Letter of Development Policy

Jakarta, October 2012

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Mr. James Yong Kim
President
The World Bank
1818 H Street, NW
Washington, DC 20433

Dear Mr. Kim,

On behalf of the Government of Indonesia, we would like to express our gratitude for the long term support that the World Bank has provided as a development partner within the multilateral economic and financial framework. We are hereby writing, on behalf of the Government of Indonesia to request the World Bank support through three lending operations:

- The Institutional, Tax Administration, Social and Investment Development Policy Loan (INSTANSI DPL) for USD 300 million.
- The Financial Sector and Investment Climate Reform and Modernization Development Policy Loan (FIRM DPL) for USD 100 million.
- The Connectivity Development Policy Loan for USD 100 million.

These three operations together form an important package of support to the Government that will help it achieve its medium term economic development and poverty reduction goals for Indonesia. Each of the development policy loans addresses strategic areas of reform including public financial management, poverty alleviation, financial sector development, investment climate, and connectivity. The three operations are fully aligned with the priority elements of our development agenda, as we have outlined in Indonesia’s National Medium-Term Development Plan (RPJMN) 2010-2014, the Master Plan for Acceleration and Expansion of Indonesia’s Economic Development 2011-2025 (MP3EI), as well as the Annual Government Action Plans (RKP), ministry/agency work programs, and reform packages. As you are aware, Indonesia has made important progress over the past decade in many areas of social and economic development and poverty reduction. However, continued implementation of its earnest reform agenda is essential if it is to meet the goals in terms of sustainable and inclusive growth. This Letter of Development Policy outlines the Government’s recent progress implementing its reform program and its medium term agenda in the areas supported by the loans.
standards have been formally established and are largely being adhered to in the production of comprehensive annual financial statements, while the capacity of the internal and external audit functions continues to grow. A new public Financial Management Information System (SPAN), which should streamline budget execution and provide more timely and robust information for budget management at all levels of government, is expected to be rolled out in 2013. The reform momentum has also gradually shifted toward the implementation of more performance orientated practices with the introduction of the Medium-Term Expenditure framework (MTEF), Performance-Based Budgeting (PBB), and results-based monitoring.

Developing a sound, efficient and inclusive financial sector

In recent years, the Government has made important progress in terms of achieving stability in the financial sector. This has been demonstrated by improved soundness indicators of the banking sector in particular, and the relatively modest impact to date of both the global financial market instability since 2008 and ongoing crisis in the Eurozone. The Government has responded proactively to such global developments, identifying and implementing key measures to maintain the stability of the financial sector and to reduce volatility in our financial markets. For instance, the Government has established a bond stabilization framework that aims to stabilize the government bond market in the case of a sudden reversal in capital flows or shock. This mechanism includes a number of potential actions to stabilize government bond market in the case of crisis.

In addition to our efforts noted above, we plan to continue our longer term reforms to promote financial sector stability, by pursuing reform of the underlying legal and regulatory framework. Reinforcing the Government’s commitment to promote the financial stability, in October 2011, the Indonesian Parliament passed the new Financial Services Authority Law (the “OJK Law”), which provides the legal basis for the establishment of a new consolidated financial sector supervisory authority. Importantly, in the medium and longer term this law provides us with an opportunity to further strengthen the quality of financial sector supervision in Indonesia. In this way, the new law establishes a legal basis for improved coordination in monitoring financial sector stability through the Financial Sector Stability Coordination Forum. To this end, we are supporting efforts to improve crisis prevention and management arrangements. This has included development of the National Crisis Management Protocol, and agreement on information sharing and coordination arrangements between the Ministry of Finance, Bank Indonesia, and Indonesia Deposit Insurance Corporation (LPS).

The current global economic environment reinforces the importance for Indonesia financial sector authorities to continue to implement its reform agenda related to financial sector diversification and inclusion. This includes the pursuit of deeper reforms of the financial sector to enhance efficiency and expand access to services for the poor and underserved. In the medium term, this will imply measures to promote the development of non-bank financial institutions, including capital markets and insurance sector. Specific reform challenges and priority measures are outlined in the Bapepam-LK Capital Market and NBFI Master Plan 2010-2014, which is currently under implementation. The Government’s reform program will also include taking important steps to implement the National Strategy for Financial Inclusion in order to enhance the prospects of the poor engaging in Indonesia’s financial system and accessing a wide range of
In recent years, the Government has also made significant policy and institutional reform efforts to address connectivity challenges. The Government introduced reforms aimed at improving policy coordination surrounding connectivity, improving domestic logistics efficiency, facilitating investment in public infrastructure projects, improving trade facilitation and strengthening inclusive development. We introduced a National Logistics Blueprint that will guide reforms in logistics and established the mechanism for linking these reforms with implementation of the MP3EI. Recently, we issued an implementing regulation for the new Land Acquisition Law that would help facilitate investment projects that enhance national connectivity. The Government has also introduced reforms to strengthen Information and Communications Technology (ICT) connection, particularly for Eastern Indonesia. On international connectivity, we continue to undertake reforms surrounding the Indonesian National Single Window (INSW) as a mechanism to better facilitate international trade.

We therefore plan to focus our efforts going forward on a reform program that is aimed at reducing domestic logistics costs and strengthen inclusive development, including efforts to strengthen national coordination and regulation, and connectivity on an intra-island, inter-island and international level.

Conclusion

In conclusion, Indonesia continues to make solid progress in the areas to be supported by the DPL program lending, specifically towards enhancing the quality of public spending for poverty reduction and service delivery, developing a sound, efficient and inclusive financial sector, supporting improvements in the investment climate, and improving national connectivity. We therefore appreciate your positive response to our request for support and look forward to working with you in the context of the INSTANSI, FIRM, and Connectivity DPLs.

Minister of Finance
Republic of Indonesia

Agus D.W Martowardojo

Coordinating Minister for Economic Affairs
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M. Hatta Rajasa