



# Completion Report

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Project Number:  
Loan Numbers: 2305 and 2394  
September 2009

## Indonesia: Second Development Policy Support Program and Third Development Policy Support Program



**CURRENCY EQUIVALENTS**  
Currency Unit – Rupiah

		<b>At Appraisal (DPSP-2)</b> (as of 25 November 2002)	<b>At Project Completion (DPSP-3)</b> (as of 20 December 2007)
Rp1.00	=	0.0001097	0.0001062
\$1.00	=	9,115.77	9,412.50

**ABBREVIATIONS**

ADB	–	Asian Development Bank
BAPEPAM-LK	–	<i>Badan Pengawas Pasar Modal dan Lembaga Keuangan</i> (Capital Market and Financial Institution Supervisory Agency)
BAPPENAS	–	<i>Badan Perencanaan Pembangunan Nasional</i> (Planning Ministry)
BUMD	–	<i>Badan usaha milik daerah</i> (regional government-owned enterprises)
CMEA	–	Coordinating Ministry for Economic Affairs
DPL	–	Development Policy Loan
DPSP	–	Development Policy Support Program
GDP	–	gross domestic product
IMF	–	International Monetary Fund
LIBOR	–	London interbank offered rate
MOF	–	Ministry of Finance
NBFI	–	nonbank financial institution
NPO	–	National Procurement Office
PEPI	–	National Team for Accelerating Investments and Exports
PFM	–	public financial management
PNPM	–	<i>Program Nasional Pemberdayaan Masyarakat</i> (National Community Empowerment Program)
RPJM	–	<i>Rencana Pembangunan Jangka Menengah</i> (Medium-Term Development Plan)
SME	–	small or medium enterprise
TSA	–	treasury single account
TA	–	technical assistance
VAT	–	value-added tax

**NOTE**

In this report, "\$" refers to US dollars.

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## DPSP-2: BASIC DATA

### A. Loan Identification

1.	Country	Indonesia
2.	Loan Number	2305
3.	Program Title	Second Development Policy Support Program
4.	Borrower	Republic of Indonesia
5.	Executing Agency	Ministry of Finance
6.	Amount of Loan	\$200.00 million
7.	Program Completion Report Number	1114-INO

### B. Loan Data

1.	Appraisal	
	– Date Started	6 November 2006
	– Date Completed	6 November 2006
2.	Loan Negotiations	
	– Date Started	16 November 2006
	– Date Completed	16 November 2006
3.	Date of Board Approval	20 December 2006
4.	Date of Loan Agreement	21 December 2006
5.	Date of Loan Effectiveness	
	– Actual	21 December 2006
	– Number of Extensions	0
6.	Closing Date	
	– Actual	21 December 2006
	– Number of Extensions	0
7.	Terms of Loan	
	– Interest Rate	LIBOR + 0.60%
	– Maturity (number of years)	15 years
	– Grace Period (number of years)	3 years

#### 8. Disbursements

##### a. Dates

Initial Disbursement	Final Disbursement	Time Interval
21 December 2006	21 December 2006	0 days
Effective Date	Original Closing Date	Time Interval
21 December 2006	30 June 2007	6 months and 9 days

##### b. Amount (\$million)

Category or Subloan	Original Allocation	Last Revised Allocation	Amount Canceled	Net Amount Available	Amount Disbursed	Undisbursed Balance
Total	200	200	0	200	200	0

**C. Program Data**1. Program Cost (\$million)<sup>a</sup>

<b>Cost</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
Foreign Exchange Cost	900	900
Local Currency Cost		
<b>Total</b>	<b>900</b>	<b>900</b>

<sup>a</sup> This refers to the total cost of the DPSP-2 and includes financing by the World Bank and the Government of Japan.

## 2. Financing Plan (\$million)

<b>Cost</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
Implementation Costs		
Borrower Financed		
ADB Financed	200	200
Other External Financing		
- World Bank	600	600
- Japan Bank for International Cooperation	100	100
<b>Total</b>	<b>900</b>	<b>900</b>

ADB = Asian Development Bank.

## 3. Cost Breakdown by Program Component (\$)

<b>Component</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
None		

## 4. Program Schedule

<b>Item</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
Date of Contract with Consultants	none	

## 5. Program Performance Report Ratings

<b>Implementation Period</b>	<b>Ratings</b>	
	<b>Development Objectives</b>	<b>Implementation Progress</b>
From 20 December 2006 to 21 December 2006	Highly satisfactory	Highly satisfactory

**D. Data on Asian Development Bank Missions**

<b>Name of Mission</b>	<b>Date</b>	<b>No. of Persons</b>	<b>No. of Person-Days</b>	<b>Specialization of Members</b>
Appraisal Mission	6 November 2006	2	2	(i) Principal Economist, (ii) Financial Sector Officer
Loan Negotiations	16 November 2006	4	4	(i) Principal Programs Coordination Specialist (ii) Senior Counsel (iii) Principal Economist (iv) Financial Control Specialist
Program Completion Review	22 June to 9 July 2008, and 1–24 June 2009 (intermittent)	3	30	(i) Senior Country Economist (ii) Principal Country Specialist (iii) Programs Officer

### DPSP-3: BASIC DATA

#### A. Loan Identification

1.	Country	Indonesia
2.	Loan Number	2394
3.	Program Title	Third Development Policy Support Program
4.	Borrower	Republic of Indonesia
5.	Executing Agency	Ministry of Finance
6.	Amount of Loan	\$200.00 million
7.	Program Completion Report Number	

#### B. Loan Data

1.	Appraisal	
	– Date Started	9 October 2007
	– Date Completed	10 October 2007
2.	Loan Negotiations	
	– Date Started	8 November 2007
	– Date Completed	9 November 2007
3.	Date of Board Approval	17 December 2007
4.	Date of Loan Agreement	17 December 2007
5.	Date of Loan Effectiveness	
	– Actual	19 December 2007
	– Number of Extensions	0
6.	Closing Date	
	– Actual	20 December 2007
	– Number of Extensions	0
7.	Terms of Loan	
	– Interest Rate	LIBOR-based
	– Maturity (number of years)	15 years
	– Grace Period (number of years)	3 years

#### 8. Disbursements

##### a. Dates

Initial Disbursement	Final Disbursement	Time Interval
20 December 2007	20 December 2007	0 day
Effective Date	Original Closing Date	Time Interval
19 December 2007	31 March 2008	102 days

##### b. Amount (\$million)

Category or Subloan	Original Allocation	Last Revised Allocation	Amount Canceled	Net Amount Available	Amount Disbursed	Undisbursed Balance
<b>Total</b>	<b>200</b>			<b>200</b>	<b>200</b>	

**C. Program Data**2. Program Cost (\$million)<sup>a</sup>

<b>Cost</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
Foreign Exchange Cost	900	900
Local Currency Cost		
<b>Total</b>	<b>900</b>	<b>900</b>

<sup>a</sup> This refers to the total cost of the DPSP-3 and includes financing by the World Bank and the Government of Japan.

## 2. Financing Plan (\$million)

<b>Cost</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
Implementation Costs		
Borrower Financed		
ADB Financed	200	200
Other External Financing		
- World Bank	600	600
- Japan Bank for International Cooperation	100	100
<b>Total</b>	<b>900</b>	<b>900</b>

ADB = Asian Development Bank.

## 3. Cost Breakdown by Program Component (\$)

<b>Component</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
None		

## 4. Program Schedule

<b>Item</b>	<b>Appraisal Estimate</b>	<b>Actual</b>
Date of Contract with Consultants	none	

## 5. Program Performance Report Ratings

<b>Implementation Period</b>	<b>Ratings</b>	
	<b>Development Objectives</b>	<b>Implementation Progress</b>
From 17 December 2007 to 20 December 2007	Highly Satisfactory	Highly Satisfactory

**D. Data on Asian Development Bank Missions**

<b>Name of Mission</b>	<b>Date</b>	<b>No. of Persons</b>	<b>No. of Person - Days</b>	<b>Specialization of Members</b>
Appraisal Mission	9–10 October 2007	2	4	(i) Principal Country Specialist (ii) Financial Sector Officer
Loan Negotiations	8–9 November 2007	3	6	(i) Principal Country Specialist (ii) Senior Counsel (iii) Financial Sector/Small Medium Enterprises Specialist (iv) Financial Control Specialist
Program Completion Review	22 June to 9 July 2008, and 1–24 June 2009 (intermittent)	3	3 0	(i) Senior Country Economist (ii) Principal Country Specialist (iii) Programs Officer

## I. PROGRAM DESCRIPTION

1. After exiting in 2003 a program supported by the International Monetary Fund (IMF)<sup>1</sup>, the Government of Indonesia signaled its commitment to continuing the process of reform and fiscal consolidation by issuing a white paper on policy reforms and its Medium-Term Development Plan (*Rencana Pembangunan Jangka Menengah* or RPJM) for 2004–2009.<sup>2</sup> In 2004 the World Bank began to provide assistance for the RPJM through its First Development Policy Loan (DPL-1), supported with parallel-financing support from the Government of Japan. In 2005 Asian Development Bank (ADB) joined the World Bank and the Government of Japan and provided parallel program financing through its First Development Policy Support Program (DPSP-1)<sup>3</sup> in the amount of \$200 million to DPL-2.

2. The DPSP-2 and DPSP-3 cluster programs—each worth \$200 million—were successor programs to DPSP-1 and provided parallel cofinancing to DPL-3 and DPL-4 under a joint policy matrix. DPSP-2 and DPSP-3 were consistent with ADB's reform agenda, Long-Term Strategic Framework, Medium-Term Strategy, and the Middle Income Country Initiative.<sup>4</sup> Both loans supported the Government's reform program in four core policy areas: (i) improving macroeconomic stability and creditworthiness, (ii) improving the investment climate, (iii) improving public financial management (PFM) and reducing corruption, and (iv) improving public service delivery.

3. DPSP-2 and DPSP-3 were part of a program cluster in which every program builds on reforms undertaken in the previous program, while simultaneously setting the groundwork for the subsequent program. Both loans were single-tranche operations based on up-front, completed actions or triggers that demonstrated substantive progress towards the Government's medium-term objectives. Between 2004 and the completion of DPL-4/DPSP-3 \$2.9 billion was disbursed: \$1.9 billion by the World Bank (DPL 1-4), \$400 million by the Government of Japan, and \$600 million of parallel financing provided by ADB through DPSP 1–3. Neither the World Bank nor ADB provided direct technical assistance (TA) linked to DPL/DPSP. The World Bank, the Government of Japan, and ADB have continued to support policy reforms through the DPL/DPSP series, and are processing DLP-6/DPSP-5 for 2009, the sixth consecutive yearly policy program.

4. The harmonized approach to policy-based lending under DPL-3/DPSP-2 and DPL-4/DPSP-3 was supported through a variety of analytical and technical advisory assistance, including a World Bank poverty assessment, a public expenditure review, an investment climate survey, and input from the Government's Financial Management and Revenue Administration project.<sup>5</sup> ADB has been engaged in policy dialogue in all areas of DPSP, particularly on policies

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<sup>1</sup> International Monetary Fund. 2003. *IMF supports Indonesia's decision to enter into post-program monitoring*. Washington.

<sup>2</sup> Ministry of Economy. 2003. *Economy Policy Package Pre and Post IMF*. Jakarta; and BAPPENAS. 2005. *Presidential Regulation Number 7 of 2005 on the National Medium-Term Development Plan*. Jakarta.

<sup>3</sup> ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Government of Indonesia for the Development Policy Support Program*. Manila. Further, ADB. 2008. *Completion Report - Indonesia: Development Policy Support Program*. Manila.

<sup>4</sup> ADB. 2001. *Moving the Poverty Reduction Agenda Forward in Asia and the Pacific: the Long-Term Strategic Framework of the Asian Development Bank (2001–2005)*. Manila; ADB. 2001. *Medium-Term Strategy (2001–2005)*. Manila; and ADB. 2008. *Enhancing Asian Development Bank Support to Middle-Income Countries and Borrowers from Ordinary Capital Resources: First Progress Report*. Manila.

<sup>5</sup> World Bank. 2007. *International Bank for Reconstruction and Development Program Document for a Proposed fourth Development Policy Loan (DLP-4) in the amount of \$600 million to the Republic of Indonesia*. Washington, P. 30.

concerning decentralization and infrastructure but also through input from the State Audit Reform Sector Development Program.<sup>6</sup> Findings of the current review are largely based on missions jointly conducted with the World Bank, and involving consultations with ministers and senior officials of key implementing agencies.<sup>7</sup>

5. Appendixes 1 to 3 provide further information on (i) the design and monitoring framework, (ii) the status of compliance with loan covenants, and (iii) triggers and outcomes of both programs.

## II. EVALUATION OF DESIGN AND IMPLEMENTATION

### A. Relevance of Design and Formulation

6. As was their predecessor, DPSP-1, both DPSP-2 and DPSP-3 were closely aligned to ADB's policy and reform agenda, reflected in the Long-Term Strategic Framework<sup>8</sup>, Medium-Term Strategy<sup>9</sup>, and Middle Income Country Initiative<sup>10</sup>. Close donor cooperation in program design and implementation led to joint policy matrixes that were in line with commitments under the Rome Declaration to harmonize development banks' procedures, and were in line with the Paris Declaration on aid management and effectiveness.<sup>11</sup> The selection of key areas for action was driven by the overall objectives of promoting broad-based growth sustainable over the medium-term, and achieving lower levels of poverty and unemployment.

7. As the design of the DPSP and the choice of program outcomes corresponded to the Government's reform plans, there was strong ownership by the Government, with officials of key agencies (the Coordinating Ministry of Economic Affairs, the Ministry of Finance, and the National Development Planning Agency) involved closely through extensive formal discussions and informal consultations. Furthermore, the DPL/DPSP series of policy-based programs aimed to harmonize the policy-reform support being provided by key development partners. ADB's involvement in the DPL process effectively built on and deepened sector-specific reforms supported by ADB through its Country Strategy and Program 2006-2009.

8. The policy agenda emerged from various analytical and advisory activities and was not augmented through direct TA support. ADB, the World Bank, and the Government of Japan have worked on the DPL/DPSP series as equal partners, jointly carrying out preparatory work, drawing up common policy stances, and reaching common agreement on the fulfillment of triggers, on the progress of program implementation, on the achievement of medium-term objectives, and on the selection of indicative triggers for the next program. Moreover, while the work of ongoing and previous sector reform programs was reflected in the design of the DPSP-

<sup>6</sup> ADB. 2004. *State Audit Reform Sector Development Program*. Manila.

<sup>7</sup> These missions led to World Bank's implementation completion and results report covering DPL 1–4 (including DPSP-2 and DPSP-3). World Bank. 2009. *Implementation completion and results report on a series of credit and loans in the amount of SDR47.4 million (US\$70 million equivalent) in credit and \$1.830 billion in loans to the Republic of Indonesia for Development Policy Loans I-IV*. Washington.

<sup>8</sup> ADB, 2008. *Strategy 2020 - The Long-Term Strategic Framework of the Asian Development Bank 2008-2020*. Manila.

<sup>9</sup> ADB. 2006. *Medium-Term Strategy II (2006-2008)*. Manila.

<sup>10</sup> ADB. 2006. *Enhancing Asian Development Bank Support to Middle-Income Countries and Borrowers from Ordinary Capital Resources*. Manila.

<sup>11</sup> The Rome Declaration refers to the 2003 agreement on harmonizing procedures of development banks under which major multilateral and bilateral aid agencies agreed to improve the management and effectiveness of aid and to take stock of concrete programs. The 2005 Paris Declaration is an international agreement that commits participating countries and organizations to improving aid harmonization, alignment, and management, and to measuring results using a set of monitorable actions and indicators.

2 and DPSP-3, care was taken to avoid any duplication or double counting of reform actions. Implementation was aided by the fact that there were several key government counterparts who were committed to enacting the reforms and to engaging with the task teams of the three development partners on monitoring progress. As a result, the DPL/DPSP programs have successfully supported the Government's own reform agenda. Furthermore, most of the team members were based in their organization's field office and were therefore able to cultivate close working relationships with Government counterparts. This facilitated dialogue, especially as the breadth and depth of the engagement grew.

9. Senior Government officials have expressed their appreciation for the reduction in transactions costs as duplications of discussions on core reform actions had been reduced through the joint DPL/DPSP program arrangements. Program discussions have been held jointly with the Government at every stage of the DPL/DPSP series. Before DPSP-1, the DPL had sought to consolidate macroeconomic stability following Indonesia's exit from its post-crisis IMF program. With macroeconomic stability underway, DPSP-1 focused more on creating fiscal space for additional pro-poor expenditures. After a reduction in fuel subsidies created more fiscal space in 2006, the focus of DPSP-2 shifted to improving service delivery. In 2007, during DPSP-3, the focus shifted to deepening institutional reforms.

## **B. Program Outputs**

10. Program outputs—defined as "triggers"—were formulated for the four core policy areas outlined in para. 2. DPSP-2 covered all four core policy areas while DPSP-3 excluded the first core area—improving macroeconomic stability and creditworthiness—because of indications that broad macroeconomic stability was well underway. All triggers were achieved before the loans were approved (Appendix 3). The Reports and Recommendations of the President to the Board of Directors for DPSP-2 and DPSP-3 outline achievements at length; they will only be summarized here in the context of both loans.<sup>12</sup>

### **a. Improved Macroeconomic Stability and Creditworthiness**

11. Over the period of DPSP-2 and DPSP-3, economic growth increased to 6.3% in 2007, budget deficits were conservative (not higher than 1.3% of gross domestic product [GDP]) and foreign reserves rose to record levels (\$56.9 billion in 2007). By 2007 the Government had reduced its debt-to-GDP ratio to less than 35% and was already closing on its 2010 debt-to-GDP ratio target of 30%—an impressive reduction from 60% in 2003. Recognizing this overall prudent macroeconomic management, the three major rating agencies raised their sovereign credit ratings for Indonesia by three or more notches between 2002 and 2007.

12. As mentioned earlier, only DPSP-2 targeted macroeconomic stability, specifically in three trigger areas: (i) fiscal policy, (ii) debt management, and (iii) decentralization.

13. **Improving fiscal policy.** A Fiscal Policy Office, replacing the Agency for Economic and Financial Research and International Cooperation, was established in 2006 to separate fiscal policy formulation from fiscal policy implementation within the Ministry of Finance (MOF). The Government has since introduced a process for regularly transferring data and information on taxes to improve forecasting accuracy. The Fiscal Policy Office now reports all data and

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<sup>12</sup> This section follows to some extent World Bank's completion report (see footnote 7). The World Bank, the Government of Japan, and ADB conducted a joint program completion mission from 22 June to 9 July 2008 on DPL 1-4 (DPSP 1-3); the findings were discussed among all partners.

assessments on a monthly basis to the economic ministers in the Cabinet, thereby increasing transparency and accountability. The tariff-setting process was further improved through a completed tariff harmonization exercise and through improved coordination between the Ministry of Trade and MOF.

14. **Improving Debt Management.** Indonesia has achieved significant progress on debt management. Smaller budget deficits and non-debt financing (e.g., sales of assets of the Indonesian Bank Restructuring Agency), along with steady economic growth, have brought the debt-to-GDP ratio down rapidly. The State Finances Law specifies a debt-to-GDP ratio below 60% of GDP as a safe level (building on the so-called "Maastricht norms"). This ratio was further reduced and reached 34.8% shortly after the implementation of DPSP-2. MOF is now continuously assessing the costs and risks associated with public debt. To facilitate implementation of improved debt management, a new Directorate General was created to deal exclusively with debt management in MOF. Periodic debt reports that integrate foreign and domestic debt are now being published quarterly, and further detailed information on debt is being presented on a newly established website (<http://www.dmo.or.id>). Moreover, the Government has begun to assess civil service liabilities under DPSP-2.

15. **Streamlining decentralization framework.** As part of the DPSP-2 process, the Government issued ministerial decrees clarifying on-granting and on-lending procedures to attract more financing for infrastructure projects and improve service delivery. The system for issuing subnational government bonds was strengthened, and restructuring schemes and re-scheduling procedures for sub-national debt were worked out. To further accelerate reforms related to regional finances, a separate Directorate General for Inter-Governmental Fiscal Relations was established in MOF.

#### **b. Improved Investment Climate**

16. In conjunction with the 2003 white paper, the Government in 2006 began to issue economic policy packages covering the investment climate, infrastructure, and financial reforms. To assist the Government in improving the investment climate, DPSP-2 and DPSP-3 "tackled reforms in areas such as (i) investment laws and regulations, (ii) tax and custom administration, (iii) the financial sector, and (iv) strengthening small businesses.

17. Over the course of DPSP-2/DPSP-3 substantial improvements in the investment climate were recorded, but the full impact of some reforms has yet to be realized. In 2003 investment rates were below 20% of GDP. By 2007 this figure had improved to 25% of GDP. Fitch's credit rating agency upgraded Indonesia to BB in February 2008, directly attributing the upgrade to the Government's efforts to improve the investment climate. Moreover, measured by World Bank's ranking system of "Doing Business" the investment climate improved considerably.<sup>13</sup> In "Doing Business 2008", Indonesia ranked 123 out of 178 countries, but the country's overall rank rose 10 places in the 2007 rankings. The country made double-digit jumps in the categories of (i) dealing with licenses, (ii) paying taxes, and (iii) trading across borders.

18. **Regulatory reforms and improved legal framework for investment.** DPSP 2 and 3 supported the Investment Law—approved in March 2007—which encouraged, among other things, (i) a unified framework for investment, (ii) equal treatment of domestic and foreign investors, (iii) a clear and well defined negative list, (iv) removal of forced divestment, (v) an

<sup>13</sup> See World Bank. 2007. Doing Business 2008. Available: <http://www.doingbusiness.org>

extension of the duration of foreign investment, (vi) reaffirmation of the principles of no expropriation without compensation and free repatriation of capital, (vii) allowances for internationally recognized arbitration. The National Team for Accelerating Investments and Exports (PEPI) was revitalized and charged with formulating investment policies and resolving key constraints faced by the private sector.

19. Further support went toward reorganizing the consolidated non-bank financial institutions (NBFI) supervisory agency. The merger of the Capital Markets Supervisory Agency and Directorate General of Financial Institutions led to the new Capital Market and Financial Institutions Supervisory Agency (BAPEPAM-LK), which now acts as the combined capital markets and NBFI regulator.

20. **Tax and custom administration reforms.** Substantial progress has been achieved in improving value-added tax (VAT) administration. The average time taken to settle the VAT refund claims of manufacturing exporters fell to 5.1 months in 2008, compared with 12-18 months in 2003. The settlement process of VAT refunds was further accelerated through the Tax Administration Law, which allows taxpayers to self-assess amounts from disputed audits until they are officially resolved in tax courts. Taxpayer rights have also been extended in other ways. Tax audit procedures now allow taxpayers to request the details of audit findings, while changes in the Tax Law have strengthened the position of taxpayers in disputed audits. This shift in the balance of power from the tax administration to the taxpayers makes it more difficult for tax officials to extract bribes, and instills in taxpayers a greater sense of confidence in the integrity of the tax system.

21. Progress on trade and customs reform was advanced through the development of Indonesia's national single window<sup>14</sup> and paperless import clearance. Under the single window, exporters and importers are no longer required to apply individually to multiple agencies, significantly reducing the average processing time of 26 days in 2007 and reducing associated governance problems and costs. The blueprint for the national single window was released with a pilot project for Tanjung Priok port in Jakarta, which handles about 60% of Indonesia's trade, as a first step for the nationwide launch and integration into the ASEAN single window. Establishing the national single window is a major institutional and coordination challenge involving 32 ministries and agencies.

22. **Financial sector reforms.** To improve stability in the financial sector, the DPSP series assisted the Government in reducing the potential moral hazard created by the blanket guarantee of deposits introduced during the Asian crisis. This focused on establishing a deposit insurance scheme and phasing out the blanket guarantee. By DPSP-3, coverage of deposits had been reduced from a blanket guarantee to Rp100 million (\$10,660 as of 31 December 2007). The coverage of deposits was later increased to Rp200 million (\$18,100 as of 31 December 2008) as a response to the current global crisis, but the Government indicated that it would not reintroduce a full guarantee on bank deposits, as the governments of Singapore and Malaysia had done.

23. Another important reform supported was the clarification of the legal status of regional government-owned enterprises (BUMD)—especially regarding their fiscal and financial relationship with regional governments, as stipulated in the respective BUMD law. The Law on

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<sup>14</sup> A national single window is an electronic system to facilitate trade, increase efficiency of the Government delivery system and provide benefits to all members of the trading community, including government agencies.

BUMD also leads to improved BUMD governance by regulating BUMD financial operations such as long-term borrowing, profit-sharing, and bankruptcy.

24. **Strengthening small businesses.** The enactment of the Warehouse Receipts Law was supported in DPSP-2 and DPSP-3 to establish designated warehouses providing centrally registered receipts for commodities stored by farmers, growers, and traders. These warehouses can be used by farmers or small and medium enterprises (SMEs) in the agro-business to allow for flexibility in selling their products based on market conditions. The receipts can be traded as derivatives, used to settle maturing futures contracts on a commodity exchange, or used as collateral to obtain bank loans. Further support was granted on SME policies to increase SME's access to finance.

### c. Improved Public Financial Management (PFM) and Anticorruption

25. To improve efficiency, transparency and accountability of public finances, DPSP 2–3 focused on three key areas of reform: (i) modernizing PFM systems and budgeting, (ii) strengthening anticorruption institutions, and (iii) civil service reforms.

26. **Modernizing PFM systems and budgeting.** The old PFM system—largely based on outdated laws—was characterized by (i) systematic and pervasive corruption; (ii) collusion and nepotism, in part because assignments were unclear; (iii) low transparency and poor enforcement; (iv) opaque and inefficient budget formulation; (v) delayed budget execution; (vi) weak monitoring arrangements; (vii) corruption- and collusion-prone procurement processes; (viii) fragmented and unreliable accounting and reporting processes; and (ix) unclear mandates of government audit bodies. The DPSP series supported various regulatory and other measures needed to create and operate a modern PFM system.

27. A major achievement of both programs was the implementation of a treasury single account (TSA) to improve cash management of public finances. In 2004, more than 18,000 separate commercial bank accounts—and other accounts unknown to the Treasury—handled government funds. After addressing the regulatory deficiencies and having supported TSAs on a pilot basis, DPSP-2 extended the coverage to 50 regional treasury offices. DPSP-3 extended the coverage to all government expenditure accounts. With the TSA Indonesia consolidates its government accounts, an important milestone for transparency in public finances and anti-corruption.

28. Budget procedures were improved throughout the course of both programs, and the Government budget is now compatible with IMF's international standard Government Finance Statistics classification system.<sup>15</sup> DPSP-2 helped implement quarterly reporting of budget performance by organizational classification and by functional and economic classifications. Financial transactions between the Treasury and line ministries are now being reconciled on a monthly basis at the State Treasury Office, and on a quarterly basis at the provincial level. Financial statement disclosure has improved within the central Government, especially in relation to audit reports. Elements of a medium-term expenditure framework and of a performance-based budgeting system—both supported by DPSP-3—were introduced, but progress has been uneven as budget execution remains weak (about 50% of capital expenditures are still spent in the last quarter of each year).

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<sup>15</sup> International Monetary Fund. 2001. Government Finance Statistic Manual 2001. Washington.

29. Tax administration and revenue management were other areas targeted for PFM reform. In contrast to the previous tax administration system, which focused on the type of tax, the Directorate General of Tax has adopted a new structure to refocus on key functions including risk management, internal controls, monitoring tax official's code of conduct, change management, research and outreach. DPSP-2 and DPSP-3 further supported the implementation of a modernization strategy leading to a re-engineering of the tax department. Revenue management support included the introduction of transparent accountability arrangements for central Government investment funding accounts and regional development accounts. Ministerial decrees have addressed the following: operational matters such as administration and supervision of investments; management of the Infrastructure Guarantee Fund<sup>16</sup>; minimum service standards for investment funds; administrative requirements for financial management of public service agencies; supervisory boards for public service agencies; and establishing an investment committee for the central Government.

30. In the area of procurement reforms, the original goal of DPSP-2 was to strengthen the National Procurement Office, located within the Planning Ministry (BAPPENAS). Later the Government decided that the National Procurement Office should become an independent office directly under the President. The establishment of this office was achieved in 2007 under DPSP-3. This new and independent agency has started to drive public procurement reforms leading to national public sector Procurement Law that rectifies decentralization-related inconsistencies in procurement.

31. **Strengthening anticorruption institutions.** Throughout the DPSP series support has been provided to establish anticorruption institutions with considerable autonomy and authority. The number of cases prosecuted has gone up dramatically, and high-profile corruption investigations have been launched at every level of government and state-owned enterprise. Newspapers carry regular accounts of new cases and the latest prosecutions. DPSP-2 supported the approval of the Witness and Victim Protection Law, and anticorruption support has been incorporated into larger civil service reforms.

32. **Civil service reforms.** The first step taken by the Government was redesign the job classification system and remuneration policy for high-ranking officials, with the aim of providing sufficient monetary incentives for civil servants and improving public service delivery. To provide comparability criteria within the civil service a task force was set up to examine the compensation packages of these high-level officials, with the goal of creating a more transparent, systematic, and coherent framework for pay and allowances. Subsequently, DPSP began to focus on the need for civil service reforms in support of PFM reforms at the MOF. MOF has now implemented several important reforms to improve its efficiency and staff performance, such as improved job descriptions, new grading schemes, and additional allowances based on responsibility and performance. Based on the selected pilot projects in MOF, the Government is now implementing broader civil service reforms in other targeted departments.

#### **d. Improved Delivery of Public Services**

33. After the fuel subsidies were reduced in 2005, the Government launched an unconditional cash transfer program to compensate poor and near-poor households. The unconditional cash program was assessed under DPSP-2 leading to changes and improvements in the disbursement of the second tranche of cash transfers. In addition,

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<sup>16</sup> The Infrastructure Guarantee Fund assists in providing appropriate public support to privately financed infrastructure projects in Indonesia.

qualitative assessments of the education programs and health programs in selected provinces were undertaken, which led to better mapping of target groups.

34. DPSP-3 started to enhance the assessment framework for selected service delivery programs of the Government. Further reforms supported education and community-based development. Standards for teachers were formalized and procedures for teacher certification were put in place. DPSP-3 further supported a mechanism to reallocate unspent community designed development funds of one year into the subsequent budgets as on top budgets. This mechanism was introduced as not all local governments had the capacity developed to absorb national budget-funded programs in a timely manner. At the same time procurement procedures for national budget-funded community-based programs were clarified allowing for faster disbursements of allocated funds.

### **C. Program Costs**

35. DPSP-2 and DPSP-3 represent parallel financing facilities to support policy reforms. While DPSP resources were not directly allocated to specific reforms, they underpinned the Government's ability to undertake its planned reform program as outlined in the respective development policy letters and policy matrixes. There were no changes in program costs, as both programs were approved after the Government had met all policy reform triggers. Loan proceeds were used to support the balance of payments.

### **D. Disbursements**

36. The DPSP-2 loan became effective on 21 December 2006. As all outcomes were fulfilled satisfactorily before loan approval, disbursement of the single tranche loan took place on 21 December 2006. Like its predecessor, DPSP-3 was structured as a single tranche loan. It became effective on 19 December 2007, and all outcomes were fulfilled satisfactorily before loan approval. Full disbursement of the loan took place on 20 December 2007.

### **E. Program Schedule**

37. For both programs all outcomes were satisfactorily fulfilled before ADB Board approval. The planned program period for DPSP-2 was 21 December 2006 to 30 June 2007. The financial account was closed upon final disbursement on 21 December 2006.

38. The planned program period for DPSP-3 was from 19 December 2007 to 20 December 2007, and the financial account was closed on 20 December 2007.

### **F. Implementation Arrangements**

39. Both programs were implemented as designed at appraisal without any changes. The Coordinating Ministry of Economic Affairs, the Executing Agency, supervised implementation together with MOF and BAPPENAS. With team members in the field from all three development partners, monitoring was done on a continuous basis and supported by complementary investment projects, TA and/or analytical and advisory activities that aided in the design and implementation of the reform.

## **G. Conditions and Covenants**

40. DPSP-2 consisted of 16 policy triggers and DPSP-3 consisted of 17 policy triggers. All loan triggers, together with supporting policy measures, were satisfied at the time of loan approval. Both loan agreements included sections of particular covenants, all of which have been complied with (see Appendix 2).

## **H. Related Technical Assistance**

41. There was no TA directly linked to DPSP-2 and DPSP-3. The DPSP policy triggers, though mainly drawn from the Government's reform agenda, also drew on the continuous dialogue between the three development partners and the Government, as well as on the World Bank's extensive analytical work (including annual development policy reviews; biannual public expenditure reviews; flagship reports on decentralization, combating corruption, poverty and trade; policy briefs for the incoming Government; and an investment climate assessment.<sup>17</sup> The DPSP series further benefited from several bilateral donor-funded trust funds, which helped underpin the policy dialogue on the Program. ADB provided technical input through three additional programs: a program on decentralization<sup>18</sup>, a program on state audit systems<sup>19</sup>, and a program to improve infrastructure development.<sup>20</sup> The Government of Japan provided background studies on trade and the investment climate.<sup>21</sup>

## **I. Consultant Recruitment and Procurement**

42. No consultants were recruited to assist with the design or implementation of DPSP-1 or DPSP-2.

## **J. Performance of Consultants, Contractors, and Suppliers**

43. There were no consultants, contractors, or suppliers involved in the design or implementation of DPSP-2 or DPSP-3.

## **K. Performance of the Borrower and the Executing Agency**

44. All program outcomes were achieved in advance of Board approval, and the Borrower and Executing Agency complied with the loan covenants to the extent practicable (see Appendix 2).

45. The Executing Agency is relatively strong in terms of institutional capacity within the Government. The Executing Agency's close engagement with ADB and the other development partners over the course of the programs allowed it to develop a deeper understanding of donor

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<sup>17</sup> World Bank. 2007. *Indonesia Public Expenditure Review 2007*. Jakarta. World Bank. 2007. *Combating Corruption in Decentralized Indonesia*. Jakarta. World Bank. 2006. *Indonesia: Rural Investment Climate Assessment Report*. Jakarta.

<sup>18</sup> ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for the Local Government Finance and Governance Reform Sector Development Program*. Manila.

<sup>19</sup> ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for the State Audit Reform Sector Development Program*. Manila.

<sup>20</sup> ADB. 2005. *Support for Infrastructure Development*. Manila.

<sup>21</sup> Japan International Cooperation Agency. 2005. *Study on Trade Related Systems and Procedures in the Republic of Indonesia*. Jakarta.

operating procedures and processes. This greatly facilitated the design and formulation of the programs and ultimately helped ensure their success.

46. The performance of the Borrower and Executing Agency under the Program is rated highly satisfactory. It should be noted that this is largely a reflection the Executing Agency's competency and ownership.

#### **L. Performance of the Asian Development Bank**

47. As mentioned earlier, both DPSP-2 and DPSP-3 were harmonized with support provided by the World Bank and the Government of Japan. Consultations took place regularly and led to joint missions in which all three development partners participated. Furthermore, both programs were decentralized to the Indonesia Resident Mission, which allowed for closer interaction with the Government. ADB's performance was rated as satisfactory on the basis of discussions with stakeholders and donor partners.

### **III. EVALUATION OF PERFORMANCE**

#### **A. Relevance**

48. The series of policy-based operations under DPL/DPSP underpins some of the most important items in the Government's reform agenda and places all involved development partners at the center of the reform policy process in Indonesia. DPL/DPSP supported key agents of change in the targeted sectors, and provided ADB with a unique opportunity to support the reform process. The DPL/DPSP series underlined the maturity in the relationship with the Government, with evidence of considerable trust and mutual understanding of the constraints imposed by institutional guidelines and internal processes. Each DPSP program builds on the achievements of the previous program, while simultaneously setting the policy agenda for the subsequent program in the context of the Government's RPJM.

49. The relevance of the Program remained high throughout DPSP-2 and DPSP-3. In relation to the entire DPL/DPSP series, the focus of the Program underwent two significant changes over the course of DPSP-2 and DPSP-3. First, the focus on macroeconomic stability was reduced, and the focus on service delivery increased, in DPSP-3. This change was driven by an improvement of the overall macroeconomic situation, which created sufficient fiscal space to allow for increased prioritization of public service delivery. Second, infrastructure reforms, which initially had been included in DPSP-3 (under the core policy area of improving the investment climate), grew in importance and became an key element of the Government's own reform agenda. Infrastructure reforms are now supported by separate programs, such as the ADB-led Infrastructure Reform Sector Development Program.<sup>22</sup>

#### **B. Effectiveness in Achieving Outcome**

50. DPSP-2 and DPSP-3 advanced Government reform efforts effectively and in a timely manner. The programs provided resources to support and sustain outcomes achieved in the four core policy areas. ADB staff involved in designing and implementing the DPSP programs was successful in building a relationship of trust and cooperation with the Government.

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<sup>22</sup> ADB. 2006. *Republic of Indonesia: Infrastructure Reform Sector Development Program*. Manila.

51. Design proposals and implementation risks were discussed at an early stage in a spirit of mutual responsibility for the success of the Program. This process was facilitated by continuity in personnel on the government's side and the participation of high-level government counterparts in program discussions. ADB coordinated closely with its development partners to monitor progress in both programs. Meetings with the government agencies were conducted as needed, especially when constraints appeared that threatened to slow the pace of reform. Therefore, following up the implementation of milestone activities was closely observed by all stakeholders.

### **C. Efficiency in Achieving Outcome and Outputs**

52. Executing and implementing agencies fully achieved all outcomes prior to Board approval. Discussions with stakeholders and developing partners indicated that ADB's support and supervision of the Program were handled efficiently.

### **D. Preliminary Assessment of Sustainability**

53. In view of the medium-term nature of many of the targeted structural reforms, a high level of sustainability was achieved. As a result, after DPL-5/DPSP-4 the sixth DPL and fifth DPSP are now being launched. When DPSP-2 and DPSP-3 were designed, it was thought that DPL-4/DPSP-3 would be the last of the series. As it turned out, the Program proved so successful that the Government and the developing partners ended up extending the series. The series now offers a kind of policy work plan from one year to the next, with each program containing indicative policy triggers for the next program.

54. The continuous policy dialogue allowed for changing the emphasis of the reform agenda. Macroeconomic stability was achieved first; after that, the Program placed higher emphasis on pro-poor spending and improved service delivery. In DPSP-3, more emphasis was placed on supporting institutions. Continuous policy dialogue also led to support being given to new sectors, such as infrastructure development (which ultimately proved to be something that warranted a separate program). Further, there was widespread appreciation of the fact that policy triggers represented actions the Government regarded as necessary to achieving its own policy agenda. This strong national ownership of the reforms reflected in the DPSP series was viewed as a critical factor in ensuring sustainability and future progress.

### **E. Impact**

55. Regarding the Design and Monitoring Framework, DPSP-2 and DPSP-3 aimed to achieve (i) higher economic growth sustained over the medium-term and lower levels of unemployment and poverty as an impact, and (ii) improved overall economic management anchored on good governance as an outcome. The impact was formulated according to the Government's RPJM for DPSP-2, and according to the Government's annual work plan target for DPSP-3. The DPSP-2 impact results—GDP growth of 7%, reduction of the poverty rate to 8.2%, and reduction of the unemployment rate to 5.1% by 2009—proved highly optimistic. Nevertheless, the Government achieved substantial progress in the fight against corruption. DPSP-3 formulated its impact results in late 2007 based on the Government's annual work plan for 2008, and thereby achieved better-than-expected results. The Design and Monitoring Framework also included expected outcomes for both programs, which together with the impacts are summarized in Table 1.

**Table 1: Selected Envisaged DPSP-2 and DPSP 3 Impact and Outcome Goals**

<b>Impacts</b>	<b>DPSP-2</b>	<b>Realized results</b>	<b>DPSP-3</b>	<b>Realized results</b>
	GDP growth: 7% (2009)	4.4% (Q1 2009)	GDP growth: 7% (2009)	4.4% (Q1 2009)
	Poverty rate: 8.2% (2009)	14.2% (March 2009)	Poverty rate: 15-16% (2008)	8.2% (2009)
	Unemployment rate: 5.1% (2009)	8.1% (Feb 2009)	Unemployment rate: 8-9% (2009)	8.1% (Feb 2009)
	Level of corruption reduced by 2009	Level of corruption reduced <sup>a</sup>	Level of corruption reduced by 2009	Level of corruption reduced <sup>a</sup>
<b>Outcomes</b>	Government debt-to-GDP ratio: 40% (2008)	33% (2008)	Government debt-to-GDP ratio: below 38% (2008)	33% (2008)
	Average start-up time for new businesses: 30 days (2008)	76 (2008)	Mobilize additional domestic non-oil and gas tax revenues as a share of GDP from 10.4% of GDP in 2003 to 12–13% in 2008 (11.4% in 2006)	11.6% (2008)
	Continued implementation of the deposit insurance scheme, with coverage declining from full protection in September 2005 to a maximum of Rp100 million (\$11,000) by March 2007	Increased deposit guarantees up to Rp2 billion (October 2008)	Significant budgetary allocations made for poverty reduction programs (\$2.6 billion allocated for social assistance spending in 2005, \$4.4 billion allocated in 2006, and a projected \$7.4 billion allocated in 2008)	\$7.4 billion projected for 2008, but \$5.8 billion were finally realized, slightly higher than the \$5.5 billion for 2007.
	Investment-to-GDP ratio raised by 3–5% from 18.9% in 2003 (it was 22% in 2005)	24% (2008)		

Notes:

<sup>a</sup> Corruption Eradication Commission (KPK) processed cases increased to 194 in 2008 from 146 in 2007. In the same period recovered funds rose to Rp410 billion (US\$36m), from Rp48.4 billion.

Sources: ADB. 2006. Proposed Program Cluster and Loan Second Development Policy Support Program (Indonesia). Manila; ADB. 2007. Proposed Loan Third Development Policy Support Program (Indonesia), Manila; Asian Development Bank and World Bank data.

56. However, judging the impact only through highly aggregated statistical numbers may not fully reflect the benefits of these programs, as various institutions and systems were created or strengthened through these programs: For the macroeconomic policy area, institutional arrangements and policy reforms had been supported around debt management and the development of a fiscal policy office. The investment climate was strengthened through reforms leading to the national single window to facilitate trade and through the implementation of the investment law. Further institutional strengthening focused on BAPEPAM-LK as an integrated capital market and financial institution supervisory agency and PEPI, which serves as a liaison between the Government and the private sector. Regarding PFM both programs supported reforms leading to improved budgeting and financial reporting, the development of a treasury single account and the establishment of a modern tax administration. First reforms leading to a better civil service had been supported in the Finance Ministry. On service delivery, 14 poverty programs were evaluated, after which resources were shifted to the three strongest poverty programs of (i) PNPM, (ii) operational aid to schools and (iii) cash transfers. Evaluating the impact of these reforms would require separate impact assessments that need to take into account longer periods than the durations of DPSP-2 and DPSP-3.

## IV. OVERALL ASSESSMENT AND RECOMMENDATIONS

### A. Overall Assessment

57. DPSP-2 and DPSP-3 were implemented as conceived, and the overall assessment of both programs were highly satisfactory based on discussions with stakeholders and the fact that the Government completed all planned reform actions under both programs in a timely manner. Key economic, social, and fiscal indicators showed steady improvement throughout the DPSP series. Progress has been better than expected in three of the four core policy areas (the exception being improved investment climate). While some investment indicators, as measured by 'Doing Business', improved, investment levels remain well below the pre-crisis levels of 30% of GDP and well below investment levels in comparable countries in the region.

58. The supported macroeconomic objectives included continued debt reduction, the widening of the tax base, and improved financial stability. To support growth and attract investment, the Program targeted some of the main obstacles to investment, such as long business start-up times, VAT refund delays, and the lack of a national single window for trade. Governance and transparency of public spending were improved through the modernization of PFM and revenue administration systems. Public service delivery improved, mainly as a result of improved poverty targeting and some early civil service reforms, mainly in the Ministry of Finance.

### B. Lessons Learned

59. The following lessons learned are relevant to ADB operations in Indonesia and may be useful in operational planning in other developing member countries.

- (i) **Program Loan Modality.** The modality with indicative actions being formulated in the predecessor program (DPSP-2) which then form the basis for the translation into triggers in the successor program (DPSP-3) have shown that it is a practical and a sufficiently flexible approach to pursue constructive policy dialogue.
- (ii) **Donor coordination.** DPL/DPSP developed to become the most important platform for key donors to coordinate policy-based programs in Indonesia. The Government welcomed the development of a consistent approach to key reform issues among key donors as a harmonized approach not only strengthens the reform agenda but also reduces transaction costs of the Government in dealing with development partners.
- (iii) **Coordination within Government.** To develop joint positions on targeted policy issues necessitated regular and continuous interagency consultation and coordination that may have indirectly led to systemic changes in policy coordination processes within key agencies of the Government. This was noted by stakeholders during the review process. It was also mentioned not to expand the policy dialogue into too many fields as coordination involving multitudes of departments would become increasingly difficult.
- (iv) **Formulation of triggers and flexibility.** In formulating triggers equal weight needs to be given in driving reform processes by also assuring the continuity of the Program. A deep understanding of the bureaucracy and political will is absolutely essential. Besides the selection of triggers it was important to identify the reformers that assisted in pushing for their implementation.
- (v) **Strengthening change management capacity in the Government.** The success of DPSP-2 and DPSP-3 hinged on the proactive role taken by key counterparts willing to take up difficult change-management functions. This involved a strong communications strategy with all concerned stakeholders, making assessments of potential gains and

losses to key stakeholders, having realistic assessments of the timeframes required to implement specific actions, and identifying potential risks and obstacles as well as remedial and palliative actions. It was widely recognized that supporting the agencies leading the reform process (through advisory services or technical support) would yield disproportionately large benefits in terms of facilitating future reforms and the formulation and design of the Government's forward-looking reform agenda.

## C. Recommendations

### 1. Program Related

60. The following are recommendations for designing future policy-based programs such as the DPSP:

- (i) **Umbrella program.** The success of the DPL/DPSP series is showing the importance of multiyear policy-umbrella programs. DPL/DPSP wasn't developed as a policy-umbrella program but it evolved into one over time as it expanded beyond macroeconomic stabilization and PFM into investment climate and public service delivery support. All areas were formulated broadly, allowing the spin-off of other policy-based programs such as the Infrastructure Reform Sector Development Program (footnote 22). Future programs should be designed from the outset as multiyear umbrella or cluster programs that target a broad set of measurable policy goals.
- (ii) **Design and monitoring framework.** The purpose of the Design and Monitoring Framework is to guide project preparation and implementation, but such a framework may not be conducive for single-tranche operations based on up-front and already completed actions. All outputs in the Design and Monitoring Framework had already been completed when DPSP-2 and DPSP-3 were considered by the Board. It would be preferable to develop only one design and monitoring framework covering the entire cluster or multi-year umbrella program. As DPL/DPSP is still ongoing it may be appropriate to use the design and monitoring framework for an even longer period which may add further clarity on what impact and outcomes are expected as results of these programs in the medium-term.

61. **Future Monitoring.** DPSP-2 and DPSP-3 were single tranche operations based on up-front, completed actions or triggers, and both loans were fully disbursed shortly after board approval. The disbursement date was either on the same day of loan effectiveness or one day later. It is recommended that future reviews of DPSP successor programs be undertaken in a multiyear framework (preferably related to the Government's RPJM), given the interrelated and multiyear implementation of many of the reform actions undertaken under the DPSP. The World Bank prepared a single implementation completion and results report for the entire DPL 1-4 series. This approach is not only more economical in terms of effort and staff resources, but it also allows for more accurate tracking and analysis of the different reform streams under the programs.

62. **Covenants.** Most of the covenants may be retained in their current form. However, some covenants relating to quarterly reporting on implementation (Article IV, Section 4.01 (b), Schedule 5, paragraph 7, and Article IV, Section 4.05 (b)) and the maintenance of records and documents adequate to identify eligible items financed out of loan proceeds may not be particularly applicable for general budget support program loans, such as the DPSP, where monitoring and reporting takes place on a regular basis.

63. Further, the covenant in which the borrower shall ensure that counterpart funds are used to support the adjustment costs of reforms (schedule 5, para 6) may be reconsidered as DPL/DPSP are budget support programs which are used to support reform measures during and after program implementation.

64. **Further Action or Follow-Up.** No further actions are required for implementation.

65. **Additional Assistance.** In view of the medium-term nature of many of the targeted reforms, further parallel financing support along the lines of the DPSP could be provided to allow for further deepening of the reforms. For selected policy reforms it would be preferable to piggyback TA to the loan.

66. No program performance evaluation report was prepared for the DPSP, as the single-tranche nature of the Program required that targets be met before program approval.

## 2. General

67. The current format for evaluating and reviewing programs is not conducive to single-tranche macroeconomic policy reform programs such as the DPSP series, in which all policy conditions and triggers must be achieved *before* Board approval. In light of this, and in light of the medium-term nature of the reforms targeted by such programs, it would be more appropriate to (i) undertake a multiyear, multiprogram review to examine program performance (as is done by the World Bank for the DPL-1-4 series), and (ii) review broader program outcomes in the changes in economic trends over the medium term.

## DPSP-2: DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/ Reporting Mechanisms	Assumptions and Risks
<p><b>Impact</b> Sustained higher economic growth, with reduced poverty and unemployment and improved public financial management</p>	<p>By 2009, progress made towards the following goals of the Medium-Term Development Plan (RPJM):</p> <ul style="list-style-type: none"> <li>(i) real gross domestic product (GDP) growth at 7%</li> <li>(ii) poverty halved to 8.2%, from 16.6% in 2004</li> <li>(iii) unemployment reduced to 5.1%, from 9.9% in 2004</li> <li>(iv) corruption reduced (to be monitored through corruption perception surveys, and cases handled by the Corruption Eradication Commission (KPK))</li> </ul> <p>Tangible improvements in social indicators in areas benefiting from the post-fuel subsidy compensation program</p> <p>Development spending revived from the current low levels of about 3% of GDP to at least 6% of GDP</p>	<p>Central Bureau of Statistics data</p> <p>Ministry of Finance (MOF) data</p> <p>Data from KPK Data on Millennium Development Goals from Central Bureau of Statistics, line ministry surveys, and from other development partners</p>	<p><b>Assumption</b></p> <ul style="list-style-type: none"> <li>• Macroeconomic and political stability</li> </ul> <p><b>Risks</b></p> <ul style="list-style-type: none"> <li>• Lack of effective coordination between national Government ministries</li> <li>• Slow pace of reforms</li> <li>• Public opposition to reforms</li> </ul>
<p><b>Outcome</b> Improved overall economic management, anchored on good governance</p>	<p>Sustained macroeconomic stability, improved investment climate, better financial management, and improved service delivery achieved by 2008. Among other things (see "Outputs," below), these achievements will be demonstrated by:</p> <ul style="list-style-type: none"> <li>• Government debt-to-GDP ratio reduced from 59% in 2003 to below 40% (47% in December 2005, and projected to reach 38% by the end of 2006)</li> <li>• Start-up time for new businesses reduced from 151 days in 2003 to 30 days by 2008 (at the end of 2005, it was 91 days)</li> <li>• Continued implementation of the deposit insurance scheme, with coverage declining from full protection in September 2005 to a maximum of Rp100 million (\$11,000) by March 2007</li> <li>• Investment-to-GDP ratio raised by 3–5%, from 18.9% in 2003 (it was 22% in 2005)</li> <li>• All core Government cash operations consolidated into a treasury single account (TSA), in relation to more than 18,000 cash operations in existence with no cash management standards in place at the end of 2003 (TSA pilots started in Jakarta, and 50 more treasury offices will convert in 2006)</li> <li>• Significant budgetary allocations made for poverty reduction out of fuel subsidy savings (\$1.8 billion allocated for poverty reduction programs in the 2005 budget; about \$6 billion in 2006; and upwards of \$7 billion–\$8 billion in 2007)</li> </ul>	<p>MOF reports</p> <p>Consolidated government-wide financial reports submitted to Parliament</p> <p>Directorate General of Treasury reports on budget outturns</p> <p>Debt outcome reports produced on a quarterly basis by Directorate General of Treasury</p> <p>Audit reports of the Supreme Audit Institution (BPK) on Government financial accountability</p>	<p><b>Assumption</b></p> <ul style="list-style-type: none"> <li>• Economy able to withstand external or domestic shocks</li> </ul> <p><b>Risk</b></p> <ul style="list-style-type: none"> <li>• Legal and regulatory uncertainties may continue to prevail</li> </ul>

Design Summary	Performance Targets/Indicators	Data Sources/ Reporting Mechanisms	Assumptions and Risks
<p><b>Outputs</b></p> <p><b>I. Improved macroeconomic stability</b></p> <ul style="list-style-type: none"> <li>• An operational Fiscal Policy Office</li> <li>• Sustained debt reduction, accompanied by efficient debt management</li> <li>• Improved on-granting procedures, and procedures formulated for subnational debt issuance and workouts</li> </ul> <p><b>II. Improved investment climate</b></p> <ul style="list-style-type: none"> <li>• Legal status of regional government-owned enterprises (BUMDs) clarified</li> <li>• Warehouse Receipts Law enacted</li> <li>• Financial sector safety net implemented in a sustained manner</li> <li>• Reorganization of the integrated nonbank financial institution (NBFI) regulator completed, and a strategy for strengthening NBFIs initiated</li> <li>• Implementing regulations drafted for the new Investment Law</li> </ul>	<p>By the end of 2008, compared with 2003 (with a current assessment presented in brackets , where appropriate):</p> <ul style="list-style-type: none"> <li>• Budget deficit reduced to below 1.0% of GDP from 1.7% in 2003 (at 0.5% in 2005; projected to be 1.1% for 2006)</li> <li>• Mobilization of 0.6% to 0.9% of GDP in additional non-oil and gas revenues, from a base of 10.4% of GDP in 2003 (between 2005 and 2006, about 1.6% of GDP equivalent is likely to be mobilized)</li> <li>• Sovereign credit rating raised to and maintained at BB or equivalent from B in 2003 (Standard &amp; Poor's [S&amp;P] raised rating from B to B+ in December 2005, and to BB- in July 2006)</li> <li>• Share of financial assets at NBFIs increased by 5–10%, from 20.3% in 2003 (in 2004, the ratio was 24.5%, but it declined to 20.3% in 2005 because of large redemptions of mutual funds)</li> </ul>	<p>MOF and statistical reports</p> <p>Asian Development Bank (ADB) review missions</p> <p>Assessments done by external credit rating agencies</p> <p>Investor perception surveys</p> <p>Data on financial markets</p>	<p><b>Assumption</b></p> <ul style="list-style-type: none"> <li>• Government stays fully on course with key policy reform measures, and is able to liaise effectively with Parliament and explain its policy and regulatory stance to judicial authorities</li> </ul> <p><b>Risks</b></p> <ul style="list-style-type: none"> <li>• Any unanticipated global or regional macroeconomic shocks that may affect Indonesia's economy</li> <li>• Weak interagency coordination</li> <li>• Capacity constraints slowing policy reforms and reducing the quality of outputs</li> <li>• Delays in enactment of laws, which in turn would lead to delays in passing regulations</li> <li>• Social tensions to key policy changes effectively contained</li> </ul>

Design Summary	Performance Targets/Indicators	Data Sources/ Reporting Mechanisms	Assumptions and Risks
<p><b>III. Improved public financial management and reduced corruption</b></p> <ul style="list-style-type: none"> <li>• Implementing regulations issued for Treasury Law and State Audit Law</li> <li>• TSA implemented in stages</li> <li>• Budgetary reporting improved</li> <li>• National Procurement Policy Office (NPPO) fully operational</li> <li>• Tax administration gradually modernized and governance improved</li> <li>• Witness Protection Law submitted to Parliament</li> <li>• Civil service reform efforts piloted</li> </ul> <p><b>IV. Improved public service delivery</b></p> <ul style="list-style-type: none"> <li>• Assessment of post-fuel subsidy reduction compensation program</li> </ul>	<ul style="list-style-type: none"> <li>• Budget disbursement pattern improved as payments to line agencies are shifted to the first quarter from the third or fourth quarters (all disbursements from the Ministry of Finance took place in January 2006)</li> <li>• All line ministries prepare Government financial statements on the basis of new government accounting standards—demonstrating improvement over 2003 when the accounting standards were being drafted (as of 2005, a consolidated financial statement is prepared for the entire Government on the basis of new accounting standards; the rollout to line ministries is happening in stages)</li> <li>• Positive trend in investigations, reflected by a higher percentage of investigations having successful outcomes (Investigative unit in place in MOF at the end of 2005)</li> <li>• All Government agencies follow Presidential Decree No. 80/2003 on public procurement, and: (i) prices of public procurement within market prices; and (ii) bidders from other provinces and districts allowed to openly participate (as of mid-2006, a directorate was functional in BAPPENAS, and a draft decree was prepared to institute one at NPPO)</li> <li>• Assessments of the unconditional cash transfer (UCT) scheme, leading to notable improvements in UCT programs, and design of conditional cash transfer programs</li> <li>• Greater allocation to health and education needs in the 2007–2008 budgets, with the education budget being increased by at least 15%, and health spending increased by at least 4–5% every year</li> </ul>	<p>Quarterly budget outturn reporting system supported under the Program; and reconciliation reports produced by Directorate General of Treasury</p> <p>Daily balance reporting system under the TSA (including the treasury office jurisdictions that go through the TSA pilots)</p> <p>Reports from Inspectorate General of MOF, and audits of the BPK</p> <p>National and regional assessment reports on the poverty reduction programs launched after the fuel subsidy reduction in 2005</p>	

**Activities with Milestones** (during the program period)

- Create an operational Fiscal Policy Office by 2007
- Improve the quality and usefulness of information on taxes
- Improve tariff setting processes
- Assess and monitor overall debt
- Publish periodic integrated (domestic and foreign) debt reports
- Extend the debt management strategy and capabilities to cover contingent and implicit liabilities, including an assessment of civil service pension liabilities
- Issue ministerial decrees for blue-book and on-granting procedures
- Improve the framework for subnational bond issuance
- Issue work-out procedures for subnational government debt
- Clarify the legal status of BUMDs
- Submit to Parliament the Warehouse Receipts Law
- Continue implementation of the financial sector safety net
- Complete the reorganization of the Capital Markets and NBF Supervisory Agency
- Develop and implement a medium-term strategy for strengthening NBFs
- Improve the legal and regulatory framework for the participation of NBFs in infrastructure
- Make progress in reducing business start-up time from 151 days to 30 days
- Revitalize the National Team for the Development of Exports and Investments
- Propose revisions to the Tax Law to allow taxpayers to delay the payment of tax assessments from disputed audits
- Issue sound implementing regulations for the Investment Law
- Shift from a system of investment approvals to registration
- Issue additional implementing regulations for the Treasury Law and the State Audit Law
- Extend the pilot for zero-balance non-salary accounts to at least 50 KPPNs
- Consolidated Regional Development Accounts and the oil transitory accounts within the State Treasury
- Improve quarterly reporting of budget performance by organizational classification
- Institute regular reporting by functional and economic classifications
- Improve fiscal reporting by timely presentation of aggregate central Government financial statements for 2005
- Ensure adequate disclosure of central Government financial statements
- Improve reconciliation of financial transactions between the Directorate General of Treasury and line ministry operations
- Establish an operational NPPO fully staffed by a first echelon official
- Modernize the headquarters of Directorate General Tax by changing the structure into a functional type
- Develop a separate unit in Directorate General Tax that handles the modernization program
- Develop a new governance unit to monitor and communicate a code of conduct within Directorate General Tax
- Improve the operation of Directorate General Tax headquarters by using more sophisticated information technology
- Submit Witness and Victim Protection Law to Parliament
- Pilot civil service reform through the design of a job-classification and remuneration policy for high-ranking state officials
- Submit regulation on the establishment of an independent Remuneration Commission
- Monitor the effectiveness and undertake independent assessments of the various pro-poor compensation programs
- Use evaluation findings to improve future compensation schemes

**Inputs**

- ADB program loan (\$200 million) for the Second Development Policy Support Program (DPSP-2)
- World Bank support of \$600 million
- Parallel cofinancing support from Japan under consideration
- Parallel technical assistance support from ADB and other donors

### DPSP-3: DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/ Reporting Mechanisms	Assumptions and Risks
<p><b>Impact:</b> Higher economic growth sustained over the medium term and lower levels of unemployment and poverty.</p>	<p>By 2009, progress made in achieving the following goals of the Medium-Term Development Plan:</p> <ul style="list-style-type: none"> <li>(i) real gross domestic product (GDP) growth at 7%</li> <li>(ii) poverty reduced from 16.6% in September 2007 to 15–16% by end-2008 (Government work plan 2008 target)</li> <li>(iii) unemployment reduced to 8-9% by end-2008 from 9.7% in February 2007 (Government work plan 2008 target)</li> <li>(iv) corruption reduced (to be monitored through corruption perception surveys and cases handled by the Corruption Eradication Commission [KPK])</li> </ul> <p>Development spending increased from the 1996 level of 2.8% of GDP to 4% of GDP by end-2008</p>	<p>Central Bureau of Statistics data</p> <p>Ministry of Finance data</p> <p>Data from KPK</p> <p>Data on Millennium Development Goals from Central Bureau of Statistics, line ministry surveys, and other development partners</p>	<p><b>Assumption</b></p> <ul style="list-style-type: none"> <li>• Macroeconomic and political stability</li> </ul> <p><b>Risks</b></p> <ul style="list-style-type: none"> <li>• Lack of effective coordination between national Government ministries</li> <li>• Slow pace of reforms</li> <li>• Public opposition to reforms</li> </ul>
<p><b>Outcome</b> Improved overall economic management anchored on good governance</p>	<p>Sustained macroeconomic stability, improved investment climate, better public financial management, and improved service delivery achieved by 2008. These achievements will be demonstrated by, among other things:</p> <ul style="list-style-type: none"> <li>• Reduction of government debt-to-GDP ratio from 59% in 2003 to below 38% (38.6% at end-2006, and projected to fall below 35% by end-2007)</li> <li>• Mobilize additional domestic non-oil and gas tax revenues as a share of GDP from 10.4% of GDP in 2003 to 12–13% in 2008 (11.4% in 2006).</li> <li>• Significant budgetary allocations made for poverty reduction programs (\$2.6 billion allocated for social assistance spending in 2005, \$4.4 billion allocated in 2006, and a projected \$7.4 billion allocated in 2008).</li> </ul>	<p>Ministry of Finance reports</p> <p>Consolidated government-wide financial reports submitted to Parliament</p> <p>Directorate General of Treasury reports on budget outcomes</p> <p>Debt outcome reports produced on a quarterly basis by Directorate General of Treasury</p> <p>Audit reports of the Supreme Audit Institution on Government Financial Accountability</p>	<p><b>Assumption</b></p> <ul style="list-style-type: none"> <li>• Economy able to withstand external or domestic shocks</li> </ul> <p><b>Risk</b></p> <ul style="list-style-type: none"> <li>• Legal and regulatory uncertainties continue to prevail</li> </ul>
<p><b>Outputs</b></p> <p><b>(i) Improved investment climate</b></p>	<p>By end-2008 as compared with 2003 (with a current assessment, where appropriate, presented in brackets)</p> <p>Standard &amp; Poor's (S&amp;P) sovereign rating upgraded from CCC+ in 2003 to</p>	<p>Assessments done by external credit rating agencies</p>	<p><b>Assumption</b></p> <ul style="list-style-type: none"> <li>• Government stays fully on course with key policy reform measures and is effectively able to</li> </ul>

<ul style="list-style-type: none"> <li>• Improved VAT by reducing time for VAT refunds</li> <li>• Improve transparency of tax audit procedures</li> <li>• Roll out national single window with online clearance of merchandise</li> <li>• Enhance procedures for tariff setting</li> <li>• Implement Investment Law</li> <li>• Reduce the time required to set up a business</li> <li>• Increase small and medium enterprise (SME) access to finance, in part by implementing Warehouse Receipts Law</li> <li>• Implement good corporate governance and risk management standards, particularly in state-owned banks, and implement the financial sector safety net in a sustained manner</li> </ul> <p><b>(ii) Improved public financial management and anticorruption</b></p>	<p>BB in 2008 (BB- in 2007)</p> <p>Reduce time to obtain VAT refunds from 12–18 months in 2003 (average time to obtain VAT refunds was 5.1 months in September 2007)</p> <p>Reduce proportion of respondents who identify tax administration as a moderate, severe, or very severe constraint to doing business from 57% of respondents in 2003 (down to 38% by September 2007)</p> <p>Reduce average import clearance time from 8 days in red lane in 2004 (average import clearance time was 6 days in the red lane by September 2007)</p> <p>Increase investment-to-GDP ratio from 18.9% in 2003 to 23–25% (it was 22.6% in 2006 and was projected to rise to 24% in 2007)</p> <p>Reduce start-up time for a new business to 30 days from 168 days in 2003 (start-up time for a new business takes 105 days in 2007)</p> <p>Progressively increase loans to SMEs from 47% of total loans in 2003 (was 52% of total loans in June 2007)</p> <p>Reduce the share of state banks in the overall banking system from 46% in 2003 (the share was down to 36% by September 2007)</p> <p>Implement Basel II standards by end-2008</p> <p>Reduce the blanket guarantee on all bank deposits that was introduced in response to the financial crisis in 1997 to Rp100 million from 22 March 2007 (coverage on deposits reduced to Rp100 million as per schedule)</p> <p>Improve budget disbursement pattern on capital and material expenditures from an average of 54% disbursed in the last quarter of the fiscal year in 2001– 2004 (In 2006, 52% of these expenditures were dispersed in the final quarter; by July 2007, 32% of budgeted amounts for these expenditures had been made, compared with 26% by July 2006.)</p> <p>Incorporate a macro-fiscal framework in</p>	<p>Doing Business Surveys</p> <p>Investment Climate Surveys</p> <p>Data on financial markets</p> <p>Central Bureau of Statistics data</p> <p>Directorate General of Treasury reports on budget outturn</p>	<p>liaise with Parliament and explain its policy</p>
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<ul style="list-style-type: none"> <li>• Medium-term expenditure framework implemented with forward estimates for 2008 budget</li> <li>• Continue to consolidate core government revenue and expenditure bank accounts</li> <li>• Implement transparent accountability arrangements for central Government investment funding (RDI) accounts and regional development accounts (RDAs)</li> <li>• Fully operationalize the National Procurement Policy Office (NPPO)</li> <li>• Establish body to recommend pay policy and pay levels for high-level state officials</li> <li>• Develop civil service reform plan for the Ministry of Finance as a pilot for civil service reform on a larger scale</li> </ul> <p><b>(iii) Improved public service delivery</b></p> <ul style="list-style-type: none"> <li>• Develop enhanced assessment framework for post-fuel subsidy compensation programs</li> </ul>	<p>the 2008 budget with projections of aggregate revenue and expenditure for 2009 and 2010.</p> <p>Improved management of state finances by consolidating more than 18,000 commercial bank accounts handling government funds (situation in 2003) into a treasury single account (TSA) (Pilots started in Jakarta and extended to 50 regional treasury offices by 2006. Pilot to be extended to all 178 regional treasury offices by end-2007.)</p> <p>Complete the computerization of RDI and RDA balances, a listing of debtors and amounts due classified into amounts collectible or not collectible, and formalize standard operating procedures for authorizing and recording of such investments or loan transactions.</p> <p>Issue a Presidential decree creating an independent NPPO by end-2007 and commence implementation in 2008</p> <p>Develop a new job evaluation and grading system for 200 job descriptions intended to cover some 7000 high-ranking state official positions</p> <p>MOF to implement a comprehensive strategy of reforms related to business process and human resource management, including remuneration, service standards, and internal ethics.</p> <p>Greater allocation to health and education needs in the 2007–2008 budgets, with the education budget being increased by at least 15% and health spending increased by at least 4–5% each year.</p> <p>Lessons learned from assessments of post-fuel subsidy compensation programs used to design and pilot a better targeted, publicized, and managed conditional cash transfer program for the poor in seven regions benefiting 500,000 households.</p> <p>Increase proportion of teachers with 4-year university degrees from 36% in 2004 (By 2006, this proportion had increased to 40%).</p> <p>The Government to introduce a mechanism to reallocate unspent funds for a given year into the next years' budgets</p>	<p>Daily balance reporting system under the TSA (including the treasury office jurisdictions that go through the TSA pilots)</p> <p>Directorate General of Treasury reports on budget outturn</p> <p>National and regional assessment reports on the poverty reduction programs launched after the fuel subsidy reduction in 2005</p>	
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<ul style="list-style-type: none"> <li>• Establish competency standards for teacher certification</li> <li>• Permit community spending over multiyear periods</li> </ul>			
<p><b>Activities with Milestones (during the program period)</b></p> <ul style="list-style-type: none"> <li>• Directorate General tax regulation 122/2006 is being implemented (strengthened by Directorate General tax circular letter in July 2007).</li> <li>• Ministry of Finance Decree 123/PMK 03/2006 issued.</li> <li>• Complete a pilot for the national single window by December 2007.</li> <li>• Technical team supporting team tariff reconstituted and receiving technical assistance from the World Bank to improve capacity.</li> <li>• Government regulations 76/2007 and 77/2007 on negative lists issued. Decrees pertaining to investment procedures and one-stop integrated services to be issued by December 2007</li> <li>• Ministry of Justice decree simplifying the procedure to legalize a limited liability company has been issued. Ministry of Trade decrees to reduce the time to obtain the business trading license, and the business registration certificate issued.</li> <li>• Presidential Instruction 6/2007 issued. Also implementation regulations for Warehouse Receipts Law (PP/36/2007) issued.</li> <li>• Implementation of the financial sector safety net continues, and coverage of deposits has been reduced to Rp100 million.</li> <li>• Projections for expenditure and revenue for two out-years included in the medium-term expenditure framework.</li> <li>• Roll out zero-balancing banking arrangement for all regional treasury officers by end 2007.</li> <li>• Complete computerization of subsidiary loan account, RDI, and RDA balances currently outstanding and listing of debtors and amounts due and collectible; and formalize Standard Operating Procedures for the authorization and recording of such loan transactions by end-2008.</li> <li>• Issue decree to create an independent NPPO by end-2007.</li> <li>• Interdepartmental team to recommend pay levels and policy established and has completed a pay proposal for high state officials.</li> <li>• A comprehensive civil service reform plan for Ministry of Finance developed.</li> <li>• Enhanced assessment framework for selected service delivery programs developed in National Development Planning Agency.</li> <li>• Regulations to establish competency standards for teacher certification approved,</li> <li>• Ministry of Finance to approve arrangements for carryover of unspent community budgets from one year to the next by end 2007.</li> </ul>		<p><b>Inputs</b></p> <ul style="list-style-type: none"> <li>• ADB program loan (\$200 million) for DPSP-3</li> <li>• World Bank support of \$600 million for DPL-4</li> <li>• Parallel cofinancing support from the Government of Japan envisaged at \$200 million</li> </ul>	

**DPSP-2: STATUS OF COMPLIANCE WITH LOAN COVENANTS**

<b>Covenant</b>	<b>Reference in Loan Agreement</b>	<b>Status of Compliance</b>
The Borrower shall cause the Program to be carried out with due diligence and efficiency and in conformity with sound administrative, financial and governance practices.	<b>Section 4.01, (a)</b>	<b>Complied with.</b>
In the carrying out of the Program the Borrower shall perform, or cause to be performed, all obligations set forth in Schedule 5 to this Loan Agreement.	<b>Section 4.01, (b)</b>	
<u>Program Management</u> 1. The Coordinating Ministry of Economic Affairs shall be the Program Executing Agency and shall be responsible for the overall implementation of the Program Cluster, the administration and disbursement of the Loan proceeds, the maintenance of accounts, and the reporting to ADB.	<b>Schedule 5, para 1</b>	<b>Complied with.</b>
<u>Implementation of the Policy Letter</u> 2. The Borrower shall ensure that the policies adopted and actions taken as described in the Policy Letter, including the Policy Matrix, prior to the date of this Loan Agreement continue in effect for the duration of the Program Cluster Period and subsequently.	<b>Schedule 5, para 2</b>	<b>Complied with.</b>
<u>Policy Dialogue</u> 3. The Borrower shall keep ADB informed of, and the Borrower and ADB shall from time to time exchange views on, sector issues, policy reforms and additional reforms during the Program Cluster Period that may be considered necessary or desirable, including the progress made in carrying out policies and actions set out in the Policy Letter and the Policy Matrix.	<b>Schedule 5, para 3</b>	<b>Complied with.</b>
4. The Borrower shall engage in policy dialogue with ADB, in a timely manner, on problems and constraints encountered during the implementation of the Program Cluster and on desirable changes to overcome or mitigate such problems and constraints.	<b>Schedule 5, para 4</b>	<b>Complied with.</b>
5. The Borrower shall keep ADB	<b>Schedule 5,</b>	<b>Complied with.</b>

<p>informed of policy discussions with other multilateral or bilateral agencies that have implications for implementation of the Program Cluster, and shall provide ADB with an opportunity to comment, on any resulting policy proposals. The Borrower shall take ADB's view into consideration before finalizing and implementing any such proposals.</p>	<p><b>para 5</b></p>	
<p><b>Counterpart Funds</b> 6. The Borrower shall ensure that the Counterpart Funds are used to finance the local currency cost relating to the implementation of the Program and other activities consistent with the objectives of the Program and shall provide the necessary budget appropriations to finance the structural adjustment costs relating to the implementation of reforms under the Program.</p>	<p><b>Schedule 5, para 6</b></p>	<p><b>Complied with.</b> Budgetary resources were used to support reform measures during and after program implementation.</p>
<p><b>Monitoring of the Program Cluster</b> 7. The Borrower shall cause the Coordinating Ministry of Economic Affairs, MOF, and the BAPPENAS to monitor the implementation of the Program Cluster and its impacts, in line with the overall program framework and outcome indicators agreed upon between the Borrower and the World Bank as part of its Third Development Policy Loan, and submit to ADB quarterly reports on the implementation of the Program Cluster, including accomplishment of the measures and refinements thereto, set forth in the Policy Letter and the Policy Matrix.</p>	<p><b>Schedule 5, para 7</b></p>	<p><b>Complied with.</b> At the time of loan approval, all policy actions (conditions) were met. Development partners and the Government met more frequently than once a quarter, and the Government fully briefed Development Partners on the progress of implementation of the prior actions of the program.</p>
<p>8. The Borrower shall ensure that the Coordinating Ministry of Economic Affairs conducts, jointly with ADB, a Program performance completion review at the end of the Program Period to evaluate the progress of the reform measures and their impact on the Borrower's economy. The Borrower and ADB shall use the findings of such assessment and evaluation to refine the Program Cluster. The Borrower shall actively assist and support ongoing Program Cluster monitoring and evaluation including facilitating consultations with central and provincial agencies, civil society, and</p>	<p><b>Schedule 5, para 8</b></p>	<p><b>Complied with.</b> The Program Completion Report includes the assessment. However, a separate report within 6 months of the end of the Program Cluster Period had not been furnished as the series of DPSP is continuing and assessments on the predecessor program are always part of the new RRP.</p>

<p>other key stakeholders as appropriate and shall ensure that these reports are used at the completion of the Program Cluster to produce a comprehensive report on the overall impact of the policy reforms described in the Policy Letter and Policy Matrix within 6 months of the end of the Program Cluster Period. To facilitate such reviews, the Borrower shall assist ADB by providing relevant data and information such detail as ADB may reasonably request.</p>		
<p>The Borrower shall make available, promptly as needed, the funds, facilities, services and other resources which are required, in addition to the proceeds of the Loan, for the carrying out of the Program.</p>	<p><b>Section 4.02</b></p>	<p><b>Complied with.</b></p>
<p>The Borrower shall ensure that the activities of its departments and agencies with respect to the carrying out of the Program are conducted and coordinated in accordance with sound administrative policies and procedures.</p>	<p><b>Section 4.03</b></p>	<p><b>Complied with.</b></p>
<p>The Borrower shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible Items financed out of the proceeds of the Loan and to indicate the progress of the Program.</p>	<p><b>Section 4.04, (a)</b></p>	<p><b>Complied with.</b></p>
<p>The Borrower shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a) of this Section.</p>	<p><b>Section 4.04, (b)</b></p>	<p><b>Complied with.</b></p>
<p>As part of the reports and information referred to in Section 7.04 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning the implementation of the Program Cluster, including the accomplishment of the targets and carrying out of the actions set out in the Policy Letter.</p>	<p><b>Section 4.05, (a)</b></p>	<p><b>Complied with.</b></p>
<p>Without limiting the generality of the foregoing or Section 7.04 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB quarterly reports on the carrying out of the Program Cluster and on the</p>	<p><b>Section 4.05, (b)</b></p>	<p><b>Complied with.</b></p>

accomplishment of the targets and carrying out of the actions set out in the Policy Letter.		
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**DPSP-3: STATUS OF COMPLIANCE WITH LOAN COVENANTS**

<b>Covenant</b>	<b>Reference in Loan Agreement</b>	<b>Status of Compliance</b>
The Borrower shall cause the Program to be carried out with due diligence and efficiency and in conformity with sound administrative, financial and governance practices.	<b>Section 4.01, (a)</b>	<b>Complied with</b>
In the carrying out of the Program, the Borrower shall perform, or cause to be performed, all obligations set forth in Schedule 5 to this Loan Agreement.	<b>Section 4.01, (b)</b>	
<u>Implementation and Coordination</u> 1. CMEA shall be the Program Executing Agency. Appends, MOF, MOT, MCSME, and Bank Indonesia shall be the Implementing Agencies. CMEA shall be responsible for (a) coordinating, monitoring and supervising program implementation activities detailed in the Policy Letter and Policy Matrix; (b) providing guidance and direction to the Implementing Agencies and other relevant line agencies of the Borrower; and (c) reporting to ADB. MOF shall be responsible for administering and disbursing the Loan proceeds, and maintaining accounts.	<b>Schedule 5, para 1</b>	<b>Complied with.</b>
<u>Implementation of the Policy Letter</u> 2. The Borrower shall ensure that the policies adopted and actions taken as described in the Policy Letter, either prior to the date of this Loan Agreement, as well as those undertaken subsequently, continue in effect.	<b>Schedule 5, para 2</b>	<b>Complied with.</b>
<u>Policy and Sector Dialogue</u> 3. The Borrower shall keep ADB informed of, and the Borrower and ADB shall from time to time exchange views on sector issues and policy reforms that may be considered necessary or desirable, including the progress made in carrying out policies and actions set out in the Policy Letter and the Policy Matrix.	<b>Schedule 5, para 3</b>	<b>Complied with.</b>
4. The Borrower shall promptly discuss with ADB problems and constraints encountered during the implementation of the Program and appropriate	<b>Schedule 5, para 4</b>	<b>Complied with.</b>

measures to overcome or mitigate such problems and constraints.		
5. The Borrower shall keep ADB informed of policy discussions with other multilateral or bilateral agencies that have implications for implementation of the Program Cluster, and shall provide ADB with an opportunity to comment, on any resulting policy proposals. The Borrower shall take ADB's view into consideration before finalizing and implementing any such proposals.	<b>Schedule 5, para 5</b>	<b>Complied with.</b>
<u>Counterpart Funds</u> 6. The Borrower shall ensure that the Counterpart Funds are used to finance the local currency cost relating to the implementation of the Program and other activities consistent with the objectives of the Program and shall provide the necessary budget appropriations to finance the structural adjustment costs relating to the implementation of reforms under the Program.	<b>Schedule 5, para 6</b>	<b>Complied with.</b> Budgetary resources were used to support reform measures during and after program implementation.
<u>Program Performance Monitoring and Review</u> 7. The Borrower shall ensure that reporting on progress and outcome of the Program following the Program Period through periodic meetings is made by relevant line agencies of the Borrower to the Executing Agency which will in turn, report to ADB. The Executing Agency will, as needed, hold consultative meetings with stakeholders and development partner community to solicit their feedback on emerging regulations and the progress and outcome of Program.	<b>Schedule 5, para 7</b>	<b>Complied with.</b>
8. The Borrower and ADB shall jointly assess the impact and evaluate the benefits of the Program and Program Cluster within six months after Loan Effectiveness, in accordance with the Program Performance Management system. The Borrower and ADB may use the findings of such assessment and evaluation in determining future programs.	<b>Schedule 5, para 8</b>	<b>Complied with.</b> The impact of the predecessor program is being assessed as part of the new RRP. The series of DPSPs is still ongoing.
The Borrower shall make available, promptly as needed, the funds, facilities,	<b>Section 4.02</b>	<b>Complied with.</b>

services and other resources which are required, in addition to the proceeds of the Loan, for the carrying out and continuation of the Program.		
The Borrower shall ensure that the activities of its departments and agencies with respect to the carrying out of the Program are conducted and coordinated in accordance with sound administrative policies and procedures.	<b>Section 4.03</b>	<b>Complied with.</b>
The Borrower shall maintain, or cause to be maintained, records and documents adequate to identify the Eligible Items financed out of the proceeds of the Loan and to indicate the progress of the Program.	<b>Section 4.04, (a)</b>	<b>Complied with.</b>
The Borrower shall enable ADB's representatives to inspect any relevant records and documents referred to in paragraph (a) of this Section.	<b>Section 4.04, (b)</b>	<b>Complied with.</b>
As part of the reports and information referred to in Section 7.04 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning the implementation of the Program, and the accomplishment of the targets and carrying out of the actions set out in the Policy Letter and Policy Matrix.	<b>Section 4.05, (a)</b>	<b>Complied with.</b>
Without limiting the generality of the foregoing or Section 7.04 of the Loan Regulations, the Borrower shall furnish, or cause to be furnished, to ADB quarterly reports on the carrying out of the Program and on the accomplishment of the targets and carrying out of the actions set out in the Policy Letter and Policy Matrix. These reports shall be used at the completion of the Program Cluster to produce a comprehensive report on the overall impact of the policy reform described in the Policy Letter and Policy Matrix.	<b>Section 4.05, (b)</b>	<b>Complied with.</b>

DPSP-2: Trigger/Outputs<sup>23</sup>

Item	Status
<b>Core Policy Area I: Improved Macroeconomic Stability and Creditworthiness</b>	
<b>Trigger 1: Fiscal Policy Office.</b> Improve fiscal policy:	
1.1. Create a Fiscal Policy Office by 2007 with capability and access to information sufficient to provide analysis of proposed tax, tariff, and financial market policies.	Fulfilled
1.2. Improve the quality and usefulness of information on taxes to improve tax forecasting and policy analysis.	Fulfilled
1.3. Improve tariff-setting processes by modernizing team tariff with sufficient budget, information, and administrative procedures.	Satisfactory*
<b>Trigger 2: Debt Management.</b> Continue implementing debt management strategy:	
2.1. Assess and monitor overall debt by quantifying costs and risks on public debt.	Fulfilled
2.2. Publish periodic integrated (domestic and foreign) debt reports	Fulfilled
2.3. Extend strategy and capabilities to cover contingent and implicit liabilities, including an assessment of civil service pension liabilities	Satisfactory
<b>Trigger 3: Decentralization Framework.</b> Improve decentralization framework:	
3.1. Issue ministerial decrees for blue-book and on-granting procedures	Fulfilled
3.2. Improve the framework for subnational government bond issuance	Satisfactory
3.3. Issue work out procedures for sub-national government debt	Satisfactory
<b>II. Improved Investment Climate</b>	
<b>Trigger 4: BUMD Law.</b> Clarify the legal status of regional government enterprises (BUMD), especially regarding their fiscal and financial relationship with regional governments, by submitting to Parliament a draft Law on BUMD	Satisfactory
<b>Trigger 5: Warehouse Receipts Law.</b> Submit to Parliament a Warehouse Receipts Law that establishes a system of designated warehouses providing official, centrally registered receipts for commodities stored by farmers and small and medium enterprises (SMEs)	Fulfilled
<b>Trigger 6: Financial Sector Safety Net.</b> Continue implementation of the financial sector safety net, including implementing the lowering of the coverage of the deposit guarantee to Rp1 billion by September 2006 as per announced schedule	Fulfilled
<b>Trigger 7: Non-Bank Financial Institution (NBFI) Strategy/ Infrastructure</b>	
7.1 Complete the reorganization of the Capital Market and Financial Institution Supervisory Agency (BAPEPAM) and DGFI	Fulfilled
7.2. Develop and implement a medium-term strategy for strengthening NBFIs	Fulfilled
7.3. Improve the legal and regulatory framework for participation of NBFIs in infrastructure	Satisfactory
<b>Trigger 8: Investment Climate.</b> Improve business climate through:	
8.1 Reduce business start-up time from 151 days to 30 days by simplifying the process of forming companies	Fulfilled
8.2 Revitalize National Team for the Development of Exports and Investment	Fulfilled

<sup>23</sup> Policy Matrix from DPSP-2 loan agreement had been used.

(PEPI)	
8.3. Propose revisions to Tax Law to allow taxpayers to delay the payment of tax assessments from disputed audits ( <b>Note:</b> this measure added during DPSP-2 implementation)	Fulfilled
8.4. Issue sound implementing regulations for the Investment Law, including the creation of a transparent negative list.	Satisfactory
8.5. Shift from a system of approvals to registration	Satisfactory
<b>III. Improved Public Financial Management and Anticorruption</b>	
<b>Trigger 9: Treasury / Audit Law.</b> Issue additional implementing regulations for the Treasury Law and the State Audit Law	Satisfactory
<b>Trigger 10: Treasury Single Account (TSA).</b> Continue development of TSA	
10.1. Extend the pilot for zero-balance non-salary accounts to at least 50 local State Treasury Service Offices (KPPNs)	Fulfilled
10.2 Consolidate accounts at MOF (particularly RDI/RDA and oil transitory accounts) within the State Treasury (BUN)	Satisfactory
<b>Trigger 11: Budget and Financial Reporting / Accounting</b>	
11.1. Improve quarterly reporting of budget performance by organizational classification	Fulfilled
11.2. Institute regular reporting by functional and economic classification	Fulfilled
11.3. Publish regular reporting in the public domain	Fulfilled
11.4. Improve fiscal reporting through timely presentation of aggregate central Government financial statements for fiscal year 2005	Fulfilled
11.5. Ensure adequate disclosure of central Government financial statements	Fulfilled
11.6 Improve reconciliation of financial transactions between Treasury and line ministry operations (including other directorates within the Ministry of Finance)	Fulfilled
<b>Trigger 12: Procurement policy.</b> An operational national procurement policy office (NPPO) is fully staffed and led by a first echelon official	Satisfactory
<b>Trigger 13: Tax Administration Reform.</b> [ <b>Note:</b> This trigger was not originally included in the DPSP documentation submitted to ADB's Board of Directors in December 2005. It has subsequently been introduced based on strong commitment from MOF to carry forward reforms in this important area.	
13.1. Change the structure into a functional type	Fulfilled
13.2. Develop a separate unit that handles the modernization program on a fulltime basis	Fulfilled
13.3. Develop a new governance unit to monitor and communicate the code of conduct	Fulfilled
13.4. Improve the operation of headquarters by using more sophisticated information technology	Fulfilled
<b>Trigger 14: Governance.</b> Submit Witness Protection Law to Parliament for approval	Fulfilled
<b>Trigger 15: Civil Service Reform.</b>	
15.1. Pilot civil service reform through the design of a new job classification and remuneration policy for high-ranking state officials (pejabat negara)	Fulfilled
15.2. Submit regulation for establishment of an independent Remuneration Commission	Fulfilled
<b>IV. Improved Public Service Delivery</b>	
<b>Trigger 16: Public Service Delivery</b>	

16.1. Monitor effectiveness and undertake independent assessment of the new compensation programs—including fiduciary aspects of these programs—funded by reallocated fuel subsidy funds (e.g. cash transfer, health, education, and village infrastructure programs)	Fulfilled
16.2. Use evaluation findings to improve future compensation schemes	Fulfilled

\* "Satisfactory" means that the outcome was not fully achieved under the mentioned program but that its content was to be followed up in subsequent programs.

DPSP-3: Trigger/Outputs<sup>24</sup>

Item	Status
<b><i>I. Improved Investment Climate</i></b>	
<b>A. Improve tax and customs administration</b>	
<b>Trigger 1:</b> Improve the value-added tax (VAT) by, among other things, implementing the Directorate General tax regulation No. 122/2006 to reduce lag time for VAT refunds.	Fulfilled
<b>Trigger 2:</b> Issue MOF decree on tax audit procedures that allows taxpayers to request details of audit findings and a review in case of disputes after closing conference but before completion of audit.	Fulfilled
<b>Trigger 3:</b> Roll out a national single window with online clearance of merchandise	Fulfilled
<b>B. Improve trade policy</b>	
<b>Trigger 4:</b> Enhance procedures for setting tariffs by improving methodology, improving research capability, and adopting better information technology	Fulfilled
<b>C. Improve investment procedures and reduce business start up time</b>	
<b>Trigger 5:</b> Implement the Investment Law, its supporting regulations, and new operating procedures.	Satisfactory*
<b>Trigger 6:</b> Simplify or eliminate unnecessary and/or redundant business licenses, procedures, and multiple registration requirements	Fulfilled
<b>D. Strengthen Small Businesses</b>	
<b>Trigger 7:</b> Issue a comprehensive SME policy package (including supporting industries) that, among other things, increases SMEs' access to finance and implements the Warehouse Receipts Law	Fulfilled
<b>E. Strengthen the Financial Sector</b>	
<b>Trigger 8:</b> Implement good corporate governance and risk management standards, particularly in state-owned banks, and continue implementation of a financial sector safety net	Fulfilled
<b><i>II. Improved Public Financial Management and Anticorruption</i></b>	
<b>F. Strengthen budgeting, controls, transparency, in financial management.</b>	
<b>Trigger 9:</b> Implement medium-term expenditure framework with a system of clear forward estimates for the 2008 budget.	Fulfilled
<b>Trigger 10:</b> Continue to consolidate core government bank accounts	Fulfilled
<b>Trigger 11:</b> Implement transparent accountability arrangements for RDI and RDA accounts	Satisfactory
<b>G. Improve procurement processes and outcomes</b>	
<b>Trigger 12:</b> Operationalize NPPO issue draft Procurement Law	Satisfactory
<b>H. Initiate civil service reform</b>	
<b>Trigger 13:</b> Establish a Remuneration Commission or interdepartmental team to recommend pay policies and pay levels for high-level state officials	Fulfilled
<b>Trigger 14:</b> Develop a comprehensive civil service reform plan for the Ministry of Finance as a pilot for civil service reforms on a larger scale	Fulfilled
<b><i>III. Improved Public Service Delivery</i></b>	

<sup>24</sup> Policy Matrix from DPSP 3 loan agreement had been used.

<b>I. Institutionalize assessments of service delivery mechanisms</b>	
<b>Trigger 15:</b> Develop an enhanced assessment framework for selected service delivery programs	Fulfilled
<b>J. Strengthen public service delivery in education and community-based development</b>	
<b>Trigger 16:</b> Establish competency standards for teacher certification and introduce instruments for measuring compliance with those standards.	Fulfilled
<b>Trigger 17:</b> Permit community spending over multiyear periods and clarify procurement procedures for national budget-funded CDD programs	Satisfactory

\* "Satisfactory" means that the outcome was not fully achieved under the mentioned program but that its content was to be followed up in subsequent programs.