



Indonesia:

Improving Development Outcomes
through Better Institutions

IBRD Results

SYNOPSIS

The World Bank Group, and IBRD in particular, has for many years supported Indonesia's efforts to transform its economy and improve the lives of its poorest people. Through a range of financial and technical programs, IBRD has helped Indonesians enjoy greater access to clean water and sanitation, endure far less red tape to start a business, rebuild after disasters, protect their natural resources and fight corruption.

Challenge

Indonesia's transition has come a long way in terms of the public's voice and the state's stability. Amidst the global economic slump, Indonesia is one of the few countries to continue posting significant growth, and the national economy is expected to grow by 5.5 percent in 2010 and by 6 percent in 2011. While Indonesia is doing well, it could be doing far better in the areas of poverty reduction, service delivery and governance.

More than 32 million Indonesians currently live below the poverty line and approximately half of all households remain clustered around the national poverty line set at 200,262 Indonesia Rupiah (equivalent to US\$21.47 as of February 12, 2010). Employment growth has been slower than population growth. Public services remain inadequate by middle income standards. Indonesia is also doing poorly in a number of health- and infrastructure-related indicators, and as a result may fail to reach several Millennium Development Goals (MDGs). For example, in terms of maternal mortality, 2008 data shows that Indonesia is still suffering 307 deaths for every 100,000 live births—more than double the MDG target of 105 deaths by 2015. Also, despite recent progress, access to improved sanitation facilities currently stands at 68 percent of the population, significantly short of the MDG target of 86 percent.

Key Statistics and Results

- US\$10 billion – the amount of extra funds Indonesia has available to spend per year after cutting costly subsidies.
- 60 days – the time required to start up a new business in Indonesia.
- 24,000 kms – the length of roads preserved in Sumatra.
- 1,500 kms – the length of roads improved in Eastern Indonesia.
- 4,500 meters – the combined length of bridges improved in Eastern Indonesia.
- 851,501 – the number of land title certificates distributed to land owners in nine provinces under the Land Management Policy Development Project.
- 121,594 – the number of land title certificates distributed to land owners in post-tsunami Aceh, as of May 2008.
- 50 percent – the amount by which illegal and destructive fishing and coral mining activities have been reduced in most pilot areas under the Coral Reef Rehabilitation and Management Program (COREMAP).
- 75 percent – the proportion of Indonesia's public now aware of the dangers of coral reef degradation.
- 38,000 – the number of villages and cities that have increased access to vital infrastructure and water/sanitation resources through community-driven development programs.



- 250,000 hectares – the size of the irrigated area benefiting from improved water management.
- 72 percent – the proportion of births now attended by trained health workers, as of 2007.
- 1,208 – the number of villages now benefitting from functioning water supply systems.

Results in Detail

Since 2004, the IBRD has disbursed a total of US\$1.9 billion in development policy loans (DPLs)—which have proven to be an effective way of providing budgetary and technical support to the Indonesian government’s policy reforms in the areas of macroeconomic stability, investment climate, service delivery and public financial management:

Macroeconomic stability – since the DPL series began, Indonesia has managed to fulfill many of its fiscal targets, including:

- Improved budget discipline → the budget deficit was reduced to 2.2 percent of gross domestic product (GDP) in 2009 from 4.4 percent in 1998.
- Improved debt management → the debt-to-GDP ratio fell to 30.7 percent in 2008 from 61 percent in 2003.
- Higher non-oil tax revenues, thanks to a modernized tax system → revenues amounted to approximately

US\$30 billion in 2009, higher than the IBRD estimate of US\$27 billion.

- Significant reductions in fuel subsidies, and less spending on subsidies overall → the Indonesian government now has an extra US\$10 billion a year to spend on social protection programs.

Investment climate – the ways in which the DPL series has helped to create a more supportive business environment for investors, as well as to strengthen, diversify and increase access to the finance sector, include:

- Reducing the state bank share of the overall banking system → to 36 percent in 2007 from 46 percent in 2003, indicating an increasing role for private banks.
- Helping small- and medium-sized enterprises (SMEs) benefit from market-based services → loans to SMEs comprised 52 percent of total loans in 2007, compared to 47 percent in 2003.
- Reducing the start-up time for a new business to 60 days in 2009 from 168 days in 2003.
- Improving regulatory and institutional frameworks for public-private partnerships (PPPs) → a decree was issued requiring transparent competitive bidding for PPPs, and special committees and units have been established within Ministry of Finance to determine public funding for PPPs.

Public service delivery – in several areas, the DPL series has helped the government to improve the quality, coverage and utilization of basic services, especially for the poor, including:

- Improved professional competency and performance incentives of all teachers → the number of junior and senior high school teachers with bachelor’s level degrees increased to 375,620 in 2008 from 260,026 in 2002. Initial anecdotal evidence also shows that a 2007 Ministerial Decree requiring teachers to perform 24 teaching hours per week has led to teachers in overstuffed school requesting transfers to understaffed schools.
- Stronger district and provincial capacity to manage a decentralized health system thanks to three IBRD-financed Provincial Health Projects → helped to increase the proportion of birth deliveries by trained

health workers from 37 percent in 1995 to 72 percent in 2007, and to improve the immunization coverage of measles vaccine from 63 percent in 1995 to 72 percent in 2007.

- Successful piloting of conditional cash transfer programs in seven provinces → cash transfers are given to poor families on condition that their children are enrolled in and attend schools, and make better use of public health facilities.
- Increased percentage of households with access to safe drinking water → functioning water supply systems have been established in 1,208 villages (covering 3.04 million villagers).

Public financial management – the DPL series has helped to improve transparency, accountability, efficiency and effectiveness in the use of public resources, as well as to improve the institutional framework for addressing corruption by:

- Having all line ministries prepare financial statements using new government accounting standards.
- Improving cash management through a Treasury Single Account Approach.
- Creating a new decree that defines service delivery responsibilities at each level of government.
- Helping to build the legal basis for the Anti-Corruption Commission (KPK), to ensure due process in the selection of its members and to provide support in its operation.

The IBRD has played a significant advisory role in **helping Indonesia become more transparent and accountable in managing its public finances**. New laws and regulations on State Finances, State Treasury and State Audit have been passed. The Ministry of Finance is now a better organized, more efficient, more accountable and more productive state apparatus, thanks to the IBRD-supported Government Financial Management and Revenue Administration Project (GFMRAP).

Segments of Indonesia's poor and marginalized people now have **greater access to judicial services**. The IBRD-supported Justice for the Poor (non-lending) program was born on the premise that formal justice institutions are inaccessible

to many of Indonesia's poor, and that non-state justice systems—for example, mediation through village heads—are seen as more reliable options that need strengthening.

Indonesia's commitment to **eradicating corruption** gained significant ground with the establishment of the independent KPK, whose many investigations have led to numerous high-profile prosecutions. The IBRD was instrumental in helping to build the legal basis for the KPK, to ensure due process in the selection of its members and to provide support in its operations.

Since 2007, the IBRD has disbursed a total of US\$650 million in **infrastructure** development policy loans (I-DPLs) to support efforts to increase the level and effectiveness of infrastructure financing. The number of new infrastructure projects dropped significantly after the 1997 Asian financial crisis, and the lack of adequate infrastructure is now the main constraint to Indonesia's growth potential. IBRD studies indicate that infrastructure investments of US\$4.7 billion could boost GDP by 2.4 percent. Now in its fourth annual installment, among other things, the I-DPL series has contributed to efforts:

- To increase capital spending by infrastructure ministries by 25 percent.
- To increase the proportion of electricity subsidies allocated to the lowest income consumers.
- To prepare competitive and transparent tenders for PPP transactions.
- To speed up the processing of construction contracts.

In the area of **disaster risk management**, at the government's request, the IBRD initiated, designed and drafted the founding legislation for the establishment of the Aceh Reconstruction and Rehabilitation Agency, which successfully managed the complex reconstruction and rehabilitation of Aceh and Nias in the wake of the tsunami of December 2004. The IBRD also provided continuous technical assistance and support during the first few months of BRR's existence.

Multi-Donor Fund (MDF) for Aceh and Nias – The IBRD mobilized over US\$700 million in commitments from 15 donors in support of the MDF for Aceh and Nias

(under World Bank administration), as well as leveraging additional bilateral Trust Funds and restructuring a number of International Development Association (IDA) projects.

- ▶ The MDF helped build 4,400 new houses; rehabilitate 4,050 old houses; build 43 community health clinics; build or repair 282 schools; repair 846 bridges; rebuild 2,330 kilometers of village roads and 199 kilometers of urban roads; finance 1,211 irrigation and drainage projects in rural areas; rehabilitate 178 kms of drainage in urban areas; build 1,148 clean water systems; and build 1,032 sanitation units.

Java Reconstruction Fund – Lessons from Aceh were also applied successfully to Yogyakarta and Central Java’s reconstruction, following the May 2006 earthquake. The government employed the IBRD’s community-based approach in its own large housing program. In addition to support on donor coordination, and the damage and loss assessment exercise, at the government’s request the IBRD also established the Multi-donor Java Reconstruction Fund (JRF) bringing together over US\$85 million in grant funds, primarily supporting home reconstruction. The closing dates of both MDF and JRF were recently extended and their scope enhanced to promote sustainable, locally centered and managed institutional and economic development.

- ▶ 146,173 houses have been built through Bank support as of March 2007.

The Approach

Since 2004, the IBRD’s support for Indonesia has evolved to become an integral part of the policy agenda defined and led by the government. IBRD is well positioned to advise the government on several issues, proving its value as a “go to” partner on policy issues. A substantial effort was made to seek entry-points into key emerging policy issues such as education, environment, fuel subsidy reduction, unconditional cash transfers and conditional cash transfers. Equally important was the IBRD’s foresight in identifying and prioritizing problems before they were widely recognized as challenges, as well as IBRD’s flexibility to respond quickly to government requests and needs on demand.

The outcomes achieved following IBRD’s shift in approach have been significant:

CDD projects continue to achieve results on the ground – the two IBRD-financed CDD programs, the Kecamatan Development Project and the Urban Poverty Program, have been successful in delivering small-scale infrastructure and basic services to poor communities. These programs have built or rehabilitated schools, health center facilities, water and sanitation systems, roads, bridges, markets and electrification systems and are providing employment, building capacity and deepening local governance.

DPLs have contributed strongly to advancing cross-cutting reforms – policy-based loans have become the centerpiece of a more mature partnership between IBRD and Indonesia. The DPL program has been effective in three ways:

- ▶ **Advancing reforms** – the DPLs have allowed reform-minded policy-makers to translate broad objectives into priority actions.
- ▶ **Predictable low-cost financing** – as a middle income country, Indonesia can choose from a variety of funding sources. However, with Indonesia’s high gross borrowing needs (over US\$16 billion annually), DPLs have become a preferred option.
- ▶ **Cementing development partner coordination** – the DPL series has improved harmonization and reinforced support for reforms among Indonesia’s main development partners: the IBRD, the Asian Development Bank (ADB) and Japan. The ADB and Japan been providing parallel financing to the DPL program.

Strong donor partnerships leading to trust fund mobilization have allowed IBRD to re-engage in some sectors and deepen support in others – the availability of trust fund financing has led to a marked increase in the IBRD’s analytical, technical assistance and advisory services. For example, IBRD has become an ally in the government’s efforts to encourage donor support for its education agenda.

IBRD has emerged as a key convener that responds quickly and efficiently to post-disaster reconstruction and other emerging requests – IBRD’s role became evident during

the immediate post-tsunami/earthquake period when it was asked by the government to lead a coordinated donor effort to address the reconstruction in Aceh, Nias and Yogyakarta.

IBRD has also launched a first generation of local government projects to build capacity for improved local governance, accountability and transparency while maintaining a focus on poverty reduction at the local level. As part of the Initiatives for Local Government Reform project preparation, local level poverty reduction strategies were formulated in 15 districts after public consultations.

Summary Timeline

The World Bank Group has maintained an active presence in Indonesia since 1967. Indonesia briefly graduated from IDA in the early-1990s but became IDA-eligible again in the mid-1990s and a “blend” country—receiving both IDA and IBRD financing—when it was hit by the Asian economic crisis. In the past ten years, Indonesia has transformed itself into a confident middle-income country and an active IBRD borrower.

IBRD Contribution

As of December 31, 2009, IDA/IBRD’s lending portfolio in Indonesia consists of 32 active projects with total com-



mitments of US\$5.98 billion in various sectors including roads, energy, education, health, irrigation and rural development. In addition, the Bank supervises another 11 projects financed out of the Aceh and Nias MTF and the Java Reconstruction Fund.

In the 2009 fiscal year, IBRD lending more than doubled the expected US\$2 billion envelope under the new Country Partnership Strategy (2009–2012) to US\$4.2 billion, including the US\$2 billion Public Expenditure Support Facility/Development Policy Loan with a Deferred Draw-down Option (DPL-DDO).

In addition to lending, the IBRD administers for Indonesia the largest portfolio of trust funds and grants in the EAP region, totaling about US\$1 billion.

The IBRD is playing a lead role in supporting decentralization through the management and administration of a multi-donor Decentralization Support Facility. The Bank’s private sector arm, the International Finance Corp has helped to improve the investment climate by working with district governments on licensing and other regulatory reforms.

World Bank Group Engagement

IFC has strongly increased its program in Indonesia and currently has a portfolio of US\$960 million invested in such sectors as financial services, agribusiness and manufacturing. Out of US\$960 million, some US\$840 million is debt, US\$100 million is equity and the remaining US\$20 million is quasi-equity. Reforms in the business environment have resulted in the improved ranking of Indonesia in the Doing Business 2010 report from 129th in 2009 to 122th in 2010, although significant challenges remain, with Indonesian businesses identifying labor, infrastructure and general regulatory reforms as critical to increased investment. Through its advisory program, IFC has built the capacity of rural banks and micro-finance institutions, which is now being complemented by investments. IFC has worked with six women’s cooperatives, 153 farmers’ groups, and rural

banks in Bali and Eastern Java. IFC is contributing to the creation of the first wholesale micro-finance institution.

The Multilateral Investment Guarantee Agency continues to use its online services to assist Indonesia to attract foreign direct investment by profiling potential investment opportunities in the country.

Good Practices Developed/ Replicated

The Multi-Donor Fund for Aceh and Nias—the largest post-disaster fund in the Bank—is considered a “best practice” mechanism for donor coordination in response to natural disasters. The MDF’s close coordination with the Aceh Reconstruction and Rehabilitation Agency and the local government has contributed greatly to its success.

Next Steps

Future success now depends on improving the quality of Indonesia’s public institutions. This includes improving regulatory quality, the rule of law, the control of corruption through more accountability, and institutional capacity. With more effective and accountable public institutions, Indonesia’s available resources can be turned into greater development outcomes. Stronger institutional capacity to

deliver public goods, coupled with increased private investment, would also create a cycle of sustainable and inclusive growth.

World Bank Group support for Indonesia will continue to embrace a wide range of sectors, both economic and social: agriculture, civil service, climate change, energy, urban development, health, education, public financial management, disaster risk mitigation, water and sanitation, roads and service decentralization.

Partners

A number of key development partners will continue to leverage IBRD’s technical, managerial and fiduciary capabilities on the ground to advance on shared objectives. This is reflected by a robust set of strategic partnerships, most notably through bilateral and multilateral trust funds and co-financing arrangements. Major World Bank Group partners include the Asian Development Bank, the Australian Government, the European Commission, as well as the Japanese, Dutch and British Governments.

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