

1. Name of the Program

Country: The Republic of Indonesia
 Program: Development Policy Loan (VII)
 Loan Agreement: December 10, 2010
 Loan Amount: 8,391 million yen
 Borrower: The Republic of Indonesia

2. Background and Necessity of the Program

(1) Current State and Issues of Development in Indonesia

President Susilo Bambang Yudhoyono, who took office in October 2004, was reelected gaining over 60% of the votes in the presidential election held in July 2009. He formed his second government in October of the same year. Since his first term in office, President Yudhoyono laid out promises to be achieved as follows: (i) stabilization of the macro economy, (ii) improvement of investment climate, (iii) improvement of fiscal administration and anti-graft measures, and (4) poverty reduction. As a result of these reforms, over 5% economic growth was achieved for five consecutive years (2004-2008), supported by strong domestic consumption and private investment. In 2009, growth rate remained at 4.5% despite concerns regarding the global financial crisis, and it is expected to be around 6% in 2010. In terms of the fiscal deficit, it has expanded from 0.1% to GDP in 2008 to 1.6% in 2009, the year that Jakarta implemented the economic stimulus package under a revised budget. Under the revised budget for FY2010, the Government of Indonesia (GOI) expects 2.1% growth. As for public debt outstanding, it has been constantly decreasing and expected to decrease to around 27% against GDP at the end of 2010.

In the Med-term National Development Plan (RPJM 2004-2009), GOI set the targets of 5.1% for reducing the unemployment rate (9.9% in 2004), and 7.6% for economic growth rate. However, unemployment rate stands at 7.9% (as of August 2009) and economic growth rate in 2009 was 4.5%. Considering that 2 million new workers enter into the labor market every year, further economic growth is needed to create employment. Moreover, the effects of the global financial crisis on the financial market became obvious, including temporary closure of the stock market, increased issuance costs for government bonds and a further weakening of the rupiah. Therefore it has become a critical issue to continue reform efforts towards improving the investment climate and fiscal administration, and reducing poverty.

(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 (GOJ) prioritizes three areas of “sustainable growth driven by the private sector”, “creation of a democratic and fair society”, and “peace and stability” in its “Country Assistance Program for Indonesia” (2004 November). Under the priority area of “sustainable growth driven by the private sector”, GOJ provides assistance in below areas: (i) ensuring fiscal sustainability, (ii) establishing economic infrastructure to improve the investment environment, (iii) revitalizing the subsidiary industries and SMEs, and (iv) creating economic systems and reforming financial sector. In the meantime, JICA defined “support for establishing/improving economic policies” as one of the development issue. Thus, this Program is consistent with the above policies.

Since 2004, JICA has also provided continual support for policy reform by GOI together with the World Bank and the Asian Development Bank (ADB) by providing Development Policy Loan over six terms (74.67 billion yen in total). These programs include policy actions such as

taxation improvement, based on the dialogues with working groups of the Strategic Investment Action Plan (SIAP).

(4) Necessity of the Program

This program contributes to sustainable development in Indonesia through support for implementing vital policy reform efforts in improving investment climate and fiscal administration, and reducing poverty. It is necessary to support the second Yudhoyono administration to promote policy reform in a steady and continuous fashion. 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 fiscal administration, 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 and ADB, based on the achievements in a series of policy reforms by the Government of Indonesia.

(2) Program Components

Reformed items	Actions achieved	Actions to be taken in the following year
1. Improvement of the investment climate	<ul style="list-style-type: none"> ○ Revision of investment negative list (issuance of Presidential Regulation) ○ Issuance of detailed regulations on One Stop Integrated Service (Playanan Terpadu Satu Pintu: PTSP) ○ Starting operation of National Single Window (NSW) at major ports (4 seaports and 1 airport) (selecting Directorate General of Customs and Excise as a temporary operator) ○ Preparation of draft Presidential Regulation on National Logistics System Development ○ Implementation of reporting system for local trade bureaus issued to the central government ○ Issuance of Guideline for Transfer Pricing Taxation 	<ul style="list-style-type: none"> ○ Enhancing review function including consultation between public and private sectors for revised investment negative list ○ Implementation of PTSP and monitoring of benefits and evaluations ○ Preparation of standard operating procedure (SOP) for organizing regular meetings with the private sector to implement NSW ○ Evaluation to understand bottlenecks in improving services at five major ports ○ Approval of mid-term HR strategic plan for Directorate General of Customs and Excise ○ Establishment of revised SOP for objection petitions
2. Improvement of fiscal administration	<ul style="list-style-type: none"> ○ Presentation of detailed information on mid-term government expenditure framework to Parliament ○ Issuance of Ministry of Finance regulation on cash flow forecast¹ ○ Issuance of joint decree 	<ul style="list-style-type: none"> ○ Publication of review results of operation indices/operation information system ○ Reviewing execution of Ministry of Finance regulations on cash flow forecast ○ Establishment of system database for managing

¹ Enhances cash flow prediction in order to realize transparency and effectiveness in budget management.

	between Ministry of Finance and National Land Agency on state asset certification <input type="radio"/> Finalization of draft procurement regulation for public consultation process	government assets and integration with the accounting system for government assets <input type="radio"/> Submission of procurement regulation to the Parliament
3. Poverty reduction	<input type="radio"/> Establishment of inter-ministerial National Team for the acceleration of poverty reduction by Presidential Regulation <input type="radio"/> Revision of calculating method for national poverty line	<input type="radio"/> Establishment of evaluation framework for a poverty reduction program <input type="radio"/> Holding workshop on calculation method for revised national poverty line

(3) Total Program Cost/Estimated Loan Amount

Loan Amount: 8,391 million yen (equivalent to 100 million dollars)

(4) Program Implementation Structure

1) Borrower: The Republic of Indonesia

2) Executing Agency: Coordinating Ministry of Economic Affairs and Ministry of Finance

(5) Schedule

January 2009 to December 2010. This phase of the program shall be completed when the loan is disbursed (expected in December 2010).

(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, since it stimulates public spending to improve social services for the poor.

3) Promotion of Social Development (Gender Perspective Infectious Disease including HIV/AIDS, Participatory Development, and Considerations for Disabled Persons, etc): None in particular

(7) Cooperation with Other Schemes, Donors, etc.: Co-financing with World Bank (600 million dollars) and ADB (200 million dollars)

(8) Other Important Issues

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. Experts for these projects have provided input necessary to promote policy actions, through monitoring meetings, etc.

4. Targeted Outcomes

Performance Indicators (Operation and Effect Indicators)

Indicator	Baseline (achievements from 2007 to 2010)	Target (2012 ²)
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 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○ 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)	<ul style="list-style-type: none">○ 12.4%

5. External Factors and Risk Control

None in particular

6. Lessons Learned from Past Programs

Co-financed programs implemented in the past have shown that it is important to exchange information among the parties involved throughout all stages from appraisal to monitoring. Based on this lesson, the Program will be monitored in close coordination with the World Bank and Asian Development Bank, the co-financing institutions.

7. Plan for Future Evaluation

(1) Indicators to be used:

- 1) Achievements in improving the investment climate (increase in investment to GDP by improving the investment-related systems, etc.)
- 2) Achievements in improving fiscal administration (increase in executing capital spending to 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 completion of third series in the Development Policy Loans (Development Policy Loan (VII) to (IX)) (planned).

² The last year of the third series in the Development Policy Loans (VII to IX)