ADB

Report and Recommendation of the President to the Board of Directors

Project Number: 46093
November 2013

Proposed Policy-Based Loan for Subprogram 2 Republic of Indonesia: Inclusive Growth through Improved Connectivity Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 15 October 2013)

Currency unit	–	rupiah (Rp)
Rp1.00	=	$0.0001
$1.00	=	Rp11,316

ABBREVIATIONS

ADB	–	Asian Development Bank
BAPPENAS	–	Badan Perencanaan dan Pembangunan Nasional (National Development Planning Agency)
CMEA	–	Coordinating Ministry for Economic Affairs
ICT	–	information and communication technology
INSW	–	Indonesia National Single Window
KKPPI	–	Komite Kebijakan Percepatan Penyediaan Infrastruktur (Policy Committee for Acceleration of Infrastructure Delivery)
MOF	–	Ministry of Finance
MP3EI	–	Masterplan Percepatan dan Perluasan Pembangunan Ekonomi Indonesia (Master Plan for Acceleration and Expansion of Indonesia's Economic Development)
PPP	–	public–private partnership
VGF	–	viability gap fund

NOTES

(i) The fiscal year (FY) of the Government of Indonesia and its agencies ends on 31 December.

(ii) In this report, "$" refers to US dollars.

Vice-President	S. Groff, Operations 2
Director General	J. A. Nugent, Southeast Asia Department (SERD)
Officer-in-Charge and Team leader	E. Ginting, Deputy Country Director, Indonesia Resident Mission (IRM), SERD
Team members	P. Aji, Senior Economics Officer, IRM, SERD A. Gill, Senior Country Specialist, IRM, SERD B. Hutagalung, Programs Officer, IRM, SERD K. Leung, Finance Specialist, SERD C. Roos, Operations Assistant, IRM, SERD K. Sasradipoera, Regional Cooperation Specialist, SERD S. Zaidansyah, Senior Counsel, Office of the General Counsel
Peer reviewer	A. Veron-Okamoto, Transport Economist, East Asia Department

CONTENTS

PROJECT AT A GLANCE

1. Project Name: Inclusive Growth through Improved Connectivity, Subprogram 2 **2. Project Number:** 46093-004

3. Country: Indonesia **4. Department/Division:** Southeast Asia Department/Indonesia Resident Mission

5. Sector Classification:

Sectors	Primary	Subsectors
Transport, and information and communication technology	√	Transport management and policies

6. Thematic Classification:

Themes	Primary	Subthemes
Economic growth	√	Widening access to markets and economic opportunities
Private sector development		Promotion of private sector investment
Regional cooperation and integration		Trade and investments

6a. Climate Change Impact

No Climate Change Indicator available.

6b. Gender Mainstreaming

Gender equity theme (GEN)	
Effective gender mainstreaming (EGM)	
Some gender elements (SGE)	
No gender elements (NGE)	√

7. Targeting Classification:

General Intervention	Targeted Intervention		
	Geographic dimensions of inclusive growth	Millennium development goals	Income poverty at household level
√			

8. Location Impact:

National	High
Regional	Medium
Urban	Medium

9. Project Risk Categorization: Complex

10. Safeguards Categorization:

Environment	C
Involuntary resettlement	C
Indigenous peoples	C

11. ADB Financing:

Sovereign/ Nonsovereign	Modality	Source	Amount ($ Million)
Sovereign	Program loan	Ordinary capital resources	400.0
Total			400.0

12. Cofinancing:

Financier	Category	Amount ($ Million)	Administration Type
Japan International Cooperation Agency	Official-Loan	200.0	Not ADB Administered
World Bank	Official-Loan	300.0	Not ADB Administered
Agence Française de Développement	Official-Loan	100.0	Not ADB Administered
Total		600.0	

13. Counterpart Financing:

No Counterpart Financing available.

14. Aid Effectiveness:

Parallel project implementation unit	No
Program-based approach	Yes

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan to the Republic of Indonesia for subprogram 2 of the Inclusive Growth through Improved Connectivity Program.[1]

2. Indonesia has recorded strong economic growth, averaging around 6% since 2007. Despite this achievement, several studies suggest that the economic growth is still below the country's potential. Indonesia also made significant strides in reducing poverty as its incidence declined from 16.6% in 2007 to 12% in 2012. At the same time, despite the declining poverty incidence, the country experienced a steady rise in inequality as shown by an increasing Gini coefficient. The government's Master Plan for Acceleration and Expansion of Indonesia's Economic Development, 2011–2025 (MP3EI) aims to achieve higher and more inclusive economic growth based on a three-pillar strategy: (i) spreading economic development across the country through development of six economic corridors, (ii) improving domestic and international connectivity, and (iii) enhancing technology and human resources. The MP3EI includes regulatory reforms as an integral initial step in accelerating economic development that ADB could appropriately support through a policy-based loan. The proposed subprogram 2 will support the continuation of reforms achieved under the first subprogram on the second strategic pillar of the MP3EI.[2] The government has implemented further reforms aimed at improving the policy, regulatory, financial, institutional, and business climate frameworks for connectivity and infrastructure development. A stronger enabling environment for domestic and international connectivity will in turn enable more infrastructure investments by the public and private sectors to support sustainable, higher, and more inclusive economic growth. Now, as economic growth has started to slow down, there is increased urgency to advance implementation of these reforms to accelerate connectivity improvement and infrastructure development in general.

II. THE PROGRAM

A. Rationale

3. **Indonesia's economic growth performance and infrastructure.** After reaching 6.5% in 2011 (the highest since the Asian crisis 1997–1998), economic growth declined to 6.2% in 2012 following the recession in the eurozone and lower growth in Indonesia's other key trading partners. Economic growth weakened further in the first quarter of 2013 due to slower than expected recovery of demand for the country's exports. Given the slow recovery in the global economy, the government now recognizes the need to accelerate infrastructure-related reforms and investments to remove the obstacles that keep the country from reaching its growth potential.[3] An Asian Development Bank (ADB) study highlights inadequacies in infrastructure as a critical constraint on economic growth.[4] After increasing its infrastructure spending, and implementing reforms to support infrastructure development, Indonesia's global competitiveness index ranking rose by 12 places to 38 in the 2013 Global Competitiveness Index.[5] However, significant challenges remain. Although Indonesia's ranking on infrastructure has moved up by

[1] The design and monitoring framework is in Appendix 1.

[2] ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach, Policy-Based Loan for Subprogram 1, and Technical Assistance Grant to the Republic of Indonesia for Inclusive Growth through Improved Connectivity Program.* Manila.

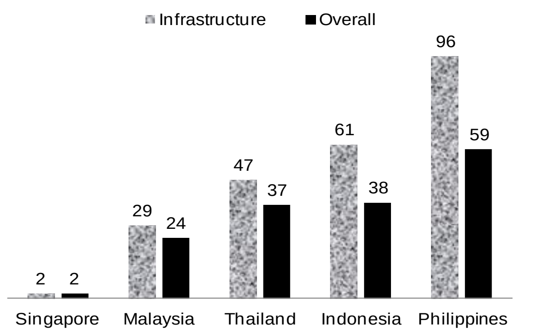
[3] For 2014–2016, the International Monetary Fund (IMF) had estimated a baseline potential growth rate of 7.1%, which would increase to 7.9% if infrastructure development and economic reforms were accelerated.

[4] H. Hill, M. E. Khan, and J. Zhuong, eds. 2012. *Diagnosing the Indonesian Economy: Toward Inclusive and Green Growth.* London: Asian Development Bank / Anthem Press.

[5] World Economic Forum. 2013. *Global Competitiveness Report, 2013–2014.* Geneva.

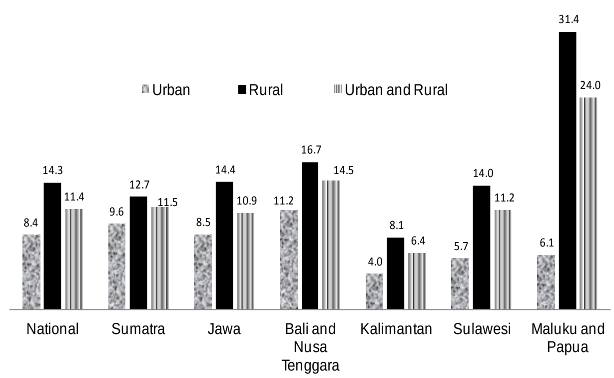
17 places to 61, it is still much lower than the country's overall ranking of 38 out of 148 countries (Figure 1). The impact of lagging infrastructure still appears in a number of forms. Deteriorating roads in the provinces and districts increase domestic transport and logistics costs. Congested ports and underdeveloped interisland transport have led to high domestic shipping costs. Congested and underdeveloped international ports also limit a deeper integration of Indonesia's manufacturing sector into international production networks.

Figure 1: Global Competitiveness Index Ranking for Connectivity Infrastructure, 2013–2014
(out of 148 countries)



Source: World Economic Forum. 2013. *Global Competitiveness Report, 2013–2014*

Figure 2: Poverty Incidence by Location, March 2013
(% of population)



Source: Statistics Indonesia (BPS) website (accessed 3 July 2013)

4. **Poverty reduction and inequality.** Despite slightly declining growth in 2012, the unemployment rate declined from 6.3% in February 2012 to 5.9% in February 2013. The quality of employment also improved further thanks to a greater size of the economy's productive sector, illustrated by 3.5 million more jobs in the formal sector and 2.3 million fewer jobs in the informal sector. This helped reduce the poverty rate to 11.4% in March 2013, from 12.0% in March 2012. However, formidable efforts are needed to reduce the poverty incidence further. The share of the country's labor force employed in the informal sector, where wages and job security are low, is still high at 60.0%. While the overall poverty rate has trended downward, achievement varies across the country as economic development is still centered in western Indonesia and in urban areas. The national rural poverty rate of 14.3% is much higher than the national urban poverty rate of 8.4%. Poverty rates in some provinces in eastern Indonesia are much higher than elsewhere in the country—e.g., 24.0% in Maluku and Papua (Figure 2). At the same time, inequality was rising steadily until 2012, with the Gini coefficient reaching 0.41.

5. **Inclusive growth through better developed connectivity.** Alleviating the country's multidimensional poverty will require not only accelerated economic growth but also a more inclusive growth process that provides rural areas and disadvantaged regions with greater economic opportunity and access to social services. Improving and developing the country's connectivity is key to reducing the poverty incidence. First, improving intraisland connectivity between rural areas with regional growth poles will reduce rural poverty through lower transport costs and widen access to markets and services. Second, improving connectivity between the poorer eastern parts of Indonesia with markets in western areas through more efficient interisland transport systems will help reduce development gaps and poverty through increased domestic trade and larger economic opportunities in the eastern provinces. Finally, improving international connectivity to boost the competitiveness of the country's tradable sector will help generate more productive jobs in the formal sector. Combined, these connectivity efforts are

expected to have a key role in increasing access to and delivery of services, thereby enhancing economic productivity and social well-being, and reducing the overall poverty incidence.

6. **Convergence of government national strategies and ADB strategy.** The government recognizes that lagging infrastructure, underdeveloped intraisland and interisland connectivity, weak international connectivity, and inefficient logistics constrain achievement of its medium- and long-term targets of higher growth and faster poverty reduction. The policy to reduce fuel subsidies introduced in June 2013 will provide significant fiscal space to support larger infrastructure spending in 2014 and beyond. Strategically, the government's National Medium-Term Development Plan, 2010–2014 provides direction for the two pillars of ADB's Indonesia country partnership strategy, 2012–2014: inclusive growth and environmental sustainability.[6] Reforms assisted by the proposed program will support the inclusive growth pillar of the country partnership strategy. In addition, improving connectivity is a strategic focus of the MP3EI. The MP3EI will guide the convergence of ADB's policy-based, sector, and thematic interventions related to connectivity and the government's vision of sustainable economic development.

7. **Lessons from ADB policy-based loans and development coordination.** Several lessons from the previous country strategy for Indonesia (2006–2009) and support for policy-based loans were considered.[7] Achieving tangible results with ADB's relatively modest program requires selective support targeting key government priorities and use of programmatic approaches in coordination with other development partners. Specifically, ADB effectiveness can be increased by (i) concentrating on a more limited set of program areas where there are clear synergies between ADB's policy, project, and private sector support, (ii) focusing on core sectors identified by Strategy 2020 and emphasizing sectors where ADB has a strong track record,[8] and (iii) supporting operations where ADB can play a catalytic role with good prospects for collaboration with other partners. The program will involve collaborative cofinancing with the World Bank and the Government of Japan. In addition, ADB coordinates with the Australian Agency for International Development on infrastructure issues through its Infrastructure Development Initiative Project in Indonesia as well as ADB's Sustainable Infrastructure Assistance Program technical assistance cluster, which is financed by the Government of Australia.[9] This connectivity-related policy-based loan builds on ADB's earlier policy-based loans, notably the Infrastructure Reform Sector Development Program, which supported government reforms to improve regulatory frameworks; open up key infrastructure sectors for private sector participation, including public–private partnerships (PPPs); increase competition; and improve infrastructure.[10] A key lesson from ADB's experience is to simplify the program to focus on high-impact policy reforms.

B. Impact and Outcome

8. The program's impact will be to reduce transport and logistics costs, a key requirement for achieving higher and more inclusive economic growth that is sustained over the medium term. The outcome will be more developed domestic and international connectivity anchored on

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[6] ADB. 2012. *Country Partnership Strategy: Indonesia, 2012–2014.* Manila.
[7] ADB. 2006. *Country Strategy and Program: Indonesia, 2006–2009.* Manila.
[8] ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020.* Manila.
[9] ADB. 2013. *Technical Assistance to the Republic of Indonesia for Sustainable Infrastructure Assistance Program*. Manila
[10] ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loan for Subprogram 2 to the Republic of Indonesia for the Infrastructure Reform Sector Development Program.* Manila (Loan 4025-INO).

rigorous coordination and regulation, which will help generate more and better jobs and contribute to sustainable poverty reduction.

C. Outputs

9. The programmatic approach consists of two subprograms sequenced to support the government's medium-term reforms to strengthen domestic and international connectivity. The proposed policy-based loan will support subprogram 2. The overall program supports the government's efforts in four core reform areas: (i) strengthening national coordination, regulatory, and institutional frameworks for more effective implementation of the connectivity agenda; (ii) strengthening intraisland connectivity to and from growth centers, with optimal use of resources for sustainable improvement and maintenance of land transportation and networks; (iii) improving interisland connectivity by stepping up efficiencies and service performance of domestic air and sea transportation; and (iv) enhancing international connectivity by making Indonesia's ports more efficient in handling traffic and trade volume. The policy actions have been developed to ensure consistency with the government's development efforts and initiatives, as outlined in the National Medium-Term Development Plan, 2010–2014 and the MP3EI, 2011–2025 (Appendix 4). After completing all policy actions under subprogram 1 in mid-September 2012, the government has made significant progress in implementing policy actions for subprogram 2.[11] Of the 11 policy actions originally envisaged for subprogram 2, ten have been completed. The policy action related to the establishment of the new Indonesia National Single Window (INSW) agency is expected to be completed in early 2014. Three more significant policy actions have been added into the policy matrix to reflect the government's reform priority.[12]

1. Connectivity Coordination and Regulatory Frameworks Strengthened

10. The policy reforms will strengthen coordination across institutions and harmonize regulations related to connectivity infrastructure and logistics. While the government has established working groups to coordinate and monitor implementation of the three pillars of the MP3EI activities, their operational effectiveness has been constrained by an ineffective mechanism for reaching collective decisions on priority infrastructure and by the lack of a budget mechanism for financing project preparation.

11. **National logistics blueprint and debottlenecking mechanism for priority infrastructure.** Under subprogram 1, the government issued a national logistics blueprint to specify short- and medium-term reform targets. In support of the connectivity agenda, under subprogram 2, the government has developed and operationalized a working team to monitor and evaluate the implementation of the national logistics blueprint. CMEA also established a mechanism to resolve issues that cause delay in the implementation of priority projects.

12. **Policy Committee for Acceleration of Priority Infrastructure Delivery.** The government has identified various bottlenecks in the development of priority infrastructure. For PPPs, these include lack of coordination and capacity in preparing bankable projects to meet international standards. For infrastructure in general, the government is yet to develop a clear budget mechanism for financing a pre-feasibility study in preparation of infrastructure projects. To rectify these issues, CMEA has drafted a presidential decree aimed at revitalizing the Policy

[11] Policy actions are policy triggers for the loan (noted in bold in the policy matrix [Appendix 4]). Policy milestones, while important in achieving the objectives of the program, are not policy triggers for the loan. They are presented to demonstrate additional reforms implemented by the government.

[12] Appendix 4 shows all of the changes introduced into the policy matrix.

Committee for Acceleration of Priority Infrastructure Delivery (KKPPI) by streamlining its structure and strengthening its function and its secretariat. With its revitalization, KKPPI is to function as a collective decision-making body for all stakeholders to (i) develop infrastructure policy and priorities, (ii) coordinate implementation of a pre-feasibility study to determine which infrastructure is to be financed by which sources (e.g., public sector, state-owned enterprises, private sector, public–private partnerships, development partners); (iii) set standards for the quality of project preparation; and (iv) help remove bottlenecks in infrastructure development.

13. **Viability gap fund to support public–private partnerships.** Recognizing the limited public resources available to meet the country's large financing needs for future infrastructure, the government has made significant efforts to attract and leverage private financing of infrastructure through PPPs. While some PPP projects are socially and economically desirable, they are not always financially viable due to limited cost-recovery prospects through user fees or tariffs. This low degree of cost recovery has constrained private sector interest, underscoring the need to close the financial viability gap with public resources. The government is setting up a viability gap fund (VGF) to provide public financial support to well-prepared PPP projects and so boost their bankability and financial viability. Under subprogram 1, the Ministry of Finance (MOF) prepared a draft ministerial decree for the establishment of the fund. Under subprogram 2, MOF issued ministerial decree No. 223/PMK011/2012 on implementation guidelines for the VGF. The decree specifies clear eligibility criteria for VGF support, the approval processes, and VGF allocation and disbursement, as well as contractual and monitoring arrangements. In addition, MOF has drafted the framework and business process of a PPP unit within the ministry. The PPP unit is expected to be developed into an anchor PPP center in the medium term to mainstream PPP implementation.

2. Intraisland Connectivity Upgraded

14. Improving intraisland connectivity is an important part of the government's connectivity strategy to reduce rural poverty. The policy reforms will support its efforts to accelerate development of transport systems and infrastructure to improve access from rural areas to the nearest growth centers and between industrial zones and ports. Linking rural areas with growth centers within islands is constrained by inadequate road infrastructure, delays in land acquisition, and substandard maintenance of the existing road network.

15. **Land acquisition.** The difficulty in acquiring land for public use has been a key reason for the late disbursement of the government's capital spending in the transport sector. The private sector considers the land acquisition problem a major source of uncertainty in project development, costs, and implementation, lowering investor confidence on the prospects for road investment. It also has delayed the development of PPPs, particularly for toll roads. Overcoming this constraint is key to advancing the connectivity and infrastructure agenda. Under subprogram 1, the government achieved significant progress through the passage of the Land Acquisition Law for Public Use (Law No. 2/2012) and the issuance of Presidential Decree No. 71/2012. Subprogram 2 supports further progress in this area by the issuance of the Minister of Finance Regulation No. 13/PMK.02/2013, Minister of Home Affairs Regulation No. 72/2012 , and the Head of National Land Agency Regulation No. 5/2012. These final sets of regulatory framework provide guidelines for operational costs for land acquisition for public use and its implementation by local governments. The new regulatory framework reallocates responsibilities from districts and provinces to BPN to ensure a more consistent national approach.

16. **Performance-based contract and national road network.** The Directorate General Highway within the Ministry of Public Works issued Circular No.06/SE/06/2012 recommending the use of performance-based contracting for any road project was supported under subprogram 1. The circular provides an opportunity to mainstream the performance-based contract into national road management practices. It will help improve road preservation management by phasing out the force account approach and boost efficiency through competition. Directorate General Highway has expanded its implementation to three roads in Central Java under subprogram 2. Directorate General Highway also issued a circular on medium-term national network to support the implementation of road connectivity across economic corridors under the MP3EI.

17. **Mechanism for allocation of grant funds to subnational governments.** The public expenditure review of the road sector by the World Bank finds that 24% of provincial roads and 41% of district roads are in bad or poor condition.[13] The performance is better for national roads, where only 12% are in bad or poor condition. To start tackling this problem, the government introduced a pilot mechanism for reimbursable road maintenance in eastern Indonesia. Under it, the national government will disburse road infrastructure grant funds to local governments only if they meet pre-agreed road maintenance quality and performance standards.

3. Interisland Connectivity Improved

18. The key objectives of interisland connectivity reforms are to strengthen the policy framework to step up port productivity and to improve transport access in eastern Indonesia. In a large, archipelagic country with a dispersed population, reducing the cost of interisland shipping is expected to make a significant contribution to economic growth and poverty reduction by connecting islands through lower-cost and higher-volume trade and movement of people. The high cost and low level of reliability of interisland shipping services are a major constraint in the transportation of consumer goods to remote and often poor islands. These contribute to higher and more volatile prices for consumer goods in remote provinces. Improving interisland connectivity means reducing the cost of interisland cargo transportation and making transportation more reliable. The government has increased the number of pioneer shipping services and has started to upgrade the quality of ships servicing eastern Indonesia.

19. **National port master plan.** The Shipping Law No. 17/2008 marks the start of reforms with the long-term objective of developing a competitive shipping industry to support domestic and international trade. The law includes a provision to issue a national port master plan to guide implementation of reform and port investment across the country, including eastern Indonesia. The Ministry of Transport issued Decree No. 414/2013 which serves as the port national master plan and will integrate development of economic corridors envisioned under the MP3EI and national transport and port systems. The master plan also includes port investment plans, both public and private, and also covers policies to support improvements in port operation and efficiency.

4. International Connectivity Enhanced

20. These reforms aim to improve regulatory certainty in customs clearance and reduce ship dwelling time. The bulk of the country's international trade is facilitated by five main ports. The largest is Tanjung Priok, the country's main international gateway in Jakarta, serving about 70%

[13] World Bank. 2012. *Investing in Indonesia's Roads: Improving Efficiency and Closing the Financing Gap.* Washington, DC.

of internationally traded goods. Tanjung Priok also serves 29% of container traffic between Java and other islands. While Tanjung Priok is Indonesia's most efficient port, its productivity is much lower than that of major ports in Southeast Asia. Container dwelling time in Tanjung Priok was 6.7 days in January 2012 compared with only 4.9 days in 2010. The cost of delivering one container from Cikarang (the nearest industrial zone) to Tanjung Priok across a distance of about 56 kilometers is $750, much higher than the cost of $450 across a similar distance in Malaysia (from Pasir Gudang to Tanjung Pelepas). The 2013 logistics performance index, which measures the efficiency of logistics services for international trade, confirms that Indonesia's performance is much lower than that of neighboring countries due to lagging infrastructure efficiency.

21. **Indonesia National Single Window.** Improving transparency in trade regulations is key to facilitating international trade. While efforts to simplify export and import procedures are ongoing, the number of agencies and documents involved remains large. Thus, the INSW plays an important role in reducing the time and costs of importing and exporting by enabling single submission, single processing, and single approval of import and export documents. Development of the INSW was conducted in stages, and so far 15 agencies and six major ports, which together represent about 80% of Indonesia's total international trade volume, have implemented the INSW. The single submission and sign-on systems are the final goals of the INSW. With those features, the INSW will significantly improve the efficiency of the cargo clearance process, which will reduce costs for exporters and importers and in turn strengthen the competitiveness in trade logistics. The government has incorporated the National Agency of Drug and Food Control, one of the major issuers of import and export permits, into the INSW single sign-on system. Under subprogram 2, two additional agencies, the Ministry of Trade and the Ministry of Agriculture, have been added to the INSW single sign-on system. The function of the INSW agency is still being performed by the Directorate General Customs. The government is in the process of developing a new institutional setup of the INSW, which is to be established in 2014. To reduce the dwelling time in Tanjung Priok port, the government has started the operation of Cikarang dry port. The expansion of the Tanjung Priok port is under way.

22. **Post-program partnership framework.** The program recognizes that achieving its intended outcome will require a coherent medium-term reform strategy. The government's connectivity reform agenda will continue beyond the completion of the triggers for subprogram 2 in September 2013. The government has requested that ADB remain engaged in the connectivity reforms. ADB and the government have developed a nonbinding post-program partnership framework to enable continuous dialogue and to guide the reform agenda from 1 October 2013 to 30 September 2014. Under this framework, the government will continue its connectivity reform by focusing on making KKPPI operational, improving capacity in implementing the land acquisition regulations, implementing the VGF to support PPP projects, establishing a PPP unit within the Ministry of Finance, and establishing a new agency to run the INSW. ADB will build capacity through technical assistance for Supporting Inclusive Growth through Better Connectivity.[14]

D. Development Financing Needs

23. The loan amount is based on the strengths of the policy package, its development impact, the importance of the sectors covered, indicative costs of reform, and the government's resulting financing needs. Recognizing the importance of accelerating infrastructure development, including connectivity, the central government has more than doubled its

[14] Attached to footnote 2 (TA 8215-INO).

infrastructure spending since 2010 (Table 1). Implementation of some policy reforms in this area (such as revitalizing KKPPI, implementing land acquisition regulations, and operationalizing the VGF and performance-based contracts) requires adjustment costs. Effective implementation of connectivity reforms will also require capacity improvements at related agencies. The government has increased its annual budget allocation to improve transport operations and related infrastructure in eastern Indonesia. Despite the recent policy to reduce the fuel subsidy, the government still needs to widen its 2013 budget deficit target from 1.6% of gross domestic product to 2.4% due to additional infrastructure spending and one-off compensation for the poor. As a result, government's net financing need is expected to increase to about $22 billion. Currently, the government obtains over 75% of its financing needs from market sources. The ongoing financial market turbulence has caused government bond yields to increase significantly. The government has requested a total of $1.1 billion in policy-based lending from development partners, of which $400 million is from ADB. The entire process of the policy based-loan will be disbursed in a single tranche, upon satisfaction of the core policy action in the policy matrix.

Table 1: Government Financing Needs, 2010–2013
(Rp trillion)

Item	**2010 Actual**	**2011 Actual**	**2012 Actual (unaudited)**	**2013 Revised Budget**
Revenues	995	1,211	1,336	1,502
Expenditures	1,042	1,295	1,482	1,726
Central government, of which	697	884	1,001	1,197
Material	98	125	137	203
Capital	80	118	140	188
Surplus/deficit	(47)	(84)	(146)	(224)
Deficit (% of GDP)	(0.7)	(1.1)	(1.8)	(2.4)
Net financing	92	131	180	224
Domestic financing	96	149	199	241
Foreign financing	(4.6)	(17.8)	(19.2)	(16.9)

( ) = negative, GDP = gross domestic product.
Source: Ministry of Finance.

24. To support its reform initiatives, the government has requested a loan of $400 million from ADB's ordinary capital resources to help finance subprogram 2. The loan will have a 15-year term, including a grace period of 3 years, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions set forth in the draft loan agreement. Based on this, the average loan maturity is 9.25 years, and there is no maturity premium payable to ADB. The loan proceeds will be used to finance the full exchange cost (excluding local taxes and duties) of items produced and procured in ADB member countries, excluding ineligible items and imports financed by other bilateral and multilateral sources. The proceeds of the policy-based loan will be disbursed to Indonesia in accordance with ADB's guidelines on simplifying disbursement requirements for program loans.[15] Collaborative cofinancing will be provided by the World Bank ($300 million), the Government of Japan ($200 million), and the Agence Française de Développement ($100 million). ADB will provide support on PPP, land acquisition, and KKPPI, while the World Bank will assist in the VGF, PPP center, and logistics. Japan International Cooperation Agency and Agence Française de Développement will focus on urban infrastructure, capacity building, and port development.

[15] ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans.* Manila.

E. Implementation Arrangements

25. The program period for subprogram 2 is from October 2012 to September 2013. The National Development Planning Agency (BAPPENAS) will be the executing agency. The implementing agencies will be the Ministry of Finance, Ministry of Public Works, Ministry of Transport, Ministry of Communication and Information, Ministry of Agriculture, Ministry of Trade, National Land Agency, and CMEA. The government will form a steering committee, chaired by the vice-minister of BAPPENAS, with senior representatives of the implementing agencies and development partners (ADB, Agence Française de Développement, Japan International Cooperation Agency, and the World Bank) as members. The committee will meet semiannually to review and confirm attainment and compliance with policy actions and to provide overall guidance on the implementation of the reform agenda under the program. The committee will work with the connectivity working group, which is also chaired by BAPPENAS and responsible for coordinating the implementation of the government's connectivity reform agenda under MP3EI.

III. DUE DILIGENCE

A. Economic and Financial

26. The policy actions of the program are derived from the government's medium-term reform priorities, which are crucial in achieving the government's strategy of higher and more inclusive growth. Currently, with exports still slow to recover, investment will need to play a larger role in supporting growth. The proposed reforms are expected to stimulate infrastructure investment, which could generate additional economic growth of up to one percentage point annually over the medium term.[16] The proposed reforms will also help improve the quality of employment by increasing employment opportunities in the formal sector and reduce poverty in the rural areas and in the eastern Indonesia, where poverty incidence is much higher. Improved connectivity will also lead to improvement in access to and delivery of services in the rural areas and in the eastern Indonesia. Combined, these will help reduce inequality over the medium term.

B. Governance

27. The government has made considerable progress in the legal and regulatory framework for public financial management. Since the enactment of the laws on state finance, state treasury, and state audit in 2003–2004, most of the regulations underpinning the laws have been promulgated. In 2012, the number of government agencies that received unqualified audit opinion from the External Audit Agency increased to 65%, from about 40% in 2019. ADB reinforces this momentum with continuing support to improve technical capacity and controls. Building on previous programs, ADB technical assistance for Strengthening National Public Procurement Processes has been committed to boosting transparency and efficiency in public procurement processes.[17] As a result of the government's continuing commitment to reduce corruption, the capacity of the Corruption Eradication Commission has improved markedly. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

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

[17] ADB. 2010. *Technical Assistance to the Republic of Indonesia for Strengthening National Public Procurement Processes*. Manila.

C. Poverty and Social

28. The reforms supported under the program will accelerate economic growth and generate more productive jobs, which are key to reducing poverty and reducing the risk of the employed labor force falling back into poverty. The program will also promote better connectivity for rural areas and eastern Indonesia, which is expected to help expedite poverty reduction in these areas.[18] Impact assessments of the program are expected to demonstrate the productivity-boosting and poverty-reducing effects of connectivity reforms and development.

D. Safeguards

29. The program does not trigger ADB's safeguard policies and is classified under category C for impacts on the environment, involuntary resettlement, and indigenous peoples.

E. Risks and Mitigating Measures

30. The three main risks to the program, rated low to medium, are (i) weak coordination in and between key government agencies; (ii) continued under disbursement of capital spending; and (iii) a rise in international fuel prices, which could divert government budgetary resources from capital investment to fuel subsidies. To mitigate risks (i) and (ii), the government has set up a high-level task force for connectivity and tasked the President's delivery unit to monitor the progress. For the third risk, the government has increased fuel prices by 44% for gasoline and 22% for diesel in June 2013.[19]

IV. ASSURANCES AND CONDITIONS

31. The government has assured ADB that implementation of subprogram 2 shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan documents.

V. RECOMMENDATION

32. 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 the loan of $400,000,000 to the Republic of Indonesia for subprogram 2 of the Inclusive Growth through Improved Connectivity Program, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao
President

5 November 2013

[18] Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).
[19] Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks[a]
Impact Reduced transport and logistics costs	By 2016: Lower share of transport and logistics costs in the total cost of production by 5% (2012 baseline: 27%) Poverty rate in rural and eastern Indonesia decreasing more quickly (2012 baseline: 15.6% for rural poverty and 25.3% for poverty in Papua and Maluku)	BPS BPS	**Assumption** Macroeconomic stability maintained **Risk** Implementation delay due to regulatory and political processes
Outcome Better developed domestic and international connectivity	By end 2013: Increased share of public and private investments in the transport sector (2012 baseline: 17%) Dwelling time in Tanjung Priok port reduced to under 6 days (2011 baseline: 6.7 days)	BPS and report from the investment board BPS and other independent surveys	**Assumption** Government staying on course with its key structural reforms **Risk** Weak coordination in government agencies Reform slowed by vested interest
Outputs 1. Connectivity coordination and regulatory framework strengthened	By end 2013: Preparation for KKPPI establishment completed Priority list for infrastructure projects issued with source of financing PPP unit established within MOF VGF used to support selected PPP projects	Government report MP3EI annual report Government website Government report	**Assumption** Proposed reforms implemented within established timelines **Risk** Weak capacity of government agencies to implement reforms

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks[a]
2. Key initiatives to upgrade intraisland connectivity implemented	By end 2013: Government spending on road maintenance and reconstruction increased by 22.5% (from Rp34 trillion in 2012) Performance-based contracts and extended warranty implemented for road construction projects Reduction in land acquisition delays for key projects supporting connectivity to maximum 400 days	Report from the minister of public works Report from independent agencies Report from the minister of public works Report from the government and independent agencies	**Risk** Weak capacity in government agencies to implement reform
3. Measures and strategy to improve interisland connectivity put in place	By end 2013: Dwelling time in key regional ports reduced (2011 baseline: 4 days) ICT fund fully operational Shipping routes to eastern Indonesia increased (2012 baseline: 66) National port master plan implemented	Reports from the minister of transport Reports from independent agencies Government report and website Report from independent agencies	**Risk** Vested interests undermining policy reform
4. Key policies executed to enhance international connectivity	By end 2013: Single sign-on system through the INSW introduced in five agencies All export and import procedures simplified and made more transparent (from 42 export documents in 2011) and included in the single window	Reports from independent agencies World Bank logistics performance report Reports and publication on impact assessments Report from CMEA	**Risk** Vested interests undermining policy reform

Activities with Milestones	Inputs
1. Strengthen policy coordination and regulatory framework 1.1. CMEA submitted a draft presidential decree to the cabinet (September 2013) 1.2. CMEA operationalized monitoring mechanism for the progress in logistics reform (January 2013) 1.3. MOF issued regulation to provide guidelines for VGF operation (March 2013) 1.4. MOF approved the design of the PPP unit (September 2013) **2. Upgrade intraisland connectivity** 2.1. MOHA and National Land Agency issued Implementing decree for Law on Land Acquisition for Public Use (November 2012) 2.2. MOF issued Implementing decree for Law on Land Acquisition for Public Use (January 2013) 2.3. Ministry of Public Works expanded implementation of performance-based contracts for road reconstruction on pilot basis (March 2013) 2.4. Directorate General Highway piloted grant allocation mechanism for road maintenance (April 2013) **3. Improve interisland connectivity** 3.1. MOT issued port master plan (April 2013) 3.2. Draft regulation of short-sea shipping completed (September 2013) 3.3. MOT issued regulation to increase shipping routes to eastern Indonesia (November 2012). 3.4. The tender of Palapa Ring II to support ICT fund operationalization conducted (June 2013) **4. Improve international connectivity** 4.1. CMEA submitted draft presidential decree for the organizational setup of the INSW (September 2013). 4.2. INSW single sign-on system introduced for the Ministry of Trade and the Ministry of Agriculture (March 2013)	**Asian Development Bank:** $400 million **Government:** $2,545 million

BPS = Badan Pusat Statistik (Statistics Indonesia), CMEA = Coordinating Ministry for Economic Affairs, ICT = information and communication technology, INSW = Indonesia National Single Window, MOF = Ministry of Finance, MOHA = Ministry of Home Affairs, MOT = Ministry of Transport, MP3EI = Master Plan for Acceleration and Expansion of Indonesia's Economic Development, VGF = viability gap fund.
Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

http://www.adb.org/Documents/RRPs/?id=46093-004-3

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

Supplementary Documents

10. Summary Program Impact Assessment

DEVELOPMENT POLICY LETTER

REPUBLIC OF INDONESIA

MINISTRY OF NATIONAL DEVELOPMENT PLANNING/
NATIONAL DEVELOPMENT PLANNING AGENCY
AND
MINISTRY OF FINANCE

No. 0288 /M.PPN/09/2013
No. S- 697/MK.08/2013

Jakarta, September 23 , 2013

Mr. Takehiko Nakao
President
Asian Development Bank
Manila, Philippines

Letter of Development Policy

Dear Mr. Nakao,

On behalf of the Government of Indonesia, we would like to provide an update on recent economic, political and policy developments, and to request the Asian Development Bank's support for a policy-based lending operation through Inclusive Growth through Improved Connectivity Program (DPL on Connectivity) for USD 400 million.

The current Government is now approaching the last year of its second and final term in office. We remain focused on our core reform agenda to improve economic growth, generate better employment, and reduce poverty and regional disparities while enhancing governance. Despite the current financial market turbullence, we expect the country's economic growth will remain resilient in the future as we have strived to put in place a strong macroeconomic foundation for our economy to grow further. With a diversified economic base and a growing middle class, consumer spending and investments have good medium- to long-terms prospects. While we expect a lower economic growth in 2013, we have continued to adjust our fiscal and environment. We recently introduced a policy package to help stabilize the economy and put a more solid foundation for growth in the coming years.

To reach the country's full potential economic growth, we will need to embark upon more progressive reforms to accelerate infrastructure development including improved connectivity along with investments in human capital. The Government has more than doubled its budget allocation to support infrastructure development and connectivity investments since 2010. In 2013, Rp 205.8 trillion is allocated by the central government for capital/infrastructure spending including supporting connectivity-related projects in eastern Indonesia. While significant challanges remain, a large increase in the infrastructure spending in the past few years together with reforms implemented to support infrastructure development have started to bear fruit. Indonesia's global competitiveness index ranking rose by twelve places to 38th in the 2013 based on the Global Competitiveness Index 2013 – 2014 by the World Economic Forum. According to the report, the most improvement for Indonesia's competitiveness was in the infrastructure pillar where it moved up by 17 places to 61st.

To expedite the process of sustainable economic growth in Indonesia, the Indonesian Government developed and implemented the Master Plan for Acceleration and Expansion of Indonesia Economic Development (MP3EI) in 2011. The MP3EI targets to accelerate our economic growth by structurally transforming the economy through investments in priority sectors and changing 'business as usual' practices. The MP3EI focuses on three strategic pillars: (i) development of six economic corridors to foster centers of growth in each major island; (ii) strengthening of national connectivity to build synergies and linkages between the centers of growth, including international connectivity for trade and tourism; and (iii) acceleration of technological and research and development capacity.

The Government connectivity reform program is anchored in the second pillar of the MP3EI. The joint support of the Asian Development Bank, the World Bank and the Government of Japan for our national connectivity reform program would produce high dividends over the medium-term. It reinforces the Government's reform progress and generates productive synergies with our development partners while providing Indonesia with a reliable source of development financing. For 2013, we are requesting that the Asian Development Bank, the World Bank, and the Government of Japan to provide US$ 400 million, US$ 300 million and US$ 200 million respectivelly for this second program loan Inclusive Growth through Improved Connectivity Program.

The Economic Situation

Like many other countries in the region, Indonesia has faced a number of external challenges. Since the announcement of the potential quantitative easing (QE) tapering by the US Federal Reserve Bank, the pendulum of capital flow has swung back somewhat to advanced economies. From end-May to late August, the Jakarta Stock Exchange Index fell by close to 25 percent prior to rebounding by 10 percent and the 5-year Indonesia Rupiah (IDR) bond yield rose by 280 bps, and the rupiah has depreciated by close to 18 percent against the US dollar year to date. The Credit Default Swap rate for Indonesia has increased more sharply than other countries in the region. While the primary trigger was external and related to the potential QE tapering, Indonesia has been more severely affected mainly because of its relatively open capital account and the significant foreign presence in its stock and bond markets. At the same time, the domestic bond market is still very shallow compared to other countries in the region.

To cope with the heightened financial market turbulence, the Government has implemented comprehensive measures. On the macroeconomic side, Bank Indonesia has increased its policy rate 150 bps from June to September to reach 7 percent and allowed more room for the rupiah to depreciate. The Government has also issued structural policy measures targeted to reduce the current account deficit, support investment and exports, and ease inflationary pressure from key commodities. To add a buffer to the country's large reserves, the swap line between Bank Indonesia and Bank of Japan worth US$ 12 billion has been extended for another 2 years. In addition, to ensure that Indonesia could continue with its development and reform agenda even in the event of larger financial market turbulence, the Government had already put together US$ 5 billion contingent financing facility with the support from the Asian Development Bank, the World Bank, the Government of Australia and the Government of Japan

Thanks to the extensive structural reforms implemented over the last few years, many of which have been supported by the development partners, Indonesia would continue to be relatively well-positioned to weather the increasing global economic and financial headwinds for emerging markets. The revised 2013 Budget approved in June 2013 also includes measures to increase fuel prices and compensation for the poor while providing the Government with significant flexibility to respond to evolving global economic conditions. Despite a projected increased budget deficit to 2.4 percent of GDP which is needed to support increased infrastructure spending, the downward trajectory of government debt-to-GDP ratio is projected to continue in 2013. With its strong capital base, the financial sector should remain resilient to the financial market turbulence. We believe that all these factors together with continued structural reforms would support continued solid investment and economic growth in the country over the medium-term.

The Government is committed to continuously improving Indonesia's economic resilience such as improving poverty reduction, connectivity and bureaucracy reforms, and programs, as outlined in the proposed 2014 Budget that is currently under discussion with Parliament and is expected to be approved by end October. The proposed Budget also foresees the implementation of new policies such as the health dimension of the new National Social Security Law, and a proposal to adjust electricity tariffs for selected customers to further improve the quality of spending. As in the 2012 and 2013 Budgets, and reflecting the potential the uncertainties over the outlook, the proposed 2014 Budget includes provisions relating to crisis preparedness to allow the Government the flexibility to respond to potentially rapidly changing macroeconomic developments.

Strengthening Coordination and Regulatory Frameworks for Connectivity

The MP3EI provides a strategic guidance on policies to improve national connectivity. Recognizing the fact that nearly every aspect of connectivity falls under the jurisdiction of multiple government bodies, we are thus strengthening coordination across institutions and are examining ways to harmonize key regulations related to connectivity. We have identified the lack of coordination and capacity in preparing bankable projects to meet international standard and unclear budget mechanisms for financing project pre-feasibility studies as key constraints to accelerating infrastructure development. We have completed a draft regulation aimed at revitalizing the Policy Committee for the Acceleration of Infrastructure Provision (KKPPI) by streamlining its structure and strengthening its functions, including developing infrastructure policy and priority projects, coordinating implementation of project pre-feasibility studies, determining the source of financing for each priority project, and facilitating in streamlining of infrastructure development.

We recognize that the public resources available for financing large infrastructure projects are limited and because of that we will have to also rely on private sector financing. One avenue for attracting private investment is through public-private partnerships (PPPs) for infrastructure. We have established supportive legal, regulatory and institutional frameworks, along with the Indonesia Infrastructure Guarantee Fund and the Indonesia Infrastructure Financing Facility. We are also taking steps to strengthen and revitalize the capacity to prepare and successfully transact bankable PPP projects, although challenges remain in this area. To provide further incentives for PPPs and to more transparently allocate public sector support, we have set up a viability gap fund (VGF) mechanism to enhance finacial viability of projects that are socially and economically desirable but may have inadequate financial returns. We are also in the process of establishing a PPP Unit within the Ministry of Finance to strengthen internal coordination in the preparation of PPP projects on a revolving fund basis.

Strengthening Intra-island Connectivity

Rural development in much of Indonesia's vast archipelago is constrained by inadequate roads, rail infrastructure, and intermodal transport links. In order to spread the benefits of economic development and reduce rural poverty, we aim to improve access of rural areas to the nearest growth centers, industrial zones and ports. Many of our provincial and district roads are in poor condition. To address this problem, we have rolled out performance-based contracts while piloting a more efficient grant allocation mechanism for road maintenance with sub-national governments.

Uncertainties surrounding land acquisition have been a major deterrent to investment by causing delays in infrastructure development by the government and the private sector, particularly for toll roads. To address this issue, the Government has now completed the regulatory framework by the issuance of three regulations from the

National Land Agency, the Ministry of Finance, and the Ministry of Home Affairs. Capacity building and socialization of the new regulation to all relevant government agencies is now ongoing to help effective application of the new regulation framework on land acquisition for development for public interest.

We also continue to restructure the railway sector to become more competitive and responsive to public needs. With the enactment of Law No. 23/2007 on Railway, Presidential Regulation No. 53/2012, which sets the institutional arrangements and general rules for provisions of subsidized passenger services under public service obligations (PSO), maintenance operations, and track access charges (TAC) in the railway sector, along with the ministerial guidelines, to improve certainty in provisions of PSO services in railway while encouraging growth in commercial railway services. Further, we have rolled out performance-based contracts, while putting in place a medium term plan for the national road network in order to improve the planning and implementation of public road investments.

Improving Inter-Island Connectivity

We have also embarked on reforms aimed at reducing the cost of inter-island shipping while improving transport and information technology (ICT) access in the eastern part of Indonesia. As a large archipelagic country, our producers suffer from high costs due to poor logistics and inadequate market and transport information.

Developing regular container services along major ports across Indonesia's economic corridors is an important step for developing an efficient and reliable sea freight network. These new routes will also help reduce freight loads on the country's overloaded road network. The government has issued a port master plan to provide clear long-term direction on port development across the archipelago.

In order to improve connectivity with eastern Indonesia, we have increased the frequency of pioneer shipping services for more remote island ports while reviewing the current institutional arrangement. Connectivity also involves improved access to ICT services so we are implementing an ICT Fund to incentivize and accelerate the development of backbone communications infrastructure in the currently underserved areas of Indonesia. Further, we have prepared a National Port Master Plan that establishes the classification and traffic projection for all Indonesian sea ports, which will help establish priority and development plans for each individual sea ports for the next 20 years.

Improving International Connectivity

We have made progress on trade facilitation. We recognize that improving transparency in trade regulations is a key to facilitate international trade. The Indonesian National Single Window (INSW) plays an important role in reducing the time and costs of importing and exporting by facilitating single submission, single processing, and single approval of import/export documents. While the development of the INSW was conducted in stages, now 18 agencies and 6 major ports, which together represent about 80 percent of Indonesia's total international trade volume, have been part of the INSW system. Most recently, the Ministry of Trade and the Ministry of Agriculture were incorporated into the INSW. The function of the INSW agency is currently being performed by DG Customs. We expect to finalize a clear organizational set-up of the INSW to play increasingly significant role in facilitating trade in the coming years. The government will issue a presidential decree to set the organizational setup of the INSW.

Recognizing that improved connectivity requires integrated end-to-end supply chains, the President issued a National Logistics Blueprint (NLB) in 2012 in order to reduce logistics costs and prepare for ASEAN integration. To effectively implement the NLB, we have developed an integrated monitoring mechanism to assess progress in the implementation and improvement of the national logistics system.

Conclusion

Despite the global economic challenges, the Government of Indonesia has continued to implement proactive measures to ensure that the country sustains its solid economic growth and poverty reduction. We are committed to maintaining macroeconomic stability while enhancing our preparedness for meeting any global economic shocks or potential financial market turbulence. At the same time, we are pushing ahead with our medium- and long-term economic reforms to meet our development priorities. The Government values the support provided by development partners in helping to address Indonesia's critical constraints related to connectivity and inclusive growth. In closing, let me reiterate the Government's strong ownership of and commitment to the connectivity reform program where we are soliciting the support of the Asian Development Bank, the World Bank and the Government of Japan. We look forward to continue engagement and support of the development partners for Indonesia's economic development agenda in the coming years.

Minister of National Development Planning/
Head of Bappenas
Republic of Indonesia

Armida S. Alisjahbana

Minister of Finance
Republic of Indonesia

M. Chatib Basri

POLICY MATRIX

Reform Aim	Policy Actions 1st Connectivity DPL (by September 2012)	Indicative Policy Actions 2nd Connectivity DPL (by September 2012)	Policy Actions 2nd Connectivity DPL (by September 2013)	Post-Program Partnership Framework
Pillar 1: Strengthening National Coordination and Regulation				
Strengthen policy coordination and reforms surrounding national connectivity	**The Government issued a Presidential Regulation on MP3EI and the Coordinating Ministry of Economic Affairs issued a ministerial decree on the establishment of the institutional set-up for coordination and implementation of the national connectivity, as part of the MP3EI.**	**The Coordinating Minister of Economic Affairs (CMEA) established a monitoring system to assess progress in implementation of the national logistic system.** **CMEA will issue a "debottlenecking" (streamlining) mechanism in KP3EI secretariat to enhance the implementation of prioritized national connectivity infrastructure.**	**The Coordinating Minister of Economic Affairs (CMEA) established a monitoring system to assess progress in implementation of the national logistic system.** **The Government has established debottlenecking mechanism to enhance the implementation of prioritized national connectivity infrastructure.** **CMEA prepared a draft presidential decree to revitalize the Policy Committee for Acceleration of Infrastructure Delivery (Komite Kebijakan Percepatan Penyediaan Infrastruktur/KKPPI). a/** CMEA completed the selection of 56 MP3EI priority projects.	Operationalize KKPPI with budget allocation for project pre-feasibility studies and a stronger secretariat
Strengthen budget execution for public investment and operations on connectivity	**The Ministry of Finance prepared a draft regulation on guidelines for Viability Gap Fund (VGF), which will clarify mechanism for the use of government funds to improve the financial viability of PPP projects.**	**The Ministry of Finance (MoF) will issue a regulation and guidelines on the Viability Gap Fund (VGF) and allocate financing of two pilot PPP projects through VGF.**	**MoF (i) issued regulation on procedures for the Viability Gap Fund (VGF) to allocate financing for PPP project and (ii) allocated budget for VGF of PPP projects.**	Operationalize VGF with implementation of PPP projects

Reform Aim	Policy Actions 1st Connectivity DPL (by September 2012)	Indicative Policy Actions 2nd Connectivity DPL (by September 2012)	Policy Actions 2nd Connectivity DPL (by September 2013)	Post-Program Partnership Framework
			MoF prepared the draft framework and business process of a PPP Unit within the MoF to strengthen its internal coordination for preparing public finance support on proposed PPP projects. b/ MOF increased the capital of PT SMI to enhance infrastructure and PPP project preparation.	Establish PPP Unit within the Ministry of Finance as an embryo for the anchor PPP Center
Pillar 2: Strengthening Intra-island Connectivity (rail and road)				
Improve investors' confidence on the prospects for road investment	**The Parliament passed the Law on Land Acquisition for Public Use and the Government issued Presidential Regulation on the Implementation of land acquisition for Public Use.**	**The Ministry of Finance (MoF) and BPN will issue regulations on technical guidelines for land acquisition.**	**MoF, Ministry of Home Affairs, and BPN issued regulations on technical guidelines for land acquisition.**	Expand capacity building and training programs to strengthen the implementation of the land acquisition process at all levels of government
Strengthen incentives for railway operator to improve services	**The Government issued a Presidential regulation to (i) establish budgetary mechanism to transfer subsidies for Public Service Obligation (PSO) in railway services, (ii) reimburse infrastructure maintenance operation (IMO), and (iii) reimburse track access charges (TAC) to railway infrastructure.**	**The Ministry of Transport (MoT) will establish implementation guidelines for PSO/IMO/TAC that are in line with the restructuring of railway sector under Law No. 23/2007 on Railway Sector.**	The Ministry of Transport (MoT) established implementation guidelines for IMO in line with the restructuring of railway sector under Law No. 23/2007 on Railway Sector.	
Improve efficiency of railway traffic	The Government allocated budget in fiscal year 2012 for	The Government will allocate budget in fiscal year 2013 to	The Government allocated budget in fiscal year 2013 to	

Reform Aim	Policy Actions 1st Connectivity DPL (by September 2012)	Indicative Policy Actions 2nd Connectivity DPL (by September 2012)	Policy Actions 2nd Connectivity DPL (by September 2013)	Post-Program Partnership Framework
	double-track rail between Semarang-Cirebon (on the island of Java) by 2014.	complete double-track rail between Semarang-Cirebon by 2014.	complete double-track rail between Semarang-Cirebon by 2014.	
Improve mechanism for allocation of grant funds to sub-national governments	The Government completed the review of the framework to strengthen the allocation of road infrastructure grant funds to sub-national governments.	**The Government will revise the mechanism for the allocation of road infrastructure grant funds to sub-national governments.**	**The Government piloted a new mechanism for the allocation of road infrastructure grant funds to sub-national governments.**	Develop a more robust mechanism for the allocation of road infrastructure grant fund to sub-national government
Improve planning and implementation of public road investment	**The Ministry of Public Works (MoPW) through Directorate General (DG) Highway issued a Circular on performance-based contract for road construction and implements two projects.**	**The MoPW through DG Highway will implement performance-based contract for 3 new projects.**	**MoPW through DG Highway implemented performance-based contracts for 3 new projects.**	Mainstream implementation of PBC by implementing it into more road projects to support MP3EI
	The MoPW established a framework for the development of national road network master plan.	**The DG Highway will issue a regulation on medium-term development plan for the National Road Network to support domestic connectivity.**	**DG Highway issued regulation on medium-term development plan for the National Road Network to support domestic connectivity.**	Issue DG Highway regulation on medium-term development plan for the National Road Network to support domestic connectivity
Improve urban transportation system in the JABODETABEK area	The CMEA prepared the (i) draft presidential regulations on JABODETABEK (the Greater Jakarta) Urban Transportation Master Plan; and (ii) draft presidential decree on the establishment of JABODETABEK (the Greater Jakarta) Transportation Authority to accelerate regional development of transport in the JABODETABEK (the Greater Jakarta) area.	The CMEA will submit to the Cabinet Secretariat the (i) draft presidential regulations on JABODETABEK (the Greater Jakarta) Urban Transportation Master Plan; and (ii) draft presidential decree on the establishment of JABODETABEK (the Greater Jakarta) Transportation Authority.	CMEA updated the JABODETABEK (the Greater Jakarta) Urban Transportation Master Plan.	

Reform Aim	Policy Actions 1st Connectivity DPL (by September 2012)	Indicative Policy Actions 2nd Connectivity DPL (by September 2012)	Policy Actions 2nd Connectivity DPL (by September 2013)	Post-Program Partnership Framework
Pillar 3: Improving Inter-island Connectivity (airport, port and ferry/RO-RO services)				
Strengthen policy framework to facilitate achievement in port development and improvement in port productivity	The Government conducted market sounding of selected PPP investment project in port. **The MoT issued Ministerial regulation on the Master Plan for Port Development in Greater Jakarta Port.** **The Government issued a joint decree of DGs of (i) Sea Transport, (ii) Labor Supervision, and (iii) Cooperatives Institutions that grants more competitive pricing to increase competition in cargo handling services at seaports.**	The Ministry of Transport (MoT) will issue a ministerial regulation on National Port Master Plan (NPMP).	**MOT issued the port national masterplan. c/** MOT issued a regulation to increase shipping routes to the eastern part of Indonesia.	Issue policy to improve the operation and sustainability of shipping services in eastern Indonesia
Strengthen ICT connectivity between eastern and western Indonesia and introduce more competition in broadband services	**The MoCI issued a regulation on establishing a mechanism to utilize ICT funds to support development of back-bone ICT infrastructure in underserved areas in Indonesia.**	**The MoCI will operationalize ICT Fund through the completion of tender process and contract award for phase 1 telecommunications backbone packages under the ICT Fund.**	MoCI operationalized ICT Fund through the completion of tender process for phase 1 telecommunications backbone packages under the ICT Fund.	The ICT will be fully operational, including support for the ICT backbone for the eastern part of Indonesia
Improve budgetary incentives for operator to improve pioneer shipping services	The MoT increased number of routes and service frequency of pioneer shipping services to the eastern part of Indonesia.	The MoF will amend the necessary regulation to introduce multi-year performance contracts that will improve pioneer shipping services.		

Reform Aim	Policy Actions 1st Connectivity DPL (by September 2012)	Indicative Policy Actions 2nd Connectivity DPL (by September 2012)	Policy Actions 2nd Connectivity DPL (by September 2013)	Post-Program Partnership Framework
	The Government completed feasibility study to develop Public Ship Finance System (PFSP).	The Government will propose development of institutional arrangements to promote PFSP to encourage national fleet enhancement.		
Pillar 4: Enhancing International Connectivity (port decongestion and trade facilitation)				
Improve regulatory certainty in customs clearance and reduce import dwell time	**The Government amended Presidential Decree No. 10/2008 to establish Indonesia National Single Window system (INSW) as the only reference portal for cross-border trade regulations in customs clearance process.** The CMEA extended INSW system and services to dry port in Cikarang.	**The Government will establish an INSW Agency that may be operated by the private sector.** The CMEA will operationalize quarantine services in Cikarang dry port.	The Government operationalized quarantine services in Cikarang dry port.	Establish INSW Agency
Improve regulatory certainty on logistics and improve timeliness in cargo handling at port	**The Government issued a Presidential regulation on the Blueprint for National Logistic Development System to strengthen the effectiveness and focus of reform process in improving national logistics performance.**			
	CMEA introduced single sign-on by the National Authority for Food and Drug Control into the INSW.	**CMEA will introduce single sign on by Ministry of Trade and Agriculture into the INSW**	**CMEA introduced single sign on by the Ministry of Trade and Ministry of Agriculture into the INSW.**	

Note: The Policy Actions in bold are the core policy actions for the policy-based loan, whereas the remaining actions are considered as milestones to support the core actions. a/, b/, c/ are new core policy actions.
MP3EI = Master Plan for Acceleration and Expansion of Indonesia's Economic Development, KP3EI = Committee for Acceleration and Expansion of Indonesia's.
Source: Asian Development Bank