

1. Name of the Program

Country: The Republic of Indonesia

Program: Development Policy Loan (VIII)

Loan Agreement: January 23, 2013

Loan Amount: 15,490 million yen

Borrower: The Republic of Indonesia

2. Background and Necessity of the Program**(1) Current State and Issues of Development in Indonesia**

The Government of Indonesia has implemented a number of policies in stabilizing the macro economy, improving the investment climate and public finance management, and reducing poverty, while receiving support from Japan, the World Bank and the Asian Development Bank. Indonesia's economy has shown steady growth under the Yudhoyono administration. In 2009, it slightly slowed down due to the global financial and economic crisis. In 2011, however, it recorded the high GDP growth rate of 6.5%, supported by strong domestic consumption and private investment. Its growth rate is expected to maintain the level of 6% in 2012 as well. Moreover, Indonesia's budget deficits are expected to be kept low at 1.8% of GDP in 2012, following 1.1% in 2011. While its balance of public debt has steadily decreased since 2000, it became 24.5% of GDP at the end of 2011, which recovered better than before the currency crisis in 1997. At the same time, its direct investment has also increased since 2010. According to the World Bank's "Doing Business 2012," however, Indonesia's business environment ranks 129th among 183 countries and regions in the world. This shows that there is a room for improvement if it is compared with the neighboring countries in Asia. In order to keep growing the economy, the country is expected to improve the investment climate including development of infrastructure, and keep expanding its investment. Furthermore, it is pointed out that the country needs to improve its budget execution, because its capital spending in 2011 was about 20% below the initial budget. In addition, the country still has so many vulnerable people who live just above the poverty line. There are concerns that its economic growth might increase income disparity and regional gaps. Therefore, it has become a critical issue to continue reform efforts towards improving the investment climate and public finance management, and reducing poverty, as well as continue to implement sound fiscal policies.

(2) Development Policies in Indonesia and the Priority of the Program

The current Mid-term National Development Plan (RPJM 2010-2014) sets up 11 national development priorities. Out of 11 priorities, this program provides support for promoting "improvement of the business environment for investment" and "poverty reduction."

(3) Japan and JICA's Policy and Operations, and Other Donors' Activities

The Government of Japan considers "Assistance for further economic growth" as one of the priority areas in the "Country Assistance Policy for Indonesia" (April, 2012). The Japanese government aims to cooperate in improving the business environment and investment climate, while providing support for improving a variety of regulations and systems as part of its specific policies. In the meantime, JICA analyzes "improvement of the business environment" and "enhancement of connectivity" as one of its development priorities. Thus, this program is in accordance with these policies and analyses. JICA has also provided continual support for policy reform by the Government of Indonesia together with the

World Bank and the Asian Development Bank (ADB) since 2004, by providing the Development Policy Loans seven times (totaling 83.06 billion yen) in the past.

(4) Necessity of the Program

This program contributes to sustainable development in Indonesia, through support for implementing vital policy reform efforts in improving the investment climate and fiscal administration, and reducing poverty. JICA and the World Bank have evaluated the progress of Indonesia's policy reform efforts together, and made sure that the reform items (refer to 3. (2) "actions achieved" to be described below) had been achieved well by the country. Furthermore, this program can be used for effective improvement of the investment climate based on the needs of private sectors, through dialogue with the Government of Indonesia. It is necessary that the second Yudhoyono administration promote policy reform in a steady and continuous fashion, for the country to continue its economic development.

As described above, this program is in accordance with the country's issues and development policies, as well as with the assistance policies of Japan and JICA. Therefore, it is highly necessary and relevant for JICA to provide assistance through this program.

3. Program Description

(1) Program Objectives

This program contributes to (i) Improving the investment climate, (ii) Strengthening public financial management, and (iii) Enhancing poverty alleviation and service delivery efforts in Indonesia, while continuing to promote policy reform and policy dialogue with the Government of Japan, by supporting the country's policy reform in association with the World Bank, based on the achievements in a series of policy reforms by the Government of Indonesia.

(2) Program Components

Reform items	Actions achieved	Actions to be taken in the following year
1. Improvement of the investment climate	<ul style="list-style-type: none"> ○ Enhancing the system to promote discussions on trade investment between the public and private sectors (issuance of the Presidential /Ministerial decree) ○ Creating standard operating procedures for carrying out discussions on the National Single Window (hereinafter referred to as "NSW") between the public and private sectors ○ Establishing a team to come up with non-tariff measures and creating a procedure manual which clarifies standard operations (issuance of the decree by Ministry of Trade) ○ Formulating and disclosing the mid-term human resource 	<ul style="list-style-type: none"> ○ Reviewing and harmonizing new investment-related laws and regulations by a team to promote national export investment ○ Integrating the information system for container yards and the NSW information system at Tanjung Priok Port ○ Issuance of a government decree on the system to disclose all the trade-related laws and regulations on the NSW website ○ Establishing a system for port administration at the Jakarta airport and creating standard operating procedures for 24-hour operation ○ Implementing the mid-term human resource strategic plan

	<p>strategic plan for the Directorate General of Tax</p> <ul style="list-style-type: none"> ○ Publishing the revised standard operating procedure for objection and appeal ○ Formulating the follow-up guidelines for transfer pricing taxation ○ Issuance of the Presidential /Ministerial decree on an organization and a system to enhance connectivity ○ Start performing customs clearance at Cikarang Dry Port 	<p>for the Directorate General of Tax (launching the system to certify job categories, etc.)</p>
2. Improvement of fiscal administration	<ul style="list-style-type: none"> ○ Creating manuals to select indicators for performance based budgeting ○ Formulating a human resource plan/strategy to strengthen the procurement capacity of the government ○ Issuance of government rules for accrual accounting 	<ul style="list-style-type: none"> ○ Drafting monitoring/evaluation guidelines for drawing up the Mid-term Development Plan/annual budget based on performance evaluation ○ Carrying out a pilot project for the process to predict how much cash will be needed, making full use of the integrated financial management system (SPAN)
3. Poverty reduction	<ul style="list-style-type: none"> ○ Promoting the use of the national integrated database for the poor ○ Analyzing cost scenarios of health insurance for the poor ○ Drafting national strategies for Financial Inclusion 	<ul style="list-style-type: none"> ○ Implementing cash benefit and health insurance programs for the poor based on the integrated database ○ Approving and implementing national strategies for Financial Inclusion

(3) Total Program Costs/Estimated Loan Amount

Loan Amount: 15,490 million yen (equivalent to 200 million dollars)

(4) Program Implementation Structure

- 1) Borrower: The Republic of Indonesia
- 2) Executing Agency: The Coordinating Ministry of Economic Affairs and the Ministry of Finance

(5) Schedule

September 2010 to September 2011. This phase of the program shall be completed when the loan is disbursed (expected in in March 2013).

(6) Environmental and Social Consideration/Poverty Reduction/Social Development

- 1) Environmental and social consideration
 - i. Category: C

- ii. Reason for categorization: This program is likely to have minimal adverse impact on the environment under “Japan International Cooperation Agency Guidelines for Environmental and Social Consideration” (April 2010).
- 2) Promotion of poverty reduction: This program also promotes community development led by the community itself, and contributes to poverty reduction, because it promotes an increase in public spending to improve social services for the poor.
- 3) Promotion of social development (gender perspective, measures for infectious diseases including HIV/AIDS, participatory development, consideration for persons with disabilities, etc.): None in particular

(7) Coordination with Other Schemes, Donors, etc.: Co-financing with the World Bank (400 million dollars)

This program has been offered in tandem with JICA technical cooperation, which is provided in each field of improving the investment climate and fiscal administration, and reducing poverty. For example, as far as improvement of the investment climate concerned, the program has provided support for publishing the revised standard operating procedure for filing an objection to taxation. It has also provided support for formulating the follow-up guidelines for transfer pricing taxation in the technical cooperation project, the “Project on Modernization of Tax Administration (Phase 2),” which was launched in December 2009, as well as support for improving trade procedures in the technical cooperation, the “Project on Capacity Development for Trade-related Administration,” which was launched in March 2010. In addition, the program has provided support for budget drafting based on performance evaluation in the technical cooperation, the “Project on Planning and Budgeting Reform for the Performance-Based Budgeting (PBB) System Implementation,” which was launched in May 2010, with regard to improvement of fiscal administration. Experts for these projects have provided input necessary to promote policy actions, through monitoring meetings, etc.

(8) Other important issues: None in particular

4. Targeted Outcomes

(1) Quantitative Impact

1) Performance Indicators (Operation and Effect Indicators)

Indicator	Baseline (achievements from 2007 to 2010)	Target (2012 ¹)
Improvement of the investment climate	<ul style="list-style-type: none"> ○ Investment: 23.2% of GDP (average between 2007 and 2009) ○ Net inflow from foreign direct investment: 7 billion dollars (average between 2007 and 2009) ○ Number of days to establish a business: 60 days (2009) ○ Growth rate of non-petroleum exports: 7.7% (average between 2007 and 2009) ○ Number of importers and exporters who use NSW: 3,791 (2010) ○ Number of days required for importing and exporting: Investment 21 days /import (2009) 27 days ○ Number of hours required for filing tax returns: 266 hours (2009) 	<ul style="list-style-type: none"> ○ 25.1% ○ 7.9 billion dollars ○ 50 days ○ 9.24% ○ 4,500 ○ Investment 20 days /import 26 days ○ 240 hours
Improvement of fiscal administration	<ul style="list-style-type: none"> ○ Capital spending executed until the second quarter: 19% (2010) (percentage of the annual capital spending) ○ Gap between quarterly cash planning and actual cash flow: property expenses 129%, capital spending 43% (fourth quarter of 2009) 	<ul style="list-style-type: none"> ○ 27% ○ 40%
Poverty reduction	<ul style="list-style-type: none"> ○ Percentage of the population below the poverty line in the country: 13.3% (2010) ○ Percentage of social assistance programs in central government expenditures: 3% (2009) 	<ul style="list-style-type: none"> ○ 12.4% ○ 4.5%

(2) Qualitative Impact: Improvement of governance, economic growth, promotion of employment and poverty reduction

5. External Factors and Risk Control

None in particular

6. Lessons Learned from Findings of Similar Programs Undertaken in the Past

According to the ex-post evaluation, the Development Policy Loans (I to IV) for Indonesia have made it possible to (i) present what JICA has been concerned about directly to high-level officials at the government, (ii) obtain commitments to a variety of reforms from high-level officials in the government, and (iii) perform continual monitoring of what the government has implemented for its reforms, as an added value which can be gained only by general budget support, through continual policy dialogue with high-level officials in the Government of Indonesia. The evaluation also points out that the loans have enhanced complementary relationship with project-based Japanese ODA Loans and technical cooperation implemented by JICA, and promoted more effective reforms in Indonesia.

¹ The last year of the third series in the Development Policy Loans (VII to IX)

Furthermore, the evaluation gives us lessons, saying that it is critical to bring problems and issues on the ground extracted from efforts in technical cooperation into policy dialogue for the Development Policy Loans, as well as promote reform efforts, while connecting policy issues discussed within the framework of the Development Policy Loans to implementation of technical cooperation on the ground.

7. Plan for Future Evaluation

(1) Indicators for Future Evaluation:

- 1) Achievements in improving the investment climate (increase in the investment percentage against GDP by improving the investment-related system, etc.)
- 2) Achievements in improving fiscal administration (increase in the percentage of executing capital spending against GDP by improving the national budget system, etc.)
- 3) Achievements in reducing poverty (decrease in the percentage of the population below the poverty line in the country by enhancing strategies focusing on the poor, etc.)

(2) Timing of Next Evaluation: After the end of the third series in the Development Policy Loans (The Development Policy Loans (VII) to (IX))