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MAPPING THE POLITICAL ECONOMY OF THE INDONESIAN FINANCIAL ECOSYSTEM

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1. Introduction to E3G's political economy mapping of the global financial ecosystem
2. Mapping the Indonesian financial ecosystem
 - Overview of key financial indicators
 - Policy and diplomatic calendar 2021-22
 - Opportunities and barriers to a green recovery
 - Assessing the greenness of economic response to Covid-19
 - Integration of climate-related risks into the financial system
 - National positions in multilateral institutions
 - Recommendations for action



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1. INTRODUCTION

- **Aim** - E3G’s political economy mapping of the global financial ecosystem takes stock of opportunities and challenges for systemic economic and financial reform for climate safety across 14 key countries and institutions (“venues”). It aims to better understand countries and institutions’ positions on key aspects of fiscal and monetary policy, and financial regulation, analyse the interactions between these venues, show the main champions and blockers of a progressive sustainable finance agenda, and assess opportunities for green reforms over the next 12-24 months.
- **Method** – E3G is working with a number of in-country partners to develop this research. We have used a mixed-research methodology for each venue – a mixture of desktop research and semi-structured interviews with key stakeholders (policymakers, academics, civil society) following a series of defined research questions. E3G compiles the findings into a presentation for each venue, tests the results internally with other E3G colleagues and then presents the results as appropriate to external stakeholders.
- **Usage** – This research will be used as an internal and external resource to inform civil society and financing strategies for specific countries.

2. INDONESIA: KEY FINANCIAL INDICATORS



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GDP (Current USD, 2021)	1.159 trillion
GDP growth (2020-21)	9.4 %
GDP per capita rank	110 / 192
Value add of finance sector to GDP (2020)	4.51%
Share of public & private debt in GDP (2020)	39.4% & 31.34 %
Human Development Index (HDI) Rank: (2020)	107/ 195
GHG Emissions: (Mt CO2, 2018)	542 (313 % higher than 1990)
Credit rating: (2020)	BBB (Fitch)

INDONESIA : OPPORTUNITIES AND BARRIERS TO A GREEN RECOVERY



Opportunities

- The establishment of a green taxonomy as demanded by MDBs will likely lead to an increase in climate risk capacity within the financial sector to develop green finance instruments which can then elevate the bankability of many green projects.
- Use G20 Presidency to advance climate and sustainable development
- Build on Low Carbon Development Initiative (LCDI) to further integrate climate action into Indonesia's development agenda
- Recently, President Joko Widodo has expressed his interest in making Indonesia a top player in the global electric car market. This was derived from the fact that Indonesia is one of the world's largest producers of nickel, an essential component to the production of lithium-ion batteries that power electric vehicle

Barriers

- Indonesia is one of the major global emitters of greenhouse gases (GHG). The country was the world's 4th largest emitter of GHG in 2015 with 9.2 tonnes of emissions per capita.
- Large financing gap for climate transition, lacking 66% of required investments to achieve current NDC
- With the current prioritisation on economic recovery, it has been decided that there will be no adjustment towards a higher climate target prior to 2030 as agreed on by the NDC
- A successful adoption and implementation of LCDI policies will be contingent on the undertaking of substantive, well-coordinated engagement, support and communication strategies, within BAPPENAS, across national government entities, with regional levels of government, and with private sector, civil society and the international community.

INDONESIA: ASSESSING THE GREENNESS OF ECONOMIC STIMULUS / RESPONSE TO COVID-19



- Covid-19 has brought many challenges to Indonesia's economy.
 - Economy contracting by 2.07% in 2020 (first full year contraction since the 1998 Asian financial crisis)
- To bounce back the economy, Indonesia's central bank proceeded to lower its benchmark interest rate
- The reduction in development financing negatively affected Indonesia's NDC targets and commitments to reduce carbon emissions and prevent climate change.
- In 2020, the Government released a regulation regarding various measures to deal with the pandemic and maintain national economic condition as well as financial system stability
 - The fiscal stimulus program issued by Indonesia has not yet adequately considered sustainability and climate risk aspects
- The Ministry of Finance (MOF) is facing the challenge in handling economic and green recovery simultaneously where both seem to be paired in trade-offs.
 - Due to international and national pressure on green recovery, MOF is trying to mainstream the green stimulus even though the larger aspect of Indonesian economic stimulus is yet to be green.
 - To further attract private sector investors to close the financing gap for a green recovery, MOF provided fiscal incentives to increase low-carbon development (such as geothermal funding). However, the private sector still faces regulatory obstacles and underdeveloped financial markets
- To strengthen the green recovery effort the MEMR provides incentives especially for the development of NRE.
- Bappenas is currently preparing a road map for the implementation of low-carbon development funding in the form of a stimulus for green recovery which is expected to be launched in 2022.

INDONESIA: INTEGRATION OF CLIMATE-RELATED RISKS INTO THE FINANCIAL SYSTEM



- **Financial sector in Indonesia is currently still lacking the capacity and experience to adequately analyse and underwrite environmental risks and investment**
- **The Financial Service Authority OJK** leads through the establishment of the Sustainable Finance Roadmap but yet to complete a most anticipated work on green taxonomy.
 - Yet to set any timeline regarding climate risk assessment for the financial sector.
 - An additional task for OJK would be providing the capacity building needs and mandates for banks and the wider financial institutions in relation to the TCFD recommendation in which they are currently lacking the awareness at.
- **Bank Indonesia** is part of the Network for Greening the Financial System (NGFS), with the specific task of developing an analytical framework for environmental risk assessment.
 - To date, there is relatively quiet news coming out from the Bank Indonesia on the risk assessment framework, and most of the supporters prefer to approach the OJK.

INDONESIA: NATIONAL POSITIONS IN MULTILATERAL INSTITUTIONS

- **G20:** Being appointed the G20 Presidency in 2022, Indonesia is expected put higher focus on climate and sustainability development. The MOF and Bank Indonesia have participated in the G20 agreement for global economic recovery with the orientation of sustainable and inclusive growth, prioritising a green recovery, while increasing financial sector resilience.
- **IMF:** Indonesia, along with other G20 member countries have requested the IMF to prepare a Special Drawing Rights (SDR) allocation proposal to maintain liquidity amidst Covid-19 recovery plan
- **MDBs:** MDBs have been able to support and express the substantial amount of urgency towards achieving Indonesia's climate agenda through loan, grant and debt restructuring mechanisms to assure the timely alignment between the economic development and climate change mitigation and adaptation. Furthermore, apart from providing climate financing, MDBs are hoping to increase the awareness of climate risk and improve the knowledge regarding climate risk and disclosure in order to elevate the number of bankable green projects. This capacity building would be able to enhance the attractiveness of Indonesia's investment climate for sustainable development.
- **NGFS:** The Bank Indonesia, which is almost exclusively tasked to manage the monetary policy, has started to take part in the Network for Greening the Financial System (NGFS), with a specific task of developing an analytical framework for environmental risk assessment.

INDONESIA: RECOMMENDATIONS FOR ACTION



- Making it highly vulnerable to the impact of climate change (Indonesia among 35 countries with the highest risk of natural disaster), it is **critical for Indonesia to transition to an inclusive green economy**, leaving the “business as usual” scenario.
- **Establishment of a Green Taxonomy**
 - The implementation of ESG in financial institutions really needs to be encouraged by regulators, especially the OJK, so that it can accelerate the application of sustainable finance in financial institutions.
- **Closing the financing gap**
 - The fiscal challenges in green recovery are due to the limitation of funds from the State Budget.
 - According to the second biennial update report in 2018, Indonesia needs at least USD 247.2 billion or around USD 19 billion per year to achieve the NDC target by 2030. However, in the last 5 years (2016-2020), Indonesia has only been able to fund around 34% of the need for national climate financing every year.
 - To close the 66% financing gap, Indonesia requires financing from the private sector, which plays a key role in the development and implementation of climate projects.
 - To further attract private sector investors, the government provided fiscal incentives to increase low-carbon development such as geothermal funding to reduce exploration risks. However, the private sector still faces regulatory obstacles and underdeveloped financial markets

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ClimateWorks Australia bridges research and action, to achieve the system-level transitions required to reach net zero emissions across Australia, Southeast Asia and the Pacific. Founded in 2009 we act as trusted advisers, influencing decision-makers with the power to reduce emissions at scale. ClimateWorks is hosted by Monash University – which recently establish Monash University Indonesia. Since 2019, ClimateWorks has a team operating in Indonesia aiming to become an Indonesian entity under Monash University Indonesia in 2021

E3G is an independent climate change think tank accelerating the transition to a climate-safe world. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.



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ANNEX

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