**PROGRAM INFORMATION DOCUMENT (PID)**

**CONCEPT STAGE**

Report No.: AB7368

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| **Operation Name** | Second Financial Sector and Investment Climate Reform and Modernization Development Policy Loan (INDONESIA FIRM DPL 2) |
| **Region** | EAST ASIA AND PACIFIC |
| **Sector** | Financial and Private Sector, Poverty Reduction |
| **Project ID** | P145550 |
| **Borrower(s)** | REPUBLIC OF INDONESIA |
| **Implementing Agency** | MINISTRY OF FINANCE AND CMEA |
| **Date PID Prepared** | April 14, 2013 |
| **Estimated Date of Appraisal Authorization** | April 1, 2014 |
| **Estimated Date of Board Approval** | July 30, 2014 |

 **I**. **Key development issues and rationale for Bank involvement**

**The proposed Second Indonesia Financial Sector and Investment Climate Reform and Modernization Program Development Policy Loan (FIRM DPL 2), in the form of a USD 100 million single tranche IBRD variable spread loan, is designed to support the Government of Indonesia in its ongoing efforts to promote the development of its financial sector development and improve the investment climate.** Indonesia has made remarkable progress over the last decade in order to reduce poverty and meet its economic development objectives. In an effort to continue this progress, the Government of Indonesia has recently articulated its commitment to turn Indonesia’s economy into one of the world’s top ten largest by 2025. A strong financial system that accelerates and supports private sector growth is thus vital to Indonesia’s continued competitiveness and the Bank and other development partners support these efforts.

**Indonesian authorities have already taken several positive steps in order to enable the financial sector to provide the kinds of products and services that can cater to the demands of the vast majority of Indonesia’s population and its real sector at competitive prices, as well as accelerating investment for growth.** These reforms have been taken in financial system stability, financial sector diversification, financial inclusion and investment climate regulatory reform. Specifically, the government has been working to create a robust financial sector safety net to improve both crisis prevention and management. Further, in an effort to gradually reduce the dominance of the banking sector, the MOF issued a Capital Markets and Non-Banking Financial Sector Master Plan 2010-2014, which provides a working guideline for financial sector diversification. Additionally, the GOI has recently launched a number of efforts to increase access to a broad array of financial services to the poor and underserved, including the launching of a National Strategy for Financial Inclusion and scaling up its flagship People’s Business Credit program as a way to expand access to credit.

**The FIRM Program is intended to complement the ongoing Indonesia DPL series, which supports a core reform program in the economic ministries**. The operation is fully aligned with the World Bank Group Indonesia Country Partnership Strategy (CPS) for the period of FY2013-2015, in its pro-growth, pro-jobs, pro-poor and pro-green engagement areas. In particular, the Program supports the emphasis on enabling local capacity to implement and deliver and strengthening economic competitiveness of the private sector. The FIRM program focuses on enhancing institutional and structural reforms specific to the financial and private sector, aiming to build capacity of several key institutions in their ongoing efforts to bolster financial system stability and deepen the financial sector: the Ministry of Finance, the Indonesia Financial Services Authority, Bank Indonesia, and other agencies.

**II.** **Proposed Objective(s)**

**The main objective of the proposed loan is to promote the development of a sound, efficient and inclusive financial sector and support improvements in the investment climate in Indonesia to help the Government of Indonesia (GOI) achieve its medium-term economic development and poverty reduction goals.** To date the government’s focus on maintaining and strengthening the stability of the financial system of the last decade has had demonstrable success. Indonesia’s financial sector has only suffered relatively minor affects from the ongoing Eurozone crisis and financial market volatility.

**Despite this stability, however, Indonesia’s financial sector requires continued deepening, widening, and efficiency, in order to remain supportive of competitiveness and growth goals.** Indonesia’s financial sector remains bank-dominated, and as such, financial services are dominated by short-maturity financial instruments, typically time deposits. The amount of long-term financing needed by corporations, infrastructure and SMEs remains limited, acting as a drag on growth. In addition, much of the population does not have access to appropriate financial products and services[[1]](#footnote-1). MSMEs are important for Indonesia, as they contributed to 60 percent of GDP and provided 97 percent of total employment in 2010, and to grow further they need adequate access to finance.

**The policy package is thus expected to cover the following priority areas:**

1. reinforcing financial sector stability,
2. promoting financial sector diversification,
3. enhancing financial inclusion for underserved groups and the poor, and
4. supporting investment climate regulatory reform.

**III.** **Preliminary Description**

**In financial sector stability**, the operation will focus on supporting the establishment of an effective financial sector regulatory and supervisory framework and enhancing crisis preparedness.

**In financial sector diversification,** the operation will focus on a set of priority actions to address promote microfinance and micro-insurance industry development.

**In financial inclusion,** the operation will focus on promoting policy coordination for expanding financial services to the poor, developing innovative financial products, and increasing the efficiency of the payments systems. The Government has launched major initiatives on a number of fronts to promote financial inclusion, including the launching of the first National Strategy for Financial Inclusion and the FIRM will support this effort.

**Regards promoting investment climate regulatory reform**, the operation will concentrate on supporting GOI programs at the strategic level, such as through supporting the Indonesia Investment Coordinating Board (BKPM), and the recently instituted online fiduciary registration regulations.

**IV.** **Poverty and Social Impacts and Environment Aspects**

**The proposed policy actions under this operation are expected to have positive poverty and social impacts and to have no significant negative environmental effects.** Specifically, the operation promotes overall financial sector stability by improving the authorities’ ability to prevent and handle financial crisis. Indonesia’s experience during the Asian Financial crisis in 1997/1998 took a huge toll on the poor and vulnerable, massively increasing the poverty rate and reducing jobs. The GOI has made important strides since that time in establishing financial sector stability, and the FIRM DPL 2 aims to bolster these efforts. The focus of the operation on also promoting financial inclusion and diversification is expected to have positive poverty and social impacts, increasing employment opportunities, income and enhancing social protection through savings and other financial products targeting the poor. Without inclusive financial systems, poor individuals and small enterprises need to rely on their personal wealth or informal services to invest in their education, become entrepreneurs or take advantage of promising growing opportunities. The investment climate reforms are also expected to help create equal opportunities for businesses and improve the overall ease of doing business, thereby promoting job creation and inclusive growth.

**V. Tentative financing**

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| Source: | ($m.) |
| Borrower | 0 |
| International Bank for Reconstruction and Development | 100 |
|  Total | 100 |

1. **Contact point**

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1. Less than 50% population has access to formal financial services [↑](#footnote-ref-1)