FINANCIAL INCLUSION IN INDONESIA – WHAT WE CAN DO MORE

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This policy brief is the result of an activity entitled "Economic Policymaking in Indonesia' which is jointly conducted by Centre for Strategic and International Studies (CSIS) and Economic Research Institute for ASEAN and East Asia (ERIA). This activity is a contribution from research community that is expected to assist the government in formulating more effective economic policies in the future. In this activity, CSIS and ERIA invited 16 economists with specific fields of expertise from some leading research institutions to conduct in-depth discussions on seven strategic issues facing Indonesian economy (infrastructure development, competitiveness, investment climate, food policy, services sector policy, fiscal policy, and social protection policy), which is then summarized into policy briefs covering each of the topics.

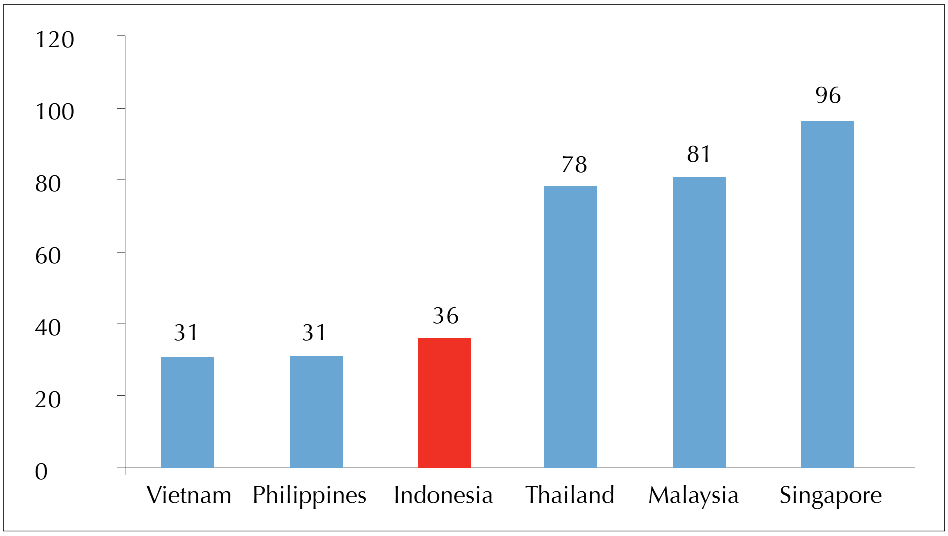
Dissemination of the findings and recommendations produced by this activity is conducted through several channels. First, this activity has made efforts to engage the relevant government officials through some Focus Group Discussions (FGD), the publication of High Level Policy Notes, and hearings with some strategic policymakers with regard to each of the strategic issues mentioned above. Secondly, this activity also conducts widespread public disseminations through Public Seminars on each of the strategic issues, along with publications of the Policy Briefs and supporting multimedia that can be accessed online through www.paradigmaekonomi.org.

NATIONAL STRATEGY ON FINANCIAL INCLUSION

The benefit of financial inclusion in economic development is widely recognized not only to help low-income people manage risk and absorb financial shocks, but also to establish a foundation for stable and inclusive economic growth by boosting job creation and increasing investment in education. Government realizes that serving the underserved will benefit not only the underserved but the whole economy. The underserved is not only the poor and the vulnerable but also micro and small business that face barriers to enter financial services.

Financial inclusion in Indonesia is relatively low compared to other ASEAN countries. As reported by World Bank in Global Financial Inclusion Database 2015, percentage of Indonesian above 15 years old who have account at financial inclusion is 36%, far below Thailand (78%), Malaysia (81%) and Singapore (96%).

Figure 1: Number of people above 15 years old who have account at financial institution[1] in several ASEAN countries in 2014 (%)



With the low rate of financial inclusion and realizing a strong causal relationship between financial system and economic growth and individuals' welfare, government of Indonesia launched a national strategy for financial inclusion in 2012. In this strategy, financial inclusion is defined as

> The right of every individual to have access to a full range of quality financial services in a timely, convenient, informed manner and at an affordable cost in full respect of his/her personal dignity. Financial services are provided to all segments of the society, with a particular attention to low income poor, productive poor, migrant workers and people living in remote areas.[2]

However this definition lacks of the first step of financial inclusion which is awareness of the importance of financial inclusion which can be done through financial literacy. As described in the National Strategy for Financial Literacy

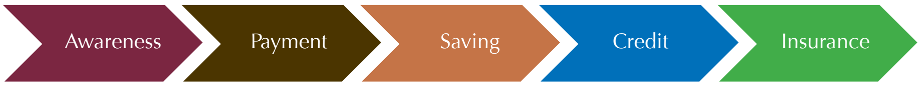
1 Financial institution account includes respondents who report having an account at a bank or at another type of financial inclusion such as a credit union, microfinance institution, cooperative, or the post office (if applicable), or having a debt card in their own name.

2 Sekretariat Wakil Presiden Republik Indonesia, 2012. "National Strategy for Financial Inclusion Fostering Economic Growth and Accelerating Poverty Reduction.

prepared by OJK, although the utility index of financial services in Indonesia is almost 60% but the literacy index was only around 22%[3]. It means that many customers use the financial service products without sufficient knowledge about the products. This condition urges OJK to focus on financial literacy as a way to improve financial inclusion in Indonesia.

Once the customer has sufficient knowledge, the next step of intervention in financial inclusion is payment transaction. In the case of the poor and vulnerable population, they will have access to financial system when they receive transfer from government through Government-to-Person (G2P) program using non-cash. When they have remaining balance from the transfer, the next step is saving. Once they start accumulate the savings, they will need to have more resources and since they are now bankable there is an opportunity to received credit from formal financial institutions. Later on they start to realize that they need insurance to protect their families and wealth. Meanwhile for the non-poor, once they have awareness about financial services, they will use it for saving rather than payment and the following steps are similar with the poor and vulnerable.

Figure 2: Sequencing in Financial Inclusion

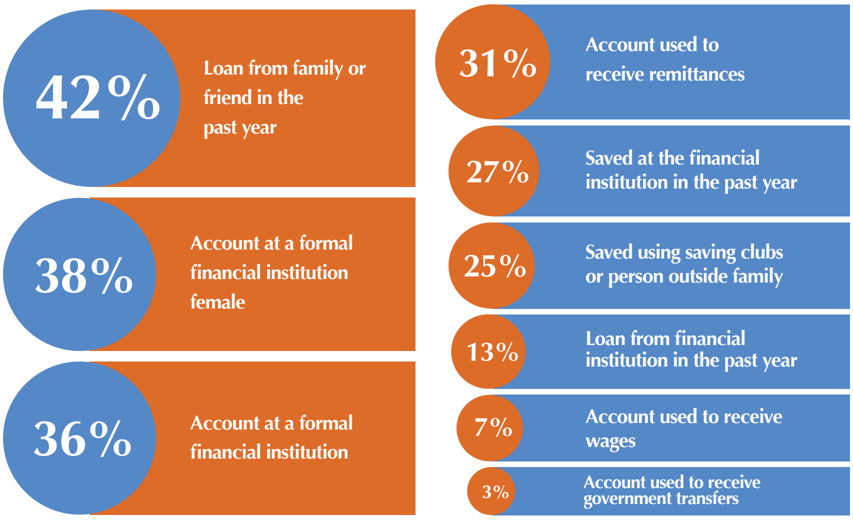


There is clear and detail strategy to include the poor and vulnerable into formal financial system in the current national strategy for financial inclusion, however the strategy to include non-poor (individuals and business) is not yet described in detailed although there is evidence that many small business and individuals just above the poor and vulnerable population that are still excluded from the formal financial system due to several reasons and the most significant reason is lack of awareness, followed by lack of access and usage (no available instruments fit their needs).

As shown in Figure 3 below, only 27% of age 15+ populations actually save in financial institution and 25% save at the saving clubs or person outside family. On credit side, only 13% received loan from financial institution and 42% received loan from family and friends, the rest received loan from informal financial institutions which are usually charged a very high interest. Among people who have account in formal financial institutions only 7% use their account to receive wages, 31% to receive remittances and 3% to receive government transfer. With this condition there is actually ample of opportunity to increase financial inclusion in Indonesia as long as the awareness, access and usage of financial system are improved.

3 Otoritas Jasa Keuangan, 2013, Strategi Nasional Literasi Keuangan Indonesia.

Figure 3: Financial Inclusion in Indonesia 2014 (% age 15+)



FINANCIAL INCLUSION PROGRAMS IN INDONESIA

Government has implemented several financial inclusion programs since 2010 with the Gerakan Indonesia Menabung and introduction of Tabunganku – a saving with easy procedure such as no administration fee and initial deposit of Rp. 20.000 for commercial banks and Rp.10.000 for syariah banks. Until June 2014 the number of customer for Tabunganku was around 12 thousand account compared to December 2013's figure of around 11 thousand while the average balance of the account was actually lower than in 2010 when it was firstly implemented (Rp. 842 thousand in 2014 compared to Rp. 933 thousand in 2010). With this situation one can infer that free administration fee is not a major attraction for saving but more about the accessibility to financial services.

With the geographical condition of Indonesia which makes opening branches of bank is expensive coupled with the high penetration of mobile banking even among the poor and vulnerable population, Bank Indonesia conduct a pilot project on branchless banking in May – November 2013 that introduce concept of financial transaction without going to bank branches but through agent and mobile phone. The result of this pilot project was satisfying and lead to the issuance of Electronic Money (Layanan Keuangan Digital - LKD) regulation in 2014 which enable customer to have limited financial services using technology both mobile based and web based through third party (agent) with the target for unbanked and underbanked population.

With the LKD, in late 2014, government changed the methods of G2P transfer from cash to non-cash for 1 million eligible households. The use of e-money actually provides financial access to G2P recipients who are most likely come from "unbanked" segment. Government also persuades the recipients to save some of their money. Since then, several G2P program were changed from cash to non-cash such as for Program Keluarga Harapan (PKH), Kartu Indonesia Sehat, Kartu Indonesia Pintar and Kartu Keluarga Sejahtera. However the implementation of this scheme is yet to be evaluated to improve the transfer mechanism.

In 2014, OJK issued LAKU PANDAI (Layanan Keuangan Tanpa Kantor Dalam Rangka Keuangan Inklusif - Branchless banking) regulation. The main different between LKD and LAKU PANDAI is that LKD is based on electronic money which is not directly connected to the bank account, while LAKU PANDAI is branchless banking where a customer actually has a bank account. Furthermore, OJK introduce LAKU MIKRO which provide one stop service where customer can have saving, micro insurance protection, micro mutual funds, micro financing and gold installment with easy requirements.

Both LKD and LAKU PANDAI use agent for their operation, however their agent has different characteristics. LAKU PANDAI agent is actually the extension of banks, since they are the front-line of banks for the unbanked population while LKD agent acts as selling point for e-money. Therefore the recruitment and training for agent is crucial for banks and it's costly especially if each bank has to provide training by itself. The requirement for agent for LKD and LAKU PANDAI is also different. LKD agent can be an agent for several banks and telecommunication companies, while LAKU PANDAI agent is exclusive for one commercial bank and one syariah bank.

Another new saving account introduce by OJK is Simpanan Pelajar – Simpel (student account) which targets student with only Rp.5.000 for initial deposit and free monthly administration fee and the student get saving book and ATM. OJK also set the first Wednesday of the month of Saving Day. On this day, students are encouraged to save in their Simpel. This new saving account is intended to replicate the success of Tabanas account back in the 1970s. Since it was just introduced last year, it is still need to see the success of this saving compared to Tabunganku which was introduced earlier and not very successful.

With two institutions oversee and regulate the financial system, i.e. Bank Indonesia and OJK and each of them issue similar products and regulations, it creates confusion not only for customer but also for financial institution. One example is the issuance of LKD (by Bank Indonesia) and LAKU PANDAI (by OJK). Basically these two products aim to the same population: unbanked and underbanked population especially in remote areas. The only different of LKD is not directly connected to bank account while LAKU PANDAI is connected to bank account. Currently the implementation of these two products confuses not only customer but also agent and bank. Actually both products offer the same thing, financial service without going to bank branches but doing it through agent or mobile phone. The customer does not really care whether their "saving" is connected to bank account or not as long as they can conduct the financial transaction they need such as pay bills, buy cellphone credit (pulsa) and pay installment. But with the different products and different agents who usually locate side by side, the potential customers become confuse and might cancel their intention to have financial services.

Not only for the customer, agents also confuse because they are now facing a choice to become agent of LKD or LAKU PANDAI. If they become the agent of LKD they can sell products from different banks and telecommunication companies but when they choose to become LAKU PANDAI agent they can only serve one commercial bank and one syariah bank.

On the other hand, bank's operation becomes more complicated with the implementation of these programs. In some banks, there is a competition between transaction banking where LKD usually managed and micro banking where LAKU PANDAI is managed. They also have to hire agents for both LKD and LAKU PANDAI programs. While in some banks, they separate the system for these two programs which make them very reluctant to combine the system if there is a merger between these two programs in the future.

Currently the implementation of financial inclusion has not been fully integrated into other government programs such as in-kind subsidy to farmer and fisherman. Actually such integration is another way to increase financial inclusion where in-kind transfer program is converted into cash/non-cash transfer programs. Many studies have shown that in-kind programs are not efficient because in many cases the logistic cost is higher than the value of the in-kind. Several in-kind programs that can be converted into cash/non-cash programs are the ones for farmers and fishermen. It includes seeds, fertilizers and fuel for boats. With the change of in-kind transfer to cash/non-cash transfer the recipients are automatically included in the financial system and the government program can reach targeted persons, which is not the case currently. One challenge of the well-targeted transfer program is the availability of reliable data on the eligible recipients. Therefore the Ministry of Agriculture and Ministry of Fishery have to prepare this data before they launch the cash/non-cash transfer as a replacement of in-kind subsidy.

POLICY RECOMMENDATIONS

Given the existing condition in financial inclusion programs in Indonesia and lessons learned from other countries, there are several recommendations can be considered to improve the condition:

1. Better coordination between BI and OJK therefore financial sector has better legal and administration certainty in implementing financial inclusion strategy. One example is the implementation of LKD and LAKU PANDAI which confuse not only the customer but also agents and banks. These programs can be merged and the customer can choose between using the LKD or LAKU PANDAI when they want to do their financial transaction.
2. Convert in kind transfer for farmer and fishermen to cash/non-cash transfer using the existence of LAKU PANDAI agents so it will be well-targeted. However the reliable database on the eligible recipients is mandatory before the program started.
3. Expand the use of e-money in public transportation not only for bus and train but also for taxi. However, banks should also improve their infrastructure so there is incentive for taxi driver to use the m-money.

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