Report Number : ICRR13883

IEG ICR Review

Independent Evaluation Group

1. Project Data :			Date Posted :	09/06/2012
Country :	Indonesia			
	Is this Review for a Programmatic Series?			Yes ● No
Series ID :				
First Project ID :	P115199		Appraisal	Actual
Project Name :	Public Expenditure Support Facility (dpl-ddo)	Project Costs (US$M):	$2,000	$2,000
L/C Number:	L7658	Loan/Credit (US$M):	$2,000	$2,000
Sector Board :	Economic Policy	Cofinancing (US$M):		
Cofinanciers :		Board Approval Date :		03/03/2009
		Closing Date :	12/31/2011	01/07/2012
Sector(s):	Central government administration (31%); General finance sector (23%); General industry and trade sector (23%); Banking (15%); Mining and other extractive (8%)			
Theme(s):	Other economic management (34% - P); Regulation and competition policy (29% - S); International financial standards and systems (21%); Export development and competitiveness (8%); Other accountability/anti-corruption (8%)			
Evaluator :	Panel Reviewer :	ICR Review Coordinator :	Group :	
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2. Project Objectives and Components:

a. Objectives:

The main objective of operation was to assist the Government of Indonesia (GoI) in addressing the potential adverse impacts of the ongoing global financial crisis on public expenditures during 2009/2010. Based on lessons learned from the crisis of 1997/98, the GoI sought to ensure that essential public expenditures were maintained even during the period of stress. Through the operation, it aimed to put in place arrangements that would give international and domestic markets confidence -boosting policy measures and back-up financing arrangements. This support was to available in case the stress in the market continued, thereby reducing the possibility of a financing shortfall (Program Document, p. vii).

b. If this is a single DPL operation (not part of a series), were the project objectives/ key associated outcome targets revised during implementation?

No

c. Policy Areas:

The loan supported the GoI's efforts in the following policy areas :

(1) Reassuring financial markets and maintaining financial system stability - This included issuing and implementing a financial safety net government regulation in lieu of a law, maintaining the stability of the banking system issuing a government regulation in lieu of a law increasing the ceiling on deposit insurance from 100 million to 2 billion rupiah, and pursuing a financial sector assessment program by increasing the implementation of a financial system safety net on which government had been working since 1995, improving the security, and

(2) Sustaining critical public expenditures while maintaining budget discipline through establishing a crisis monitoring and response system, coordinating national poverty reduction efforts, including specific provision in the 2009 budget law to sustain, or, if necessary increase critical public expenditures in the event of a pronounced slowdown in GDP growth, and implementing specific regulatory measures and socialization efforts to expedite budget disbursements, and

(3) Facilitating private investment and supporting exports through improving the business environment to promote private sector investment, improving transparency in extractive industries' revenues, promoting trade finance through Bank Indonesia activating its "re-discount window" for trade receivables, and establishing the Indonesian Eximbank.

d. Comments on Project Cost, Financing, Borrower Contribution, and Dates:

This DPL was for $2.0 billion, with a deferred drawn down option allowing the government to drawn the money only if interest rates in the market exceeded a certain well defined benchmark. The operation was appraised in January 2009, approved by the Board on March 3, 2009, became effective on August 8, 2009 and closed on December 31, 2010. While providing potential support, the funds were never drawn by the GoI, and was not extended when it ended on Dec. 31, 2010. The DPL-DDO was part of a package of foreign support totalling $5 billion (Australia, Japan and ADB). Most of this assistance was also contingent and not drawn.

3. Relevance of Objectives & Design:

a. Relevance of Objectives:

The objectives of the operation were highly relevant to the situation in 2009, when Indonesia's outlook for access to international capital markets was highly uncertain. The primary objective of the DDO was to strengthen confidence and avoid capital outflows. It was designed to avoid the mistakes of 1997/98 when a financial crisis resulted capital flight, and in wide-spread reductions in public expenditures, which further exacerbated the crisis. The loan sought to strengthen the banking sector, and to protect key social and infrastructure expenditures, and maintain public capital investment. It also included steps to encourage private investment by reducing the restrictions on FDI (foreign direct investment) and improving access to export finance.

b. Relevance of Design:

The design was highly relevant, since it provided a DPL-DDO that could be drawn at the borrower's option subject to certain clearly defined triggers agreed with the Bank. It also helped to support key structural reforms in areas important to growth and recovery, including protection of key expenditures. The presence of the DDO and other donor support helped ensure Indonesia's access to foreign capital at a reasonable spread, since it essentially bolstered the *de facto* reserves of the country while signaling a high degree of foreign donor support. At the same time, the DPL provided support to moving forward on pending reforms, in such areas as financial safety net regulations, crisis coordination, investment law, and support for the EITI (Extractive Industries Transparency Initiative).

4. Achievement of Objectives (Efficacy):

Specific objectives were defined in three broad areas:

1. **Financial Markets and Financial System Stability**. Prior to this operation, Indonesia faced a particularly sharp increase in borrowing costs in foreign and domestic markets in late 2008 and early 2009. Market spreads declined sharply in early 2009 as the DDO was being prepared, in anticipation of the multi-donor support package. However, other factors were equally important, including a general world wide decline in rates, an election in April 2009 in Indonesia, and quantitative easing by the US Fed. Indonesia was able to withstand sharp capital outflows in May 2010 and August/September 2010. As prior actions, the Government issued a new financial safety net regulation that clarified the roles, responsibilities and procedures governing actions of the Bank Indonesia, the Ministry of Finance, and the Deposit Insurance Corporation in the event of the a financial institution failure. The Government also issued a regulation raising the ceiling on bank deposit insurance from 100 million rupiah to 2 billion rupiah, which also allows the Government to provide a blanket guarantee of all bank deposits, if necessary.These actions helped keep the financial sector steady and profitable. Although the safety net legislation noted above expired, the parliament has passed the establishment of the Financial Services Authority by law which is a key pillar for

financial sector stability, and the Government is now in the final stages of drafting the Financial Sector Safety Law. Further, a Financial Sector Safety Coordination Forum has been established under the law. Therefore, a stronger basis for financial sector stability is being established. The Government also agreed to receive an FSAP mission, and committed to the implementation of a Financing Plan for 2009 that specified the terms and circumstances which the Government would draw from the DPL-DDO and related support. Ratings on government borrowings have been increased by all three rating agencies between 2009 and 2010 (e.g. S&P went from BB- to BB+). Achievements here are rated *substantial.*

2. **Sustaining Critical Public Expenditures**. The policy matrix calls for the maintenance of social and infrastructure expenditures in 2009 at 2008 levels with respect to GDP. In fact, social expenditures rose from 8.3 to 11.7 percent of GDP during the period, and infrastructure rose from 6.2 to 8.4 percent of GDP. In addition, the government took steps to smooth out capital spending in 2009, by increasing expenditures in the first half of the year. This was a temporary improvement that was not repeated in 2010 (first half spending rose from 21 percent of projected annual expenditure in 2008 to 27 percent in 2009, but fell to 17 percent in 2010). To lay the basis for a more sustainable approach, the Bank and Indonesia are working on a longer term reform aimed at revising budget execution. The government also set up a national Crisis Monitoring and Response System (CMRS) designed to monitor household welfare and identify problems, and promulgated a Presidential Decree on Coordination of National Poverty Reduction efforts. It also agreed in the budget law to increase critical public expenditures in the event of a growth slowdown (although this was not necessary). Achievements in this area are rated *substantial*.
3. **Facilitating Private Investment and Supporting Exports**. This policy area covered a number of policy improvements, including:
   - opened a re-discount window for trade finance through Bank Indonesia and created an Export Financing Agency;
   - clarification of the rules on investment by a Decree detailing the negative list of business fields, resulting in 40 fields being more open (but 10 being more closed); and
   - initiating the implementation of the EITI (Extractive Industries Transparency Initiative), which will clarify tax and revenue issues.

   As a result of these initiatives, and global improvements, FDI increased by 52 percent in 2010, and is now significantly higher than the level achieved before the 2008 crisis. However, the level still remains below Indonesia's regional peers. Overall, achievement in this area is rated as *substantial.*

Macro Environment. In addition to these specific objectives, there have been substantial improvements in the macro-economic situation. GDP growth rose from 4.6 percent in 2009 to 6.4 percent in 2011, while inflation remains low at 4.1 percent (2011, year-end). The budget deficit was 1.6 percent of GDP in 2009, and while it rose to 2.1 percent in 2011, the expectation is that 2012 it will decline to 1.5 percent (see Indonesia Economic Quarterly, World Bank). The current account has moved from a surplus to a small deficit, reflecting increased capital inflows. Direct foreign investment rose from $3 billion to $11 billion between 2009 and 2011, and reserves have almost doubled. Despite the economic crisis, poverty rates did not rise, and the overall poverty rate remains low at about 12.5 percent (2011).

5. Efficiency (not applicable to DPLs):

6. Outcome:

The DPL-DDO contributed to a multi-donor support to the government which helped calm the markets and allowed the GoI to meet its financing needs. The objectives of the operation were highly relevant and its design was appropriate. The contingent nature of the DDO meant that it provided support, without being disbursed, and served as a kind of insurance against a further deterioration of conditions. The impact of the DDO, and other donor support while presumably large is difficult to gauge since it appears that interest rates had already peaked before the DDO came into effect. At the same time, it helped prevent reductions in key social and infrastructure expenditures, and supported reforms to encourage private investment, including the activation of the EITI process. However, some problems remain. Improvements in public expenditure management undertaken as part of the DPL-DDO proved to be temporary, and more efforts are needed to improve the system. While not yet fully achieved, there has been substantial progress towards creating a financial sector safety net. The FSAP mission completed its work in May, 2010 and while some recommendations have been implemented, reforms of the bank safety net system and legal and regulatory framework are still under discussion. Nevertheless, the banking sector appears healthy, direct foreign investment is increasing, and Indonesian bonds are now rated as investment grade by two of three rating agencies. Rates on Indonesian 10 year bonds have fallen from 9 percent to 6 percent in the past year.

a. Outcome Rating : Satisfactory

7. Rationale for Risk to Development Outcome Rating:

The major risk is the recurrence of a similar crisis in the future, with attendant problems in the financial sector . While the government has demonstrated good crisis management skills, work is ongoing to firm up the needed financial sector safety net, as well as to improve disbursement performance for capital expenditures . The Government continues to maintain a negative list of investment sectors, excluding foreign investment from certain key areas (e.g cell phone towers). In addition, there remains a risk that the EITI process will not be completed all the way to full accession .

a. Risk to Development Outcome Rating : Moderate

8. Assessment of Bank Performance:

a. Quality at entry:

The Bank responded quickly in the face of a crisis, using a novel instrument with few precedents . The loan drew on existing TA and AAA, and the experience of a prior series of DPLs (DPL1-5). It shows good cooperation with other donors . The Bank staff worked closely with the government to devise an innovative approach defining the trigger for DDO disbursement based on interest rates and Government financing needs. This trigger mechanism was an innovation not found in other DDOs, as most other DDOs done by the Bank have no mechanism to control the government's use of the funds .. The trigger mechanism helped insure that the DDO would only be used in the event of a crisis . In terms of results orientation, many measures in the policy framework were vaguely defined, so that they could not be adequately measured, and/or related to policy steps rather than outcomes .

Quality-at-Entry Rating : Highly Satisfactory

b. Quality of supervision:

All policy actions were completed as prior actions . There was only one supervision report, and there were no supervision missions. Rather, resident staff were in contact on a daily basis with counterparts, and the MoF conducted quarterly meetings, which focused on (i) an assessment of whether the program was on track, including the macroeconomic policy framework, and (ii) whether financing targets by GoI had been met (i.e. whether GoI was going to request a draw down). Since the information regarding the thresholds and financing targets is confidential, these minutes have not been made public . However, there seems to have been little focus on financial sector or public expenditure issues . In part, this arose from the focus of the operation on short-term crisis management, rather than longer term policy adjustments, but this still appears to be a deficiency .The policy dialogue on some issues was followed up in dialogue connected with other policy-based lending operations. For instance, DPL 6-8 (2009-11), focus on improving the investment climate, public sector financial management, and poverty alleviation, but not on the problems of the financial sector. The findings of the FSAP mission have been under discussion with the Government since it completed its work (May 2010), and some reforms have been implemented as a result ..

Quality of Supervision Rating : Satisfactory

Overall Bank Performance Rating : Satisfactory

9. Assessment of Borrower Performance:

a. Government Performance:

The government was committed to the DPL, and worked closely with the Bank. Progress in some key areas was notable. The Government recognized the "insurance" value of the undrawn DDO, and successfully resisted pressures from within the public sector to utilize the funds, even if it required a request for a waiver of the interest rate trigger mechanism. The Government correctly saw the value of the undrawn DDO in lowering long term borrowing costs, and the damage a request for a waiver would have on its credit standing. In general, the Government did a good job of implementing the policy recommendations, and most targets were met or sustained, in such areas as increasing the levels of social sector and investment spending, making some improvements in the financial sector, and improving foreign investment regulation, among others. Some deficiencies, however, are noted in the area of financial sector safety nets, and budget disbursements. The Parliament did not ratify the financial safety net improvements enacted by Presidential decree, and they therefore lapsed. The legal and regulatory framework for bank intervention is still unclear.

Government Performance Rating : Satisfactory

b. Implementing Agency Performance:

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. Most of the comments above related to the Ministry of Finance, and therefore will not be repeated here.

Implementing Agency Performance Rating : Satisfactory

Overall Borrower Performance Rating : Satisfactory

10. M&E Design, Implementation, & Utilization:

a. M&E Design:

The triggers for the disbursement of the DDO were closely monitored, but never came into force. The items in the results framework relate mostly to policy measures undertaken, and contain few quantitative measures of results (aside from public expenditures). Many of the measures are vague in definition, e.g. "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 (start EITI, monitor poverty, coordination of poverty programs, undertake FSAP). The focus is on monitoring reforms rather than on results in terms of outcomes or impact.

b. M&E Implementation:

There appears to have been no implementation of a specific M&E system for this loan. The Government, with Bank assistance, has been working on improving its system of public expenditure management, including program budgeting and monitoring of results. In addition, the Government has established a crisis monitoring and response system to coordinate responses to future crises, and agreed to undertake an FSAP for the financial sector.

c. M&E Utilization:

The results of performance monitoring are only just beginning to feed into the budget process. Results of the FSAP do not yet appear to have resulted in major reforms.

M&E Quality Rating : Modest

11. Other Issues

a. Safeguards:

b. Fiduciary Compliance:

c. Unintended Impacts (positive or negative):

The DDO was instrumental in building momentum for the EITI, and the GoI has taken the initiative in pushing for the participation of other ASEAN countries.

d. Other:

The nature of the DDO required the Bank to maintain $2 billion in reserves against a possible draw down of the DDO, which in turn limited the headroom available for new lending. This was a factor in the Government's decision not to extend the DDO past December 2010, despite being offered a costless extension (e.g. no commitment fee).

12. Ratings:	ICR	IEG Review	Reason for Disagreement /Comments
Outcome:	Highly Satisfactory	Satisfactory	The DDO provided important and quick support to the Government, permitting continued access to capital markets. While the DDO was an important component of the Indonesia's success in avoiding adverse consequences of the global economic crisis, a Highly Satisfactory rating according to OPCS/ IEG methodology would have required objectives to have been exceeded, which was not the case. Important work is continuing on financial sector and budget reforms.
Risk to Development Outcome:	Negligible to Low	Moderate	Work remains to be done on the financial sector safety net and on budget reforms.
Bank Performance :	Satisfactory	Satisfactory	
Borrower Performance :	Highly Satisfactory	Satisfactory	The Government was clearly eager to have the financial support of the DDO, but had less success implementing some major reforms.
Quality of ICR :		Satisfactory	

NOTES:
- When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
- The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

13. Lessons:

In a short term crisis, the DDO instrument is probably better than a long-term loan, since it offers support without being disbursed. However, should the DDO be disbursed, it can actually serve as a negative factor, indicating government weakness.

- Triggers for DDO disbursement should be flexible enough to allow for changes in market conditions.
- The DDO would be a more popular instrument if the commitment did not count 100% against the capital allocation even when it is not drawn.
- Policy based lending in a crisis requires an on-going program of AAA and/or engagement with the Government prior to the crisis to be thoroughly familiar with policy issues. It is unwise to eliminate AAA programs when countries are no longer borrowing, when there is possibility of a rapid return to borrowing in a crisis.

14. Assessment Recommended? ○ Yes ● No

15. Comments on Quality of ICR:

The overall quality of the ICR is good, but with some shortcomings. It is clear and concise, and reports on progress on the progress indicators. Shortcomings include an inadequate discussion of supervision, and a weak results focus in terms of ultimate impact of the operation. The ICR clearly sees the DDO as a short-term response mechanism, and does not emphasize the policy reforms as much as might be warranted. It would have been useful to demonstrate to what extent these reforms have been followed up in other operations.

a.Quality of ICR Rating : Satisfactory