ADB

Validation Report

Reference Number: PVR–239
Project Number: 39605
Loan Number: 2228
December 2012

Indonesia: Development Policy Support Program

Independent Evaluation Department
Asian Development Bank

ABBREVIATIONS

ADB	–	Asian Development Bank
DPL	–	development policy loan
GDP	–	gross domestic product
KPK	–	Corruption Eradication Commission
MTDP	–	Medium Term Development Plan
MTEF	–	Medium-Term Expenditure Framework
PCR	–	project completion report
SDP	–	sector development program
TA	–	technical assistance

NOTE

In this report, “$” refers to US dollars.

Key Words

adb, development policy support, indonesia, dpsp, public sector management

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PROGRAM BASIC DATA

Project Number:	39605	**PCR Circulation Date:**	Oct 2008	
Loan Number:	2228	**PCR Validation Date:**	Dec 2012	
Program Name:	Development Policy Support Program			
Country:	Indonesia		**Approved** ($ million)	**Actual** ($ million)
Sector:	Public sector management	**Total Project Costs:**	700.0	700.0
ADB Financing: ($ million)	**ADF:** 0.0	**Loan:**	200.0	200.0
	OCR: 200.0	**Borrower:**	0.0	0.0
Cofinanciers:	World Bank Japan Bank for International Cooperation	**Total Cofinancing:**	500.0	500.0
Approval Date:	21 Dec 2005	**Effectiveness Date:**		23 Dec 2005
Signing Date:	22 Dec 2005	**Closing Date:**	31 Dec 2006	23 Dec 2005
Program Officer:	R. Subramaniam	**Location:**	Indonesia Resident Mission	
Validator:	R. Alonzo, Consultant	**Peer Reviewer:**	B. Graham, Senior Evaluation Specialist, IED1	
Quality Reviewer:	R. Sabirova, Evaluation Specialist, IED1	**Director:**	W. Kolkma, IED1	

ADB = Asian Development Bank, ADF = Asian Development Fund, IED1 = Independent Evaluation Department (Division 1), OCR = ordinary capital resources, PCR = program completion report.

I. PROGRAM DESCRIPTION

A. Rationale

1. The Development Policy Support Program[1] was conceived in support of the Government's Medium Term Development Plan (MTDP) for 2004–2009, which had two broad goals: (i) stimulate higher and sustainable economic growth through better fiscal management and an improved investment climate, and (ii) reduce poverty and unemployment by reorienting public expenditures to productive needs and strengthening governance in public financial management. In consonance with the MTDP, the program consisted of a series of structural reform packages aimed to achieve the following:

(i) Sustain macroeconomic stability and improve creditworthiness by enhancing the quality of fiscal management through (a) reducing inefficient spending to allow fiscal space for social and poverty-related spending; (b) modernizing the tax administration and tax policy changes; (c) adopting a new debt management strategy to manage risks prudently; and (d) simplifying the process for approving and implementing decentralized development spending.

[1] ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Development Policy Support Program.* Manila; ADB. 2008. *Completion Report: Development Policy Support Program in Indonesia.* Manila.

(ii) Improve the investment climate by (a) clarifying and strengthening the legal framework in which foreign and domestic businesses operate; (b) introducing measures to reduce transaction costs for businesses, including small and medium-sized enterprises; and (c) facilitating infrastructure development through greater public–private participation and initiating steps for effective risk mitigation.

(iii) Promote financial sector stability and diversification through (a) establishing a financial safety net and implementing the deposit guarantee framework; (b) enforcing effective regulatory, governance, and risk mitigation systems; (c) developing further the financial infrastructure to promote industry and product diversification; and (d) initiating measures for effective resolution of problem banks.

(iv) Enhance public sector governance and combat corruption by (a) improving performance orientation and internal controls while building transparency, (b) strengthening treasury systems and cash management control, (c) improving accountability in the public sector, and (d) strengthening procurement systems.[2]

2. Supported by a $200 million single tranche operation, the program's key achievements are the upfront implementation of the core policy actions. The program supported the development and building of full government commitment for a forward-looking program that deepens the reforms in the core areas, while striving to strengthen public service delivery to the poor.

3. The program was aligned with policy reform support of other key development partners that provided parallel financing: the World Bank ($400 million) and the Government of Japan ($100 million). In 2004 and 2005, the two institutions provided a Development Policy Loan (DPL-1) that supported the government's white paper reforms and the new President's "100-Day Plan." While Asian Development Bank (ADB) participation in DPL-1 was in policy dialogue, it supported the formulation and implementation of the white paper through reforms in finance and governance.[3] The program built on and effectively deepened those sector-specific reforms supported by ADB.

B. Expected Impact

4. The program design and monitoring framework presented in the report and recommendation of the President had very specific performance targets for impact. By 2009, the following MTDP goals were to be attained: (i) real gross domestic product (GDP) growth at 7%; (ii) poverty halved to 8.2% from 16.6% in 2004; (iii) unemployment reduced to 5.1% from 9.9% in 2004; and (iv) corruption reduced, which was to be monitored through corruption perception surveys and through cases handled by the Corruption Eradication Commission (KPK).

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[2] A fifth policy area, "Make services work better for the poor by improving service delivery and the poverty-orientation of public spending," was meant for the forward-looking phase of the program.

[3] ADB assistance undertaken in 2003–2004 included the following: (i) the Financial Governance and Social Security Reform Program, State-Owned Governance and Privatization Program, and Industrial Competitiveness and Small and Medium Enterprise Development Program; and (ii) policy dialogue to strengthen national and local government public financial management, which led to the Local Government Finance and Governance Reform Sector Development Program (SDP) and State Audit Reform SDP.

5. Other goals included the following: (i) tangible improvements in social indicators in areas benefiting from the post-fuel-subsidy compensation program; (ii) development spending revived from the current low levels of around 3% of GDP to at least 6% of GDP; and (iii) investments in infrastructure stimulated through public–private partnerships; specifically, bidding completed and implementation under way for a majority of the 91 projects announced at the Indonesia Infrastructure Summit in January 2005.

C. Objectives or Expected Outcomes

6. The key expected outcomes were enhanced macroeconomic stability, improved investment environment, more financial stability, and greater accountability through efficient public financial management. The expected outcomes were to be monitored and measured by steady progress in the fiscal and investment indicators outlined in the performance targets for outputs in the program design and monitoring framework, and discussed in the next section.

7. In addition, a Medium-Term Expenditure Framework (MTEF) was to be prepared on a 3-year rolling basis and adopted in the beginning of the 2007 fiscal year. The MTEF was a key element of public financial management reforms, improving the quality at entry of the national budget as line agencies learned to prepare more results-oriented and output- and outcomes-based expenditure programs.

D. Components and Outputs

8. Table 1 shows the four principal policy areas under the program.

Table 1: Outputs of the Development Policy Support Program

	Item
1.	**Improved Macroeconomic Stability and Creditworthiness**
1.1	Reduce subsidies to the nonpoor and control inefficient spending.
1.2	Reorient public expenditures toward poverty reduction.
1.3	Make tax revenue administration more efficient by expanding modern tax offices.
1.4	Develop and implement a debt management strategy.
1.5	Streamline intergovernmental on-lending and on-granting arrangements.
2.	**Improved Investment Climate**
2.1	Strengthen the legal and regulatory framework on investments, with the aim of reducing transaction costs for business, by drafting amendments to the Law on Regional Taxes and Charges and the Law on Investments.
2.2.	Develop a medium-term plan for infrastructure development that encourages public–private partnerships.
2.3.	Develop a medium-term action plan and effective framework to coordinate the development of small and medium-sized enterprises.
3.	**Strengthened Financial Sector**
3.1.	Continue establishing a financial safety net, to include implementing the first phase of removing the deposit guarantee and establishing the Deposit Insurance Agency (LPS), clarifying roles with respect to the closing of problem banks and emergency operations.
3.2.	Enhance overall financial system stability by (i) strengthening minimum capital requirements, (ii) improving the payment system, (iii) undertaking measures to strengthen corporate governance in commercial banks, (iv) strengthening risk management in banks, (v) introducing measures to improve asset quality, and (vi) increasing customer protection.
3.3.	Develop strategy to strengthen nonbank financial institutions.
4.	**Improved Public Financial Management and Anticorruption Initiatives**

Item
4.1. Issue additional implementing regulations for the State Finance Law, Treasury Law, and State Audit Law.
4.2. Adopt timetable for establishing the treasury single account and an activity plan for the consolidation of bank accounts.
4.3. Establish an investigative unit in the Inspectorate General of the Ministry of Finance and make it operational, vested with the necessary legal powers to investigate any of the ministry's employees.

Source: ADB. 2008. *Completion Report: Development Policy Support Program in Indonesia.* Manila.

E. Provision of Inputs

9. The DPSP was supported by a $200 million single tranche loan from ADB's ordinary capital resources. Overall, the program represents a parallel financing facility focused on supporting policy reforms. Parallel financing was provided by the World Bank ($400 million) and the Japan Bank for International Cooperation ($100 million). These resources were used among others to support increased spending on development and social programs/initiatives as well support the country's balance of payments by financing eligible imports. As all outcomes were fulfilled prior to loan approval, disbursement of the single-tranche loan took place on 23 December 2005.

F. Implementation Arrangements

10 The program was implemented as designed without any changes. The Ministry of Finance was the executing agency, and it worked closely with the National Development Planning Agency and the Coordinating Ministry of Economic Affairs in monitoring the program. The interministerial monitoring committee met bimonthly. These oversight agencies had no direct control over implementing any particular reform. Implementation of reforms rested on line agencies and Parliament. The program implementation nevertheless went smoothly, attesting to the government's strong sense of program ownership.

11. Table 1 shows the program policy conditions, which were all satisfied by the time of loan approval. There were five conditions on improving macroeconomic stability and creditworthiness, three on improving the investment climate, three on strengthening the financial sector, and three on improving public financial management and anticorruption initiatives. All the covenants in the loan agreement for the program have been complied with. Although no technical assistance (TA) was directly linked to the program, technical assistance was implemented for sector programs that provided technical inputs for program design, such as on decentralization and state audit systems.[4] The program did not use any consultants, contractors, or suppliers in design or implementation.

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[4] ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the State Audit Reform Sector Development Program.* Manila (Approved in December for the equivalent of $25.0 million); ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Local Government Finance and Governance Reform Sector Development Program.* Manila; and ADB. 2005. *Technical Assistance to the Republic Indonesia on Support for Infrastructure Development.* Manila.

II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

12. The project completion report (PCR) did not categorically rate the relevance of the program. As the program takes off from the government's own reform agenda as expressed in its MTDP, there was a strong sense of government ownership of the program. The program was perceived to have contributed significantly to strengthening the foundation for further reforms toward sustained growth and poverty reduction. At the same time, through the program, ADB was able to engage more meaningfully the key agents of the policy reform process, both at the macro and at the sector levels. The program also demonstrated how coordination among the major donor agencies produces significant results. As such, this validation rates the program as *relevant*.

B. Effectiveness in Achieving Program Outputs and Outcomes

13. The PCR's discussion in this section focused on how "ADB staff involved in the program design were successful in building relationships of trust and cooperation with the Government" and how this contributed to program success, but these aspects have more to do with efficiency than with effectiveness. The PCR listed the following documentation to indicate that performance targets in the design and monitoring framework were achieved: (i) key fiscal and investment indicators on a steady course of improvement (as outlined under Outputs), and (ii) adoption of an MTEF from fiscal year 2007. The PCR is dated November 2008, by which time there should have been sufficient information at least on macro indicators.

14. A cursory review of Indonesia's macroeconomic performance since 2005 would show positive developments, to which the program have contributed, even if the targets set out may have been overly optimistic. On the investment climate, sovereign credit rating, as indicated by various rating companies, had improved: Moody's, from B1 in May 2006 to Ba3 in October 2007; Fitch, from BB- in January 2005 to BB in February 2008; Rating and Investment, from BB- in July 2005 to BB+ in October 2007; and Japan Credit Rating Agency, from BB- in September 2006 to BB in September 2007. Such progress is attributable to a host of factors, including the subsequent program-2 and program-3. No reference was made in the PCR to an MTEF, but this is presumably part of the MTDP.

15. The PCR stated that all the program outcomes and outputs were achieved prior to loan approval by the Board. However, the PCR could have presented additional evidence on the extent by which the outcomes and outputs have been achieved. Overall, this validation concurs with the PCR rating as *effective.*

C. Efficiency of Resource Use in Achieving Outputs and Outcomes

16. The PCR considered the program *efficient* as the "executing and implementing agencies were able to ensure the full achievement of all outcomes prior to the Board's approval." But in the design of the program, Board approval would be given only after all outcomes shall have been achieved. This validation rates the program as *efficient* because it took only a short period to "package" the program, and it did not use any consultants, contractors, or suppliers in design or implementation. The PCR also noted that "discussions with stakeholders and donor partners indicate that ADB's support and supervision of the Program were handled efficiently."

D. Preliminary Assessment of Sustainability

17. The PCR did not rate sustainability of the program. As the PCR noted, the program from the start was envisaged as one in a series of such programs. In fact, the program was actually meant as a complement to the World Bank and the Government of Japan's DPL-2. The macroeconomic situation has improved since 2005. Given the government's strong sense of ownership and the harmonious cooperation among the donor partners, this validation assesses the program as *likely to be sustainable*.

E. Impact

18. As indications of positive impact, the PCR cited significant results of real GDP growth of 5.5% in 2006 and 6.3% in 2007, moderate budget deficits (0.9% and 1.5% of GDP), and falling debt to GDP ratios (39% and 35%). It acknowledges that these results are not solely or directly attributable to the program, especially after considering that program-2 and program-3 followed a year and two after. Program support of fiscal consolidation and macroeconomic stabilization and reforms in the other three areas—investment climate, public financial management, and anticorruption initiatives—may have enhanced the medium-term growth prospects and better targeted delivery of social services, even though there was no mention in the PCR of marked improvements in these areas. This validation assesses the impact of the program as *significant.*

III. OTHER PERFORMANCE ASSESSMENTS

A. Performance of the Borrower and Executing Agency

19. This validation concurs with the PCR's rating of the borrower and the executing agency as *highly satisfactory*. The PCR noted that this rating is largely a reflection of the nature of the program, where all program outcomes were by design to be achieved prior to Board approval, At the same time, the Ministry of Finance as executing agency is known to have a relatively strong institutional capacity and has had a long history of close engagement with ADB and the other development partners. As such, the executing agency is very familiar with donor operating procedures and processes. Although the PCR did not mention it in this section, the two other oversight agencies that assisted in program monitoring, the National Development Planning Agency and the Coordinating Ministry of Economic Affairs, contributed to ensuring the *highly satisfactory* performance.

B. Performance of the Asian Development Bank

20. The preparation of the program involved close coordination of ADB's Southeast Asia Regional Department mission (supported by ADB's Indonesia Resident Mission) with the Government of Indonesia, the World Bank, and the Government of Japan. Program formulation was facilitated as the World Bank and the Government of Japan in 2005 were already into the preparation of the second phase of their Development Policy Loan (DPL-2).

21. The PCR rated ADB performance as *highly satisfactory,* based on PCR mission discussions with stakeholders and donor partners. This validation concurs with the *highly satisfactory* rating for ADB performance.

C. Others

22. The PCR did not discuss safeguards and fiduciary aspects since there were no related issues. It also did not mention about the government's own assessment of the program, if any.

Given that the program loan closed exactly 1 year after loan effectiveness, with program-2 soon to follow, there was really not much time for a stand-alone assessment of the program, and the recommendation that reviews of programs such as this be done in a multiyear framework.

IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS

A. Overall Assessment and Ratings

23. The PCR gave the program an overall rating of *highly successful* based primarily on discussions with stakeholders and the fact that the government was able to complete all planned reform actions in a timely manner. However, this is incorrect and the overall rating should be a result of the weighted average of the four core evaluation criteria: relevance, effectiveness, efficiency, and sustainability. This validation assesses the program was *relevant, effective, efficient*, and *likely sustainable.* Based on these ratings, the overall performance of the program comes to *successful* (Table 2).

24. Despite adverse developments in the world economy such as increases in international fuel and food prices and interest rates, Indonesia's key economic, social, and fiscal indicators stayed on track and continued to improve. Credit is partly due to the government's strong buy-in of the reform agenda, which is proposed in its MTDP. It is also partly due to the two-pronged approach that ADB adopted, under which the program with its macroeconomic thrust was complemented by sector assistance.

25. There was a lack of progress in only one reform area, the investment climate, as investment had remained below the pre-crisis level of 30% of GDP, despite the improvements in sovereign risk ratings cited earlier. It was not until 2009 that domestic investment got back to more than 30% of GDP.

Table 2: Overall Ratings

Criteria	PCR	IED Review	Reason for Disagreement and/or Comments
Relevance	Not rated	Relevant	The PCR did not rate relevance (para. 11).
Effectiveness in achieving outcome	Effective	Effective	
Efficiency in achieving outcome and outputs	Efficient	Efficient	
Preliminary assessment of sustainability	Not rated	Likely	The PCR did not rate sustainability (para. 16)
Overall assessment	**Highly successful**	**Successful**	Overall rating should be based on the ratings given to relevance, effectiveness, efficiency, and sustainability. The PCR's *highly successful* rating was incorrect.
Borrower and executing agency	Highly satisfactory	Highly Satisfactory	
Performance of ADB	Highly satisfactory	Highly Satisfactory	
Impact	Not rated	Significant	See para. 17.
Quality of PCR		Less than satisfactory	The PCR did not follow the guidelines and did not rate relevance, sustainability and impact subcriteria (para. 31).

ADB = Asian Development Bank, IED = Independent Evaluation Department, PCR = program completion report.
Note: From May 2012, IED views the PCR's rating terminology of "partly" or "less" as equivalent to "less than" and uses this terminology for its own rating categories to improve clarity.
Source: ADB Independent Evaluation Department.

B. Lessons

26. The PCR listed six important lessons, to which this validation agrees. In particular, coordination among donors and coordination within the government are two very important ingredients of successful program design and implementation. The PCR also noted that in the development of DPL-2/program, donor–government negotiations brought out the need for different agencies of government to "develop joint positions on 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 most intense among the three oversight agencies involved: the Ministry of Finance, the National Development Planning Agency, and the Coordinating Ministry of Economic Affairs.

27. There was no technical assistance attached to the program. Prior to the loan, however, technical assistance was provided for sector programs that provided technical inputs for the program design on decentralization and state audit systems, and capacity building in infrastructure development for the National Committee for the Acceleration of Infrastructure Development (KKPPI).

C. Recommendations for Follow-Up

28. The first recommendation stated that "provision of parallel financing to support policy reforms should be augmented with technical advisory support for key agencies leading the change-management process." However, the PCR stated earlier that there was no TA attached to the program. Instead, prior to the program loan, technical assistance was provided for sector programs that provided technical inputs to program design and formulation. This recommendation, therefore, should perhaps be qualified, that the technical support should come ahead of the reform program, so that the key agencies shall have been "primed" before actual program implementation.

29. The second recommendation, on developing medium-term policy road maps, is important, so that policy triggers are not ad hoc and are consistent with each other. The third recommendation, that the review process should mirror the multiyear character of these programs, was followed in program-2 and program-3, where a single PCR mission was deployed for the two programs.

V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Evaluation Design, Implementation, and Utilization

30. The program's design and monitoring framework contains quantitative performance targets, the attainment of which was not discussed in the PCR. On the performance targets for impact, the reference year for goals to be attained was 2009, after PCR submission. The PCR nevertheless could have reported on progress in 2006 and 2007 (as it did with some of the output and outcome indicators).

31. In other words, the PCR could have been more systematic in reporting of monitoring results. It mentioned that the three oversight agencies comprised the government's monitoring committee. According to loan covenant 7, "The Borrower shall cause [the three oversight agencies] to monitor the implementation of the Program and its impacts … and submit to ADB quarterly reports on the implementation of the program." Loan covenant 8 stated, "The Borrower

shall conduct, 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." Appendix 2 of the PCR stated that all loan covenants were complied with, so there must be a wealth of progress reports that could further inform interested parties on program accomplishments. However, such reports were not mentioned in the PCR.

B. Comments on Project Completion Report Quality

32. The PCR offered a *less satisfactory* assessment of program results. While the PCR stressed correctly the importance of government's ownership of the reform agenda and donor coordination as key ingredients to the success of programs pushing reform initiatives, audience would have been better informed if the PCR discussed the evaluation findings in more detail and presented more quantitative monitoring results, without necessarily preempting the review of the successor program-2 and program-3. The PCR incorrectly stated the overall rating of the program, and did not provide a rating to the relevance of the program.

C. Data Sources for Validation

33. This validation is based mainly on information gleaned from (i) the project's report and recommendation of the President; (ii) project completion report; (iii) minutes of the management review meeting; (iv) the loan agreement for the project; (v) Bank Indonesia Sovereign Rating 2009; and (vi) World Bank's Aide Memoire: Development Policy Loan Implementation Review.

D. Recommendation for Independent Evaluation Department Follow-Up

34. This validation report has no major deviation from the PCR findings and does not consider a program performance evaluation for this project to be warranted.