ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 50168-002
May 2018

Proposed Policy-Based Loan for Subprogram 2 Republic of Indonesia: Fiscal and Public Expenditure Management Program

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 18 May 2018)

Currency unit	–	rupiah (Rp)
Rp1.00	=	$0.000071
$1.00	=	Rp14,073

ABBREVIATIONS

ADB	–	Asian Development Bank
BAPPENAS	–	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
CCT	–	conditional cash transfer
DAK	–	Dana Alokasi Khusus (Specific Allocation Fund)
DAU	–	Dana Alokasi Umum (General Allocation Fund)
DID	–	Dana Insentif Daerah (Regional Incentive Fund)
GDP	–	gross domestic product
IMF	–	International Monetary Fund
MDG	–	Millennium Development Goal
MOF	–	Ministry of Finance
NEET	–	not in employment, education, or training
PEM	–	public expenditure management
PFM	–	public financial management
RPJMN	–	Rencana Pembangunan Jangka Menengah Nasional (National Medium-Term Development Plan)
SDG	–	Sustainable Development Goal
SPAN	–	Sistem Perbendaharaan dan Anggaran Negara (National Financial Management Information System)
TA	–	technical assistance

NOTE

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

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PROGRAM AT A GLANCE

1. Basic Data			**Project Number:** 50168-002
Project Name	Fiscal and Public Expenditure Management Program (Subprogram 2)	**Department/Division**	SERD/SEPF
Country	Indonesia	**Executing Agency**	Fiscal Policy Office-Ministry of Finance
Borrower	Government of Indonesia		

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

3. Strategic Agenda	**Subcomponents**	**Climate Change Information**	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low

4. Drivers of Change	**Components**	**Gender Equity and Mainstreaming**	
Governance and capacity development (GCD)	Public financial governance	Effective gender mainstreaming (EGM)	✓
Partnerships (PAR)	Bilateral institutions (not client government) Official cofinancing		

5. Poverty and SDG Targeting		**Location Impact**	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG3, SDG4, SDG5, SDG8, SDG9, SDG10, SDG16		

6. Risk Categorization: Complex

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

8. Financing

Modality and Sources	Amount ($ million)
ADB	**500.00**
Sovereign Program (Regular Loan): Ordinary capital resources	500.00
Cofinancing	**239.02**
KfW Bankengruppe - Program loan (Not ADB Administered)	239.02
Counterpart	**0.00**
None	0.00
Total	**739.02**

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed policy-based loan (PBL) to the Republic of Indonesia for subprogram 2 of the Fiscal and Public Expenditure Management Program (FPEMP)[1] and (ii) the inclusion of an additional subprogram in the programmatic approach.

2. FPEMP is part of coordinated assistance provided by the Asian Development Bank (ADB) to support the government's focus on reducing poverty and inequality through sustainable and inclusive growth. The program (i) aligns the government's medium-term expenditure with the RPJMN and the Sustainable Development Goals (SDGs); (ii) enhances the national public expenditure system; and (iii) improves fiscal transfers and spending for better service delivery at the subnational government level. The design and monitoring framework is in Appendix 1. Subprogram 2 is included in ADB's country operations business plan (2018–2020) for Indonesia as a deliverable in 2018.[2]

II. PROGRAM AND RATIONALE

A. Background and Development Constraints

3. **Programmatic approach and budget support.** FPEMP uses a programmatic approach which aligns ADB's support with the government's reform program through a PBL over a medium to long-term time horizon. The design of FPEMP provided for targeted support of the government's National Medium-Term Development Plan (RPJMN) 2015–2019 to reduce income and regional inequality.[3] This objective is part of the second pillar of ADB's Country Partnership Strategy 2016–2019 which seeks to enhance economic governance.[4] The programmatic approach and subprogram 1 amounting to $500 million single tranche loan were approved by the ADB's Board of Directors on 10 November 2016. Subprogram 1 which consisted of 12 policy actions mapped the government's medium-term expenditure with the RPJMN and SDGs and improved public expenditure management (PEM) at the national and subnational levels. This provided a basis for more targeted and efficient expenditure management and a foundation for the reforms in subprogram 2. Subprogram 2 with 13 policy actions links spending with targets under the RPJMN and SDGs and strengthens PEM reforms by synchronizing planning with the entire budget cycle. The program also complements the government's medium-term revenue strategy, which is supported by the World Bank.

4. The program was designed to comprise two subprograms with the possibility of including two additional subprograms. This approach allows ADB to pace its support to the government's reform efforts. Based on the government's request, FPEMP will include a third subprogram to continue the reform momentum and strengthen the links between the RPJMN and SDGs. Subprogram 2 improves budget preparation, transparency, execution, and monitoring, including implementation of gender-responsive tagging and budgeting. Subprogram 3 will include 13 policy

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1 ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan to the Republic of Indonesia for Subprogram 1 of the Fiscal and Public Expenditure Management Program*. Manila.

2 ADB. 2017. *Country Operations Business Plan: Indonesia, 2018–2020.* Manila.

3 Government of Indonesia, BAPPENAS. National Development Planning Agency. 2015. *National Medium-Term Development Plan: RPJMN, 2015–2019*. Jakarta.

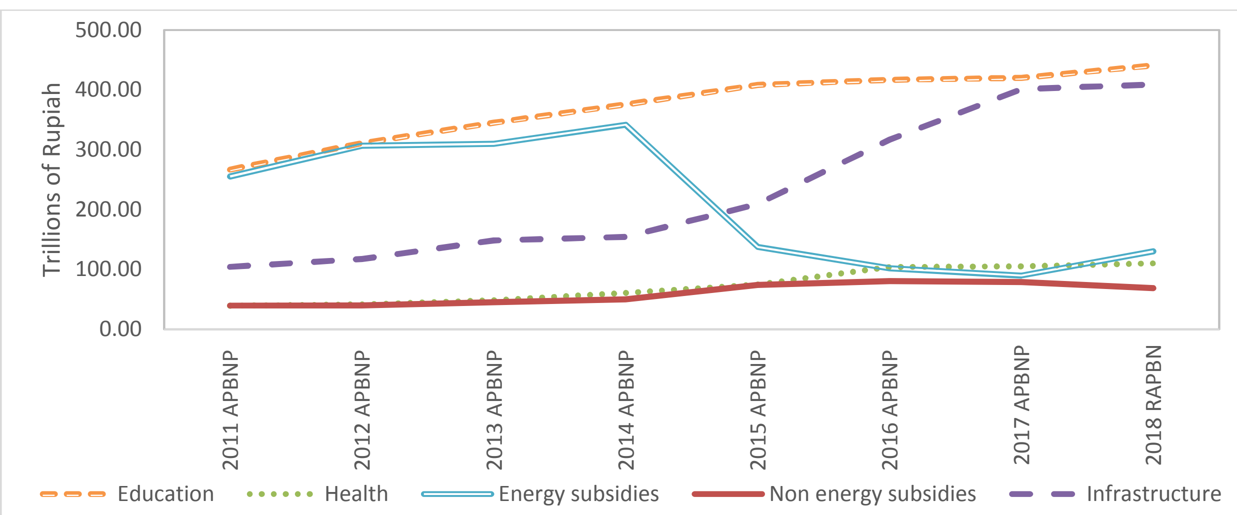
4 ADB. 2016. *Country Partnership Strategy: Indonesia, 2016–2019—Towards a Higher, More Inclusive and Sustainable Growth Path.* Manila.

actions, six of which are considered prior actions, including piloting labor market activation programs for SDGs implementation, which will be supported through ADB technical assistance.

5. **The development problem.** The government faces interrelated challenges of increasing economic growth, alleviating poverty, and reducing income inequality. Indonesia's economic growth rate declined from 6.4% in 2010 to an average of 5.0% from 2014 to 2017. Growth is expected to pick up to around 5.3% in 2018, suggesting a gradual recovery toward its medium-term growth rate of 5.6% (2010–2017).[5] Reforms and the resulting growth have led to a reduction in the poverty rate from 24.0% in 1999 to 10.6% in 2017. However, this may still not be sufficient to provide employment for the 3 million additional people who attain working age each year. In addition, close to 40.0% of the population remains clustered around the national poverty line. They are vulnerable to shocks such as food price increases, environmental hazards, and ill health.

6. Indonesia has seen inequality widen. The Gini coefficient, a measure of inequality, has increased at a faster pace (from 0.30 in 2000 to 0.40 in 2015 before declining to 0.39 in 2017) than in neighboring Southeast Asian countries. The uneven nature of infrastructure investment and economic growth across provinces has also widened regional income disparities and inequality. Further, Indonesia's social assistance programs have not adequately tackled poverty and income inequality. Social spending and social protection have long been used predominantly as a shock-coping mechanism rather than a long-term targeted program to reduce poverty and inequality. As a result, Indonesia has been less successful in reducing income inequality through social assistance programs compared with its regional comparators. Analysis in subprogram 1 (footnote 1) showed that in 2013, Indonesia's income redistribution and social assistance policies reduced the Gini index from 44.8 to 42.0, or by 2.8 points, compared with reductions of 4.5 points in Philippines and 4.0 points in Malaysia. Further accentuating the problem, one in four youth are not in employment, education, or training (NEET). Young women are even more at risk, with 32% aged from 15 to 24 classified as NEET. Those categorized as NEET come from low-income families, and the job entry barriers they face often perpetuate cycles of poverty and inequality.

Figure 1: Reallocation of Energy Subsidies to Social Sectors and Infrastructure



APBNP = Anggaran Pendapatan dan Belanja Negara tahun anggaran (State Budget Revenue and Expenditure Budget Year).
Source: Government of Indonesia, Ministry of Finance.

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[5] The government forecasted growth of 5.4% for 2018, while ADB, the International Monetary Fund (IMF), and the World Bank projected growth of 5.3%.

7. In recognition of these challenges, the government in 2014 made reducing income inequality a priority in its national strategy. This strategy emphasizes the multidimensional and long-term nature of poverty alleviation and differs from past practices by reducing universal subsidies including regressive fuel subsidies in favor of more targeted social assistance programs. This coupled with reforms in tax administration created significant fiscal space for increased expenditure in education, health, infrastructure, and social assistance (Figure 1). After exceeding infrastructure spending by 35% and aggregating 3 times the level of targeted social assistance spending in 2014, the energy subsidies declined significantly and represented only a fraction of these expenditures in 2015.[6] This shift from universal subsidies to pro-poor targeted social assistance has been effective. Beginning 2015, the trend of increasing inequality reversed, and the Gini coefficient dropped from 0.40 in 2015 to 0.39 in 2016, marking its first time below 0.40 since 2011. However, reaching the government's Gini coefficient target of 0.36 by 2019 and reducing the poverty rate to below 10.0% from 10.6% in 2017 will require stronger economic and fiscal performance, coupled with targeted spending on education, health, infrastructure, and social assistance programs. In addition, the public expenditure framework should be enhanced, the quality of service delivery improved, and access to finance increased. Programs also need to be developed to help young Indonesians find quality jobs.

8. **Binding constraints.** The government has identified the challenges it needs to address to meet its Gini target. A more effective fiscal and PEM framework will be required, including (i) alignment of medium-term expenditures with the RPJMN and SDGs targets, (ii) enhancements to the national public expenditure system, and (iii) improvements in fiscal transfers and the related spending by subnational governments for service delivery (paras. 9–12).

9. **Misalignment of medium-term expenditures and programs.** The government's medium-term expenditure framework is anchored on both the RPJMN and SDGs. Achieving this alignment requires (i) increased pro-poor budget allocations, particularly for education, health, infrastructure, and targeted social assistance programs; and (ii) improved quality of spending through better governance and PEM. For example, Indonesia's index for allocations to higher education was 20.4 points in 2016 compared with 29.6 in Thailand and 86.3 in Malaysia. Overall, Indonesia's higher education system scored 33.3 points compared with 39.7 in Thailand and 56.7 in Malaysia.[7] Given the legal requirement to keep the deficit below 3% of gross domestic product (GDP), improvements in the quality of public expenditure will be required.

10. Several constraints have been identified. First, until recently the government did not have a high-level national coordination body for implementing the SDGs. Targets for the RPJMN and SDGs are multidimensional and require implementation of several programs across line ministries. Without a national coordination body, the risk of contradictory implementation across ministries is high. For example, the noncash social assistance program, started during subprogram 1, needs to be expanded and monitored more closely. During the first quarter of 2017, only 10% of the smart card beneficiaries received their benefits. Second, the necessary end-to-end coordination from planning, budget preparation, execution, monitoring, and reporting has not been established. Without this coordination, priority programs will not receive sufficient budget allocations. Moreover, implementation will be ad hoc and monitoring weak. Third, the existing labor market programs are underfunded and not integrated and, therefore, have not been effective in tackling the high rate of youth NEET.

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[6] Sector Assessment (Summary): Public Sector Management (Public Expenditure and Fiscal Management), (accessible from list of linked documents in Appendix 2).

[7] R. Williams, A. Leahy, and P. Jensen. 2017. U21 Ranking of National Higher Education Systems 2017. Birmingham, United Kingdom: Universitas 21 (University of Birmingham).

11. **Weaknesses in national public expenditure management.** Indonesia introduced the medium-term expenditure framework in 2011. However, weaknesses remain in budget planning, execution, monitoring, and reporting, which impede pro-poor spending. Constraints include a lack of budget transparency; inefficient budget planning and approval; and slow budget execution, especially for capital expenditure. The 2015 International Budget Partnership Report scored Indonesia's budget transparency at 59 out of 100, due to limited disclosure of budget information to the public.[8] In addition, the use of multi-year contracts is still low because provisions allowing its use are narrow and spending units of line ministries are concern if the use of multi-year contracts may lead to allegations of corruption. This results in multiple procurements for single projects, which is inefficient and increases project cost. Advance procurement in its current form is also not effective. Line ministries can only begin the tender process when budget allocations are approved in November, delaying contract signing and the entire procurement process. As recently as 2016, 50%–60% of capital spending was disbursed in the last quarter.

12. **Ineffective fiscal transfers lead to poor quality of public service delivery by subnational governments.** International empirical studies show that the quality of service delivery at the subnational government level is enhanced by efficient and effective fiscal transfers with adequate monitoring.[9] In Indonesia as of 2017, 53% of total government spending was at the subnational government level, with 38% at the district level and 15% at the provincial level.[10] This compares favorably with 2000, when only 16% spending was at the subnational government level.[11] Despite this progress, the following weaknesses remain in the design, coordination, and monitoring of the different channels of fiscal transfers (from national to subnational): (i) the conditions for subsequent disbursement of the Specific Allocation Fund (DAK) are not linked to absorption and performance; (ii) the performance indicators of the Regional Incentive Fund (DID) are not clearly linked to the quality of public service delivery, particularly in education, health, and infrastructure; and (iii) the transfers of the General Allocation Fund (DAU) and Revenue-Sharing Fund are not linked to reporting requirements, and have in the past resulted in subnational governments having idle funds. Overall, improvements in all channels of fiscal transfers are required and more targeted expenditure is necessary to reduce regional disparities and inequality.

B. Policy Reform and ADB's Value Addition

13. **The government's reform agenda.** The government's medium-term strategy is to create sustainable and equitable economic growth through optimizing revenue, improving spending quality, improving subsidy schemes, and decentralizing fiscal authority. The reallocation of the energy subsidy has provided an opportunity for the government to increase public spending on education, health, social assistance programs, and infrastructure since the 2015 budget. This has helped reduce regional disparities and strengthen basic service delivery. On the revenue side, Indonesia seeks to increase its tax-to-GDP ratio from about 10.0% in 2016 to 11.5% in 2018, and to 12.7%–13.3% by 2021. To support this increase, the government launched the tax amnesty program in 2016 to widen the tax base. This along with other tax administrative reforms brought in $10.2 billion in additional revenues and the tax compliance rate went up from about 63% in 2016 to about 73% in 2017.

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[8] International Budget Partnership. Open Budget Survey. Indonesia. https://www.internationalbudget.org/open-budget-survey/results-by-country/country-info/?country=id, accessed 30 March 2018.

[9] IMF. 2015. *Fiscal Decentralization and the Efficiency of Public Service Delivery.* Washington, DC.

[10] Broadly, there are four types of fiscal transfers in Indonesia: from the: (i) General Allocation Fund (DAU) to support recurring spending; (ii) Specific Allocation Fund (DAK) for specific investment expenditures aligned with national priorities; (iii) Revenue-Sharing Fund, which covers natural resources; and (iv) Regional Incentive Fund (DID), which provides an incentive to subnational governments to improve their performance.

[11] World Bank. 2017. *Indonesia Economic Quarterly: Decentralization That Delivers.* December 2017. Jakarta.

14. **Policy reforms.** The program aligns medium-term expenditure with the RPJMN and SDGs targets, enhances national public expenditure system, and improves fiscal transfers and subnational governments' spending for service delivery. The effect of these reforms is to increase and improve the quality of targeted spending through a better public financial management (PFM) framework. At the inception of the programmatic approach, the government agreed to accomplish six expected prior actions (or triggers) and six policy milestones as a basis for subprogram 2.[12] During processing of subprogram 2, a new prior action on synchronizing planning and the budget process was added, as it is a necessary reform to align spending with the SDGs. Subprogram 2 now contains 13 reform actions (seven expected prior actions representing high-impact reforms, and six policy milestones), all of which have been accomplished.

15. **Medium-term expenditure aligned with National Medium-Term Development Plan and Sustainable Development Goal targets.** This reform area supports SDG 3 (good health), SDG 4 (quality education), and SDG 5 (gender equality) by increasing government funding of core services and mainstreaming gender. Reforms completed in subprogram 1 included mapping of the SDGs targets against targets in RPJMN 2015–2019 and piloting the non-cash social assistance program. Subprogram 2 builds upon these reforms with three key accomplishments. First, the government established the national coordination team for SDGs implementation chaired by the President of Indonesia. The team monitors and provides annual reporting on progress in achieving SDGs targets, including those related to gender.[13] This up-front commitment by the President was based on lessons learned during the implementation of the Millennium Development Goals (MDGs), where the President's involvement was limited to the last few years of its implementation. Second, the government synchronized national development priorities with budget preparation, execution, monitoring, and reporting under a unified results framework. This coordination requirement reflects the government's commitment to meet the SDGs and to have a national budget with a focus on pro-poor expenditure to reverse inequality. From 2016 to 2018, budget allocations have increased as follows: (i) education, from $30.2 billion to $32.0 billion; (ii) health, from $7.6 billion to $8.1 billion; (iii) social assistance, from $10.4 billion to $11.8 billion; and (iv) infrastructure, from $23.0 billion to $29.8 billion.[14]

16. Third, supplementing the increase in budget allocations, coverage of noncash social assistance programs (smart cards) to purchase food essentials was increased to 1.4 million households, higher than the original target of 1.2 million households. The conditional cash transfer (CCT) program, that provides allowances based on the condition that beneficiary families access basic health and education services, increased from 6 million to 10 million beneficiary families including approximately 125,000 pregnant women. A World Bank report estimated that the bottom 30% of the population receive over two-thirds of the benefits from this program, on par with other internationally recognized CCT programs such as in Brazil and in the Philippines.[15] The same report estimated that expanding the CCT program to 6 million households could reduce the poverty rate by about 0.8 percentage points. Third, to address the problem of delayed delivery of the noncash social assistance program (para 10), the government set up a monitoring team headed by the minister of the Coordinating Ministry for Human Development and Cultural Affairs.

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[12] Prior actions are considered loan disbursement conditions, and policy milestones strengthen the program. A comparison of the original and the revised subprogram 2 is in Summary Assessment of Policy Actions (accessible from the list of linked documents in Appendix 2).

[13] The National Development Planning Agency leads the national coordination secretariat for SDG implementation, and is also responsible for mainstreaming gender in national development plans.

[14] During the period of subprogram 2 (from September 2016 to March 2018), on an aggregate basis, there was a real increase of 7% in the budget allocation for education, health, social assistance, and infrastructure.

[15] World Bank. 2017. *Indonesia Social Assistance Public Expenditure Review Update: Towards a Comprehensive, Integrated, and Effective Social Assistance System in Indonesia.* Jakarta.

By the end of August 2017, more than 95% of targeted families had received assistance. The impact of these reforms (2015–2018) is demonstrated across key SDGs indicators. Maternal mortality rate has dropped by 14% from 2012 to 2017 and the percentage of deliveries in health care facilities increased from 77% in 2016 to 86% by 2017. In addition, better targeting and gradual expansion of social assistance programs helped reduce the Gini coefficient from 0.40 in 2015 to 0.39 in 2016 (footnote 6).

17. For subprogram 3, the government will develop regional SDGs action plan and adopt the National Strategy for Accelerating Gender Mainstreaming. The government will also pilot labor market activation programs for young women and men categorized as NEET.

18. **National public expenditure system enhanced.** This reform area contributes to implementation of SDG 9 (industry, innovation, and infrastructure). Specifically, the government improved the speed of disbursement of capital expenditure by providing greater control and flexibility over budgeting and procurement to line ministries. Reforms completed in subprogram 1 included implementation of online monitoring system for revenue and expenditure. There were two key accomplishments under subprogram 2. First, to improve budget transparency, the government published a detailed medium-term fiscal framework in the Macroeconomic and Fiscal Policy Framework. In addition, budget data was published in a dedicated portal, including a pre-budget statement, and disaggregated budget data was based on thematic areas, including climate change and gender-responsive budgeting. As a result, the International Budget Partnership concluded that the government made all key budget documents publicly available in a time frame that is consistent with international standards.[16]

19. Second, efforts continue to simplify budget execution to expedite budgeted expenditures, including advance procurement and usage of multi-year contracts. The Presidential Regulations on Procurement issued in March 2018 expanded the use of multi-year contracts. Line ministries will be able to use them for services that overlap fiscal years and for recurring services or infrastructure projects that can be shown to benefit from such an approach (even if the work is for less than 12 months). In addition, line ministries can better plan for advance procurement. The regulations allow line ministries to begin the tender process when the estimated budget is approved in June. This is a significant reform, as previously the tender process could only begin when the budget allocation was approved in November. This will expedite budgeted expenditures, which have traditionally been lopsided toward the last quarter of the year.

20. For subprogram 3, the government will improve budget efficiency by implementing an electronic budget request system. MOF will also issue implementing regulations to support the Presidential Regulations on Procurement to support use of multi-year contract.

21. **Fiscal transfers and subnational governments' spending for service delivery improved.** This reform area strengthened PEM systems at the subnational government level for public service delivery. The impact of these reforms cut across several SDGs at the subnational level, including SDGs 3, 4, 9, and 16 (accountable and inclusive institutions at all levels). Reforms completed in subprogram 1 included increased and better targeted fiscal transfers and implementation of government bond transfers to address idle funds at subnational government level.[17] Subprogram 2 builds upon these reforms with three key accomplishments. First, the government provided direct allocations through local transfers in 2016 for community health care

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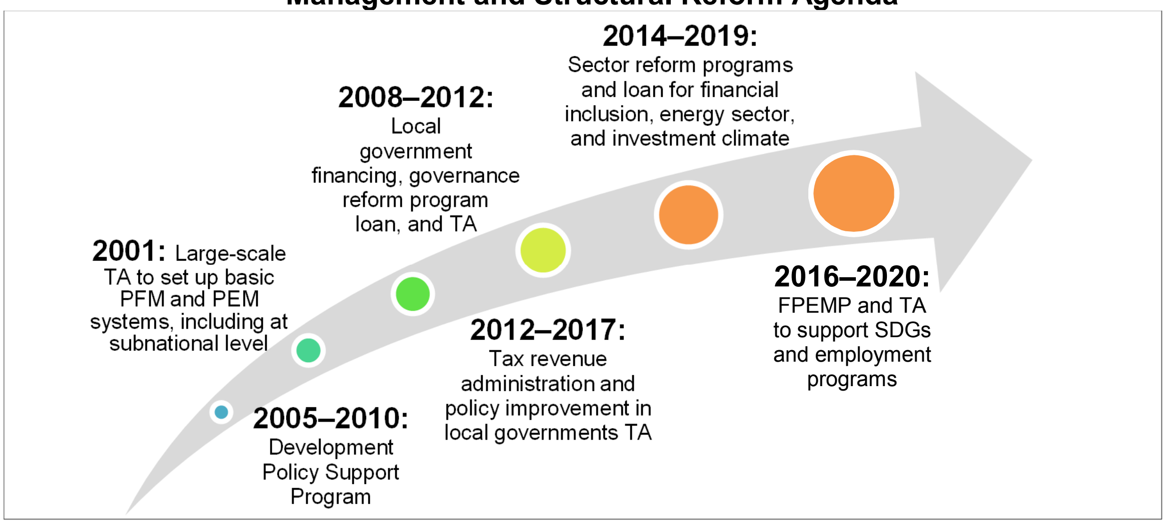
[16] International Budget Partnership. Open Budget Survey. Indonesia. https://www.internationalbudget.org/budget-work-by-country/findgroup/group-data/?country=id (accessed 30 March 2018).

[17] Subnational governments with low levels of budget execution are given bonds in lieu of cash disbursements.

and family planning, and more than doubled the allocations from Rp4.6 trillion in 2016 to Rp10.4 trillion in 2018. Second, the government introduced a new compliance mechanism to strengthen monitoring and evaluation of fiscal transfers. Disbursements will only be made after subnational governments provide full accounting of previous expenditures. As of 2017, all 2,500 spending units of local governments reported expenditure and accounting of the DAK and the Village Fund through the National Financial Management Information System (SPAN). Third, the Ministry of Finance (MOF) refined the governance performance indicators to improve the selection criteria for the DID by linking it to (i) fiscal management, (ii) the quality of public service delivery, and (iii) the human development index. The impact of these reforms is an improvement in accountability of subnational governments. This together with other structural reforms has the potential to reduce the cost for the government to raise capital necessary to meet SDGs targets.

22. For subprogram 3, the government will implement a prior action to improve the fiscal transfers to make them more predictable and to link the DID with SDGs-related indicators, including stunting and maternal mortality.

Figure 2: Asian Development Bank's Engagement in Public Expenditure Management and Structural Reform Agenda



FPEMP = Fiscal and Public Expenditure Management Program, PEM = public expenditure management, PFM = public financial management, SDGs = Sustainable Development Goals, TA = technical assistance.
Source: Asian Development Bank.

23. **ADB experience.** ADB has supported reforms in PEM and social protection through a sequential approach (Figure 2). In 2001, ADB provided TA to set up the PFM and PEM framework at the national and subnational levels. This was followed by support for the government to build a modern national PFM system, including a public debt management office in 2005. In the second phase (2008), ADB provided support to introduce financial management information systems within 147 local governments and to decentralize the tax framework.[18] Since 2012, ADB has provided TA to improve the fiscal sustainability of social security, strengthen the fiscal decentralization framework, and improve fiscal risk management of contingent liabilities arising from accelerated infrastructure investment.[19] ADB also provided support to the government for implementation of the MDGs, generating lessons that have been incorporated into output 1 of the

[18] ADB. 2016. *Completion Report: Second Local Government Finance and Governance Reform Program in Indonesia*. Manila.
[19] ADB. 2016. *Technical Assistance to the Republic of Indonesia for Strengthening Fiscal Risk Management of Accelerated Infrastructure Delivery*. Manila.

program to better support implementation of the SDGs (para. 24). Complementing the program, ADB also supports the government's efforts to improve its investment climate and improve access to finance. The reforms to expand use of advance procurement and multi-year contracts are complimentary to the reforms to improve the framework for private sector participation in infrastructure including to operationalize the joint Public-Private Partnership Office.[20]

24. **Lessons learned.** ADB's experience provided three key lessons that have been incorporated into the design of the program. First, through ADB's program supporting MDGs, ADB learned that meeting SDGs targets requires well-defined indicators, monitoring, and evaluation at the subnational government level, all supported by reliable data collection.[21] Second, responding to the challenges the government faced in meeting MDGs related to gender equality and maternal mortality, the implementation of the SDGs has been bolstered by the National Strategy for Accelerating Gender Mainstreaming, which incorporates gender targets into the implementation of SDGs. Third, social assistance programs have different impacts on inequality (footnote 6). These programs require close monitoring and refinement to fully benefit the intended recipients.

25. **ADB's value addition to program design and implementation.** ADB's long-term engagement and structured policy dialogue with the government helped the government to prioritize and sequence reforms to develop the SDGs framework and design policy actions to implement SDGs. ADB supported the design and evaluation of the CCT program during the pilot phase.[22] ADB also provided TA to support the introduction of SDGs by assisting the government undertake a fiscal gap analysis for social assistance programs.[23] In addition, ADB provided support through sector-specific TA to implement programs linked with SDGs targets covering the education, energy, and finance sectors. In the health sector, ADB's regional TA supported diagnostics on national health insurance to support the government achieve universal health care.[24] At the subnational level, ADB provided governance capacity development to 4 districts in East Java to deliver good-quality education and health services.[25] ADB's dialogue and assistance have strengthened the national PEM framework, fiscal transfers, and service delivery of subnational governments. By 2017, the proportion of targeted national and subnational spending increased by 10% to approximately Rp1,094 trillion from the 2015 baseline of Rp995 trillion, including a significant 26% increase for infrastructure. To achieve SDGs targets, ADB also introduced innovative labor market activation programs based on international practice and the experience gained from ADB's successful implementation of similar programs in the Philippines.[26]

26. **Development partner coordination.** The government leads development partner coordination in the areas of PFM and PEM. ADB consulted the International Monetary Fund (IMF) on fiscal projections. IMF's research and macroeconomic analysis informed the design of the program. The program also complements IMF's recommendations to link the national strategy to SDGs targets. The policy matrix was jointly developed with the German development cooperation through KfW. KfW and GIZ also provide TA, to support the government's diagnostic on SDGs

[20] ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loan to the Republic of Indonesia for the Stepping Up Investments for Growth Acceleration Program.* Manila.
[21] ADB. 2017. *Completion Report: Poverty Reduction and Millennium Development Goals Program in Indonesia.* Manila.
[22] ADB. 2009. *Technical Assistance to the Republic of Indonesia for Pro-Poor Planning and Budgeting.* Manila.
[23] ADB. 2017. *Technical Assistance for Strategies for Financing Social Protection to Achieve Sustainable Development Goals in Developing Member Countries.* Manila.
[24] ADB. 2015. *Technical Assistance for Universal Health Coverage for Inclusive Growth: Supporting the Implementation of the Operational Plan for Health, 2015–2020.* Manila.
[25] ADB. 2015. *Technical Assistance for Unlocking Innovation for Development.* Manila.
[26] ADB. 2015. *Technical Assistance to the Republic of the Philippines for Support for the Nationwide Rollout of JobStart Philippines*. Manila.

implementation and develop regional action plan. The World Bank supports the government's fiscal and revenue mobilization reform. ADB also coordinates with bilateral agencies of the governments of Australia, France, Japan, and the United States on PFM reforms.[27]

C. Impacts of the Reform

27. **Economic impacts of the program.** This program addresses Indonesia's needs for fiscal reform. It supports improvements in government planning and public investment, and it aligns national development with implementation of the SDGs. The program impact assessment estimates the net gains from these initiatives at $4.1 billion. A large proportion of the gross benefits arise through returns from investment in education ($3.8 billion) and via the mobilization of unutilized government assets in the form of land and buildings ($2.0 billion).[28] The total costs of reform for subprogram 2 is $1.9 billion, and they are generated by additional spending on education and social assistance, as well as by the costs of improved service delivery to the poor.[29]

D. Development Financing Needs and Budget Support

28. The government has requested a single tranche loan of $500 million from ADB's ordinary capital resources to help finance subprogram 2.[30] The loan will have a 15-year term, including a grace period of 3 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan agreement. The average loan maturity is 9.25 years, and there is no maturity premium payable to ADB. The German development cooperation through KfW is providing collaborative financing for subprogram 2. The loan size is based on Indonesia's financing needs, the development impact of the policy reform, and development spending from the reform (footnote 29). In 2018, the government's gross financing need is $58.4 billion, with a projected budget deficit of 2.2% of GDP. To finance the deficit, the government plans to raise $43.8 billion from the issuance of securities and $3.8 billion from official foreign loans.

E. Implementation Arrangements

29. The MOF's Fiscal Policy Agency as the executing agency is responsible for coordinating program-related reforms. Implementing agencies include the directorates general of budget, treasury, and fiscal balance. The national SDGs committee monitors SDGs implementation and progress reports. The implementation period is from September 2016 to March 2018 for subprogram 2 and from April 2018 to December 2019 for subprogram 3. The proceeds of the PBL will be withdrawn in accordance with ADB's Loan Disbursement Handbook (2017, as amended from time to time).

III. DUE DILIGENCE

30. **Safeguards.** Following evaluation of the policy actions, the subprogram will not have any likely environmental, involuntary resettlement, and indigenous peoples' impacts. The subprogram is classified category C for environment, involuntary resettlement, and indigenous peoples.

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[27] Development Coordination (accessible from the list of linked documents in Appendix 2).
[28] Formal analysis of the Indonesian education system broadly suggests that a 20% increase in income, or uplift factor, applied to the minimum wage of $3,110 for the 550,000 students who are assumed to enroll delivers a present value of $3.8 billion.
[29] Program Impact Assessment (accessible from the list of linked documents in Appendix 2).
[30] The loan may be disbursed in one or more installments.

31. **Poverty and social.** Subprogram 2 is categorized as effective gender mainstreaming. Increased expenditure in education, health, and infrastructure, as well as better-targeted social assistance, will reduce poverty and help the bottom 40% of the population, including pregnant women, the elderly, and people with disabilities, to have access to basic services. The government developed the National Strategy for Accelerating Gender Mainstreaming. The government also provided direct allocations for community health care and family planning through local transfers, with allocations more than doubling in 2018 compared to 2017.

32. **Governance.** The government has made considerable progress in improving the legal and regulatory framework for PFM. Since the enactment of laws on state finance, state treasury, and state audit in 2003–2004, regulations underpinning these laws have been promulgated. Governance has also improved, with 70% of subnational governments receiving an unqualified opinion for their financial reports. ADB has reinforced this momentum with continuing support to improve state audit capacity. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the MOF's Fiscal Policy Agency.

33. **Risks and mitigating measures.** Major risks and mitigating measures are described in the risk assessment and risk management plan.[31] The expected net benefits and impacts of the program are expected to outweigh the risks. Inadequate capacity, especially at the subnational government level, is a high risk that may slow the implementation of the SDGs. ADB is providing TA to improve capacity for SDGs implementation in health and education (footnotes 24–25).

IV. ASSURANCES

34. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan agreement. No disbursement shall be made unless ADB is satisfied that the government has completed the policy actions specified in the policy matrix relating to the program.

V. RECOMMENDATION

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

(i) the loan of $500,000,000 to the Republic of Indonesia for subprogram 2 of the Fiscal and Public Expenditure Management Program, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board; and

(ii) the inclusion of an additional subprogram 3 in the programmatic approach for the Fiscal and Public Expenditure Management Program, as described in para. 4.

Takehiko Nakao
President

18 May 2018

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

DESIGN AND MONITORING FRAMEWORK

Country's Overarching Development Objective
Household income inequality reduced (National Medium-Term Development Plan, 2015–2019)[a]

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Effect of the Reform Social sector and infrastructure spending improved	By 2021: a. Aggregate expenditure outturn compared with originally approved budget improved by one grade (2012 baseline: PEFA report rating of *C*) b. Composition of expenditure outturn compared with originally approved budget improved by one grade (2012 baseline: PEFA report rating of *D*) c. Extent of central government monitoring of subnational governments improved by one grade (2012 baseline: PEFA report rating of *C*) d. Proportion of targeted national and subnational spending increased (2015 baseline: Rp995.5 trillion)	a–c. PEFA report (every 3–4 years) d. Government statistics and official budget data (annually)	Continuous market turmoil and low commodity prices affect budget revenue
Reform Areas under Subprogram 2 1. Medium-term expenditure aligned with RPJMN and SDGs targets	**Key Policy Actions** 1a. National SDGs coordination team chaired by President set up (2016 baseline: No coordination team) 1b. National Strategy for Accelerating Gender Mainstreaming developed (2016 baseline: No strategy) 1c. Smart card social assistance program expanded to 1.4 million households and conditional cash transfer social assistance program (including for	1a. Indonesia's voluntary report to the United Nations and report from the Ministry of Women's Empowerment and Child Protection (both annually) 1b. Report of the Ministry of Women Empower and Child Protection 1c. Report of the vice president's office (annually)	Lower budget revenue results in lower spending on infrastructure and critical social sectors

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	pregnant mothers) expanded to 10 million families (2016 baseline: Smart card piloted and conditional cash transfer covered 3.5 million families) 1d. Budget allocation for education, health, social assistance, and infrastructure increased by aggregate of 7% (2016 baseline: Allocation for education Rp416.6 trillion, allocation for infrastructure Rp317.1 trillion, allocation for health Rp104.1 trillion, allocation for social assistance Rp150.8 trillion)	 1d. Budget data (annually)	
2. National public expenditure system enhanced	2a. Budget data published in a dedicated portal and budget tagging disaggregated to include climate change and gender-responsive budgeting (2016 baseline: Budget data not fully published and tagging did not include gender-responsive budgeting) 2b. Budget realization expedited by allowing line ministries to engage procurement agents and allow tender process to begin when estimated budget is approved in June (2016 baseline: Procurement agents not allowed and tender process only begins when budget is approved in November) 2c. Online monitoring SPAN expanded to cover DAK and Village Fund at subnational level (2016	2a. Report of Fiscal Policy Agency (annually) 2b. Report of government which shows usage (BAPPENAS and Ministry of Finance) (annually) 2c. Directorate General of Fiscal Balance report (annually)	

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	baseline: Basic online monitoring SPAN implemented)		
3.Fiscal transfers and subnational governments' spending for service delivery improved	3a. Report-based compliance mechanism for DAK implemented (2016 baseline: DAK implementation not based on reporting compliance) 3b. Increased allocations for community health care and family planning to Rp10.4 trillion (2016 baseline: Rp4.6 trillion) 3c. SDGs-aligned local government performance indicators for recipients of DID in use (2016 baseline: Indicators not aligned to SDGs)	3a. Report of Directorate General of Fiscal Balance (annually) 3b. Budget report (annually) 3c. Directorate General of Fiscal Balance report (annually)	Weak capacity of local governments in public financial management and public procurement
Budget Support Asian Development Bank: Subprogram 2: $500,000,000 (loan)			
Assumptions for Partner Financing German development cooperation through KfW: €200,000,000 or its equivalent in United States dollars (indicative)			

[a] Government of Indonesia, BAPPENAS. National Development Planning Agency. 2015. National Medium-Term Development Plan: RPJMN, 2015–2019. Jakarta.

BAPPENAS = Badan Perencanaan Pembangunan Nasional (National Development Planning Agency), DAK = Dana Alokasi Khusus (Specific Allocation Fund), DID = Dana Insentif Daerah (Regional Incentive Fund), PEFA = Public Expenditure Financial Accountability, RPJMN = Rencana Pembangunan Jangka Menengah Nasional (Medium-Term Development Plan), SDGs = Sustainable Development Goals, SPAN = Sistem Perbendaharaan dan Anggaran Negara (National Financial Management Information System).

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=50168-002-3

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

Supplementary Documents

11. Public Financial Management Assessment
12. Program Impact Assessment
13. Summary Assessment of Policy Actions under Subprogram 2

DEVELOPMENT POLICY LETTER

MINISTER OF FINANCE
OF THE REPUBLIC OF INDONESIA

DEVELOPMENT POLICY LETTER

No.: S-295/MK.08/2018 Jakarta,30 April 2018

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

Subject: Fiscal and Public Expenditure Management Program - Subprogram 2

Dear Mr. President;

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

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

Indonesia has achieved significant progress in reducing poverty from 24 percent in 1999 to 10.9 percent in 2016. Along with this progress, Indonesia has addressed inequality as the Gini index moderated at 0.391 in September 2017 compared to 0.408 in March 2015. The Gini index has continued to decline slightly and slowly due to fuel subsidy reform, the implementation of national health insurance, and strengthening social assistance programs to reduce inequality. The government realizes the importance of addressing inequality to promote inclusive economic growth. In this regard, the government is committed to protect its medium-term expenditure in critical social sectors and infrastructure in line with the targets of RPJMN and SDGs. In achieving this, it recognizes the significance of public expenditure management (PEM) reforms at the national and SNGs levels. To this end, we appreciate ADB continuous support through the Fiscal and Public Expenditure Management Program (FPEMP) to continue related structural reforms to reverse widening inequality and to strengthen growth momentum in the medium term.

In the attached policy matrix, we have identified key reforms and development programs under the RPJMN, which we propose to be continuedly supported by FPEMP, Subprogram 2 loan, building on the good progress of the Subprogram 1. Thus, we would like to request financial assistance from ADB through FPEMP, Subprogram 2 to continue support the reform we have initiated. This loan amounting to $500,000,000 will allow the government to sustain our momentum in implementing our reform program. The Program is expected to include co-financing with an estimated amount of Euro 200,000,000 from the German Development Bank (KfW).

The loan proceeds from Subprogram 2 of FPEMP will be used to support the program related development spending in the 2018 and 2019 national government budget. This includes implementation of the legislated 5% budget allocation for health, increased spending to increase the number of subsidized beneficiaries of the national health insurance, increased spending for education, health, social protection programs and public infrastructure investments and execution of the new integrated planning and budgeting platform. We trust the loan will be approved as soon as possible.

The National Medium-Term Development Plan (2015-2019)

Indonesia experienced a robust economic growth averaged 6.2 percent during 2010-2013. Due to the commodities downturn, the GDP growth however declined to 4.8 percent in 2015, the lowest since the global financial crisis in 2008, and rebounded slightly to 5.0-5.2 percent in the past few years. The decline in commodity prices and the slowdown in economic growth consequently resulted in significant decrease in fiscal revenues in 2015. Simultaneously, the increasing income inequality and slowdown in the pace of poverty reduction have posed significant challenges for Indonesia's development. In this context, strengthening our focus on income inequality reduction as one of the main priorities, we are implementing our new National Medium-Term Development Plan 2015-2019. In the 2017 budget, we are therefore committed to improve quantity and quality of public spending on social sectors and infrastructure. However, the projected fiscal revenues of Rp 1,822.5 trillion and modest economic growth rate of 5.3 percent in the revised budget 2017 are insufficient to respond the current situation. Hence, we expect an optimal fiscal deficit and manageable financing gap this year. To create the fiscal space for increased spending on critical social sectors and infrastructure while adhering to the constitutional limit of 3.0 percent budget deficit of GDP, Indonesia's public expenditure management has to be improved.

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

Medium Term Expenditure aligned with RPJMN and SDGs Targets

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

Under the FPEMP, the government adopted strategic policies to align budget planning with RPJMN and SDGs, and increased expenditure and improve targeting in critical social sectors and public infrastructure investments. In this regard, to promote pro-growth and pro-poor central government budgeting, the government adopted a unified results framework to guide the synchronization of national development priorities with budget preparation, execution, monitoring and reporting. To enhance the alignment of SDGs and RPJMN, the government issued Presidential regulations to establish the national coordination team chaired by President to implement SDGs, monitor progress, and provide annual reporting on achievement of targets. The SDGs are implemented through the enhanced social assistance program coordinated by the control team headed by the Minister of Coordinating Ministry of Human and Cultural Development, with expanded coverage of the non-cash social assistance programs (smart-card) to 1.4 million households and conditional cash transfer program to 10 million families (from 3.5 million) and added flexibility in the frequency of accessing assistance based on beneficiary needs. The SDGs are implemented with increased budget allocation in real terms in education, health, social protection and public infrastructure by 7% from 2016 to 2018, including funding to support mandatory primary education for 12 years. In terms of spending, compared to 2016 budget, in 2018, the government increased expenditure for education from Rp 370 trillion to Rp 422 trillion, health programs from Rp 92 trillion to Rp 111 trillion, social protection programs from Rp 151 trillion to Rp 162 trillion, and public infrastructure investment from Rp 269 trillion to Rp 411 trillion. In addition to budget allocation, MOF also enhanced the multi-year budgeting approval process to provide line ministries greater authority to plan their public investment program through (i) providing guidance on the approval and endorsement process, ii) simplifying the process and structure of account codes in relation to government aid, and (iii) streamlining of reporting.

National Public Expenditure System Enhanced

Indonesia has consistently progressed in strengthening its public expenditure management systems over the years. The government further sought to improve public expenditure management reform oversight under the 2012 Medium Term Strategy Note (MTSN). Hence, under the FPEMP, we will continue to advance our reforms related to national public expenditure management system through adopting best practices in budget preparation, and strengthening budget execution and cash management. The government enhanced the multi-year budgeting approval process to provide line ministries greater authority to plan their public investment program by (i) providing guidance on the approval and endorsement process and (ii) issuing a new Presidential regulation allowing the use of multi-year contract for projects and service contract that would benefit from using multiyear contract. In enhancing the budget system to account for fiscal risk and adopting performance based budgeting, the government set up the asset registry within MOF, and expanded the operations of the State Asset Management Agency by issuing the organizational framework and standard operating procedures for the management of $2.8 billion of idle assets, which would enable the assessment of all government assets and planning maintenance expenditure accordingly.

Furthermore, in order to provide more autonomy and control to the line ministries, the MOF implemented Government Finance Statistics (GFS) standard in national budget through Budget Law and Presidential Regulation. It also promoted transparency in budget process by i) publishing medium-term fiscal framework in the Macroeconomic and Fiscal Policy Framework including background analysis, forward challenges, and reforms to strengthen budget functions ii) publishing budget data in a dedicated portal and iii) further disaggregation of budget tagging into thematic areas including climate change and gender responsive budgeting. Subsequently, MOF and BAPPENAS jointly developed and implemented a new system (KRISNA) which integrates planning, budgeting, execution and performance monitoring of public expenditures and implemented the system for the 2018 budget.

In the area of budget execution and cash management, to address the inefficiencies, the government institutionalized a framework along with a real-time monitoring system. This was established in response to addressing slow budget execution at central and SNGs levels. Moreover, the MOF implemented online monitoring of Financial Management Information System (SPAN), and expanded the use of OM SPAN to cover DAK and Village Fund through a phased roll out of accounting modules (SAKTI) to 322 spending units and piloting of automated payments (e-SPM). This would further strengthen budget management through monitoring its realization on real time basis.

Fiscal Transfers and Subnational Governments' Spending For Service Delivery Improved

Improving public expenditure management systems at the SNG level is anchored through the Blueprint for Institutional Transformation of Directorate General Fiscal Balance. To this effort, the government will focus on improving inter-government transfer to support better public service delivery at the SNG level. To provide direct funding to SNGs for the implementation of national priority projects, the MOF expanded the scope and allocation of the specific allocation fund (DAK). MOF enhanced its fiscal transfers to improve service delivery and increase infrastructure spending by (i) requiring 25% of DAU and regional sharing fund be allocated for local infrastructure, (ii) increasing allocations for community health care and family planning from Rp. 4.6 trillion in 2016 to Rp. 10.4 trillion in 2018, and (iii) improving monitoring and evaluation of the specific allocation grant by requiring reporting of output achievements for subsequent disbursements.

Furthermore, the government improved the regional incentive fund (DID) with the aim of enhancing service delivery performance by providing DID flexibility as block grants (rather than earmarked) to respond to local governments' SNGs needs, refined local government performance indicators to improve the selection criteria for recipients of DID covering i) fiscal health and financial management, ii) public service delivery (education, health and infrastructure) iii) social welfare (economic growth, Human Development Index, and poverty ratio) and iv) required unqualified opinion for financial reports. The government refined local government performance indicators to improve the selection criteria for recipients of DID by covering (i) fiscal health and financial management, (ii) public service delivery (education, health and infrastructure), (iii) social welfare (Human Development Index).

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

Conclusion

The government remains firmly committed to the agenda outlined above and to implement reform efforts already instituted. We would appreciate your prompt consideration of this loan. We look forward to working together on the Subprogram 2 of FPEMP, and to continue our partnership with ADB to meet the development objectives of Indonesia.

Minister of Finance Republic of Indonesia

Sri Mulyani Indrawati

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

POLICY MATRIX

Outputs	Subprogram 2 September 2016 – March 2018 (Prior Action are in bold)	Subprogram 3 April 2018 – December 2019 (Prior Action are in bold)	Medium-Term Framework (2020)
Output 1: Medium Term Expenditure Aligned with RPJMN and SDGs Targets			
1.1 The government adopted strategic policies to align budget planning with RPJMN and SDGs targets ADB TA 9341: Strategies for Financing Social Protection to Achieve Sustainable Development Goals in Developing Member Countries.	*The government implements budget plans to achieve RPJMN and SDGs targets.* 1. The government implemented SDGs strategy by (i) approving Presidential regulations which established national coordination team chaired by President to monitor progress and provide annual reporting on achievement of targets (including gender related targets) and (ii) developing a National Strategy for Accelerating Gender Mainstreaming.	1. The government develops financing strategy, regional action plans and adopts National Strategy for Accelerating Gender Mainstreaming for SDGs implementation.	The government makes substantial progress achieving RPJMN targets on health, education and social protection: (i) Universal health coverage achieved (in line with relevant targets in SDG 1 and SDG 3). (ii) Substantial reduction in maternal mortality rate to from 306 per 100,000 lives to move towards the SDG indicator target of less than 70 per 100,000 lives by 2030 (in line with relevant targets in SDG 3). (iii) Increased and equitable access to quality education for both girls and boys (in line with SDG 4).
	2. The government synchronized national development priorities with budget preparation, execution, monitoring and reporting under a unified results framework.	**2. The government issues standard operating procedure and builds capacity for implementation of the government regulations synchronizing planning of national development priorities and budget cycle.**	The government integrates gender responsive budgeting in implementation of Presidential regulations 17.

Outputs	Subprogram 2 September 2016 – March 2018 (Prior Action are in bold)	Subprogram 3 April 2018 – December 2019 (Prior Action are in bold)	Medium-Term Framework (2020)
1.2 The government increased expenditures and improved targeting in critical social sectors and infrastructure ADB TA 4762: Pro-Poor Planning and Budgeting.	**3. The government enhanced its social assistance program by:** **(i) expanding the coverage of the non-cash social assistance programs (smart-card) to 1.4 million households and conditional cash transfer program from 3.5 million to 10 million families (including pregnant mothers);** **(ii) establishing a monitoring team headed by the Minister of Coordinating Ministry of Human and Cultural Development; and** **(iii) providing flexibility in the frequency of accessing assistance based on beneficiary needs.**	**3. The government increase the number of social assistance programs into the smart card and expand coverage to 10 million households.**	
		4. The government pilots labor market activation programs to address unemployment amongst youth and upgrade skills of existing employees (32.2% of female and 18.9% of male between the age of 15-24 are categorized as not in education, employment or training).	Reduction of overall youth unemployment especially amongst women (in line with SDG 8).
	The government continues to allocate spending to critical sectors.	5. The government continues to provide budget allocation that represents real increases in	

Outputs	Subprogram 2 September 2016 – March 2018 (Prior Action are in bold)	Subprogram 3 April 2018 – December 2019 (Prior Action are in bold)	Medium-Term Framework (2020)
ADB Regional TA 8983: Universal Health Coverage for Inclusive Growth: Supporting the Implementation of the Operational Plan for Health, 2015–2020. ADB TA 9109: Strengthening Fiscal Risk Management of Accelerated Infrastructure Delivery.	4. The government increased budget allocation in real terms in education, health, social assistance and public infrastructure by 7% from 2016 to 2018, including funding to support mandatory primary education for 12 years.	education, health, social assistance and public infrastructure.	
Output 2: National public expenditure system enhanced			
2.1 The government adopted best practices in budget preparation	**5. The government enhanced the multi- year budgeting approval process to provide line ministries greater authority to plan their public investment program by (i) providing guidance on the approval and endorsement process and (ii) issuing a Presidential regulation allowing the use of multi-year contract for projects and service contract that would benefit from using multi-year contract.**	6. The government develops operational guidelines to implement Presidential regulation on procurement.	Improvement in aggregate expenditure out-turn compared to original approved budget (PEFA Report/Open Budget Index).
	6. The government expanded the operations of the State Asset		

Outputs	Subprogram 2 September 2016 – March 2018 (Prior Action are in bold)	Subprogram 3 April 2018 – December 2019 (Prior Action are in bold)	Medium-Term Framework (2020)
	Management Agency by issuing the organizational framework and standard operating procedures for the management of $2.8 billion of idle assets.		
	7. The government promoted transparency in budget process by (i) publishing medium-term fiscal framework in the Macroeconomic and Fiscal Policy Framework including background analysis, forward challenges, and reforms to strengthen budget functions (ii) publishing budget data in a dedicated portal and (iii) disaggregating budget tagging into thematic areas including climate change and gender responsive budgeting.	**7. The government issues standard operating procedures (Juklak) on KEM-PPKF drafting and documentation to improve business process and accountability on drafting and documentation.**	Gender responsive budgeting tagging implemented by ministries/institutions in their workplans and budget plans.
	8. MOF and BAPPENAS jointly developed and implemented a new system (KRISNA) which integrates planning, budgeting, execution and performance monitoring of public expenditures and implemented the system for the 2018 budget.	**8. The government will utilize KRISNA to review budget allocation for the purpose of aligning budget process with national priorities including gender mainstreaming.**	
2.2 The government strengthened budget execution and	*The government improves budget disbursements on timely basis.* **9. The government expedited budget realization by**	9. MOF will implement electronic budget request	

Outputs	Subprogram 2 September 2016 – March 2018 (Prior Action are in bold)	Subprogram 3 April 2018 – December 2019 (Prior Action are in bold)	Medium-Term Framework (2020)
cash management	**(i) implementing automated payment (e-payment) and roll out of accounting modules (SAKTI) to 322 spending units, (ii) issuing a Presidential regulation which allow line ministries to engage procurement agents and which allow tender process to begin when estimated budget is approved.**	system to enable spending units in line ministries to make budget request electronically through e-SPM.	Efficient and transparent budget execution at national level (in line with relevant target in SDG 16).
	10. MOF expanded the use of OM SPAN to cover DAK and Village Fund to strengthen accountability at subnational government level.	10. The government will reformulate the base for allocation and enhance targeting of the village fund including performance-based disbursement for better service delivery at the district level.	
Output 3: Fiscal transfers and subnational governments' spending for service delivery improved			
ADB TA 9017: Unlocking Innovation for Development.	*The government implements reforms to inter-government transfer mechanisms.* **11. MOF enhanced its fiscal transfers to improve service delivery and increase infrastructure spending by (i) requiring 25% of DAU and regional sharing fund be allocated for local infrastructure,**	**11. The government will improve the specific allocation grant (DAK) governances through:** **(i) Synchronizing funded activities across sectors and line ministries to avoid overlapping end results;**	Better public service delivery at local government level through increased and improved DAK and DID allocation as well as effective monitoring of budget execution (in line with relevant targets in SDG 1, SDG 3, SDG 4 and SDG 5).

Outputs	Subprogram 2 September 2016 – March 2018 (Prior Action are in bold)	Subprogram 3 April 2018 – December 2019 (Prior Action are in bold)	Medium-Term Framework (2020)
	(ii) increasing allocations for community health care and family planning from Rp. 4.6 trillion in 2016 to Rp. 10.4 trillion in 2018, and (iii) improving monitoring and evaluation of the specific allocation grant by requiring reporting of output achievements for subsequent disbursements.	**(ii) performance-based disbursement (achieving targets and physical outputs).**	
	12. The government refined local government performance indicators to improve the selection criteria for recipients of DID by covering (i) fiscal health and financial management, (ii) public service delivery (education, health and infrastructure), (iii) social welfare (Human Development Index).	12. The government will link DID allocation with SDGs target including stunting and maternal mortality.	Improvement in extent of central government monitoring of subnational governments' expenditure (PEFA Report/Open Budget Index).
	13. The government addressed idle funds by postponing subsequent disbursement of the general allocation fund and the revenue sharing fund subject to timely submission of monthly reports.	13. The government will enhance cash management of subnational government through capacity building programs to reduce idle fund.	