Indonesia

AJDF for Indonesia Category B, PNEC Program

Report Date: May, 2002
Field Survey: July, 2001

1. Project Profile and Japan's ODA Loan

Location Map of the Project

Project Site

1.1 Background

Since the decline of oil prices in 1986, the Indonesian Government has been trying to reduce the dependency of the national economy on the gas and oil sectors. One of its major policies in this regard is the promotion of small-scale, labor-intensive export industries that utilize local resources. Since non-oil export products such as palm oil, rubber, coffee, tea, coconuts and cacao are produced by private farms, the development of these enterprises in the agro-industry sector is crucial for the Indonesian economy. In light of these aims, it was decided that the ASEAN-Japan Development Fund (AJDF) would be used to support two credit facilities of the Indonesian Government: KI ("Investment Credit," a long-term financing facility for small enterprises in supporting industries) and PNEC ("Private National Estate Credit," a credit facility for farmers that produce specific commodity crops). After the loan agreement was signed, the Indonesian Government abolished KI, with the idea that small enterprises in supporting industries could be financed by private financial institutions. As a consequence, only PNEC was to be financed by JBIC.

1.2 Objectives

To promote export industries and earn foreign currencies by providing private farms in agro-industry (palm oil, rubber, coffee, tea, coconut, and cacao) with low interest rate, long-term credits through participating banks.

1.3 Project Scope

(1) Long-term credits to project proponents eligible for the PNEC, a credit scheme extended by the Bank Indonesia to participating banks, and
(2) Consultancy services for credit management, monitoring and training.

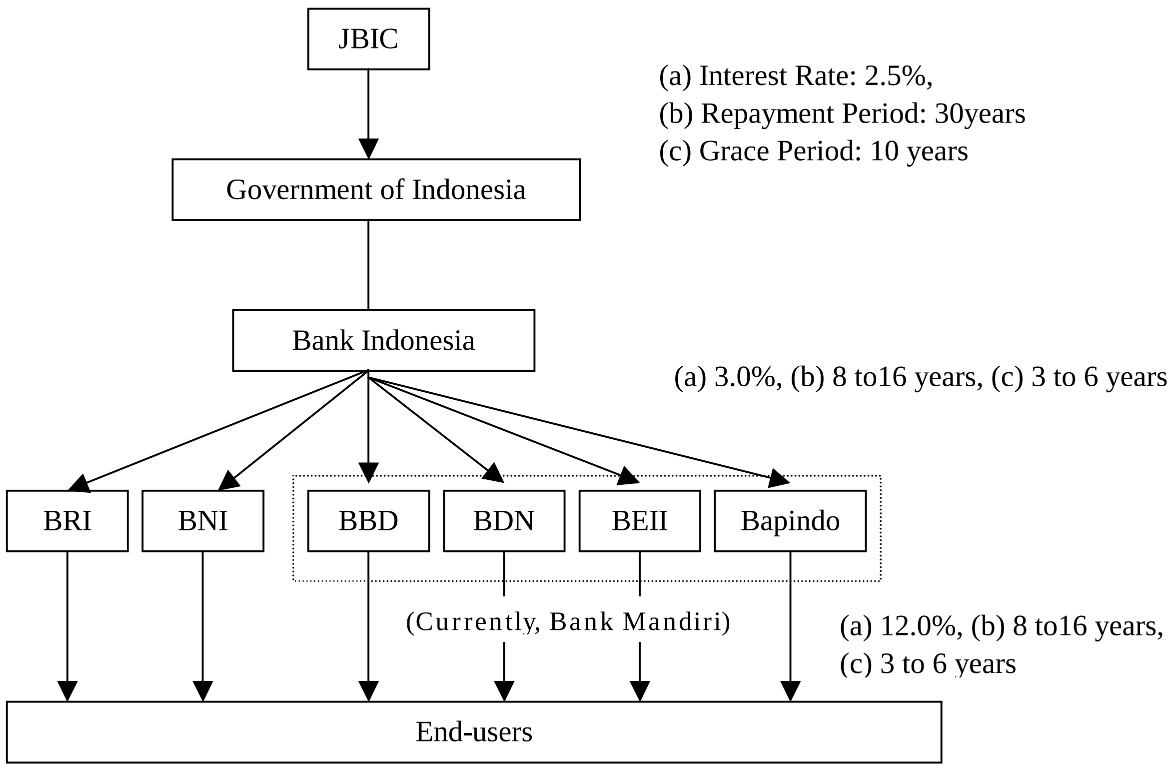
1.4 Borrower/Executing Agency

Government of the Republic of Indonesia / Bank Indonesia (BI)

1.5 Outline of Loan Agreement

Loan Amount (estimated) Loan Disbursed Amount	16,955 million Yen 16,408 million Yen
Exchange of Notes Loan Agreement (L/A)	Sep 1989 Nov. 1989
Terms and Conditions Interest Rate Repayment Period (Grace Period) Procurement	 2.50% 30 years (10 years) General Untied
Final Disbursement Date	Dec. 1996

<AJDF/B2 Loan Scheme>



* The government of Indonesia restructured four government banks, which are BBD, BBN, BEII, and Bapindo and formed Bank Mandiri at the end of February, 1998.

2. Results and Evaluation

2.1 Relevance

Since the sharp decline of oil prices in 1986, the Indonesian Government has adopted a deregulation policy package -- including reforms of the financial sector, tax and custom systems, and foreign investment procedures -- in order to promote non-oil and non-gas industries. This policy orientation is reflected in the Fifth and Sixth Five-year National Development Plans (1989-1994 and 1995-1999), in which the Indonesian Government intended to promote private, labor-intensive, export-oriented plantations that utilize local resources. Private farms that produced palm oil, rubber, coffee, tea, or cocoa, were major exporters of non-oil and non-gas products, and had significant potential to grow further. The export value of these five products was US$1,930 million in 1988, accounting for 11% of all exports and 20% of non-oil and non-gas exports.

The Five Year National Development Program (Propenas), which was formulated in 2000 based on the State Policy Guidelines (GBHN, Garis Besar Haluan Negara) for 1999–2004, intends to increase value added in agriculture through better industrial linkages among agriculture and other economic sectors. Access of agricultural communities to capital sources, such as banks and non-bank financial institutions, is also promoted. Thus, the project remains consistent with national development policy. On the other hand, due to the Indonesia's increased awareness for the preservation of forest resources, the Propenas also gives priority to the preservation of natural resources through the participation of the local communities. In this regard, the balance between promotion of agribusiness, preservation of natural resources and the interests of local communities needs to be duly considered.

2.2 Efficiency

2.2.1 *Disbursement of Sub-loans*

There has been basically no change in the two-step loan scheme since appraisal. The two-step loan was channeled from the Bank Indonesia to six state-owned participating banks (PBs) – Bank Rakyat Indonesia (Indonesian People's Bank - BRI), Bank Negara Indonesia (National Bank of Indonesia - BNI), Bank Bumi Daya (Bumi Daya Bank - BBD), Bank Dagang Negara (State Commercial Bank - BDN), Bank Expor Impor Indonesia (Indonesian Export-Import Bank - BEII), and Bank Pembanguan Indonesia (Indonesian Development Bank - Bapindo). In February 1998, BBD, BDN, BEII and Bapindo were merged to form Bank Mandiri, a new state-owned bank.

Disbursement was carried out within the loan period. The following table shows the yearly data of the disbursed amount.

Table 1 Disbursed Amount (billion Rupiah)

	1991	1992	1993	1994	1995	1996	Total
Sub-loans (original loans)	28.51	27.69	64.74	43.54	22.12	125.62	312.22
Consulting Services	-	-	0.13	0.05	0.65	0.93	0.34
Total	28.51	27.69	64.87	43.59	22.77	126.55	312.56

Source: BI

The total number of sub-projects was 42. Some of the sub-projects belong to big, well-known company groups in Indonesia. Although 24 sub-projects were contracted in 1990, the actual disbursement was significantly delayed, owing to a delay in estate development and slow and lengthy administrative procedures between PBs and the BI. Eighteen (18) additional projects were contracted in 1996, the last year of the project period. The delay in estate development was caused mainly by natural disasters and difficulties in employing skilled laborers.

Table 2 shows the number and amount of 32 sub-loans by type of crop. Data for the remaining 10 sub-loans were not provided by the BI. Three of them had been transferred to the Indonesian Bank Restructuring Agency (IBRA, see Section 2.5 for the details of the transfer of sub-loans to IBRA), while the account information for the other seven already closed loans was missing. Oil palm plantation accounts for 84% of the total loan amount, with an average loan amount of 26 billion Rupiah.

Table2 Number and Amount of Sub-loans Disbursed

Main Crop	Number of sub-loans	Total disbursed amount of sub-loans (million Rupiah)	Share in Amount	Average amount of sub-loans (million Rupiah.)
Oil Palm	23	589,618	84%	25,635
Cacao	5	24,534	4%	4,907
Rubber	3	54,106	8%	18,035
Coconuts	1	32,300	5%	32,300
Total	32	700,558	100%	21,892

Source: BI

Table 3 shows the geographical distribution of sub-loans. End-users are located in four islands: Sumatra, Jawa, Kalimantan and Sulawesi. Sixty percent (60%) of end-users are located in Sumatra Island, owing to the island’s climate and soil conditions, which are suitable for oil palm plantations.

Table3 Geographical Distribution of Sub-loans

Name of Island	Name of Province	Number of Sub-loans
Sumatra	Aceh	3
	North Sumatra	5
	West Sumatra	1
	Riau	7
	Bengkulu	2
	Lampung	2
Jawa	West Jawa	1
	Central Jawa	1
	East Jawa	1
Kalimantan	West Kalimantan	1
	South Kalimantan	2
	East Kalimantan	1
Sulawesi	South Sulawesi	5
Total		32

Source: BI

Most of the sub-loans are new investments, used mainly for plantation, factories and other supporting facilities. Table 4 shows the share of investment of the 32 sub-loans by utilization purpose. Plantation includes land clearance, preparation and planting of seedlings; infrastructure and building include construction of roads, water channels and administrative buildings.

Table 4 Share of Investment by Utilization Purpose

Plantation	Infrastructure and Building	Processing Factory	Working Capital
46%	23%	26%	5%

Source: Loan contracts

As agreed with JBIC, a 12% fixed interest rate was applied to all the sub-loans while the weighted average market interest rates have been exceeding the applied interest rate: three percentage points higher than the applied interest rate in 1990, peaking 16 percentage points higher in 1998.

2.2.2 *Consulting services*

The delay in implementing sub-projects also caused a delay in implementing consulting services. A total of 122 million Yen was disbursed for consulting services, 72 million Yen lower than originally planned. The consultant was expected to contribute to the improvement of management information and of the communication systems for the AJDF at BI and PBs, respectively, as well as between PBs and End-Users. The consultant was also expected to contribute to the development of the capacity of BI and PB staffs to manage investment credit. However, in the implementation of the project, consultancy was limited to assessment, trouble-shooting and impact analysis of sub-projects. There seems to have been no significant improvement in the management abilities of the BI and PBs.

2.3 Effectiveness

The objective of the project was to promote export industries and earn foreign currency. It was known from the available data for the PBs that 130,000 hectares of oil palm plantation had been established from 20 sub-projects. That figure represents 5% of the total current oil palm plantation area in Indonesia. It was also confirmed that 400,000 tons of crude palm oil (CPO) were produced in 2000 from 15 of the above-mentioned 20 sub-projects (the data on the production for the remaining five projects could not be obtained), which accounts for some 7% of total CPO production in Indonesia. Since half of the palm oil production is slated for export and its FOB value was US$340 per ton at 1999 prices, it is estimated that US$50 million to US$70 million in foreign currency is earned by these 15 sub-projects every year.

2.4 Impact

2.4.1 *Social Impact*

Creation of employment was expected at the time of appraisal. According to the data from the PBs, 21,148 people were newly employed permanently by 15 sub-projects. Some of this skilled labor was brought from Java Island under the framework of transmigration, although the number is unknown. On the other hand, those people who had been previously engaged in subsistence agriculture as small farmers on the sub-project sites were employed as unskilled labor. It is said that their cash income has increased as a result of the project.

The implementation of sub-projects required the acquisition of land use rights and/or the settlement of customary land rights of the inhabitants. It should be noted that settlement of land rights has often been a politicized undertaking, and that generally during plantation development, there are not a few farmers who are dissatisfied with the compensation or arrangement of land rights. As to the project, according to PBs, in order to mitigate conflict with the local society during the implementation of this project, sub-projects not only offered local farmers employment and resettlement compensation, but also provided social services, such as schools and clinics. As a consequence, no significant social conflicts have been reported from the sub-projects.

2.4.2 *Environmental Impact*

Government regulations stipulate that estate crop plantations be established only in conversion forest areas, i.e. forest areas that are allowed to be converted to agricultural and other non-forest uses. However, it is reported that the existing rules of land allocation and forest classification are not exercised appropriately. Furthermore, the process by which forest areas are declared to be conversion forest is not transparently observed. The promotion of oil palm plantation should have been accompanied by enhancement of the capacity and institutional strengthening of law enforcement authorities aimed at protecting natural forests. With regard to the project, PBs disbursed loans to end-users based on their licenses, which are issued by the Government, however, PBs did not have detailed information on whether end-users observed the rules and regulations properly. BI or PBs should establish an appropriate system to assess environmental issues on each sub-project in the flow of two-step loan.

2.5 Sustainability

2.5.1 *Sub-projects*

Since the Bank Indonesia does not have information on individual sub-loans, the information on the repayment of sub-loans was collected from each PB. Out of the 32 sub-loans for which loan contracts were identified at BI, information on the account status of 29 sub-loans was provided to JBIC by PBs (the remaining three sub-loans had already been transferred to IBRA from 2000 to 2001). The following table shows the current status of the sub-loans.

Table 5 Current Account Status of Sub-Projects by Participating Bank (as of Dec. 2000)

	Fully Repaid	Performing	Overdue	Foreclosed	Transferred to IBRA*	No Account Information	Total
BRI	4	1	-	-	-	-	5
BNI	2	5	-	-	1	1	9
Bank Mandiri	3	7	4	3	5	6	28
(Ex-BBD)	-	1	2	1	2	2	8
(Ex-BDN)	2	2	-	1	-	1	6
(Ex-BEII)	1	2	1	1	2	3	10
(Ex-Bapindo)	-	2	1	-	1	-	4
Total	9	13	4	3	6	7	42

Source: BI, BRI, BNI and Bank Mandiri

Seven sub-loans are either overdue or foreclosed, while an additional six sub-loans were transferred to IBRA. According to PBs, the poor performance of these sub-loans can be attributed to disasters such as fire (two sub-loans) or excessively dry weather (two), conflicts or mismanagement within the company (four), or social unrest in Aceh Province (two).

These 13 non-performing loans will be eventually restructured, liquidated or sold to a third party. According to the information from PBs, the production of the 13 performing sub-loans is steady; they are deemed viable, in spite of price fluctuation and severe global competition, because of their competitiveness in costs and quality of main crops (oil palms, cacao, and etc.).

2.5.2 *Participating Banks*

The state banks have long suffered from a weak credit culture, inadequate loan loss provisioning and poor risk management. Furthermore, the 1997 currency crisis aggravated their financial position. The four weakest banks – BBD, BDN, BEII and Bapindo – were merged into a single bank -- Bank Mandiri -- with the intention of downsizing the banks and making the best use of scarce managerial and advisory resources. The management personnel of all four component banks were replaced by a totally new team brought in from outside the state bank sector. Bank Mandiri received three time capitalization tranche in 1999 and 2000, to restore it to an 8 percent capital adequacy ratio; as a result, the bank's solvency was restored, at least for the time being. During 2000, the Government started the recapitalization of the remaining two banks – BRI and BNI. The Government has announced its plan to privatize Bank Mandiri, with an initial primary share issue for up to 30 percent, expected to be launched by the end of 2001 and completed by the first quarter of 2002. The Government is also examining the privatization of the remaining state banks and will announce its plan in consultation with Parliament by December 2001.

2.5.3 PBs' Current Debt Status to BI

The repayment from PBs to BI has been carried out strictly on schedule. If a PB misses a repayment to BI, an equivalent amount of money is simply withdrawn from the PB's reserve in BI. Under the Government's state bank recapitalization program, a total of 175 billion Rupiah of PB debt vis-à-vis BI has been converted into Government bonds and transferred to BI. None of these bonds have matured at the time of this evaluation survey. Table 6 shows the current status of PB debt to BI (disbursement amount and repaid amount do not include the ten sub-projects for which information was not provided by BI).

Table 6 Status of PB's Debt to BI as of August 31, 2001 (Principle, million Rupiah)

	Total Disbursement	Conversion to Gov't Bond	Repaid	Outstanding
BRI	142,361	69,808	51,794	20,759
BNI	165,460	33,300	101,415	30,745
Bank Mandiri	350,945	63,869	167,202	119,874
(Ex-BBD)	99,894	50,190	10,596	32,198
(Ex-BDN)	101,009	0	54,568	46,441
(Ex-BEII)	112,825	0	84,497	28,327
(Ex-Bapindo)	83,550	22,107	32,665	28,778
Total	698,189	175,405	335,535	187,249

Source: BI

With regard to the six non-performing sub-loans that were transferred to the IBRA, the PBs repaid these debts to BI at the time of the transfer, as the equivalent amount of capital was injected into PBs as part of the Government's state bank recapitalization program.

2.5.4 Special Account (*Revolving Fund)*

BI is required, under the loan agreement, to establish a special account (revolving fund) to pool repayment from end-users in order to re-disburse loans to the same target beneficiaries on the same conditions. As shown in Table 6, 336 billion Rupiah, originally planned to be used as a revolving fund, has been repaid to BI . However, since the new regulations prohibit BI from directly engaging in new two-step loans, the BI is hesitant to revolve the repaid fund, although the AJDF/B-2 project is not necessarily considered a “new” project. As a result, the repaid fund currently remains within BI.

3. Recommendations

[Recommendations to JBIC]

The loan agreement states that “funds repaid from end-users must be re-disbursed for the same purposes stipulated in this loan contract”, and the borrower is obliged to submit regular statements on the special account to JBIC. However, the banking sector restructuring process in Indonesia which followed the currency crisis makes it impossible to confirm the status of the sub-loan fund for this loan. The majority of non-performing loans have been transferred to the IBRA, but the Indonesian government must be made to examine the status of the sub-loans under the ODA loan, observe the related rules and establish a system for regular monitoring of the fund (This suggestion was made by the Board of Audit in 1997).

Comparison of Original and Actual Scope

Item	Original	Actual
(1) Project Scope	(1) Low-interest, long-term credits to project proponents eligible for PNEC. (2) Consultancy services for the credit management, monitoring and training.	(1) Low-interest, long-term credits to project proponents eligible for PNEC. (2) Consultancy services for the credit management, monitoring and training.
(2) Implementation Schedule	Nov. 1989 to Dec. 1996	Nov. 1989 to Dec. 1996
(3) Project Cost Foreign Currency Local Currency Total ODA Loan Portion	 16,955 million Yen - 16,955 million Yen 16,955 million Yen	 16,408 million Yen - 16,408 million Yen 16,408 million Yen

Independent Evaluator's Opinion on AJDF for Indonesia Category B-2, PNEC Program

Pande Radja Silalahi
Head of the Department of Economic Affairs, CSIS, Jakarta

1. This draft report is concise, presenting a range of relevant subjects within the DAC evaluator criteria.
2. The goal of this project is highly relevant to promoting increased non oil-gas exports, with credit made available specifically to small and medium enterprises. Both now and in the future, steady growth can be expected in demand for this kind of credit.
3. The two-step loan is actually an effective means of channeling funds if well designed. However, a large interest rate differential (9.5%) could reduce the effectiveness of this loan.
4. When compared to the prevailing interest rate on two-step loans, this loan is under priced. However, because of the excessive margin collected by BI and the executing bank, the efficiency of this loan is questionable and in this draft report is not analyzed in detail.
5. This project will create substantial employment, but land issues, compensation issues, and matters related to traditional laws and customs are typically the problems that arise with land acquisition in Indonesia.

This project will bring about changes in land use. These changes will inevitably affect the environment. However, the draft report does not elaborate whether any important or negative factors will arise from the project (changes in land use).

6. Availability of credit is crucial to non oil-gas export growth.Lending under two-step loan arrangements will continue to have a place. This lending will be able to achieve its objectives more effectively if margins for intermediaries can be reduced with the benefits accruing to exporters.

The fact that Indonesia is still a long way from recovery in itself means that the management, control, and design of lending will play a very important role.

JBIC Comments:
The 9.5% difference of interest rate (spread) between original JBIC interest rate and on-lending interest rate to end-users took account of following items; firstly 'exchange rate risk' which was taken by Ministry of Finance (MOF) in order to on-lend loans in local currency base, secondly, 'administrative expense' of Handling Banks (HBs) for on-lending operations, and thirdly, 'credit risk' cost for HBs. For effective on-lending operations, these cost items need to be covered in real terms, ie. excluding inflation factor.

The annual inflation rate from 1989 to 1996 (the period of the project) was actually around 8.4% on average. Taking account of the above items and the average inflation rate, the spread of 9.5% was considered as an appropriate level. In addition, it should be noted that this project scheme had benefit to end-users in terms of relatively longer repayment period between 8 and 16 years, which was not offered by commercial banks.