



Report and Recommendation of the President to the Board of Directors

INTERNAL

Project Number: 55235-001
October 2022

Proposed Programmatic Approach and Policy- Based Loan for Subprogram 1 Republic of Indonesia: State-Owned Enterprises' Reform Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 24 October 2022)

Currency unit	–	rupiah (Rp)
Rp1.00	=	\$0.000064
\$1.00	=	Rp15,589

ABBREVIATIONS

ADB	–	Asian Development Bank
COVID-19	–	coronavirus disease
GDP	–	gross domestic product
GHG	–	greenhouse gas
IMF	–	International Monetary Fund
IPO	–	initial public offering
MOF	–	Ministry of Finance
MSOE	–	Ministry of State-Owned Enterprises
OECD	–	Organisation for Economic Co-operation and Development
RPJMN	–	Rencana Pembangunan Jangka Menengah Nasional (National Medium-Term Development Plan)
SOE	–	state-owned enterprise
TA	–	technical assistance
tCO ₂ e	–	tons of carbon dioxide equivalent

NOTE

In this report, "\$" refers to United States dollars.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 55235-001	
Project Name	State-Owned Enterprises' Reform Program, Subprogram 1	Department/Division	SERD/SEPF
Country	Indonesia	Executing Agency	Ministry of State-Owned Enterprises
Borrower	Republic of Indonesia		
Country Economic Indicators	https://www.adb.org/Documents/LinkedDocs/?id=55235-001-CEI		
Portfolio at a Glance	https://www.adb.org/Documents/LinkedDocs/?id=55235-001-PortAtaGlance		
2. Sector		ADB Financing (\$ million)	
✓ Public sector management	Economic affairs management		100.000
	Reforms of state owned enterprises		400.000
		Total	500.000
3. Operational Priorities		Climate Change Information	
✓ OP1: Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	11,500,000
✓ OP2: Accelerating progress in gender equality		Climate Change impact on the Project	Low
✓ OP3: Tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability			
✓ OP6: Strengthening governance and institutional capacity			
Sustainable Development Goals		ADB Financing	
SDG 1.4		Adaptation (\$ million)	38.330
SDG 5.5		Mitigation (\$ million)	55.000
SDG 8.1			
SDG 10.2			
SDG 12.6			
SDG 13.a			
SDG 16.6			
4. Risk Categorization:		Cofinancing	
	Complex	Adaptation (\$ million)	0.000
		Mitigation (\$ million)	0.000
5. Safeguard Categorization		Gender Equity and Mainstreaming	
		Effective gender mainstreaming (EGM)	✓
6. Financing		Poverty Targeting	
		General Intervention on Poverty	✓

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed programmatic approach for the State-Owned Enterprises' Reform Program, and (ii) a proposed policy-based loan to the Republic of Indonesia for subprogram 1 of the State-Owned Enterprises' Reform Program.

2. State-owned enterprises (SOEs) play an important role in the Indonesian economy. They serve as both commercial enterprises that provide revenue to the state and agents of development that provide a range of core public services, from infrastructure development in rural areas to vaccine procurement for the coronavirus disease (COVID-19). As such, SOEs will be instrumental in fostering an inclusive and sustainable recovery from the pandemic. However, structural weaknesses that impede efficiency and corporate governance restrict SOEs' potential to deliver greater value. To address these constraints, the government is implementing an ambitious State-Owned Enterprises Roadmap (2020–2024). Aligned to it, the program aims to increase the economic, environmental, and social value that SOEs provide to Indonesia by supporting the government's reforms on improving efficiency and resilience of SOEs and strengthening the corporate governance framework for SOEs. The program adopts a programmatic approach, which allows for complex and challenging reforms to be addressed comprehensively through policy-based loans combined with technical assistance (TA) and knowledge work. Subprogram 1 covers the first phase of the implementation of the roadmap for the reform of SOEs, while subprogram 2 will institutionalize these reforms.

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Macroeconomic context.** Supported by consumption and exports reviving after the COVID-19 pandemic, Indonesia's economy is projected to grow by 5.4% in 2022 and by 5.0% in 2023.¹ The economy faces challenges, however, because of financial volatility, the continuing threat of the pandemic, and worsening global growth outlook. The government plans to consolidate public finances, with projected budget deficit of 3.9% of gross domestic product (GDP) in 2022 and of 2.8% of GDP in 2023. The macroeconomic framework remains satisfactory, and the central government debt was sustainable at 41% of GDP in 2021, below the threshold of 60% of GDP.² In the current macroeconomic context of tightening fiscal and monetary conditions, further strengthening of government revenue will be important to support the economic recovery.³ As SOEs are important sources of government revenues through dividends and non-tax payments (para. 5), reforming them will improve their financial performance and enhance their revenue payouts to the government. Increased revenue from the SOEs will help the government meet its recovery plans, including fiscal consolidation efforts.

¹ Asian Development Bank (ADB). 2022. [Asian Development Outlook 2022 Update: Entrepreneurship in the Digital Age](#). Manila.

² International Monetary Fund (IMF). 2022. [Indonesia: Article IV Consultation – Staff Report](#). Washington, DC. The IMF projects Indonesia's general government debt to increase to 42.9% of GDP in 2022 and 2023. The World Bank country partnership framework for Indonesia estimates that Indonesia's exposure to explicit contingent liabilities in the form of loan guarantees to SOEs was the equivalent of 1.6% of GDP in 2020, below the guarantee ceiling of 6.0% of GDP.

³ Indonesia has one of the lowest revenues–GDP ratios among the Group of Twenty (G20) countries, an intergovernment forum consisting of 19 countries and the European Union.

4. **Indonesia's state-owned enterprises.** In 2021, there were more than 100 SOEs in Indonesia, holding \$610 billion in assets equivalent to 52.9% of GDP. These SOEs are managed by the Ministry of State-Owned Enterprises (MSOE) and provide a range of public services including electricity, pharmaceuticals, air navigation services, food distribution, and logistics.⁴ In 2021, the largest SOEs in terms of assets were in banking and insurance (Bank Mandiri, Bank Negara Indonesia, Bank Rakyat Indonesia, Bank Tabungan Negara, and Taspen), energy (Pertamina and Perusahaan Listrik Negara), manufacturing (Inalum), plantation (Perkebunan Nusantara), and telecommunications (Telkom). These 10 SOEs accounted for more than 84.0% of the total assets held by SOEs, while the smallest 50 accounted for just 0.5% of the total assets, highlighting the high degree of concentration of SOE assets. Following the enactment of the 2020 Job Creation Law, most of the sectors in which SOEs operate are open to both domestic and foreign direct investments, and, as a result, SOEs no longer benefit from monopoly powers.

5. **Declining economic value.** SOEs in Indonesia hold dual roles – as commercial entities and as agents of government policy. As commercial entities, SOEs contribute to state revenues. During 2010–2019, SOEs provided annual dividends to the state equivalent to 0.4% of GDP on average, while their tax payments were 1.6% of GDP on average annually.⁵ As development agents, SOEs are called on to provide subsidized goods and services (e.g., electricity, fuel, and fertilizers), which averaged 1.4% of GDP annually during 2015–2019. However, frequent delays in government payments to SOEs for the provision of these subsidized goods and services have adversely affected SOEs' financial condition.⁶ Implicit subsidies to the SOEs, or the SOE's foregone profits, averaged about Rp258 trillion (1.6% of GDP) during 2019–2021.⁷ Many SOEs have also been called on to develop infrastructure, for which they have been provided equity injections by the state (Rp126 trillion during 2010–2019). This arrangement is burdensome to the SOEs, as they must take on debt to finance the remaining costs of projects, which may not be commercially viable. Consequently, SOEs' consolidated debt–equity ratio increased to 2.56 in 2020 from 1.87 in 2016. As a result, the economic value added of SOEs declined to 6% of GDP in 2017 from 8% in 2013, and recent SOEs' performance since 2017 has not reversed this trend (footnote 6).

6. **Pandemic's impact on SOEs' performance.** SOEs were at the forefront in responding to the pandemic and were a key pillar in the implementation of the Pemulihan Ekonomi Nasional (National Economic Recovery) plan. For example, SOEs helped deliver government's support to micro and small businesses, a salary subsidy program, and the distribution of COVID-19 vaccines. However, the COVID-19 pandemic adversely impacted Indonesia's SOEs. From 2019 to 2020, the SOEs' consolidated net income declined by 89% and, as of the end of 2021, earnings had not yet recovered to pre-pandemic levels. While all SOEs recorded declining revenues, those focused on tourism, logistics, and infrastructure were particularly impacted. For example, Garuda Indonesia, the national airline, underwent a court-supervised debt restructuring. To ensure that they continue to provide public services, the government provided equity injections of \$3.8 billion to SOEs in 2020; Perusahaan Listrik Negara (electricity utility) and Pertamina (oil-and-gas SOE)

⁴ Ministry of State-Owned Enterprises. 2022. [2021 Annual Report](#). Jakarta. While the Ministry of Finance (MOF) is the ultimate shareholder of all SOEs, the MSOE looks after the operations of SOEs from the corporate side. Line and technical ministries also influence SOEs in their role in regulating economic sectors. The coordinating ministries, such as the Coordinating Ministry for Economic Affairs and the Coordinating Ministry for Maritime and Investment Affairs, may also influence SOEs in their planning and coordination roles.

⁵ Sector Assessment (Summary): Public Sector Management (Reforms of State-Owned Enterprises) (accessible from the list of linked documents in Appendix 2).

⁶ ADB. 2020. [Reforms, Opportunities, and Challenges for State-Owned Enterprises](#). Manila; and ADB. Forthcoming. *Indonesia's State-Owned Enterprises: Unlocking Economic and Social Value*. Manila.

⁷ Implicit subsidies can be interpreted as an opportunity cost to the government of allocating its capital to SOEs on which they do not generate a sufficient return to cover the risk-adjusted cost of capital.

were the largest recipients of the equity injections. In the same year, SOEs provided \$4.7 billion of revenue to the state. Given SOEs' large presence in the economy as well as their role in providing core public services, reforming them will be important for the recovery from the pandemic.

7. **Development constraints.** A portfolio of well performing SOEs will be instrumental to government's efforts in fostering an inclusive and sustainable recovery. The Organisation for Economic Co-operation and Development (OECD) defines the purpose of state ownership of enterprises as maximizing value for society through an efficient allocation of resources.⁸ By this definition, two critical constraints have led to the declining economic, environmental, and social value generated by Indonesia's SOEs: (i) weak performance and resilience; and (ii) a suboptimal corporate governance framework.

8. **Weak performance and resilience.** In 2019, 43 out of the 114 SOEs managed by the MSOE were assessed as not commercially viable (footnote 6).⁹ At the aggregate level, SOEs' financial indicators have progressively worsened, and their outstanding liabilities have substantially increased. SOEs' return on equity fell from 17.3% in 2010 to 3.9% in 2019, and their return on assets declined from 4.3% in 2010 to 1.2% in 2019. The revenues–assets ratio halved for nonfinancial SOEs during 2013–2017, suggesting a decline in their effectiveness in converting assets into revenue.

9. The weak performance and resilience of the SOEs are due to the following factors. First, SOEs have expanded into businesses beyond their core operational areas (e.g., an oil-and-gas SOE owning hospitals). The expansion into noncore operations has also heightened the trade-off between the commercial and public service objectives of the SOEs. Second, unviable SOEs continue to exist, but are not in operation. Third, while publicly listed SOEs in Indonesia often perform better than others because they are subjected to higher reporting and transparency requirements (footnote 6), few SOEs are publicly listed. Fourth, line ministries require SOEs to undertake assignments, for example development of certain infrastructure and/or provision of subsidized goods and services, without sufficient consideration of the financial implications for the SOEs of such assignments. Such practices placed financial burden on SOEs and put pressure on their budgets, while government decisions to provide equity injections to SOEs have lacked clear evaluation criteria. Fifth, SOE balance sheet has been heavily leveraged as seen by the increase in SOEs' outstanding liabilities from 26.3% of GDP in 2010 to 38.8% in 2019, which further increased to 43.0% in 2020 due to the adverse impact of the pandemic. Furthermore, SOEs have not transformed their business models to be climate resilient, which has reduced their preparedness to withstand shocks.

10. **Suboptimal corporate governance framework.** International best practices in the management of SOEs call for centralization of the state's ownership function, to avoid conflicts of interest that may arise by separating ownership from other government functions that impact SOEs (footnote 8). In Indonesia, however, SOE governance is fragmented, and the overall context can be best characterized by a dual-ownership between the MOF and the MSOE coupled with multiple centers of control that provide what is at times contradictory oversight. This has contributed to worsening of the trade-offs faced by SOEs in undertaking commercial and development policy roles.

⁸ OECD. 2021. [*Ownership and Governance of State-Owned Enterprises: A Compendium of National Practices 2021*](#). Paris.

⁹ The number of SOEs is based on the data as of the second quarter of 2019. Consolidation of SOEs was initiated in the second half of 2019 and, as of 31 December 2019, there were 112 SOEs.

11. A number of factors contribute to Indonesia's suboptimal corporate governance framework for SOEs. First, the MSOE exercises many but not all aspects of the state's ownership functions over the SOEs (footnote 6), and its organizational structure and capacity were not conducive to effectively managing the SOEs in its portfolio, including on the issue of climate change. Although SOEs are a large contributor of greenhouse gas (GHG) emissions, MSOE lacked detailed information on SOEs' emissions and a targeted decarbonization plan to steer SOEs towards supporting Indonesia's goals on reducing emissions. Second, over time the government has introduced new regulations pertaining to SOEs without sufficient attention to ensure consistency with prevailing regulations. As a result, SOEs face a regulatory environment that may not be conducive to their operations, while the prevalence of regulatory inconsistencies can weaken the implementation of any new reform measure. Third, the government's ability to undertake robust financial monitoring of SOEs has been undermined by the lack of aggregate financial data at the SOE portfolio level and a comprehensive risk management framework that accounts for the unique sector level risks faced by SOEs. Fourth, the absence of sound regulatory framework for SOEs on anti-corruption, aligned with international standards, has led to instances of operational mismanagement at SOEs. Fifth, unclear selection criteria for SOE board members have contributed to unqualified appointees, which in turn has affected SOE performance. Sixth, despite evidence that inclusivity and diversity increase a company's financial performance, women accounted for only 9% of SOE leadership positions in 2020.¹⁰

12. **State-owned enterprises' reform and the need to address challenges.** Indonesia is undertaking wide-ranging reforms to achieve its goal of becoming a high-income country by 2045. The government's current efforts to reform the SOEs form an integral part of the broader economic reform agenda aimed at transforming the economy. The government understands that SOEs will be critical in progressing toward its long-term goal, and that reforming SOEs will be crucial in order for Indonesia's economy to achieve higher levels of productivity and growth. Actions taken by the SOEs to reduce the emissions will be instrumental for achieving Indonesia's climate agenda (para. 39). However, there has been no comprehensive SOE reform program since the Asian financial crisis, partly because of a lack of political leadership and weak capacity of the MSOE.¹¹ This changed at the beginning of the second term of President Joko Widodo, who introduced notable changes that have generated the necessary momentum for reforming the SOEs. In 2019, the President appointed a new minister of SOEs and two vice-ministers with substantial private sector experience. The minister appointed senior advisors with experience in international finance institutions and corporate finance as well as in managing listed companies. Moreover, the government's SOE reform agenda is being driven by a comprehensive 5-year State-Owned Enterprises Roadmap (2020–2024) (para. 14).¹²

13. **Strategic alignment.** The program is aligned with the government's Vision of Indonesia 2045 and National Medium-Term Development Plan, 2020–2024 (RPJMN).¹³ It is also aligned with ADB's Strategy 2030 and will contribute to the following operational priorities: (i) addressing remaining poverty and reducing inequalities, by improving the delivery of public services; (ii) accelerating progress in gender equality, by improving gender balance in management of SOEs; (iii) tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability, by reducing SOEs' carbon emissions; and (iv) strengthening

¹⁰ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

¹¹ In the years following the Asian financial crisis, the government implemented reforms targeting SOEs, which were partly supported by ADB. 2001. [Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the State-Owned Enterprises Governance and Privatization Program](#). Manila.

¹² Government of Indonesia. 2020. *State-Owned Enterprises Roadmap (2020–2024)*. Jakarta.

¹³ Government of Indonesia. 2019. *Vision of Indonesia 2045*. Jakarta; and Government of Indonesia. 2019. [National Medium Term Development Plan \(RPJMN\), 2020–2024](#). Jakarta.

governance and institutional capacity, by improving the corporate governance of SOEs.¹⁴ It will contribute to pillar 2 of ADB's country partnership strategy for Indonesia, 2020–2024 by helping to accelerate economic recovery.¹⁵ The program will also help strengthen the financial condition of SOEs to attract private sector participation.¹⁶

B. Policy Reform, ADB's Value Addition, and Sustainability

14. **Government's state-owned enterprises' reform agenda.** To address the challenges faced by SOEs, the government launched an ambitious and comprehensive 5-year State-Owned Enterprises Roadmap (2020–2024) (footnote 12), which is aligned with the RPJMN (footnote 13). The roadmap for reforming the SOEs seeks to right-size the number of SOEs; restructure SOEs to focus on their core businesses; optimize SOEs' asset values and build a healthy investment ecosystem; professionalize SOE governance and human resources; and strengthen SOEs' digital capability, including stepping up investment in innovation and tackling climate change. The government has substantially increased the technical capacity of the MSOE to lead the reform of SOEs under its management, and to ensure that reform measures draw on international best practices (footnote 8). A strategic delivery unit was established at the office of the minister of SOEs and has been tasked to monitor and remove bottlenecks to the implementation of the roadmap. The leadership at the MSOE, supported by relevant line ministries, has been engaging with all stakeholders, including the national parliament and the public, on all its key reform initiatives and, as a result, the roadmap has received broad-based support.

Table 1: Achievements under Suprogram 1 and Key Target Results of the Program

Key Achievements under Subprogram 1	Key Target Results of the Program by 2025
<ul style="list-style-type: none"> ✓ Comprehensive roadmap for reforming SOEs adopted ✓ Ministry of SOE structure and capacity overhauled ✓ All SOEs organized into sectoral clusters ✓ Number of SOEs reduced to 75 from 112; closure of 7 unviable SOEs approved; and the process of divestment of state shares begun ✓ GHG emission baseline for SOEs that account for 25% of Indonesia's emissions established and SOE-level decarbonization plan initiated ✓ Aggregate financial statements for the entire SOE portfolio adopted ✓ SOEs required to adopt international standards on anti-bribery ✓ Target to increase representation of women on SOE boards and respectful workplace policy adopted 	<p>Improving the efficiency and resilience of SOEs:</p> <ul style="list-style-type: none"> ✓ SOE net profit increased to Rp180.0 trillion from Rp13.3 trillion in 2020 ✓ SOE contribution to state revenue increased to Rp550 trillion from Rp465 trillion in 2020 ✓ State equity injection to SOEs reduced to Rp17.8 trillion from Rp31.3 trillion in 2020 ✓ Financially viable SOEs as a share of total SOE portfolio increased to 84% from 77% in 2020 ✓ Total SOE debt–equity ratio reduced to 2.00 from 2.56 in 2020 <p>Strengthening the corporate governance framework for SOEs:</p> <ul style="list-style-type: none"> ✓ Centralized oversight of SOEs aligned with the guidelines of the Organisation for Economic Co-operation and Development ✓ All SOEs meet international standards on antibribery ✓ SOEs reduce GHG emissions by at least 14%, compared to forecast business-as-usual scenario ✓ Representation of women on SOE boards increased to 25% from 9% in 2020 ✓ Productivity of SOEs' workforce increased to Rp3.45 trillion per person from Rp3.07 trillion per person in 2020

GHG = greenhouse gas; SOE = state-owned enterprise.

Source: Asian Development Bank.

15. **Programmatic approach.** The program will comprise of two subprograms with two reform areas: (i) efficiency and resilience of SOEs improved; and (ii) corporate governance framework

¹⁴ ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila.

¹⁵ ADB. 2020. *Country Partnership Strategy: Indonesia, 2020–2024—Emerging Stronger*. Manila.

¹⁶ Private Sector Assessment (accessible from the list of linked documents in Appendix 2).

for SOEs strengthened.¹⁷ The subprograms are interlinked and seek to progressively deepen and widen the reforms, so that they achieve the results targeted by the program (table 1). Reform area 1 supports measures that will right-size MSOE's portfolio, address unviable SOEs, control distortions caused by the government's assignments on SOEs, and help SOEs adopt climate compatible business models. Reform area 2 will reinforce measures under reform area 1 by supporting actions on improving the oversight of SOEs, strengthening the quality of SOE boards, decarbonizing SOEs, and strengthening financial monitoring of SOEs. All 10 prior actions for subprogram 1 have been completed. The prior actions under subprogram 1 mark the first phase of the implementation of the government's State-Owned Enterprises Roadmap (2020–2024). The reforms supported under subprogram 1 will be further deepened and institutionalized in subprogram 2. The implementation period for subprogram 1 is from January 2020 to September 2022, and it will be from October 2022 to March 2024 for subprogram 2. A third subprogram may be considered depending on the lessons learned, progress of the reforms, identification of other reform dimensions, and the government's emerging needs for assistance.

1. Reform Area 1: Efficiency and Resilience of State-Owned Enterprises Improved

16. Making state-owned enterprises focus on their core activities. Policy actions in this cluster will right-size the portfolio of SOEs overseen by the MSOE and limit the expansion by SOEs into noncore business activities. Under subprogram 1, the government reduced the number of SOEs from 112 (as of 31 December 2019) to 75 (as of 1 September 2022), including the merger of four port operators (PT Pelindo I, II, III, and IV) and two companies providing logistics services (PT Bhandha Ghara Rekso and PT Perusahaan Perdagangan Indonesia).¹⁸ The remaining SOEs were consolidated under newly established sector-focused holding companies, including in the areas of health, tourism, and insurance. This has improved the MSOE's oversight and facilitated the retention of experienced managers. Under subprogram 2, the government will complete the restructuring by reducing the total number of SOEs under MSOE management to 41 by 2024. The MSOE will also establish updated nondiscriminatory and gender-sensitive procedures based on international best practice to manage labor redundancy that could include retraining opportunities or placements into jobs for men and women with other SOEs or the private sector.

17. Closing unviable state-owned enterprises. Policy actions in this cluster will address the continued existence of unviable SOEs. Under subprogram 1, the government, through shareholder endorsement, decided to close seven SOEs in the manufacturing, transport, and construction sectors to address unviable SOEs. The three SOEs in the manufacturing sector that will be closed account for 21% of the total number of SOEs in the sector. The closure of these unviable SOEs will be done in compliance with all relevant laws, including labor regulations. Under subprogram 2, the government will transfer the ownership of additional troubled SOEs to PT Perusahaan Pengelola Aset (an asset management company), and close SOEs that are not financially viable in compliance with government regulations, including labor laws.

18. Divesting state ownership in state-owned enterprises. Policy actions in this cluster will address the poor performance of certain SOEs, while helping to catalyze investments. Under subprogram 1, the government successfully completed an initial public offering (IPO) for PT Dayamitra Telekomunikasi, which manages more than 28,000 telecommunications towers,

¹⁷ The design of the program is aligned with ADB. 2020. [Guidance Note on State-Owned Enterprise Reform in Sovereign Projects and Programs](#). Manila.

¹⁸ The number of SOEs is based on government regulations as of July 2022. As per MSOE data, there were 112 SOEs as of 31 December 2019 and 75 as of 1 September 2022.

including those in the outer islands. The IPO raised \$1.2 billion, which will help the company expand its services. The government has also identified additional SOEs and their subsidiaries for IPOs. Under subprogram 2, the government will divest state ownership in more SOEs through IPOs. It plans to list 13 SOEs in the energy, oil and gas, health, food, fertilizer, telecommunications, and mining sectors on the Indonesian Stock Exchange.

19. Controlling the distortions caused by government assignments to state-owned enterprises. Policy actions in this cluster will address the fiscal pressure on the budget and the financial burden on SOEs caused by government assignments. Under subprogram 1, the government made all government assignments to SOEs, including public service obligations, contingent on prior approval of the minister of SOEs, to ensure that such assignments are assessed by the MSOE from a broader corporate and financial viability perspective. In addition, for an SOE to receive capital for restructuring purposes, the government required that an assessment be prepared by the board of directors, together with written responses from the board of commissioners and/or supervisors for the concerned SOE.¹⁹ Finally, the government also put in place a requirement that economic, environmental, fiscal, financial, and legal assessments be undertaken as a prerequisite for the approval of state equity injections for business development purposes. Under subprogram 2, the government will require that financing for government assignments to SOEs, including national strategic projects, must be secured prior to the approval of such assignments. This will further reduce the pressure on the state budget and the financial burdens of SOEs. A centralized mechanism at the MSOE will be established to monitor and report on all government assignments to SOEs.

20. Deleveraging state-owned enterprises and transitioning to a climate-compatible business model. Policy actions in this cluster will address the excessive leverage on SOE balance sheets, while requiring them to adopt climate-compatible business models. Under subprogram 1, the government established guidelines for SOEs to transfer select, commercially viable assets to the Indonesia Investment Authority, a sovereign wealth fund, to recycle their assets, particularly infrastructure assets, to help deleverage SOEs' balance sheets and catalyze investments.²⁰ In addition, it implemented a strategy for SOEs to adopt climate-compatible business models to strengthen resilience to climate, disaster, and transition risks. Under subprogram 2, the government will further recycle SOEs' assets in partnership with the Indonesia Investment Authority and require SOEs to enter into strategic partnerships with the private sector.

2. Reform Area 2: Corporate Governance Framework for State-Owned Enterprises Strengthened

21. Improving institutional oversight and decarbonizing state-owned enterprises. Policy actions in this cluster will address the fragmentation of the oversight of SOEs and help set SOEs with high levels of greenhouse gas emissions on a path to decarbonization. Under subprogram 1, the government organized all SOEs into 12 sector clusters, with each cluster consisting of SOEs with similar business models and value chains. The government also overhauled the management structure of the MSOE to match the composition of the SOE clusters and to strengthen the overall capacity and competencies of MSOE staff, so that they could oversee the SOEs more effectively. The government established a greenhouse gas emission baseline, consistent with international emission accounting standards, for seven SOEs with the largest

¹⁹ Indonesian companies have a two-tiered board system: a board of commissioners, which has a supervisory role, and a board of directors, which manages the company.

²⁰ Asset recycling entails monetizing the value from revenue-generating public assets and using the proceeds to invest in existing and/or new infrastructure assets. World Economic Forum. 2017. [Recycling our Infrastructure for Future Generations](#). Geneva.

emission footprint, which is projected to account for 25% of Indonesia's emissions in 2030 under a business-as-usual scenario.²¹ It also designated climate change focal points in these SOEs responsible for developing and implementing decarbonization plan.²² Under subprogram 2, the government will further strengthen the oversight of commercial and noncommercial SOEs in line with international best practices on reporting, accountability, gender diversity, and transparency. To further strengthen the incentive for the MSOE to improve SOE performance as well as to provide it with resources needed to implement reforms, the government will consider allocating a portion of SOE dividends to the MSOE every year for the ministry's operations, as part of its budget allocation to the MSOE. The MSOE will be subject to an audit and disclosure requirements covering the use of these dividends. The government will also implement and monitor SOE decarbonization plans to contribute to the achievement of Indonesia's commitment to the Paris Agreement on climate change.

22. Further, in subprogram 2, the improved institutional oversight will be complemented by addressing inconsistencies in the regulations issued for SOEs, which have undermined the effective implementation of the SOE reform road map. The government will undertake a risk-based review of all regulations issued by the MSOE and remove those identified to be inconsistent. The government will also require the MSOE to conduct a regulatory impact assessment for all future regulations. The regulatory impact assessment will provide for a systemic approach to critically assess the effects of proposed regulations and allow a more evidence-based approach to policy making.

23. **Strengthening financial monitoring and disclosure.** Policy actions in this cluster will address the lack of aggregate financial reporting and comprehensive management of SOE risks. Under subprogram 1, the government adopted aggregate financial statements for the entire SOE portfolio, enabling improved oversight, evaluation, management control, and financial planning at the consolidated and cluster levels. The government also adopted new and comprehensive risk management guidelines for SOEs. It established key performance indicators on profitability, business growth, partnerships and workforce productivity for the SOEs' boards of commissioners and directors, and implemented a monitoring and management system to evaluate the performance of these oversight bodies. Under subprogram 2, the government will establish accounting policies for aggregated SOE financial statements, aligned with the International Financial Reporting Standards, and implement the new, comprehensive risk management guideline across all SOEs. It will disclose the consolidated financial statements through annual reports and integrated financial planning, assess which international sustainability standards (including climate-related financial disclosure standards) may be applicable to Indonesia's SOEs, and monitor and take corrective measures on SOE risks and key performance indicators.

24. **Strengthening anticorruption measures.** Policy actions in this cluster will address operational mismanagement in SOEs (para. 11 and footnote 6). Under subprogram 1, the government required disclosure of personal finances by all members of SOE boards of commissioners and directors, and established an integrated whistleblowing system for all SOEs under Indonesia's Corruption Eradication Commission. The government required all SOEs to adopt corruption prevention guidance, with large SOEs required to adopt international standards on antibribery. It also updated the core values on human resources for all SOE employees. Under

²¹ The seven SOEs include: Pertamina, Perusahaan Listrik Negara, Semen Indonesia, Pupuk Indonesia, Mining Industry Indonesia, Perhutani, and Perkebunan Nusantara.

²² ADB's ASEAN Catalytic Green Finance Facility and Agence Française de Développement, which may provide cofinancing for subprogram 2, are exploring provision of TA to the MSOE on SOE decarbonization plans. German development cooperation through KfW, as a cofinancing partner, is providing TA to the MSOE on international climate-related financial disclosure standards.

subprogram 2, the government will ensure that all SOEs meet the international standards on antibribery and disclose their corruption prevention guidance on their websites. The government will issue a legal clarification that an SOE's loss is a corporate loss, and not a state loss, to address critical decision paralysis at SOEs.²³

25. Improving the quality of state-owned enterprise boards. Policy actions in this cluster will address the quality of SOE leadership. Under subprogram 1, the government established clearer selection criteria for all SOE board members (footnote 19), including requirements that a candidate: (i) holds a taxpayer identification number; and (ii) has never been declared personally bankrupt or been a member of a board of directors, a board of commissioners, or a supervisory board found guilty of causing a company to be declared bankrupt. The government established an SOE leadership and management research institute to build among SOE officials corporate financial management expertise in line with international standards. It also established an onboarding program for new members of the boards of commissioners and directors, as well as a centralized talent pool at the MSOE for positions of leadership at SOEs. An independent entity has been competitively selected to verify the qualifications and experience of prospective board members. Under subprogram 2, the government will permit SOE staff to be appointed to a board of directors of an SOE without having to resign first, thereby creating an integrated SOE workforce and correcting a disincentive for talented staff to move from one SOE to another, particularly to SOEs in financial trouble and in critical need of expertise.

26. Enhancing inclusivity and diversity in state-owned enterprises. Policy actions in this cluster will address the limited diversity in SOE leadership and help make SOEs respectful workplaces. Under subprogram 1, the government set a target to ensure that women account for at least 15% of SOE boards of directors by 2024 and adopted a respectful workplace policy to create work environments free from discrimination, violence, and harassment. Evidence shows that enhancing inclusion and diversity (defined as a greater proportion of women and individuals from ethnic and culturally diverse backgrounds) has a positive impact on a company's performance.²⁴ In April 2022, ADB provided training to 40 female leaders and aspiring female leaders from across SOEs in Indonesia under the first country-specific Asia Women Leaders Program. Under subprogram 2, the government will further increase its target for women on SOE boards of directors to 25% by 2025. It will implement a policy to: (i) close gender pay gaps and offer flexible working hours to support the new respectful workplace policy; (ii) use corporate social responsibility mandates to support businesses owned by women; and (iii) report annually on progress toward achieving the gender target on SOE boards of directors.

27. Value addition and sustainability. The program builds on ADB's knowledge work, policy dialogue, and operational engagement with SOEs in Indonesia. ADB carried out an economic analysis of Indonesia's SOEs in 2018 and discussed the findings at a high-level policy dialogue with the Ministry of Finance (MOF) in 2019. In 2021, ADB undertook an in-depth study of the constraints faced by SOEs. These knowledge products, coupled with the high-level policy dialogue, helped inform the government's reform plans for SOEs, including the development of the State-Owned Enterprises Roadmap (2020–2024). ADB, in close coordination with Indonesia's other key development partners, is providing TA to the MSOE and the MOF to implement SOE reforms. ADB is supporting Srikandi, an association of women working in SOEs, with a leadership

²³ The existing legal provisions in Indonesia on anticorruption have at times been interpreted by law enforcement agencies that senior officials at SOEs who caused a corporate loss because of a wrong decision made in good faith can be held accountable under the legal ambit of "state loss", which can potentially lead to a prison sentence. This has deterred many SOE officials from taking strategic and difficult business decisions.

²⁴ McKinsey Global Institute. 2018. [*The Power of Parity: The Power of Parity: Advancing Women's Equality in Asia Pacific*](#). Brussels.

development program to help women into leadership positions in SOEs. Furthermore, the sustainability of the program will be supported by the inclusion of the program's outcome targets in the MSOE's new planning document, medium-term development plan (2025–2030), and ADB's engagement with selected SOEs (e.g., SOEs in the electricity, pharmaceuticals, and transport sectors). The program complements ADB's broader sovereign and non-sovereign operations in Indonesia.

28. **Prior ADB engagement and lessons.** ADB has a long-standing operational engagement with SOEs in Indonesia. In 2001, ADB approved a program loan to help SOEs with corporate governance improvement and privatization. It has subsequently provided financing to selected SOEs to develop core infrastructure and helped to promote public–private partnerships and strengthen corporate governance, including environmental and social safeguards. SOEs are important partners in the implementation of country operations in Indonesia and, more recently, have played an important role, as off-takers, for ADB-financed nonsovereign investments in renewable energy. A key lesson learned from previous engagements is that political dynamics and strong government ownership are critical, and that, to be sustainable, reform measures need to be aligned with the country's medium- to long-term development aspirations.²⁵ Therefore, a programmatic approach is best suited to tackling the constraints present in Indonesia's SOE ecosystem, while the links to broader country operations will help deepen the impact of the reform measures supported by the program. To support the current program's links with other ADB operations in Indonesia, it was prepared by a One ADB team, which included members from ADB's Indonesia Resident Mission, Private Sector Operations Department, Office of Public–Private Partnership, Economic Research and Regional Cooperation Department, Sustainable Development and Climate Change Department, and the Office of the General Counsel.

29. **Development partner coordination.** The government, through the MSOE, leads development partner coordination on reforms targeting SOEs, and there is strong collaboration between the key development partners working in the SOE sector.²⁶ Among the development partners, ADB is taking the lead in the SOEs' reform program in Indonesia. The OECD is a dialogue partner for the MSOE, including on sharing international best practices. Since 2020, ADB has been holding regular discussions with the OECD and the World Bank on the program's policy design and monitoring framework, including on the reform measures supported by the program. ADB has been coordinating with the program's cofinancing partners—German development cooperation through KfW and Agence Française de Développement (for subprogram 2)—in the preparation of the program as well as on providing technical support to the MSOE. ADB discussed the program with the International Monetary Fund (IMF), while ADB staff regularly discuss the macroeconomic outlook and policy issues with the IMF. ADB coordinates with the IMF, the World Bank, and bilateral funding agencies on policy-based loans to Indonesia.²⁷

C. Expected Outcome of the Reforms

30. The outcome will be increased economic, environmental, and social value provided by SOEs. The program is aligned with the following overarching development objective of Indonesia: economic resilience for quality growth strengthened and disparities between regions reduced (footnote 13).

²⁵ ADB. 2018. [State-Owned Enterprises Engagement and Reform](#). Manila.

²⁶ Development Coordination (accessible from the list of linked documents in Appendix 2).

²⁷ The IMF confirmed on 14 July 2022 that the press release for the 2022 Article IV consultation with Indonesia (released on 11 March 2022) may serve as the IMF assessment letter.

31. The program adopts a balanced scorecard approach in developing the monitoring framework, with a mix of quantitative and qualitative indicators to capture the results.²⁸ While the indicators for the reform area on improving efficiency and resilience are quantitative in nature, those for the reform area on strengthening corporate governance include qualitative indicators. Policy actions under reform area 1 are expected to increase the consolidated net profits of SOEs by 14-fold and their contribution to state revenue by 18% by 2025. The program will help increase the share of financially viable SOEs in the portfolio from 77% to 84%, reduce the need for state equity injections to SOEs by 20%, and lower their total consolidated debt–equity ratio to 2.00 by 2025 from 2.56 in 2020. Policy actions under reform area 2 will improve the oversight of SOEs in line with OECD guidelines and will ensure compliance with international standards on anticorruption measures by 2025. They are expected to increase the workforce productivity of SOEs by 11%, while increasing the number of women in leadership positions in SOEs to 25% by 2025 from 9% in 2020. The reform measures are also expected to lead to a 14% reduction in the greenhouse gas emissions of SOEs by 2025 compared to the business-as-usual scenario, and to set SOEs on a decarbonization path.

32. The program will also help reduce SOE losses and improve their profitability, thereby delivering extra resources to the government for development expenditures and fiscal consolidation efforts. Simulations conducted to evaluate the impact of the proposed reforms on GDP growth suggests that, through optimal allocation of public resources and reduction of the productivity gap between SOEs and private enterprises, the level of GDP is projected to be higher by 1.8%–2.6% during 2020–2025, compared with the no reform scenario.²⁹ The analysis corroborates that improved performance of SOEs will play an important role in helping Indonesia advance towards its long-term goals. However, continued strong MSOE leadership and technical capacity will be critical for managing the political economy challenges and driving the results. Macroeconomic stability and political commitment to structural economic reforms will be key for translating the outcomes generated by reforming the SOEs into broader economy-wide benefits.

D. Development Financing Needs and Budget Support

33. Based on the expected budget deficit, the government's financing needs are estimated to be \$82.7 billion in 2022, which will be met through domestic (\$66.7 billion) and foreign (\$16.0 billion) sources. In 2023, financing needs are projected to be \$87.4 billion, which will be met through \$69.9 billion from domestic sources and \$17.5 billion from foreign sources. The programmatic approach is estimated to cost \$1 billion. Subprogram 1 of \$500 million is estimated to represent 0.6% of the government's financing needs in 2022.³⁰ The size of the loan is based on the country's current financing needs and impact of the reforms. The indicative amount of the loan for subprogram 2 is \$500 million.

34. The government has requested a regular loan of \$500 million from ADB's ordinary capital resources to help finance subprogram 1. The loan for subprogram 1 will have a 15-year term, including a grace period of 3 years; an interest rate determined in accordance with ADB's Flexible Loan Product; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement. Based on the 5% annuity method, the average maturity is 9.84 years, and there is no maturity premium payable to ADB. German development cooperation through KfW will provide parallel cofinancing of €300 million (\$295.86 million equivalent) for

²⁸ ADB. 2007. [*Balanced Scorecard for State-Owned Enterprises: Driving Performance and Corporate Governance*](#). Manila.

²⁹ Program Economic Assessment (accessible from the list of linked documents in Appendix 2).

³⁰ In 2022, ADB's country program for Indonesia includes policy-based loans totaling \$1.5 billion.

subprogram 1. KfW is also expected to provide parallel cofinancing in the same amount for subprogram 2, and Agence Française de Développement has expressed interest in providing parallel cofinancing for subprogram 2 for €150 million (\$147.93 million equivalent).

E. Implementation Arrangements

35. The MSOE will be the executing agency. The MOF and the MSOE will be the implementing agencies. The office of the minister of SOEs will act as the focal point for: (i) the implementation of the reform actions; and (ii) coordinating the knowledge work and TA provided by ADB and the program's cofinancing partners.³¹ The proceeds of the policy-based loan will be drawn down following ADB's *Loan Disbursement Handbook* (2017, as amended from time to time).³²

36. **Program monitoring mechanism.** The MSOE as the executing agency will hold monitoring meetings twice a year with the MOF, SOEs, ADB, and the program's cofinancing partners. The monitoring meeting will be led by the MSOE vice-minister and will include senior MOF officials and ADB. The findings and discussions from the monitoring meetings will guide the implementation of the program as well as inform the government's broader reform measures, including updates to the implementation of the government's SOE roadmap.

III. DUE DILIGENCE

37. **Poverty.** The unprecedented impact of the COVID-19 pandemic reversed Indonesia's gains in reducing unemployment and poverty over the years. Unemployment rose from 5.01% in February 2019 to 7.07% in August 2020—the highest rate in 9 years—and was at 5.83% in February 2022. The poverty rate, which had not increased since 2015, rose from 9.2% in 2019 to 10.2% in 2020, before falling back to 9.5% in March 2022. Low-income households, particularly in the outer regions of the country, are critically dependent on the goods and services provided by the SOEs.³³ For instance, Bank Rakyat Indonesia has 49,835 agents in remote areas who provide financial services to the poor and marginalized households and micro businesses. Telkom (telecommunication SOE) has 251,116 base transceiver stations, including in the most remote areas of the country, which play a key role in facilitating communication across the country. The reform measures supported by the program will improve the performance, resilience, and governance of SOEs, which in turn will help increase the efficiency of SOEs in providing goods and services that the poor and vulnerable households depend on.

38. **Gender.** Subprogram 1 is categorized *effective gender mainstreaming*, and subprogram 2 will target the same categorization. Women are more likely to be in poverty than men (the current poverty rate is 10.4% for women and 9.9% for men) (footnote 33). Women are also underrepresented in the formal economy and in leadership. Female workforce participation rate is 54%, significantly lower than the male participation rate of 82%, and women are overrepresented in the informal sector and in running small enterprises. Inefficient and expensive SOE services and products, such as energy, water, and food, disproportionately impact women and poor households. Women comprise one-third of the total SOE workforce, but the leadership of SOEs does not reflect the diversity of the broader population, with female directors comprising only 12% of SOE boards in 2022. This is lower than the aggregate company average for the Association of Southeast Asian Nations (ASEAN) (14.9% in 2022). The program includes proactive targets for women on SOE boards, together with the implementation of a respectful

³¹ ADB is providing TA to the MSOE and MOF through the Sustainable Infrastructure Assistance Phase II.

³² List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

³³ Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

workplace policy. These elements will contribute to creating an ecosystem that enables women to participate to their full capacity.

39. **Climate change.** Indonesia recognizes its role in combating global climate change by pursuing a just and affordable transition to a low-carbon future and to ensuring the stability and availability of essential services. Under its enhanced nationally determined contribution, Indonesia has set an unconditional target of a 31.89% reduction in GHG emissions by 2030, compared to a business-as-usual scenario, and a target of 43.20% reduction conditional on official development assistance.³⁴ Under its Long-Term Strategy for Low Carbon and Climate Resilience 2050, Indonesia has outlined priorities for adaptation and resilience.³⁵ In 2019, SOEs emitted 669 million tons of carbon dioxide equivalent (tCO₂e) in greenhouse gases, with estimated business-as-usual emissions of 1,136 million tCO₂e by 2030 and 1,558 million tCO₂e by 2060. The MSOE has confirmed its intention to contribute to Indonesia's national goals by enhancing the climate and disaster resilience of SOEs and supporting implementation of their decarbonization programs. It is estimated that the reform measures supported under subprogram 1 will contribute \$38.33 million in climate change adaptation and \$55.00 million in climate change mitigation.³⁶

40. **Safeguards.** In compliance with ADB's Safeguard Policy Statement (2009), the program is classified category C for environment, involuntary resettlement, and indigenous people's safeguards. The program is not expected to have significant adverse environmental or social safeguard impacts within the meaning of ADB's Safeguard Policy Statement (2009).

41. **Public financial management.** Indonesia has made impressive improvements to public financial management since the Asian financial crisis. The MOF is responsible for coordinating budget formulation and disbursement, with the National Planning Agency tasked with preparing priority programs. With regards to the SOEs, they are now subject to the same accounting and auditing standards as are locally listed companies, with local standards for financial disclosure requirements largely aligned with the International Financial Reporting Standards. Several international assessments have pointed to marked progress in public financial management practices in general, although many deficiencies remain, particularly on the budgeting process and oversight, the timeliness of disbursements, and revenue collection. These are all deficiencies that also impact the health and stability of SOEs, and are further compounded by SOE specific governance issues, in particular the weak oversight capacity of the MSOE (para. 11). Reforms of SOEs supported under subprogram 1, including consolidations of SOEs, overhauling the MSOE's structure and capacity, a new SOE risk management framework, and improved monitoring of SOEs' financial health, will strengthen public financial management practices across SOEs.³⁷

42. **Risks and mitigating measures.** Major risks and mitigating measures are summarized in table 2 and described in detail in the risk assessment and risk management plan.³⁸

Table 2: Summary of Risks and Mitigating Measures

Risks	Mitigation Measures
Global economic uncertainty. The uncertainty exists because of: (i) the commodity price shocks arising from the Russian invasion of Ukraine; (ii) monetary policy	Fiscal and monetary policy are being appropriately tightened, supported by strong macroeconomic coordination. This will help

³⁴ Government of Indonesia. 2022. [Enhanced Nationally Determined Contribution \(ENDC\): Indonesia's Commitment to Contribute to Maintaining Global Temperatures](#). Jakarta.

³⁵ Government of Indonesia. 2021. [Long-Term Strategy for Low Carbon and Climate Resilience 2050](#). Jakarta.

³⁶ Climate Change Assessment (accessible from the list of linked documents in Appendix 2).

³⁷ Public Financial Management Assessment (accessible from the list of linked documents in Appendix 2).

³⁸ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

Risks	Mitigation Measures
tightening in advanced economies; (iii) the economic slowdown in the People's Republic of China, induced by lockdowns; and (iv) potential coronavirus disease (COVID-19) outbreaks. This economic uncertainty and the possible market volatility may affect state-owned enterprise (SOE) performance.	contain second-round inflationary effects of global commodity shocks and domestic fuel price adjustments, restore the macro fiscal framework that served Indonesia well, ensure fiscal space for coping with income shocks, and mitigate volatility in the external financial account. The Asian Development Bank (ADB) and the executing agency will establish a program monitoring mechanism (para. 36) to monitor the program and discuss updates to the policy actions in subprogram 2 and outcome targets, if needed.
Technical capacity at the Ministry of State-Owned Enterprises (MSOE). The MSOE lacks the technical and human resources capacity to oversee and manage the SOEs in its portfolio. MSOE employees often lack the skills needed to evaluate commercial enterprises.	Staffing has improved along with the new structure of the MSOE and the appointment of more officials with private sector experience. Together with other development partners, ADB is providing technical assistance to the MSOE.
Reform momentum. There is pushback against SOEs' reform by vested interest groups because of political economy considerations.	There is strong government-wide support for the SOE reform road map. The leadership of the MSOE, supported by those of other relevant line ministries, has been engaging with all stakeholders, including the national parliament and the public, on all its key reform initiatives.

Source: Asian Development Bank.

43. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the MSOE.

IV. ASSURANCES

44. 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 draft loan agreement.

V. RECOMMENDATION

45. 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 State-Owned Enterprises' Reform Program, and
- (ii) the loan of \$500,000,000 to the Republic of Indonesia for subprogram 1 of the State-Owned Enterprises' Reform Program, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's Flexible Loan Product; 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.

25 October 2022

Masatsugu Asakawa
President

POLICY DESIGN AND MONITORING FRAMEWORK

Country's Overarching Development Objective Economic resilience for quality growth strengthened and disparities between regions reduced (National Medium-Term Development Plan, 2020–2024; Vision of Indonesia 2045) ^a		
Outcome Increased economic, environmental, and social value provided by SOEs	Risks and Critical Assumptions R: Global economic uncertainty and market volatility could affect the performance of SOEs	
Prior actions: Subprogram 1 Completed (January 2020–September 2022)	Policy Actions: Subprogram 2 (October 2022–March 2024)	Outcome Indicators By 2025
Reform Area 1: Efficiency and resilience of SOEs improved		
1.1. The government reduced the number of SOEs from 112 to 75 which included the mergers of four state-owned port corporations and the establishment of a holding company for each of the health, tourism, and insurance clusters, to focus SOEs on their core business activity. ^b (MSOE)	2.1 The government will: (i) further reduce the total number of SOEs to 41; and (ii) implement updated nondiscriminatory and gender-sensitive procedures based on international best practice to manage labor redundancy. (MSOE)	a. SOE contribution to state revenue increased to Rp550 trillion (2020 Baseline: Rp465 trillion) (Source: MSOE and MOF)
1.2. The MOF (the shareholder) endorsed the closure of 7 SOEs in the manufacturing, transport, and construction sectors, to address unviable SOEs. ^c (MOF, MSOE)	2.2 The government will: (i) transfer the ownership of additional troubled SOEs to PT Perusahaan Pengelola Aset (an asset management company); and (ii) close financially unviable SOEs in an orderly manner. (MOF, MSOE)	b. SOE net profit increased to Rp180 trillion (2020 Baseline: Rp13.3 trillion) (Source: MSOE and MOF)
1.3. The government divested state ownership in an SOE by successfully undertaking an IPO in the telecommunication sector and identified additional SOEs for IPOs, to improve performance of the SOEs and crowd-in investments. ^d (MOF, MSOE)	2.3 The government will further divest state ownership in SOEs through IPOs and list 13 SOEs on the Indonesian Stock Exchange in the energy, oil and gas, health, food and fertilizer, telecommunications, and mining sectors. (MSOE)	c. State equity injection to SOEs reduced to Rp17.8 trillion (2020 Baseline: Rp31.3 trillion) (Source: MSOE and MOF)
1.4. The government implemented regulations that: (i) made all government assignments to SOEs, including public service obligations, contingent on prior approval of the minister of SOEs; (ii) required that	2.4 The government will: (i) implement regulation requiring the financing for government assignments to SOEs, including national strategic projects, to be secured prior to the approval of such	d. Financially viable SOEs as a share of total SOE portfolio increased to 84% (2020 Baseline: 77%) (Source: MSOE and MOF)
		e. Total SOE debt-to-equity ratio reduced to 2.00 (2020 Baseline: 2.56) Source: MSOE and MOF

Prior actions: Subprogram 1 Completed (January 2020–September 2022)	Policy Actions: Subprogram 2 (October 2022–March 2024)	Outcome Indicators By 2025
<p>any proposal for state capital participation for restructuring and/or rescuing of SOEs be accompanied by assessment by board of directors with written responses from the board of commissioners and/or supervisors; and (iii) required that economic, fiscal, financial, legal, environmental and social assessments be undertaken as a prerequisite for approval of state equity injections.^e (MOF, MSOE)</p> <p>1.5. The government implemented: (i) guidelines for the transfer of relevant, commercially viable SOE assets to the Indonesia Investment Authority, to deleverage SOEs' balance sheets; and (ii) strategy for SOEs to adopt climate compatible business models to strengthen resilience to climate, disaster and transition risks.^f (MOF, MSOE)</p>	<p>assignments, to control the pressure on the state budget and financial burden on SOEs; and (ii) implement a centralized mechanism at the MSOE to monitor and report on all government assignments to SOEs. (MOF, MSOE)</p> <p>2.5 The government will: (i) further recycle SOEs assets in partnership with the Indonesia Investment Authority, following the guidelines for the transfer of relevant SOEs assets to the Indonesia Investment Authority; and (ii) implement strategic partnerships between SOEs and the private sector. (MOF, MSOE)</p>	
Reform Area 2: Corporate governance framework for SOEs strengthened		
<p>1.6. The government: (i) organized SOEs into 12 sectoral clusters consisting of SOEs with similar business models and value-chains, overhauled MSOE's management structure to match appropriate expertise with the clusters, and developed the overall capacity and competencies of MSOE's staff, to strengthen the MSOE's oversight of SOEs; (ii) established a GHG emission baseline in line with international GHG emission accounting standard(s) for the seven SOEs with the largest carbon footprints to support the development of SOE-level decarbonization plans; and (iii) designated a climate change focal in each of the seven SOEs, who is responsible for the development of the</p>	<p>2.6 The government will: (i) implement international best practices on reporting, accountability, gender diversity, and transparency, to further strengthen the institutional oversight of commercial and noncommercial SOEs; (ii) implement and monitor SOE-level decarbonization plans; (iii) provide the MSOE annually budget considering a portion of SOE dividends for the ministry's operations, commencing from 2024; and (iv) subject the MSOE to an audit and required disclosures covering the use of the dividends for the ministry's operations, commencing from 2024. (MOF, MSOE)</p>	<p>f. Centralized oversight of SOEs, aligned with OECD guidelines¹ (2020 Baseline: Limited oversight) (Source: MSOE)</p> <p>g. GHG emissions by SOEs reduced by at least 14%, compared to forecasted business-as-usual scenario (2020 Baseline: Scope 1 emissions of 328 million tCO₂e forecasted by 2025 under business-as-usual scenario) (Source: MSOE)</p> <p>h. All MSOE regulations fully harmonized (2020 Baseline: 60%) (Source: MSOE)</p>

Prior actions: Subprogram 1 Completed (January 2020–September 2022)	Policy Actions: Subprogram 2 (October 2022–March 2024)	Outcome Indicators By 2025
<p>decarbonization plan and its future implementation.⁹ (MSOE)</p> <p>1.7. The government: (i) adopted aggregate financial statements for the entire SOE portfolio, to enable monitoring of the entire portfolio of SOEs for improved oversight, evaluation, management control, and financial planning at the consolidated and cluster-levels; (ii) adopted new, comprehensive risk management guidelines for SOEs; (iii) implemented key performance indicators on profitability, business growth, partnerships, and workforce productivity for the SOEs' boards of commissioners and directors; and (iv) implemented a monitoring and performance management system to evaluate the performance of SOEs.^h (MSOE)</p> <p>1.8. The government: (i) required the disclosure of personal finances by all members of the SOEs' boards of commissioners and directors; (ii) operationalized an integrated SOEs-wide whistleblowing system with Indonesia's Corruption Eradication</p>	<p>2.7 The government will: (i) undertake a risk-based review of all regulations issued by the MSOE; (ii) remove inconsistent MSOE regulations; and (iii) implement a regulatory impact assessment for all future regulations issued by the MSOE, to create a strong regulatory environment for SOEs. (MSOE)</p> <p>2.8 The government will: (i) establish accounting policies for aggregated SOE financial statements, which are aligned with the International Financial Reporting Standards; (ii) operationalize new, comprehensive risk management guidelines across all SOEs; (iii) implement guidelines on the disclosure of consolidated financial statements through annual reports and integrated financial planning; (iv) assess international sustainability standard (including climate-related financial disclosure standards) applicable to Indonesia's SOEs; and (v) undertake regular monitoring of SOEs' risks and key performance indicators on an annual basis and take corrective measures commencing from 2023. (MSOE)</p> <p>2.9 The government will: (i) complete the adoption and operationalization of the international standards on anti-bribery (ISO 37001:2016) for all SOEs and disclose them on their individual websites; and (ii) issue legal clarity that an SOE's loss is a corporate loss and not a state</p>	<p>i. International standards on anti-bribery met by all SOEs (2020 Baseline: None) (Source: MSOE)</p> <p>j. Productivity of SOEs' workforce increased to Rp3.45 million per person (2020 Baseline: Rp3.07 million per person) (Source: MSOE)</p> <p>k. Women account for 25% of board of directors of SOEs (2020 Baseline: 9%) (Source: MSOE)</p>

Prior actions: Subprogram 1 Completed (January 2020–September 2022)	Policy Actions: Subprogram 2 (October 2022–March 2024)	Outcome Indicators By 2025
<p>Commission; (iii) required all SOEs to adopt corruption prevention guidance, with large SOEs required to adopt international standards on anti-bribery (ISO 37001:2016; effective from January 2020); and (iv) implemented updated the core values for all SOEs' employees.ⁱ (MSOE)</p> <p>1.9. The government implemented: (i) clearer selection criteria for all SOEs' boards members, which require that candidates have never been personally declared bankrupt or been a member of a board of directors or board of commissioners/supervisory board found guilty of causing a company to be declared bankrupt, hold a taxpayer identification number, and are not in political party management; (ii) an SOE leadership and management institute for building corporate financial management expertise among SOE officials in line with international-standards; (iii) an onboarding program for new members of the boards of commissioners and directors; and (iv) a centralized MSOE talent pool for SOEs for positions of SOEs' leadership with an independent entity competitively selected to verify individual talent to upgrade the quality of SOEs' human resources.ⁱ (MSOE)</p> <p>1.10. The government: (i) set a target to ensure women account for at least 15% of SOEs' board of directors by 2024; and (ii) prepared and implemented a respectful workplace policy to create a</p>	<p>loss, to address the critical decision paralysis at SOEs, effective from 2024. (MSOE)</p> <p>2.10 The government will permit SOEs' staff to be appointed to boards of directors of SOEs without having to first resign, thereby correcting the disincentive placed on talented staff to move from one SOE to another, particularly to SOEs in financial trouble and hence in critical need of expertise. (MSOE)</p> <p>2.11 The government will: (i) further increase the target for women on SOEs' board of directors to 25% by 2024; (ii) prepare and implement a policy on closing gender pay gaps and providing flexible</p>	

Prior actions: Subprogram 1 Completed (January 2020–September 2022)	Policy Actions: Subprogram 2 (October 2022–March 2024)	Outcome Indicators By 2025
work environment free from discrimination, violence, and harassment. ^k (MSOE)	working hours to support the new respectful workplace policy; (iii) use corporate social responsibility mandates to support women-owned businesses; and (iv) report annually on the progress toward achieving the gender target on SOE boards of directors. (MSOE)	
Budget Support Asian Development Bank Subprogram 1: \$500.00 million (policy-based loan) Subprogram 2: \$500.00 million (policy-based loan, indicative) German development cooperation through KfW Subprogram 1: \$295.86 million (€300 million, policy-based loan) Subprogram 2: \$295.86 million (€300 million, policy-based loan, indicative) Agence Française de Développement Subprogram 2: \$147.93 million (€150 million, policy-based loan, indicative)		

IPO = initial public offering, ISO = International Organization for Standardization, GHG = greenhouse gas, MOF = Ministry of Finance, MSOE = Ministry of State-Owned Enterprises, MtCO_{2e} = metric tons of carbon dioxide equivalent, OECD = Organisation for Economic Co-operation and Development, R = risk, Rp = rupiah, SOE = state-owned enterprise.

^a Government of Indonesia. 2019. *National Medium-Term Development Plan (RPJMN) 2020–2024*. Jakarta; Government of Indonesia. 2019. *Vision of Indonesia 2045*. Jakarta.

^b Per the data shared by the MSOE, there were 112 SOEs as of 31 December 2019 under MSOE management. The number of SOEs were reduced to 75 as of 1 September 2022 through various government regulations. The government consolidated SOEs by establishing holding companies through: (i) government regulation number 5/2022 on the addition of state capital participation into the share capital of PT LEN Industri through the transfer of all government shares (series B) owned by PT Dirgantara Indonesia, PT PAL Indonesia, PT Pindad, and PT Dahana to PT LEN Industri; (ii) government regulation number 65/2021 on the addition of state capital participation into the share capital of PT Perusahaan Listrik Negara (PT PLN) through the transfer of all government shares (series B) owned by PT Energy Management Indonesia to PT PLN; (iii) government regulation number 118/2021 on the addition of state capital participation into the share capital of PT Rajawali Nusantara Indonesia through the transfer of all government shares (series B) owned by PT Perusahaan Perdagangan Indonesia, PT Garam, PT Sang Hyang Seri, PT Berdikari, and PT Perikanan Indonesia to PT Rajawali Nusantara Indonesia; (iv) government regulation number 7/2022 on the addition of state capital participation into the share capital of PT Danareksa through the transfer of all government shares (series B) owned by PT Kliring Berjangka Indonesia, PT Kawasan Industri Medan, PT Kawasan Industri Wijayakusuma, PT Kawasan Industri Makassar, PT Kawasan Berikat Nusantara, PT Penerbitan dan Percetakan Balai Pustaka, and PT Perusahaan Pengelola Aset to PT Danareksa; (v) government regulation number 66/2021 on the addition of state capital participation into the share capital of PT Biro Klasifikasi Indonesia through the transfer of all government shares (series B) owned by PT Surveyor Indonesia and PT Superintending Company Indonesia (Sucofindo) to PT Biro Klasifikasi Indonesia; (vi) government regulation number 73/2021 on the addition of state capital participation into the share capital of PT Bank Rakyat Indonesia through the transfer of all government shares (series B) owned by PT Pegadaian and PT Permodalan Nasional Madani to PT Bank Rakyat Indonesia; (vii) government regulation number 104/2021 on the addition of state capital participation into the share capital of PT Aviasi Pariwisata Indonesia through the transfer of all government shares (series B) owned by PT Hotel Indonesia Natour, PT Sarinah, PT Taman Wisata Candi Borobudur, Prambanan dan Ratu Boko, PT Angkasa Pura I, and PT Angkasa Pura II to PT Aviasi Pariwisata Indonesia; (viii) government regulation number 20/2020 on the addition of state capital participation into the share capital of PT Bahana Pembinaan Usaha Indonesia through the transfer of all government shares (series B) owned by PT Asuransi Kredit Indonesia, PT Asuransi Jasa Indonesia, PT Asuransi Kerugian Jasa Raharja, and PT Jaminan Kredit Indonesia to PT Bahana Pembinaan Usaha Indonesia; and (ix) government regulation number 10/2022 on the addition of state capital participation into PT

Bio Farma through the transfer of all government shares (series B) owned by PT Industri Nuklir Indonesia to PT Bio Farma. The government also consolidated SOEs by merging them through: (i) government regulation number 97/2021 on the merger of PT Bhandha Ghara Reksa into PT Perusahaan Perdagangan Indonesia; (ii) government regulation number 101/2021 on the merger of PT Pelindo I, PT Pelindo III, and PT Pelindo IV into PT Pelindo II; (iii) government regulation number 98/2021 on the merger of PT Pertani into PT Sang Hyang Seri; and (iv) government regulation number 99/2021 on the merger of PT Perikanan Nusantara into PT Perikanan Indonesia.

- ^c The Ministry of Finance endorsed the closure of the following seven SOEs: PT Industri Sandang Nusantara; PT Industri Gelas; PT Kertas Kraft Aceh; PT Kertas Leces; PT Merpati Nusantara Airlines; PT Istaka Karya; and PT Pengembangan Armada Niaga Nasional. The closures are being conducted in compliance with all relevant laws, including labor law.
- ^d PT Dayamitra Telekomunikasi (subsidiary of PT Telkom Indonesia) was listed on the Indonesia Stock Exchange and issued shares through an IPO on 22 November 2021 (information available on the Indonesia Stock Exchange [website](#)). Government also notified additional IPOs of SOEs through [Press Conference Number PR-10/S.MBU/2/2021](#).
- ^e The government issued MSOE regulation PER-1/MBU/03/2021 providing guidance on proposals, reporting, monitoring, and changes in utilizing additional state capital by SOEs and established the requirement for the prior approval of the minister of SOEs on all government assignments to SOEs. The government issued MOF regulation PMK 218/PMK.06/2020 on the assessment of proposals for budget allocation from treasurer for government investments, including state capital and equity participation in SOEs, and established tougher and clearer economic, financial, fiscal, legal, and environmental criteria. These criteria include assessment of economic internal rate of return, financial internal rate of return, suitability with prevailing laws and regulations, and development of mitigation strategy for environmental impact.
- ^f The government regulation number 74/2020 established the Indonesian Sovereign Wealth Fund/Indonesia Investment Authority (INA), while MSOE regulation PER-07/MBU/04/2021 established the partnership between SOEs and INA. The partnership may include INA's management of SOEs' assets, establishment of joint venture company, investment fund management, lease-rent assets, operational cooperation, build-operate-transfer, build-own-transfer-operate, equip-operate-transfer, equip-operate-transfer, and/or other types of cooperation based on the relevant SOE's articles of association. The MSOE developed strategy to support SOEs transition to climate-compatible business model. The strategy included the following four key initiatives: (i) MSOE carbon market; (ii) sustainable industrial cluster; (iii) nature-based solution; and (iv) scaling up electric vehicle adoption. An SOE has been identified as the lead for each initiative, and progress in transitioning to climate-compatible business model is included as one of its key performance indicators.
- ^g Guided by the State-Owned Enterprises Roadmap (2020–2040), the government completed the grouping of SOEs into 12 clusters through MSOE regulation PER-4/MBU/03/2021 and disclosed the clusters through the MSOE [website](#). The government implemented Presidential regulation No. 81, issued in 2019, on reorganization of the MSOE, through MSOE regulation PER-4/MBU/03/2021, which established two newly appointed vice ministers directly responsible for SOEs' portfolio management as well as the working procedures. MSOE regulation PER-8/MBU/05/2021 permitted high-level positions at the MSOE to be filled by qualified individuals from the private sector with corporate management experience and required disclosure of such appointments through the list of SOEs' management on the MSOE [website](#). The MSOE established the following GHG emission baseline for SOEs: In 2019, GHG emissions for scopes 1, 2 and 3 was 669 million tCO₂e, with estimated business-as-usual emissions in 2030 and 2060 of 1,136 million tCO₂e per annum and 1,558 million tCO₂e per annum, respectively. The following 7 SOEs have the highest GHG emissions of all SOEs: Pertamina, Perusahaan Listrik Negara, Semen Indonesia, Pupuk, Indonesia, MIND ID, Perhutani and Perkebunan Nusantara. A climate focal was established at each of these 7 SOEs. [Scope 1 emissions](#) — it covers the GHG emissions that a company makes directly. [Scope 2 emissions](#) — these are the emissions it makes indirectly — like when the electricity or energy it buys for heating and cooling buildings. [Scope 3 emissions](#) — emissions associated not with the company itself, but that the organisation is indirectly responsible for up and down its value chain.
- ^h The MSOE issued ministerial decrees SK-164/MBU/05/2021 on producing aggregated financial reports for SOEs to increase the transparency and accountability of SOEs. The MSOE issued letter S-787/MBU/10/2021 to all boards of commissioners and directors on shareholders' aspirations and established key performance indicators aligned to the SOE roadmap (2020–2024). Based on MSOE regulation PER-11/MBU/11/2020 on management contract and annual management contract for SOEs, MSOE is using ANAPLAN (business planning software) as a performance management system to monitor and evaluate the performance of SOEs. It integrates the full planning cycle from strategy, SOE-level plan, SOE KPI, quarterly review, and annual performance evaluation.
- ⁱ MSOE circular letter SE-12/MBU/10/2021 requires all members of boards of commissioners and directors of SOEs to submit a state official wealth report (LHKPN), which is disclosed on Indonesia's Corruption Eradication Commission [website](#). The government established an integrated SOEs-wide whistleblowing system through a memorandum of understanding with the Corruption Eradication Commission, which is operational and [online](#). The government also required SOEs to adopt international anti-bribery standards (ISO 37001:2016) through minister of SOE's letter to SOEs' boards S-35/MBU/01/2020 on the implementation of an

anti-bribery management system in SOEs. The government implemented the new core value (AHLAK) through minister of SOEs' circular letter SE-7/MBU/07/2020 on Core Values of Human Resources in SOEs.

^j The government issued MSOE Regulation PER-10/MBU/10/2020 and PER-11/MBU/07/2021 on the requirements and mechanisms of the appointment and termination of the members of boards of commissioners and directors, respectively. The government established an onboarding program for boards of commissioners and directors through MSOE circular letter SE-1/MBU/02/2021 on the transformation of a learning function center and corporate university, research, and innovation center of SOEs, and established the BUMN (SOE) Leadership and Management Institute as a center for research, innovation, collaboration, managerial skills, and leadership across all clusters of SOEs. Since establishment, the institute has delivered onboarding program for 120 directors and commissioners of SOEs, training to 110 chief financial officers of SOEs, and leadership forum for more than 100 directors of SOEs. While MSOE regulation PER-11/MBU/07/2021 established the talent pool, ministerial decree SK-394/MBU/12/2021 established the guidance on the implementation of the talent assessment and management for SOEs' boards of directors.

^k The MSOE medium-term development plan (2020–2024) sets a target for women to account for 15% of board of directors by 2024. The MSOE's medium-term plan was approved through MSOE regulation number PER-8/MBU/2020. To boost company performance, growth, and sustainability, the government issued MSOE circular letter SE-3/MBU/04/2022 on respectful workplace policy for SOEs, which requires the boards of directors of SOEs to prepare and implement a respectful workplace policy within the SOE company groups and directs all SOE personnel to create a work environment free from discrimination, violence, and harassment.

^l OECD. 2015. [*OECD Guidelines on Corporate Governance of State-Owned Enterprises*](#). Paris.

Contribution to Strategy 2030 Operational Priorities: Operational priority indicators to which this operation will contribute results are detailed in Contribution to Strategy 2030 Operational Priorities (accessible from the list of linked documents in Appendix 2).

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=55235-001-3>

1. Loan Agreement
2. Sector Assessment (Summary): Public Sector Management (Reforms of State-Owned Enterprises)
3. Contribution to Strategy 2030 Operational Priorities
4. Development Coordination
5. International Monetary Fund Assessment Letter¹
6. Summary Poverty Reduction and Social Strategy
7. Program Economic Assessment
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

Supplementary Documents

10. Country Economic Indicators
11. Private Sector Assessment
12. Climate Change Assessment
13. Public Financial Management Assessment

¹ The International Monetary Fund confirmed on 14 July 2022 that the press release for the 2022 Article IV consultation with Indonesia (released on 11 March 2022) may serve as the International Monetary Fund Assessment Letter.



MINISTER OF FINANCE
OF THE REPUBLIC OF INDONESIA

No : S-805/MK.08/2022

29 September 2022

DEVELOPMENT POLICY LETTER

Mr. Masatsugu Asakawa
President
Asian Development Bank
Manila, Philippines

**Subject: State-Owned Enterprises' Reform Program,
Subprogram 1**

Dear Mr. Asakawa,

On behalf of the Government of Indonesia, let me again express our appreciation for the continuous commitment and support of the Asian Development Bank (ADB) for our overall reform efforts and the national development agenda.

The purpose of this Development Policy Letter is to provide an overview of the government's reform priorities to improve the efficiency and resilience of State-Owned Enterprises (SOEs) and to strengthen the corporate governance framework for SOEs in Indonesia. We recognize that these reforms are vital to ensuring SOEs provide basic services, implement key actions to accelerate economic recovery, and establish a strong base for a sustained SOE reform.

In the attached policy design and monitoring framework, we have identified key SOEs' reform actions. These reform actions are aligned with the government's National Medium-Term Development Plan, 2020–2024, (RPJMN) and the SOEs' reform roadmap (2020–2024), and we propose that they be supported by the State-Owned Enterprises' Reform Program, which consists of two subprograms. We would like to request financial assistance from ADB through subprogram 1 to support the reform initiatives we have implemented. This loan amounting to \$500,000,000 will allow the government to sustain the momentum in implementing its SOE reform program. The loan proceeds from subprogram 1 will be used to support related development spending in 2023 of the national budget, which includes the implementation of government's SOE reform roadmap (2020–2024).

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

Inclusive and sustainable development

As stated in the Indonesia Vision 2045, we aspire to be a high-income country by 2045. Indonesia is on the cusp of becoming an upper middle-income country; however, the pandemic has a devastating impact on poverty and unemployment. Through proactive government policies, Indonesia was able to manage and alleviate the impact of the pandemic, while the economy expanded, albeit at a slower pace than previously, despite the severe headwinds. Indonesia's economy is projected to grow in the range of 5.1 – 5.4% in 2022 and 5.3% in 2023, supported by favorable commodity prices, but the downside risks are significant due to the global economic uncertainty. Because of the government's continued commitment to maintain macroeconomic

stability, Indonesia is well positioned to weather the uncertain times that lie ahead. The government plans to consolidate public finances with a projected budget deficit of 3.92% of gross domestic product (GDP) in 2022 and 2.85% of GDP by 2023. The central government debt is sustainable at 41.2% of GDP in 2021, below the threshold of 60% of GDP.

The government recognizes that reforming state-owned enterprises will be central to achieving its medium-term development plan, ensuring efficient delivery of essential public services and realizing Indonesia's long-term development aspiration. With over \$600 billion in assets, SOEs managed by the MSOE play an important role in contributing their dividends to the national budget, providing public services, particularly in the outer regions of the country where poverty incidence is higher than elsewhere, and developing core national public infrastructure. Recently, they have been tasked to assist the government in helping the government to tackle climate change and in ensuring a just and affordable transition to a low carbon economy. But to do this, the economic, environmental, and social value generated by Indonesia's SOEs needs to increase. To this end, in 2020 the government adopted a roadmap for the reform of SOEs (2020–2024). The government then embarked on restructuring SOEs and subjecting them to international corporate governance standards, which remains ongoing. By 2024, key outcome of the reform will be a reduced SOE portfolio, which consists of viable and resilient SOEs, and they meet international best practices on SOE governance as established by the Organization for Economic Cooperation and Development. The forthcoming ADB's SOE diagnostic study, technical assistance and policy dialogue are helping the implementation of the SOE reform roadmap.

Improving the efficiency and resilience of state-owned enterprises

To right size the portfolio of SOEs and to address their expansion into noncore business activities, the government reduced the number of SOEs from 112 (as of 31 December 2019) to 75 (as of 1 September 2022). The government merged four port operators and two companies providing logistic services. It established sector-focused holding companies in hospital, tourism, pharmaceuticals, industry, with each holding company consisting of SOEs with similar business and value chain. Under the government's SOEs' reform roadmap (2020–2024), the government will reduce the clusters of SOE's under MSOE from 27 to 12 and SOEs under MSOE management to 41 by 2024. The government endorsed the closure of 7 unviable SOEs in the manufacturing, transport, and construction sectors. The closure of these SOEs is inevitable since they have been in hiatus for a long time. The closure of these SOEs is being carried out in compliance with relevant laws, including labor regulations. The government also identified additional unviable SOEs for closure. The government successfully completed the initial public offering (IPO) of an SOE Subsidiary in the telecommunications sector and has identified additional SOEs and their subsidiaries for IPOs.

To control the distortions caused by government assignments to SOEs, the government required that all government assignments to SOEs, including public service obligations, were made contingent on prior approval from the minister of SOEs. It required assessment from the relevant board of directors with written responses from the board of commissioners and/or supervisors on SOE restructuring. The government has also toughened the economic, fiscal, financial criteria for approving state equity injections to SOEs. Furthermore, the government took measures to address the excessive leverage of SOE balance sheet. The government will recycle relevant commercially viable SOE assets, through the Indonesia Investment Authority, to help deleverage SOEs' balance sheets. And it required relevant SOEs to adopt climate-compatible business model to reduce the transitional and physical risks posed by climate change.

Strengthening corporate governance framework for state-owned enterprises

To improve institutional oversight, the government has organized all SOEs into 12 sectoral clusters with each cluster consisting of SOEs with similar business models and value-chains. The government overhauled the MSOE's management structure to match appropriate structure with the SOEs clusters, while developing the overall capacity and competencies of MSOE staff to ensure it can more effectively oversee SOEs under its management.

The government has also encouraged SOEs to adopt green accounting by establishing a greenhouse gas emission baseline consistent with international emission accounting standards for the seven SOEs with the largest GHG emission footprint and designated a climate change focal in the seven SOEs who would be responsible for the development of the decarbonization plan and its future implementation. These efforts will contribute to Indonesia meeting its commitment under the Paris agreement as well as its Long-Term Strategy for Low Carbon and Climate Resilience 2050.

The government has strengthened the financial monitoring and disclosure of SOEs by adopting aggregate financial statements for the entire SOE portfolio, enabling improved oversight, evaluation, management control, and financial planning at the consolidated and cluster-levels. The government has also adopted new and comprehensive risk management guideline for SOEs. It is establishing enterprise risk management system and the position of director for risk management in large SOEs. It will issue guidelines for strengthening reporting on SOEs' financial situation and on their sustainability. The government established key performance indicators on profitability, business growth, partnerships, and workforce productivity for the SOE boards of commissioners and directors and implemented a monitoring and performance management system to evaluate the performance of the boards of commissioners and directors. The government updated the codes of ethics and conduct for all SOE employees and required the disclosure of personal finances by all members of the SOE boards of commissioners and directors and required all SOEs to adopt corruption prevention guidance, with large SOEs required to adopt international standards on anti-bribery. It has established an integrated SOE-wide whistleblowing system with Indonesia's Corruption Eradication Commission.

The government recognizes the importance of having high-quality SOE management and its link to SOE performance. The government has set clearer selection criteria for all SOE boards members, which require that candidates have never been personally declared personally bankrupt or been a member of a Board of Directors or Board of Commissioners/Supervisory Board found guilty of causing a company to be declared bankrupt, hold a taxpayer identification number, and are not politically affiliated. The government has established an SOE leadership and management research institute for building corporate financial management expertise among SOE officials in line with international standards. It has also established an onboarding program for new members of the boards of commissioners and directors as well as a centralized SOE talent pool at the MSOE for positions of SOE leadership with an independent entity competitively selected to verify individual talent to upgrade the quality of SOE human resources. The government has set a target to ensure women account for at least 15% of SOEs' board of directors by 2024 and has adopted a respectful workplace policy to increase inclusivity and diversity in SOEs.

The government remains firmly committed to the SOE reform agenda outlined above and to implementing the reform actions already instituted. We greatly value ADB's strong partnership in advancing government's structural reforms over the years, and we look forward to ADB's continued engagement and support.

We would appreciate the prompt consideration of the loan for the State-Owned Enterprises Reform Program, subprogram 1.

Minister of Finance



Ditandatangani secara elektronik
Sri Mulyani Indrawati

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C.c:

1. Vice Ministers of Ministry of Finance
2. Vice Minister of SOEs I, Ministry of State-Owned Enterprises
3. Vice Minister of SOEs II, Ministry of State-Owned Enterprises
4. Director General of Budget Financing and Risk Management, Ministry of Finance
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