



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 23-Nov-2020 | Report No: PIDC29853



BASIC INFORMATION

A. Basic Project Data

Country Indonesia	Project ID P172439	Project Name Indonesia Investment and Trade Reforms DPL (P172439)	Parent Project ID (if any)
Region EAST ASIA AND PACIFIC	Estimated Board Date Mar 24, 2021	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Republic of Indonesia	Implementing Agency Coordinating Ministry of Economic Affairs		

Proposed Development Objective(s)

To support the reform of Indonesia’s investment and trade policies in support of economic recovery and transformation.

Financing (in US\$, Millions)

SUMMARY

Total Financing	800.00
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DETAILS

Total World Bank Group Financing	800.00
World Bank Lending	800.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **After more than two decades of robust economic growth and poverty reduction, the COVID-19 pandemic has caused a deep recession in Indonesia.** Strong economic management over the past two decades has helped improve Indonesia’s economic fundamentals with stable and largely resilient economic growth, low inflation, a conservative fiscal deficit, and enhanced fiscal credibility. However, mainly as a result of the significant reduction in mobility in response to the pandemic, real GDP contracted by 5.3 percent year on year (yoy) in Q2 2020 and growth is projected to contract by 1.6 percent in 2020. Without Government’s strong social assistance measures in response to the crisis, the economic



fallout of the pandemic would have threatened to wipe out gains achieved in poverty reduction over the last seven years. The policy mix in response to the COVID-19 crisis has been consistent with macroeconomic stability and the management of risks. The lifting 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 come to an end in 2023. Medium-term fiscal policy remains sustainable as debt levels remain well below the legal debt threshold, with a low share of foreign exchange-dominated debt.

2. **As the crisis has exacerbated the challenges of an economy which does not create enough middle-class jobs, the Government has accelerated its ambitious reform program to address some of these challenges.** The economy's moderate exposure to international trade and weak integration into global value chains (GVCs) have slowed the growth of manufacturing and other non-commodity tradable sectors. Indonesia attracts little FDI relative to GDP compared to other countries in the region, thus losing a source of technology and knowledge transfer and external funding for the economy. As a result, agriculture and low-value-added, low-wage services have created most new jobs in the past 15 years. Restrictive trade policies are also partly responsible for high and volatile prices of staple food products and production inputs, particularly at a time when consumers and producers struggle to make ends meet. The Government has therefore accelerated its ambitious investment and trade program of reforms to help address these structural challenges and aid the economic recovery. The centerpiece of the reform agenda is the Omnibus Law on Job Creation, which amends 76 individual laws and abolishes 2 laws to improve the investment climate. The law's investment reform cluster, one out of 11 clusters, is arguably Indonesia's most ambitious reform effort to attract investments in recent decades. The Omnibus Bill was adopted by Parliament on October 5, 2020 and promulgated into law on November 2, 2020.

Relationship to CPF

3. **The proposed Development Policy Operation (DPO) is fully aligned with the (forthcoming) World Bank Group's Country Partnership Framework (CPF) for Indonesia.** The FY21-25 CPF for Indonesia (currently under preparation) draws on the 2020 Systematic Country Diagnostic (SCD) Update which identified four pathways for the elimination of extreme poverty and increasing shared prosperity: (i) Strengthening the competitiveness and resilience of the economy, (ii) Building more infrastructure, better and faster; (iii) Nurturing world-class human capital; and (iv) Managing natural assets for enduring prosperity. The proposed DPO supports the FY2021-25 CPF mainly through the engagement area that focuses on strengthening economic competitiveness and resilience. It is also relevant to the achievement of the objectives of engagement area II that covers infrastructure as well as of the engagement area that focuses on nurturing human capital.

C. Proposed Development Objective(s)

4. **The proposed DPO aims to support the reform of Indonesia's investment and trade policies in support of economic recovery and transformation.** It is a stand-alone IBRD loan to the Republic of Indonesia aiming to support the Government of Indonesia in: (i) attracting investments, particularly foreign direct investment (FDI); and (ii) reforming trade policy to support competitiveness and the economic recovery. The operation supports the most ambitious reform program to attract investments and liberalize trade that Indonesia has undertaken in decades. This has the potential to help the urgently needed transformation of the economy towards higher productivity, higher value-added sectors and economic recovery from the COVID-19 shock.

Key Results

5. **Key expected results of the operation include:** (i) increases in the: (a) share of manufacturing FDI inflows to



Indonesia in total manufacturing FDI outflows from high-income countries; (b) number of non-natural resource sectors with at least one planned investment among liberalized sectors; (c) share of expatriate work permits in total number of skilled workers; (d) value of annual investments in renewable energy as a share of GDP; (e) share of laws and regulations reviewed by the Regulatory Oversight Body; and (f) share of manufacturing inputs exempted from compulsory product certification in total intermediate imports; and (ii) reductions in the: (a) difference between domestic and international price of medium-quality rice; and (b) share of product codes subject to at least one change in import rules in a year.

D. Concept Description

6. **The proposed operation supports the Government's objective to attract investments and improve the competitiveness of the economy.** It does so by supporting the relevant institutional and policy reforms by the Government in this area. In doing so the operation has been selective on which government initiatives and reforms to support – namely those that are expected to have the highest contribution to the overall objectives through the medium term. For instance, licensing simplification and regulatory reforms related to outsourcing, minimum wage and severance pay are not included, as the evidence suggests that these are not as significant as investment and trade reforms in promoting investment.

7. **The proposed operation is structured around the following Program Development objectives and Pillars:**

- **Pillar A: Attracting investments, particularly FDI** by: (i) opening sectors to private investments, including foreign; (ii) facilitating the supply of high-skilled professionals; (iii) increasing the commercial viability of private investment in renewable energy; and (iv) establishing a regulatory oversight body to increase the quality, coherence and certainty in government regulatory activity.
- **Pillar B: Reforming trade policy to support competitiveness and the economic recovery** by: (i) increasing accessibility and affordability of key commodities as part of the COVID-19 response; (ii) facilitating access to manufacturing inputs; and (iii) increasing predictability of trade policy making.

8. **The objectives of the operation are closely aligned to Government's priority reforms on investment, trade and regulatory uncertainty.** Through amendments in various laws through the Omnibus Law for Job Creation, the Government has sought to address key investment bottlenecks regarding establishment rules for businesses and sourcing of high-skilled professionals, and to increase certainty in economic policymaking, particularly on trade. This agenda has been complemented by significant trade liberalization reforms to increase accessibility of basic commodities and intermediates and by reforms to increase the commercial viability of private investment in renewable energy.

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

Poverty and Social Impacts

9. **The overall poverty and social impact of the program is likely to be positive.** The growth-stimulating effects of the reforms will be crucial in putting the country back on track to reduce poverty and build a large, vibrant and economically secure middle class. It is expected that Indonesia's expanded and increasingly better targeted safety net architecture would provide viable ways to mitigate adverse impacts of these reforms on households and informal workers. These include the recently introduced income support program to support low-wage workers amidst the pandemic and the introduction (through the Omnibus Law) of an unemployment insurance scheme, which needs an accompanying implementing regulation to be effective. The Omnibus Law also brings a number of amendments to laws related to land acquisition and land use. The potential impacts of the Omnibus Law on the land rights of communities and Indigenous Peoples groups will be assessed to understand the poverty and social impact of Pillar A reforms. Any potential adverse poverty and social impacts could be mitigated through subsequent regulations, to be promulgated to implement the



Omnibus Law. Potential measures to mitigate significant gaps, shortcomings and associated operational risks identified through the poverty and social impact assessment will be developed.

Environmental, Forests, and Other Natural Resource Aspects

10. **The Omnibus Law includes several amendments to existing environmental management and protection and natural resources laws, which could pose environmental risks if not mitigated through implementing regulations.** These amendments relate to the extent of environmental due diligence, review requirements and monitoring. As part of the DPO preparation, the overall impacts of the reforms on the environment, forests and other natural resource aspects will be further assessed and re-evaluated once the relevant implementing regulations are adopted. Measures will be developed to address significant gaps or shortcomings in Indonesia's system for reducing the adverse impacts of the DPO and mitigating associated operational risks.

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APPROVAL

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