

Ex-ante Evaluation

1. Name of the Project

Country: The Republic of Indonesia
Project: Development Policy Loan (III)
Loan Agreement: March 23, 2007
Loan Amount: 11,777 million yen
Borrower: The Republic of Indonesia

2. Necessity and Relevance of JBIC's Assistance

Under the rule of H.E. Dr. Susilo Bambang Yudoyono, the President of the Republic of Indonesia, the Government of Indonesia has implemented policies to (1) stabilize the macroeconomy, (2) improve the investment climate, and (3) enhance public financial management and anti-corruption measures. From 2005, the government added (4) poverty reduction. In addition, the Government of Indonesia has asked the World Bank and the Government of Japan for assistance in the form of development policy loans. In response, in FY2004, the latter provided cofinancing totaling 400 million dollars, of which JBIC provided 100 million dollars (10,794 million yen) in yen loans. In FY2005, a total of 700 million dollars in loans were provided for the Development Policy Loan (II) (including the amount provided by the Asian Development Bank), of which JBIC provided 100 million dollars (11,729 million yen).

Under these assistances, the Government of Indonesia has been promoting reforms to enhance macroeconomic stability, improve the investment climate, public financial management, and anti-corruption, and implement poverty reduction measures. GDP growth rates of 5.5% and 6.2% are expected in FY2006 and FY2007, respectively. On the fiscal front, in the FY2007 budget proposal fiscal deficit to GDP is projected to decline to 1.1% from 1.3% in FY2006. Debt to GDP ratio declined to 41% in September 2006, and the government plans to further reduce this to 31.8% by FY2009.

However, the poor people living under USD 2 a day account for 50% of the population, and in a situation where some 2 million people enter the labor market every year, there is a need to generate employment through further economic development.

Additionally, the fuel subsidy was reduced in 2005. Although a conditional cash transfer program was launched on condition that, among other things, parents send their children to school, in 2006, the share of people living in extreme poverty increased slightly, so poverty reduction remains an important issue.

In the "Country Assistance Program for Indonesia" (adopted in November 2004), the following five areas are cited to achieve sustainable growth led by the private sector: (1) securing of sustainable public financing, (2) development of economic infrastructure to improve the investment climate, (3) promotion of support for industries and small-to-medium-sized companies, (4) improvement of economic policies, and (5) support for financial sectors, etc. Additionally, in the Mid-Term Strategy for Overseas Economic Cooperation Operations (adopted in April 2005), JBIC regards infrastructure development towards sustainable growth and support for poverty reduction as priority areas. Moreover, with regard to Indonesia, in addition to viewing economic infrastructure development to improve the investment climate as a focus area, efforts will be made to contribute to the promotion of

various reforms, including the maintenance of fiscal sustainability. The Country Assistance Program for Indonesia is consistent with these reforms, meaning JBIC's support is highly necessary and relevant.

3. Project Objectives

The objective of this project involves promoting sustainable policy reform and policy dialog with Japan by evaluating the performance of the Indonesian government's policy reform, providing Development Policies I and II, cooperating with the World Bank and the Asian Development Bank, and supporting Indonesia's policy reform, and thereby contributing to (1) the stability of Indonesia's macroeconomy, (2) improvement of its investment climate, (3) enhancement of its public financial management and anti-corruption measures, and (4) poverty reduction.

4. Project Description

(1) Project Outline

Measures to be implemented in this project are (1) macroeconomic stability, (2) improvement of the investment climate, (3) enhancement of Indonesia's public financial management and anti-corruption measures, and (4) poverty reduction.

| Reform Items | Actions Carried Out | Future Actions (scheduled) |
|---------------------------------------|---|--|
| (a) Macro-economic stability | <ul style="list-style-type: none"> ● Improvement of fiscal policy ● Establishment of a fiscal policy office by 2007 ● Continuation of debt management strategies ● Improvement of decentralization frameworks | (Though the subsidy for electrical power and similar are serious causes for concern, the macroeconomic situation is satisfactory. Thus no specific action will be taken.) |
| (b) Improvement of investment climate | <ul style="list-style-type: none"> ● Clarification of the legal status of regional government enterprises ● Improving efficiency of domestic and international trade ● Continuation of development of financial sector safety nets ● Revitalize National Team for the Development of Exports and Investment ● Enhancement of risk management (function to be operational and empowered) ● Establishment of public-private partnership (PPP) | <ul style="list-style-type: none"> ● Implementation of supporting documents related to new investment law ● Shortening of VAT refunding period for exporters ● Issue MOF (Ministry of Finance) Decree on tax audit procedures that allows tax payers to request audit findings and a review in case of disputes ● Streamlining of investment process ● Issue a comprehensive SME policy package |

| | frameworks (function to be operational and empowered) | |
|--|---|---|
| (c) Public financial management improvement and anti-corruption measures | <ul style="list-style-type: none"> ● Issue additional implementing regulations for Treasury Law and State Audit Law ● Implementation of Treasury Single Account ● Improvement of quarterly reporting of budget execution ● Improvement of statement of accounts ● Enhancement of function of NPPO (National Procurement Policy Office) ● Modernization of the Headquarters of Director General of Tax ● Submit Witness Protection Law to Parliament for approval | <ul style="list-style-type: none"> ● Fully operationalize NPPO (National Procurement Policy Office) and issue draft procurement law ● Reform the Ministry of Finance as a model of civil service reform |
| (d) Poverty reduction | <ul style="list-style-type: none"> ● Monitoring related to the implementation of compensation programs | <ul style="list-style-type: none"> ● Establishment of competency standards for teacher certification and the instruments for measuring compliance standards |

(2) Total Project Cost/Loan Amount

Donor support for the entire project: Approximately US\$900 million

Yen Loan Amount: 11,777 million yen (Approximately US\$100 million)

World Bank fund: US\$6 00 million

Asian Development Bank fund: US\$200 million

(3) Implementation Structure:

(a) Borrower: The Republic of Indonesia

(b) Implementing Agency: The Ministry of Finance

(c) Operation and Maintenance System: Same as (b)

(4) Environmental and Social Consideration

(a) Environmental Effects/Land Acquisition and Resident Relocation

(i) Category: C

(ii) Reason for Categorization: This project is likely to have minimal adverse impact on the environment due to the fact that the project sector and characteristics are not likely to exert an impact and the project is not located in a sensitive area under the “Japan Bank for International Cooperation Guidelines for Confirmation of Environmental and Social

Consideration” (established in April 2002). Thus this project is classified as Category C.

(b) Promotion of Poverty Reduction: Since this project contains a conditional cash transfer program to the poor under certain conditions, it will contribute to the implementation of poverty reduction measures

(c) Promotion of Social Development (e.g. Gender Perspective): This project provides support for “good governance” by, among others, promoting decentralization and enhancing public financial management.

(5) Other Important Issues: None

5. Outcome Targets

(1) Evaluation Indicators (Operation and Effect Indicator)

| Indicator | Baseline (2003) | Target (2008) |
|---|---|---|
| (a) Macroeconomic stability | <ul style="list-style-type: none"> ● Fiscal deficit to GDP: 1.7% ● Debt to GDP ratio: 59% | <ul style="list-style-type: none"> ● Fiscal deficit to GDP: 1.0% ● Debt to GDP ratio: 38% |
| b) Improvement of the investment climate | <ul style="list-style-type: none"> ● Investment to GDP ratio: 18.9% ● Start up time for new business: 151 days | <ul style="list-style-type: none"> ● Establish departments and agencies to promote the implementation of public private partnerships (PPP) ● Investment to GDP ratio: 23-25% ● Budget appropriation for risk management in the 2006 supplementary budget and the 2007 budget proposal ● Start up time for new business: 30 days |
| (c) Improvement of public financial management and anti-corruption measures | <ul style="list-style-type: none"> ● More than 18,000 government cash operations in existence with no cash management standard | <ul style="list-style-type: none"> ● All core government cash operations are consolidated into Treasury Single Account |
| (d) Poverty reduction measures | <ul style="list-style-type: none"> ● Emergency safety nets and various grants (via which the fuel price is kept low, etc.) | <ul style="list-style-type: none"> ● Implement anti-poverty measures for 500,000 households |

6. External Risk Factors

Political uncertainties in central and local assemblies

7. Lessons Learned from Findings of Similar Projects Undertaken in the Past

A lesson learned from the findings of similar projects undertaken in the past is that in cofinancing projects it is important to exchange information, from the stage of appraisal to monitoring and supervision, in close cooperation with relevant organizations. Therefore the loans approved for this project will be supervised in close cooperation with the cofinancing agencies, namely, the World Bank and the Asian Development Bank.

8. Plans for Future Evaluation

Timing of Next Evaluation
After completion of program