector's risk exposure to market fluctuations and increases the allocation of resources for risk management and hedging as a key strategy for MNCs in dealing with exchange rate volatility and other financial risks (Mawardi, 2023).

Systemic risk is one of the main issues often found in the literature on financial stability. The two-way relationship between systemic risk and macroeconomic conditions has proven to be very significant in the Indonesian context. When the economy weakens, such as during the COVID-19 pandemic, the banking sector experiences great pressure in various forms, ranging from an increase in non-performing loans (NPLs), a decrease in credit demand from the real sector, to a weakening of liquidity that affects the intermediation function. Conversely, when the banking sector faces serious instability, the impact will spread to the real sector, marked by credit freezing, a decline in asset prices, and a weakening of domestic investment. The study by Wang et al. (2021) confirms that the close link between macroeconomic stability and banking is a crucial factor that cannot be separated in systemic risk analysis.

In addition, the literature also highlights the role of financial distress in the dynamics of Indonesian banking. Financial distress experienced by non-financial corporations ultimately adds to the risk burden for banks, especially in the form of potential loan defaults. This condition directly affects the quality of bank assets, as bad credit will increase. Empirical studies in Indonesia show that distress in companies is often the main trigger for an increase in the NPL rate in the banking system, which then pressures the profitability of financial institutions. Trihadmini & Falianty (2020) affirm that this phenomenon became more apparent during the COVID-19 pandemic, when many small and medium-sized companies faced liquidity difficulties and failed to meet loan payment obligations. To respond to this situation, Bank Indonesia issued a credit restructuring policy as a relaxation measure. However, this policy is only short-term, and its effectiveness is highly dependent on the ability of the real sector to recover after the pandemic.

The presence of foreign investors in the Indonesian banking system adds a layer of complexity that cannot be ignored. On one hand, foreign investors bring great benefits in the form of additional capital, financing diversification, and the application of more sophisticated financial technology. Many foreign banks operating in Indonesia introduce international operational standards that focus on efficiency, transparency, and risk control. This condition provides a positive impetus for the governance practices of domestic banks and encourages a beneficial transfer of knowledge. However, the presence of foreign investors also opens up new opportunities for vulnerability, especially when a sudden capital outflow occurs. For example, when the US Federal Reserve raised interest rates, foreign capital flowed out of Indonesia significantly, which put pressure on the rupiah exchange rate and increased the volatility of the domestic financial market (Devereux & Yu, 2020). Thus, the role of foreign investors must be seen as dual, namely as a source of strength and a potential weakness in national financial stability.

The results of the Guedhami et al. (2022) study further affirm the dark side of globalization, especially during the COVID-19 pandemic. When the global health crisis occurred, MNCs and foreign investors actually focused more on saving their global portfolios by withdrawing capital from the domestic market. As a result, Indonesia and other emerging markets were left in a more fragile condition. This phenomenon reveals that global integration not only brings benefits in the form of capital flows and technology transfer but also increases the exposure of developing countries to external shocks, such as pandemics, trade wars between major countries, and drastic changes in global monetary policy.

In addition to external risks, the literature also highlights internal factors that worsen the vulnerability of Indonesian banking. Corporate governance is still a major challenge. Recent studies show that a number of domestic banks in Indonesia are still facing fundamental problems, including a low level of transparency in financial reporting, a weak risk management system, and an excessive dependence on certain sectors such as consumer credit. This condition increases the possibility of distress when the economy is shaken. Not only that, but Islamic banking, which is increasingly developing in Indonesia, also faces a different form of systemic risk. The profit-sharing-based financing system, although more in line with the principles of justice, has limitations on hedging instruments, making it vulnerable to global market volatility (Abasimel, 2023). In a stable economic condition, conventional banks are often superior in terms of profitability. However, when there is economic uncertainty or a crisis, Islamic banks are able to maintain stability because their profit-sharing system is based on business performance, not on fixed interest payments (Fauzi et al., 2023).

The results of the literature analysis also show the important role of government policy in maintaining national banking stability. Monetary and fiscal policies, including the provision of credit stimuli, loan restructuring policies, and liquidity support from monetary authorities, have proven to be able to reduce the short-term pressure experienced by banking. However, the effectiveness of these policies is highly dependent on the trust of foreign investors and the stability of the policy itself. When investors judge government policy to be credible and consistent, capital flows tend to remain, even in the midst of global uncertainty. Conversely, policy uncertainty can accelerate capital outflows, increase market volatility, and ultimately add to systemic risk. Valerio Roncagliolo and Villamonte Blas (2022) affirm that the credibility of public policy is a determining factor in maintaining market trust and the stability of the financial system.

Thus, the overall results of the literature study confirm that Indonesian banking is currently at a crucial crossroads. On one hand, globalization and the entry of MNCs provide great opportunities to strengthen the capacity of national banking through modernization, improved governance, and foreign capital flows. On the other hand, the increasing dependence on global dynamics increases systemic risk that is difficult to control with domestic instruments alone. Foreign investors bring benefits in the form of capital strengthening and efficiency, but also add vulnerability due to the potential for sudden capital outflows. Financial distress that arises from both the corporate and banking sectors itself is an early indicator that must be anticipated more seriously so that it does not develop into a broader systemic crisis. All these factors are closely related and require a more holistic, coordinated, and adaptive policy approach to rapid global changes.

5. Discussion

The results of the literature study show a great paradox of globalization on the development of the banking sector in Indonesia. Globalization, on one hand, creates very broad opportunities through the entry of foreign investment, the penetration of modern financial technology, and an increase in corporate governance standards. This positive impact makes Indonesia's banking sector more connected to more advanced international practices. However, on the other hand, the deepening integration with the global market actually creates greater structural vulnerability, especially to various external shocks that are difficult to predict. Therefore, globalization is understood as a dual force that brings both opportunities and serious challenges. This literature discussion is then focused on three main issues, namely the role of MNCs, systemic risk, and the position of foreign investors in the Indonesian banking structure.

First, the presence of multinational corporations (MNCs) in Indonesia has increased the need for a much more competitive and efficient banking system. Domestic banks are encouraged to improve the quality of their services, expand access to financing, and adapt to international standards. However, direct competition with foreign banks that have global networks and strong capital support is often a heavy pressure, especially for medium and small-scale banks. This condition has the potential to create a dualism in the banking industry, where large banks are able to survive and adapt, while small banks are more vulnerable to financial distress and difficulty in maintaining long-term profitability (Flori et al., 2022). Second, systemic risk in Indonesian banking is proven to be still very closely related to global macroeconomic conditions. The COVID-19 pandemic is a real example of how external shocks can significantly worsen domestic conditions. The close link between the quality of banking credit and corporate conditions shows that distress in the real sector will soon be transmitted to the financial sector. Therefore, crisis prevention policies cannot be just reactive but must be designed proactively by strengthening risk management, expanding the availability of hedging instruments, and improving a macroprudential regulatory framework that is adaptive to global dynamics.

Third, foreign investors play a dual role in the national financial system. In stable periods, foreign investors provide great support in the form of additional liquidity, strengthening market trust, and encouraging governance efficiency.

However, when a crisis strikes, foreign capital actually tends to leave more quickly to secure global portfolios, thereby exacerbating the pressure on the rupiah exchange rate and increasing the risk of banking instability. This shows that the stability of Indonesian banking is not only determined by domestic conditions alone but is also greatly influenced by global policy dynamics, especially the monetary policies taken by developed countries. Thus, this literature discussion affirms that the stability of Indonesian banking must be viewed from a globalization perspective. Domestic policies need to be formulated carefully so that they are able to balance the benefits of globalization with the mitigation of its risks. Sustainable governance reform, strengthening of the banking supervisory system, and diversification of national funding sources are the main keys to building long-term resilience.

6. Conclusion

Economic globalization has fundamentally changed the landscape of Indonesian banking. The entry of multinational corporations expands economic capacity through capital and technology, while foreign investors increase liquidity and governance standards. However, all these benefits come with significant risks, including financial distress, systemic risk, and dependence on external conditions. The COVID-19 pandemic confirmed the fragility of Indonesia's financial stability against global shocks, where capital outflow, an increase in non-performing loans, and liquidity pressures worsened domestic conditions. This study concludes that the stability of Indonesian banking is highly dependent on the balance between the benefits of globalization and the mitigation of its risks. MNCs and foreign investors must be seen as strategic partners, but with strict regulations to prevent excessive vulnerability. Meanwhile, financial distress needs to be anticipated earlier as an early indicator of a crisis. Strong macroprudential policies, strengthening of banking governance, and diversification of funding sources are the keys to the resilience of the banking system in an increasingly uncertain global dynamic. With the right strategy, Indonesia can maximize the opportunities of globalization while strengthening its financial stability in the midst of increasingly uncertain global dynamics.

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