ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 50168-001
October 2016

Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1
Republic of Indonesia: Fiscal and Public Expenditure Management Program

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 19 October 2016)

Currency unit	–	rupiah (Rp)
Rp1.00	=	$0.000076
$1.00	=	Rp13,018

ABBREVIATIONS

ADB	–	Asian Development Bank
DAK	–	dana alokasi khusus (specific allocation grant)
DID	–	dana insentif daerah (regional incentive fund)
FPEMP	–	Fiscal and Public Expenditure Management Program
GDP	–	gross domestic product
JKN	–	Jaminan Kesehatan Nasional (National Health Insurance)
PEM	–	public expenditure management
PFM	_	public financial management
RASKIN	–	Beras Untuk Keluarga Miskin (subsidized rice program for the poor)
RPJMN	–	Rencana Pembangunan Jangka Menengah Nasional (national medium-term development plan)
SDG	–	Sustainable Development Goal
TA	–	technical assistance

NOTE

In this report, “$” refers to US dollars.

Vice-President	S. Groff, Operations 2
Director General	J. Nugent, Southeast Asia Department (SERD)
Directors	K. Bird, Public Management, Financial Sector, and Trade Division, SERD S. Shrestha, Officer-in-Charge, Indonesia Resident Mission, SERD
Team leader	S. Ismail, Financial Sector Specialist, SERD
Team members	E. Allen, Country Economist, SERD G. Bhatta, Technical Advisor (Governance), Sustainable Development and Climate Change Department (SDCC) C. de Vera, Operations Assistant, SERD J. Ghimire, Senior Counsel, Office of the General Counsel R. Hattari, Public Management Economist, SERD P. Jayawardana, Young Professional, SERD L. Jovellanos, Senior Economics Officer, SERD A. Ramayandi, Senior Economist, Economic Research and Regional Cooperation Department
Peer reviewers	G. Giannetto, Senior Financial Sector Specialist, East Asia Department W. Turner, Senior Public Management Specialist, SDCC

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PROGRAM AT A GLANCE

1. Basic Data			**Project Number:** 50168-001
Project Name	Fiscal and Public Expenditure Management Program (Subprogram 1)	**Department /Division**	SERD/SEPF
Country	Indonesia	**Executing Agency**	Fiscal Policy Office-Ministry of Finance
Borrower	Republic of Indonesia		

2. Sector	**Subsector(s)**	**ADB Financing ($ million)**
Public sector management	Public expenditure and fiscal management	500.00
	Total	**500.00**

3. Strategic Agenda	**Subcomponents**	**Climate Change Information**	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low

4. Drivers of Change	**Components**	**Gender Equity and Mainstreaming**	
Governance and capacity development (GCD)	Public financial governance	No gender elements (NGE)	✓
Partnerships (PAR)	International finance institutions (IFI) Official cofinancing		

5. Poverty and SDG Targeting		**Location Impact**	
Project directly targets poverty and SDGs	No	Nation-wide	High

6. Risk Categorization: Complex

7. Safeguard Categorization **Environment:** C **Involuntary Resettlement:** C **Indigenous Peoples:** C

8. Financing

Modality and Sources	**Amount ($ million)**
ADB	**500.00**
Sovereign Program loan: Ordinary capital resources	500.00
Cofinancing	**0.00**
None	0.00
Counterpart	**0.00**
None	0.00
Total	**500.00**

9. Effective Development Cooperation

Use of country procurement systems	Yes
Use of country public financial management systems	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the Fiscal and Public Expenditure Management Program (FPEMP), and (ii) a proposed policy-based loan to the Republic of Indonesia for subprogram 1 of the FPEMP.[1]

2. FPEMP supports the government's commitment to reduce household income inequality, and represents a medium- to long-term partnership between the Asian Development Bank (ADB) and the government. The government's priority areas to reduce income inequality include (i) aligning medium-term expenditure and programs with its national medium-term development plan (RPJMN) and Sustainable Development Goals (SDGs) targets,[2] (ii) enhancing the national public expenditure systems to improve quality of spending, and (iii) improving fiscal transfers and subnational governments' spending to promote better public service delivery.

II. THE PROGRAM

A. Rationale

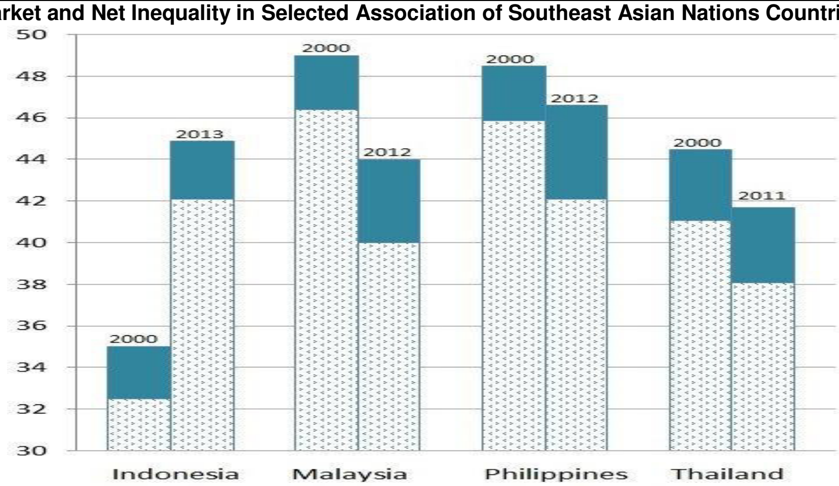
3. **The development problem.** Indonesia is facing the twin problems of prolonged economic slowdown and rising household income inequality. Economic growth has steadily declined from 6.4% in 2010 to 4.8% in 2015, and is expected to remain only slightly above 5.0% in 2016 and 2017.[3] Growth slowed initially because of falling commodity prices, which then fed back into lower growth in the non-resource sector, while new sources of growth have yet to emerge. The economic slowdown, combined with persistent volatility in the global financial and commodity markets, also translated into lower fiscal revenue collection, which in turn challenges the government's efforts to stimulate the economy. Revenue collection fell by 9.8% from January to April 2016, compared with the same period in 2015, and the government expects a shortfall of $16.7 billion in 2016. Given the constitutional limit on the budget deficit at 3.0% of gross domestic product (GDP), falling budget revenues impose constraints on the government's spending in the social sector and for infrastructure, even though these are necessary to overcome the income inequality problem. ADB analysis shows that expenditure on education and health is most sensitive to declines in revenue and to overall deficit levels, despite the government being legally required to allocate 20% of the budget to education and 5% to health.[4]

4. Against this backdrop of slower economic growth and increased fiscal pressures, the government is finding it difficult to reverse the trend of rising income inequality. Since 2000, Indonesia has experienced one of the largest increases in household income inequality in Southeast Asia. The Gini coefficient, which measures a country's household income inequality, increased from 0.30 in 2000 to 0.40 in 2015. Income inequality is closely connected to poverty, especially in rural areas, where it stands at 14.1% of the population (urban poverty: 7.8% of the population). Moreover, while 10.9% of the population lives below the poverty line, about 40% of

[1] The design and monitoring framework is in Appendix 1.
[2] The full list of SDGs is available at http://www.un.org/sustainabledevelopment/sustainable-developmentgoals (accessed on 21 April 2016). Please refer to Measures to Implement SDGs (accessible from the list of linked documents in Appendix 2).
[3] The government, the World Bank and ADB's updated Asian Development Outlook projects growth of 5.1%, and the International Monetary Fund projects growth of 4.9% for 2016.
[4] Sector Assessment (Summary): Public Expenditure and Fiscal Management (accessible from the list of linked documents in Appendix 2).

all people remain clustered around the national poverty line.[5] This situation is caused by unequal access to education, public services, and jobs; and by the fact that commodity-driven economic growth creates few jobs and concentrates wealth.[6] Uneven infrastructure investment and economic growth across provinces has widened regional income disparities and inequality; some provinces in Eastern Indonesia significantly lag Java and Bali in per capita income.

Figure 1: Market and Net Inequality in Selected Association of Southeast Asian Nations Countries, 2000-2013



Note: The full length of the bars and the shorter bars represent market and net inequality respectively. The gap between market and net inequality (shaded areas) highlights the impact of social protection programs and government's redistribution policies.
Source: Asian Development Bank estimates based on the Standardized World Income Inequality Database, 2014.

5. Indonesia's social protection programs have not adequately tackled the income inequality problem, as reflected in Figure 1,[7] which reports two indexes taken from the recent International Monetary Fund study and the standardized world income inequality database.[8] The first index—the Market Gini Index— measures income inequality without subsidies and income transfers to the population. This shows the counterfactual condition of what income inequality would be without the government's income redistribution policies. The second index—the Net Gini Index—measures income inequality with government subsidies and income transfers to the population and is the most commonly reported Gini index. The difference between the two indexes (represented by the shaded areas in Figure 1) shows the estimated reduction in income inequality as a result of the government's income redistribution policies. Figure 1 provides two conclusions. First, Indonesia's Gini index has increased significantly, while Malaysia, the Philippines, and Thailand have all experienced declines in their Gini indexes between 2000 and 2013. Second, Indonesia has been less successful in reducing income inequality through social policies and programs than the other three countries. In 2013, Indonesia's income redistribution policies reduced the Gini index from 44.8 to 42.0, or by 2.8 points, compared with much larger reductions in the Philippines (4.5 points), in Malaysia (4.0 points), and in Thailand (3.5 points).[9]

6. Insufficient public spending on social programs and infrastructure, weaknesses in national and subnational public expenditure management (PEM), overreliance on universal price subsidies (such as on energy), and poor targeting of income transfers to the population explain the smaller reduction impact on income inequality in Indonesia. For example, public

[5] Statistics from Indonesia's National Statistics Office and the World Bank Indonesia Overview http://www.worldbank.org/en/country/indonesia/ (accessed 7 April 2016).
[6] ADB. 2016. *Country Partnership Strategy: Indonesia, 2016–2019: Towards a Higher, More Inclusive and Sustainable Growth Path.* Manila.
[7] Social Protection Programs Analysis (accessible from the list of linked documents in Appendix 2).
[8] International Monetary Fund. 2014. *Redistribution, Inequality, and Growth.* Washington, DC and the Standardized World Income Inequality Database available at http://fsolt.org/swiid/ (accessed on 7 April 2016).
[9] There is a small discrepancy between data obtained from the database and government's official statistics.

spending on health is about 3% of GDP—one-third of the average in Organisation for Economic Co-operation and Development economies—and Indonesia ranks 147th out of 195 countries in health spending per capita. The low public spending is manifested in the poor performance of key health indicators. For example, maternal mortality ratios stand at 359 for every 100,000 births, and infant mortality rates are at 22.8 for every 1,000 births in 2015. Although these indicators have improved, they are still relatively high for a middle-income country. Similarly, in 2013, Indonesia's spending on education was 17.6% of total government expenditure, compared with 21.5% in Malaysia, 20.0% in Singapore, and 21.4% in Thailand. While the net enrollment rate in basic education stands at 95.5% in 2013, the rate for senior secondary education falls steeply to only 57.7%. Public spending on infrastructure averaged 1.5% of GDP between 2008 and 2012, and Indonesia ranks 62nd out of 140 countries in the quality of overall infrastructure, well below Malaysia (24th) and Thailand (44th). The SDGs stress the importance of targets related to health, education, social protection, and infrastructure quality to overcome income inequality, so the government will have to boost volume and efficiency of spending to meet these targets. There is an extensive volume of international empirical studies that show that an efficient and effective PEM systems (good governance) at both the national and subnational government level enables a reduction in household income inequality through better design and targeting of pro-poor spending initiatives over the medium term (footnote 8).

7. **Binding constraints.** The government has recognized the challenges it needs to address to improve social sectors and infrastructure spending: (i) poor alignment of medium-term expenditures and programs with its RPJMN and SDGs targets, (ii) weaknesses in the national PEM system that affect the quality of pro-poor spending, and (iii) poor quality of public service delivery by subnational governments. These constraints are discussed in paras. 8–10.

8. **Misalignment of medium-term expenditures and programs.** Lessons learned from Indonesia's experience in implementing the Millennium Development Goals shows that meeting targets requires sequential steps such as mapping SDGs against the RPJMN targets and devising an effective monitoring mechanism with regular reporting on implementation progress. To achieve the SDGs, the government will need to embed these targets into the budget planning process and medium-term expenditure of relevant line ministries, address funding deficiencies in key social and infrastructure areas, and undertake incremental but vital reforms to social protection so they are fiscally sustainable while expanding program coverage to the poor. By 2016, 167 million citizens (65% of the population) were covered by the national health insurance (JKN), although some of the poorest 40% can't afford the coverage. The monthly premium contributions of the non-poor beneficiaries are also very low at Rp19,225 per person (about $1.50), resulting in higher public subsidy to fully fund the program (the subsidy amounted to Rp20.3 trillion in 2015). Premium rates require upward adjustment to ensure JKN's fiscal sustainability. Another major anti-poverty program that needs reform is the subsidized rice program (RASKIN). The program benefits many poor families but is costly to run, and program targeting could be improved. In 2015, the government allocated Rp18.9 trillion for the program, and 42.6% of households received support, greater than the intended target. It is estimated that eligible households receive only one-third of the subsidy (footnote 7). The RASKIN assistance program needs to be better targeted to the poor and this will require the use of information and communications technology to register beneficiaries and record benefit entitlements.

9. **Weaknesses in national public expenditure management**. Although MOF has introduced the medium-term expenditure framework in 2011, weaknesses remain in budget planning, execution, monitoring, and reporting that impede quality pro-poor spending. For example, inconsistent information on government assets makes it difficult to manage assets and allocate budget for maintenance expenditure, which undermines the quality of public

infrastructure investment. Another recurring constraint that has impeded pro-poor spending is the low and delayed disbursement rates for capital spending, i.e., 50%–60% of disbursements are made in the last quarter of each fiscal year.[10] These constraints are largely attributed to cumbersome and complicated reallocation procedures between spending units and expenditure programs, and severe delays in procurement because of insufficient capacity in spending units. Another constraint in PEM is the incomplete implementation of performance-based budgeting, which is important for embedding RPJMN targets in the budget process and monitoring progress toward achieving them. Also, a budget reporting system is needed to support a robust monitoring and evaluation process that gives more immediate information on spending impacts. Finally, macroeconomic risk analyses of the budget must be made transparent to ensure the overall fiscal sustainability of spending goals. The 2012 Public Expenditure and Financial Accountability Report (PEFA) noted that weaknesses in budget execution, such as high variation between budget plans and outturns, affect the government's budget and expenditure credibility.[11] The PEFA report rated Indonesia's aggregate expenditure outturn as C and downgraded the composition of expenditure outturn from C to D. Both ratings reflect the government's focus on expenditure controls rather than delivery and performance.

10. **Poor quality of public service delivery by subnational governments.** The central government implemented major local governance and fiscal decentralization reforms in 2001. The government instituted four types of fiscal transfers: (i) general allocation to support basic spending including civil service salaries; (ii) specific allocation grant (DAK) for specific investment expenditures aligned with national priorities; (iii) revenue-sharing fund which covers natural resources and tax revenue; and (iv) regional incentive fund (DID) to incentivize subnational governments' performance including on public financial management. While much was accomplished, Indonesia's decentralization reforms remain a work in progress. The volume and quality of local public service delivery varies across subnational governments, and improving public service delivery in the poorer localities is a critical element of the government's efforts to reduce household income inequality. Two main factors impede quality of public service delivery. First, fiscal transfers to poorer regions are insufficient to overcome funding deficiencies in social sectors and infrastructure therefore do not have the revenue equalizing effect intended, nor are they linked to improved performance in service delivery and financial management of subnational governments (footnote 4). Second, PFM capacities are uneven especially in poorer regions. Different accounting and reporting systems are used leading to difficulties in monitoring by the central government. The PEFA report (footnote 11) graded the extent of central government monitoring of subnational government's budget performance as C. One outcome of these weaknesses is that even when transfers are made, some subnational governments deposit transfers into fixed-term accounts instead of spending for public service delivery, due to inability to plan expenditure—the total of subnational governments' budget amounts deposited in banks increased from Rp52.2 trillion in 2009 to Rp99.13 trillion in 2012.

11. **Government reform agenda.** The government's approach is to manage the twin problems of the prolonged economic slowdown and rising household income inequality is built around two pillars. The first is to tackle household income inequality directly by implementing its SDGs—aligning them with RPJMN targets, working out the cost and incorporating them into the medium-term expenditure of line ministries, and addressing public spending deficiencies in the social sector and for infrastructure. The government will complement SDG implementation with national and subnational PEM reforms to improve the quality of pro-poor spending, reinforcement of performance incentives for fiscal transfers, and incremental but vital reforms to

[10] International Monetary Fund. 2013. Staff Report for the 2013 Article IV Consultation. Washington, DC.
[11] World Bank. 2012. *Repeat Public Expenditure and Financial Accountability Report*. Jakarta.

social protection programs. Fiscal decentralization is executed through the government's 2014 institutional transformation blueprint. The second pillar is to stimulate the economy through fiscal expansion with more spending on public infrastructure and the social sector, which is considered to have the largest multiplier effects on the economy. Fiscal savings of about Rp211 trillion annually from the recent reduction in general subsidies to the non-poor will help fund the targeted social protection programs and the fiscal stimulus. Even so, to fund the stimulus, the government expects to operate much higher national government budget deficits close to the constitutional limit of 3.0% and net financing needs estimated at $22.3 billion in June 2016. The government is implementing reforms to boost fiscal revenue collection which should bear result in the medium-term. In the long-term, higher economic growth will be achieved through structural reforms to the investment climate, access to finance, energy sectors, more public and private infrastructure investments, and reforms to basic education, all supported through other ADB program and project loans as well as technical assistance (TA).

12. **ADB experience.** ADB has long supported reforms in PEM and social protection through several loan programs and TA (Figure 2). In 2005, the governance focus was on building a modern national public financial management (PFM) system and ADB provided support in setting up the public debt management office. In 2008, this shifted to developing a stronger intergovernmental fiscal and governance framework. ADB's support produced measurable results, including introduction of financial management information system at 147 local governments and devolution of local taxes to subnational governments.[12] ADB also supported the development of a social protection framework such as the conditional cash transfer program and fiscal sustainability of JKN.[13] Since 2012, ADB provided TA to improve the fiscal sustainability of social security, strengthen the fiscal decentralization framework (including DAK reform), and support fiscal risk management from accelerated delivery of infrastructure projects.[14] Going forward, the FPEMP provides an umbrella operation supporting PEM reforms both at national and subnational levels to better align SDGs with the RPJMN and the budget planning process, address deficiencies in expenditure in social sectors and for infrastructure, and improve effectiveness of social protection programs. The FPEMP supplements ADB's programs supporting the government to promote inclusive growth (footnote 6).[15]

13. **Lessons from the experience.** ADB's experience provided three lessons that were incorporated into the program. First, addressing household income inequality requires a comprehensive approach. This includes establishing an efficient PFM system to improve quality of spending and reforms to social protection to enable better targeting of pro-poor interventions. ADB's previous Development Policy Support programs (footnote 13), and international empirical evidence shows a direct link between improvements in PEM and a reduction in poverty and the Gini index (footnote 8). Second, based on ADB's program supporting Millennium Development

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[12] ADB. 2016. *Completion Report: Second Local Government Finance and Governance Reform Program in Indonesia*. Manila.

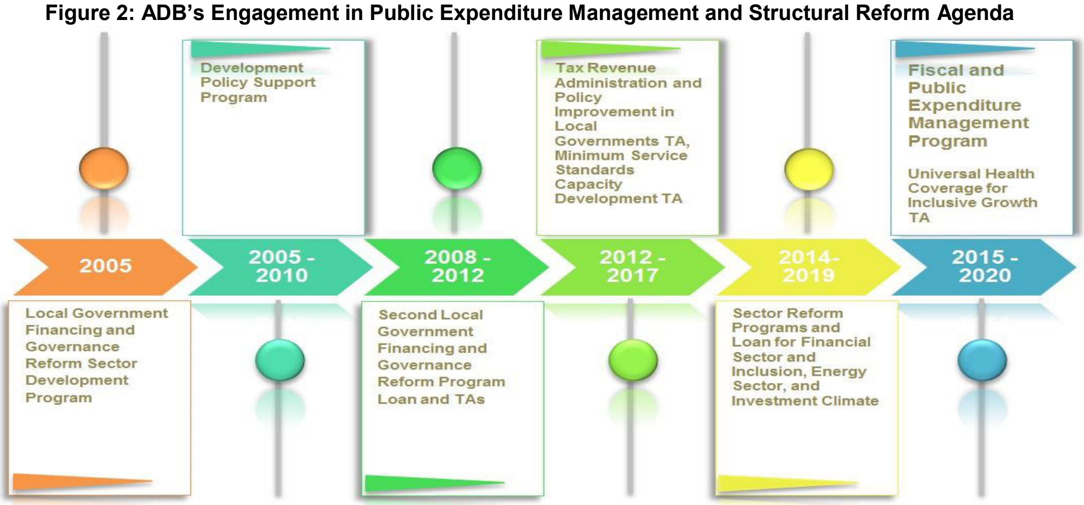
[13] ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Sixth Development Policy Support Program.* Manila.

[14] ADB. 2012. *Technical Assistance to Indonesia for Fiscal Aspect of Social Security Reform.* Manila (TA 8202-INO); ADB. 2015 and ADB. 2016. *Technical Assistance to Indonesia for Strengthening Fiscal Risk Management of Accelerated Infrastructure Delivery.* Manila.

[15] ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan to the Republic of Indonesia for Subprogram 1 of the Financial Market Development and Inclusion Program.* Manila; ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan to the Republic of Indonesia for Subprogram 1 of the Sustainable and Inclusive Energy Program.* Manila; ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan to the Republic of Indonesia for Subprogram 2 of the Stepping Up Investments for Growth Acceleration Program*. Manila.

Goals, achieving international goals and targets requires mapping of targets into the national strategy, budget costing for implementation and robust monitoring and reporting framework. Finally, a 'one-ADB' approach is required to support the government to meet international targets as the SDGs targets span across multiple sectors. This requires coordination across ADB including TA support and knowledge products on social protection and health sector reforms to achieve SDGs targets from the Sustainable Development and Climate Change Department.[16]

Figure 2: ADB's Engagement in Public Expenditure Management and Structural Reform Agenda



TA: Technical Assistance
Source: Asian Development Bank

14. **ADB's value addition to program design and implementation.** ADB has given direct support to selected reforms that underpin FPEMP. ADB provided TAs to improve the fiscal sustainability of social security reforms including JKN and strengthening fiscal decentralization framework including introduction of performance based grant mechanism (footnote 13-14). ADB also helped improve the fiscal transfer mechanism by creating forward estimates for intergovernmental financing, upgrading the design and monitoring of DAK, and providing capacity building on fiscal decentralization. ADB support in JKN reforms resulted in upward adjustments in premiums which improved JKN's financial sustainability. In addition, ADB is providing TA support to the education sector including capacity development of subnational governments in 108 districts and municipal administrations in 16 provinces to achieve the minimum service standards for basic education.[17] A TA is being prepared to help the government monitor and report progress in achieving the SDGs.

15. **Development partner coordination.** Development partner coordination is strong in the area of fiscal policy and PFM. The German development cooperation through KfW is considering parallel financing for subprogram 1 with an indicative amount of €200 million. Both the ADB and KfW teams have worked closely with the government in formulating the program, including the policy matrix. The World Bank supports the government's efforts on revenue mobilization through its development policy loan. Close coordination between ADB, the IMF, the World Bank, and other development partners created strong programmatic synergies in supporting the government's fiscal policy and PEM reforms. The government leads the development partner coordination for assistance in decentralization, fiscal and PEM policies at

[16] ADB. 2015. *Regional Technical Assistance for Universal Health Coverage for Inclusive Growth: Supporting the Implementation of the Operational Plan for Health 2015-2020*. Manila. (TA 8983-REG).
[17] ADB. 2013. *Technical Assistance to Indonesia for Minimum Services Standards Capacity Development Program* (TA 8358-INO). Manila.

subnational government level and ADB co-chaired the coordination meeting in June 2016. The governments of Australia, France, Germany, and the United States are also active in PFM.[18]

16. **The programmatic approach and policy-based loans.** The programmatic approach through policy-based loans was chosen over other financing modalities because it is the most effective in: (i) implementing policies to achieve RPJMN and SDGs targets; (ii) leveraging reforms to PEM to make social protection programs fiscally sustainable; (iii) contributing to filling the gap in the government's financing needs to address funding deficiencies in education, health, social protection and infrastructure; and (iv) enabling ADB to have a medium-term engagement with the government. The program will have two subprograms covered by a medium-term results framework that reflects the long-term engagement between ADB and the government on fiscal policy and PEM reform. Subprograms 3 and 4 may be included subsequently and will be formulated during the processing of subprogram 2 to ensure a continuous dialogue with stakeholders on emerging policy priorities including domestic revenue mobilization and the government's request. Flexibility is retained in determining the loan size depending on the financing needs of the government in this period of revenue uncertainty.

17. **Economic impact of the program**. The three outputs of the program combined are expected to lead to improved social sector and infrastructure spending. The following potential economic gains are to be achieved through efficiency gains: (i) medium-term expenditure aligned with RPJMN; (ii) national public expenditure system enhanced; and (iii) transfers and subnational governments' spending on service delivery improved (para. 28).

B. Impact and Outcome

18. The impact will be reduced household income inequality as measured by the Gini coefficient in alignment with the government's RPJMN targets. The outcome will be social sector and infrastructure spending improved. The program will include a series of policy reforms and interventions and is designed to deliver three outputs. Subprogram 1 contains 12 reform actions, which the government completed between January and August 2016. Subprogram 2 contains 12 reform policy actions, six of which are expected prior actions (triggers).

C. Outputs

19**. Output 1: Medium-term expenditures aligned with National Medium-Term Development Plan and Sustainable Development Goals' targets.** This output will align the government's medium-term expenditure with RPJMN and SDGs targets, increase spending in social sectors and infrastructure and reform social protection programs. Achievements under subprogram 1 included the following. In 2016, the government developed the SDG implementation framework. The Presidential Regulation submitted to the Cabinet Secretariat laid out implementation plans in a sequential manner, including mapping the SDGs targets against existing targets in RPJMN and setting up a steering committee chaired by the Minister of National Development Planning Agency to coordinate implementation. The additional fiscal space created by the reduction in general subsidies was utilized to increase spending on education, health, social protection, and infrastructure. In the 2016 budget, the government implemented a 5% budget allocation to health (compared to 3.8% of total spending in the 2015 budget), which amounts to a 39% increase in health spending. The 2016 education budget increased by 2.0% over the 2015 budget, which translated to a small decline in spending when adjusted for inflation. Social protection programs received a five-fold increase in the 2016

[18] Development Coordination (accessible from the list of linked documents in Appendix 2).

budget allocation. The government, through the Social Security Agency, implements the JKN, which guarantees participants' access to basic health care. The government provides subsidies to those who fall within the bottom 40% of Indonesia's income distribution. In 2016, the number of subsidy recipients increased from 88.2 million to 92.4 million, representing 37% of the bottom 40% of the population. In addition, the government implemented a 20% increase in the health insurance premium of better off beneficiaries to improve the fiscal sustainability of the JKN. The government also approved implementation of non-cash social protection (smart card) to improve targeting and efficiency of the subsidized rice program (RASKIN).

20. For subprogram 2, the government will delineate responsibilities of line ministries for SDG implementation and provide periodic reporting of progress achieved. The government will also implement (i) measures to improve the targeting, coverage, and monitoring of its social protection programs, (ii) inflation-adjusted spending increases in education and health aligned with mandated target and (iii) inflation adjusted spending increase in public infrastructure.

21. **Output 2: National public expenditure system enhanced.** This output will improve the national PEM with a focus on disbursement, reporting and evaluation. Accomplishments included under subprogram 1 included the following. The government adopted information technology tools (i) which required line ministries to prepare standardized budget proposal focusing on output and outcomes and (ii) through Ministry of Finance implemented online monitoring of budget implementation including revenue, expenditure and financing. Both reforms are part of the broader integrated financial management information system supporting performance-based budgeting. The government also established a budget realization evaluation and monitoring team headed by the Minister of Finance to speed up budget execution. The state treasury and budget system aims to manage all financial transaction data of the central government in a full cycle, from budget appropriation to production of financial statements.

22. For subprogram 2, the government will simplify budget execution, such as giving line ministries more flexibility, and improve online monitoring of financial management information.

23. **Output 3: Fiscal transfers and subnational governments' spending for service delivery improved.** This output will strengthen subnational PFM system to improve budget execution. Accomplishments under subprogram 1 included the following. The government increased allocation and better-targeted fiscal transfers. In 2016, 51% of the national budget consists of transfers to subnational governments. This is a significant increase in the overall DAK —from Rp58.8 trillion in 2015 to Rp211 trillion in 2016— and in DAK allocation for health service: from Rp6.8 trillion in 2015 to Rp20.9 trillion in 2016. The government also increased DID allocation from Rp1.6 trillion in the revised 2015 national budget to Rp5.0 trillion in the national budget for 2016. To provide incentives for better performance by subnational governments, the government integrated local government rating on PFM and public services delivery to determine DID allocation. Finally, to address idle funds, the government implemented government bond transfers to subnational governments with low levels of budget execution.

24. For subprogram 2, the government will implement a monitoring and evaluation system of the DAK for health, education, and local infrastructure; refine subnational governments' performance indicators to improve the selection criteria for recipients of DID; and reinforce measures to address idle funds and slow budget execution at subnational governments' level.

D. Development Financing Needs

25. The government has requested a policy-based loan of $500 million from ADB's ordinary

capital resources to help finance subprogram 1. The loan will have a 15-year term, including a grace period of 3 years, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions set forth in the draft loan agreement. Based on this, the average loan maturity is 9.25 years, and no maturity premium is payable to ADB. The proceeds of the policy-based loan will be disbursed to Indonesia in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time).

26. The net development financing needs are estimated between $22.3 billion and $26.8 billion, and the budget deficit between 2.4% and 2.8% of GDP depending on final tax revenue collection. To finance the deficit, the government planned to raise $5.5 billion from official foreign loans (including USD 2.7 billion of program loans). The size of subprogram 1 primarily reflects the government's financing needs, the strength of the reform program, and the implementation costs, including increasing JKN subsidies for the bottom 40% and boosting spending on education and health (para. 28).

E. Implementation Arrangements

27. The Ministry of Finance's Fiscal Policy Agency as the executing agency is responsible for coordinating the government's FPEMP-related reforms. Implementing agencies include the directorates general of budget, treasury, and fiscal balance. SDG implementation, monitoring, and progress reports will be through the national steering committee on SDG implementation. The implementation period is January 2015 to August 2016 for subprogram 1 and September 2016 to November 2017 for subprogram 2.

III. DUE DILIGENCE

A. Economic and Financial

28. The program will have positive economy-wide impacts. The program impact assessment estimates the potential new quantifiable benefits of the program at $6.4 billion, under conservative discounting assumptions, which well exceed the program's costs.[19] Using the social accounting matrixes, the reallocation of general subsidies to additional expenditure on health and education is estimated to yield a benefit of $3.0 billion, social protection at $7.3 billion, and infrastructure at $1.6 billion. Strengthening subnational PEM systems, increasing fiscal transfer and design of DAK and DID, is estimated to yield a benefit of $8.8 billion. The reforms and associated higher expenditures will entail costs of about $14.8 billion.

B. Governance

29. The government has made considerable progress in improving the legal and regulatory framework for PFM. Since the enactment of laws on state finance, state treasury, and state audit in 2003–2004, most regulations underpinning these laws have been promulgated. In 2012, the number of government agencies that received an unqualified audit opinion from the external audit agency increased to 65% (from about 40% in 2009). ADB has reinforced this momentum with continuing support to improve technical capacity on state audit. As a result of the government's continuing commitment to reducing corruption, the capacity of the Corruption Eradication Commission has improved markedly. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

[19] Program Impact Assessment (accessible from the list of linked documents in Appendix 2).

C. Poverty and Social

30. The reforms supported under the program will help reduce income inequality. More pro-poor spending and better-targeted subsidies will benefit the bottom 40% of the population. Improved PEM systems and additional and better-designed fiscal transfers to subnational governments will benefit the poor through improved targeting of assistance. Subprogram 1 is categorized as *no gender elements*, but ADB will discuss with government to elevate future subprograms to at least *some gender elements*.

D. Safeguards

31. Following an assessment of the proposed policy actions, the program will not have any likely social safeguard issues and is assigned category C for environment, involuntary resettlement, and indigenous peoples.

E. Risks and Mitigating Measures

32. Major risks and mitigating measures are described in detail in the risk assessment and risk management plan.[20] The expected net benefits and impacts of the program are expected to outweigh the risks. Weakness in PEM and inadequate capacity are risks that may slow implementation of RPJMN and SDG targets. Revenue shortfall may also undermine government's proposed spending in social sector and for infrastructure. ADB is supporting strengthening PEM through the program and is providing TA to improve capacity on state audit and SDG implementation in health and education (footnotes 16 and 17).

IV. ASSURANCES

33. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan documents.

V. RECOMMENDATION

34. I am satisfied that the proposed programmatic approach and policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

(i) the programmatic approach for the Fiscal and Public Expenditure Management Program, and

(ii) the loan of $500,000,000 to the Republic of Indonesia for subprogram 1 of the Fiscal and Public Expenditure Management Program, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao
President

19 October 2016

[20] Risk Assessment and Risk Management Plan (accessible form the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Impact the Program is Aligned with
Household income inequality reduced (National Medium-Term Development Plan, 2015–2019)[a]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
Outcome Social sector and infrastructure spending improved	By 2020 a. Aggregate expenditure outturn compared with originally approved budget improved by one grade (2012 baseline: PEFA report rating of C) b. Composition of expenditure outturn compared with originally approved budget improved by one grade level (2012 baseline: PEFA report rating of D) c. Extent of central government monitoring of subnational governments improved by one grade level (2012 baseline: PEFA report rating of C) d. Proportion of targeted national and subnational spending increased (2015 baseline: Rp995.5 trillion) [c]	a. PEFA Report (every 3 to 4 years) [b] b. PEFA Report c. PEFA Report d. Government statistics and official budget data (annually)	Continuous market turmoil and low commodity prices affect budget revenue.
Outputs 1. Medium-term expenditures aligned with RPJMN and SDG targets	**Subprogram 1 (2016):** 1a. Strategic framework for implementation of SDGs established (2015 baseline: no framework) 1b. 5% budget allocation for expenditures on health as required under the Health Law implemented (2015 baseline: approval of Health Law) 1c. Coverage of social security outlays increased by 4 million participants (2015 baseline: 88.2 million participants in the national health insurance program 1d. Infrastructure investments increased to Rp317.1 trillion (2015 baseline: Rp290 trillion); 1e. Spending on education	 1a. BAPPENAS Report (semiannually) 1b. Government statistics and official budget data (annually) 1c. Government and Social Security Agency report on JKN (annually) 1d–1e. Government statistics and official budget data (annually)	 Inadequate capacity and insufficient resources allocated to line ministries may undermine implementation of SDGs. Lower budget revenue results in lower spending on infrastructure and critical social sectors.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
	increased to Rp416.6 trillion in 2016 (2015 baseline: Rp408.5 trillion) **Subprogram 2 (2017–2018):** 1a. Reporting of SDGs' implementation undertaken (2016 baseline: implementation framework approved) 1b. Infrastructure investments increased (2016 baseline: Rp317.1 trillion) 1c. Spending on education increased (2016 baseline: Rp416.6 trillion)	1a. BAPPENAS report (semiannually) 1b–1c. Government statistics and official budget data (annually)	
2. National public expenditure system enhanced	**Subprogram 1 (2016):** 2a. TEPRA established (2015 baseline: 0) 2b. ADIK system implemented as part of PBB (2015 baseline: basic PBB framework implemented) 2c. OM-SPAN implemented (2015 baseline: 0) 2d. State asset management agency set up (2015 baseline: 0) **Subprogram 2 (2017–2018):** 2a. Budget execution mechanism to expedite budget realization simplified (2016 baseline: establishment of TEPRA to monitor and oversee budget realization) 2b. Guidelines created to reinforce the mechanism for budget review, monitoring, and evaluation (2016 baseline: implementation of ADIK as part of PBB) 2c. The output performance of OM-SPAN expanded (2016 baseline: basic OM-SPAN implemented)	2a–2c. MOF report (annually) 2a–2c. MOF Report (annually)	Inadequate coordination to implement ADIK and OM-SPAN across government

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
3. Fiscal transfers and subnational governments' spending for service delivery improved	**Subprogram 1 (2016):** 3a. The DAK budget increased to Rp211 trillion in 2016 (2015 baseline: Rp58.8 trillion) 3b. DID increased to Rp5 trillion (2015 baseline: Rp1.6 trillion) **Subprogram 2 (2017–2018):** 3a. A monitoring and evaluation system for the DAK for health, education, and local infrastructure implemented (2016 baseline: increase in DAK allocation to Rp211 trillion) 3b. Selection criteria for recipients of DID improved (2016 baseline: allocation for DID raised to Rp5 trillion)	 3a–3b. Directorate general fiscal balance report (annually) 3a–3b. Directorate general fiscal balance report (annually)	Insufficient capacity to at subnational government level to plan and execute fiscal transfers for public service delivery.

Key Activities with Milestones

Not applicable.

Inputs

ADB (Subprogram 1): $500,000,000 (ordinary capital resources)
ADB (Subprogram 2): $500,000,000 (indicative)

Assumptions for Partner Financing

KfW: €200,000,000 or its equivalent in US dollars (indicative)

ADIK = arsitektur dasar informasi kinerja (architecture and performance Information system), BAPPENAS = Badan Perencanaan dan Pembangunan Nasional (National Development Planning Agency), DAK = dana alokasi khusus (specific allocation grant), DID = dana insentif daerah (regional incentive fund), MOF = Ministry of Finance, OM-SPAN = online monitoring of sistem perbendaharaan dan anggaran negara (financial management information system), PEFA = public expenditure financial accountability, PBB = performance-based budgeting, RPJMN = Rencana Pembangunan Jangka Menengah Nasional (National Medium-Term Development Plan), SDG = Sustainable Development Goal, TEPRA = tim evaluasi dan pengawasan realisasi anggaran pendapatan dan belanja negara dan anggaran pendapatan dan belanja daerah (budget realization and monitoring team).

[a] Government of Indonesia. 2015. *National Medium-Term Development Plan, 2015–2019*. Jakarta.

[b] An alternative data source is the Open Budget Index performed by Directorate General Budget annually.

[c] Targeted spending refers to pro-poor expenditure on education, health, social security, and public infrastructure.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=50168-001-3

1. Loan Agreement
2. Sector Assessment (Summary): Public Expenditure and Fiscal Management
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

Supplementary Documents

10. Public Financial Management Assessment
11. Program Impact Assessment
12. Social Protection Programs Analysis
13. Measures to Implement Sustainable Development Goals
14. Macroeconomic Analysis

MINISTER OF FINANCE
OF THE REPUBLIC OF INDONESIA

DEVELOPMENT POLICY LETTER

No.: S - 793/MK.08/2016 Jakarta, 19 September 2016

Mr. Takehiko Nakao,
President
Asian Development Bank
Manila, Philippines

Subject: Fiscal and Public Expenditure Management Program - Subprogram 1

Dear Mr. President;

On behalf of the Government of Indonesia, we would like to express our appreciation for the continuous commitment and support of the Asian Development Bank (ADB) towards our overall reform efforts and national development agenda.

This Development Policy Letter highlights the Indonesian Government's commitment to achieve inclusive growth by reducing household income inequality through aligning medium term expenditure with the National Medium Term Development Plan 2015–2019 (RPJMN) and Sustainable Development Goals (SDGs), strengthening national public expenditure system, and improving fiscal transfers and subnational governments' (SNGs) expenditure for delivery.

Indonesia has achieved significant progress in reducing poverty from 24 percent in 1999 to 10.86 percent in 2015. Along with this progress, Indonesia has addressed inequality as the Gini index moderated at 0.397 in March 2016 compared to 0.408 in March 2015. The Gini index has declined slightly due to fuel subsidy reform, the implementation of national health insurance, and strengthening social assistance programs to reduce inequality. The government realizes the importance of addressing inequality to promote inclusive economic growth. In this regard, the government is committed to protect its medium term expenditure in critical social sectors and infrastructure in line with the targets of RPJMN and SDGs. In achieving this, it recognizes the significance of public expenditure management (PEM) reforms at the national and SNGs levels. To this end, we appreciate ADB support through the Fiscal and Public Expenditure Management Program (FPEMP) to continue related structural reforms to reverse widening inequality and to strengthen growth momentum in the medium term.

In the attached policy matrix, we have identified key reforms and development programs under the RPJMN, which we propose to be supported by FPEMP, Subprogram 1 loan. Thus we would like to request financial assistance from ADB through FPEMP, Subprogram 1 to support the reform initiatives we have implemented. This loan amounting to $ 500,000,000 will allow the government to sustain our momentum in implementing our reform program. The Program is expected to include co-financing with an estimated amount of Euro 200,000,000 from the German Development Bank (KfW).

The loan proceeds from Subprogram 1 of FPEMP will be used to support the program related development spending in the 2015 and 2016 national government budget. This includes implementation of the legislated 5% budget allocation for health, increased spending to increase the number of subsidized beneficiaries of the national health insurance, increased spending for education to Rp 416.6 trillion, health to Rp 104.1 trillion, social protection programs to Rp 150.8 trillion and public infrastructure investments to Rp 317.1 trillion and execution of Architecture and Performance Information System (ADIK) in 2015.

We trust the loan will be approved as soon as possible.

The National Medium Term Development Plan (2015–2019)

Indonesia experienced a robust economic growth averaged 6.2 percent during 2010–2013. Due to the commodities downturn, the GDP growth however declined to 4.8 percent in 2015 recording the lowest rate since the global financial crisis in 2008. The decline in commodity prices and the slowdown in economic growth consequently resulted in significant decrease in fiscal revenues in 2015. Simultaneously, the increasing income inequality and slowdown in the pace of poverty reduction have posed significant challenges for Indonesia's development. In this context, strengthening our focus on income inequality reduction as one of the main priorities, we are implementing our new National Medium Term Development Plan 2015–2019. In the 2016 budget, we are therefore committed to improve quantity and quality of public spending on social sectors and infrastructure. However, the projected fiscal revenues of Rp 1,822.5 trillion and modest economic growth rate of 5.3 percent in the revised budget 2016 are insufficient to respond the current situation. Hence, we expect a higher fiscal deficit and a larger financing gap this year. To create the fiscal space for increased spending on critical social sectors and infrastructure while adhering to the constitutional limit of 3.0 percent budget deficit of GDP, Indonesia's public expenditure management has to be improved.

Understanding the significance of effective fiscal policy and public expenditure management in accelerating economic growth and reducing poverty and inequality, the government recognizes the urgency in deepening our reform agenda in these areas. In line with this, we have rolled out a series of economic policy packages to stimulate the economy through fiscal policy and public expenditure management to achieve long term development impact in critical social sectors and infrastructure through increased and efficient spending towards meeting the targets of RPJMN and SDGs. The FPEMP is aligned with our National Medium Term Development Plan 2015–2019. The Development Policy Letter focuses on these ongoing and forward looking policy reforms and emphasizes the Government's commitment to ensuring their full implementation.

Medium Term Expenditure aligned with RPJMN and SDGs Targets

In addressing income inequality and achieving sustained economic growth, inefficient and insufficient spending in critical social sectors and infrastructure remains as a key constraint. In terms of expenditure in critical social sectors, the government is legally required to allocate 20 percent of the budget for education and 5 percent for health. However, the pressure on fiscal policy adversely impacts spending targets of these sectors. Similarly, low public spending in infrastructure is one of the main factors contributing to under investment in this area. From 2008 to 2012, annual investment in infrastructure remained as 1.5 percent of GDP highlighting a significant gap. We have considerably invested our efforts and resources in critical social sectors including education, health, and social protection along with infrastructure development across the country. However, much needs to be done to improve these sectors and achieve long term development impact.

Under the FPEMP, the government will adopt strategic policies to align budget planning with RPJMN and SDGs, and increase expenditure and improve targeting in critical social sectors and public infrastructure investments. In this regard, to promote pro-growth and pro-poor central government budgeting, the government established a strategic framework to guide the progress in implementing and achieving the SDGs targets aligned with RPJMN. To enhance alignment of social sector programs with the targets of SDGs and RPJMN, the government implemented budget reforms. These include the allocation of legislated 5 percent budget for health, expansion of subsidized national health insurance program (JKN) from 88.2 million to 92.4 million persons covering 37 percent of population, increase of JKN monthly premium per person from Rp 19,225 to Rp 23,000 to improve fiscal sustainability of the program, and strengthening of the administration of the Raskin rice subsidy for the poor program. In terms of spending, compared to 2015 budget, in 2016, the government increased expenditure for education from Rp 408.5 trillion to Rp 416.6 trillion, health programs from Rp 74.8 trillion to Rp 104.1 trillion, social protection programs from Rp 22.6 trillion to Rp 150.8 trillion, and public infrastructure investment from Rp 290.3 trillion to Rp 317.1 trillion.

Enhanced National Public Expenditure System

Indonesia has consistently progressed in strengthening its public expenditure management systems over the years. The government further sought to improve public expenditure management reform oversight under the 2012 Medium Term Strategy Note (MTSN). Hence, under the FPEMP, we will advance our reforms related to national public expenditure management system through adopting best practices in budget preparation, and strengthening budget execution and cash management. In enhancing the budget system to account for fiscal risk and adopting performance based budgeting, the government approved setting up of asset registry within MOF. This will allow planning for maintenance expenditure by providing assessment of all government assets. Furthermore, in order to provide more autonomy and control to the line ministries, the MOF implemented Government Finance Statistics (GFS) standard in national budget through Budget Law and Presidential Regulation. To enhance fiscal risk management including external factors, the MOF also conducted fiscal test and published in Financial Note to National Budget of 2015 and 2016. In monitoring budget allocation and performance, in 2015, the MOF implemented Architecture and Performance Information System (ADIK) in 2015 as a part of its Performance Based Budgeting. In the area of budget execution and cash management, to address the inefficiencies, the government institutionalized a framework along with a real time monitoring system. Under the leadership of the MOF, the government established inter-ministerial high level Budget Realization and Monitoring Team (TEPRA). This was established in response to addressing slow budget execution at central and SNGs levels. Moreover, the MOF implemented online monitoring of Financial Management Information System (SPAN). This will further strengthen budget management through monitoring its realization on real time basis.

Improved Quality of Fiscal Transfers and SNGs Spending for Service Delivery

Improving public expenditure management systems at the SNG level is anchored through the Blueprint for Institutional Transformation of Directorate General Fiscal Balance. To this effort, the government will focus on improving inter-government transfer to support better public service delivery at the SNG level. To provide direct funding to SNGs for the implementation of national priority projects, the MOF expanded the scope and allocation of the specific allocation fund (DAK). In 2016, Rp 211.0 trillion was allocated to DAK, compared to Rp 58.8 trillion in 2015, a significant increase highlighting the government's commitment to improve funding for public services at the SNG level. Furthermore, the government improved the regional incentive fund (DID) with the aim of enhancing service delivery performance. This integrated local government rating on public financial management, public service delivery, and local economic management. In 2016, Rp 5.0 trillion is allocated to DID increasing from Rp1.6 trillion in the revised national budget in 2015. In providing flexibility for SNGs to respond their needs, DID was also changed from earmarked to block grant. To improve cash management, the MOF implemented a bond redemption scheme. This is expected to address the idle funds and slow budget execution at SNG level.

In addition, complementing the above mentioned reforms in the expenditure side, the Government is continuing its efforts on the revenue side. For instance, in strengthening tax administration processes and capability to improve revenue performance, we are enhancing VAT administration, increasing electronic filling of income taxes, establishing a unique and permanent tax payer ID system, and improving DG tax to access taxpayer asset and financial data for audits. Moreover, in implementing tax policy reforms to increase the tax base and economic efficiency of tax policy, we are improving VAT, Luxury Goods Sales Tax and Excise Tax Policy, and income tax policy including the MSME final tax, and tackling sources of tax base erosion.

Conclusion

The government remains firmly committed to the agenda outlined above and to implement reform efforts already instituted. We would appreciate your prompt consideration of this loan. We look forward to working together on the Subprogram 1 of FPEMP, and to continue our partnership with ADB to meet the development objectives of Indonesia.

Minister of Finance
Republic of Indonesia

Sri Mulyani Indrawati

Cc:
1. Director General of Budget Financing and Risk Management, Ministry of Finance
2. Head of Fiscal Policy Agency, Ministry of Finance

POLICY MATRIX

Outputs	Subprogram 1 Accomplishments January 2015 – August 2016 (accomplishments with triggers in bold)	Subprogram 2 September 2016 – December 2017 (Triggers are in bold)	Medium-term framework and expected results (By 2020)
Output 1: Medium Term Expenditure Aligned with RPJMN and SDG Targets			
1.1 Government adopted strategic policies to align budget planning with RPJMN and SDG targets	*Government's budget planning system aligned to RPJMN. Achievements included:* 1. Government established strategic framework to achieve progress in implementing SDGs including by aligning SDGs targets with RPJMN targets and developing implementation, monitoring and reporting mechanisms chaired by Minister of National Development Planning Agency (BAPPENAS).	*Government implements budget plans to achieve RPJMN and SDGs targets.* 1. Government implements SDG strategy by (i) approving Presidential Regulation that details SDG implementation framework and delineates responsibilities of line ministries, and (ii) provide periodic reporting of progress achieved against set timelines.	Government makes substantial progress achieving RPJMN targets on health and social protection: i) Universal health coverage achieved (in line with relevant targets in SDG 1 and SDG 3)
ADB TA 8202: Fiscal Aspect of Social Security Reform AB TA 8983: Universal Health Coverage for Inclusive Growth	**2. Government implemented budget reforms in the social sector including (i) implemented the legislated 5% budget allocation for health, (ii) expanded the coverage of subsidized national health insurance program (JKN) from 88.2 million to 92.4 million persons (37% of population), (iii) increased the monthly premium per person for JKN from Rp19,225 to Rp23,000 to improve fiscal sustainability of the program, and (iv) approved policy to gradually implement non-cash social protection (smart card) to enhance targeting efficiency in the rice**	**2. Government improves the targeting, coverage and monitoring of government social protection programs including implementation of non-cash social protection (smart card) to 1.2 million households.**	ii) Reduce maternal mortality rate to 306 per 100,000 lives (in line with relevant targets in SDG 3). iii) Improve the quality and increase the coverage for non-cash social protection programs.

Outputs	Subprogram 1 Accomplishments January 2015 – August 2016 (accomplishments with triggers in bold)	Subprogram 2 September 2016 – December 2017 (Triggers are in bold)	Medium-term framework and expected results (By 2020)
	subsidy program (RASKIN/RASTRA).		
1.2 Government increase expenditures and improved targeting in critical social sectors and infrastructure ADB TA 8358: Minimum Services Standards Capacity Development AB TA 8983	*Government commenced alignment of spending to critical sectors including allocating savings of Rp211 trillion generated from reducing the gasoline fuel subsidy to increase spending in social sectors and public infrastructure investments. Accomplishments included:* **3. Government increased spending for (i) education from Rp408.5 trillion in 2015 to Rp416.6 trillion in 2016, (ii) social protection programs from Rp22.6 trillion in 2015 to Rp150.8 trillion in 2016, (iii) health programs from Rp74.8 trillion in 2015 to Rp104.1 trillion in 2016.** **4. Government increased public infrastructure investment spending from Rp290.3 trillion in 2015 to Rp317.1 trillion in 2016.**	*Government continues to allocate spending to critical sectors.* 3. Government increases real spending in education, health, social protection and public infrastructure including funding to support mandatory primary education for 12 years. **4. MOF enhances the multi- year budgeting approval process to provide line ministries greater authority to plan their public investment program.**	Government will meet majority of targets and indicators on education and infrastructure in RPJMN 2015-2019. By 2019, net enrollment ratio to be: (i) elementary school 94.78%, (ii) junior secondary school 82.02%, and (iii) senior secondary school 67.48% (in line with relevant targets in SDG 4).

Outputs	Subprogram 1 Accomplishments January 2015 – August 2016 (accomplishments with triggers in bold)	Subprogram 2 September 2016 – December 2017 (Triggers are in bold)	Medium-term framework and expected results (By 2020)
Output 2: National public expenditure system enhanced			
2.1 The Government adopted best practices in budget preparation ADB TA 7184: Local Government Finance and Governance Reform ADB TA 7452: Local Government Finance and Governance Reform 2	*The Government's budget system enhanced to account for fiscal risk and adoption of performance based budgeting. Accomplishments included:* **5. Government approved setting up of state asset management agency within MOF that centralizes management of government assets and allows better planning for maintenance expenditure.** 6. MOF implemented measures to enhance transparency and credibility of budget process by (i) implementing Government Finance Statistics Manual in national budget in line with IMF's classification that allows cross country comparison, (ii) carrying out fiscal risk test, and (iii) published the results in the Financial Note to National Budget of 2015 and 2016. **7. MOF implemented Architecture and Performance Information system (ADIK) in 2015 as part of its performance-based budgeting, to monitor the budget allocation in line with output and outcome.**	The Government implements enhanced budget system. 5. Government approves guidelines and operational procedure for management of idle assets. **6. Government consistently publishes medium-term fiscal framework (MTFF) in Macroeconomic and Fiscal Policy Framework.** 7. MOF reinforces implementation of ADIK in line ministries as input for budget review and implementation of medium-term expenditure Framework (MTEF) and performance-based budgeting.	Improvement in aggregate expenditure out-turn compared to original approved budget (PEFA Report/Open Budget Index).

Outputs	Subprogram 1 Accomplishments January 2015 – August 2016 (accomplishments with triggers in bold)	Subprogram 2 September 2016 – December 2017 (Triggers are in bold)	Medium-term framework and expected results (By 2020)
2.2 The Government strengthened budget execution and cash management	*The Government institutionalized framework to address slow budget execution and established systems to monitor cash flow on real time basis. Accomplishments included:* **8. Government established inter-ministerial high-level Budget Realization and Monitoring Team (TEPRA) headed by Minister of Finance to address slow budget execution at central and local government levels.** 9. MOF implemented online monitoring of Financial Management Information System (SPAN) to monitor budget (revenue, expenditure and financing) realization on real time basis.	*Government improves budget disbursements on timely basis.* **8. MOF continues to simplify the budget execution mechanism to expedite budget realization including by giving more flexibility for line ministries to undertake activities for budget execution.** 9. MOF will improve online monitoring of Financial Management Information System (SPAN).	Efficient and transparent budget execution at national level (in line with relevant target in SDG 16).
Output 3: Fiscal transfers and subnational governments' spending for service delivery improved			
ADB TA 7184 and ADB TA 7452	*The Government improved inter-government transfer to support better public service delivery at the local level. Accomplishments included:* **10. To improve public service delivery at local level, Government expanded the specific allocation fund/specific transfer fund (DAK/DTK) to provide direct funding to local governments for the implementation of national priority projects including in health and**	*Government implements reforms to inter-government transfer mechanisms.* **10. MOF implements a monitoring and evaluation system for specific allocation grant (DAK) for health, education, and local infrastructure to ensure DAK funding is being properly used at local level and improves the capacity building for local**	Better public service delivery at local government level through increased and improved DAK and DID allocation as well as effective monitoring of budget execution (in line

Outputs	Subprogram 1 Accomplishments January 2015 – August 2016 (accomplishments with triggers in bold)	Subprogram 2 September 2016 – December 2017 (Triggers are in bold)	Medium-term framework and expected results (By 2020)
	education, which resulted in increased DAK allocation from Rp58.8 trillion in 2015 to Rp211 trillion in 2016.	**government in planning and budget execution.**	with relevant targets in SDG 1).
ADB TA 7184 and ADB TA 7452	**11. Government improved the regional incentive fund (DID) with the aim of improving service delivery performance by (i) integrating local government rating of public services delivery, (ii) increasing its allocation from Rp1.6 trillion in the 2015 national budget to Rp5.0 trillion in the 2016 national budget, and (iii) expanding the scope and purpose of DID to enhance subnational governments' public service delivery.**	**11. The government refines local government performance indicators to improve the selection criteria for recipients of DID.**	Improvement in extent of central government monitoring of subnational governments' expenditure (PEFA Report/Open Budget Index).
	12. In order to improve cash management and budget execution at local level, MOF implemented a government bond redemption scheme whereby surplus cash are swapped for government bonds.	12. The government undertakes additional measures to address idle fund and slow budget execution at local level.	

***Triggers are expected prior actions**