



Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 28-Apr-2020 | Report No: PIDA29214



BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Indonesia	P174025	Indonesia First Financial Sector Reform Development Policy Financing: COVID-19 Supplemental Financing (P174025)	P170940
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
EAST ASIA AND PACIFIC	15-May-2020	Finance, Competitiveness and Innovation	Development Policy Financing
Borrower(s)	Implementing Agency		
Republic of Indonesia	Fiscal Policy Agency, Ministry of Finance		

Proposed Development Objective(s)

The program development objective of this programmatic operation is to support financial sector reforms that will assist the Government of Indonesia (GoI) in achieving a deep, efficient and resilient financial sector. The proposed operation is the first in a series of three programmatic operations.

This programmatic DPL series is structured around the following three pillars and set of objectives:

- Pillar A: Increasing the Depth of the Financial Sector. Pillar objectives: to expand the size of the financial sector by increasing outreach, broadening financial market products and mobilizing long-term savings.
- Pillar B: Improving the Efficiency of the Financial Sector. Pillar objectives: to lower the costs for individuals and enterprises by strengthening the insolvency and creditor rights framework, protecting consumers and personal data and promoting interoperability of payment systems.
- Pillar C: Strengthening the Resilience of the Financial Sector. Pillar objectives: to strengthen the capacity of the sector to withstand financial and non-financial shocks by strengthening the resolution framework, implementing sustainable finance practices and establishing disaster risk finance mechanisms.

Financing (in US\$, Millions)

SUMMARY

Total Financing	300.00
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DETAILS

Total World Bank Group Financing	300.00
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World Bank Lending

300.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

The proposed operation provides US\$ 300 million in supplemental financing for the First Financial Sector Reform Development Policy Operation (DPO1) to help the Government of Indonesia (GoI) cover an unanticipated financing gap that has arisen due to the impact of the COVID-19 outbreak. On March 20, 2020, the Board approved DPO1 – valued at US\$ 300 million – which had the development objective of: i) increasing the depth, ii) improving the efficiency and iii) strengthening the resilience of the financial sector. This proposed operation is part of a broader emergency package offered by the World Bank, anchored to the key measures taken by the Government and complemented by the support of other development partners.

The public health measures taken to manage the outbreak have led most economic activities to come to a sharp halt, and policy responses have been announced to soften the impact on the economy. Markets for products and services are affected by shrinking demand and supply. Industries that were first to be hit include tourism and transportation; however, given the scale of the outbreak and the measures, the adverse impact is widespread. These negative economic effects will increase with the duration and severity of the outbreak. In response, the Government is implementing a number of measures to cushion the expected adverse economic effects, focusing on three priority areas: enhancing healthcare, expanding social protection and preventing mass bankruptcies in the private sector that could adversely affect potential output. A Government Regulation in-lieu of Law (Perppu No. 1/2020), issued by President Jokowi on March 31st, allows the authorities to undertake extraordinary measures to manage the COVID-19 outbreak, including a relaxation of the 3 percent of GDP fiscal deficit rule through 2020-22 and allowing Bank Indonesia to purchase government bonds directly in the primary market. A sequence of three packages of fiscal measures, for a total US\$ 28.7 billion (2.7 percent of GDP), has been issued by the Ministry of Finance, including US\$ 9.9 billion (35 percent of total financing) for loan restructuring programs and credit facilities for SMEs and US\$7.3 billion (25 percent of total financing) for social safety nets. The Ministry of Finance is also working closely with Bank Indonesia (BI), the Financial Services Authority (OJK) and Deposit Insurance Corporation (LPS) to avoid a systemic crisis. BI has implemented various measures to cushion the depreciation of the currency and inject liquidity in the market, while OJK has issued a regulation which temporarily allows special treatment to lending to MSMEs and other COVID-affected debtors.

The macroeconomic policy framework is considered adequate for the proposed operation. Strong economic management has helped improve Indonesia’s economic fundamentals with stable and largely resilient economic growth, low inflation, a conservative fiscal deficit, plus enhanced fiscal credibility. The policy mix in response to the COVID-19 crisis has been consistent with macroeconomic stability and the management of risks that may arise. Monetary policy continues to be credible and responsive to the shock within its limited space. The suspension of the 3 percent of GDP fiscal deficit rule to support the health, social and economic measures to mitigate the negative effects of the COVID-19 crisis is legally time-bound and will return in place from 2023, which will contain Indonesia’s still low level of debt. In addition, ongoing



reforms such as the Omnibus Bill on job creation will contribute to maintaining a conducive and stable fiscal framework, which will consequently support inclusive growth and expand potential growth.

Relationship to CPF

The proposed operation is consistent with the Bank's Country Partnership Framework (CPF) for Indonesia. The FY16-20 WBG CPF for Indonesia draws on the 2015 Systematic Country Diagnostic (SCD) which identified three pathways for the elimination of extreme poverty and increasing shared prosperity: i.e. creation of better jobs, improving equality of opportunity, and helping Indonesia manage its vast endowment of natural resources in a sustainable way. An SCD Update is currently being finalized and will provide the analytical underpinnings for the new FY21-25 WBG CPF. The SCD Update posits four pathways to overcome the constraints to poverty reduction and shared prosperity: (i) strengthening the competitiveness and resilience of the economy; (ii) building more quality infrastructure, faster; (iii) nurturing world-class human capital; and (iv) managing natural assets. The proposed supplemental DPO, in line with the parent DPO, supports the FY2016-20 WBG Country Partnership Framework through two supporting beams (Supporting Beam I: "Leveraging the Private Sector - Investment, Business Climate and Functioning of Markets" and Supporting Beam II: "Shared Prosperity, Equality and Inclusion". Moreover, it is aligned with the "strengthening competitiveness and resilience of the economy" of the SCD Update.

C. Proposed Development Objective(s)

The program development objective of this programmatic operation is to support financial sector reforms that will assist the Government of Indonesia (GoI) in achieving a deep, efficient and resilient financial sector.

The programmatic DPL series is structured around the following three pillars and set of objectives:

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Key Results

The reform program of this DPO series aims at increasing the depth, improving the efficiency and strengthening the resilience of the financial sector. The package of supplemental and regular DPOs of the programmatic series plays a key role in cushioning the COVID-related crisis by supporting the real economy (i.e. channeling funds to households and firms while maintaining the resilience of the financial sector) and managing second round effects related to the deterioration of assets quality and banks' balance sheets. The DPO series comprises reforms to develop new long-term instruments to broaden Indonesia's investor base and deepen its capital markets, which is critical in view of the exit of foreign portfolio investors; reforms to increase the number of payment channels, which are crucial for the implementation of large-scale social assistance payments to protect livelihoods during the crisis; and reforms to strengthen the resolution framework for troubled banks and establishing a clear funding mechanism, which will be a



key element of a recovery strategy. Finally, establishing a pooling fund that could provide targeted and timely financing to beneficiaries through dedicated channels in case of a disaster can be highly relevant in case of a pandemic.

D. Project Description

The program is on track and the government has already made progress in the policy areas relevant for the next operation. Specific reforms focus on: (i) adopting a joint policy framework on agent networks between BI and OJK; (ii) establishing standard reporting and improving monitoring of issuances of debt securities in the private placement market; (iii) expanding the number of long-term instruments eligible for investments by pension funds and insurance companies; (iv) enhancing supervision of insolvency practitioners; (v) introducing a new legal framework on general data protection and privacy; (vi) issuing Quick Response (QR) Indonesia Standards to advance interoperability of digital payment instruments; (vii) developing a single customer view based data reporting by banks to enhance timeliness and accuracy of the insured deposit payout function of the Deposit Insurance Corporation (LPS); (viii) strengthening the institutional capacity of banks and supervisors on sustainable finance practices; (ix) establishing the legal framework for a disaster mitigation pooling fund. Implementation of the reforms supported under DPO1 is continuing. As noted above, an adequate macroeconomic framework has also been maintained, despite broad fiscal measures to stem the negative effects of the COVID-19 emergency. The Government is already taking steps toward completion of the indicative triggers for DPO2. While risks of implementation delays of certain reforms due to competing budgetary and capacity priorities arising from the COVID-19 outbreak cannot be excluded, the DPO program remains on track.

The economic downturn and COVID-19 emergency responses have created substantial unanticipated fiscal financing needs that are challenging for GoI to meet solely by financing through capital markets. The COVID-19 outbreak represents an exceptional twin supply and demand shock. The outbreak has created substantial unanticipated fiscal financing needs in 2020, due to the revenue impact as a result of the downturn, relief measures and urgent new spending needs. Economic uncertainty remains high and unanticipated fiscal financing needs is likely to increase with the duration of the outbreak and/or worsening economic conditions. While financial stability indicators confirm the soundness of the financial sector, the current challenges in accessing financial markets and mitigating the impact of capital outflows on external balances and on the Rupiah confirm the importance of two of the key development objectives of the DPO program, that are, increasing the depth of the Indonesian financial sector and strengthening its resilience to shocks.

DPO supplemental financing is the fastest way for the World Bank to provide timely financing to Indonesia and has successfully been used to rapidly disburse financing following large unanticipated shocks in several other countries in the past. In addition, financing from multilateral development banks helps to diversify funding sources and has proven to be an important signal of creditworthiness to markets. Development partners have committed support to the Government response on the technical (e.g. WHO, UNICEF, USAID – CDC, DFAT), humanitarian (e.g. UN system under the coordination of UNOCHA), as well as financial fronts. To date, total short-run emergency financing from international donors tentatively amounts to more than US\$ 2.0 billion with the World Bank contributing nearly 32 percent.¹ Further financial support is expected during the recovery from the outbreak. To date, Indonesia has not requested any financing from the International Monetary Fund (IMF). While DPO funds are not earmarked for specific purposes, quick disbursement of this Supplemental DPO financing would enable the Government to pursue immediate priorities that currently remain unfunded. This immediate availability of funding could help the Government reduce the longer-term impacts of the crisis, such as higher debt servicing costs and those related to reduced human capital (e.g., education delays, malnutrition),

¹ Based on information shared at the development partners meeting on April 1, 2020.



higher incidence and depth of poverty, and delays in infrastructure development.

E. Implementation

Institutional and Implementation Arrangements

Progress on the results indicators will be monitored and evaluated by the Recipient. The Fiscal Policy Agency (BKF) under the Ministry of Finance will be the executing agency for the proposed operation while BI, OJK, LPS, Ministry of Law and Human Rights (MoLHR), Ministry of National Development Planning (Bappenas) and Ministry of Communication and Information Technology (Kominfo) will act as implementing agencies. Bappenas will then play a coordinator role among other agencies (such as Ministry of Human Development and Culture, Ministry of Energy and Mineral Resources) to ensure that the trigger for DPL3 under reforms area #1 is completed on time. The BKF team is well-coordinated and given their experience in implementing DPOs with the World Bank, they are increasingly well prepared to obtain and share data to monitor implementation against the agreed result indicators. The World Bank closely follows this progress through supervision activities.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

This operation supports the Government in meeting unanticipated financing needs arising from emergency policy measures to mitigate the economic impacts of the COVID pandemic, which if left unchecked could reverse recent gains in poverty reduction. Preliminary estimates suggest that the pandemic could lead to an increase in the number of poor of between 5.6 and 9.6 million in 2020 relative to a benchmark scenario without the pandemic. The Government is implementing a number of measures to cushion the expected adverse economic effects, including interventions to enhance healthcare, expand social protection and prevent mass bankruptcies in the private sector. Collectively, these interventions could significantly benefit the poor and vulnerable, if appropriately targeted. Enhanced healthcare may help address vulnerability to infection and burden of disease among the poor and vulnerable, which is expected to be more intense than among the non-poor. Second, expanded social assistance will benefit the poor and vulnerable employed largely informally in low-value-added service sectors such as wholesale and retail trade, accommodation and food/beverage services most adversely affected by the pandemic. Overall, the package of response measures would help mitigate the substantial risk of reversal of Indonesia's gains in poverty reduction in recent years.

The results from the PSIA for the parent DPL still apply in the context of the coronavirus pandemic, with no immediate adverse impacts for the poor and vulnerable and benefits likely to emerge in the long run. The link between financial sector stability and poverty in crises is well-established in Indonesia. During the 1997-1998 Asian Financial Crisis, steep declines in employment, negative economic growth and rising food prices caused the poverty rate to increase from 17.5 percent in 1996 to 24.2 percent in 1998. While the pandemic is fast-evolving and much remains uncertain about its duration and depth of impact in Indonesia, it is likely that many of the same adverse impacts in terms of lost earnings, declines in employment and increases in poverty will be felt across the country, at least temporarily. The parent DPL aims to increase the depth of the financial sector and improve its efficiency and resilience, which contributes to a more favorable economic environment for growth and sustained poverty reduction in the long run. As such, the program's objectives promote financial stability and gain in significance in the context of the ongoing pandemic.



Environmental, Forests, and Other Natural Resource Aspects

The emergence of the coronavirus pandemic has not affected environmental impacts expected under the parent DPL.

The environmental assessment for parent operation found that two of the DPO1 prior actions are expected to have positive effects on the environment. Embedding sustainability in the practices of the financial services industry, with emphasis on climate change, will contribute to disaster prevention, disaster risk mitigation, climate change adaptation, and environmental management in Indonesia. Moreover, the establishment of a pooling fund for disaster risk financing has the potential to lead to significant positive effects on the natural and human/built environment. This is because the Disaster Risk Finance and Insurance (DRFI) Strategy recognizes that disaster management financing is needed for three periods – non-disaster, emergency response, and rehabilitation/reconstruction. Within the non-disaster period, pre-disaster financing is to be used, inter alia, for disaster risk mitigation activities or programs, disaster prevention programs, and education on disasters. Whether the potential for positive effects is realized or not will depend in part on the extent to which adoption of the DRFI Strategy leads to pre-disaster financing, and in part on other activities and programs of national and regional governments. The latter may include climate change resilience, disaster-resistant infrastructure, upgraded building codes, and early warning systems. None of the other prior actions will have positive or negative effects on environment, forest, or other natural resources. They will not result in construction, development or operation of facilities that could generate solid or liquid wastes or air emissions, conversion of natural habitat, damage to cultural heritage, loss of biodiversity, or changes in management policies or practices affecting forests or other natural resources.

G. Risks and Mitigation

The overall risk level is substantial, an increase from the moderate risk assessment for the parent operation. The change in the risk assessment from moderate to substantial is linked to a perceived increase in macroeconomic risk. As with most other countries, the pandemic has unleashed an unprecedented economic impact on Indonesia through both domestic and external channels. Given that uncertainty remains high and the severity of the fallout could further increase, there is a risk that reforms are delayed as Government refocus its efforts and resources to cushion the negative economic effects of the infection on the economy and the population. In addition, because of the economic growth slowdown, tax revenue growth will also weaken while expenditures temporarily balloon, posing some risks to fiscal sustainability. The financing of the wider deficit will also weigh on fiscal debt sustainability in the medium term. These risks will increase with the duration of the outbreak which is still evolving locally and globally. This operation contributes to the mitigation of fiscal risks by providing multilateral financing which would lower debt service costs as compared to financing through capital markets. The risks around technical design of the program and institutional capacity, rated as substantial, are being mitigated by strong dialogue between the Bank and the Government, the coordination of technical assistance, and the decision to proceed with supplemental financing rather than attempting to accelerate the processing of the second DPO in the series. The implementation of the reforms supported by this DPO series requires strong collaboration among a large number of implementing agencies and strong coordination by the Ministry of Finance as executing agency. Moreover, the proposed reforms require intense technical work to guarantee their completion and the sustainability of their results. The DPO mitigates this risk by providing strong technical support to each implementing agency under a parallel advisory service and analytical program in close coordination with the international development partners.



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APPROVAL

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The World Bank

Indonesia First Financial Sector Reform Development Policy Financing: COVID-19 Supplemental Financing (P174025)

Approved By

Country Director:	Satu Kristiina Kahkonen	16-Apr-2020
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