

Ex-ante Evaluation

1. Name of the Project

Country: The Republic of Indonesia

Project: Development Policy Loan IV

(Loan Agreement: March 18, 2008; Loan Amount: 22,080 million yen; Borrower: The Republic of Indonesia)

2. Necessity and Relevance of JBIC's Assistance

The Indonesian government is implementing improvements in the investment climate, improvements in public financial management, anti-corruption reforms, and a poverty reduction policy, with the assistance of Japan, the World Bank, and the Asian Development Bank. The macro-economy is performing well overall, and during the five-year period from 2002 to 2006, the real GDP growth rate rose steadily.¹ Supported by strong domestic consumption and investment, the GDP growth rate from 2008 forward is expected to steadily increase. The inflation rate rose temporarily (to 13.1%) due to the reduction of fuel subsidies in 2006, but it declined to 6.4% in 2007. In the exchange rate, there is movement visible due to external factors such as the sub-prime problem, but the current account is positive, supported by global demand for primary products, and Indonesia holds foreign reserves equivalent to 6.8 months worth of imports.

In the area of investment climate improvement, an "Investment Climate Package" was announced in March 2006 with the objective of expanding private investment through policy improvements in the fields of investment policy, customs tax, the tax system, and labor. In March 2007, the "New Investment Law," which aims at non-discrimination between domestic and foreign investments as well as swift approval of investments, was enacted. Based on that law, a presidential order was promulgated in July 2007 to clarify who is ineligible to invest in Indonesia. In the area of customs tax and the tax system, steps being undertaken include unification of customs procedures (a national single window), acceleration of the refund process of the value-added tax (VAT), and improvement in the objection process to taxation. Additionally, in June 2007, with the aim of advancing economic growth and expanding employment opportunities, the government announced (1) development of the investment climate, (2) financial sector reforms, (3) infrastructure development promotion, and (4) a comprehensive "Policy Package," one pillar of which is to strengthen small and medium-sized enterprises and very small businesses. Together with such initiatives to improve the investment climate, in August 2007 the Japan-Indonesia Economic Partnership Agreement (EPA) was signed, and it is expected to advance economic cooperation between the two countries in the fields of trade, investment, and services.

In the area of public financial management, the primary balance is positive,² and the ratio of Government debt-to-GDP is in a steady downtrend.³ The fiscal deficit⁴ has been in an expansionary trend since 2007 due to increased subsidy expenditures accompanying increased public spending in

¹ The GDP growth rate was 4.8% in 2003, 5.0% in 2004, 5.7% in 2005, 5.5% in 2006, and 6.3% in 2007.

² Primary balance to GDP ratio from 2003 to 2007 was 1.7% in 2003, 1.7% in 2004, 1.8% in 2005, 1.5% in 2006, and 0.6% in 2007.

³ The ratio of Government debt-to-GDP is declining, from 78.1% (2001) to 35.4% (2007).

⁴ The fiscal deficit to GDP ratio from 2003 to 2006 was 1.7% in 2003, 1.0% in 2004, 0.5% in 2005, 0.9% in 2006, and 1.7% in 2007. It is expected to rise to 2% in 2008.

infrastructure to promote economic growth and accompanying soaring crude oil prices and food prices. However, the Indonesian government's policy is to reduce fiscal deficit to 2.0% of GDP or less through streamlining of expenditures, etc. With the aim of further improving public financial management, the Indonesian government is promoting greater transparency in its annual expenditures by progressively centralizing the National Treasury. Moreover, the government's policy is to promote integration of its development plan and its budget as well as streamlining of expenditures through introduction of a Medium-Term Expenditure Framework (MTEF) starting with the FY2008 budget. In the area of anti-corruption, in 2006 the "National Action Plan to Eradicate Corruption" was promulgated by presidential order. Thus, improvement of transparency in the public procurement process, etc., and revamp of the civil service system are being promoted.

In the area of poverty reduction, in an effort to achieve the Millennium Development Goals, the government is promoting improvement in the quality of education and public and private healthcare as well as improvement of access to safe water and sanitation facilities. Additionally, the government plans to increase funding for programs such as conditional cash transfer programs directly to the poor⁵ and a National Community Empowerment Program (PNPM).⁶

For the purpose of assisting sustainable private-led growth, Japan's "Country Assistance Program for Indonesia" (November 2004) advocates the securing of the sustainability of public finances, development of economic infrastructure to improve the investment climate, and support of the promotion of supporting industries and small and medium-sized enterprises, and the development of economic policies and the financial sector. Moreover, JBIC's Medium-Term Strategy for Overseas Economic Cooperation Operations (April 2005) advocates, as priority areas, support for poverty reduction and infrastructure development for sustainable growth. Because Indonesia is endeavoring to contribute to the promotion of various reforms such as for maintaining the sustainability of public finances together with making a priority area of economic infrastructure development for the purpose investment climate development, the government's policies are consistent with this project. Thus, JBIC's assistance for this project is highly necessary and relevant.

3. Project Objectives

This project is to promote continuation of policy reforms and to promote policy dialogue between Japan and Indonesia by evaluating the policy reform record of the Indonesian government following Development Policy Loans I, II, and III, by coordinating with the World Bank and the Asian Development Bank, and by supporting the policy reforms of Indonesia, thereby contributing to (1) improvement of the investment climate, (2) anti-corruption and improvement of public financial management, and (3) poverty reduction .

⁵ Given that the direct cash transfer program, implemented as a fuel subsidy reduction compensation program in 2005, did not adequately reach the poor, in the conditional cash transfer program, cash is provided to the poor on certain conditions, such as that they send their children to school.

⁶ PNPM is scheduled to be implemented until 2010 in all counties in Indonesia as a comprehensive program for existing and new community development programs.

4. Project Description

(1) Project Outline

This project will implement the policies below for the objectives of (1) improvement of the investment climate, (2) improvement of public financial management and anti-corruption, and (3) poverty reduction.

Reform	Achieved Action ⁷	Future Action
(1) Improvement of investment climate	<ul style="list-style-type: none"> - Preparation of detailed rules for the New Investment Law - Shortening of the period taken for the refund of the value-added tax (VAT) for exporters⁸ - Promulgation of Ministry of Finance order enabling the filing of the objection concerning taxation⁹ - Expansion of the region where customers procedures are centralized - Improvement of policies for small and medium-sized enterprises 	<ul style="list-style-type: none"> - Preparation of detailed rules pertaining to the Investment Law, review of the list of persons ineligible to invest* - Implementation of monitoring of the time required for VAT refunds and time for the process of the objection examination to taxation * - Issue the decree on The Tax Administration Law. - Study of appropriate customs tax rates and other import regulations by a customs tax task team* - Improvement of the credit system for small and medium-sized enterprises
(2) Improvement of public financial management and anti-corruption	<ul style="list-style-type: none"> - Introduction of the Medium-Term Expenditure Framework (MTEF) - Improvement of civil service salaries and benefits, and implementation of the Ministry of Finance's reorganization plan - Promotion of centralization of the National Treasury 	<ul style="list-style-type: none"> - Strengthening of the implementation system for the performance budget system, and simplification of execution procedures for multi-year budgets* - Ongoing implementation of revamping of the civil service system - Completion of centralization of the National Treasury
(3) Poverty reduction	<ul style="list-style-type: none"> - Establishment of standards for granting teacher's licenses - Preparation of regulations for issuance of local bonds 	<ul style="list-style-type: none"> - Improvement of teachers' salaries and benefits - Construction of a system for evaluating poverty reduction programs - Compilation of a database to improve the accuracy of targeting the poor - Provide grants for community development projects in keeping with the project results

⁷ Out of the 20 actions achieved in Development Policy Loan III, 3 exceeded the target, 13 achieved the target, and 4 showed substantial progress.

⁸ The VAT refund period was shortened from about 1 year in 2003 to 6.3 months two years ago and 5.1 months in July last year. According to a questionnaire sent to Japanese companies in Indonesia, 80% of the companies had received VAT refunds as of July last year.

⁹ This was part of an enactment of a Minister of Finance order to improve tax audit procedures. Through this, taxpayers who disagree with the amount of their tax bill may raise an objection rather than pay the entire amount. Also, if taxpayers disagree with the result of an audit, they may file a complaint with a top-level agency.

*Already achieved.

(2) Total Project Cost/Loan Amount

Donor support for the entire project: Approximately 1,000 million yen (Yen Loan Amount: 22,080 million yen (equivalent to US\$200 million))

World Bank funds: US\$600 million

Asian Development Bank funds: US\$200 million

(3) Implementation Structure

(a) Borrower: The Republic of Indonesia

(b) Executing Agency: Ministry of Finance, Coordinating Ministry of Economic Affairs

(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 project characteristics are not likely to exert 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 Considerations” (established in April 2002). Thus this project is classified as Category C.

(b) Promotion of Poverty Reduction

This project includes improvement of the quality of education and promotion of locally-led community development. Because this project promotes improvement of policies and systems for the purpose of improving social services for the poor, it is a poverty countermeasure project.

(c) Promotion of Social Development (e.g. Gender Perspective, countermeasures for infectious diseases such as AIDS, participatory development, consideration for disabled persons, etc.)

The programs in this project include promotion of decentralization of authority and improvement of the fiscal expenditure system, etc., and so it supports “good governance.”

(5) Other Important Issues

None

5. Outcome Targets

(1) Evaluation Indicators (Operation and Effect Indicator)

Indicator	Baseline (2003 actual)	Current Level (2007 year-end actual)	Target ¹⁰ (2008 year-end)
(1) Macroeconomic stability	<ul style="list-style-type: none"> - Fiscal deficit to GDP: 1.7% - Public debt to GDP ratio: 59% 	<ul style="list-style-type: none"> - Fiscal deficit to GDP: 1.7% - Public debt to GDP ratio: 35.4% 	<ul style="list-style-type: none"> - Fiscal deficit to GDP: 1.0% - Public debt to GDP ratio: 31.8% or less
(2) Improvement of investment climate	<ul style="list-style-type: none"> - Investment to GDP ratio: 18.9% - Days required to start a new business: 151 days 	<ul style="list-style-type: none"> - Investment to GDP ratio: 24% - Days required to start a new business: 105 days 	<ul style="list-style-type: none"> - Establishment of bureaus to promote implementation of PPP* - Investment to GDP ratio: 23%-25% - Budget for risk management appropriated in the 2006 revised budget and the 2007 budget plan* - Days required to start a new business: 30 days
(3) Improvement of public financial management and anti-corruption	-No mechanism to manage the country's nearly 18,000 cash operations	- Work underway to centralize the National Treasury	- Centralization of National Treasury completed
(4) Poverty reduction	-Many recipients of the social safety net and subsidies are not poor	- Implementation of conditional cash transfer program for the poor (pilot program)	- Implementation of conditional cash transfer program for the poor*

source: Indonesia's Ministry of Finance and Economic Coordination Minister Office, World Bank

*Already achieved.

6. External Risk Factors

None

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

In co-financing projects, it has been learned that it is important to conduct detailed exchange of information among the relevant institutions from the screening stage to monitoring. Based on this, this project plans to carry out monitoring of the loan while engaging in close collaboration with the World Bank and the Asian Development Bank, which are co-financing institutions.

¹⁰ These are the overall results since Development Policy Loan I. In the Development Policy Loans, because the series of actions since Development Policy Loan I are evaluated comprehensively, macroeconomic stability, which is not included in this project, is incorporated as an index.

8. Plans for Future Evaluation

(1) Indicators for Future Evaluation

- (a) Outcomes related to the macroeconomic stability (reduction of public debt, etc.)
- (b) Outcomes related to improvement of the investment climate (shortening of days required to start a new business, etc.)
- (c) Outcomes related to improvement of public financial management and anti-corruption (completion of centralization of National Treasury)
- (d) Outcomes related to poverty reduction (implementation of conditional cash transfer program for the poor)

(2) Timing of Next Evaluation

After completion of the project