## PROGRAM INFORMATION DOCUMENT (PID)
### CONCEPT STAGE

<table>
<thead>
<tr>
<th>Operation Name</th>
<th>Financial Sector and Investment Climate Reform and Modernization Development Policy Loan (INDONESIA FIRM-DPL)</th>
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<tbody>
<tr>
<td>Region</td>
<td>EAST ASIA AND PACIFIC</td>
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<tr>
<td>Sector</td>
<td>Financial Sector, Poverty Reduction.</td>
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<tr>
<td>Project ID</td>
<td>P130150</td>
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<td>Borrower(s)</td>
<td>REPUBLIC OF INDONESIA</td>
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<td>Implementing Agency</td>
<td>MINISTRY OF FINANCE AND CMEA</td>
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<td>Date PID Prepared</td>
<td>May 22, 2012</td>
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<td>Estimated Date of Appraisal Authorization</td>
<td>July 10, 2012</td>
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<td>Estimated Date of Board Approval</td>
<td>September 4, 2012</td>
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### Key development issues and rationale for Bank involvement

The proposed Indonesia Financial Sector and Investment Climate Reform and Modernization Program (FIRM), 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 and accelerate investment for accelerated economic expansion and poverty reduction. Indonesia has proven itself as a major developing economy, making efforts over the last decades to develop strong macroeconomic fundamentals and a robust financial sector. Indonesia’s economy demonstrated this resilience through the recent volatility in financial markets and a slowdown in growth in the developed countries, culminating in positive growth of above 6 percent in 2010 and 2011. Moving forward, the Government of Indonesia is committed 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 preparation of a National Strategy for financial Inclusion for implementation in the medium term 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. In accordance with the FY09-FY12 CPS, the DPL series has been at the center of WBG support in strengthening Indonesia’s central government institutions and systems, a key cross-sectoral engagement theme under the CPS. The latest installment of the series was DPL-8, a USD 400 million loan, approved by the Board on November 22, 2011. Additionally, the FIRM program builds directly on the USD 2 billion PERISAI DPL-DDO (approved May 2012) with its focus on enhancing financial crisis preparedness. 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, LPS, Bank Indonesia, among other agencies.

II. Proposed Objective(s)

The main objective of the proposed loan is to assist the Government in promoting the development of a sound, efficient and inclusive financial sector and accelerate investment in order to achieve its economic expansion 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. In 2011 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. Today Indonesia’s financial sector remains bank-dominated, and as such, financing is dominated by short-maturity financial instruments, typically time deposits. The amount of long-term financing needed by corporations, infrastructure and SMEs remains very limited acting as a drag on growth. In addition, much of the population does not have access to appropriate financial products and services\textsuperscript{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:

(i) reinforcing financial sector stability,

(ii) promoting financial sector diversification,

(iii) enhancing financial inclusion for underserved groups and the poor, and

(iv) supporting investment climate regulatory reform

III. Preliminary Description

In financial sector stability, the FIRM Program will focus on supporting the establishment of an effective financial sector regulatory and supervisory framework, enhancing crisis preparedness and strengthening the deposit insurance system to enhance confidence in the sector.

In financial sector diversification, the FIRM Program focuses on a set of priority actions to address primary recommendations identified in the FSAP for capital market and insurance industry development, including the need to improve the corporate governance and transparency of Indonesia’s capital markets and improve the overall soundness and promote consolidation of the insurance industry.

In financial inclusion, promoting policy coordination and developing innovative financial products are the primary focus. The Government has launched major initiatives on a number of fronts to promote financial inclusion, including the development of the first National Strategy for Financial Inclusion and the FIRM will support this effort.

Regards promoting investment climate regulatory reform, the FIRM Program will concentrate on supporting GoI programs at the strategic level, to attain leadership and coordination for reform, such as through the establishment of a National Committee on the Improving the Ease of Doing Business.

IV. Poverty and Social Impacts and Environment Aspects

\textsuperscript{1} Less than 50% population has access to formal financial services
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 Program aims to further bolster these efforts. The focus of the operation also on 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 financing products targeting the poor. Without inclusive financial systems, poor individuals and small enterprises need to rely on their personal wealth or internal resources 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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<th>Source</th>
<th>($m.)</th>
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<tr>
<td>Borrower</td>
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<tr>
<td>International Bank for Reconstruction and Development</td>
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<td>Total</td>
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VI. Contact point

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