

Ex-ante evaluation

1. Name of the Program

Country: The Republic of Indonesia

Project name: Connectivity Development Policy Loan

Loan Agreement December 2, 2013

Loan Amount: 19,848 million yen

Borrower: The Republic of Indonesia

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

Although foreign direct investment in Indonesia has increased in recent years, the country's investment environment is still immature compared to those of other countries. According to the World Bank's "Doing Business Report 2013", Indonesia's investment environment is ranked 128th among 185 countries, lower than those of other major East Asian countries. For sustainable economic growth, it is necessary to further increase investment by improving the investment environment including infrastructure development.

Although the Government of Indonesia has introduced various policies to improve the investment environment and promote infrastructure development, a lack of policies and coordination functions for such development become bottleneck for the implementation of related projects. On the fiscal front, the securement of funding for infrastructure improvement is an issue and it is highly expected to utilize public-private partnership (PPP) scheme as one of the effective means of private capital mobilization. However, the number of realized PPP projects is limited so far because systems for their promotion have not been sufficiently established. Japanese companies and other parties have also identified the simplification and enhancement of trading procedure as issues to be addressed as part of investment environment improvement. The overview of the macro-economic condition is described below.

(a) Real economy

Indonesia's real GDP growth rate fell to 5.6% in the third quarter of 2013 due to a weakening trend of exports caused by the drop in international resource prices seen since the latter half of 2012 and the slowing economies of China, India and other countries. On a short-term basis, downward pressure is placed on personal consumption due to the depreciation of Indonesia's currency, the rupiah, caused by fuel subsidy reform, current-account deficit and other factors.

(b) Finance/Currency exchange

Between June and November 2013, Bank Indonesia raised the benchmark interest (BI) rate from 5.75% to 7.50% and by 175 bps in total to deal with inflationary pressure caused by fuel subsidy reform and the depreciation of the rupiah. While the rate of inflation had increased by 8.90% year on year in August due to higher fuel prices and other factors, it has decreased since then. The rate showed an 8.32% year-on-year rise in October and remained above 8% throughout 2013.

Attention must be paid to the depreciating tendency of the rupiah due to the expanding current-account deficit and short-term capital outflows in response to the US government's reduction of

monetary easing measures. Bank Indonesia's foreign currency reserve is decreasing due to exchange market intervention and other factors, and stood at the equivalent of 5.2 months of imports as of the end of September 2013.

(c) Fiscal administration

The public debt outstanding to GDP ratio has fallen steadily to 23.3% (as of June 2013) thanks to economic growth and fiscal consolidation measures, and a high degree of soundness is one of the country's advantages.

In the FY 2013 budget (supplemented in June), while subsidiary expenditure was reduced by fuel subsidy reform, support for low-income earners was included. Although the budget deficit to GDP ratio is 2.7% and shows a slight increase, it remains within the limit set by the government (3% of GDP). As financing relies mostly on domestic borrowing (mainly bonds), there is little external risk. The ratio of overseas borrowing (gross) to GDP was only 0.6% (incl. 0.1% of program loans) in 2013.

In terms of the quality of expenditure, the ratio of the central government's public capital expenditure to GDP is as low as 2.3%, and the securement of funding for infrastructure development is a challenge. Due to Indonesia's delayed economic and social capital development, Japanese companies and other private-sector operators have pointed out that investment/business environment improvement and infrastructure development should be addressed as top priorities.

(d) Balance of payments

While exports have declined due to the global economic downturn since 2012, imports have increased due to strong domestic demand, resulting in a current account deficit since the fourth quarter of 2011. This deficit has exceeded direct investment since the first quarter of 2012. Dependence on securities investments has increased in the international balance of finance, and the overall balance of payments fell into the red in the first and second quarters of 2013.

On August 23, 2013, the government announced a measure to improve the current account balance through an economic policy package (including controls on imports of luxuries, oil, etc., exports of minerals and preferential tax treatment for labor-intensive industries) in order to reduce the current account deficit.

(2) Development Policies in Indonesia on Investment Environment Improvement, Infrastructure Development and Connectivity, and the Positioning of the Project

This project is intended to support investment/business environment improvement including infrastructure development, simplification of procedures and support for the utilization of PPP schemes, which are incorporated into the development agenda of national priority in the current Mid-term National Development Plan (RPJM2010-2014). The project is also intended to support the goal of the Master Plan for the Acceleration and Expansion of Indonesia's Economic Development (MP3EI) (May 2011), which aims to facilitate personal, physical and information flows and local industrial development through consolidation of domestic and international connectivity and to correct inter-regional gaps in development through the promotion of regional development and industry.

(3) Japan and JICA's Policies and Operations, and Other Donor's Activities

The three pillars of Japan's Country Assistance Policy for the Republic of Indonesia (April 2012) are 1) Assistance for further economic growth, 2) Assistance for correction of inequality and establishment of a

safe society, and 3) Assistance for the enhancement of capacity to address issues of Asian region and international society. Among these, specific policies to promote further economic growth include efforts related to business/investment environment improvement through support for the enhancement of various regulations and systems. Development issues listed on the basis of JICA Analytical Work also include improvement of business climate and connectivity enhancement. The project qualifies as an initiative relating to such policies and analysis.

(4) Support from Other Aid Organizations

Co-financing with the World Bank and the Asian Development Bank (ADB) is scheduled for the project. The World Bank's Country Partnership Strategy for Indonesia (CPS) 2013 – 2015 identifies pro-growth through strengthening connectivity and logistics improvement as a priority area. The Asian Development Bank's Country Partnership Strategy for Indonesia (CPS) 2012-2014 states that ADB will provide connectivity enhancement support toward the achievement of inclusive growth.

(5) Project Necessity

The project is intended to support the promotion of infrastructure development, whose slow progress is obstructing the sustainable growth of Indonesia and Indonesian government policy reform related to connectivity enhancement to correct inter-regional gaps in development.

As described above, this project is in accordance with the country's issues and development policies as well as with the assistance policies of Japan and JICA. It is highly necessary and appropriate for JICA to support the implementation of the project due to its potential to assist effective improvement of the investment environment based on the needs of Japanese companies through dialog with the Indonesian government.

3. Project Overview

(1) Project Objectives

The project is intended to promote improvement of Indonesia's investment environment and connectivity enhancement through continuous policy reform and policy dialog with Japan, and to contribute to sustainable development and correction among different regions in the country. These goals will be achieved by supporting the country's policy reform in cooperation with the World Bank and the Asian Development Bank based on an evaluation of the Indonesian government's series of policy reform achievements.

(2) Project Site/Location:

Throughout Indonesia

(3) Project summary

Reform items	Major policy actions achieved by September 2012	Major policy actions scheduled to be taken by September 2013
i) Strengthening National Coordination and Regulation	<ul style="list-style-type: none"> - Issuance of a Presidential Regulation (No.26/2012) / Ministerial Decree (No.49/2012) of the Coordinating Ministry for Economic Affairs related to establishing the national logistics system blueprint - Preparation of a draft Ministerial Regulation to establish the mechanism for channeling Government funds to public-private partnership projects in infrastructure 	<ul style="list-style-type: none"> - Establish a monitoring system to assess progress in implementation of the national logistics system - Enhancement for the functions of the MP3EI Secretariat (KP3EI) - Revitalize the Policy Committee for Acceleration of Infrastructure Delivery (KKPPI) - Submission of the draft budget of Project preparation facilities (Pre-FS fund, PDF/TA fund) to support PPP infrastructure projects - Issue Ministry of Finance regulation on Viability Gap Funding (VGF; governmental financial support for projects whose profitability is difficult to foresee) - Increased capital of the Indonesia Infrastructure Guarantee Fund (IIGF) and the Infrastructure Finance Company (SMI)
ii) Strengthening Intra-island Connectivity	<ul style="list-style-type: none"> - Issuance of the land acquisition Law (No.2/2012) and a Presidential Regulation (No.71/2012) on land acquisition for public purpose development. - Preparation for draft Presidential Regulation for the establishment of the Jabodetabek Transportation Authority. 	<ul style="list-style-type: none"> - Issuance of implementing regulations on land acquisition for public purpose development. - Preparation the work schedule for updating JABODETABEK Urban Transportation Master Plan
iii) Strengthening Inter-island Connectivity	<ul style="list-style-type: none"> - Issuance of a Ministerial Regulation of the Ministry of Communications and Information Technology (No. 23/2012) on the use of the ICT Fund. 	<ul style="list-style-type: none"> - Operationalization of the ICT Fund
iv) Strengthening International Connectivity	<ul style="list-style-type: none"> - The amendment of the Presidential Regulation No. 10/2008 to make the Indonesia National Single Window System (NSW). - Indonesia Single Window System using the Single Sign-On has introduced to the national Agency of Drug and Food Control into the Indonesia Single Window System using the Single Sign-On 	<ul style="list-style-type: none"> - Preparation of organizational set-up for the INSW Agency. - Introduce single sign on by Ministries of Trade and Agriculture (Plant Quarantine) into the INSW.

- (4) Total Project Cost/Estimated Loan Amount
Loan amount: 19,848 million yen (equivalent to 200 million US dollars.)
- (5) Project Schedule (period of assistance)
September 2012 to September 2013. This phase of the project shall be considered complete on the day the loan is disbursed (scheduled for March 2014).
- (6) Project Implementation Structure
 - 1) Borrower: The Republic of Indonesia
 - 2) Executing Agency: Ministry of National Development Planning (BAPPENAS), Coordinating Ministry of Economic Affairs (CMEA)
 - 3) Operation, maintenance and management structure
Monitoring of future action scheduled within the Project will be implemented in collaboration with the World Bank and the Asian Development Bank. Experts active in technical cooperation conducted by JICA in related fields will also attend monitoring meetings.
- (7) Environmental and Societal Considerations, Poverty Reduction, Societal Development
 - 1) Environmental and societal considerations
 - i) Category C
 - ii) Basis of 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) Poverty reduction contribution: The project will contribute to poverty reduction by correcting inter-regional gaps in development through connectivity enhancement.
 - 3) Societal development contribution (e.g., gender considerations, measures against AIDS and other infectious diseases, participatory development, consideration for the disabled): The project will contribute to the promotion of social development by correcting inter-regional gaps through connectivity enhancement.
- (8) Coordination with Other Schemes, Donors, etc.: A joint loan with the World Bank (scheduled amount: 300 million dollars) and the Asian Development Bank (400 million dollars) will be provided. Cooperation in policy support will be provided by "The project for PPP Network Enhancement" and other technical cooperation initiatives.
- (9) Other Remarks: none

4. Project Outcomes

Indicator	Base Line (2011/2012)	Target (2014)
Strengthening National Coordination and Regulation - Gross Investment (percentage of GDP, %) - Gross fixed investment (percentage of GDP, %) - Number of VGF applications on infrastructure PPP project	32.8 (2011) 8.8 (2011) 0 (2012)	36.2 10.0 1
Strengthening Intra-island Connectivity - Access to broadband internet services (%)	5 (2011)	10
Strengthening International Connectivity - Logistics Performance Index (LPI)	2.53 (2012)	2.70

Note: The Logistics Performance Index (LPI) is an index to measure the logistics friendliness (e.g., customs, infrastructure, international shipping, quality and competitiveness of distribution) based on a survey of operators conducted by the World Bank.

(2) Qualitative Impact: Implementation of the project will facilitate infrastructure development and enhancement of domestic and international connectivity as promoted by the Indonesian government, and is also expected to improve the country's investment environment. Enhancement of this environment and other achievements will contribute especially to economic growth, employment promotion and poverty reduction.

5. External Factors/Risk Control

Deterioration of the country's political/economic situation, conversion of its policies due to the change of government in 2014, etc.

6. Results of Evaluation for Similar Past Projects and Lessons for the Current Project

(1) Results of Evaluation for Similar Projects: The results of ex-post evaluation regarding Development Policy Loans (I to IV) show the importance of promoting reform at the field level through intensive technical cooperation in parallel with the achievement of policy action. Another lesson learned involves the importance of including issues and challenges identified through technical cooperation in policy dialog on development policy loans.

(2) Lessons for the Current Project: The project provides support for the promotion of reform related to policy action in combination with technical cooperation based on the results of evaluation for similar projects. Specifically, "The project for PPP Network Enhancement"(Technical Cooperation) facilitates consolidation of the mutual coordination ability of government agencies involved in PPP projects and supports the formation of model projects in combination with policy actions related to the establishment of PPP-related systems. "The Project on Capacity Development for Trade-related Administration"(Technical Cooperation) facilitates policy reform related to the introduction of NSW and Single Sign-On (SSO) and contributes to the enhancement of international connectivity. Concerning transportation planning for the Jakarta Metropolitan Area, continuous support has been provided through "The Study on Integrated Transportation Master Plan for JABOTABEK in the Republic of Indonesia"(Technical Cooperation for Development Planning) and "JABODETABEK Urban Transportation Policy Integration Project" (Technical Cooperation). Based on the experience of such cooperation projects, JICA has proposed policy actions concerning the

7. Future Evaluation Plans

(1) Indicators for Future Evaluation

- 1) Results related to investment environment improvement (e.g., Gross investment ratio (percentage of GDP, %))
- 2) Results related to the promotion of infrastructure development (e.g., Gross fixed investment (percentage of GDP, %))
- 3) Results related to the establishment of systems for PPP infrastructure promotion (e.g., Number of VGF applications on infrastructure PPP project)
- 4) Results related to intra-island Connectivity (e.g., ratio of population with access to Internet services (%))
- 5) Results related to international Connectivity (e.g., Logistics Performance Index (LPI))

(2) Timing of Next Evaluation: after project completion