Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 25-Jan-2018 | Report No: 123028

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Indonesia	P163973	Indonesia Maritime Logistics DPL II	Indonesia Maritime Logistics DPL
Region	**Estimated Board Date**	**Practice Area (Lead)(s)**	**Financing Instrument**
EAP	15 March 2018	Macroeconomics Trade and Investments	Development Policy Financing
Borrower(s)	**Implementing Agency**		
The Republic of Indonesia	Coordinating Ministry of Economic Affairs		

Proposed Development Objective(s)

The objective is to:
 * Enhancing ports' performance
 * Improving logistics services
 * Strengthening trade processing

Financing (in US$, Millions)

SUMMARY

Total Financing	400

DETAILS

Source:
IBRD

Decision

The summary Decision from the Decision Meeting, for example authorization to appraise and negotiate the DPF?
The Meeting authorized the team to proceed with appraisal and negotiations towards a Board Date in March 2018.

B. Introduction and Context

Country Context

Over the past decade, Indonesia has seen strong growth and job creation, supporting poverty reduction; the end of the commodity boom, nonetheless, 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, along with 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 5.0 percent in 2016 and projected at 5.2 percent in 2017.

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 where prices are declining, and to move towards manufacturing and modern services. Efficient logistics is a vital tool to achieving that end as it can reliably and cost-effectively bring products from the source to those who use them, whether producers or final consumers.

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 by inadequate infrastructure, burdensome regulations – related to trade processing and investments - and low labor productivity also play a role.[1] 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 critical infrastructure gaps.[2] The government has started to address some of the factors behind under-investment in port infrastructure, such as strengthening the distinction between the roles of port landlord and port operator, but other areas such as port assets ownership, remain ambiguous and can stifle investments. Restrictions to competition in logistics service markets are another important hindrance to the logistics sector. Indonesia is the most restrictive among the 44 countries surveyed by the OECD in several logistics services, including freight forwarding and maritime transport.[3] The first operation supported a relaxation of restrictions to foreign ownership, but other barriers such as excessive minimum capital requirements, restrictions on the location of operations and cumbersome licensing requirements, stifle competition into these markets. Finally, cumbersome regulatory requirements and inefficient procedures make trade processing a further weak link in the logistics chain.

[1] World Bank (2015a). "Improving Indonesia's Freight logistics a plan for action."
[2] World Bank (2015b) "RAS Port Development Priority Project and Financing Strategy"
[3] OECD Services Trade Restrictiveness Index 2016.

Relationship to CPF

This DPL series forms an integral part of the Indonesia Country Partnership Framework (CPF) *Maritime Economy and Connectivity* engagement, which aims to support the Government's efforts to improve connectivity, and the *Leveraging the Private Sector* supporting beam, which aims to improve the business climate and markets.[4] This operation builds on the reforms supported by the first DPL and aims to address key policy and institutional bottlenecks in support of the Government's logistics and trade reforms to improve the efficiency of ports, enhance competition in logistics services, and streamline trade processing. The reduction in logistics costs should help reduce poverty and increase shared prosperity by increasing the competitiveness of Indonesian sectors and reducing price disparities across the archipelago.

C. Proposed Development Objective(s)

The objective is to reduce the costs and improve the reliability of the logistics chain in Indonesia by strengthening port's governance and operations, enabling a competitive business environment for logistics service providers and making trade processing more efficient and transparent.

Key Results

The main expected results of the operation are: *Increase in*: use of internationally certified management systems; number of container handling equipment; number of ports handling more than 2000 TEU vessels; number of approved applications for BOT for public seaports development; number of new foreign licenses for freight forwarders and maritime cargo handling licenses and overall new shipping agents licenses; number of operational logistics bonded centres as well as of centres handling trans-shipment operations; share of relevant regulations included in the Indonesia National Trade Repository. *Reduction in*: ships' waiting times in sea-ports; dwelling time main sea-ports; and in the share of import shipments classified as red channel in Tanjung Priok.

D. Program Description

The proposed operation, in the amount of US$ 400 million, is the second in a programmatic series of two single-tranche operations supporting critical policy and institutional reforms to address bottlenecks at various points of the supply chain The DPL is structured around the following three pillars, set of objectives and government program reform areas:

- Pillar A: Enhancing ports' performance. Strengthening port's governance and operations by (i) improving the governance of ports by clarifying the role of Port authorities vis-à-vis port operators; (ii) facilitating the entry of port services operators; and (iii) enhancing coordination of documentary and container examination in ports.
- Pillar B: Improving logistics services. Enabling a competitive business environment for logistics service providers by increasing competition in: (i) freight forwarding services; (ii) shipping and auxiliary shipping services; and (iii) reducing inventory costs of imported materials for producers.
- Pillar C: Strengthening trade processing. Making trade processing more efficient and transparent by (i) facilitating traders' compliance with trade regulatory requirements; and (ii) improving risk management of border agencies.

The second operation in the DPL series builds on the achievements of the first one; its design has benefited from an extensive collaboration between the Government, in particular the CMEA, the INSW Portal Administrator, the Ministry of Transport, and the Ministry of Finance, and the World Bank. The operation builds upon the long-term collaboration on logistics and trade facilitation between the Bank and various government ministries and agencies particularly the

[4] *Country Partnership Framework For The Republic Of Indonesia (Fy16 – Fy20)*, World Bank, 2015.

CMEA. This collaboration includes support in the drafting of the Indonesia's logistics blueprint and the preparation to introduce the INSW. It is underpinned by other advisory and analytical work (past, ongoing and planned) by the Bank and other development partners, particularly Australia and Japan. Additional TA has been initiated to support the government to design and implement the triggers for the second operation.

The Government of Germany, through the German Bank for Development (KfW) and the Government of France, through the Agence Française de Développement (AFD), are also providing policy loans in support of the government's program, under this DPL series. AFD signed a EUR 150 million credit facility agreement with the Ministry of Finance in March 2017 and KfW signed a similar agreement for EUR 200 million in August 2017 following World Bank Board approval of the first operation in November 2016. Strong collaboration in preparation of the remaining loans in the series continues with both institutions.

E. Implementation

Institutional and Implementation Arrangements

The development policy 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 and Ministry of Transport. 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. We have been using the Bank's technical assistance programme to the INSW to help gather the relevant data and set up the reporting system. It is expected that the prior actions will be completed by Q1 of 2018 and the operation will go to the Board in Q1 of 2018 with a closing date of Q4 of 2018, which means the ICR completion by late 2019-early 2020. The team has also been complementing the secondary data available with specific data collection through a survey among manufacturers of their logistics operations.

F. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

While improved logistics is likely to generate net poverty and social gains in Indonesia, it may also have adverse effects in terms of job losses. For example the increased competition in goods markets that better logistics services can bring about may undermine the rents of producers and traders in net importing regions. As with any trade shocks, this could generate losers among the incumbent firms and workers in those sectors. This could translate into job losses, which can induce some people to fall into poverty especially when they involve low-skilled workers. Hence the targeted use of policy instruments like social assistance should be an important complement to the logistics reforms. The recent government's reforms of the social assistance framework, including the establishment of a Unified Database for targeting all major social assistance programs, are a positive development in this respect. At the same time, the government has been expanding key social assistance programs (CCT, scholarships, health insurance) so that greater coverage is possible. The government has also requested TA from the Bank on establishing skills training programs, which could be targeted in part to displaced workers.

Most reform areas in this DPL series have likely indirect impacts on poverty. Reforms in all areas, port performance, competition in logistics services markets and trade processing, are expected to affect poverty through two channels. First, by raising the efficiency of the logistics chain, they could reduce the prices and expand the variety of the goods that households consume.5 Poorer households should particularly benefit from it given the relatively higher shares of goods in their consumption basket. Second, improvements in logistics would increase producers' competitiveness by reducing their costs of accessing markets as well as their costs of sourcing supplies for production. Given the nature of the reforms many of these reductions are expected to be particularly important for international goods trade. These competitiveness gains could boost employment generation and labor incomes. In addition the import simplification reforms are expected to reduce the costs of importing and - subject to a positive pass-through on prices – directly reduce prices of final goods.

Environmental Aspects

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, 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. In addition increased vessels' traffic may heighten the risk of oil spills and other marine pollution incidents and may generate greater volumes of ship waste to be managed by port operating companies and local waste processing and disposal facilities. Nonetheless, Indonesia has a well-established system for managing such impacts, such as the Law 32/2009 on Environmental Protection and Management. While there are areas of weaknesses in its implementation, there is evidence that the system undertakes serious scrutiny to port infrastructure projects. Mitigation of the weaknesses in the country system will require improvements that will need to be accomplished incrementally, as they cannot all be accommodated in this DPL.

G. Risks and Mitigation

The overall risk rating of this operation is moderate. Main risks are the following: (a) political economy and governance challenges, (b) stakeholders risk and (c) the weak institutional and implementation capacity. These risks, if materialized, could negatively impact the Government's willingness and ability to achieve the intended positive results of the DPL series (even if all of the prior actions are completed). 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. To mitigate these risks the team has broadened the scope of collaboration with the government by directly engaging with the relevant directorates in the line ministries responsible for the implementation of the reforms and it has been implementing a technical assistance program (together with AfD) to help strengthen the regulatory function of the Port Authorities linked to the DPL implementation.

[5] This is conditional on the assumption that at least part of the gains in logistics efficiency would be passed on to final prices.

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