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Policy and Regulatory Framework for Remittance - Indonesia

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Preface

This report provides a brief overview of the policy and regulatory framework for remittances in Indonesia. In particular, the report provides an overview of the foreign exchange licencing rules and regulations; rules relating to mobilisation of deposits by non-bank institutions; prudential regulations affecting non-bank sector growth; tax treatment; and incentives relating to migration and remittances.

This report was prepared as part of a wider Australian Research Council (ARC) funded research project on 'Leveraging Remittances with Microfinance: A Cross-country study'. The six-country study involves Sri Lanka, Philippines, Indonesia, Samoa, Fiji and Timor Leste.

This project is currently on-going. Further work and subsequent findings on this important and growing field is envisaged to be published for dissemination in mid-2007.

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Preparation of the country report on Indonesia's policy and regulatory framework for remittance was led by Kurniawan (Indonesia) and Ms Frances Barns (FDC Consulting Associate).

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EXECUTIVE SUMMARY

With large numbers of Indonesians working overseas, interest in remittance as a source of foreign exchange and development finance has grown in recent years. According to recent estimates, remittance contribution to GDP is only 0.7% in 2004. However, it is the volume of remittances, recorded between US$2-3 billion a year that is significance to the government and policy makers. In some areas, the contribution of remittances is much higher as a percentage of Gross Regional Domestic Product (GRDP) than the contribution at national level to GDP. In Ponorogo District in East Java, in 2004, for example, remittances constituted 104 percent of GRDP.

The regulatory environment for remittance in Indonesia is fairly restrictive. There are a range of limitations on foreign exchange handling and international transfers, and restrictions on commercial banks. This has been partly due to government's conservative approach to managing the financial system amid concerns about monetary stability and the health of the banking system in the wake of the financial crisis in the 1990s.

In the case of Indonesia, this report states that the cost of transfer is mainly related to the institutions in sending countries, and has very little impact on the receiving countries. Thus, there is a significant difference in the sender vs. recipient regulatory environment with much of the fees incurred at the sender's end.

With regards to tax implications, there is no sufficient information to gauge its impact on remittances. Thus, further work is required in this area.

Indonesia has introduced regulations for Banks, NBFIs and Non Financial Companies to report on their international transactions and foreign exchange handling including the implementation of IMF's 'Know Your Customer' (KYC). For transactions above US$10,000 an explanation must be provided on who is transferring the money, the relationship between the transactors and the purpose of the transaction. Under US$10,000 information on transfers can be combined and categorised according to the currency and type of account. Banks, NBFI and Non Financial Institution Companies must all provide a monthly transaction report and a bi-annual position report to BI.

The government has introduced policies and programs to facilitate migration as well the provision of remittance related services, particularly in rural areas. For instance, the government has a focus on providing loans for obtaining overseas work contracts through the banking sector and has programs to involve the rural banks in this provision. Furthermore, the government has a policy to empower the Micro, Small and Medium Enterprise Sector (MSME) as part of a strategy to increase investment options for migrants.

1. Introduction

This paper examines the policy and regulatory environment pertaining to remittances in Indonesia. The paper looks at what types of players have access to the money transfer market, what are the regulations pertaining to foreign exchange handling and who has access to the payments system. The paper also assesses what policies and programs are in place to increase financial intermediation by migrants and remittance recipient households and looks at the role of microfinance institutions (MFIs) in the remittance sector. Also discussed are policies relating to the investment of remittances, particularly policies to grow the Micro, Small and Medium Enterprises Sector (MSME).

2. Foreign Exchange Licencing Rules and Regulations

Interest in Indonesia in remittances as a source of foreign exchange and development financing has definitely grown in recent years, in step with the growing global awareness of the significance of remittances. Indeed, the need to expand numbers of migrant workers has actually been written into the IMF Post program monitoring agreement as a way to increase foreign exchange earnings. The Minister responsible for migrant workers, the Minister for Labour and Transmigration, Erman Soeparno has set a target of Rp 186 Trillion in remittances annually by 2009 (Susilo, 2006).

However, despite this interest, remittance related priorities - such as promoting the availability of cheap and good quality transfer services - are not in the forefront of Government and Central Bank policy makers in shaping and regulating the financial sector. A decade on from the Asian financial crisis its devastating effect is still being felt. As part of a long term effort to build up an economy and banking sector that was virtually destroyed, Government and Bank Indonesia (BI) financial sector policy is still very much preoccupied with fundamental issues such as monetary stability, controlling inflation and ensuring the health of the banking sector through prudential controls (Charitonenko, S, 2003, Bank Indonesia, 2005). The orientation is thus toward limiting and controlling participation in the financial system rather than throwing open the playing field.

This can be seen in regulations regarding the payments system. Only fully fledged commercial banks are able to handle money transfers, NBFIs such as MFIs are not permitted. In Indonesia banks are divided into commercial banks, literally known as "public banks" *Bank Umum* (BU) and rural banks, or "people's credit banks" *Bank Percreditan Rakyat* (BPR). Commercial banks have a full range of functions and are able to participate in the payments system (Banking Act 7, 1992). BPR have limited functions in savings and credit and do not participate in the payments system. BU is permitted to deal in foreign exchange but BPR are not. Banks that deal in foreign exchange are described as *Bank Devisa* (Foreign Exchange Banks) and they must obtain a license from BI to carry out banking functions involving foreign exchange (BI Reg. 6/15/PBI/2004).

The only cross over by an MFI into the money transfer market is Bank Rakyat Indonesia (BRI) which is a state owned commercial bank with a specific mandate for microfinance fulfilled by its network of Unit offices at sub-district level throughout the country (Charitonenko, 2003). It is the only bank to have a presence in the rural areas beyond district towns.[1] Money Transfer Operators are permitted to operate in Indonesia but only with a Bank as an agent. There are also special provisions for post offices to provide international money transfer services (ADB, 2005).

[1] Bank Danamon now also has a strategy to open Units at sub-district level as part of a shift into the microfinance market (Asian Banker, interview with Sebastian Parades, president director, Bank Danamon, 21/2/06)

BPRs and other companies, under certain conditions are permitted to become Foreign Exchange Traders (PVA) (BI Regulation 5/2/PBI/2003, 3/10/2003) with limited powers to handle foreign exchange. Foreign exchange traders may buy travellers cheques and trade foreign currency bills but they are not permitted to make payments based on instructions from overseas, send or receive international money transfers or sell foreign currency travellers cheques.

In addition to limiting who can handle foreign exchange, BI also puts controls on the handling of the Rupiah in the international financial markets. In order to combat the problem of currency instability which has plagued Indonesia since the Crisis, BI has a policy to prevent speculation on the Rupiah and thus the Rupiah cannot be traded or used for international transfers (BI reg. 3/3/PBI/2001). The only trade in Rupiah that is permitted is some trade in derivatives to a limit of US$3 million. Moreover, Indonesian Banks are not permitted to provide credit to foreigners or foreign institutions.

2.1 The Impact of Sender vs Recipient Regulatory Environments

The Indonesian regulatory environment for transfer services is regarded to be quite restrictive. In considering how this impacts on the services that are available for Indonesian migrants and remittance recipients it is important to note that much of the costs of transfers are incurred in the sender country. There are three components to the fees charged for a money transfer including:

a) the fee charged by the sending institution
b) the foreign exchange spread in which the transfer provider charges higher than market interest ranges and
c) fees charged by the recipient agency. In many cases the recipient institution acts as an agent of the sender institution and so the majority of the fees are incurred in the sender country (Martinez, 2005).

The fact that Rupiah cannot be traded may have some impact on the interaction between sender and recipient agents in sharing fees on foreign exchange spreads. However, generally the regulatory framework in the sender country may have a greater impact on the cost of transfers than the regulatory framework in the recipient country. Despite the advantage of a closed market in Indonesia, most banks do not charge the receiver to collect the transfer. On the other hand, the ADB Southeast Asia Workers' Remittances Study has shown the level of money transfer operator regulation in the sender country to be a statistically significant indicator of cost along with the volume of transfers and level of informality (see Table 1).

Table 1: Migration Levels and Remittance Costs in Southeast Asia

Country	Total no of migrants from individual country	Average income (US$)	Average remittance (US$D) + annual no of transactions	Average cost of transfer for US$1,000	
Japan	Indonesia	22,000	22,000	830/5	6.3%
	Philippines	180,000	19,000	567/11	9.4%
Malaysia	Indonesia	1,000,000 (400,000 undocumented)	4,000	151/6	8.4%
	Philippines	140,000 (100,000 undocumented)	2,500	132/10	7.4%
Hong Kong	Indonesia	108,000	4,800	268/11	2.8%
	Philippines	142,000	5,000	322/15	2.3%
Singapore	Indonesia	60,000	2,000	284/3	4.3%
	Philippines	90,000	9,000	294/14	3.3%

(Source: ADB, Southeast Asia Workers' Remittances Study)

Studies have shown that migrant corridors in which there is an active policy dialogue between sending and recipient country governments tend to have lower fees. For example, the US Governments and Mexico have signed agreements to allow funds to be transferred through the US Federal Reserve Bank's ACH (Martinez, 2005). The US and Philippines Governments are also discussing ways to improve the connectivity of payment systems to facilitate low cost transfers between the two countries (ADB, 2004). There have been discussions between corporations and banks in Indonesia and in destination countries for Indonesian workers[2] . Indonesia is not yet at a stage of exploring integration of payments systems with other nations, it is only just developing its own electronic payments facilities. Remittances are touched on in bilateral policy discussions and international fora such as APEC and ASEAN in practice, but there is no formal program for coordination along specific corridors (ADB, 2005).

In Indonesia, remittances can only be collected from banks (ADB, 2005). Currently, rural residents do not have to travel as far as they once did to get to a bank. A series of banking reforms, known as PAKTO, which began in 1988, allowed commercial banks to extend their network throughout Indonesia and they are now present in district towns (*Ibu Kota Kabupaten*) throughout the archipelago, apart from the Bank Rakyat Indonesia (BRI) which has a wide network of units at sub-district level (Charitonenko, 2003). There are also indications that although the number of banks is not increasing, the number of branch offices of banks is continuing to multiply. For example, in East Java the number of Bank branch offices was 1,612 in 1997 but had increased to 2,174 in 2005 (Soebagyo, 2006).[3] This does not necessarily mean that banks are getting closer to rural communities, just that more branches are clustering in district towns.

3. Rules Relating to Mobilisation of Deposits by Non-bank Financial Institutions

Despite the large number of micro-enterprises and their substantial contribution to GDP, microfinance lending is still not a big market for the commercial banks in Indonesia. There are a number of reasons for this including effects of the financial crisis. Most banks are not present in the rural areas and many do not have micro-enterprise products, or they are not promoted in the way that consumer wants it. Micro-savings accounts are more common than micro-credit among the banks. It is notable that the majority of migrant workers remit to banks accounts with commercial banks but there is no correlation with loans being taken out at the same institutions (Didik et al 2006).

Much of the lending done by the banks to the poor is through lines of credit channelled by BI for lending to specific target groups. These credit programs known as KLBI are no longer managed by BI. The Act 23/99 which removed the function of credit provision from BI restricted its role to monetary policy and financial sector regulation and supervision. However, other institutions were designated to manage credit programs on BI's behalf. BI regulation 5/20/PBI/2003 on Liquidity Credit channels funds to the state owned enterprises: Bank Rakyat Indonesia, Bank Tabungan Negara and PNM. The funds include special programs for particular groups such as farmers, cooperatives, sugar producers and housing credit for low income earners, MSMEs, MFIs and migrant workers. Some of the funds are channeled directly to community groups through programs and others are channeled through commercial banks. There is also a linkage program between commercial banks and BPRs. The programs offer funds at subsidised rates. When commercial banks are involved in the programs they tend not to continue with the lending practices after the program is finished (Didik et. al. 2006).

[2] For example, on 23rd November 2006 Singpost and Post Indonesia announced an agreement to work together on a number of initiatives including remittances.

[3] The number of Shariah banks is also increasing, For example, in East Java in 1997 there were 5 Shariah Bank branches and in 2005 there were 36.

As for MFIs, while they are large in number, their potential for growth and expansion on commercial terms is hampered by a difficult legislative and regulatory environment and crowding out by subsidised credit programs. BPRs are generally commercial but the very high minimum capitalisation requirements, which was raised from Rp 50 million to Rp 500 million or Rp 1- 2 billion for provincial and district levels respectively (with high levels also for branches) has hampered their expansion (Charitonenko, 2003).

Cooperatives are numerous in Indonesia. They provide savings and loan facilities to members and non-members. There is a comprehensive legal framework for cooperatives but supervision is weak. The Department of Cooperatives is aware of the problems but lacks the resources to improve the situation which is also complicated by the fact that supervision and guidance has been devolved to the Provinces. Banks are not inclined to lend to cooperatives as they are seen as high risk and it is presumed that funding for them should be sourced through the Department of Cooperatives (ProFI, 2005).

There are many other types of MFIs in Indonesia including village credit organisations (BKD) and village credit institutions (LDKP), the state owned pawning company (PT Perum Pengadaian) and NGO programs. Apart from the Pawn company which has its own legislation, MFIs in Indonesia operate in a legal limbo. There is no specific MFI legislation. although there has been draft bill in process since 2001 (Charitonenko, 2003). The options for a *badan hukum* (legal body) for MFIs are thus to be a bank or a cooperative. Becoming a bank is out of the league of most MFIs due to the high minimum capitalisation requirements and becoming a cooperative does not really integrate them into the financial system. On the other hand, without a *badan hukum,* MFIs can't legally accept savings deposits or obtain commercial finance. Many MFIs thus remain fairly small operations, accepting savings and providing loans, but with an unclear legal basis unable to pursue aggressive expansion.

The remittance market in Indonesia is not of the scale of those countries where remittance products have really taken off in the banking, NBFI and MFI sectors. At US$2–3 billion a year (US$1.85 Billion in 2004, US$2.9 Billion in 2005) remittances constitute about 0.7 percent of GDP (2004) (Ibrahim, 2006). While these figures are likely to be a significant underestimation due to issues with data collection, clearly the remittance market is not of the scale of India, Turkey or Mexico and does not represent the proportion of GDP of some African and small island states. However, in Indonesia, migration for work and the associated remittance transfers occurs in pockets with the majority of migrants coming from Kalimantan, Lombok and East and West Java (Depnakertrans).

In some areas, the contribution of remittances is much higher as a percentage of Gross Regional Domestic Product (GRDP) than the contribution at national level to GDP. In Ponorogo District in East Java, in 2004, for example, remittances constituted 104 percent of GRDP. However, with the commercial banking sector more focused on consumer and corporate lending in the cities and the MFI sector stuck in a rather un-dynamic growth pattern – the financial services sector is not responsive at the local level. That is FSPs are not in the habit of developing products and innovations to suit a particular region, such as more convenient transfer services and other financial products specially tailored for migrants in areas of dense migration.

4. Interest Rates and Prudential Regulations Affecting Non-Bank Sector Growth and Competitiveness

To meet the recommendations of the Financial Action Taskforce and the IMF's Know Your Customer (KYC) requirements it is important that adequate information is collected about remittance transfers. Indonesia has introduced regulations for Banks, NBFIs and Non Financial Companies to report on their international transactions and foreign exchange handling (Bank Indonesia reg 1/9/PBI/99, 4/2/PBI/2002 and associated circular letters). NBFIs are described as including insurance companies, pension funds, securities, venture capital funds, payment companies and other bodies that manage community funds. Banks are required to report transfers to and from Indonesia, payments to non-residents and foreign exchange transactions between citizens. For transactions above US$10,000 an explanation must be provided on who is transferring the money, the relationship between the transactors and the purpose of the transaction. Under US$10,000 information on transfers can be combined and categorised according to the currency and type of account. Banks, NBFI and Non Financial Institution Companies must all provide a monthly transaction report and a bi-annual position report to BI.

Commercial and rural banks are required to implement KYC principles through policies and procedures to identify and assess customers, monitor accounts and transactions and manage risk (Act 15/02 on the Crime of Money Laundering, BI reg. 3/23/PBI/2001 on the Implementation of KYC principles and BI reg. 5/23/PBI/2003 on the Implementation of KYC principles for rural banks). These policies and procedures must be submitted to BI. A Centre for Reporting and Analysis of Financial Transactions (PPATK) was established in 2002. All Banks are required to report suspicious transactions to the PPATK (Act. 15/2002, Act 23/2003).

Information and data on remittance transfers is also important for Balance of Payments figures and providing information for potential investors in the remittance market. Statistics on remittance inflows are collected as part of Balance of Payments figures by BI. BI receives information from Depnakertrans on the numbers of migrant workers and these numbers are then multiplied by the standard wage for each country. These figures are matched with the value of "all residual balance of payment" transfers once the figures from other BoP categories are extracted to estimate the value of remittances. Because information on the purpose of transactions is not collected on individual transfers under US$10,000 it is impossible to collect information directly on remittance transfers. Official Depnaker figures are commonly assumed to be a significant underestimation of actual numbers so it is likely that remittance figures are also highly underestimated.

5. Tax Treatment of Remittances

There is a dearth of information relating to the issue of taxation and remittances in Indonesia. Under the normal income tax regime, remittances may be classified as taxable income. Individual income tax in Indonesia is progressive and range from 5% to 30%. As far it can be determined, remittances which are transferred as savings from overseas may be exempted.

To avoid incidental double taxation on income earned, Indonesia has signed agreements (tax treaties) with 50 countries. This includes some of the main destinations for overseas Indonesian workers such as Saudi Arabia, Malaysia, Singapore and Taiwan.

6. Other Incentives Relating to Migration and Remittances

6.1 Financial Intermediation

In many countries increased financial intermediation for migrants and their families occurs as financial institutions offering transfer services seek to attract migrants to other financial products such as savings, credit and insurance products etc. This is one of the reasons why the involvement of the MFI sector in the transfer market is seen as positive.

In Indonesia, increased financial intermediation for migrants has largely been the product of government programs. For example, the Department of Labour and Transmigration (Depnaker) and some of the banks including Bank Mandiri, BNI, BCA and Bank Danamon are collaborating to encourage migrant workers to open bank accounts by offering special low fee accounts to migrant workers with a low minimum opening balance (reduced from the usual Rp 100,000 to 10,000) (Didik et.al 2006).

In addition, there are programs in place to help migrant worker finance the down payments on their overseas work contracts. In Indonesia, migration for work, in the mind of the Indonesian public, is synonymous with exploitation and abuse of migrants, particularly of the women who travel overseas to work as domestic servants who form the bulk of the migrant worker population. One well known aspect of this abuse is the charging of illegally high fees (*pungutan liar*) by migration placement agents (PJTKI) who loan the funds to the migrants and then extract repayments through salary cuts.

In 2005 Depnakertrans decreed that all financing of migrants must be carried out with the cooperation of the Banking sector. The logic was that the availability of finance through the banking sector, should remove the need to borrow from the high cost agents. The agents would still facilitate the placements but the banks would finance the migrants and PJTKI would go as guarantor to the loans. KLBI – TKI funds, one of the streams of credit that was devolved from BI (UU 23/99), have been channeled through the banks for this purpose. A number of programs are already being carried out. Depnakertrans is working with the Bank of China Trust, Indonesia, to facilitate credit for TKI going to work in Taiwan and with Bank Mandiri to provide credit to Indonesians traveling to Taiwan and the Middle East (InterBankNews.com, 2007).

In keeping with the policy to build the BPR industry so that it can become a reliable source of financing of micro-enterprises, the poor and rural community members (which will be discussed in the next section), the Government is also promoting the role of the BPRs in the provision of pre-departure finance for migrants. Under this program, BPR provide lending from their own resources in cooperation with commercial banks, insurance agencies and reputable PJTKI. BI sees migrant workers as a potentially profitable market for developing the BPR. Some programs are already underway. For example, the BPR, Bank Pasar Kulo Progo in Yogyakarta has a MoU with a PJTKI that is an agent for many companies in Malaysia (InterBankNews.com, 2007).

6.2 Promoting Investment of Remittances – Developing the MSME Sector

The extent to which migrants have an investment or a consumption orientation in the spending of remittances is another issue that has bearing on the development impact of remittances. While consumption spending is more stable, investment spending has more impact on long term poverty reduction and sustainable development. There is thus an international consensus that investment spending of remittances should be encouraged. Such options might include local real estate markets or the purchase of bonds issued by local governments. More broadly, as many migrants and remittance recipients come from poorer households, support for micro-enterprises is essential to encourage options for investment of remittance income.

In Indonesia the Micro, Small and Medium Enterprise (MSME) sector is the Government's target sector for poverty reduction. There is recognition that the sector weathered the crisis in a way more formal sectors did not and of the significant contribution the sector makes to the economy. In Indonesia UMKM employ 79 million people, contribute 56.7 percent to GDP and 19.9 percent of non-oil exports (Primahendra, 2006).

However, as discussed above, financing for MSMEs is fairly minimal. The Government has a policy to develop the BPR sector as a means to finance MSME. The Government has developed a blueprint for the BPRs which include institution building, upgrading the regulatory framework, enhancing the effectiveness of supervision, capacity building, improved industry infrastructure, the development of a microfinance policy and a linkage program between commercial banks and BPR. The linkage program, which was launched by the BI Governor on 24 August 2005 involves the funding of BPR by commercial banks through three mechanisms. These are:

a) channelling - whereby the BU would provide loan funds to the BPR for on lending to UMKM
b) executing - where the BPR would act as an agent of the commercial bank in providing loan funds to the UMKM and joint financing.
c) the program has also included a parallel program for Sharia Banks (Media Informasi BPR, Sept 2005).

At this stage the scale of rural banks is still small; total BPR assets are less than one percent of the total assets of the banking sector (InterBankNews.com 2006). However, BPR assets constitute 15 percent of the total assets of the microfinance sector (Media Informasi BPR, Sept 2005). Some of the initiatives to strengthen the BPR sector may be effective in enhancing the role of BPR in supporting the MSME Sector.

There are several pilots projects being undertaken working towards the establishment of an Apex bank for BPRs such as the LDA BPR in Central Java. Some of the proposed benefits of establishing the Apex institution including increased liquidity for BPRs, networked IT systems and a national network of ATMs and more competitive savings products. It is anticipated that eventually the Apex Institution may become an independent institution or commercial banks owned collectively by the BPRs which would allow the BPRs better access to funding by giving them a central platform to negotiate with potential funders (Media Informasi BPR, December 2005). If the BPR were to move in this direction it would not be unfeasible for the BPR to begin to be drawn into the payments system, if not for international transfers at least for domestic payments. However, a fair bit of development of the sector is still required before getting to that point.

7. Conclusion

This paper has analysed the policy and regulatory environment in Indonesia pertaining to remittances. With foreign exchange handling, payments and remittance transfers permitted only by commercial banks, the regulatory environment for remittances can be described as restrictive. More fundamental concerns about the monetary and financial system in the wake of the Asian crisis may be the cause of this.

The restrictive environment in Indonesia may not have as much affect on the cost of transfers, as the environment in sender countries. To drive costs down it is important to engage in policy dialogue with sender countries and nothing concrete has been done in this regard, yet. While the effect of the restrictive environment on cost may be limited, it does seem to reduce the level of innovation in the remittance transfer market, for instance in using new technologies and microfinance programs to bring remittance services closer to clients. The early stage of the development of the electronic payments system and a slow pace of commercialisation in the microfinance sector may be causal factors in this lack of innovation.

While there is lack of innovation in the private sector, the Government initiated programs to increase financial intermediation by migrants. In particular the Government has a focus on providing loans for obtaining overseas work contracts through the banking sector and has programs to involve the rural banks in this provision. The Government is also seeking to strengthen the Micro, Small and Medium Enterprise Sector (MSME) which would increase the investment options available to migrants. To do this there is a policy to strengthen the rural banks to become the "engine" for the MSME sector.

In regard to data and information collection on remittances, the Government is reasonably stringent on collecting financial transaction data by Banks, NBFIs and non financial companies. However, accurate estimation of remittances is still marred by the lack of individual tracking of transactions under US$10,000.

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