SUMMARY PROGRAM IMPACT ASSESSMENT

I. Introduction

1. The proposed Inclusive Growth through Improved Connectivity (IGIC) will support a key strategic pillar of the government’s medium- and long-term development plans to achieve higher and more inclusive economic growth through improved national connectivity. An analysis using a computable inter-regional model of the Indonesian economy (Indo-TERM) suggests that sustained reforms that lead to significant efficiency improvement in the transport and logistics sectors over the medium-term could improve economic growth by about 1 percentage point annually. It will also reduce the country’s poverty incidence by 2.2% (4.7 million people) over a five-year period.

II. The Problem

2. Despite improved rates, recent economic growth is still significantly below the country’s growth potential. For 2014-2016, the IMF estimates a baseline potential growth rate of 7.1%, but which would increase to 7.9% if infrastructure development and economic reforms are accelerated. The ADB study Diagnosing the Indonesian Economy\(^1\) also identifies inadequacies in infrastructure as one of the critical constraints to economic growth. Indonesia’s overall ranking in the Global Competitiveness Index is at 50 out of 144 countries.\(^2\) However, the country only ranks 78 out of 144 on overall quality of infrastructure, far below its overall ranking, implying that infrastructure is a drag on the country’s competitiveness (Figure 1a). The impact of lagging infrastructure appears in a number of forms. Deteriorating road systems in the provinces and districts increases domestic transport and logistics costs. Congested port and underdeveloped inter-island transport systems have led to expensive domestic shipping costs. Congested and underdeveloped international ports limit the efficient integration of Indonesia’s manufacturing sector into international production networks.

<table>
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<tr>
<th>Figure 1: Infrastructure and Ship’s Dwelling Time in the Port</th>
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<td><strong>a. Global Competitiveness Index Ranking 2011-2012 (out of 142 countries)</strong></td>
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<tr>
<td>Infrastructure</td>
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<td>2</td>
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3. **Intra-island connectivity.** Linking rural areas with growth poles within islands is constrained by inadequate road infrastructure and poor maintenance, and underdeveloped railway networks. Due to sustained low government spending in infrastructure spending, the quality of the existing road network has deteriorated significantly. The recent Public Expenditure Review of the Road Sector conducted by the World Bank finds that, respectively, 24% and 41% of provincial and district roads are in bad or poor condition. The performance is better at the national level where only 12% of the roads are in bad or poor condition. Inability to acquire land for public use has been one of the reasons for the delayed disbursement of government’s capital spending. It has also delayed the development of public-private partnerships (PPPs), particularly for toll roads. The private sector considers the land acquisition problem as a major source of uncertainties for project development, costs and implementation. The existing rail network mainly provides passenger service only in Java and limited freight services in Sumatra.

4. **Inter-Island connectivity.** As a large archipelagic country, reducing the cost of inter-island shipping will contribute significantly to economic growth and poverty reduction across islands of the country. At present, domestic shipping costs constitute a large portion of producers’ total costs, with these costs being passed on to consumers throughout the country. Reflecting poor logistics and inadequate transport infrastructure, about 70% of the rice price differences across provinces is explained by the degree of remoteness. The high cost of shipping is due to a combination of inadequate hard and soft infrastructure in the ports. According to one estimate, the average turnaround time for domestic shipping at the 25 strategic ports is 2.7 days. With average sailing time being 1.5 days, ships are spending about 75% of the total time between destinations at port.

5. **International Connectivity.** The bulk of the country’s international trade is facilitated by five main ports. The largest is Tanjung Priok, the country’s main international gateway in Jakarta, currently serving approximately 70% of internationally traded goods. Tanjung Priok also serves 29% of container traffic between Java and other islands. While Tanjung Priok is Indonesia’s most efficient port, its level of productivity is much lower than that of major ports in the ASEAN region. Ship dwelling time in Tanjung Priok is 6.7 days in January 2012 compared with only 4.9 days in 2010. The cost of delivering one container from Cikarang (the nearest industrial zone) to Tanjung Priok with a distance of about 56 kilometers is $750, much higher than the cost ($450) from Pasir Gudang to Tanjung Pelepas with a similar distance in Malaysia. The 2012 Logistic Performance Index, which measured the efficiency of logistic services for international trade, confirms that Indonesia’s performance is much lower than the neighboring countries due to lagging infrastructure support.

III. **Economic Analysis and Poverty Assessment**

6. **Policy reforms to improve national connectivity in the medium term.** The Government has embarked on a connectivity reform agenda that includes: (i) strengthened coordination, regulatory and institutional frameworks; (ii) improved intra-island connectivity aimed at connecting rural areas with regional growth poles, and accelerated development and better maintenance of inland transport networks; (iii) improved inter-island connectivity to enhance efficiencies and service performance of transport services; and (iv) improved international connectivity by making the country’s key ports, logistics and intermodal systems more efficient in handling increasing traffic and trade volume. To support its priority, the

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Government has doubled its budget allocation for the transport sector from Rp 27.5 trillion in 2010 to Rp 54.2 ($5.7 billion) in 2012 to support improved connectivity.

7. **Policies to strengthen policy coordination.** The government set up a coordinating mechanism equipped with the political mandate to coordinate policy reforms on connectivity beyond the core economic agencies. The government has appointed the Coordinating Minister of Economic Affairs (CMEA) as the Executive Chairman for implementing the Master Plan for Acceleration and Expansion of Indonesia’s Economic Development (MP3EI). At the policy implementation level, CMEA has established a high-level cross-ministerial task force with a mandate to coordinate policy reforms on connectivity. Lack of policy coordination is a major challenge in addressing logistics and intermodal transport issues. Similar to other countries, there are many agencies responsible for supervising activities along the logistics chain. In this context, CMEA also formed a task force to coordinate implementation of logistics-related reforms.

8. **Policies to improve intra-island connectivity.** To address the land acquisition issue, the parliament has passed the Land Acquisition Law for Public Use (Law No. 2/2012), which is a critical step towards attracting and mobilizing infrastructure investment. The Law is also critical in facilitating PPPs in a range of sectors, most notably for toll roads, and where private investors expect strong support from government in resolving land issues. The implementing regulations of the law are expected to be issued before the end of 2012. The government has also allocated increased budget to support improvement of the country’s road networks and railway system. To improve the operational viability of the railway services, the government issued a regulation to establish a budgetary mechanism to transfer subsidies for the provision of public service obligation (PSO) in railway services, reimbursement of infrastructure maintenance operation (IMO), and reimbursement of track access charges (TAC) to government’s railway infrastructure. The regulation covers payments to private operators that are competing to provide non-commercial railway services. The government will set up a Viability Gap Fund (VGF) to provide public sector financial support to well-prepared PPP projects to enhance their bankability and financial viability, including those in the eastern part of Indonesia.

9. **Policies to improve inter-island connectivity.** Labor costs play an important role in increasing logistic costs. Previously, under the Joint Decree of Directorate General (DG) of Cooperatives, DG of Sea Transport, and DG of Industrial Relations, all labor services for cargo handling at seaports must be provided through a dedicated labor cooperative (Koperasi TKBM). The regulation effectively gives monopoly power to Koperasi TKBM for cargo handling at Indonesia’s seaports, which significantly raises costs, particularly for non-containerized products such as agricultural, raw and bulk materials. The government also recognizes the increasing importance of information and communications technology (ICT) in promoting inclusive growth through connectivity. Thus, the government has accelerated efforts to improve ICT connectivity in the eastern provinces by providing incentives for the private sector to invest in back-bone internet infrastructure in eastern Indonesia. Improving ICT assess in eastern Indonesia will complement efforts to develop improved transportation services.

10. **Policies to enhance international connectivity.** While efforts to expand the capacity of the main Jakarta port of Tanjung Priok port are underway, the government is also addressing soft infrastructure and trade facilitation impediments. While some efforts to simplify export and import procedures have been completed, the number of agencies and documents involved remains large. In this context, the Indonesia National Single Window (INSW) plays an important role to reduce the time and costs of importing and exporting by facilitating single submission, single processing and single approval of import/export documents. The government continues
the effort to simplify export and import procedures by making the INSW as the only reference portal for cross-border trade regulations in customs clearance process. This will make all trade regulations accessible for the public and facilitate streamlining of these procedures. With a projected increase in twenty-foot equivalent unit (TEU) cargo volume of 20% annually going forward, port expansion and new and/or deeper seaports will be necessary over the medium-term. More immediately, a number of efforts could be introduced to cope with increasing congestion. The dry ports in Cikarang and nearby the industrial district of Jababeka have been optimized. The government is also in the process of introducing INSW and an identical customs clearance services for dry ports in Cikarang and in Tanjung Priok.

11. **Current performance in poverty reduction.** Growth of 6.5% in 2011 resulted in about 1.5 million new jobs being generated, exceeding the number of new entrants to the labor force. The quality of employment also improved as formal employment rose by 16.0% (5.7 million positions). Most jobs were in construction, manufacturing, and services. Employment in the informal sector fell by 5.9%, or 4.2 million, as workers left the agricultural labor force. However, significant challenges remain in reducing poverty incidence further. About 62% of the employed labor force (about 68.2 million people) still works in the informal sector, where wages and job security are low. Poverty incidence fell to 12.4% in September 2011, from 13.3% in March 2010. While poverty and unemployment have trended downward, many Indonesians remain vulnerable to economic shocks. More than 60 million people still live just above the poverty line and are at high risk of falling back into poverty. The national rural poverty rate of 15.6% is still much higher than the national urban poverty rate of 9.1%. Poverty rates in some provinces in eastern Indonesia are much higher than elsewhere in the country—for example, 25.3% in Maluku and Papua (Figure 1b).

![Figure 2: Poverty and Unemployment](image)

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<thead>
<tr>
<th>a. Unemployment and Poverty Incidence</th>
<th>b. Poverty Distribution across the Country</th>
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<tr>
<td><img src="image" alt="Bar chart showing unemployment and poverty incidence from 1996 to 2011" /></td>
<td><img src="image" alt="Bar chart showing poverty distribution across the country" /></td>
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Source: Badan Pusat Statistik (BPS)

12. **Impact of sustained connectivity reforms on economic growth and poverty reduction.** An analysis using a computable inter-regional model of the Indonesian economy (Indo-TERM)\(^4\) suggests that sustained reforms that lead to a significant efficiency improvement in the transport and logistics sectors over the medium term could improve economic growth by about 1 percentage point annually. Additional economic growth in the first round is generated by

\(^4\) Indo-TERM is a bottom-up computable inter-regional model of the Indonesian economy covering 30 aggregated provinces. It is calibrated using 2005 input-output with inter-provincial trade data.
efficiency improvement in the transport and logistics sectors, which leads to more competitive domestic products and increased production of certain products such as agricultural commodities that were not tradable into the market due to expensive inter-island transport and logistics costs. In the second round, the reforms will attract new investment due to improved investment climate, both to the transport and logistics sectors and other growing industry spurred by the connectivity reforms. The improved growth prospects from sustained connectivity reforms would also reduce the country’s poverty incidence by 2.2% (4.7 million people) over a five-year period. Interestingly, poverty reduction is higher in the eastern part of Indonesia as those provinces are suffering more from connectivity impediments. In addition, it also due to a higher base poverty base in those provinces.

**Figure 3. Poverty Impact of Sustained Connectivity Reforms**

1a. Simulated impact of reduction in poverty incidence due to overall transport efficiency (%)

1b. Spatial analysis of reduction in poverty incidence due to overall transport efficiency (%)

Note: East Indonesia refers to Maluku and Papua.
Source: ADB Staff Estimates

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