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PROJECT PERFORMANCE ASSESSMENT REPORT



INDONESIA

**Public Expenditure Support Facility
Development Policy Loan with Deferred
Drawdown Option**

Report No. 110741

MAY 30, 2017

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PROJECT PERFORMANCE ASSESSMENT REPORT

INDONESIA

**PUBLIC EXPENDITURE SUPPORT FACILITY
DEVELOPMENT POLICY LOAN WITH DEFERRED DRAWDOWN OPTION
(IBRD-76580)**

May 30, 2017

Currency Equivalents (annual averages)

Currency unit = Indonesian rupiah (Rp)

2009	US\$1.00	RP 11.77
2010	US\$1.00	RP 9.37
2011	US\$1.00	RP 8.88
2012	US\$1.00	RP 8.95
2013	US\$1.00	RP 9.65
2014	US\$1.00	RP 12.08

All dollar amounts are U.S. dollars unless otherwise indicated.

Abbreviations and Acronyms

ADB	Asian Development Bank
BKPM	Badan Kordinasi Penanaman Modal
CMI	Chiang Mai Initiative
CPS	country partnership strategy
CSOs	civil society organizations
DDO	deferred drawdown option
DNI	Daftar Negatif Investasi
DPL	development policy loan
EITI	Extractive Industries Transparency Initiative
EMBI	Emerging Markets Bond Index
FDI	foreign direct investment
FSSC	Financial System Stability Committee
ICR	Implementation Completion and Results Report
IDPL	infrastructure development policy loan
IEG	Independent Evaluation Group
LPS	Deposit Insurance Corporation
M&E	monitoring and evaluation
NPLs	nonperforming loans
OJK	Otoritas Jasa Keuangan
OSS	One Stop Service
PESF	Public Expenditure Support Facility
PPAR	Project Performance Assessment Report
ROA	return on assets
SMEs	small and medium enterprises
UDB	unified database

Fiscal Year

Government: January 1 – December 31

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This report was prepared by Xiaolun Sun and Aristomene Varoudakis, who assessed the program in June 2016. The report was peer reviewed by R. Pablo Guerrero and panel reviewed by Chad Leechor. Yasmin Angeles and Carla F. Chacaltana provided administrative support.

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Principal Ratings

	ICR*	ICR Review*	PPAR
Outcome	Highly Satisfactory	Satisfactory	Satisfactory
Risk to Development Outcome	Negligible to Low	Moderate	Moderate
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Highly Satisfactory	Satisfactory	Satisfactory

* The Implementation Completion and Results (ICR) report is a self-evaluation by the responsible World Bank global practice. The ICR Review is an intermediate IEG product that seeks to independently validate the findings of the ICR.

Note: PPAR = Project Performance Assessment Report.

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IEG Mission: Improving World Bank Group development results through excellence in independent evaluation.

About this Report

The Independent Evaluation Group assesses the programs and activities of the World Bank for two purposes: first, to ensure the integrity of the World Bank's self-evaluation process and to verify that the World Bank's work is producing the expected results, and second, to help develop improved directions, policies, and procedures through the dissemination of lessons drawn from experience. As part of this work, IEG annually assesses 20–25 percent of the World Bank's lending operations through field work. In selecting operations for assessment, preference is given to those that are innovative, large, or complex; those that are relevant to upcoming studies or country evaluations; those for which Executive Directors or Bank management have requested assessments; and those that are likely to generate important lessons.

To prepare a Project Performance Assessment Report (PPAR), IEG staff examine project files and other documents, visit the borrowing country to discuss the operation with the government, and other in-country stakeholders, interview Bank staff and other donor agency staff both at headquarters and in local offices as appropriate, and apply other evaluative methods as needed.

Each PPAR is subject to technical peer review, internal IEG Panel review, and management approval. Once cleared internally, the PPAR is commented on by the responsible World Bank country management unit. The PPAR is also sent to the borrower for review. IEG incorporates both World Bank and borrower comments as appropriate, and the borrowers' comments are attached to the document that is sent to the World Bank's Board of Executive Directors. After an assessment report has been sent to the Board, it is disclosed to the public.

About the IEG Rating System for Public Sector Evaluations

IEG's use of multiple evaluation methods offers both rigor and a necessary level of flexibility to adapt to lending instrument, project design, or sectoral approach. IEG evaluators all apply the same basic method to arrive at their project ratings. Following is the definition and rating scale used for each evaluation criterion (additional information is available on the IEG website: <http://ieg.worldbankgroup.org>).

Outcome: The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: relevance, efficacy, and efficiency. *Relevance* includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current World Bank country and sectoral assistance strategies and corporate goals (expressed in Poverty Reduction Strategy Papers, country assistance strategies, sector strategy papers, and operational policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. *Efficacy* is the extent to which the project's objectives were achieved, or are expected to be achieved, taking into account their relative importance. *Efficiency* is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared to alternatives. The efficiency dimension is not applied to development policy operations, which provide general budget support. *Possible ratings for outcome:* highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, highly unsatisfactory.

Risk to Development Outcome: The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). *Possible ratings for risk to development outcome:* high, significant, moderate, negligible to low, not evaluable.

Bank Performance: The extent to which services provided by the World Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan/credit closing, toward the achievement of development outcomes. The rating has two dimensions: quality at entry and quality of supervision. *Possible ratings for World Bank performance:* highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, highly unsatisfactory.

Borrower Performance: The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation, and complied with covenants and agreements, toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. *Possible ratings for borrower performance:* highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, highly unsatisfactory.

Preface

This is the Project Performance Assessment Report (PPAR) of the Indonesia Public Expenditure Support Facility implemented in FY09–FY11. The Independent Evaluation Group (IEG) prepared the report. It is based on interviews, documents, and data collected during a mission to Indonesia in June 2016, during which government officials, external development partners, and business groups, academics, nongovernmental organizations, civil society groups, and other stakeholders were consulted. The evaluation also draws on in-depth interviews of World Bank and International Monetary Fund staff, including current and former members of the Indonesia country teams in Washington, DC, and Jakarta. The cooperation and assistance of all stakeholders and government officials are gratefully acknowledged as is the support of the World Bank office in Jakarta.

The assessment aims first to serve an accountability purpose by verifying the program’s success in achieving the intended outcomes. Secondly, as part of a cluster of PPARs on development policy loans with deferred drawdown option, the report draws lessons to inform the design and implementation of this type of instrument in Indonesia and other World Bank Group client countries.

Following standard IEG procedures, the report is sent to the government officials and agencies in Indonesia for review and feedback. Comments received are attached as appendix D.

Summary

This Project Performance Assessment Review (PPAR) evaluates the Indonesia Public Expenditure Support Facility (PESF), a \$2 billion development policy loan (DPL) with a deferred drawdown option (DDO) implemented between March 2009 and December 2010. The market-dependent drawdown conditions were not met, the loan was not disbursed, and it was closed on the original closing date. The PPAR reviews the performance of this operation based on IEG and Operations Policy and Country Services (OPCS) guidelines on program evaluations.

The main objective of the PESF was to assist the government in addressing the potential adverse impacts of the global financial crisis on public expenditures during 2009–10. To this end, the PESF supported three sets of policy objectives: (i) reassuring financial markets and maintaining financial system stability, (ii) sustaining critical public expenditures while maintaining budget discipline, and (iii) facilitating private investment and supporting exports.

The objectives of the PESF were **highly relevant** to Indonesia's situation. The country entered the global financial crisis in a sound economic position, but its structural weaknesses and the legacy of the 1997–98 crisis heightened its vulnerability. Boosting market confidence in the economy and safeguarding public expenditure were thus of critical importance. The reform agenda supported by the PESF was anchored on the government's reform program and the World Bank Group's partnership strategy. Focusing on a subset of the policy areas covered under the ongoing series of a regular DPL program, the PESF was complementary to other World Bank operations.

Design of the PESF was **highly relevant** in terms of the choice of instrument and the policy program. The decision to utilize the DDO feature was sound given the government's need for contingent financing to deal with uncertainties in capital market access. The mobilization of partner financing from the Asian Development Bank (ADB) and the governments of Australia and Japan (to a total of \$5.5 billion) served to further boost market confidence. The set of clearly defined drawdown triggers helped maximize the loan's impact by strengthening the government's commitment to withstand internal pressures to overspend during the crisis. The PESF also supported key structural reforms for growth and recovery, thus complementing OBank support through its regular DPL series.

The overall outcome of the PESF is rated **satisfactory**. It reflects the high relevance of the objectives and of the program design, and substantial efficacy in outcome achievement. As a crisis response operation, the main objective of the operation was mostly served by the actions in the first two policy areas. All the objectives in these areas were substantially achieved while the recent drastic reduction of energy subsidies went well beyond expectations when the operation was implemented. Outcome achievement in the third policy area was more modest, with backtracking in investment regulations and lack of timely compliance with Extractive Industries Transparency Initiative (EITI) obligations. The recent policy changes in foreign direct investment (FDI) regulations and the lifting of Indonesia's EITI suspension bode well for the continuation of the reform process in these areas.

The risk to development outcomes is rated **moderate**. Because Indonesia weathered the crisis well, the risk to Indonesia's ability to withstand the shock wave of the global financial crisis is no longer at stake. Regarding the medium-term objectives supported by the PESF, risk to financial stability is moderate as Indonesia has become more resilient with better defense mechanisms against financial market volatility; risk to sustaining critical public expenditure is low because the government has demonstrated its drive to protect social assistance spending; and risk to investment climate is moderate with significant FDI liberalization of several business fields in September 2015 after a period of tightening the restrictions following the global financial crisis.

Among the key lessons are:

- **The DPL DDO proved to be an effective instrument to assist Indonesia in responding to financial market turbulence in the aftermath of the 2008 global financial crisis.** To avoid the situation where rapidly rising borrowing costs potentially trigger self-fulfilling currency and/or debt crises, sending the right signals to defuse market tension was of critical importance. Designed as a contingent line of credit, the DPL DDO fulfilled this role better than any other World Bank instruments available.
- **Making the drawdown of the DPL DDO funds conditional on market borrowing conditions strengthened the government's commitment to maintain fiscal discipline despite the crisis.** This helped enhance the impact of the operation on improving market confidence. The current loan illustrates that when the DPL DDO is used strictly for crisis response purposes, it is possible for the World Bank to articulate in advance a set of clearly defined drawdown conditions, which ensures that the loan is used for its intended purposes.
- **The implementation of the PESF also illustrates that using a crisis response operation to support longer-term structural reforms may require strong client commitment and sustained post-crisis support.** As an emergency operation, the PESF's policy program appropriately focused on critical short-term measures targeted at boosting market confidence. While it also included support for long-term reforms, achieving the expected results of these reforms was ultimately beyond the scope and timeframe of the PESF, and depended critically on post-crisis Bank support through the regular DPL series.

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1. Background and Context

1.1 Indonesia entered the global financial crisis in late 2008 in a sound economic position. Aided by the favorable global economic climate that prevailed prior to the crisis, Indonesia's fundamentals were strengthened through sound macroeconomic policy, including prudent debt management and by promoting a sounder financial sector. The economy had been growing at about 6 percent since 2005, public debt had been reduced to 33 percent of GDP in 2008, and the budget was in balance. Moreover, the external current account was in surplus, the exchange rate had been stable for more than two years, and foreign exchange reserves were high, surpassing \$50 billion, equivalent to about 140 percent of short-term foreign debt (table 1.1).

Table 1.1. Macroeconomic Performance and Vulnerability in Indonesia, 2007–15

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Real GDP growth ^a	6.3	6.1	4.5	6.2	6.5	6.3	5.6	5.0	4.7
Inflation rate ^a	6.2	9.8	4.8	5.1	5.3	4.0	6.4	6.4	6.4
Current account balance ^b	2.4	0.0	2.0	0.7	0.2	-2.8	-3.2	-3.1	-2.0
Budget balance ^b	-1.2	-0.1	-1.6	-0.7	-1.1	-1.8	-2.2	-2.2	-2.8
External debt ^b	31.8	29.3	32.0	28.5	26.7	28.7	29.2	33.1	36.6
Public debt ^b	36.9	33.2	28.6	26.1	24.4	24.0	24.9	24.7	27.5
Gross ext. financing needs ^c	33.6	59.1	47.2	26.5	41.2	71.1	83.8	83.8	75.2
Foreign exchange reserves ^c	54.1	52.1	66.1	96.2	110.1	112.8	99.4	111.9	105.9
Foreign exchange reserves ^d	157.4	141.5	203.7	224	236	206	177	192	177
Exchange rate ^e	9,141	9,439	10,354	9,088	8,774	9,375	10,414	11,862	13,389

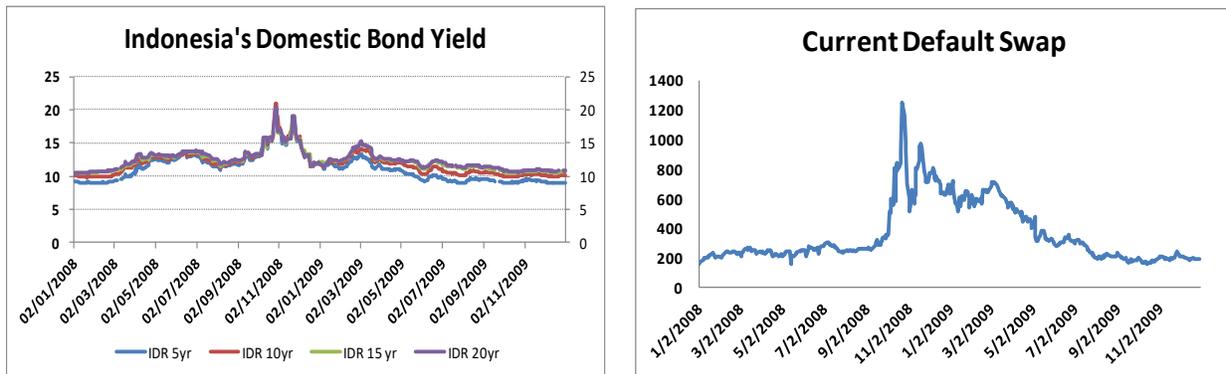
Note: a. in percent; b. in percent of GDP; c. in US\$ billions; d. in percent of short-term debt; e. average for period.

Sources: IMF, Indonesia Article IV reports.

1.2 However, the Indonesian economy suffered (and continues to suffer) from structural weaknesses that made it vulnerable to the global financial crisis. First, Indonesia's export base is narrow and dominated by primary commodities, which are subject to significant price fluctuations. Second, the capital account is open and dominated by nonresident investors who are more sensitive to changes in global market sentiment. About 80 percent of the government's financing requirements is covered by domestic debt, while 60 percent of domestic debt is bought by nonresident investors. Third, the domestic financial market is shallow, thus exacerbating foreign exchange market volatility. The legacy of the 1998 East Asian crisis, when the banking system and the Indonesian economy collapsed, is still vivid and raises market nervousness at times of global financial turbulence.

1.3 Thus, despite a sound macroeconomic framework, the increase in global risk aversion after September 2008 significantly affected the country's financial conditions. The currency had lost one-third of its value against the U.S. dollar by late November 2008, while the stock market had fallen by 50 percent. International reserves declined by \$10 billion between July and October 2008. Spreads on Indonesia's U.S. dollar sovereign bonds increased by 800 basis points, surpassing bond spreads of other countries in the region. Yields on the domestic bond market rose sharply, surpassing 20 percent in November 2008, and credit default swap spreads reached 1200 basis points in November 2008, up from 200 points in early September 2008, despite the low levels of external and public debt (figure 1.1).

Figure 1.1 Domestic bond yields and Credit Default Swap rate (2008-09, in %)



Source: Indonesian Ministry of Finance.

1.4 Indonesia's high external financing needs in 2009 (\$47 billion), the large presence of nonresident investors on both the U.S. dollar and domestic bond markets, and its open capital account raised concerns regarding its access to market financing and the cost of government borrowing if the global financial crisis further intensified. Combined with the legacy of the 1998 crisis, capital flight, widespread bankruptcies, sharp expenditure cuts, a dramatic fall in GDP, and a steep rise in poverty prompted the government to take all necessary steps to avoid repeating that experience.

1.5 The government's macroeconomic response to the global financial crisis was twofold: (i) a stimulus package to prevent a sharp slowdown of growth and (ii) mobilization of financing to ensure that Indonesia would not suffer a liquidity crunch if the global crisis persisted and deepened. The stimulus package, estimated at about 1.5 percent of GDP, consisted of a combination of tax cuts and increased spending on existing social assistance programs, infrastructure, and maintenance. These measures were included in a revised budget in February 2009, while an additional infrastructure spending package was announced in July 2009. Sound fiscal performance, which was underpinned by Indonesia's fiscal rule that limited general government deficit to 3 percent of GDP and public debt to 60 percent of GDP, helped create the fiscal space for increasing priority public spending.

1.6 To avoid the possibility of Indonesia—despite its sound macroeconomic fundamentals—being “cornered” by speculators, the government approached the World Bank immediately after the Lehman Brothers collapse for a precautionary line of credit.

Because it had prefinanced its financing requirements for 2008 and was not facing a balance-of-payments crisis, the government was not in urgent need of financing but was rather seeking a precautionary financing instrument to manage the risk of a liquidity crunch in 2009. This led to the preparation of the Indonesia Public Expenditure Support Facility (PESF), a \$2 billion development policy loan with a deferred drawdown option (DPL DDO). Other development partners—the Asian Development Bank (ADB) and the governments of Australia and Japan—joined the World Bank on similar terms, bringing the total financial package to \$5.5 billion. This financing package covered 23 percent of the government’s financing requirements in 2009. Preparation started in earnest, with a concept review in December 2008, appraisal in January 2009, and approval by the World Bank Board in March 2009.

1.7 In parallel, to bolster sentiment in the foreign exchange market, Bank Indonesia secured significant amounts of currency swaps from other central banks of the countries participating in the Chiang Mai Initiative (CMI) (see paragraph 4.6).¹ Moreover, to implement the additional fiscal stimulus in July 2009 and ensure predictability of budget financing, the government obtained a separate \$500 million loan from the ADB’s Counter-cyclical Support Facility, which was approved in October 2009.

1.8 Indonesia weathered the global financial crisis well because it benefited from strong initial conditions and timely policy responses. Despite the impact on financial markets in the last quarter of 2008 and in early 2009, the economy continued to grow albeit at a slower pace. The economy grew by 4.5 percent in 2009, the third highest growth rate among G-20 members. The strength of the economy reflected its greater dependence on domestic consumption rather than exports. The government’s fiscal stimulus and the abatement of financial market tensions also contributed to the economy’s resilience in 2009.

1.9 In subsequent years, growth remained strong at above 6 percent. Since 2013, however, it started to slow down due to the impact of adverse commodity price developments and renewed financial market turmoil. The current account and fiscal balance changed to deficit more recently, but public and external debt remained low while exchange reserves remained at comfortable levels.

2. Objectives, Design, and Their Relevance

2.1 The main objective of the PESF was to assist the government of Indonesia to address the potential adverse impacts of the global financial crisis on public expenditures during 2009–10, as stated in the program document and the loan agreement (World Bank 2009a and 2009b). To achieve this objective, the PESF supported key policy measures in three areas critical for strengthening Indonesia’s resilience at times of crisis: (i) reassuring financial markets and maintaining financial system stability, (ii) sustaining critical public expenditures while maintaining budget discipline, and (iii) facilitating private investment and supporting exports.

2.2 As part of a \$5.5 billion package, the PESF provided a contingent line of credit of \$2 billion. The government committed to using the PESF funds only if it could not meet its financing needs for 2009, equivalent to 2.5 percent of GDP, subject to specific market

conditions. To that effect, the government issued a decree, which specified the financing plan for 2009 and defined two conditions that could trigger the drawdown of contingent loans from the World Bank and the other development partners: (i) if the proceeds from the issuance of government securities in any quarter was below the specified target (on a cumulative quarterly basis) and (ii) if the interest rate for representative maturities of domestic and U.S. dollar-denominated government securities exceeded one standard deviation of the average yield for these maturities over the period 2005–08 (see appendix B). These conditions were kept confidential to avoid market manipulation.²

2.3 In addition, the financing plan specified a set of exceptional circumstances under which the drawdown option could be exercised regardless of the activation of the two conditional drawdown triggers. These exceptional circumstances referred to a possible market sell off that might have caused a sharp decline in government bond prices resulting in a ceasing of market auctions. Drawdown requests could be made subject to maintaining an appropriate macroeconomic framework as verified by the development partners. The government retained, however, the option of not drawing down the funds even if the drawdown triggers were met.

Relevance of Objectives

2.4 Relevance of objectives is rated **high**.

2.5 The objectives of the PESF were highly relevant to Indonesia's situation during the PSEF appraisal, when the outlook for access to international and domestic capital markets was grim and uncertain. Although Indonesia entered the global financial crisis in a sound macroeconomic condition, its structural weaknesses and the legacy of the 1997–98 crisis heightened its vulnerability to increased global risk aversion. Boosting market confidence in the capacity of the Indonesian economy to navigate through the crisis, preventing capital flight, and safeguarding public expenditures were thus of critical importance.

2.6 The objectives were realistically anchored on the government's reform program and the World Bank's partnership strategy with the country. In addition to strengthening the banking sector and protecting priority development spending in social assistance and infrastructure, which are short-term objectives, the PSEF also aimed to encourage private investment and exports, medium-term goals that the government continued to pursue.

2.7 The 2009–12 country partnership strategy (CPS) did not include a contingency for crisis support (World Bank 2008b), but the reform agenda supported by the PSEF was consistent with one of the CPS cross-cutting areas of engagement (improving central government institutions and systems) and one of the core engagement areas (private sector development). Indeed, the PESF focused on a subset of the policy areas covered under the ongoing series of the regular DPL program, which supported the government's reform efforts in three core areas: (i) improving the investment climate, (ii) strengthening public financial management and governance, and (iii) enhancing poverty alleviation and service delivery efforts. The DPL-5 (\$750 million) and IDPL-2 (infrastructure development policy loan, \$200 million), both part of the regular DPL series, were approved by the World Bank in December 2008, a few months prior to the PESF

approval. They supported further actions as part of a proactive response to the global financial crisis and future stress episodes.

Relevance of Design

2.8 Relevance of design is rated **substantial**.

2.9 The choice of the DPL DDO instrument was highly relevant. The government did not need an inexpensive source of financing for the 2009 fiscal stimulus, but was rather seeking a precautionary financing instrument to boost confidence and keep the cost of borrowing at reasonable levels during the crisis. The DPL DDO was the World Bank instrument that most closely matched the government's needs for a large contingent credit that could be quickly accessed when and as needed.³ Indeed, the government valued the signaling effect of the DPL DDO to the markets more than the availability of funds at favorable terms. The mobilization of other development partner financing further boosted such a signaling effect, both by bolstering the de facto reserves of the country and by showing a high degree of multilateral support.

2.10 The set of clearly defined drawdown triggers significantly strengthened its design for maximizing impact. Making disbursement of the funds conditional on market conditions reinforced the government's commitment to withstand internal pressures to overspend during the crisis. According to some interlocutors, it might have also helped resist political pressures to spend in the run up to the presidential elections scheduled in June 2009. There were some concerns by government officials that the disbursement criteria might have been too restrictive. However, the financing plan provided enough flexibility to allow immediate disbursement of the funds in case of a pronounced selloff that risked shutting out Indonesia from the bond market. Had Indonesia drawn down the PESF funds sooner instead of borrowing from markets at higher rates, contingency financing would no longer be available if conditions deteriorated, which could be perceived as a weakness and thus dampening the confidence impact sought by the DPL DDO.

2.11 Among the three sets of policy measures supported under the PESF, the first two (reassuring financial markets and maintaining financial system stability, and sustaining critical public expenditures while maintaining budget discipline) directly related to the main objective of assisting the government to address the potential adverse impacts of the global financial crisis on public expenditures during 2009–10. They were consistent with the crisis` response nature of the operation. There was a plausible logical chain linking the prior actions to expected outcomes. The third objective (facilitating private investment and supporting trade), however, had a longer-term agenda. Although they served to demonstrate the government's commitment to improve Indonesia's attractiveness to private investment, the reforms had different timing and scope from the rest of the operation and required additional support through the World Bank's regular DPL series.

3. Implementation

3.1 The turmoil spurred by the global financial crisis, along with memories of the social and economic hardship of the 1997–98 financial crisis, created a sense of urgency to secure the contingent financing package. The government would frequently refer to the PESF contingent financing, which had been announced to market participants and the public even before its approval by the World Bank Group Board, to increase leverage and follow through in the implementation of the reforms.

3.2 The preparation of the PESF moved forward quickly thanks to an actively engaged World Bank team on the ground that had strong working relationships with government counterparts. Several of the reforms supported by the PESF built upon reforms supported in past DPLs. As a result, there was a continuation of dialogue and counterpart involvement on the critical issues, which greatly facilitated the preparation of the operation. The prior actions were promptly implemented by the government, paving the way for the speedy approval of the operation by the World Bank.

3.3 With the rapid improvement of market conditions in the second half of 2009, the drawdown triggers were not activated and the funds were not disbursed. The government maintained the PESF facility while uncertainty persisted regarding a possible resurgence of market tension in 2010. Eventually the government decided that extending the PESF was not warranted. The operation was closed as planned on December 31, 2010. Part of the reason for the government's decision was that the operation counted 100 percent toward the World Bank country borrower limit for Indonesia. Closing the operation would allow other projects in the pipeline to materialize. Even though the PESF funds were never disbursed, the operation supported structural reforms through the implementation of the prior actions upon approval and catalyzed subsequent reforms in several areas.

4. Achievement of the Objectives

Objective 1: Reassure financial markets and maintain financial system stability

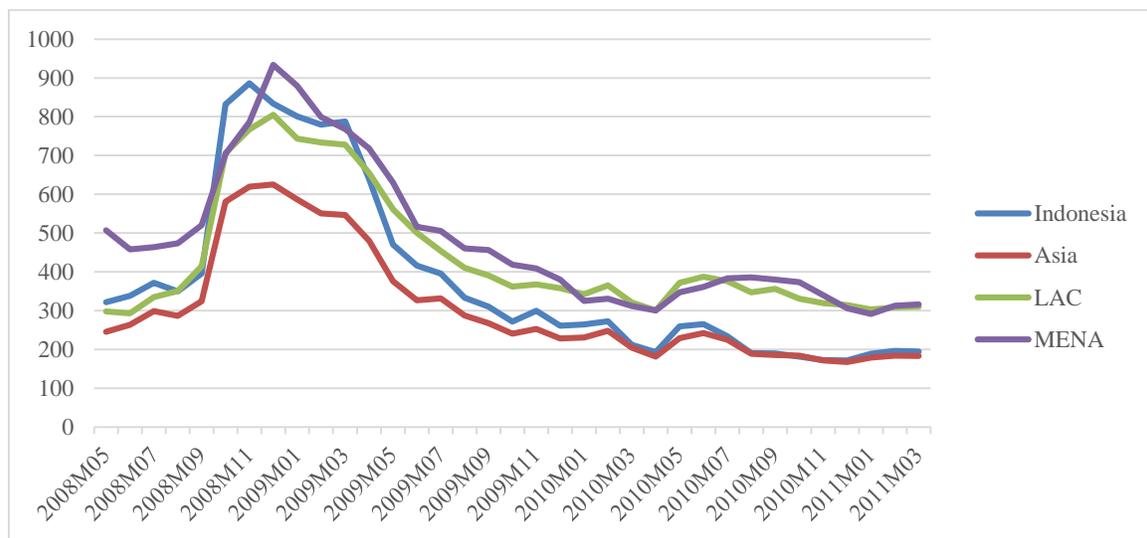
4.1 The efficacy of objective 1 is rated **substantial**.

4.2 To reassure financial markets, ease access to finance, and maintain financial system stability, the PESF supported policy measures that would facilitate prompt actions in case of bank failures, preserve banking system stability, and clarify how the government would finance its 2009 budget. The expected results were qualitative: the absence of a banking sector crisis, timely and appropriate measures to address failed financial institutions, and the ability to meet its 2009 financing needs. As shown in table 1.1, there is ample evidence that these outcomes were achieved.

FINANCIAL MARKET ASSURANCE

4.3 There is evidence that Indonesia's financial stress eased concurrently with the preparation and approval of the PESF. Interest rates started declining at the end of 2008 on both local currency government bonds (figure 1.1) and U.S. dollar bond spreads (figure 4.1), dropping to or below their precrisis levels by May 2009. The decline in Indonesia's yield spreads was among the largest in the 41 economies covered by J.P. Morgan's Emerging Markets Bond Index (EMBI), although the yields were highly correlated across countries. Indonesia's Credit Default Swap spread started declining from March 2009 (figure 1.1.b). The exchange rate rallied from Rp 12,100 per U.S. dollar in early March 2009 to its precrisis level of Rp 9,300 per U.S. dollar by October 2009.

Figure 4.1. US Dollar Sovereign Bond Spreads, May 2008–March 2011 (%)



Note: LAC = Latin America and the Caribbean; MENA = Middle East and North Africa.

Source: J.P. Morgan's Emerging Markets Bond Index.

4.4 Global and domestic political and economic developments contributed to improvement in market confidence. Worldwide responses to the financial crisis helped ease global financial market tension, with a positive impact on the borrowing costs and exchange rates of emerging market economies. The resumption of the yen carry trade (whereby investors borrow at the low interest rate in Japan to purchase assets in countries offering high interest rates such as Indonesia) contributed to exchange rate appreciation after March 2009. The resolution of political uncertainty after the comfortable first-round reelection of the incumbent president for a second mandate in July 2009 also encouraged investor interest in Indonesian assets.

4.5 Other important initiatives that probably strengthened market confidence include the swap arrangements among central banks of the countries participating in the Chiang Mai Initiative (CMI). Indonesia had three bilateral swap agreements in place at the end of 2008: \$4 billion with China, \$6 billion with Japan (increased to \$12 billion in February 2009), and \$2 billion with the Republic of Korea. In addition, China signed a Yuan-denominated 100 billion swap with Indonesia on March 24, 2009 to facilitate bilateral

trade. These swap lines are likely to have also contributed to easing tensions on the exchange rate in 2009.

4.6 Amid these global and domestic developments, and the multiple actions undertaken by the government to reassure the markets, it is difficult to clearly identify the PESF's impact on market confidence from that of others. Nevertheless, according to market observers interviewed, the PESF was in the spotlight and market panic subsided after the announcement of its preparation. The contingent facility— with fund disbursement conditional on excessive financial market tension— boosted market confidence by ensuring predictability in the coverage of Indonesia's financing requirements in 2009.

4.7 On the other hand, the structural weaknesses at the origin of Indonesia's vulnerability to international financial market turbulence remain. Thus, stress resurfaced in more recent episodes of market instabilities. The rupiah depreciated about 8 percent in 2012 as a result of broader market tension caused by the Eurozone debt crisis, and depreciated again by 25 percent between May and the end of 2013 owing to market concerns about a possible tightening of monetary policy in the United States, which triggered capital outflows from emerging economies. Pressure on the exchange rate was compounded by external current account imbalances. In 2012, Indonesia recorded its first current account deficit since 1997. Since then, a sustained current account deficit at about 3 percent of GDP has become a predominant challenge for macroeconomic management (table 4.1).

4.8 Confronting renewed financial market volatility in 2012, the government requested a second DPL DDO for \$2 billion—the Program for Economic Resilience, Investment, and Social Assistance—which was approved by the World Bank in April 2012. The drawdown of the funds was subject to similar triggers to those of the PESF. In the fall of 2015, owing to rising financing needs caused by a revenue shortfall in the 2015 budget, the funds from the second DPL DDO were drawn down when the market conditions were marginally met.

FINANCIAL SYSTEM STABILITY

4.9 Over the past decade, the government made financial system stability and development a high priority. The PESF supported actions with medium-term benefits for the stability of the financial system. The financial safety net regulation of 2009 (a prior action) clarified the roles of Bank Indonesia, the Ministry of Finance, and the Deposit Insurance Corporation (LPS) in ensuring financial stability in case of crisis and in the event of failure of financial institutions. It contributed to ensuring timely action in the resolution of failed banks while considerably increasing the coverage of deposit insurance. When the financial safety net regulation expired, there was a temporary gap in the regulatory framework until a financial safety net bill was submitted to Parliament in 2015 and passed into law in March 2016. The resulting Law No. 9 concerning Financial System Crisis Prevention and Mitigation established procedures for (i) the surveillance and safeguarding of the stability of the financial system, (ii) the management of financial system crisis, and (iii) the management of systemic bank troubles, whether in normal conditions or during a crisis.

4.10 Another important advance was the enactment of legislation in 2011 to revamp the supervisory framework. This led to the creation of Otoritas Jasa Keuangan (OJK), an independent supervisor for all financial institutions and capital markets. Partly funded by the state budget and partly from fees by financial institutions and capital market entities, OJK assumed the functions of banking supervision—previously exercised by Bank Indonesia—and the supervision of capital markets and nonbank financial institutions — previously assigned to a committee (Bapepam-LK) operating under the Ministry of Finance—at the end of 2013. This reform made it possible for Indonesia to implement a model of integrated financial supervision. OJK has already established a special unit of integrated and conglomerate supervision, and implemented risk-based supervision in banking but not in insurance and the capital markets. Indonesia is in the process of applying the Basel 3 framework to strengthen the regulation, supervision, and risk management of the banking sector. In the new regulatory framework of the financial system, Bank Indonesia and OJK conduct stress tests of the banking system jointly.

4.11 In the new regulatory framework of the financial system, Bank Indonesia is assigned the responsibilities of macroprudential regulation, monetary and exchange rate policy, and ensuring the effectiveness of the payments system. It conducts stress testing of the banking system jointly with OJK. The “top-down” stress tests are conducted by Bank Indonesia to assess the vulnerability of banks to broad financial sector shocks, while the “bottom-up” stress tests are conducted by OJK. Main macroprudential policy tools consist of the loan-to-deposit ratio, introduced in 2011, and the loan-to-value ratio, which is similar for all banks, introduced in 2012. Moreover, counter-cyclical capital buffers were first introduced in 2015.

4.12 Indonesia’s banking system remains well capitalized and is profitable. Between December 2008 and March 2016, the capital adequacy ratio of the banking sector increased from 16.8 to 22 percent and nonperforming loans (NPLs) decreased from 3.2 percent of total gross loans to 2.8 percent, although they have been on an upward trend since 2014. NPLs are provisioned at about 50 percent. The net interest rate margin of banks is high, at 5.5 percent in March 2016. Bank profitability is therefore high, with the return on assets (ROA) at 2.7 percent in 2014, surpassing by far that of major emerging market economies (see IMF 2015).

4.13 However, soundness varies across different categories of banks and pockets of vulnerability exist in the banking system. Asset quality is lower for regional development banks, with NPLs at about 4.3 percent—twice those of other banks. Due to higher funding costs, small banks are less profitable, with a ROA of 1.5 percent, compared with 3.3 percent for the four largest banks. Liquidity risk has somewhat increased, with the ratio of bank liquid assets relative to deposits and short-term funding liabilities declining from 27 percent in 2008 to 23 percent in 2014, although systemic liquidity risk remains limited because retail deposits represent a large share of total short-term bank liabilities. Bank Indonesia’s liquidity stress tests found that banks remain liquid, but some individual banks could face a liquidity crunch in the face of large and rapid capital outflows (Bank Indonesia 2015, box 4.1).

4.14 A remaining shortcoming in banking supervision, which was identified in the 2010 Financial Sector Assessment Program (FSAP) conducted as a prior action of the

PESF, is the absence of effective legal protection of supervisors. According to the FSAP findings, although the supervisors cannot be punished for decisions taken in good faith, the proof of “good faith” is onerous and practically invalidates the protection of supervisors. This affects the ability of supervisors to make timely decisions and take remedial action against troubled banks.

4.15 Finally, as part of the measures supported by the PESF, the government increased the deposit insurance coverage ceiling in December 2008 from Rp 100 million to Rp 2 billion. It also made a commitment to provide a blanket guarantee of all deposits if necessary. This commitment was considered risky by private sector stakeholders, as shown in other countries (such as Ireland) that extended blanket guarantees to bank liabilities during the crisis. Fortunately, the blanket guarantee did not have to be activated and was subsequently withdrawn. Despite the sizeable increase in coverage, bank contributions to the deposit insurance scheme were not raised. As a result, the insurance fund is undercapitalized. Its equity (about \$5 billion) could be wiped out in case of liquidation of a medium-sized bank. Moreover, the insufficient capitalization of the deposit insurance corporation could be a factor that may delay the resolution of troubled banks by creating incentives to bail them out and by keeping them open.

Objective 2: Sustain critical public expenditures while maintaining budget discipline

4.16 The efficacy of objective 2 is rated **substantial**.

4.17 In this policy area, the PESF supported measures to safeguard priority development spending, maintain budget discipline, improve crisis impact monitoring, and better coordinate antipoverty programs. The program defined quantifiable indicators to measure execution of public expenditure: maintenance of the shares of social spending and infrastructure investments in central government expenditure, and an increase in capital disbursement. The baseline figures were from 2008; no specific targets were defined. Nevertheless, there is evidence that these goals were substantially achieved.

PRIORITY DEVELOPMENT SPENDING

4.18 In line with the government’s fiscal stimulus package, social assistance spending increased in 2009 (table 4.1). The main programs of social assistance were cash transfers to poor families, food subsidies, and community empowerment transfers. Since 2011, social assistance spending has stabilized at about 1 percent of GDP, with the government’s efforts focusing on the rationalization and modernization of social assistance programs. A conditional cash transfers program was introduced in 2014, the food subsidy (mainly for rice) was better targeted, and health insurance for the poor was introduced in 2014.

Table 4.1. Budget Deficit, Priority Development Spending, and Energy Subsidies, 2008–16 (percent of GDP)

	<i>Budget balance</i>	<i>Social assistance</i>	<i>Capital spending</i>	<i>Energy subsidies</i>
2008	-0.1	1.1	0.9	4.5
2009	-1.6	1.4	1.4	1.7
2010	-0.7	1.1	1.2	2.2
2011	-1.1	0.9	1.5	3.3
2012	-1.8	0.9	1.7	3.6
2013	-2.2	1.0	1.9	3.2
2014	-2.2	0.9	1.4	3.3
2015 ^a	-2.8	0.8	1.9	1.0
2016 ^b	-2.8	0.8	1.2	0.7

Note: a. preliminary estimate; b. projections.

Source: IMF, Indonesia Article IV reports.

4.19 In parallel, the government accelerated capital disbursements to front-load the 2009 fiscal stimulus. However, although disbursements increased from 21 percent in 2008 to 27 percent of total capital spending in the first semester of 2009, the pattern of capital spending deteriorated subsequently and remained heavily concentrated in the second half of the year. Delays in land acquisition was the main obstacle in the smooth execution of the capital budget. Consequently, the Ministry of Finance, which closely monitors expenditures on public works, transport, agriculture, and energy, has established a land acquisition unit to facilitate the resolution of legal issues and speed up the execution of the capital budget. Capital spending declined in 2010, but increased thereafter, fluctuating between 1.2 and 1.9 percent of GDP.

BUDGET DISCIPLINE

4.20 On the back of relatively robust growth despite the crisis, fiscal deficit increased moderately from 0.1 percent of GDP in 2008 to 1.6 percent in 2009. It increased more after 2011 as a result of slower growth and fallen oil prices, but has remained below the fiscal rule's limit of 3 percent of GDP. The objective of maintaining budget discipline was thus broadly achieved.

4.21 Energy subsidies, mainly for fuels, have been sizable in Indonesia, limiting the fiscal room for priority development spending and putting pressure on fiscal deficit. They exceeded capital spending and in some years surpassed the sum of spending for social assistance and infrastructure (table 4.1). Between 2012 and 2014, energy subsidies swelled to an average of 3.4 percent of GDP, or 20 percent of central government expenditures. To keep the rising fiscal deficit under control, the government took a first step to reduce energy subsidies in June 2013. The subsidized petrol price was increased by 44 percent and the subsidized diesel price by 22 percent, although prices were still well below market prices. The impact on the poor was cushioned by a temporary compensation package for 2013, amounting to 0.3 percent of GDP. In a major policy shift, and taking advantage of low oil prices, in January 2015 the government introduced

a new parametrically regulated fuel pricing system with semiautomatic monthly price adjustments based on economic costs, removal of the explicit subsidy for gasoline, and introduction of a fixed per liter subsidy for diesel. As a result, energy subsidy costs declined from 3.3 percent of GDP in 2014 to an estimated 1.0 percent of GDP in 2015 (table 4.1).

4.22 This progress was a significant achievement. Although energy subsidy reform was never included in the ongoing DPL series or in emergency support operations such as the PESF or the second DPL DDO, the World Bank had engaged an active policy dialogue with the government on this sensitive issue, helping the government simulate the impact of changes in the fuel subsidy, and on social and pro-poor spending.

CRISIS IMPACT MONITORING AND ANTIPOVERTY PROGRAMS

4.23 Complementing the efforts to mitigate the adverse impacts of growth slowdown, the PESF supported the government's initiative to better monitor crisis impact on the population and better coordinate antipoverty programs. As a prior action for the PESF, the government piloted a crisis monitoring and response system (CMRS) in 2009. Between August 2009 and July 2010, National Statistics Agency (BPS) staff visited more than 14,000 households in 471 districts in three rounds at three-month intervals. The CMRS gathered information on whether and how the crisis affected the households and what coping strategies they used to meet the challenges they faced. This research allowed analysis of the impacts of the crisis at national, provincial, and district levels to determine whether crisis response measures were required and how they could most effectively be deployed (World Bank 2010a).

4.24 A major strength of the CMRS was that the survey covered all districts in the country. The fact that it was attached to the well-established labor force survey (Sakernas) ensures good quality survey data. Nevertheless, not all CMRS expectations were met. Results took longer than expected to produce while a full identification of at-risk districts was not achieved due to the limited impact of the crisis during the measurement period. The self-evaluation of the CMRS highlights ways to improve the survey process. There was interest among stakeholders in developing a vulnerability and shock monitoring and response system that would enable the government to assess rapidly the impacts of future crises and to take measures to alleviate their effects. The World Bank vigorously advocated such a system (World Bank 2010b) but the initiative has not materialized so far.

4.25 Another PESF prior action called for the submission by the government to the president of a decree to coordinate national poverty reduction efforts. Since recovering from the Asian financial crisis, Indonesia's national poverty rate has more than halved, from 24 percent in 1999 to 11 percent in 2014. Since 2010, however, the pace of poverty reduction has slowed to 0.5 percentage points per year, compared with 1.2 percentage points per year between 2007 and 2009. The poverty rate increased to 11.1 percent in September 2015, and stood at 10.7 percent in September 2016 (World Bank 2016b).

4.26 To enhance the performance of the antipoverty programs, the National Team for the Acceleration of Poverty Reduction (TNP2K) was established as a ministerial level

body, chaired by the vice president. An executive secretariat of TNP2K was also established to improve and integrate antipoverty programs. Several working groups were created under the TNP2K to commission research, formulate reforms, and support government agencies responsible for implementation of the reforms (see TNP2K 2014). Since its inception, TNP2K contributed to improving antipoverty policies by developing the Unified Database (UDB) as a tool for tightening targeting of household- and individual-based programs. The UDB is an electronic data system that contains social, economic, and demographic information on about 24.5 million households, or 96 million individuals, in the lowest welfare bracket. Using the Unified Database, TNP2K improved the design and delivery processes of social assistance programs. Since 2013, the UDB has been used for targeting by the Subsidized Rice for the Poor program (Raskin) for about 15.5 million households, by the Health Insurance for the Poor program for 84.5 million beneficiaries, by the beneficiaries of the Conditional Cash Transfer Program for Poor Families, and by the Cash Transfers to Poor Students program, which abandoned the previous selection methods by school committees.

Objective 3: Facilitate private investment and support exports

4.27 The efficacy of objective 3 is rated **modest**.

4.28 The PESF sought to provide a signal of the government's commitment to improve Indonesia's attractiveness to private investment. Three measures were taken in this direction: (i) to improve clarity of the investment law by revising the negative list for investment, (ii) to improve transparency in the energy and minerals sector by initiating the process for Indonesia's membership in the Extractive Industries Transparency Initiative (EITI), and (iii) to improve trade financing to support Indonesia's exports. The program defined qualitative indicators for gauging success, which in this case was inadequate for drawing firm conclusions. Overall, progress was mixed.

INVESTMENT CLIMATE

4.29 To reduce regulatory uncertainty and encourage investment, the government sought to clarify the rules and relax restrictions in the investment negative list (Daftar Negatif Investasi, DNI). Indonesia's revised DNI was issued in May 2010 and replaced the previous DNI from 2007.⁴ According to the investment agency Badan Kordinasi Penanaman Modal (BKPM), 40 business fields became more open to investment (such as health, creative industries, and construction services), while 10 became more restrictive, including cell towers, a highly politicized business field. It is thus difficult to determine the net effect of the changes on the investment climate. In subsequent years, the drive to liberalize foreign direct investment (FDI) was not sustained. Up until 2014, restrictions were tightened in several sectors and, as a result, Indonesia's international position on openness to FDI, as measured by the Global Competitiveness Report's (GCR) indicators, worsened. Similarly, Indonesia's ranking declined regarding domestic market competition and market dominance (table 4.2).

Table 4.2. Indonesia’s Rank in Global Competitiveness Report Indicators Related to Openness to FDI, Precrisis and Postcrisis

	<i>Rank/134 GCR 2008–09</i>	<i>Rank/140 GCR 2015–16</i>
Prevalence of foreign ownership	24	67
Business impact of rules on FDI	42	87
Intensity of local competition	44	65
Extent of market dominance	28	56

Sources: World Economic Forum, Global Competitiveness Reports (GCR).

4.30 Investment restrictions are prevalent in several sectors, such as, for example, logistics, which are key for economic efficiency. Although Indonesia’s global ranking in trade logistics improved in recent years—from 75 in 2010 to 63 in 2016, according to the World Bank’s Logistics Performance Index (World Bank 2016a)—efficiency remains low in view of Indonesia’s geography and location. Restrictions on FDI in logistics activities since 2014 have limited foreign ownership to either 30 or 49 percent. Regulations are also burdensome: transport operators are required to obtain 12 permits at the national and regional levels (World Bank 2016b). Onerous reporting requirements and a restrictive FDI policy for commercial warehouses also hamper the logistics sector. Warehousing was listed under the DNI with a 33 percent foreign equity limit, while the cold-storage warehousing limit outside Bali, Java, and Sumatra is 67 percent.

4.31 Local content requirements are another area where restrictions were tightened. In the past few years, the government regulated minimum local content for several manufactured products and services. In the telecommunication industry, a minimum of 30–40 percent local content requirement was introduced for 4G/LTE equipment. The Ministry of Trade imposed local content measures for the franchise business sector, including for food and beverage and modern retail, which require the franchisee to source domestically a minimum of 80 percent of its raw materials, equipment, and inventory. Other business sectors impacted by these measures include electricity, oil, and gas (World Bank 2016b).

4.32 Since September 2015, the government has changed its stance on investment climate reforms. It has released 10 economic policy packages aimed at attracting foreign investment, revitalizing industry, facilitating trade and logistics, and easing access to raw materials. The reforms cover trade, energy, investment licenses, small and medium enterprises (SMEs), minimum wage setting, tax relief, special economic zones, land title registration, logistics, and investment liberalization. The revision of the DNI, announced in February 2016, opened 29 business fields to 100 percent foreign ownership. It also raised the foreign equity limit to 67 percent for 29 business fields (e.g., one- and two-star hotels, warehousing, and loading/unloading cargo) and opened 19 business fields (e.g., passenger land transport, electricity installation) previously closed to foreign ownership. The establishment of One Stop Service (OSS) for investment licenses has also been a priority in the last two years. Several simplified and accelerated licensing services have been introduced.

4.33 Through these policy changes, investor sentiment has been positive. FDI rebounded from a low of \$4.8 billion in 2009 to \$13.8 billion in 2010, and reached a high of \$21.8 billion in 2014. It is estimated to have declined to \$15.5 billion in 2015. However, the ratio of FDI to GDP, at about 2.1 percent, remains below many of Indonesia's regional peers, compared, for example, with 3.3 percent of GDP in Thailand and 5 percent in Vietnam.

TRADE FINANCE

4.34 To promote trade financing during the 2009 crisis, the government took two bold measures, both of which were included as PESF prior actions. First, Bank Indonesia opened a rediscount window for trade receivables of commercial banks. The facility was not used because it was deemed relatively expensive, but it signaled the government's determination to provide needed liquidity in support of trade financing. Second, Indonesia Eximbank was established to provide financing, guarantees, insurance facilities, and advisory services for exporters.

4.35 Indonesia Eximbank's activity has grown significantly since its inception. Between 2011 and 2015, the bank's assets and financing grew by more than 200 percent, while its guarantees and export insurance increased 17 and 30 fold, respectively (table 4.3). The bank's profitability has been very strong, with the return on equity growing from 6.9 percent in 2011 to 12.9 percent in 2015. Indonesia Eximbank is adequately capitalized, with a capital adequacy ratio of 13.9 in 2015, although declining compared with previous years. Gross NPLs amounted to 3.5 percent of total loans in 2015.

Table 4.3. Indonesia Eximbank's Export Financing Facilities and Profitability, 2011–15

	2011	2012	2013	2014	2015
Assets ^a	26.3	33.3	46.5	60.5	85.0
Financing ^a	20.5	27.1	40.5	55.2	74.8
Guarantees ^a	0.35	1.1	2.0	3.6	6.2
Export insurance ^a	0.04	0.15	0.26	0.7	1.2
Return on equity ^b	6.9	8.3	10.6	13.6	12.9
Return on assets ^b	2.4	2.3	2.5	2.8	2.4

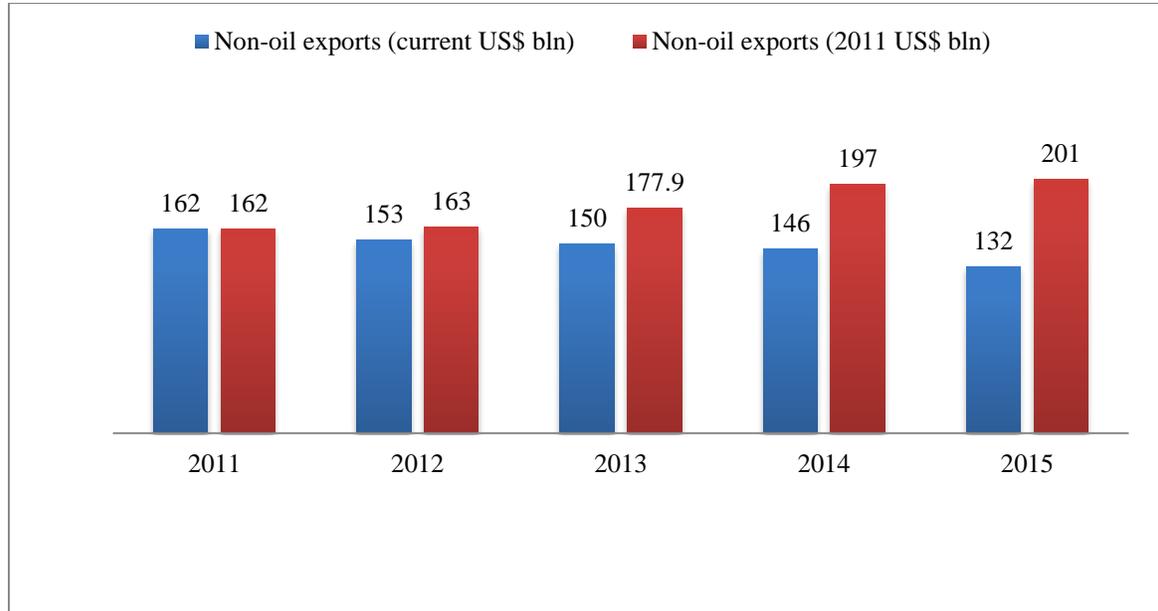
Note: a. in RP billions; b. in percent.

Source: Indonesia Eximbank.

4.36 Indonesia Eximbank supports the government's strategy to diversify Indonesia's export markets. Financing to businesses with exports in the Africa, Latin America, and Middle East has been growing, amounting to 28.6 percent of total financing in 2015. The financing of SMEs increased significantly, from Rp 637 billion in 2010 to Rp 7.3 trillion in 2015. Indonesia's non-oil and gas export performance has been robust in the period after the global financial crisis: in real terms, non-oil and gas exports grew by a cumulative 24 percent between 2011 and 2015 (figure 4.2). Indonesia Eximbank prioritizes financing for non-oil leading exports, such as crude palm oil and its derivatives, textile products, rubber products, coffee, food products, wood products,

cocoa, fish products, and footwear. In 2015, the financing to these products amount to 42.9 percent of the bank's total financing. It remained high despite the slump in global commodity prices.

Figure 4.2. Indonesian Non-oil and Gas Exports, 2011–15



Sources: World Bank and IMF Article IV reports.

EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (EITI)

4.37 The PESF supported the government's commitment to improve transparency and the investment climate in the mining and minerals sector. Recognizing the importance of improving the transparency of the tax authorities' interaction with the private sector in the extractive industries, the government initiated in 2009 the EITI application process. The initiative improves public awareness of how countries manage their oil, gas, and mineral resources by reconciling reports of revenue and production streams from firms in these sectors with reports of government agencies collecting tax revenues from these firms.⁵ This is particularly important in Indonesia where about 30 percent of budget revenue comes from the oil, gas, and minerals sector.

4.38 The government announced its commitment to joining EITI at the end of 2008 as part of the PESF's prior actions. Indonesia became a candidate country at the end of 2010. The first EITI report, covering 2009, was submitted in early 2013 and the second report, covering 2010–11 was published in early 2014. Further to the publication of these reports, in October 2014, Indonesia was designated EITI-compliant. The national EITI secretariat organized broad outreach programs for the second report. In parallel, the EITI Multi-Donor Trust Fund, administered by the World Bank, provided a grant to the government to finance technical assistance for the preparation of the EITI reports.

4.39 However, the government failed to produce the third report by the December 2014 deadline. As a result, the EITI international board suspended Indonesia in February

2015. The 2012–13 report was completed at the end of 2015 and Indonesia’s suspension was lifted. The 2013-14 report was due by the end of 2016, but was published at the end February 2017, temporarily putting Indonesia at risk of being suspended from EITI again. Misunderstanding of the World Bank’s procurement standards for selecting consultants to prepare the report and miscommunication between the National EITI secretariat and the World Bank have contributed to the delays. A main challenge to bring the EITI process forward seems to be the absence of a true champion of the initiative within the government, which meant that the organization of the reporting process remains bureaucratic and public awareness initiatives are lacking.

4.40 Despite the delays in the publication of the reports, the civil society sees value in the EITI reporting process. The “Publish What You Pay” initiative, a coalition of 35 civil society organizations (CSOs) for transparency and accountability of extractive industries revenues, has furthered the information generated by the EITI reports. According to Indonesian legislation, 15 percent of non-tax oil and gas revenue and 80 percent of non-tax mineral revenue has to be transferred to subnational authorities. Based on the EITI reports, CSOs reconcile the revenue collection from the oil, gas, and mineral industry and the money paid back by the central government to subnational authorities. It is also expected that the EITI reporting process will set new standards for license granting in the oil, gas, and minerals sector by subnational authorities. Overall, the EITI process has moved ahead but the momentum was uneven and the timeliness of reporting was not assured.

5. Ratings

Overall Outcome

5.1 The overall outcome is rated **satisfactory**.

5.2 The overall outcome rating reflects high relevance of the PESF objectives, substantial relevance of program design, and substantial efficacy in outcome achievement. As a crisis response operation, the main objective of assisting the government of Indonesia in addressing the potential adverse impacts of the global financial crisis on public expenditures during 2009–10 was mostly served by the actions in the first two policy areas. All the objectives in these areas were substantially achieved while the recent drastic reduction of energy subsidies went well beyond any expectations at the time the operation was implemented.

5.3 Outcome achievement in the third policy area was more modest, with backtracking from prior actions on investment regulations in the years following the global financial crisis and lack of timely compliance with EITI obligations. The recent policy changes in FDI regulations and the lifting of Indonesia’s EITI suspension bode well for the continuation of the reform process in these areas.

Risk to Development Outcome

5.4 Risk to development outcome is rated **moderate**.

5.5 The PESF was an emergency operation whose primary objective was to help Indonesia overcome the shock wave of the global financial crisis. Because Indonesia weathered the crisis well, the risk to the key development outcome is no longer at stake. To the extent that the PESF also supported policy reforms with medium-term outcomes, the risks facing the outcomes achieved vary and are assessed in the following paragraphs.

Risk to Financial Stability

5.6 Despite the absence of major crises, Indonesia's structural weaknesses remain and the country was exposed again, in more recent years, to episodes of market turbulence. Like other emerging market economies, Indonesia is confronted with shifts in the global economy, notably lower growth and rebalancing in China, sluggish commodity prices, and the prospect of monetary policy normalization in the United States. These shifts have impacted Indonesia through commodity prices, trade, and capital flows. They have led to a slowdown in growth since 2014, exchange rate depreciation, and tighter financing conditions. Government revenues have dropped significantly and the fiscal deficit has increased. Portfolio inflows have slowed as foreign investors' appetite for emerging market assets weakened in general.

5.7 But these episodes have also shown that Indonesia has become more resilient with better defense mechanisms to overcome periods of heightened financial market volatility. Ample international reserves have helped maintain confidence in Indonesia's ability to adjust to the changing external environment. Key reforms have also improved Indonesia's ability to better handle external turbulence than in the past. In particular, the financial safety net law has been adopted, the supervisory framework of the financial system has been modernized with the establishment of Otoritas Jasa Keuangan (OJK), macroprudential regulation has been implemented by Bank Indonesia, and, despite some weak spots, the banking system remains profitable and well capitalized.

Risk to Critical Public Expenditure

5.8 The government has demonstrated its drive to maintain social assistance spending, which has stabilized at about 1 percent of GDP. The poverty policy coordination body created in 2010 (TNP2K) has contributed to improving antipoverty policies by developing the Unified Database (UDB) as a tool for better targeting household- and individual-based programs. The government's fiscal strategy has been able to create fiscal space through energy subsidy reform and better revenue mobilization to allow for higher investment in infrastructure and social assistance programs. The landmark reform of energy subsidies will tame fiscal risks and will create the needed fiscal space for priority development spending.

Risk to Investment Climate

5.9 Indonesia's experience has shown that reforms of investment regulations are highly sensitive and there is risk of backtracking as a result of political changes and/or the action of vested interests. Indonesia has gone back and forth in this area, tightening restrictions on FDI after the global financial crisis, but embarking on a significant policy change toward opening up several business fields to foreign investment in September

2015. By contrast, thanks to the solid performance of Indonesia Eximbank, export financing has been on a sustainable track. The commitment to the EITI has been steady, but without a champion for the initiative within the government, the benefits of EITI cannot fully materialize. However, the civil society has embraced the initiative, which bodes well for keeping the momentum in the future.

World Bank Performance

5.10 World Bank performance is rated **satisfactory**.

Quality at Entry

5.11 Quality at entry is rated **satisfactory**.

5.12 The World Bank was able to design a customized and innovative DPL DDO with conditional withdrawal triggers. The operation was able to draw from an extensive array of other World Bank work, including programmatic trust-funded technical assistance (TA) and Analytical and Advisory Assistance (AAA). The World Bank team was instrumental in assisting the government to design the drawdown triggers specified in the financing plan for 2009. The team collaborated closely with the other development partners—the Asian Development Bank, and the governments of Australia and Japan—to leverage the operation and provide a maximum level of crisis assistance. The operation was prepared quickly, but was highly effective in identifying short-term measures that pushed ahead pending reforms in key policy areas that had signaling effects to the market. In hind sight, the inclusion of medium- to long-term reforms in the program, which ultimately affected the overall success of the program, required more commitment from the client and more sustained support from the Bank beyond this crisis response operation.

Quality of Supervision

5.13 Quality of supervision is rated **satisfactory**.

5.14 Intensive monitoring of the conditions specified in the 2009 financing plan, as well as of the achievement of the project development outcomes, was carried out by the World Bank in cooperation with the government and the other development partners throughout the implementation of the operation. The World Bank was instrumental in assisting the government to implement and evaluate the crisis monitoring and response system during the crisis and also provided assistance to TNP2K in the construction of the Unified Database and the evaluation of antipoverty programs. After the operation closed, continuous monitoring has been conducted through other ongoing projects and AAA. The World Bank provided TA in key areas covered by the PESF, especially in public financial management and in the implementation of the EITI commitments through the EITI Multi-Donor Trust Fund.

Borrower Performance

5.15 Borrower performance is rated **satisfactory**.

5.16 The government was committed and worked closely with the World Bank. It recognized the value of the undisbursed DPL DDO as insurance and a means to boost market confidence, and successfully resisted pressures from within the public sector to utilize the funds. The government kept a sound fiscal framework and followed through on the reform agenda in financial stability regulation, financial sector supervision, poverty policy coordination, and modernization of antipoverty programs. It recently made considerable strides in eliminating energy subsidies. Some deficiencies, however, were noted in the implementation of EITI commitments, which led to Indonesia's temporary suspension from EITI. There was also backtracking on FDI regulations, although the recent policy changes have put the reforms in the right direction in this area. The Coordinating Ministry of the Economy and the Ministry of Finance provided good support, including cross-ministerial coordination, and the attention to the completion of policy measures and conditions.

Monitoring and Evaluation (M&E)

5.17 Monitoring and evaluation is rated **modest**.

M&E DESIGN

5.18 The key concern for the operation's M&E design was to monitor the status of the government's financing plan and whether the conditions for withdrawal had been met. The program's results framework does not reflect this, but tracks progress of policy reforms supported under the operation. The indicators, however, relate mostly to policy measures undertaken, and contain few quantitative measures of results, aside from public expenditures. Some indicators are vague, for example, "timely and appropriate measures" or "overall banking system remains stable." Many measures refer to the starting of monitoring or other bureaucratic arrangements or studies that do not represent clear achievements (initiation of EITI, monitoring of poverty, coordination of poverty programs, undertaking of FSAP). The focus is on monitoring reforms rather than on results in terms of outcomes or impact.

M&E IMPLEMENTATION

5.19 The status of the financing plan was reviewed quarterly because a quarterly shortfall from the projected cash flows was one of the PESF withdrawal triggers. Monitoring progress in the policy areas supported by the operation continued as part of the World Bank's regular economic monitoring activities and its broad engagement in a number of areas.

5.20 The government, with World Bank assistance, has been working on improving its system of public expenditure management, including program budgeting and monitoring of results. A crisis monitoring and response system was established to coordinate responses to future crises while the National Team for the Acceleration of Poverty Reduction (TNP2K) has been monitoring the effectiveness of antipoverty and social assistance programs.

M&E UTILIZATION

5.21 Information generated from monitoring the financing plan was used in the decision not to draw down the contingent credit. There is no indication that the monitoring of reform progress informed the implementation of the PESF in any significant way.

5.22 A Unified Database (UDB) has been developed by TNP2K as a tool of tightening targeting of household- and individual-based programs. The UDB is an electronic data system that contains social, economic, and demographic information on about 24.5 million households, or 96 million individuals in the lowest welfare bracket. Using the Unified Database, TNP2K improved the design and delivery processes of social assistance programs.

6. Lessons

6.1 The DPL DDO proved to be an effective instrument to assist Indonesia in responding to financial market turbulence in the aftermath of the 2008 global financial crisis. Indonesia was not facing a balance of payments crisis, its budget was in balance, and it had low levels of public and foreign debt. Yet, the country was threatened with rapidly rising borrowing costs that could potentially trigger self-fulfilling twin currency and debt crises. Sending the right signals to defuse market tension is crucial in such circumstances. Designed as contingent line of credit and streamlined in 2008 to provide greater certainty to borrowers to access the contingent funds, the DPL DDO fulfilled this role well, especially without an IMF program or contingent IMF financing in place.

6.2 In Indonesia, the credibility of the DPL DDO on market confidence was dependent on the government's credibility in maintaining prudent economic policies. Making the drawdown of the DPL DDO funds conditional on market borrowing conditions can strengthen the government's commitment to maintain fiscal discipline despite the crisis, and thus leverage the impact of such operations on investor confidence. Unique among the World Bank's DPL DDO operations, the PESF clearly articulated the disbursement conditions upfront at the government's request.⁶ The current loan thus illustrates that when the DPL DDO is used strictly for crisis response purposes, it is possible for the World Bank to define drawdown conditions in advance.

6.3 The implementation of the PESF also illustrates that using a crisis response operation to support longer-term structural reforms may require strong client commitment and sustained post-crisis support. As an emergency operation, the PESF's policy program appropriately focused on critical short-term measures targeted at boosting market confidence. While it also included support for long-term reforms, achieving the expected results of these reforms was ultimately beyond the scope and timeframe of the PESF, and depended critically on post-crisis Bank support through the regular DPL series.

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¹ Established in 2000 by the ASEAN countries, China, Japan, and the Republic of Korea, the CMI provides bilateral swap arrangements of U.S. dollars with the domestic currencies of participating countries to help tame concerns about loss of international reserves in case of market turbulence.

² The government was concerned that speculators would start selling government bonds and precipitate a crisis if bond yields came close to the triggers for drawing down the contingent loans.

³ The DPL DDO was introduced in 2001 as a risk management tool supporting core structural programs in countries that are eligible for IBRD assistance and are not making full use of the World Bank’s financial resources (World Bank 2001). In 2008, changes to the pricing of DPL DDOs and the drawdown procedures reduced the cost of the instrument to borrowers and provided borrowers with greater certainty regarding the availability of DPL DDO funds (World Bank 2008a).

⁴ The details of the negative investment list as revised in 2010 are available at http://www.gbgindonesia.com/en/main/useful_resources/documents/regulations/The%20Negative%20Investment%20List%20No,%2036%20of%202010.pdf.

⁵ The reports are submitted to a multistakeholder steering group, comprising representatives of government, companies, and the civil society. An independent reconciler crosschecks the data and the international board of EITI, which validates the member countries' progress in upholding the transparency standard, supervises the whole process. Key information is disseminated annually, along with recommendations, with the aim of improving the governance of the sector.

⁶ Eight other DPL DDOs with significant fiscal content were prepared during the 2009 crisis for Costa Rica, Guatemala, Mauritius, Panama, Peru, and Uruguay but they did not include market-related disbursement conditions.

Appendix A. Basic Data Sheet

PUBLIC EXPENDITURE SUPPORT FACILITY (DPL DDO) (P115199)

Key Project Data

	Appraisal estimate (US\$, millions)	Actual or current estimate (US\$, millions)	Actual as percent of appraisal estimate
Total project costs	5,000	5,000	100
Loan amount	2,000	2,000	100

Actual Disbursements

	FY09
Appraisal estimate (US\$, millions)	2,000
Actual (US\$, millions)	5
Actual as percent of appraisal	0.25
Date of final disbursement	August 2009

Project Dates

	Original	Actual
Initiating memorandum	12/09/2008	12/09/2008
Negotiations	01/28/2009	01/28/2009
Board approval	03/03/2009	03/03/2009
Signing	01/15/2009	01/15/2009
Effectiveness	08/12/2009	08/12/2009
Closing date	12/31/2010	12/31/2010

Staff Time and Cost

Stage of project cycle	Staff time and cost (World Bank budget only)	
	Staff weeks (number)	Cost, including travel and consultant costs (US\$, thousands)
Lending		
Total	44	283
Supervision		
Total	18	76

Task Team Members

Name	Title (at time of appraisal and closure, respectively)	Unit	Responsibility/specialty
Lending			
	P.S. Srinivas	EASFP	Task Team Leader
	Enrique Aldaz	EASPR	Economist
	William Wallace	EASPR	Lead Economist
	Preeti S. Ahuja	EACIQ	Country Program Coordinator
	Shubham Chaudhuri	EASPR	Senior Country Economist
	Melinda Good	LEGES	Senior Counsel
	Peter Rosner	EASFP	Investment Climate Specialist
	Djauhari Sitoris	EASFP	Finance Specialist
	Susan Wong	EASID	Senior Social Development Specialist
	Yogana Prasta	EACIF	Senior Operations Officer
	Timothy Bulman	EASPR	Consultant
	Tim Brown	EASIS	Senior Environment Specialist
	Adam Sack	CEAR6	IFC Director for Indonesia
	Hari Purnomo	EASFP	Finance Specialist
	Vivi Alatas	EASPR	Senior Poverty Economist
	Sjamsu Rahardja	EASPR	Trade Economist
	The Fei Ming	EASFP	Private Sector Specialist
	David W. Brown	SEGOM	EITI Specialist
	Shienny Lie	EACIF	Team Assistant
	Imad Saleh	EAPPR	Senior Procurement Specialist
ICR			
	Enrique Blanco-Armas	EASPR	Senior Economist
	Elaine A. Tinsley	LCSPE	Consultant
	Ashley Taylor	EASPR	Economist

Note: CEAR6 (IFC Resident Mission: Jakarta); EACIF (World Bank Office: Jakarta) ; EACIQ (Indonesia Headquarter's Office); EAPR (EAP Regional Transition Office); EASFP (Financial and Project Sector Unit); LCSPE (Economic Policy Sector); LEGES (Legal, EAP and SAR Regions); SEGOM (Oil, Gas, and Mining Unit).

Appendix B. List of Persons Met

Name	Title	Organization
Rodrigo A. Chaves	Country Director	
Josephine M. Bassinette		
Ndiame Diop		
Hans Anand Beck		
Yogana Prasta		
M. Firdauz Muttaqin	Deputy Director	Bank Indonesia
Kurniawan Agung W	Deputy Director	Bank Indonesia
Advis Budiman	Quantitative Analyst	Deposit Insurance Corporation
Mr. Maliki	PLT. Director for Poverty Reduction	BAPPENAS
Ir. Tamba P. Hutapea	MCP Deputy Chairman for Investment Planning	BKPM
Heldy Satria Putera	Direktur Perencanaan Infrastruktur	BKPM
Azhar Lubis	Deputy Chairman for Investment Controlling and Implementation	BKPM
Wisnu W Sudibyo	Director Region 3 Deputy	BKPM
Mr. Askolani	Director General of Budget	Ministry of Finance
Kunta Wibawa Dasa Nugraha	Direktorat Penyusunan APBN	Ministry of Finance
Agung Widiadi	Direktorat Sistem Penganggaran	Ministry of Finance
Herianto Irawan		Deutsche Bank
Ayu Sukorini	Director of Loans and Grants	Ministry of Finance
Bobby Hamzar Rafinus	Deputy Bidang Koordinasi Ekonomi Macro and Keuangan	Ministry for Economic Affairs
Djauhari Sitorus	Senior Financial Sector Specialist	Ministry for Economic Affairs
Bastian Halim	Assistant Deputy for Extractive Industry Represented by pak Agus Budi Kuncoro Pak Ronald Tambunan Tenaga Ahli	National Coordinator for EITI Indonesia
Vivi Alatas	Lead Economist	

Elan Satriawan		National Team to Accelerate Poverty Reduction (TNP2K)
Rizal Affandi Lukman	Deputy Director for International Economic	
Djoko Kurnijanto	Director for International Affairs	Otoritas Jasa Keuangan (OJK)
Noriko Toyoda		
Nathaniel P. Adams		
Yue Man Lee		
Pak Marwanto Harjowiryo	Director General of Treasury Represented by Mr. Rudy Widodo Director of Cash Management	Ministry of Finance
Guillaume de Gantès	Principal	Wisma GKBI
Sylvia Sandyazmara Devi	Head	Trade Finance Department International Division
Ibu Maryati Abdullah	National Coordinator	PWYP Indonesia

Appendix C. Borrower Comments

Indonesian Government's Message

“After having internal discussion we have no comments with the draft since we do not mind with the contents.”

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