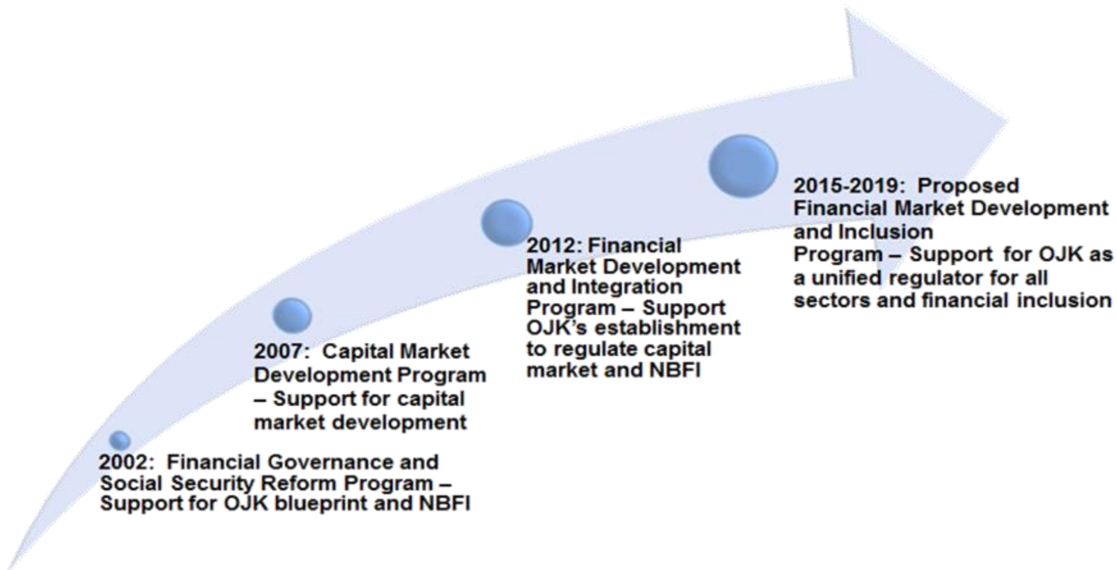
ASSESSMENT OF ADB-INDONESIA'S FINANCIAL SECTOR PROGRAMS (2002–2014)

I. ADB's Support in Establishing OJK

1. ADB has had long-term engagement with the government on financial sector development. It has undertaken six major financial sector operations in Indonesia since 1998, aimed at sequentially addressing banking, capital markets, contractual savings, and most recently, reform of the regulatory framework (Figure 1).

Figure 1: ADB's Long Term Engagement with the Government in Financial Sector Development



2. As explained in the RRP main text, ADB through a sequential approach of policy based lending and technical assistance played a leading role in supporting the Government's decision making to establish OJK as an integrated financial sector regulator including policy advice and preparation of Blueprint. Below is a summary of ADB's financial sector programs in Indonesia and their main areas of focus since 2002 with focus on their role in the setting up of OJK.

- **Financial Governance and Social Security Reform Program (2002–2005):** The program was broken down into 2 phases, phase 1 from 2002-2003 and phase 2 from 2003–2005. The program supported the development of a broad framework for the overall strengthening of the financial sector and development of sound financial institutions necessary to support good governance and economic growth. Related to the establishment of OJK, the program focused on the following (i) supported preparation of comprehensive legal reform necessary to transfer regulatory and supervisory powers to OJK; (ii) strengthened financial sector regulation and supervision under existing authorities; (iii) promoted adoption of international best practices and standards for regulation and supervision; and (iv) strengthen the soundness of financial institutions.[1]

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[1] ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Cluster, First Loan and Technical Assistance Grant to the Republic of Indonesia for the Financial Governance and Social Security Reform Program.* Manila.

- **Capital Market Development Program (2006–2009):** The focus of this program was to improve financial sector resilience and diversify the sector as a way to make the capital market more robust and improve domestic financing. This program had four outputs; (i) enhancing Information disclosure and price discovery; (ii) promoting deeper and more liquid capital markets; (iii) improving market surveillance and market protection and (iv) strengthening Governance and human resource capacity. Output 3 is directly related to the establishment of OJK as it supported the development and submission to the MOF of a proposal for an appropriate regulatory structure for the capital markets and the nonbank financial institution supervisory agency. The outcome of this support is demonstrated in the passing of the law to establish the Financial Services Authority (OJK) in 2011.

- **Financial Market Development and Integration Program (2009–2012):** The program supported implementation of the 2011 law specifically with regards to the transition process of Bapepam-LK's as regulator of capital market and non-bank financial institutions into OJK. The program also expanded ADB's engagement in support of broader financial sector development with the government's Fiscal Policy Office (FPO). The programs had 3 outputs; (i) regulatory oversights strengthened; (ii) deepened capital market provides expanded access to nonbank financing and (iii) increased mobilization of long-terms savings through a broadened investor base. The expected overall impact of the Program is an expanded nonbank financial sector supporting increased intermediation. BAPEPAM-LK mandate was incorporated into OJK on 31 December 2012.

II. Impact of Government Reforms and ADB's Programs

3. Beyond regulatory reform measured through qualitative measures such as the setting up of OJK, the government reform agenda has also seen moderate quantitative improvement. Over the last 3 programs, the Government's focus on financial sector reforms as reflected in ADB's programs have been on (i) capital market development (equity); (ii) government securities; and (iii) increasing non-bank finance subsector assets over GDP. Some improvements in financial deepening is demonstrated through the value of stock trading on a daily basis increased from Rp4 trillion in 2009 to Rp6 trillion in 2013, daily transactions in stock trading increased from 87,000 in 2009 to 154,000 in 2014, the number of listed companies increased from 400 in 2009 to 483 in 2013.[2] Market capitalization increased from Rp2,019 trillion in 2009 to Rp4,219 trillion in 2013 and as a percentage of GDP is just slightly below 50%. The value of government securities trading has also increased from Rp900 trillion in 2009 to Rp1,900 trillion in 2013. The share of non-bank finance subsector assets over GDP in 2014 is at 63.3%. Although this is slightly lower than the target of 65% as reflected in the last program in 2012, it is an improvement compared to the baseline of 60% in 2010.

4. Overall, total size of financial sector as a percentage of GDP at 103.4% is at its highest since 2005 (93.9%), however it is still lower than the average in the ASEAN region including Malaysia, Philippines and Thailand. The government's approach to consolidate financial sector supervision under OJK will address overall financial sector growth including financial inclusion and FMDIP includes outcome indicator targeting 12% growth of financial sector assets to GDP by 2020.

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[2] ADB. 2015. *Completion Report: Capital Market Development Program Cluster*. Manila

III. Lessons Learned

5. Some of the key lessons learned from previous programs include:

(i) Financial sector supervision requires strong coordination between different regulator and government. This is best achieved through consensus building and an agreed financial sector road map or master plan which specifies different roles and responsibilities of each stakeholder.

(ii) Financial sector development, especially for an integrated regulator, has to be charted through a medium- to long-term strategy. Financial market development is complex and involves major changes to the legal and regulatory framework, institutional arrangements, financial infrastructure, and human capacity. Hence, sufficient time must be allocated to program implementation.

(iii) While capital market development has an indirect link to growth, this needs to be coupled with reforms to increase access to financial services. Services such as branchless banking have to be developed to improve financial inclusion. Financial inclusion includes access to services, financial literacy and consumer protection;

(iv) The close consultations and coordination involving the government, ADB, and other development partners is essential to strengthen the government's ownership and increased the potential for funding agency buy-in.

(v) Adequate TA support is necessary to help government and OJK complete their reform agenda. Financial sector reforms entail the government adopting legal, policy, and institutional measures and established supporting infrastructure. Many of the concepts are relatively new and therefore required extensive consultation and coordination to ascertain stakeholders' understanding, acceptance, and adoption of the new measures. TA support is also important to incorporate best practices during implementation to achieve the intended results.

(vi) As a member of G20 and integral part of the ASEAN community, Indonesia has an important role to play in the international stage. Hence national financial sector development has to also take into account international and regional development. ADB can support the government and OJK in this role by providing regional technical assistances. This integrates regional collaboration and considerations into national financial sector development and builds capacities to meet national development goals, requirements of international financial systems as well as regional agenda.