

Ex-ante Evaluation

1. Name of the Project

Country: The Republic of Indonesia

Project: Development Policy Loan II

Loan Agreement: March 28, 2006

Loan Amount: 11.729 billion yen

Borrower: The Republic of Indonesia

2. Necessity and Relevance of JBIC's Assistance

In Indonesia, macroeconomic stability has been a matter of highest priority in the wake of the Asian currency crisis in 1997. An array of reforms such as fiscal rehabilitation reform was implemented under the International Monetary Fund (IMF) program and the World Bank/Asian Development Bank (ADB) program, and the IMF program was completed in the end of 2003. Indonesia subsequently unveiled an economic reform policy to carry on the promotion of economic reforms, and an array of reforms has continued to be implemented in the following years.

President Susilo Bambang Yudhoyono who took office in October 2004 expressed his intent to implement policies for (1) promoting macroeconomic stability; (2) improving the investment climate; and (3) improving public financial management as well as fighting corruption, and at the same time, requested a development policy loan to the World Bank and the Government of Japan. In response, a loan worth US\$400 million in total was co-financed in FY2004, of which JBIC provided an ODA loan amounting to 10.794 billion yen (approximately US\$100 million).

With this assistance, the Government of Indonesia has been implementing reforms related to promoting macroeconomic stability, improving the investment climate, and improving public financial management as well as fighting corruption.

The target of the Government of Indonesia is to achieve an economic growth rate of 7.6% (5.1% in 2004) and an unemployment rate of 5.1% (9.9% in 2004) in 2009. Meanwhile, the poor people living under US\$2 a day (1985 value) still account for 53% of the total population. Amid the existing situation where approximately two million new workers enter the labor market every year in Indonesia, there is a need to generate employment through further growth and other measures. Thus continued macroeconomic stability, improvement in the investment climate, improvement in public financial management and the fight against corruption remain important issues on the country's economic agenda. In addition, a cut in oil subsidies in 2005 has made launching a compensation program for the poor an important issue.

Japan's "Assistance Plan for Indonesia" (formulated November 2004) states that assistance will be provided to promote private sector-led sustainable development, such as assistance for ensuring fiscal sustainability, developing economic infrastructure to improve the

investment climate, promoting supporting industries and small- and medium-sized enterprises, developing various economic policies, and reforming the financial sector. In addition, in JBIC's "Medium-Term Strategy for Overseas Economic Cooperation Operations" (formulated April 2005), as an aid policy for Indonesia, economic infrastructure development for investment climate enhancement is identified as a priority area. The strategy concurrently states that efforts will be made to contribute to the promotion of various reforms, such as by maintaining fiscal sustainability. Therefore, JBIC's assistance is highly necessary and relevant.

3. Project Objectives

This program loan will assess the performance of the policy reforms of the Government of Indonesia after the provision of Development Policy Loan I. At the same time, the loan, cofinanced with the World Bank and the ADB, will help sustain policy reforms and advance policy dialogues with Japan by supporting Indonesia's policy reforms, thereby serving to (1) promote Indonesia's macroeconomic stability; (2) improve its investment climate; (3) improve public financial management as well as fight corruption; and (4) reduce poverty.

4. Project Description

(1) Project Outline

This program loan, with a view to (1) promoting macroeconomic stability; (2) improving the investment climate; (3) improving public financial management as well as fighting corruption; and (4) reducing poverty, will implement the following policies on each of the items.

Reform item	Future action
(1) Promote macroeconomic stability	<ul style="list-style-type: none"> ■ Improve fiscal policy ■ Continue implementation of debt management strategy ■ Improve framework for devolution of powers to regional and local authorities
(2) Improve the investment climate	<ul style="list-style-type: none"> ■ Clarify legal status of local government-controlled corporations ■ Promote efficiency in domestic and international commerce ■ Continue development of financial sector safety net ■ Restructure Capital Market Supervisory Agency and Directorate General of Financial Institutions ■ Diversify financial sector ■ Improve business environment ■ Risk Management function to be fully operational
(3) Improve public financial management	<ul style="list-style-type: none"> ■ Establish implementation regulations

and fight corruption	<p>for fiscal law and audit law</p> <ul style="list-style-type: none"> ■ Promote national treasury unification program ■ Improve quarterly report on budget use ■ Improve financial statements ■ An operational national procurement policy office fully staffed
(4) Reduce poverty	<ul style="list-style-type: none"> ■ Monitoring related to implementation of compensation program

(2) Total Project Cost/Loan Amount

Total Loan Amount from All Donors: Approximately US\$700 million
Yen Loan Amount: 11.729 billion yen (approximately US\$100 million)
World Bank Contribution: US\$400 million
ADB Contribution: US\$200 million

(3) Implementation Structure

- (a) Borrower: Republic of Indonesia
- (b) Executing Agency: Ministry of Finance
- (c) Operation and Maintenance System: Same as (b)

(4) Environmental and Social Considerations

(a) Environmental Effects/Land Acquisition and Resident Relocation

(i) Category: C

(ii) Reason for Categorization

This program is classified as Category C because it falls under a sector (policy assistance loan) with unforeseeable adverse environmental effects, and it does not have characteristics that make it likely to cause impact nor is it located in an area which is easily affected, under the “Japan Bank for International Cooperation Guidelines for Confirmation of Environmental and Social Considerations” (established April 2002).

(b) Promotion of Poverty Reduction

This program includes monitoring related to the implementation of a compensation program for the poor, and thereby, contributes to the promotion of poverty reduction.

(c) Promotion of Social Development (e.g. Gender Perspective)

This program identifies such measures as the devolution of powers to regional and local authorities and improvement of fiscal management. In this context, this program provides assistance for “good governance.”

(5) Other Important Issues

None in particular

5. Outcome Target

Evaluation Indicator (Operation and Effect Indicator)	
Base-line	Target (2006)
(1) Promote macroeconomic stability: ● Improve framework for devolution of powers to regional and local authorities	Development of procedures for issuing local government bonds
(2) Improve the investment climate: ● Risk management function to be fully operational	FY2007 budget appropriation with respect to Public-Private Partnership (PPP)assistance
(3) Improve public financial management and fight corruption: ● Establish implementation regulations for fiscal law and audit law	Establishment of same regulations
(4) Reduce poverty: ● Monitoring related to implementation of compensation program	Implementation of same monitoring
6. External Risk Factors	
Political uncertainty in state and local assemblies	
7. Lessons Learned from Findings of Similar Projects Undertaken in the Past	
In the case of cofinancing, it has been learned that it is important to conduct in-depth information exchanges with relevant agencies, from the appraisal stage to the monitoring and supervision stage. Based on this lesson, this loan program is expected to be monitored and supervised in close coordination with cofinancing agencies, the World Bank and the ADB.	
8. Plans for Future Evaluation	
(1) Indicators for Future Evaluation	
(a) Outcomes relating to macroeconomic stability (Development of procedures for issuing local government bonds)	
(b) Outcomes relating to improving the investment climate (FY2007 budget appropriation with respect to Public-Private Partnership (PPP)assistance	
(c) Outcomes relating to improving public financial management and fighting corruption (Establishment of implementation regulations for fiscal law and audit law)	
(d) Outcomes relating to reducing poverty (Implementation of monitoring related to implementation of compensation program)	
(2) Timing of Next Evaluation	
After completion of project	