PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Date 10/27/2017
Report No.: 125015

Operation Name	Indonesia Logistics Reform DPL 2
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	P163973
Lending Instrument	Development Policy Lending
Borrower(s)	The Republic of Indonesia
Implementing Agency	Coordinating Ministry of Economic Affairs
Date PID Prepared	October 27, 2017
Estimated Date of Appraisal	February 1, 2018
Estimated Date of Board Approval	March 15, 2018
Corporate Review Decision	
Other Decision *{Optional}*	*Teams can add more if they wish or delete this row if no other decisions are added*

I. Key development issues and rationale for Bank involvement

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.

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.

II. Proposed Objective(s)

This second operation in the DPL series builds on the first operation to support the Government's overall objective to reduce the costs and improve the reliability of the logistics chain in Indonesia. It does so by supporting the relevant institutional and policy reforms being undertaken by the Government. In doing so the operation has been selective on which government initiatives and reforms to support through the DPL – namely those that are expected to contribute significantly to the overall objectives through the medium-term.

III. Preliminary Description

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)

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

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.

IV. 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.

Environment 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

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

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.

V. Tentative financing

Source:		($m.)
Borrower		0
International Bank for Reconstruction and Development		400
Borrower/Recipient		
IBRD		
Others (specify)		
	Total	400

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