PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: 108385

Operation Name	Indonesian Logistics Reforms DPL
Region	EAST ASIA AND PACIFIC
Country	Indonesia
Sector	General industry and trade sector (25%); Public administration- Industry and trade (30%); Public administration- Transportation (15%); Ports, waterways and shipping (30%)
Operation ID	P158140
Lending Instrument	Development Policy Lending
Borrower(s)	The Republic of Indonesia
Implementing Agency	Coordinating Ministry of Economic Affairs (CMEA)
Date PID Prepared	September 19, 2016
Estimated Date of Appraisal	September 21, 2016
Estimated Date of Board Approval	November 1, 2016
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.
Other Decision *{Optional}*	*Teams can add more if they wish or delete this row if no other decisions are added*

I. Country and Sector Background

Over the past decade, Indonesia has seen strong growth and job creation, supporting poverty reduction; but the end of the commodity boom has exposed structural weaknesses. Following the recovery from the Asian financial crisis, annual growth averaged 5.6 percent over 2001-12. As the external tailwinds of commodity prices and demand and global financing conditions have turned to headwinds, other sectors have not been able to take up the slack of commodity exports. As a result growth has slowed, down to 4.8 percent in 2015 and projected at 5.1 percent in 2016.

The need for efficient logistics has become vital to boost competitiveness in tradable sectors, and to reverse the slowing down of poverty reduction, especially in more remote regions of the country. The Indonesian economy needs to rebalance away from commodity production, whose prices are declining, and towards manufacturing and modern services. Efficient logistics is a vital tool to that end as it can bring smoothly and cheaply products from the source to those who should use them, whether producers or final consumers.

Large inefficiencies still plague the logistics sector in Indonesia, which acts as both a drag on growth and a contributor to inequality. Logistics costs (transport, warehousing and inventory) are higher in Indonesia (25 percent of manufacturing sales) than in neighboring countries including Thailand (15 percent) and Malaysia (13 percent). A large share of these costs are associated with the need to carry high inventory levels due to a lack of predictability and unreliability of the logistics chain. On average 19 out of 100 orders will either be late or some units will be missing, a higher share than most countries at similar level of income.

Inefficient port operations, uncompetitive logistics services markets and lengthy trade procedures are at the core of the country's inefficient logistics. Ports are often a bottleneck in the Indonesian logistics chain, hampered chiefly by inadequate infrastructure, although burdensome regulations – related to trade processing and investments - and low labor productivity also play a role. The quality of ports' infrastructure across the country is a weak factor in the overall country's competitiveness and detailed work on 18 ports throughout Indonesia by the World Bank has confirmed relevant infrastructure gaps. A key reason behind under-investment in the country's port infrastructure is the lack of clarity on the roles of the port landlord and the port operator. Finally, cumbersome regulatory requirements and inefficient procedures make trade processing a further weak link in the logistics chain. Indonesian ranks 105 out of 189 economies in the Doing Business "Trading across borders" indicators.

II. Operation Objectives

The proposed DPL series supports the Government's overall objective to improve logistics performance to further the country's medium-term economic development and poverty reduction goals. The proposed operation, in the amount of US$ 400 million, is the first in a planned programmatic series of two single-tranche operations supporting critical policy and institutional reforms that have three key development objectives:

- **Pillar A: Strengthening port's governance and operations** through prior actions to clarify the role of port regulators vis-à-vis port operators; to facilitate the entry of port services operators; and to enhance the coordination of documentary and container examination in ports. These actions are expected to contribute to the following results: increase in the share of Pelindos' ports with internationally certified management systems; Increase in the number of applications for Build-Operate-Transfer scheme for sea-ports development; and a reduction in the average turn-around time in Tanjung Priok and Makassar sea-ports.
- **Pillar B: Enabling a competitive business environment for logistics service providers** through prior actions to increase competition in freight forwarding, storage and distribution services; in auxiliary shipping services; and to reduce inventory costs of imported materials for producers. These actions are expected to contribute to the following results: increase in the number of new foreign licenses for freight forwarders, warehousing and cold storage services; increase in the number of new shipping agents' (SUKK) and foreign maritime cargo handling licenses; increase in the number of logistics bonded centres.
- **Pillar C: Making trade processing more efficient and transparent** through prior actions to reduce licensing requirements for imports, facilitate traders' compliance with

trade regulatory requirements, expedite the submission of trade documentation and to improve risk management of border agencies. These actions are expected to contribute to the following results: reduction in pre-clearance time in Tanjung Priok sea-port; increase in the share of relevant regulations included in the Indonesia National Trade Repository; reduction in dwelling time in the 2 main ports of Tanjung Priok and Tanjung Perak; reduction in pre-clearance time for food and drugs imports in Tanjung Priok; decrease in the share of import shipments classified as red channel in Tanjung Priok.

III. Rationale for Bank Involvement

The DPL is central to achieving the objectives under the CPF *Maritime Economy and Connectivity* **engagement area**. Efficient connectivity has been identified in the SCD as a vital instrument to increase competitiveness and decrease poverty and inequality. The CPF reflects this through the *Maritime Economy and Connectivity* engagement. In particular the PDOs of the DPL are consistent with and contribute to the development outcomes of the engagement in terms of reducing container handling time in selected international and domestic terminals and reducing travel time for selected links to the ports. In addition some of the reforms contained in the *Enhancing ports' performance* and *Improving logistics services* pillars can also help to increase private sector investment in infrastructure (including ports, storage and distribution infrastructure), which is one of the development outcomes of the *Leveraging the Private Sector* supporting beam.

The design of the operation builds on some of the reforms supported by the previous connectivity DPLs in Indonesia while taking a more focused approach.[1] This series takes a focused sectoral approach, which aims to obtain stronger government ownership and deeper reach within the logistics sector. It has a deeper but narrower focus while it builds on some of the actions in trade facilitation and port development from the earlier DPL. It also includes new areas, in particular port governance and logistics service providers' markets.

IV. Tentative financing

Source:		($m.)
Borrower		0.00
International Bank for Reconstruction and Development		400.00
Borrower/Recipient		
IBRD		
Others (specifiy)		
	Total	400.00

V. Tranches *(if applicable)*

One tranche operation.

VI. Institutional and Implementation Arrangements

[1] Indonesia DPL Connectivity Series 2012 and 2014; and World Bank (2015a). Improving Indonesia's Freight Logistics System: A Plan of Action.

The operation, including the development of the program objectives and results indicators, has been prepared through intensive policy dialogue with the Government. The main counterpart is the Coordinating Ministry of Economic Affairs, with active engagements with the relevant line Ministries/Agencies, including the INSW, Ministry of Finance, Ministry of Transport and Ministry of Trade. Monitoring of progress on indicative triggers and result indicators will be done on a regular, quarterly basis and be coordinated by the CMEA and INSW for the trade processing side. While some result indicators, such as those on dwell time and on investments in port facilities, will be publicly available, the majority requires the cooperation of the relevant Ministries and/or the development of specific ex-post evaluation work. The latter will be conducted as part of ongoing analytical work and technical assistance that the Bank carries out to accompany this DPL series.

VII. Risks and Risk Mitigation

The overall risk rating of this operation is substantial. Major risks include the following: (a) political economy and governance challenges, (b) sector strategies and policies, in particular Ministry of Transport policies; (c) stakeholders' risks (d) and the weak institutional and implementation capacity of the relevant ministries and agencies. These risks, if materialized, could negatively impact on the Government's willingness and ability to push through further logistics reforms and its ability to implement the indicative triggers. Furthermore, these risks could affect the achievement of the PDOs as the reforms contained in the DPL are important but not sufficient conditions for achieving the PDOs. A mitigating factor against these risks is the strengthened position of the CMEA (and of the office of the DPL's counterpart specifically) as the coordinator of the economic reform packages. These have included (and will include) a wide range of logistics reforms and have received Presidential backing. In addition the Bank is providing a technical assistance programme to help relevant ministries and agencies implement the actions effectively. These risks must be set against the significant benefits of improved logistics performance in Indonesia given the challenges the sector poses for improved competitiveness, growth, and shared prosperity.

VIII. Poverty and Social Impacts and Environment Aspects

Most reform in this DPL series have likely indirect positive impacts on poverty and inequality through increased growth and lower prices. Both theory and international evidence suggest that the reduction in trade and transport costs tends to create larger market allowing for greater specialization, increased productivity and incomes. In addition better logistics performance may reduce prices for consumer goods, thus reducing the large price gaps between Indonesian regions especially between the more the remote regions and Java. As poverty is relatively higher in remote regions, above all in Eastern Indonesia, lowering prices there would have a particularly important poverty reduction effect. While improved logistics is likely to generate net poverty and social gains in Indonesia, it may also have adverse effects on certain people. The increased competition in goods markets that better logistics services can bring about could generate losers among the incumbent firms and workers in those markets. These can induce some job losses and eventually some people to fall into poverty if not tackled in a timely fashion. Hence the targeted use of social assistance programmes, which have been recently reformed by the government, should be important complement to logistics reforms.

The logistics reform actions supported by the DPL are unlikely to have any direct negative adverse environmental impacts and, insofar as they promote infrastructure improvements in the ports, they may have positive impacts overall. While all of the actions are likely to carry little environmental impact, the reforms in the port sectors may have indirect environmental impact as they may facilitate port infrastructure investments. These investments can have positive environmental impact for example as they may reduce traffic congestion (both of vessels and of trucks) outside of ports, induce the use of less energy consuming equipment and allow the use of more modern and efficient vessels. However if not assessed and managed properly these port infrastructure investments can also have adverse environmental impacts such as on marine ecology from land reclamation and dredging and on fishing communities that may lose space to moor their boats. Indonesia has a well-established system for managing such impacts mainly through a set of provisions in Law 32/2009 on Environmental Protection and Management. While there are areas of weaknesses in its implementation, there is evidence that the system undertakes some serious scrutiny to port infrastructure projects. In addition the Bank is planning some technical assistance to strengthen the port authorities' capacity to ensure environmental protection from port development and operations.

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