Country Assistance Program Evaluation

Indonesia, 2005–2018

Independent Evaluation ADB

Raising development impact through evaluation

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NOTES

(i) In this report, “$” refers to United States dollars.
(ii) For an explanation of rating descriptions used in Asian Development Bank (ADB) evaluation reports, see ADB. 2015. *2015 Guidelines for the Preparation of Country Assistance Program Evaluations and Country Partnership Strategy Final Review Validations.* Manila.

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Abbreviations

ADB	–	Asian Development Bank
AFD	–	Agence Française de Développement
ANR	–	agriculture and natural resources
BAPPENAS	–	Kementerian Perencanaan Pembangunan Nasional Republik Indonesia (Ministry of National Development Planning)
BPS	–	Badan Pusat Statistik (Statistics Indonesia)
CAPE	–	country assistance program evaluation
CDD	–	community-driven development
COBP	–	country operations business plan
CPS	–	country partnership strategy
CSP	–	country strategy and program
CSS	–	country safeguard systems
DFAT	–	Department of Foreign Affairs and Trade of Australia
DMF	–	design and monitoring framework
EIRR	–	economic internal rate of return
FDI	–	foreign direct investment
GDP	–	gross domestic product
IED	–	Independent Evaluation Department
IIF	–	Indonesia Infrastructure Finance
IMF	–	International Monetary Fund
IsDB	–	Islamic Development Bank
IWRM	–	integrated water resource management
JFPR	–	Japan Fund for Poverty Reduction
JICA	–	Japan International Cooperation Agency
KfW	–	Kreditanstalt für Wiederaufbau
LNG	–	liquefied natural gas
M&E	–	monitoring and evaluation
MDG	–	Millennium Development Goal
MFF	–	multitranche financing facility
MOF	–	Ministry of Finance
NSO	–	nonsovereign operations
O&M	–	operations and maintenance
OJK	–	Otoritas Jasa Keuangan (Indonesia Financial Service Authority)
PBL	–	policy-based lending
PCR	–	project completion report
PLN	–	Perusahaan Listrik Negara (State Electricity Company)
PPP	–	public–private partnership
PSM	–	public sector management
RBL	–	results-based lending
SDG	–	Sustainable Development Goal
SMEs	–	small and medium-sized enterprises
SOEs	–	state-owned enterprises
TA	–	technical assistance
TVET	–	technical and vocational education and training
UNDP	–	United Nations Development Programme
WTC	–	West Tarum Canal
WUS	–	water and other urban infrastructure and services
WWTP	–	wastewater treatment plant

Measurements

CO_2	–	carbon dioxide
ha	–	hectare
kWh	–	kilowatt hour
kV	–	kilovolt
m^3/s	–	cubic meter per second
MW	–	megawatt

Contents

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The Independent Evaluation Department retains full responsibility for this report.

Foreword

The Indonesian economy has been growing at a steady annual rate of about 5% in recent years. Indonesia has also made great progress in reducing its poverty rate, which fell below 10% in 2018, although income inequality is high and rural poverty remains a challenge. Infrastructure bottlenecks, a weak business environment, skills shortages, and low productivity and competitiveness are among the many challenges that Indonesia faces in accelerating its economic growth. Asian Development Bank (ADB) operations in Indonesia have aimed to address these development challenges and to ease some of the binding constraints on Indonesia's growth.

This Indonesia country assistance program evaluation (CAPE) covers operations approved by ADB during 2005–2018. These were based on three country strategies over this period, all of which had inclusive and environmentally sustainable growth as their central objective. The country program in this period comprised 72 sovereign loans, 21 grants, 23 nonsovereign loans, and 122 technical assistance operations, totalling $19.3 billion. While the country strategies favored supporting a wider range of sectors, operations focused mainly on three sectors: public sector management, energy, and finance.

Public sector management operations contributed to improvements in financial management by regional governments, internal audit strengthening to improve government accountability, and macroeconomic stability in the face of economic shocks. The finance sector program helped institution building, especially the establishment of the Indonesia Financial Service Authority (Otoritas Jasa Keuangan) to carry out integrated regulation and supervision of financial markets. The energy program helped to improve transmission and distribution systems and renewable energy outputs in remote parts of the country. The results were less impressive in the smaller programs of the agriculture, water, and social sectors. In part because of a lack of progress with investments in infrastructure development, a constant priority of the strategies, progress toward the objectives of inclusive economic growth and environmentally sustainable growth was unconvincing.

Keeping in view Indonesia's medium-term plan priorities for 2020–2024 as well as ADB's Strategy 2030, ADB should focus more on operations with a direct impact on boosting inclusive and environmentally sustainable growth. The limited capacity of subnational governments to carry out project preparation and implementation has been a drag on infrastructure development, so strengthening local government capacity will be essential. Diversifying ADB's financing modalities to include more investment projects to complement the policy-based lending would assist this. In particular, ADB should provide greater support to address project readiness issues such as land acquisition, safeguards, and procurement that have dogged the program in the past. This will improve the design quality and results of ADB-supported investment projects. The demand for policy-based lending is expected to continue, although at a lower level than before, given the need to address the persisting development constraints. Indonesia is a middle-income country, so knowledge services and support will play a stronger role; policy-based lending needs to be well-founded on sound and in-depth knowledge work.

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Independent Evaluation ADB

Country Assistance Program Evaluation for Indonesia, 2005–2018

RECOMMENDATIONS

Strategic Recommendations

1. Focus on boosting Indonesia's path to inclusive growth and environmentally sustainable and climate resilient growth, two of its most pressing development challenges, in the context of high inequality and growing environmental challenges.
2. Strengthen local government capacity by working selectively with provinces, districts, and large cities to enable local governments to provide support for infrastructure development in various sectors.

Operational Recommendations

3. Tackle project readiness issues and offer better and more innovative project designs to improve the quality and implementation of ADB-supported investment projects.
4. Diversify financing modalities, to ensure that policy reforms supported by policy-based lending are complemented by other modalities, including results-based lending and investment projects, to achieve the targeted development outcomes.
5. Improve the framing of operations by providing strong analytical underpinnings and results frameworks to support policy reforms and capacity building and institutional strengthening.

INTRODUCTION

The evaluation assessed the Asian Development Bank's (ADB) support to Indonesia during 2005–2018. It found that ADB support contributed to good results in the major sectors of focus. Notable contributions included improvements in subnational governance and macroeconomic stability, financial stability through institutional building and improved systems, clean energy, and greater access to electricity. The results were weaker in the smaller programs of agriculture, water, and social sectors and in thematic areas of inclusive economic growth and environmentally sustainable growth.

In line with its long-term strategic priorities (Strategy 2030) and keeping in view Indonesia's medium-term plan expected priorities for 2020–2024, ADB needs to focus more on boosting Indonesia's path to inclusive and environmentally sustainable growth. It should strengthen local government capacity by working selectively with provinces to support infrastructure development and scale up based on experience. ADB should complement policy-based lending (PBL) with investment projects to better achieve targeted development outcomes. It should also help the government overcome project readiness hurdles to support more investment projects.

PORTFOLIO

ADB's support to Indonesia during 2005–2018 amounted to a total of $19.3 billion, comprising $16.6 billion of sovereign, and $2.7 billion of nonsovereign operations (NSOs). There was a major focus on public sector management (PSM) constituting 45% of the portfolio, energy 24%, and finance 14%. Much of the PSM program focused on reforms through PBLs, including additional support to address crisis and emergency situations. Energy support was in power transmission and distribution, renewable power generation and policy reforms and involved PBLs, results-based lending (RBLs) and NSOs.

Finance portfolio focused on financial stability and deepening of capital markets. The rest of the portfolio comprised agriculture, transport, water, and the social sectors.

ADB activities and interventions over 2005–2018 were guided by three country partnership strategies (CPSs), one interim country strategy, and 11 country operational business plans, all of which were in sync with the government's strategies and plan priorities. Multilateral and bilateral development partners played a complementing role in several areas of intervention. ADB could attract considerable amount of cofinancing from development partners including for technical assistance.

PERFORMANCE

PSM, energy, finance, and the transport program, were all assessed overall *successful*. Performance of energy program was *satisfactory* on all evaluation criteria. Energy and transport were the only two programs with *satisfactory* development impact. The programs on water and other urban services, agriculture and natural resources, and health and education sectors were deemed *less than likely sustainable*.

RESULTS

The ADB PSM program had positive contributions in the area of economic governance: establishing a more conducive framework for macroeconomic stability and investment and strengthening subnational governance.

The ADB finance program contributed to financial stability through the establishment and support of OJK but contributions to financial access and depth were limited. ADB's contribution to infrastructure services was limited by the size of the resource envelope as well as limited success in policy actions. Except for the energy program, which contributed significantly to improved services, the rest of the sector programs contributed in a limited way to infrastructure development.

There was limited progress in developing human resources especially of the disadvantaged. The impact of increase in subnational spending on health and education sectors will depend on whether service quality and learning outcomes are prioritized.

Overall the evaluation found the contribution of the program to inclusive and environmentally sustainable growth, the overarching objectives of ADB's CPSs, *less than satisfactory.* This was mainly due to the under-utilization of resources to sectors that mattered most for the achievement of these strategic objectives as originally envisioned. For instance, PSM and finance programs forming around 60% of the portfolio touched only marginally the objective of inclusion and environmental sustainability.

LESSONS

- ADB's support is effective when a country has strong ownership of the ADB program and when operations are grounded on a deep understanding of the country's realities, geography, diversity, cultural factors, legal system, and preferences.
- Sustained demand for ADB support is more likely if ADB can build on progress made in various projects, including the relationships that were established in the process.
- Working with state-owned enterprises on infrastructure projects is an attractive option given the difficulties of working with subnational governments with limited capacities.
- The community-driven development approach was a cost-effective way of delivering small, community-based projects to build soft and hard infrastructure at the village level.
- Lack of coordination between national and regional planning levels can affect project implementation.

Executive Summary

The Indonesia country assistance program evaluation (CAPE) covered operations approved by the Asian Development Bank (ADB) during 2005–2018. These comprised 72 sovereign loans, 21 grants, 23 nonsovereign loans, and 122 technical assistance operations, totaling $19.3 billion.

The central objective of the three ADB country strategies over the CAPE period was to promote more inclusive and environmentally sustainable growth.

The evaluation rates the program *successful on the borderline.* The performance of the public sector management program (45% of the portfolio) was rated *successful*, the energy program (24%) *successful*, and the finance sector program (14%) *successful*. Among the smaller programs in the portfolio—the transport program (6%) was *successful* as well; but the programs in the water and other urban infrastructure and services, education and health, and agriculture and natural resources sectors were all rated *less than successful*. In addition, ADB's operationalization of the strategic agendas of inclusive economic growth and environmentally sustainable growth in the country program was rated *less than relevant* with *less than satisfactory* impacts. The strategic agenda of regional cooperation and integration and two drivers of change, governance and private sector development, were rated *relevant* and *satisfactory* in impact. Gender development work was rated *less than relevant* and *less than satisfactory* in impact. Considering Indonesia's medium-term plan expected priorities for 2020–2024 as well as ADB's Strategy 2030, the evaluation offers a set of strategic and operational recommendations.

Strategic recommendations. ADB should: (1) Focus on boosting Indonesia's path to inclusive growth and environmentally sustainable and climate resilient growth, two of its most pressing development challenges, in the context of high inequality and growing environmental challenges; (2) Strengthen local government capacity by working selectively with provinces, districts, and large cities, to enable local governments to provide support for infrastructure development in various sectors.

Operational recommendations. ADB should: (3) Tackle project readiness issues and offer better and more innovative project designs to improve the quality and implementation of ADB-supported investment projects; (4) Diversify financing modalities to ensure that policy reforms supported by policy-based lending are complemented by other modalities, including results-based lending and investment projects to achieve the targeted development outcomes; and (5) Improve the framing of operations by providing strong analytical underpinnings and results frameworks to support policy reforms and capacity building and institutional strengthening.

Overall Program

This Indonesia country assistance program evaluation (CAPE) covered the operations approved by the Asian Development Bank (ADB) during 2005–2018. These comprised a sovereign portfolio valued at $16.6 billion, and a nonsovereign operations (NSOs) portfolio of $2.7 billion for a total of $19.3 billion. Public sector management (PSM) accounted for 45% of total financing; followed by energy, 24%; and finance 14%. Policy-based lending (PBL) was a major part of the overall portfolio during this period (69% of sovereign lending). A large part of the PBL support was provided through PSM operations (69%), followed by finance (15%), and energy (10%). NSOs concentrated on finance and energy.

Evaluation Methodology

The evaluation followed the 2015 CAPE guidelines and used a mixed-method approach with both qualitative and quantitative assessments. Sector programs were rated for relevance, effectiveness, efficiency, sustainability, and development impacts.

In addition to sector programs, the evaluation also assessed ADB's strategic agendas and special cross-sectoral priorities as applied to the Indonesia program, in terms of their relevance and impacts. The three strategic agendas were; inclusive economic growth, environmentally sustainable growth, and regional cooperation and integration. The special priorities in the Indonesia country strategies (referred to as drivers of change in Strategy 2020) were gender equality, governance and capacity development, and private sector development. To arrive at an overall assessment of the Indonesia strategy and program, proportional weights were applied to aggregate the sectoral performance, equal weights to aggregate the thematic performance, and a simple average of the two was used for the overall performance.

The overarching evaluation question was: to what extent did the ADB program in 2005–2018 contribute to more inclusive and environmentally sustainable growth? Such growth was the central objective of the various country strategies over this period. Given ADB's strategic objectives and results frameworks and the way these were operationalized, the evaluation also asked subsidiary evaluation questions on the improvement of infrastructure services, economic governance, development of human resources, the tackling of environmental challenges, and deepening of the finance sector and increased access.

Country Context

Indonesia's annual growth rate dropped from a high of 6.4% in 2010 to a low of 4.9% in 2015 before gradually rising to 5.2% in 2018. The national poverty rate fell from 24% in 1999 to 9.8% in 2018, but income inequality is high and rural poverty remains a challenge. The Gini coefficient rose from 0.31 in 1999 to 0.41 in 2011 and stayed close to that level until 2015 before declining slightly to 0.39 in 2017. There is unequal ownership of financial and other assets and unequal access to education and other social services. Regional income disparities are widening due to uneven economic growth across provinces.

The government has prioritized infrastructure development, and this has been reflected in rising infrastructure budgets (although the new government of 2019 has emphasized education). The government has implemented several structural reforms, including fuel subsidy cuts that released funds for infrastructure and programs directly impacting the poor, including those for education and health care. Recent reforms have focused on improving the business environment, simplifying business licensing, and streamlining tax administration. Improved macroeconomic management, as reflected in the low inflation rate (3.2%) and fiscal deficit (1.8% of gross domestic product [GDP] in 2018), led to an upgrade of Indonesia's sovereign credit rating to investment grade by major international credit rating agencies in 2018.

Indonesia faces many challenges in accelerating its economic growth. Infrastructure bottlenecks, a poor business environment, skills shortages, weak agricultural policies, poor public financial management, and weak governance in the management of natural resources are among the major binding constraints identified by the World Bank's systematic country diagnostics for Indonesia in 2015. Indonesia's financial system is heavily reliant on banks. Capital markets are underdeveloped, and the poor have limited access to finance.

Infrastructure investments are hindered by a complex land acquisition process, poor project preparation in some cases, and cumbersome and lengthy procurement systems. Ineffective procedures and lack of financing, especially at the local government level, are among the key reasons for government-related delays in land acquisition for infrastructure projects. This has also affected ADB's project preparation work, and many initiatives funded by technical assistance (TA) or donor funds did not lead to a funded infrastructure project over the period. Substantial gaps exist between budgeted amounts for and actual compensation paid to affected persons through negotiations.

Skills shortages have delayed Indonesia's move to higher income generating production in many sectors. The existing education system is unable to respond to the increasing demand for workers with advanced skills by industries and services. Youth unemployment is increasing gradually.

Service delivery at the local level is hampered by capacity constraints and decentralization challenges. Local governments deliver the bulk of Indonesia's social services and are responsible for more than 50% of overall government spending. Inadequate revenue mobilization limits the governments' ability to fund key public services and weak budget execution makes public spending less effective in benefiting people. Indonesia has been experiencing rapid urbanization, but urban service provision has not kept pace.

Natural resource and environmental management are affected by weak governance and local communities' lack of land access rights that would enable them to prevent overexploitation of resources. Indonesia's rapid economic growth has come at the cost of deteriorating natural resources. Forest fires for land clearing have contributed significantly to extremely high levels of air pollution at various times of the year. Climate change impacts can be seen in the form of intense floods, drought, forest fires, storm surges, coral bleaching, and rising sea levels.

Indonesia's Strategies and Objectives

Indonesia implemented a wide range of policy reforms after the 1997–1998 Asian financial crisis. This made the economy more resilient to shocks such as the global economic crisis in 2008. The government envisioned a just and prosperous country in its National Long-Term Development Plan, 2005–2025.

The government's National Medium-Term Development Plan, 2005–2009 sought to raise levels of sustainable economic growth, create jobs, and accelerate the achievement of the Millennium Development Goals (MDGs). The government's second National Medium-Term Development Plan, 2010–2014 envisioned an Indonesia that is prosperous, democratic, and just, supported by a four-track strategy of pro-poor, pro-job, pro-growth, and pro-environment development.

The Master Plan for the Acceleration and Expansion of Economic Development of Indonesia for 2011–2025 focused on three main pillars: (i) harnessing the country's regional development potential by developing six economic corridors—Sumatra, Java, Kalimantan, Sulawesi, Bali-Nusa Tenggara, and Papua Maluku; (ii) strengthening national connectivity, both locally and internationally; and (iii) strengthening human resource capacity and national science and technology.

The National Medium-Term Development Plan, 2015–2019 prioritized a significant scaling up of infrastructure investment (power generation, toll roads, and port facilities); improvements to education and skills development; and policy reforms to improve competitiveness and service delivery. It promoted inclusive and environmentally sustainable growth by encouraging all citizens and regions to participate fully in the growth process. The reform priorities as announced in 2014 by President Joko Widodo included: improving the business climate; increasing the tax-to-GDP ratio; reducing fuel subsidies and diverting the savings to finance infrastructure; and strengthening social infrastructure through three welfare programs, social welfare cards for health, education, and conditional cash transfer programs.

ADB Strategies

ADB activities and interventions during 2005–2018 were guided by 1 country strategy and program (CSP), 2 country partnership strategies (CPSs), 1 interim CPS, and 11 country operations business plans (COBPs). The strategic objectives of pro-poor, inclusive and environmentally sustainable growth have remained constant across the different CPS periods. However, the focus of ADB support has shifted over time in response to Indonesia's changing development priorities. CSP, 2006–2009 focused on infrastructure development, finance sector deepening, decentralization, accelerating achievement of the MDGs, and environmental and natural resources management. CPS, 2012–2014 and the interim CPS, 2015 focused on infrastructure development, especially in energy and agricultural water supply, development of human resources through vocational education, urban sanitation, and financial inclusion. CPS, 2016–2019 focused again on infrastructure services but now concentrated on energy and rural irrigation and water supply, the finance sector, PSM, education quality, and skills development.

A marked shift to PSM-related budget support was seen during the implementation of the CPS, 2006–2009, although it was envisaged that there would be a gradual return to project investments in later CPSs. However, this did not happen fully and ADB provided less than expected lending to most sector programs other than PSM. CPS, 2012–2014 had anticipated a shift from PBL to investment lending but during implementation the country context changed, leading to more demand for budget support from the government. Deficit financing requirements increased due to strains in the current account arising from reverberations from financial problems in eurozone countries, devaluation of the rupiah, and high global petroleum prices.

PBL turned out to be ADB's and the government's preferred lending modality over the evaluation period. The lending focus was mostly on PSM topics and capital market development. PBL accounted for 69% of total sovereign lending volume during 2005–2018, a much higher percentage than to any other ADB developing member country. Authorities emphasized the PBL's role of providing a buffer against financial volatility, in addition to providing an opportunity for support for policy reforms. Concomitant to the government's budgetary and stability priorities, the tilting of the lending program towards PBL was partly due to the government's perception of the high transaction costs of ADB-supported infrastructure investment projects, land acquisition issues, and government's preference for using its own country systems in investment projects, which were not aligned with ADB systems and procedures. Many of the loans provided were supported by TA projects to build capacity and provide knowledge products. The most recent knowledge product was a joint ADB and Ministry of National Development Planning (BAPPENAS) report which helped identify policies for developing the manufacturing sector in Indonesia.

Sector Performance

ADB support for PSM was rated *successful*. This was based on the achievement of many governance-related outcomes and ADB's contribution to macroeconomic stability through budget and precautionary financing during crises. During 2005–2018, the approved financing for PSM comprised 24 sovereign loans, 5 grants, and 27 TA operations totaling $8.7 billion (45% of the total portfolio). In addition, $1.1 billion of parallel financing was provided by other development partners.

The PSM program was considered *relevant,* since it responded flexibly to the country's reform and macroeconomic management needs. The program evolved with the demands of the government, reflecting the external and internal economic environment. ADB provided countercyclical budget support in the wake of the global financial crisis, and later continued to respond to requests of the Ministry of Finance for budget support with additional policy reform objectives. It was able to leverage its relationship with its development partners to attract considerable cofinancing. The program focused on regional government public financial management and government auditing, which was appropriate. However, the CPS targets related to PSM were at times not well formulated; for the CPS, 2012–2014 there were none in the results framework. The PSM program had governance objectives rather than inclusive and environmentally sustainable growth objectives.

The program was rated *effective* as many of the expected outcomes under PBL relating to economic governance were achieved. Support for decentralization helped regional governments to increase their share of their own source revenue. Other important achievements included: application of minimum service standards for basic services in national and regional government planning; budget support leading to macroeconomic stabilization in the face of economic shocks, particularly after the Asian financial crisis; and, to some extent, improved government accountability through internal audit strengthening. The outcomes of the efforts to achieve the Sustainable Development Goals (SDGs) and to strengthen public financial management are, however, works in progress.

The PSM sector program assessment did not consider the criterion of efficiency since PBL was the predominant modality used. With PBL, generally no economic analysis is done since it is difficult to estimate the costs and benefits of reforms. The choice of single-tranche policy-based loans avoided the usual issues found with second and third tranche approvals of multitranche loans which was a positive feature of the program. However, some policy-based loans were prepared in response to the fact that investment project proposals in other sectors failed to materialize.

The PSM program was rated *likely sustainable* since the government's ownership of decentralization and public financial management reforms is strong and the supported policy reforms are unlikely to be reversed. The $8.7 billion in PSM lending is likely to have a positive impact on budget deficit control and macroeconomic stability. However, the sustainability of reforms in some areas, such as public–private partnerships (PPPs), depends on continued support, especially for capacity building, in order to generate PPPs that are ready for implementation.

The development impacts of the PSM program were rated *less than satisfactory*. The program did not have a significant impact on the delivery of public services, notwithstanding the positive contribution to economic governance and macroeconomic stability. Despite its size, the PSM program did not significantly target to improve the investment climate for infrastructure development. Contributions to the CPS subsidiary goals of improving infrastructure services, developing human resources, and managing environmental challenges were limited.

The ADB-supported energy program was rated *successful* overall as policy-based support combined with sovereign and NSOs helped improve distribution systems and electricity access. The energy program was the second largest in lending volume (24% of the total). ADB provided 15 sovereign loans, 3 grants, 14 nonsovereign loans, and 19 TA projects. Support included five PBL operations and two results-based lending (RBL) operations. ADB supported power transmission and distribution network improvements, renewable power generation, and policy reforms.

The energy program was rated *relevant*. Its design was aligned with the government's objectives and executed in coordination with other development partners. The program was also rated *effective*. Transmission and distribution systems improved and progress was made in renewable energy in the eastern part of the country. Electricity distribution efficiency improved as a result of the Java–Bali project. The West Kalimantan Project made possible the importation of hydropower from Malaysia, replacing higher cost diesel-based power generation and lowering carbon dioxide emissions. Despite the complexity of dealing with many ministries and agencies, the PBL support helped the government-owned electricity corporation PLN to rely less on subsidies and to be better able to meet most of its revenue requirements and debt servicing. ADB NSOs increased incomes and foreign exchange earnings through liquefied natural gas exports and the production of renewable energy at a lower cost than PLN's production costs through conventional sources in eastern parts of Indonesia.

The energy program was rated *efficient*, although it had several implementation issues. For instance, the Java–Bali transmission project experienced substantial delays, leading to its cancellation. Delays were also encountered in the implementation of policy reforms under the Sustainable and Inclusive Energy Program. Outcomes were *likely sustainable* since tariffs were rationalized and subsidies managed better. The program contributed to emission reductions to some extent, although these reductions are unlikely to make a major dent in the overall emission scenario given the continued reliance on coal. Based on the contributions to the CPS objectives of inclusive economic growth, environmentally sustainable growth, and improved sector governance development, the impact of the energy program was rated *satisfactory*.

ADB's support for the finance sector was rated *successful*. Institution building to strengthen financial stability was an area where ADB made a major contribution. The CAPE used the findings of the sector assistance program evaluation for the finance sector, conducted in parallel with the CAPE. ADB support for Indonesia's finance sector totaled more than $2 billion in 2005–2018 (14% of the overall ADB portfolio in Indonesia). The program focused on financial stability; improving regulation and supervision in the non-bank finance sector;

deepening capital markets; and, toward the end of the period, improving financial inclusiveness and promoting greater access to finance.

The finance program was aligned with ADB and country strategies and needs and was rated *relevant and efficient.* However, the program had some design issues. Notwithstanding the analytical work done to prepare the finance program, it was difficult to establish a clear causal pathway from the policy actions to the design and monitoring frameworks' results chains or to define the contribution of ADB's program to sector development. Some NSOs in the program such as support for asset securitization were introduced at a time when the conditions on the ground were not ripe for them.

The program was rated *effective.* The fundamental objectives of institution building and strengthening financial stability were achieved. The sovereign portfolio was broadly effective. Intended outputs were achieved especially with regard to institution building, financial literacy, and, to some extent, capital market development and its supervision. However, the program did not go much further than the output level and achievements at the outcome level were mixed and only significant for financial stability. Results for capital market development were modest while for financial inclusion they were limited. Transmission channels from outputs to outcomes were clear in only a few instances. The performance of the small portfolio of NSOs was *less than successful*. For these reasons the program lies at the lower end of effectiveness.

The finance sector program was rated *likely sustainable.* The government implemented the policies with a high degree of ownership. The institutional arrangements allowed for continuous monitoring of financial stability.

Development impacts were rated *less than satisfactory,* despite the progress in improving financial stability. Indonesia Financial Services Authority—Otoritas Jasa Keuangan (OJK)—is established and independent, yet supervision of financial conglomerates and financial technology remains a challenge. These are complex areas and the capacity of OJK staff needs to be built.

The results of the interventions in support of financial deepening were modest. Indonesia's bond and equity markets deepened during the evaluation period, but they remain smaller than those of peer countries. New capital market instruments such as derivatives need to be further developed to contribute to finance sector deepening.

The results of efforts to improve financial inclusion were weak due to the limited scope and reach of the interventions and overall lack of a strategic vision which would combine finance and private sector development efforts.

The Indonesian authorities stressed the interconnection between financial deepening and inclusion. Efforts on financial deepening have a direct impact on inclusion and vice versa. There was also a call for a more proactive support from ADB to the mobilization of finance from the insurance and pension industry to further deepen financial markets and foster financial inclusion and stronger cooperation among development partners.

ADB's support for the agriculture and natural resources (ANR) sector was rated *less than successful* overall due to shortfalls in outputs and outcomes and efficiency and sustainability issues. ANR operations approved during the CAPE period led to almost $1 billion of financing (5.2% of the total portfolio) through loans, grants, and TA. Nine projects were approved and these covered aquaculture, coral reef management, and water resources management, including flood management and participatory irrigation management. The ANR program was rated *relevant* as it addressed the key challenges of Indonesia and was aligned with government priorities.

The ANR program was, on balance, rated *less than effective.* The interventions during the CAPE period did not build on the legacy of older projects that had introduced new practices and achieved project objectives. The community water services project improved access to safe water and sanitation services which resulted in better health outcomes, but there were shortfalls in local government capacity building efforts. The aquaculture project helped fishing communities to increase their incomes and introduced sustainable practices in the utilization of natural resources. The coral reef rehabilitation and management project had implementation problems and is being currently managed on a grant basis; the implications for coral management and related environmentally sustainable growth were *less than satisfactory*. The large multitranche financing facility (MFF) for water resources (Integrated Citarum Water Resources Management Investment Program) did not fully achieve the outcome of improving the water quality in waterways and reservoirs for irrigation and later tranches had to be canceled after 10 years due mainly to project readiness issues.

Recent ANR projects, including the participatory irrigation management project, were more complex. They required the latest technological expertise and better implementation capability, neither of which were easily available. Coordinating small investments scattered geographically is expensive and difficulties with counterpart funding have weakened absorption capacity, leading to unutilized funds for some projects. Hence the program was rated *less than efficient.*

The ANR program was rated *less than likely sustainable* due to operations and maintenance (O&M) financing difficulties and an absence of capacity at the subnational level. The development impact was rated *less than satisfactory* because of the limited size of the investment, with thinly distributed benefits and the short-term nature of some investments.

The ADB transport program was rated *successful* overall. It improved vehicle access through the rehabilitation of roads, reduced logistics costs, and strengthened local capacity for community level planning. The program focused solely on roads, although it tried (unsuccessfully) to expand into ports, interisland connections, and multimodal transport. It consisted of seven sovereign loans and nine TA operations, with a total approved amount of $1.2 billion, a relatively modest 6.4% of the total ADB portfolio. Two of the projects involved rehabilitation and improvement of roads, three were part of multisector rural infrastructure projects using community-driven development (CDD) approach, and two were PBL projects. The PBL projects, amounting to 58% of the transport portfolio, were in the form of budget support and they promoted a policy and regulatory framework for improved connectivity and infrastructure development.

The transport program was rated *less than relevant* on design grounds because the program was skewed towards PBL projects, which had design deficiencies. The transport portfolio was relatively small as planned transport projects were often canceled, leading to differences between the planned and delivered portfolio. The program as approved was, however, rated *effective* as the projects achieved the objectives of improving vehicular access on strategic roads. The regional cooperation and integration objective was furthered through better road connections up to the border of Sabah and Sarawak, Malaysia. However, given the small portfolio, the contribution to improving the quality of national roads was limited and neither was there much contribution towards improving connectivity across islands. Completed projects were found to be economically viable but several project initiatives did not materialize, hence the portfolio did not expand in spite of the high government priority for this sector. The program is therefore rated *less than efficient*. Given the government's commitment to maintaining the quality of roads and the community involvement in O&M for the CDD projects, the program is rated *likely sustainable*.

The development impact of the transport portfolio was rated *satisfactory.* The CDD projects helped to strengthen local capacity for community planning and good governance and other projects contributed to a reduction in the share of logistics costs as a percentage of total production costs (from 27% in 2011 to 25% in 2016).

The ADB-supported program for water and other urban infrastructure and services (WUS) was rated *less than successful*. ADB support amounted to 3.0% of the overall portfolio and focused mostly on sanitation, given other development partners' presence in the water subsector. Three of the six ADB loans approved during the CAPE period were related to building new or rehabilitating existing wastewater treatment plants. The multisector Integrated Citarum Water Resources Management Investment Program MFF (the only one in Indonesia) was canceled after 10 years due to complexities and lack of progress, a disappointment given its implications for Jakarta's bulk water supply and the related continued excessive reliance on groundwater extraction leading to sinking of lands.

The WUS program was rated *relevant* since it was strategically well positioned due to its focus on sanitation. The program was rated *effective*. It produced knowledge products. Targets for access to water source and sanitation were achieved and wastewater treatment targets partially achieved. TA projects helped improve the financial performance of operators and the planning capacity of BAPPENAS.

The program was rated *less than efficient* since outcomes were affected by significant delays in all investment projects and most TA projects. The slow progress was mainly due to land acquisition issues, poor feasibility studies, and detailed engineering designs. Although ADB produced good analytical work, this did not translate well into CPS priorities. The sustainability of the WUS program was considered *less than likely*. Many city governments did not show strong ownership of investments in wastewater treatment plants. There was a lack of clarity in roles and responsibilities for O&M and pricing for connections. The CDD projects lacked financing mechanisms for O&M at the community level. Given the lack of clear policy and government leadership in the sanitation subsector, ADB could have played a more active role in leading the issue through policy dialogue.

The small social sector program was rated *less than successful*. The education program had insufficient focus on improving the quality of teaching and the health program was missing from the two most recent CPSs. The operations support for the social sectors amounted to $612 million (3.2% of the total portfolio). Four education projects were approved during the CAPE period. The Madrasah Education Development Project and the Vocational Education Strengthening Project were closed in 2014 and rated *successful*. The ongoing polytechnic education development project will close in 2019 after being extended once. The delays were due to project administration issues such as lack of familiarity with ADB procurement processes and late budget revisions. The projects generally suffered from start-up delays. The technical and vocational education and training projects spent substantial amounts procuring the latest equipment but were not successful in improving the quality of the faculty or the teaching.

Health sector interventions appeared in the CSP, 2006–2009 under the MDG acceleration program and the nutrition improvement program. However, no health sector investments were included in the CPS, 2012–2014 or the CPS, 2016–2019 as ADB did not receive a request from the government and the health sector was not among the core sectors of Strategy 2020. The nutrition improvement program was rated by the project completion report *less than successful*. Together the education and health programs were assessed *less than effective, less than efficient, less than likely sustainable,* and with *less than satisfactory* development impact.

ADB's Strategic Agendas

The evaluation found the contribution of ADB's program to inclusive economic growth *less than satisfactory* and the program design *less than relevant* in incorporating inclusive economic growth-related elements into the portfolio. The energy, transport, and ANR sector efforts were targeted at the poorer provinces and regions but the transport program was much smaller than usual for ADB. The PSM program did not incorporate sufficient specific actions related to fostering inclusive growth except for the Poverty Reduction and MDG Acceleration Program in 2007 which was truncated after the first of the three programs and the Fiscal and Public Expenditure Management Program in 2016, which supported the mainstreaming of SDGs into national planning. The inclusive economic growth impact of other sector programs was not substantial because they were very small, although households in remote and poorer areas were connected to electricity supply.

Efforts to improve financial inclusion have only been made recently with limited results. CDD approaches for rural infrastructure somewhat improved connections between poorer and richer regions, but on a limited scale.

The overall program design was *less than relevant* to the environmentally sustainable growth objective and the impact on environmentally sustainable growth was *less than satisfactory*, taking into account the prominence of the objective in the three CPSs. The programs in the WUS and ANR sectors were small. A lot of the intended urban program did not materialize. The canceled Citarum program failed to have a positive environmental impact on Jakarta, or on the quality of water in waterways. There were not many benefits from the application of ADB's safeguards policies as there were not many investment projects. Policy actions of the PSM policy-based loans did not directly address environmental and natural resource management issues. Some environmental impact was noticeable, mainly in the energy sector where the focus on energy efficiency though reductions in line losses and energy efficient appliances and renewable energy generation was geared to lowering carbon emissions. A contribution to the lowering of carbon dioxide emissions came through imports of hydropower from Malaysia and solar and wind energy infrastructure that displaced diesel-powered electricity. The environmental impact of wastewater treatment plants was positive but limited in significance.

ADB's work in Indonesia relating to the regional cooperation and integration agenda is considered *relevant* with *satisfactory* development impact. Energy transmission and road connections to the borders, as well as the improvement in port efficiency, are contributing to a greater volume of trade with the region. In the case of the finance sector, ADB supported improvements in the soft and hard infrastructure of the equity and bond markets, as well as in the banking system, to pave the way for the ASEAN financial integration.

ADB Thematic Priorities

Relevance and impact in terms of gender equity were *less than satisfactory*. Gender equity was not an explicit design feature in most programs and there were no specific interventions supporting gender equity until the end of the evaluation period. The improvements in energy, transport, and WUS, as well as the infrastructure developed in most CDD projects across all sectors, provided a better living environment for all, including women. The finance sector program considered gender equity in its financial inclusion work, but this came into focus only in 2015. In the case of the CDD projects, the resources devoted to them were small, and the degree of penetration in terms of percentage of villages supported was also small.

The relevance and development impacts of private sector development were *satisfactory*. ADB's support for policy reforms focused on removing obstacles for private sector development and putting in place appropriate policies, which had an overall *satisfactory* impact. The work on PPPs, procurement, insurance companies, mutual funds, finance companies, equity markets, the government bond market, the opening of opportunities in the energy and transport sectors, and the improvement in the viability of village entrepreneurs were all positive to some extent.

The relevance and development impacts of the ADB program's contribution to governance and capacity development were *satisfactory*. The impact was noticeable largely through PSM programs. The decentralization process is progressing with local governments increasing the shares of their revenues from their own sources. The audit function has been professionalized, and regional auditors have helped 76% of regional governments to be cleared by the Supreme Audit Agency, compared with only 3% in 2009. In the finance sector, OJK is now seen, both abroad and domestically, as a unified single regulator and supervisory agency that supported the financial system to weather external shocks, such as the global financial crisis and the gradual reduction in the United States' Federal Reserve's quantitative easing measures. Indonesia's finance sector regulation now follows world standards for the most part, including the Basel Accord, principles and standards of the International Association of Insurance Supervisors, and standards set by the

International Organization of Securities Commissions.

Overall Assessment

The overarching question of this evaluation was: to what extent did the ADB program in 2005–2018 contribute to more inclusive and environmentally sustainable growth in Indonesia? The evaluation concludes that the contribution of the ADB program to these objectives was limited. The program as it materialized was *less than relevant* to the strategic objectives of inclusive and environmentally sustainable growth and overall had *less than satisfactory* development impacts. The lack of relevance was mainly because new investment projects did not materialize in the sectors most relevant to these objectives, the infrastructure and social sectors. The subsidiary evaluation questions were: to what extent did the ADB program lead to (i) improved infrastructure services, (ii) improved economic governance, (iii) progress in developing human resources, (iv) better tackling of environmental challenges, and (v) finance sector deepening and increased access? The responses to these questions were mixed. While the program was satisfactory in improving economic governance and financial deepening, it was less so in other areas.

The evaluation rated the overall performance of the ADB Indonesia program during the CAPE period *successful on the borderline*. Table 6 in the main text, which is based on the Independent Evaluation Department's 2015 guidelines, provides the quantitative rationale for the rating.

ADB's contribution to improving infrastructure services was limited by the lower than anticipated amount of resources that could be committed, as well as by the limited success of the policy actions of PBL operations. Although the PSM program helped to improve subnational spending, there was little evidence of improvements in the quality of services. Support for PPP did not increase the number of PPP-funded projects, especially at the regional government level. Except for the energy program, which contributed to improved access to electricity in rural and urban areas, the rest of the sector programs contributed in a limited way to improvements in infrastructure services.

ADB's program had positive contributions in the area of economic governance. It helped establish a more conducive framework for macroeconomic stability and investment, strengthen subnational audit functions, improve the fiscal performance of the government-owned electricity corporation PLN, and establish OJK.

There was not much contribution to developing human resources, especially those of the disadvantaged. Subnational spending on both health and education sectors increased to more than 3% of GDP. However, the impact of these increases will depend on whether service quality and learning outcomes are prioritized.

The ADB program's contribution to addressing environmental challenges was limited as well. The environmental components of the program were in sectors that received small allocations. In the energy program, environmental components constituted only a small part. The PSM and finance programs that formed about 60% of the portfolio touched only marginally on the objective of environmental sustainability.

ADB made a notable contribution to the financial sector supervisory framework but access to and depth of financial services improved only slightly. Progress in financial deepening was hampered to some extent by cultural preferences, for example a tendency to borrow from closed groups, as noted by the World Bank's Findex data. The benefits and risks of insurance contracts are not widely understood.

The report benefitted from feedback received from key authorities during the consultation mission conducted on 26–27 September 2019. The consultations have confirmed the findings, issues, and recommendations offered by it in general and key stakeholders have expressed their appreciation for the support of ADB.

Lessons

ADB's support is effective when a country has strong ownership of the ADB program and when operations are grounded on a deep understanding of the country's realities, geography, diversity, cultural factors, legal system, and preferences. In Indonesia, programs where there was government ownership and where implementation capacity was strong moved ahead steadily (e.g., improvements in the audit function). By contrast, efforts to stimulate the municipal bond market are taking a long time to show results. Governance improvements at the local level are only possible when there is adequate capacity, and this has to be ensured before moving forward with reforms. Most PSM reforms in Indonesia assumed a civil service incentive system, that is still awaiting a much-needed reform. These problems are also seen in other sectors, most notably health and education, where ADB's assumptions about capacity were not well-grounded in civil service reform. The very strong Indonesian culture of social and family solidarity also posed a challenge to traditional products in the insurance and pension industries. A deeper insight into these areas is needed to develop financial products that would work.

Sustained demand for ADB support is more likely if ADB can build on progress made in previous projects, including the relationships that were established in the process. In the case of PSM, ADB established a good working relationship with provinces and large cities and this gave it a comparative advantage. However, ADB needs to be prepared to replicate this level of knowledge and innovation in other areas too. When this does not happen, as was the case in the WUS program, inconsistencies can arise between the national and the subnational level, leading to subnational governments losing interest.

Working with national state-owned enterprises (SOEs) on infrastructure projects is an attractive option given the difficulties of working with subnational governments with limited capacities. Working with SOEs helps speed up the process since it involves fewer approvals and can be an effective way of proceeding until insufficient project readiness and related issues are resolved. ADB was able to go forward with only a few infrastructure projects, most importantly those run by SOEs (e.g., PLN). Moreover, SOEs can make the necessary arrangements to ensure sufficient resources are made available for O&M.

The CDD approach was a cost-effective way of delivering small, community-based projects to build soft and hard infrastructure at the village level. Cost-efficiency was achieved by engaging local facilitators with hands-on guidance by consultants (using a train-the-trainer approach). By empowering villagers, including women, and involving them in different phases of the project, these operations delivered strong results. Aside from improving their livelihoods, the CDD project allowed these communities to address their physical infrastructure needs, while improving the way they interacted with their environment, including forests and coral reefs. Although community involvement boosted the likelihood that infrastructure would be maintained properly, not all these projects had well-defined arrangements for financing post-project O&M. In addition, performance was better in those projects where the government and ADB tried to target measurable results and gather enough data to assess their achievement. Another success factor was the quality and commitment of the facilitators, suggesting that taking special care in their selection, and providing them with appropriate training and advice will enable them to face any contingencies.

Lack of coordination between national and regional planning levels can affect project implementation. For instance, areas such as water and sanitation that are central to public health are left to city governments, but these do not always show the amount of interest that this issue deserves and often do not have the political will to move forward with the projects. This has affected the land acquisition process, which is the domain of the local governments, leading to inefficiencies in implementation.

Issues

The challenges to inclusive and environmentally sustainable growth in Indonesia remain significant. Income distribution worsened during most of the evaluation period, as did disparities between different provinces and regions. Youth unemployment has been gradually increasing, highlighting the urgent need for significant work on the economic growth model that Indonesia is developing and that may include an industrial policy and absorption of young people into the workforce. Indonesia's environmental resources such as the rainforest and its large biodiversity are being damaged by the country's growth process. Disasters from natural hazards have been more damaging and frequent than in the past. Given this, it is essential that the CPS, 2020–2024 for Indonesia incorporates the operational priorities under ADB's Strategy 2030, including: addressing poverty and inequalities through improved access to opportunities, quality jobs, education, health care and social protection; accelerating progress in gender equality; and tackling climate change and disaster resilience and environmental sustainability.

Subnational governments have limited capacity for project preparation and implementation. Decentralization has shifted implementation responsibilities to lower levels of government, but the weak capacity of regional government staff to address financing of projects (including alternative financing such as PPPs), and technical preparation, have been challenges to infrastructure development. Coordination problems can arise due to the multiplicity of agencies with overlapping functions and oversight, across national, provincial, district, and lower levels. This can become an obstacle for ADB to work effectively in the infrastructure projects that will be essential to connect the lagging regions with the most prosperous ones. Given that ADB's Strategy 2030 prioritizes strengthening the quality and capacity of public institutions for a country's development, this gains importance in the forthcoming CPS for Indonesia.

ADB's extensive use of PBL, while responsive to government requests and useful in supporting government budgets and needed policy reforms, did not produce the much-needed capacity development and institutional strengthening. This was one of the reasons for the weak contributions of PBL operations to achieving the CPS goals. ADB investment projects need adequate safeguards against low implementation capacity if they are to make a greater contribution to development effectiveness.

Many of ADB's planned infrastructure investment projects failed to materialize or ran into significant implementation problems. This was partly because of project readiness issues involving land acquisition problems, discrepancies with the country systems, and the poor quality of detailed engineering design. As a result, sector resource allocations did not follow the spirit of the main objectives defined in the country strategies. Most sector programs did not materialize as planned, with slow start-ups and large proportions remaining unutilized. While allocations to PSM and the finance sector were high, and the objectives of improved governance and financial deepening with access were more than adequately covered, ADB allocations to develop infrastructure, improve human capital, and address environmental challenges were low. Many of the projects identified for support through the COBPs had to be dropped, partly because they did not meet the project readiness conditions of the government that (i) land must be acquired, (ii) resettlement and environment safeguards approvals have to be in place, and (iii) detailed engineering design have to be approved before loan negotiations.

The design of results frameworks was weak at both the strategy and the program levels in several sectors. The absence of credible and useful indicators weakened ADB's ability to monitor and evaluate the program. Often, outcome indicators in both the strategy and program documents were too optimistic or did not reflect the government's or ADB's actions. While PBL can be a good tool to support reform programs, especially within a programmatic framework, its effectiveness needs to be assured by hands-on implementation support through TA projects and strong backing from analytical work to establish a clear link between policy actions, outputs, and outcomes.

Based on the issues discussed above, the following are recommendations to ADB. They take account of the need for the Indonesia CPS, 2020–2024 to cater to Indonesia's medium-term plan expected priorities for 2020–2024 and are aligned with ADB's Strategy 2030 operational priorities. ADB should:

Strategic Recommendations

Recommendation 1. Focus on boosting Indonesia's path to inclusive growth and environmentally sustainable and climate resilient growth, two of its most pressing development challenges, in the context of high inequality and growing environmental challenges. Rebalancing ADB's policy-based and investment-related support should also help the government address the income inequalities across households and between different provinces and regions. ADB should help Indonesia adjust the economic growth model, respond to environmental degradation, and make gender equity a more explicit feature in its assistance programs.

Recommendation 2. Strengthen local government capacity by working selectively with provinces, districts, and large cities to enable local governments to provide support for infrastructure development in various sectors. ADB should pursue a phased approach by focusing on selected provinces to simplify oversight and to enable it to scale up after learning from experience. Developing capacity for project preparation and implementation is best done through investment projects and by building on relationships from previous projects.

Operational Recommendations

Recommendation 3. Tackle project readiness issues and offer better and more innovative project designs to improve the quality and implementation of ADB-supported investment projects. ADB should accelerate the harmonization of procurement guidelines between ADB and government systems and provide more hands-on assistance on resolving safeguard issues, given the continuing differences between government and ADB social safeguard policies. ADB should improve the capacity of executing agencies to prepare detailed engineering designs, give good project estimates, carry out government procurement, and apply safeguard systems, so its projects can meet the government's project readiness conditions.

Recommendation 4. Diversify financing modalities, to ensure that policy reforms supported by PBL are complemented by other modalities, including RBL and investment projects, to achieve the targeted development outcomes. ADB should sequence reforms supported by PBL or RBL carefully and complement them with other instruments or modalities to provide appropriate capacity development and institutional strengthening and to ensure the effectiveness of ADB strategies.

Recommendation 5. Improve the framing of operations by providing strong analytical underpinnings and results frameworks to support policy reforms and capacity building and institutional strengthening. There is a continuing need for reforms, given the need to tackle persisting critical constraints such as low levels of productivity, lack of competitiveness, and limited human capital. Reforms need to be based on sound diagnostics and analytical foundations, based on in-depth knowledge work. ADB should provide knowledge services with a wider reach, going beyond supporting projects.

Link Between Findings and Recommendations

Issues	Recommendations
Income distribution worsened during most of the evaluation period, as did disparities between different provinces and regions. Youth unemployment has been gradually increasing, highlighting the urgent need for significant work on the economic growth model that Indonesia is developing and that may include an industrial policy and absorption of young people into the workforce. Indonesia's environmental resources such as the rainforest and its large biodiversity are being damaged by the country's growth process. In addition, disasters from natural hazards have become more damaging and more frequent. See paras. 15, 21, 25, 28, 203, and 214.	**Recommendation 1.** Focus on boosting Indonesia's path to inclusive growth and environmentally sustainable and climate resilient growth, two of its most pressing development challenges, in the context of high inequality and growing environmental challenges.
Subnational governments have limited capacity for project preparation and implementation. This is a problem as decentralization has shifted implementation responsibilities to lower levels of government. The limited capacity of regional government staff to address financing (including alternative financing such as public–private partnerships), and technical preparation, constrain infrastructure development. Coordination problems have arisen due to the multiplicity of agencies with overlapping functions and oversight, across national, provincial, district, and lower levels. This has been an obstacle for Asian Development Bank (ADB) as it tries to prepare and implement the infrastructure projects that are essential to connect the lagging regions with the most prosperous regions. See paras. 26, 80, 85 and 265.	**Recommendation 2.** Strengthen local government capacity by working selectively with provinces, districts, and large cities to enable local governments to provide support for infrastructure development in various sectors.
Many of ADB's planned infrastructure investment projects failed to materialize. This was due to project readiness issues involving land acquisition problems and the poor quality of the detailed engineering design. As a result, sector resource allocations did not follow the spirit of the main objectives defined in the country strategies. Most sector programs did not materialize as planned, with large proportions of unutilized funds. While allocations to public sector management and the finance sector were high, and the objectives of improved governance and financial deepening with access were more than adequately covered, the allocations to develop infrastructure, improve human capital, and address environmental challenges were low. Many of the projects identified for support through the country operations business plans had to be dropped partly due to difficulties in meeting conditions of the government that (i) land must be acquired, (ii) resettlement and environment safeguards approvals must be in place, and (iii) the detailed engineering design must be approved before loan negotiations. See paras. 23, 66, 72, and 182.	**Recommendation 3.** Tackle project readiness issues and offer better and more innovative project designs to improve the quality and implementation of ADB-supported investment projects.
Extensive use of policy-based lending (PBL), while useful in supporting needed reforms, did not produce the much-needed capacity development and institutional strengthening. This was the reason for ADB operations not achieving its country partnership strategies' goals. Given the weak financial management of several executing agencies and local governments, and the less than ideal harmonization of procurement systems, ADB investment projects need adequate safeguards against low implementation capacity if they are to make a greater contribution to development effectiveness. See paras. 82, 153, and 279.	**Recommendation 4.** Diversify financing modalities, to ensure that policy reforms supported by PBL are complemented by other modalities, including results-based lending and investment projects to achieve the targeted development outcomes.
The design of results frameworks was weak at both the strategy and the program levels in several sectors. The absence of credible and useful indicators weakened ADB's ability to monitor and evaluate the program. Often, outcome indicators in both the strategy and program documents were too optimistic or did not reflect the government's or ADB's actions. While PBL can be a good tool to support reform programs, especially within a programmatic framework, its effectiveness needs to be assured by hands-on implementation support through technical assistance and strong backing from analytical work to establish a clear link between policy actions, outputs, and outcomes. See paras. 41, 78, 118, 158, 258, and 270.	**Recommendation 5.** Improve the framing of operations by providing strong analytical underpinnings and results frameworks to support policy reforms and capacity building and institutional strengthening.

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Country Context, Evaluation Scope, and Methodology

Highlights:

- Indonesia is the world's fourth most populous country spread over an archipelago of more than 17,000 islands, making communications and delivery of goods and services a challenge.
- The Asian financial crisis triggered deep reforms including the transfer of responsibilities and resources to local governments along with broader efforts to strengthen governance.
- Economic growth is based on a few sectors with incomes determined to a large extent by commodity prices. Services and trade accounted for 46% of employment, agriculture for 32%, and industry for 23%.
- In 2003, Indonesia introduced a fiscal rule limiting budget deficits to less than 3% of gross domestic product. Since the rule was introduced, the external public debt has been kept to manageable levels.
- The poverty rate declined from 16.6% in 2004 to 9.8% in 2018 but the Gini coefficient rose from 0.31 in 1999 to 0.41 in 2011 before declining to 0.39 in 2017. Indonesia ranks 116 in the United Nations Development Programme's gender inequality index.
- Major challenges for Indonesia include: infrastructure bottlenecks, skill shortages, shallow capital markets, limited financial inclusion, ineffective service delivery for a rapidly urbanizing economy, and weak natural resource and environmental management.
- The evaluation questions are anchored on a theory of change which links program outcomes (reducing critical constraints) to the country partnership strategy objectives of higher, inclusive and environmentally sustainable growth.
- The overarching evaluation question is: to what extent did the Asian Development Bank (ADB) program in 2005–2018 contribute to more inclusive and environmentally sustainable growth? The subsidiary evaluation questions were, to what extent did ADB support lead to: (i) improved infrastructure services, (ii) better economic governance, (iii) progress in developing human resources, (iv) better tackling of environmental challenges, and (v) finance sector deepening and increased access?

A. Country Background

1. **With more than 17,000 islands, Indonesia is the world's largest archipelago and the fourth largest country by population.** Geographic dispersion of the population makes communication and the delivery of goods and services difficult. While some islands, such as Java and Sumatra, have a well-developed communications and transport infrastructure, the same does not hold for the more remote islands. In many of these the presence of the Indonesian state is not strongly felt, and standards of service are not as high as in the more populated and developed islands. In 2017, Indonesia's values in the United Nations Development Programme (UNDP) human development index ranged from just over 59 in the poorest regions to just over 80 in the most affluent.

2. **Indonesia's population grew from 235 million in 2005 to 265 million in 2018**. The population inhabits about 6,000 of the country's more than 17,000 islands and is made up of more than 300 distinct ethnic and linguistic groups. The largest and most dominant group is the Javanese (45% of the population), followed by Sundanese (14%), Madurese (7.5%), coastal Malays (7.5%), and others (26%).[1] Bahasa Indonesia, a form of Malay, is the official language and is used in education, the media, and day-to-day transactions. However, according to some estimates, there are more than 700 languages spoken in Indonesia,[2] with most people using a local language as their primary language. The diversity of linguistic groups is compounded by the point made in the Independent Evaluation Department's (IED) 2005 country assistance program evaluation (CAPE): "many of the poor are not fluent in the national language"[3] (footnote 1, para 154). In addition, the illiteracy rate varies widely by provinces—Indonesia's

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1 Operations Evaluation Department. 2005. *Country Assistance Program Evaluation Indonesia, 1990–2004*. Manila: ADB.
2 http://worldpopulationreview.com/countries/indonesia-population/
3 The CAPE further noted that "the great majority of the rural population have weak or non-existent English language skills."

statistics bureau (Badan Pusat Statistik [BPS]) found in its 2016 survey that illiteracy among the age group 15–59 ranged from 0.1% in the more affluent provinces to 29.0% in the poorest.

3. **Many Indonesians turn to their social groups for support when in need of credit or when facing a crisis, and willingly contribute when others in their group need financial support**. The World Bank Findex Survey of 2017 found that, while 21.5% of Indonesians older than 15 years saved in a financial institution, 29.9% of them did so in a group of family or friends. Also, 17.2% obtained loans from a financial institution, while 54.8% received loans from family or friends. Moreover, a 2014 BPS survey on the level of satisfaction with 10 aspects of life showed that family harmony ranked highest across Indonesia, with social relations coming in as the third most important. In these respects, Indonesia is different from most of its neighboring and peer countries, with demonstrated preferences that may hinder a complete move toward a Western way of finance. About 10% of the population are members of financial cooperatives that are not regulated or overseen by the financial authorities and that are held in closed groups, a percentage that is high by comparison with Indonesia's peers.[4]

4. **The Asian financial crisis of the late 1990s hit Indonesia especially hard, propelling deep transformations**. Not only was there a deep economic crisis that saw real economic activity decline dramatically, with soaring inflation and a significant weakening of the rupiah, the political and institutional setting also went through a deep transformation process. The collapse of the Suharto regime in 1998 led Indonesia into a more democratic, decentralized, and transparent political system.[5] While the transition led to initial political instability as well as to tensions and disturbances in several regions,[6] the country gradually moved to a new, more inclusive system, where most institutions and systems of the past were revisited and redefined, including systems for public governance, the powers of regional (provincial, district and city) governments, and the roles of the institutions that were at the core of the financial crisis. Today, Indonesia has a stable, multi-party democracy, and decentralized public sector management (PSM) with a national government, 34 provincial governments, and 514 district administrations. The crisis also strained the relationship between external development partners and Indonesia, leading to a redefinition of their roles and of how the government interacted with them. The government now demands a much stronger sense of ownership in each of its policy agreements.

B. Macroeconomic Developments

5. **Indonesia is the largest economy in Southeast Asia and was the seventh largest economy in the world in purchasing power parity in 2017.** It has been growing steadily since the Asian financial crisis. With a per capita gross national income (GNI) of $3,540 in 2017, Indonesia is classified as a lower middle-income economy.[7] Economic growth declined from 6.4% in 2010 to a low of 4.9% in 2015, but it has picked up gradually since then, reaching 5.2% in 2018. Indonesia's services sector has grown considerably, with its share of the gross domestic product (GDP) increasing from 40.3% in 2005 to 46.6% in 2015. The manufacturing sector share declined from 46.5% of GDP in 2005 to 39.9% in 2015 due to a loss of competitiveness following a sharp appreciation of the currency and high logistics and trade costs. Several other factors affected the manufacturing sector, including a lack of sophistication and diversity in the product mix,

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[4] Another example is the general belief that an insurance contract provides no services, a belief that starts at the highest level of Indonesian society.

[5] President Soeharto stepped down in May 1998, after holding power for 32 years.

[6] Indonesia had five presidents between 1998 and 2004. According to Country Strategy and Program, 2003–2005, the regions facing security challenges included Timor, Aceh, central and west Kalimantan, the Moluccas, Papua (then Irian Jaya), and Central Sulawesi (ADB. 2002. *Country Strategy and Program: Indonesia, 2003–2005*. Manila).

[7] The World Bank classifies economies with a GNI per capita, Atlas method (current United States dollars) between $996 and $3,895 in 2017 as lower middle-income economies.

resulting in low comparative advantage for exports. There has been a lack of consistent and cohesive industrial policy since 1966 and vocational, technical and higher education has been poor.[8] The agriculture sector remained at 13% of GDP during the period.[9]

6. **Economic growth is based on developments in a few sectors.**[10] Incomes are determined to a large extent by commodity prices. The central government is trying to reduce Indonesia's reliance on raw commodity exports by increasing the role of manufacturing in the economy. Agriculture remains a major source of employment for Indonesian workers, although its share in total employment declined steadily from about 44% in 2000 to 32% in 2016, and to about 29% in 2018. Services and trade combined accounted for 48% of employment in 2018.[11] Employment in industry increased to about 23% of total employment in 2018 from about 17% in 2000. The manufacturing employment share has been increasing over time, reaching 15% in 2018. Increasing the share further may be difficult because of slowing global growth and the increasing trend for automation of manufacturing process. Upgrading human capital through science, technology, engineering and mathematics, and vocational training is among the government's top priorities for boosting the manufacturing sector.

7. **Indonesia's economy has evolved toward a structure with heavy concentration in large corporations coupled with a very significant share of small and medium-sized enterprises (SMEs).**[12] In 2013, SMEs accounted for 99% of the total number of enterprises in Indonesia, contributing about 97% of job creation and 59% of GDP.[13] One important consequence of the Asian financial crisis was the steep increase in public ownership of large firms. The International Monetary Fund (IMF) reports that "in 2016, total state-owned enterprises (SOEs) assets amounted to 51 percent of GDP and total SOE liabilities to 33 percent of GDP."[14] The Asian Development Bank's (ADB) IED's 2005 CAPE noted that: "before the crisis, the private sector in Indonesia accounted for 60%–70% of GDP. After the crisis, the percentage fell to a low 30% in 2000 before climbing back to 40% by 2003" (footnote 1, para 120).

8. **In the wake of the Asian financial crisis, and concurrent with efforts to frame monetary and exchange rate policies in a way that is conducive to prudent macroeconomic management, in 2003 Indonesia introduced a fiscal rule that limited fiscal deficits to 3% of GDP.** This yielded mostly primary fiscal surpluses, which have reduced the ratio of external public debt to GDP to more manageable levels. Judicious fiscal policy has been at the heart of restoring macroeconomic stability. During the initial phase following the Asian financial crisis, macroeconomic policies, under an IMF arrangement, kept fiscal consolidation and monetary policy in check.[15] As a result, by mid-2002 inflationary pressures had eased, and the exchange rate had rebounded from the impact of political uncertainties and slower world growth. Moreover, external public debt declined from 103% of GDP in 1999 to 60% in 2004 and to 34% by 2017 (footnote 14).

9. **Indonesia's credit ratings were upgraded by international rating agencies in response to its prudent fiscal management, low public debt, and resilient economic growth**. Net foreign

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[8] Asian Development Bank and BAPPENAS. 2019. *Policies to Support the Development of Indonesia's Manufacturing Sector during 2020–2024*. Jakarta.

[9] https://www.adb.org/sites/default/files/publication/371316/adbi-wp783.pdf

[10] Coal mining, palm oil, extractive industries, Bali tourism, and luxury property.

[11] https://www.bps.go.id/

[12] In Indonesia, small enterprises are those with annual sales between $23,000 and $192,000, and assets between $3,800 and $38,000. Microenterprises are the ones falling below those thresholds.

[13] International Labour Organization (ILO) and Organisation for Economic Co-operation and Development Workshop for Policy Makers on Productivity and Working Conditions in SMEs, Jakarta, 13 June 2017 (presented by I. Wayan Dipta, Deputy Ministry for Production and Marketing, Ministry of Cooperatives, and SMEs).

[14] IMF. 2018. Indonesia*, Staff Report for the 2017 Article IV Consultation*. Country Report 18/32. Washington, D.C.

[15] Indonesia graduated from IMF programs in 2003.

direct investment (FDI) inflows, which had fallen after the start of the Asian financial crisis in 1997, started rising in 2004, reaching 2.8% of GDP in 2014 and 2.1% in 2017.[16]

10. **After years of limited fiscal space and low development spending, since 2015 the government has prioritized infrastructure development, and the infrastructure budget has grown.** Underspending is not good for a country that is trying to reduce joblessness, poverty, and hunger and would slow down the provision of better infrastructure and appropriate social protection programs for the poor. Following the weakening of commodity prices, the government implemented several structural reforms, including fuel subsidy cuts in 2015. These reforms released funds for programs directly impacting the poor through an expansion of social assistance programs.[17] In recent years, fuel subsidies have risen again due to the rise in global crude oil prices and political pressures surrounding the 2019 presidential elections, although the subsidy amount continues to be significantly below pre-2015 levels.

11. **The rupiah weakened in 2018 mostly because of monetary tightening by the United States Federal Reserve and weaker commodity prices.** During the 2007–2008 financial crisis the rupiah came under pressure with palm oil and rubber prices falling from their peak. Despite Bank Indonesia spending its reserves to defend the currency, the rupiah slipped past the 11,000 mark to the US dollar toward the end of 2008. Subsequently, a cut in the Federal Reserve rate to 0.25% saw the rupiah strengthen slightly. As of September 2018, the rupiah fell to its weakest position since the Asian financial crisis of 1997–1998, with Rp14,880 to the US dollar. Bank Indonesia uses a mix of measures as appropriate to sustain the increased pressure of foreign capital flows, including through the Bank Indonesia policy rate. Large foreign exchange reserves and prudential fiscal management prevented the currency from sliding too low. Inflation has remained around 3% per year.

12. **Indonesia's balance of payments turned negative in 2018, a development that is expected to be temporary.** Since 2012, the worsening current account balance has led to deficits of about 2%–3% of GDP (footnote 9). These are largely due to imports of manufactured goods driven by increased demand as a result of rising per capita income and lack of a strong domestic manufacturing sector. This deficit can be covered either through borrowing or by compensating by increases in surpluses from non-manufactured goods (e.g., services, minerals, and food). The current account deficit widened to 3% of GDP in 2018, mainly due to higher infrastructure-related imports combined with lower commodity exports. In addition, financial flows were negative on account of net portfolio outflows and lower FDI flows. The IMF expects these imbalances to turn positive over the medium term.

13. **The government has implemented several reform packages to boost growth and improve the business environment in recent years**. Some 16 economic packages have worked on streamlining regulations and strengthening productivity and competitiveness. Improvements have been made to the FDI regime, as well as to the minimum wage. Business registration has been simplified, and a single window has been established to ease import and export permits. As a result, Indonesia's position in the World Bank's Doing Business ranking improved from 106 in 2016 to 72 in 2018.

[16] http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators

[17] IMF, footnote 15, mentions that "The authorities have increased public infrastructure spending by 1 percent of GDP between 2014 and 2017, and improved the institutional framework by establishing the Committee for Acceleration of Priority Infrastructure Delivery (KPPIP) and expediting land acquisition procedures" (para. 24).

C. Poverty, Inequality, and Social Development

14. **Reflecting the impact of the Asian financial crisis and the government's response to it, the poverty rate increased from 14.7% in early 1997 to 23.5% in early 1999, gradually declining thereafter to 16.6% in 2004 and 9.8% in 2018.** [18] Despite this improvement, rural poverty remains a challenge, as does public health. Indonesia is classified by UNDP as a medium human development country,[19] with a human development index value that has gradually improved from 0.606 in 2000 to 0.694 in 2017. Progress in the achievement of the Millennium Development Goals (MDGs) has been uneven.[20] Between 2005 and 2015, infant mortality declined from 28 per thousand live births to 22; births attended by skilled professionals increased from 71% to 92%; the proportion of the population using improved drinking water sources increased from 48% to 71%; the proportion of the population with improved sanitation facilities increased from 37% to 62%. However, the maternal mortality ratio did not improve much. Maternal deaths per 100,000 live births even increased from 268 in 2005 to 305 in 2015 against a target of 98; and one in three children under 5 years of age still suffers from chronic malnutrition despite rising economic growth and falling poverty.[21] In 2013, 37% of children aged 5 years and under were stunted and 12% of children were wasted. In 2015, the incidence of stunting had reduced to 29%, while wasting remained at 12%.

15. **Reducing income inequality from its current high level remains a key challenge.** Inequality in expenditure as measured by the Gini coefficient rose from 0.31 in 1999 to 0.41 in 2011 and stayed close to that level until 2015 before slightly declining to 0.39 in 2017.[22] There is unequal ownership of financial and other assets and unequal access to education and other social services. Of the poorest 40% of Indonesian households, only 27% have savings in a formal financial institution and only 21% receive credit from formal institutions. Inequality in opportunity is large, especially between the rural and urban areas, with the urban areas doing considerably better.[23] Regional income disparities are widening due to uneven economic growth across provinces. Indonesia is urbanizing rapidly; more than half of the population now lives in urban areas, with up to two-thirds projected to live in urban areas by 2035.

16. **Indonesia ranked behind the Philippines and Viet Nam in the UNDP gender development index in 2017.** Its human development index for females is below that of males (Table 1). Indonesia's rank in the gender inequality index is 116, against 113 for the Philippines, 57 for Malaysia, 116 for Viet Nam and 83 for Thailand. While 44.5% of women aged 25 and older have at least secondary education, the percentage for men is much higher at 53.2%. Similarly, the female participation rate in the workforce, at 50.7%, is well below that of men (81.8%) and is low compared with countries with similar levels of development. For example, Thailand, classified as a middle-income country, has a female labor force participation rate of 64.3% and Viet Nam 73%.[24] In addition, women face unequal treatment in the labor market, and are relegated for the most part to low-skilled, low-paying jobs. While some progress was made over 2005–2018, women are also lagging in their participation in high levels of economic and political decision

[18] See footnote 1, para. 17. Also, Statistics Indonesia: https://www.bps.go.id/dynamictable/2016/08/18/1219/persentase-penduduk-miskin-menurut-provinsi-2007---2018.html#

[19] Other countries in the region classified by UNDP as medium human development countries include India, the Philippines, Timor Leste, and Viet Nam.

[20] ASEAN Secretariat. 2017. *ASEAN Statistical Report on Millennium Development Goals 2017*. Jakarta. https://asean.org/storage/2012/05/ASEAN_MDG_2017.pdf

[21] World Bank. 2018. *Aiming High: Indonesia's Ambition to Reduce Stunting*. Washington, D.C.

[22] https://www.bps.go.id/dynamictable/2017/04/26/1116/gini-ratio-provinsi-2002-2018.html

[23] World Bank. 2015. *Indonesia Systemic Country Diagnostic: Connecting the Bottom 40% to the Prosperity Generation*. Washington, D.C.

[24] https://www.monash.edu/business/cdes/research/publications/publications2/Womens-economic-participation-in-Indonesia-June-2017.pdf

making. Perceptions of gender roles hinder health education, resulting in high maternal mortality ratios and abortion rates.

Table 1: Gender Development Index (2017)

HDI Rank	Country or Area	GDI	Human Development Index		Life Expectancy at Birth (years)		Mean Years of Schooling	
			Female	Male	Female	Male	Female	Male
7	Hong Kong, China	0.965	0.916	0.949	87.1	81.2	11.6	12.5
9	Singapore	0.982	0.922	0.939	85.2	81.1	11.0	12.1
39	Brunei Darussalam	0.990	0.846	0.854	79.1	75.8	9.0	9.1
57	Malaysia	0.976	0.791	0.810	77.9	73.3	10.0	10.3
83	Thailand	0.996	0.753	0.756	79.3	71.8	7.4	7.8
113	Philippines	1.000	0.699	0.698	72.8	65.9	9.5	9.2
116	**Indonesia**	**0.932**	**0.666**	**0.715**	**71.6**	**67.3**	**7.5**	**8.4**
116	Viet Nam	1.005	0.696	0.692	81.0	71.8	7.9	8.5
East Asia and the Pacific		**0.957**	**0.717**	**0.750**	**78.7**	**72.8**	**7.6**	**8.3**

GDI = gender development index, HDI = human development index, PPP = purchasing power parity.
Source: United Nations Development Program and team calculations.

D. Environmental Sustainability, Climate Change, and Disaster Resilience

17. **Indonesia has abundant environmental resources, but these are under stress due to the country's growth process.** Indonesia has the world's third largest area of rainforest after the Amazon and Africa's Congo Basin, and Indonesian rainforests are home to some of the highest levels of biological diversity in the world—they contain 10% of the world's known plant species, 12% of mammal species, and 17% of all known bird species.[25] Yet Indonesia is reported to have lost up to 80% of its original forest habitat and continues to lose rainforests to deforestation practices, some of them illegal. The average annual deforestation rate is now believed to have reached 2 million hectares (ha) to 2.5 million ha, and about half of the remaining forests are threatened. Between 2011 and 2018, a total of almost 25 million ha of tree loss has been registered of which 9.2 million ha was primary forest covers.[26] By 2018, it was estimated that Indonesia had 143 million ha of tree cover and ranked with Nigeria, Sudan, Papua New Guinea, and Brazil as the countries most adversely affected by deforestation.[27] The drivers of deforestation are illegal logging, forest conversion for agricultural use, forest fires, and mining.

18. **Indonesia accounts for a large part of the Coral Triangle,[28] which is home to three-fourths of the world's coral species and contains over a third of the world's coral reef fish species, and over half of those in the Indo-Pacific region.** Indonesia's marine resources have also faced overexploitation and poor practices, with over half of the coral reefs having been degraded.[29] The marine area of 580 million ha has the potential to provide a yearly harvest of 9 million tons of high value produce such as tuna, shrimp, seaweed, and pearl. However, some 70% of the nation's coral reefs are moderately to severely damaged and threatened by destructive fishing practices. The highest volume of marine capture fisheries production was recorded for 2013 at 5.7 million tons, while that of inland open water capture fisheries production in 2013 was 0.40 million for a total of 6.1 million tons. Despite an abundance of coastal resources, more than 53% of coastal families are living below the poverty line. Many coastal regions have degraded their mangrove forests, which are essential for fish hatching, while fish catch has exceeded sustainable

[25] Rainforest Action Network: https://www.ran.org/indonesia_s_rainforests_biodiversity_and_endangered_species/
[26] https://rainforests.mongabay.com/deforestation/archive/Indonesia.htm
[27] https://en.wikipedia.org/wiki/Deforestation_in_Indonesia
[28] Other countries in the Coral Triangle are Malaysia, Papua New Guinea, the Philippines, the Solomon Islands, and Timor Leste. See WWF, https://wwf.panda.org/knowledge_hub/where_we_work/coraltriangle/coraltrianglefacts/
[29] F. Sidik. 2017. *Biodiversity Indonesia.* Jakarta.

levels. The government, especially the Ministry of Marine Affairs and Fisheries, has been increasing the size and number of protected areas.

19. **In urban and industrial areas, domestic sewage, industrial effluents, agricultural run-off, and mismanaged solid waste are major sources of surface and ground water pollution**. Indonesia has one of the lowest rates of sewerage and sanitation coverage in Asia. This has led to repeated local epidemics of gastrointestinal infections. Only half of the population has on-site sanitation (e.g., septic tanks), which is generally poorly maintained, and only 1% of the population is covered by an urban sewerage system. As for the potable water supply, almost 64% of the urban population is not covered by piped water. Jakarta is reliant to a significant extent on groundwater as source for water supply; gradual depletion of this resource is leading to the sinking of Jakarta, which is already at very low levels. The city sinks by 1 meter every 5 years, and many areas are below sea level. The risk of flooding is increasing. The government has announced the construction of a new capital in part as a response to this. Pollution in urban and industrial areas stems from increasing traffic and industrial processes, which have worsened air quality.

20. **Natural hazards are exogenous factors that impact ADB programs in Indonesia.** Over 2005–2018, Indonesia faced several earthquake-related disasters: an earthquake in Sumatra in March 2005; another earthquake in Yogyakarta in 2006, as well as one in Pangandaran; an earthquake in Padang in 2009; and the Lombok and Sulawesi earthquake that triggered a tsunami. On top of these, Indonesia endured medium-level disasters every year of the evaluation period, including volcanic eruptions, earthquakes, tsunamis, and floods. Following the tsunami that devastated Aceh and North Sumatra in 2004, Indonesia worked to develop a structured approach to improve its response to disasters. Key elements of this approach are the Law 24 of 2007 on Disaster Management, as well as the establishment of the National Disaster Management Agency (Badan Nasional Penanggulangan Bencana) to serve as a focal point to coordinate the government's response to disasters. Indonesia has also developed a disaster database and risk maps. Although the most visible natural disasters were those relating to earthquakes (with tsunamis) and volcanic eruptions, about 70% of the disasters that impact Indonesia are in fact hydro-meteorological.[30] Coastal, river, and urban flood hazards are classified as high risk (i.e., potentially damaging and life-threatening river floods are expected to occur at least once in the next 10 years). Landslide risk is classified as high (i.e., rainfall patterns, terrain slope, geology, soil, and land cover make localized landslides common).[31]

21. **Climate change poses a major threat to Indonesia's ecosystem.** It is estimated that a global temperature increase of 1 Celsius has the potential to modify the functioning and composition of Indonesia's rainforests, with devastating effects on their biodiversity. Risks of forest fires go up as temperatures increase. Tropical rainforests typically receive over 100 inches of rain a year, but each year this amount decreases, creating a chain effect of consequences.[32] In addition, increases in sea surface temperature and water chemistry are contributing to coral bleaching, and to coral death. Sea level rise poses a major threat to mangrove ecosystems through sediment erosion, inundation stress and increased salinity at landward zones.[33] Beyond the impact on the ecosystem, monsoons, rising sea levels, and sinking and collapsing lands due to the depletion of groundwater pose a major challenge for Indonesians, considering that some 22% of the population lives on the coast, and about 60% on coastal plains.

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[30] A. Wibowo, I. Surbakti, and R. Yunus. 2013. *Indonesia Disaster Database*. Jakarta.
[31] https://www.thinkhazard.org
[32] https://www.cbd.int/doc/bioday/2007/ibd-2007-booklet-01-en.pdf
[33] J. Ellison. *Climate change and sea level rise impacts on mangrove ecosystems*. University of Tasmania, Australia.

E. Development Challenges

22. **Indonesia is seen as needing to carry out many transformative processes if it is to progress to higher-income country status.** These include strengthening the business environment; moving to a high productivity economy; and managing urbanization, environmental, and disaster risks. A joint study by ADB, the International Labour Organization, and the Islamic Development Bank (IsDB) in 2010 identified poor infrastructure, weak governance, and inadequately skilled labor as the critical development constraints facing Indonesia.[34] In 2015, the World Bank identified infrastructure bottlenecks, a weak business environment, skill shortages, weak agricultural policies, weaknesses in public financial management, and weak governance in the management of natural resources among the binding constraints on achieving shared prosperity (footnote 23). A 2019 joint ADB and Ministry of Development Planning (BAPPENAS) report noted that the manufacturing sector in Indonesia was undiversified but that it had a comparative advantage in exporting relatively few products (footnote 8). Indonesia's exports are mostly unsophisticated and resource-based products, reflecting its narrow set of capabilities. The report suggested that Indonesia needs to address coordination and information problems and other market failures to revitalize the manufacturing sector. It also noted that the economic reform packages to ease investment in Indonesia need a specific sector or industry focus and not be too general in scope.

23. **Infrastructure investments are hindered by complex land acquisition processes, poor project preparation, and cumbersome and lengthy procurement systems**. Ineffective procedures and lack of financing, especially at the local government level, are among the key reasons for delays in land acquisition for infrastructure projects by the government. This is despite the government issuing several legal instruments regarding land acquisition for public purposes. Substantial gaps exist between budgeted amounts and actual compensation to be paid through negotiations. Lack of transparency in determining compensation for land acquired is often a cause for disputes. The procurement system is affected by lack of transparency and accountability. Recent progress made with e-procurement systems in Indonesia is not yet fully harmonized with ADB procurement rules needing accelerated harmonization of its rules for procurement of works by contractors. Indonesia's inadequate infrastructure is mainly due to low levels of public and private investment. Investment in infrastructure dropped during the 1997 Asian financial crisis and failed to recover fully after that. Weak infrastructure affects the competitiveness of firms. Congestion on roads, ports, railways, and airports increase shipping and logistics costs. Electricity shortages force firms to invest in electricity generators. Private investment is affected by the weak business environment, including restrictive investment and trade regulations, and time-consuming and costly procedures for obtaining permits and licenses.

24. **Indonesia's financial system is heavily reliant on banks and the country has relatively shallow capital markets, and limited financial inclusion.** The financial system is still hampered by the effects of the Asian financial crisis and has yet to find a way to work within Indonesia's cultural system. Financial illiteracy is widespread. Problematic legal treatments[35] curb the willingness of ordinary Indonesians to engage with the formal financial system. The cooperative finance sector caters to about 10% of Indonesians, while half of them resort to their own savings or to family and friends to provide loans. While the government bond market has improved, the corporate bond market is stagnant and dominated by SOEs. Indonesia is behind its regional peers with regard to its domestic bond market in relation to GDP, and the market capitalization of listed companies. A limited institutional investor base constrains long-term finance, while subtle barriers hamper competition and segment the market. As a consequence, banks have one of the

[34] ADB, ILO, and IsDB. 2010. *Indonesia: Critical Development Constraints*. Manila.

[35] Examples of such legal treatments include the double taxing of repossession (repo) operations because the tax law considers them to be two sales transactions, and limitations on the government taking out insurance for its assets.

world's largest net interest margins, artificially driving savings out of the financial system, and hindering access to credit with the high lending rates. As a result, credit to the private sector as a percentage of GDP is lower today than it was before the Asian financial crisis—dropping from 61% in 1997 to 39% in 2017. Furthermore, a large share of the adult population remains excluded from the formal financial system.

25. **Skills shortages hinder Indonesia's move toward higher-income generating production in many sectors.** The existing education system is unable to supply the increasing demand for workers with advanced skills. For many firms, it is difficult to find employees suitable for professional and managerial positions or skilled professionals such as engineers. Youth unemployment is increasing gradually. Given that routine tasks are being automated, skills development and human capital building must play a greater role in future. Low investment in research and development has also limited the diversification and sophistication of the manufacturing sector in Indonesia. Attaining a high employment share for manufacturing will be an important element in transitioning Indonesia to a high-income economy.

26. **Service delivery at the local level continues to be hampered by capacity constraints and decentralization challenges, including weaknesses in public financial management**. Local governments are responsible for delivering the vast bulk of Indonesia's social services. More than 50% of overall government spending is undertaken by local governments. Inadequate revenue mobilization limits the government's ability to fund key public services and weak budget execution makes public spending less effective in benefiting people. Budget utilization has been poor, leading to suboptimal outcomes from the National Medium-Term Development Plan, 2015–2019, with only 71.7% compliance with plans. Other challenges include inadequate integration of funding between institutions and levels of government, lack of interregional financial integration, and inefficient and an incomplete combination of sources of funding. Ministries and responsible institutions spent only 91% of allocated funds; only 67% of available foreign debt was accessed; only 34% of available interior loans were used; and only 85% of potential sharia securities were utilized.

27. **Urban service provision is not keeping pace with rapid urban population growth.** Indonesia has been urbanizing rapidly with most of its growth being generated in cities. This has strained basic service delivery and the environment. Only one in three urban households has access to decent water. Only one in a hundred is connected to a sewerage system, which poses high risks to public health. Insufficient urban drainage systems and poor municipal waste management exacerbate the impact of floods and landslides, which account for more than 60% of disasters in Indonesia. Less than 10% of urban commuters travel to work by public transport, and inadequate transport facilities contribute to congestion and significant economic losses. More comprehensive urban planning and more effective urban service delivery are needed to ensure that cities can foster sustainable growth and social development.

28. **Natural resource and environmental management are affected by weak governance and lack of land access rights to local communities**. Indonesia's rapid growth has come at the cost of deteriorating natural resources, disappearing forests, and loss of coral reefs. There is increasing air pollution and waste generated in urban areas due to urban population growth and congestion. Forest fires for land clearing have led to extremely high levels of air pollution at various times of the year. Climate change impacts can be seen in the form of intense floods, droughts, forest fires, storm surges, and rising sea levels. Volcanic eruptions and earthquakes are also common, requiring disaster risk and response management. A high and increasing proportion of the population lives in areas prone to natural disasters, the frequency and severity of which are expected to increase. Due to excessive groundwater extraction, Jakarta is sinking below sea level, and there are plans to move the capital.

F. Evaluation Scope and Methodology

29. **This CAPE is designed to provide the ADB Board of Directors and Management with an independent assessment of the performance of the ADB program in Indonesia during 2005–2018**. The evaluation was based on the principles and methodological approach outlined in the CAPE guidelines and addressed the evaluation questions laid out in the approach paper for this evaluation.[36] Program assessments were prepared for the various sectors and the evaluation examined the extent to which ADB support met the objectives of the sector strategies and their results frameworks. Each of these assessments applied the five main criteria, giving equal weights to each: relevance, effectiveness, efficiency, sustainability, and development impacts. These assessments were then aggregated at the country level with weights proportional to the portfolio allocations across sectors.

30. In addition to the sector programs, the evaluation also assessed ADB's strategic agendas and the special cross-sectoral priorities of the Indonesia program in terms of their relevance and impacts. The three strategic agendas were: (i) inclusive economic growth, (ii) environmentally sustainable growth, and (iii) regional cooperation and integration. The special priorities in the Indonesia country partnership strategies (CPSs), referred to as drivers of change in Strategy 2020) were gender equality, governance and capacity development, and private sector development. To arrive at an overall assessment of the Indonesia strategy and program, proportional weights were used to aggregate the sectoral performance, equal weights to aggregate the thematic performance, and a simple average of the two for the overall performance. The assessment of relevance at the country level considered how the strategic agendas and the key cross-cutting themes were incorporated in the design of the program. Similarly, the assessment of development impacts at the country level considered contributions in terms of strategic agendas and thematic areas of the program.

31. **The evaluation period of 2005–2018 corresponded to one country strategy and program (CSP), two full and one interim CPSs: CSP, 2006–2009; CPS, 2012–2014; interim CPS, 2015; and CPS, 2016–2019.**[37] The CAPE assessed all sovereign and nonsovereign lending operations, sovereign grants, and technical assistance (TA) projects approved during 2005–2018 which were either ongoing or closed during this period. Due to the number of large ADB operations in the country, projects approved prior to 2005 but active or closed during the evaluation period, were not included for assessment purposes but were included in some analysis to provide the context for the sequencing and continuity of projects.

32. **The overarching question of this evaluation was: to what extent did ADB support to Indonesia during 2005–2018 contribute to achieving the strategic objectives of inclusive and environmentally sustainable growth?** The evaluation asked five subsidiary questions, following the theory of change: to what extent did the ADB-supported program lead to: (i) improved infrastructure services, (ii) better economic governance within a decentralized framework, (iii) progress in developing human resources, (iv) better tackling of environmental challenges faced by Indonesia, and (v) finance sector deepening and increased access?

33. The CAPE addressed these questions based on assessments of the relevance, effectiveness, efficiency, sustainability, and development impacts of ADB's operations in Indonesia. This involved, among other things, assessing the extent to which outcome targets specified in the CPS results framework were achieved and answering evaluation questions on alignment with government priorities and policies, economic and financial performance, time

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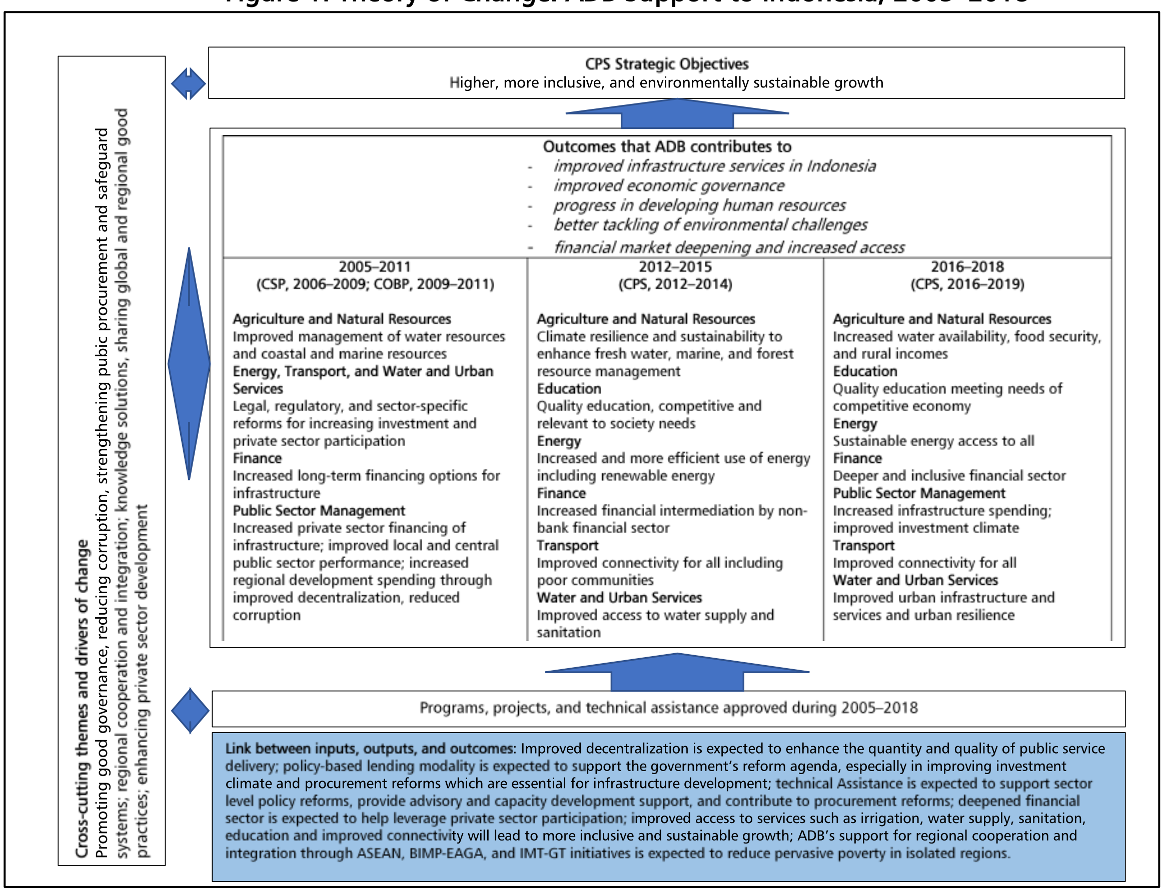
[36] IED. 2015. *Guidelines for the Preparation of Country Assistance Program Evaluations and Country Partnership Strategy Final Review Validations*. Manila: ADB.

[37] The previous CAPE for Indonesia, the first by IED, was done in 2005 and covered 1990–2004 (footnote 1).

and cost overruns, procurement, and compliance with safeguards. In addition, ADB's contribution, through nonsovereign and sovereign interventions, to cross-cutting themes such as gender and private sector development was assessed under the relevance and development impact assessments.

34. **The CAPE's main evaluation question was anchored on a theory of change derived from ADB's country strategies, results frameworks, and programs for Indonesia in 2005–2018.** The theory of change (Figure 1) was based on the overarching objective of more inclusive and environmentally sustainable growth in Indonesia discussed in government's plan priorities and ADB strategies throughout the evaluation period. It illustrates the causal links ADB sees between inputs, outputs, and outcomes supported by ADB through its country program. ADB expects sector programs to advance the three broad outcomes of: improved infrastructure services, better economic governance, and enhanced human resource development, as articulated in the CPS, 2016–2019 results framework and the earlier country strategies. The outcomes of these sector programs were also expected to help the achievement of other cross-cutting objectives such as gender equity and regional cooperation and integration, and ultimately inclusive and sustainable growth. Outcomes would be achieved by reducing such critical development constraints as low infrastructure investment, low private sector participation, a weak legal and regulatory environment, local governments' lack of capacity in preparing and implementing projects and inadequate natural resource management capacity, weak performance standards in the public sector, and low health and education spending.

Figure 1: Theory of Change: ADB Support to Indonesia, 2005–2018



ADB = Asian Development Bank, ASEAN = Association of South East Asian Nations, BIMP-EAGA = Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area, COBP = country operations business plan, CPS = country partnership strategy, CSP = country strategy and program, IMT-GT = Indonesia-Malaysia-Thailand Growth Triangle.
Source: Independent Evaluation Department evaluation team.

35. The CAPE drew its analysis from several sources: (i) a literature review and review of other documents, including country development plans and previous evaluation reports; (ii) interviews with ADB staff in headquarters and the resident mission, government officials, development partners in Indonesia, and other stakeholders; and (iii) field observations for selected projects to gather evidence on progress toward target outputs and implementation issues.

36. Sector program assessments were prepared to assess ADB-supported project performance in: (i) energy, (ii) PSM, (iii) finance, (iv) agriculture and natural resources (ANR), (v) transport, (vi) water and other urban infrastructure and services (WUS); and (vii) education and health. They are accessible through hyperlinks in the Appendix. Nonsovereign operations (NSOs) were mainly concentrated in the energy and finance sectors and were covered in the respective sector assessments. The finance sector evaluation was based on a separate sector assistance program evaluation (SAPE).

G. Past Evaluations of Indonesia Country Programs

37. **The 2005 CAPE was the first country program assessment by IED in Indonesia**. That evaluation covered the ADB support from 1990 to 2004 and rated it *partly successful* (equivalent to *less than successful* in current terminology). The CAPE review period encompassed Indonesia's economic turbulence associated with the Asian financial crisis and major changes in the political economy related to the moves to democracy and decentralization. These changes involved risks and uncertainty that adversely affected the performance of ADB operations. The CAPE also identified weaknesses in ADB's performance and received feedback from the government on areas where ADB needed to make changes to improve development results and strengthen the ADB-Indonesian partnership.

38. **The CAPE made recommendations and identified niches whereby ADB could play major role in addressing key development constraints, selecting key focus areas, reducing transaction costs, providing better services to clients, and giving vital focus to private sector participation.** The ensuing CSP, 2006–2009 considered these recommendations in crafting the country's next strategy. It focused on facilitating private sector participation in infrastructure, improving capacity in the delivery of public services, and concentrating on key sectors and addressing governance-related issues. Key areas of focus included energy, transport, water supply and sanitation, public financial management, among others. New products from ADB's innovation and efficiency initiative were also taken into account in making changes to facilitate greater private sector participation.

39. **The 2011 CSP final review validation covering CSP, 2006–2009 recommended that ADB should have a limited number of sector programs, focusing on Strategy 2020 core sectors.** It also noted that ADB should emphasize subsectors where it had a strong track record and where it could catalyze more investments. The subsequent CPS focused on government priorities that reflected ADB's comparative advantage in specific areas within six sectors: (i) ANR, (ii) education, (iii) energy, (iv) finance, (v) transport, and (vi) water supply and sanitation.

40. **The CPS final review validation in 2015 undertook an assessment of the CPS, 2012–2014.** It rated the program *successful.* The CPS final review's recommendation that ADB should develop assistance instruments more suitable for middle-income countries was endorsed by the validation. The final review's recommendation to undertake better results tracking through improvements in government systems was also noted. In addition, the validation also recommended that a programmatic approach would be crucial in meeting the needs of a middle-income country such as Indonesia. Such an approach should address policy and institutional reforms to improve the delivery of infrastructure and social services. One of the lessons identified

was that ADB's country program must be anchored on a rigorous analysis of development constraints. Empirical and evidence-based diagnostic analysis of development constraints needed to be incorporated into CPS preparation. In the ensuing CPS, ADB prepared various documents, representing analysis across sectors and themes. These covered operating risks and forward planning.

41. **IED's corporate evaluation of policy-based lending (PBL) in 2018 identified many design issues which are relevant to Indonesia.** It found that policy-based loans tended to have too many policy actions and triggers, making it difficult to assign monitoring and evaluation (M&E) indicators and track progress; results indicators in reports and recommendations of the President did not adequately capture the outcomes of policy actions, nor measure the development objectives; and the project completion reports' (PCR) assessment of the effectiveness of PBL was usually limited and did not fully discuss the criticality of the loan or TA provided to the outcomes achieved, raising the question of whether the outcomes reported by the time of the approval of the loan by ADB's Board of Directors could be directly related to it or whether they would have been achieved by the government without the loan or TA.

42. **The remainder of the report is structured as follows.** Chapter 2 provides an overview of the context in which the program was developed, highlighting Indonesia's development needs, challenges, and binding constraints. Chapter 3 summarizes Indonesia's development strategies and plan priorities throughout the evaluation period, and ADB's strategies in support of the country. Chapter 4 assesses the performance of ADB sovereign and NSOs by sector. Chapter 5 assesses the performance of ADB operations in terms of achieving their strategic and thematic objectives. Chapter 6 summarizes key findings and provides recommendations.

2

Development Strategies and ADB Support

Highlights:

- The strategic objectives of more inclusive and environmentally sustainable growth were common across the different country strategy periods.
- Asian Development Bank (ADB) operational priorities for the country partnership strategy, 2016–2019 were (i) improved infrastructure services, (ii) better economic governance, and (iii) enhanced human resource development. The priorities for the previous country strategies were also related to these areas.
- The evaluation covers projects approved by ADB during 2005–2018. It was guided by the three country strategies for 2006–2009, 2012–2014, and 2016–2019; and an interim strategy for 2015.
- The total approved portfolio during this period, combining sovereign and nonsovereign operations, amounted to $19.3 billion. The highest approved amount was for public sector management (45%), followed by energy (24%), and finance (14%).
- Policy-based lending represented 69% of the total approved amount for sovereign operations. This was partly due to government perceptions of the high transaction costs of conventional projects, its preference for budget support in times of deficit, and its preference for using its own safeguard and procurement systems. Other partners such as the World Bank had a similar experience.

A. Government Development Strategies and Policy Priorities

43. **Indonesia implemented a wide range of policy reforms after the 1997–1998 Asian financial crisis, which made the economy more resilient to shocks such as the global economic crisis in 2008.** The Indonesian economy recovered quickly from the Asian financial crisis and made improvements in major economic and social indicators. In keeping with a tradition that came from before the crisis, Indonesia formally moved to a National Development Planning System,[38] which calls for long-term plans covering 20 years, broken down into 5-year plans that coincide with presidential terms. While the long-term plan is anchored in the national goals and objectives defined in the country's Constitution, the medium-term plans marry those objectives with the priorities of the president. The government envisioned a just and prosperous country in its National Long-Term Development Plan, 2005–2025.

44. **In 2007, the government published a National Long-Term Development Plan for the period 2005–2025.**[39] The main objectives of the plan were to establish a country that was developed and self-reliant, just and democratic, and peaceful and united. The developed and self-reliant component included inclusive growth, developing Indonesia's human capital and infrastructure, and maintaining a free and active foreign policy. The just and democratic component supported a rule of law that was fair and nondiscriminatory, and affirmed Indonesia as a constitutional democracy. The peaceful and united component sought to ensure peace and safety for all Indonesians, while maintaining the country's sovereignty and territorial integrity. Although the aim was a balanced economy where all sectors could prosper, the objective defined in the plan was to reach an income per capita of about $6,000, reducing poverty rates to less than 5% of the population. Food self-sufficiency and food security were also defined as key objectives.

45. **The government's Medium-Term Development Plan, 2005–2009 sought to raise the levels of sustainable economic growth, create jobs, and accelerate achievement of the MDGs**. The medium-term plan had three main objectives: to create an Indonesia that was secure and peaceful, just and democratic, and that enhanced the welfare of the people. The emphasis on peace and security reflected the tensions that had arisen in several regions during the transition process. The emphasis on justice and democracy reflected Indonesia's efforts to uphold the rule

[38] Law 25 of 2004 on National Development Planning System.

[39] Law 17 of 2007 on Long term National Development Plan of 2005–2025. President Susilo Bambang Yudhoyono, who in 2005 was the first president to be elected by popular vote, defined the first long-term plan and started the 5-year plan cycles.

of law, address governance issues, and continue its transition towards a solid democracy. On the economic front, the plan spoke of enhancing Indonesia's welfare and prosperity by developing an "economy that can create employment opportunities and a reasonable living and that provides a solid foundation for a sustainable development." [40] Within a framework of macroeconomic stability, the plan targeted an average annual GDP growth rate of 6.6% per year, which was expected to reduce the poverty rate to 8.2% of the population, and to reduce unemployment to 5.1% by 2009. Public debt was expected to decline to about 32% of GDP by 2009.

46. **The government's second National Medium-Term Development Plan, 2010–2014 envisioned an Indonesia that was prosperous, democratic, and just, supported by a four-track strategy of pro-poor, pro-job, pro-growth, and pro-environment development**. The plan focused on reducing poverty through more rapid, more sustainable, and more inclusive economic growth; improving the quality of the public sector; fostering democracy; and strengthening the rule of law. It consisted of 11 national priorities, including education, energy (alternative energy and energy efficiency), environment (including climate change), health, infrastructure, investment and business climate, poverty reduction, and public sector reforms. It emphasized mainstreaming environmental sustainability, good governance, and gender equity in all areas, and the cross-sectoral themes of climate change and connectivity among and within Indonesia's islands. Within a prudent macroeconomic policy framework, the plan targeted average GDP growth of 6.3%–6.8% per year, a decline in unemployment to 5%–6% by 2014, a reduction in poverty to 8%–10% by 2014, and increased food security. Public debt was expected to decline to 24% of GDP by 2014.

47. **The government issued its Master Plan for the Acceleration and Expansion of Economic Development of Indonesia for 2011–2025 in 2011**. Through this master plan, then President Yudhoyono hoped to jump-start growth, to make Indonesia one of the 10 largest economies in the world by 2025. The master plan focused on three main pillars (i) harnessing the country's regional development potential by developing six economic corridors (Sumatra, Java, Kalimantan, Sulawesi, Bali-Nusa Tenggara, and Papua Maluku); (ii) strengthening national connectivity, both locally and internationally; and (iii) strengthening human resource capacity and national science and technology.

48. **The National Medium-Term Development Plan, 2015–2019 was issued in January 2015 by President Widodo**. The president chose to continue working within the framework of the long-term development plan, and the new medium-term plan had a vision of sovereignty, self-reliance, and strength through mutual cooperation: "Gotong Royong." It prioritized a significant scaling up of infrastructure investment (power generation, toll roads, and port facilities), improvements to education and skills development, and policy reforms to improve competitiveness and service delivery. The plan was guided by a vision of sovereignty, self-reliance, and strength through cooperation. It promoted inclusive and environmentally sustainable growth by encouraging all citizens and regions to participate fully in the growth process. The reform priorities, as announced by the president, included: improving the business climate; increasing the tax-to-GDP ratio; reducing fuel subsidies and diverting the savings to finance infrastructure; and strengthening social infrastructure (in particular the three welfare programs: social welfare cards for health, education, and conditional cash transfer programs). The plan aimed at an annual GDP growth rate of 8% by 2019, a reduction of poverty incidence to 7%–8% of the population, and a more equitable distribution of income.

[40] Government of Indonesia. 2005. *Presidential Regulation Number 7 of 2005 on The National Medium-Term Development Plan 2004–2009.* Jakarta.

B. ADB Strategies in Indonesia

49. **The focus of ADB assistance has shifted over time in response to Indonesia's changing development priorities.** From an early emphasis on agricultural self- sufficiency it shifted to focus on decentralization reform and building financial resilience following the Asian financial crisis. A marked shift to PBL was seen during CSP, 2006–2009, and a gradual shift back to project investments was emphasized in later CPSs. During the interim CPS, 2015 the government emphasized the importance of knowledge services in increasing resource use efficiency. In CPS, 2016–2019, ADB focused on maximizing the value addition and catalytic role of ADB assistance.

50. **The strategic objectives of CSP, 2006–2009 were a higher pro-poor rate of sustainable growth and social development.** Good governance and anticorruption were defined as cross-cutting themes.[41] The strategic goals were: (i) higher economic growth through greater investments, including enhanced infrastructure provision; (ii) greater domestic resource mobilization to support growth; (iii) greater fiscal and human capacity for sustainable service delivery; (iv) improved quantity and quality of social service delivery; (v) natural resource management done on a more sustainable basis, with an economic return for the poor and reduced incidence of pollution; and (vi) accelerated economic growth through improved investments and better PSM. ADB's operational support focused on the following outcomes: (i) improving infrastructure and infrastructure services, (ii) finance sector deepening, (iii) greater decentralization of government functions, (iv) speeding up the achievement of the MDGs, and (v) strengthening management of the environment and natural resources.

51. **During the CSP preparation, the government initiated a series of ambitious reform programs to address the economic challenges it then faced.** It asked ADB to shift to policy-based loans as the main modality. ADB was to use innovative modalities: program lending using clusters of single-tranche operations embedded in the government's medium-term reform agenda; multitranche financing facilities (MFFs) to ensure long-term, sustained sector engagement to combine investments with subsector policy improvements and to provide the opportunity to combine public sector sovereign lending with nonsovereign and private sector operations; and cluster TA projects to support policy reforms and investment in the areas of engagement. Project lending was expected to shift over time from public sector operations to nonsovereign lending and public–private partnerships (PPPs), including guarantee facilities.

52. **The country operations business plan (COBP), 2011–2013 updated the CSP, 2006–2009 results framework to reflect the operations under the core areas of operation defined in ADB's Strategy 2020.** It continued to strike a balance between (i) program loans that supported policy and institutional reforms and provided low-cost financing for the government's budget; and (ii) urgently needed investment loans, where ADB could leverage its resources to increase development impact. It adopted a selective approach by focusing policy-based operations on government priorities, areas where ADB had a comparative advantage, and where there was synergy with ADB's project investments in Indonesia. Policy-based operations during 2011–2013 were expected to continue support for improving local government finance and governance, capital market development, and infrastructure development.

53. **The strategic objectives of CPS, 2012–2014 were similar to those of the earlier CSP: inclusive growth and environmentally sustainable development with climate change mitigation and adaptation**. The differences from the previous CSP were (i) inclusion of climate change considerations as a strategic thrust, (ii) a gradual rebalancing of the portfolio toward more project investments, and (iii) a switch from a broad-based approach in eight sectors to specific activities in six sectors. Two sectors, industry and trade, and health were dropped. The areas of

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[41] ADB. 2006. *Country Strategy and Program: Indonesia, 2006–2009*. Manila.

operational focus were (i) ANR, flood management, and resilient irrigation; (ii) education (vocational); (iii) energy efficiency and renewable energy; (iv) access to finance; (v) transport and trade logistics; and (vi) access to water supply and sanitation. Cross-cutting PSM initiatives were to be included in ADB-financed programs to support national efforts to strengthen governance in an increasingly decentralized framework. Modalities used by ADB included programmatic support for policy reform, capacity development, strategic and catalytic investments, and relevant knowledge products and services. The government requested ADB to shift gradually to more project investments responding to reduced government needs for budget support.

54. **The interim CPS, 2015 for Indonesia extended the validity of the CPS, 2012–2014 for 1 year.** It focused on (i) infrastructure development, (ii) human development, and (iii) enabling economic policies. Support for infrastructure development included strengthening energy security by reforming energy sector policy, improving the reliability and efficiency of the national electricity grid, and fostering greater use of clean energy, and increasing food security by improving water availability and agricultural and fishery productivity. Support for human development focused on education quality and access, skills development, urban health, and sanitation. Support for enabling economic policies included strengthening capital markets and financial inclusion. The interim CPS emphasized the theme of PSM and governance. The government's borrowing policy emphasized the importance of knowledge services to assist the government in using its own resources more efficiently and effectively.

55. **The CPS, 2016–2019 addressed six challenges faced by the economy**. These were identified as: (i) insufficient new jobs due to the narrow base of economic growth (mainly coal mining, palm oil, extractive industries, and luxury property) and the resultant rise in inequality and poverty; (ii) low agricultural productivity, high transport and logistics costs, and low access to energy; (iii) skills shortages; (iv) strained service delivery due to rapid urbanization; (v) increasing water and air pollution that came with growth; and (vi) climate change impacts such as intense floods, drought, forest fires, and storm surges. The strategic objectives were more inclusive and environmentally sustainable growth. The operational priorities were (i) improved infrastructure services (ii) better economic governance, and (iii) enhanced human resource development.

56. **ADB's focus areas as planned in COBP, 2017–2019 were: energy, ANR, WUS, education, PSM, and finance.** ADB support for improving infrastructure services would be through support for energy security and the development of clean energy sources such as natural gas and geothermal energy; support for rural infrastructure such as irrigation; and urban infrastructure such as sanitation. To improve economic governance, ADB support would focus on strengthening PSM and service delivery by enhancing management, coordination, transparency, and the accountability of national and local government public financial management systems. ADB support would also focus on improvements to the business environment, public procurement systems, and information and communication technology policies and institutional arrangements. ADB's support for finance sector deepening and financial inclusion would continue. Support for human resource development focused primarily on improving education quality and skills development through policy reform, and better sector management. It also focused on providing knowledge support to improve social protection systems and strengthen health services. Given that ADB lending under the CPS was less than 1% of public investment, ADB support would emphasize value addition and the catalytic role of ADB assistance. Thematic areas of focus included climate change and environment, private sector development, knowledge partnerships, gender equity, and regional cooperation.

57. Although COBP, 2018–2020 is beyond the scope of this evaluation, it merits attention as ADB is now focusing on (i) long-term engagement and a programmatic approach in core sectors; (ii) incorporating knowledge, innovation, and high quality technology in projects; (iii) ensuring project readiness and quality-at-entry to minimize implementation delays; (iv) deepening the

partnership with executing and implementing agencies; (v) enhancing the capacity and flexibility to respond effectively to the government's evolving needs and priorities; and (vi) applying an effective and balanced mix of ADB's assistance modalities. ADB also plans to increase efforts to maximize synergies between sovereign and NSOs, including the promotion of PPPs in Indonesia. ADB would mainstream into its operations the cross-cutting themes of good governance, environmental sustainability, private sector development, gender equity, regional cooperation and integration, and knowledge and partnerships. In the context of a volatile global and regional economic environment, the government asked ADB to maintain a degree of flexibility on lending levels and modalities in line with evolving government development financing needs. The main changes from the previous COBP, 2017–2019 (the first COBP of CPS, 2016–2019) were: coastal aquaculture was prioritized over inland; and basic education quality policy support was replaced by advanced knowledge and skills to support a government decree prioritizing higher education and skills.

58. **The strategic objectives of pro-poor, inclusive, and environmentally sustainable growth remained constant across the different CPS periods.** Support for infrastructure development and services and environmental management has been steady across the years. Table 2 shows how the focus areas of the country strategies changed over time. CSP, 2006–2009 focused on infrastructure development, finance sector deepening, decentralization, accelerating achievement of MDGs, and environmental and natural resources management. CPS, 2012–2014 and the interim CPS, 2015 focused on infrastructure development, especially in energy and agricultural water supply, development of human resources through vocational education, urban sanitation and financial inclusion. The latest CPS, 2016–2019 focused on infrastructure services related to energy and rural irrigation and water supply, strengthening finance sector and PSM, improving education quality, and skills development.

Table 2: Key Objectives and Focus Areas of ADB Country Strategies

CSP, 2006–2009	CPS, 2012–2014	Interim CPS, 2015	CPS, 2016–2019
Strategic objectives			
Higher pro-poor sustainable growth and social development	Inclusive growth and environmentally sustainable development with climate change mitigation and adaptation	Inclusive growth and environmentally sustainable development	More inclusive and environmentally sustainable growth
Sector Focus			
(i) Infrastructure, (ii) finance sector deepening, (iii) decentralization of government functions, (iv) Millennium Development Goals, and (v) environment and natural resources	(i) Agriculture and natural resources (ii) vocational education, (iii) energy efficiency and renewable energy, (iv) access to finance, (v) transport and trade logistics, and (vi) access to water supply and sanitation	(i) Infrastructure development (energy sector policy, clean energy, agricultural water supply); (ii) human development, skills, urban health and sanitation); and (iii) enabling economic policies (capital markets, financial inclusion)	(i) Infrastructure services (energy efficiency, clean energy, rural irrigation, bulk water supply, urban sanitation, support for higher value agriculture and aquaculture); (ii) economic governance (public sector management, service delivery, business environment, finance sector strengthening, and financial inclusion); and (iii) enhanced human resource development (education quality and skills development, social protection and health services)
Thematic Focus			
Governance and anticorruption Mainstream strengthening national and subnational governance in all operations, use nonsovereign operations	Deeper partnerships with development partners, knowledge management (providing advisory assistance and sharing good practices), governance and capacity development (managing financial management systems and fiduciary risks at local and national level), gender equity,	Same as that of CPS, 2012-2014 Public sector management and governance Knowledge services to assist the government in using its resources	Climate change and environment, private sector development, good governance, knowledge partnerships, gender equity, and regional cooperation Maximizing the value addition and catalytic role of ADB

CSP, 2006–2009	CPS, 2012–2014	Interim CPS, 2015	CPS, 2016–2019
program to address corporate governance issues in lending to state-owned enterprises, include substantial governance components in program loans, promote anticorruption efforts and accountability of regional governments	regional cooperation	efficiently and effectively	assistance, given that ADB lending under the CPS is less than 1% of public investment

ADB = Asian Development Bank, CSP = country strategy and program, CPS = country partnership strategy.
Note: The early part of ADB's program during the CAPE period was influenced by the strategic thrusts identified under the Long-term Strategic Framework (LTSF) adopted by ADB in 2001: (i) sustainable economic growth, (ii) inclusive social development, and (iii) governance for effective polices and institutions. The three cross-cutting themes under the LTSF were (i) the role of the private sector in development, (ii) regional cooperation and integration for development, and (iii) environmental sustainability.
Sources: Asian Development Bank country strategy and programs and country partnership strategies for Indonesia.

59. **CPS, 2016–2019 focused on (i) improved infrastructure services, (ii) better economic governance, and (iii) enhanced human resource development.** These were the three high-priority areas identified by the National Medium-Term Development Plan, 2015–2019. PBL remained the government's preferred lending modality over the evaluation period, and the focus of this was mostly on financial, capital market development and PSM. The CPS noted that the tilting of the lending program toward policy-based loans was partly due to the government's reluctance to borrow for investment projects. It also noted that this was due to its perception of the high transaction costs associated with investment projects, land acquisition issues, and the government's preference for the use of country systems for safeguards and procurement.

C. Country Program and Portfolio

60. **ADB support for Indonesia during 2005–2018 was guided by the strategic objectives of pro-poor, inclusive, and environmentally sustainable growth**. However, there were significant differences between its planned and actual investments. Indonesia is among the largest borrowers from ADB, with a total approved portfolio of sovereign and nonsovereign lending, grants, and TA close to $19.3 billion during 2005–2018. The bulk of sovereign operations were in the form of policy-based loans providing budget support or sometimes countercyclical support to the government. ADB has been attempting a gradual rebalancing of the portfolio by increasing the number of investment loans since 2012 but with limited success so far.[42] Most of the sovereign operations focused on PSM, followed by energy and finance, whereas nonsovereign support went mainly to two sectors: energy and finance.[43] This sector focus was in alignment with the government's priorities of improving the quality of the public sector and strengthening the rule of law for more sustainable and inclusive economic growth.

61. **More than 80% of the portfolio was devoted to operations in PSM, energy, and finance sectors.** Of the total sovereign and nonsovereign loans and the grants portfolio of $19.3 billion from 2005 to 2018, PSM accounted for about 45%, energy for 24%, and finance for 14% (Figure 2). Sovereign lending was the primary intervention tool, totaling $15.9 billion.[44] ADB provided

[42] The indicative assistance pipeline in the COBP, 2019–2021 showed that the share of PBL in 2019 was 29% (ADB. 2018 *Country Operations Business Plan: Indonesia, 2019–2021*. Manila). According to the indicative resource parameters in COBP, 2020–2022, the share of PBLs in the portfolio was 23% (ADB. 2019 *Country Operations Business Plan: Indonesia, 2020–2022*. Manila).
[43] Appendix, Linked Document A provides the detailed portfolio of operations by sector and by instruments.
[44] Fifteen projects which were originally classified under multisector were reclassified under transport, WUS, and PSM sectors based on the description in project documents. However, due to the multisector nature of these projects, some of these are discussed under multiple sectors. These include Loans 2221, 2449, and 2575 which were reclassified under transport, and Loan 2768 reclassified under the WUS sector—but were discussed in the ANR sector assessment as well.

over $400.0 million in grants, which were mainly used in ANR and PSM projects. PBL constituted 69% of the total sovereign lending and grants portfolio. The biggest PBL investment during this period was the $1.0 billion countercyclical support to the country in response to the 2008 global financial crisis, aimed at implementing a series of confidence-boosting policy measures to address the increased short-term vulnerabilities and risks to the Indonesian economy.[45] In terms of nonsovereign lending, $2.7 billion was approved during the period, with 4 of the 23 loans canceled.[46] There were 14 projects in energy (65% by volume) and 6 in the finance sector (31% by volume), with health and water supply projects taking much smaller shares of the nonsovereign portfolio.

62. **Of the sovereign lending, 10 loans were funded by concessional resources (Asian Development Fund) for a total of $430.0 million**. In 2009, Indonesia graduated from being eligible for Asian Development Fund funding. Funding by ordinary capital resources (OCR) stood at $15.0 billion, with $390 million funded by the ASEAN Infrastructure Fund and two loans of $490 million equivalent financed by Agence Française de Développement (AFD).[47] Nonsovereign lending was financed mainly through OCR, with three loans having either B-Loan or equity facility funding.[48] Grant funding sources included the Japan Fund for Poverty Reduction (JFPR), the Asian Tsunami Fund, the Clean Energy Fund, and the Global Environmental Facility. Cofinancing with other development partners was either collaborative or with ADB providing full or partial administration. Collaborative partnerships were mostly with AFD and Kreditanstalt für Wiederaufbau (KfW) in the PSM and energy sectors and with International Fund for Agricultural Development (IFAD) in the agriculture sector, whereas full administration was with bilateral partners, mainly Australia, Canada Japan, and the Netherlands.[49]

63. **ADB support for PSM remained high throughout the CPS period, with 61% of ADB support being approved for this area during 2006–2009 (CSP, 2006–2009, Table 3).** The share fell to 22% during the second CPS period (2012–2014) before rising again to 40% in the latest CPS (2016–2019). The energy program started at 8% during the first CPS period (2006–2009) before rising to 38% and 36% in later CPS periods. PSM, energy, and finance programs together accounted for close to 80% of sovereign plus nonsovereign support provided by ADB during the CAPE period, indicating the focused nature of the portfolio. The transport program allocation increased from 6% to 16% between the first two CPS periods but fell to zero in the latest CPS period. The ANR program allocation increased in the latest period from 2% to 12%.

[45] ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Republic of Indonesia for the Public Expenditure Support Program*. Manila.

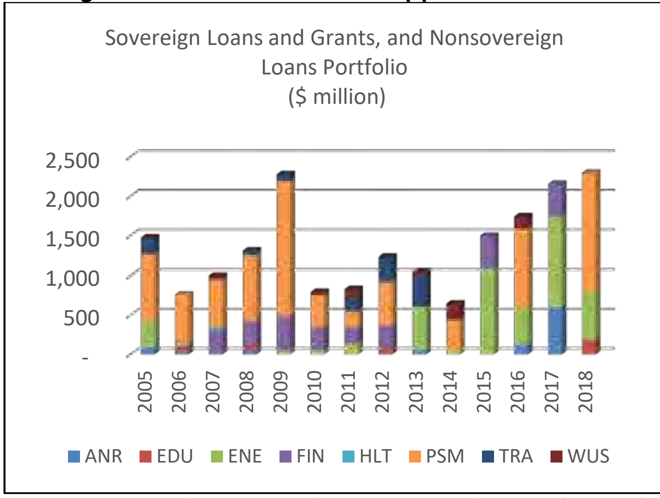
[46] Canceled loans were in the finance, energy, and WUS sectors.

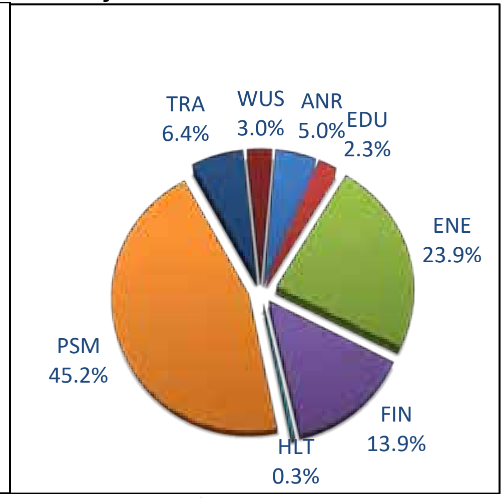
[47] ADB. 2010. *Report and Recommendation of the President to the Board of Directors for the Republic of Indonesia: Java–Bali Electricity Distribution Performance Improvement Project*. Manila; and ADB. 2013. *Report and Recommendation of the President to the Board of Directors for the Republic of Indonesia: West Kalimantan Power Grid Strengthening Project*. Manila.

[48] B Loans are funded by commercial banks and other eligible financial institutions with ADB acting as lender of record.

[49] Collaborative cofinancing imposes no contractual obligations on either ADB or the financing partner but requires close coordination during the processing and implementation of the specific project or program, documented through project- or activity-specific memorandums of understanding (MOUs) and/or aides memoire signed by the regional department and corresponding financing partner staff. Full administration cofinancing meanwhile has ADB providing to the financing partner a full range of services, including (i) procurement of goods, works, and services; (ii) selection and engagement of consultants; (iii) supervision of implementation; and (iv) disbursement of funds.

Figure 2: Portfolio of ADB Support to Indonesia Covered by the Evaluation, 2005–2018



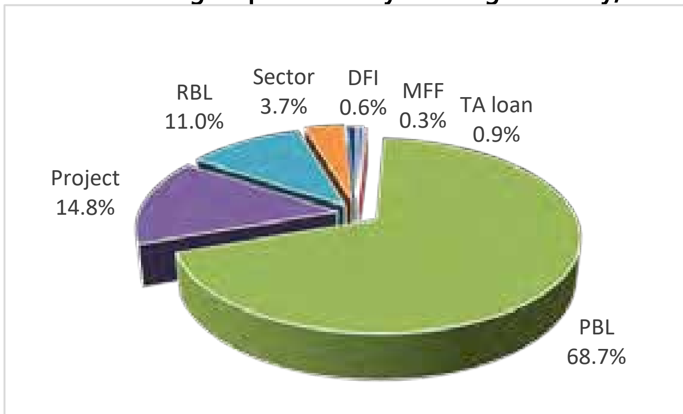


ADB = Asian Development Bank, ANR = agriculture and natural resources, EDU = education, ENE = energy, FIN = finance, HLT = health, PSM = public sector management, TRA = transport, WUS = water and other urban infrastructure services.
Sources: Asian Development Bank databases.

64. **PBL has been the modality of choice in ADB's program in Indonesia (Figure 3), as it has been for the World Bank.** PBL was used to provide budget support to the government while promoting policy reforms in local government finance, public financial management, macroeconomic reforms for better investment climate, financial and capital market development, among other things. PBL has also been used to provide countercyclical support to deal with the aftermath of economic crises. Investment lending came a far second to PBL and was widely spread across sectors; it particularly involved infrastructure investments. Although still relatively new, results-based lending (RBL) has found a niche in Indonesia, with five new loans approved in energy and ANR during 2015–2017. The share of PBL remained high during the entire evaluation period, peaking in 2007 at 95% and again in 2009 and in 2012 at 89%. PBL continued to be the main lending modality from 2013 until the end of 2018, ranging from 43% to 78% of the program (Figure 4). For some time, ADB has been making efforts to rebalance its portfolio by including more investment projects. Based on the indicative assistance pipeline in the COBP, 2019–2021, the share of PBL in 2019 will be 29% of the program, dropping to 23% in the indicative resource parameters in the COBP, 2020–2022.[50] Some of the increase in investment projects was made possible by a 2015 Ministry of Finance (MOF) regulation that allowed direct lending by international financial institutions to SOEs backed by government guarantee. The electricity SOE, PLN, is ADB's single largest client in Indonesia. There were also NSOs in the power sector, with commitments close to $600 million in 2018.

[50] ADB. 2018. *Country Operations Business Plan: Indonesia, 2019–2021. Manila; and ADB. 2019. Country Operations Business Plan: Indonesia, 2020–2022*. Manila.

Figure 3: ADB Sovereign Operations by Lending Modality, 2005–2018



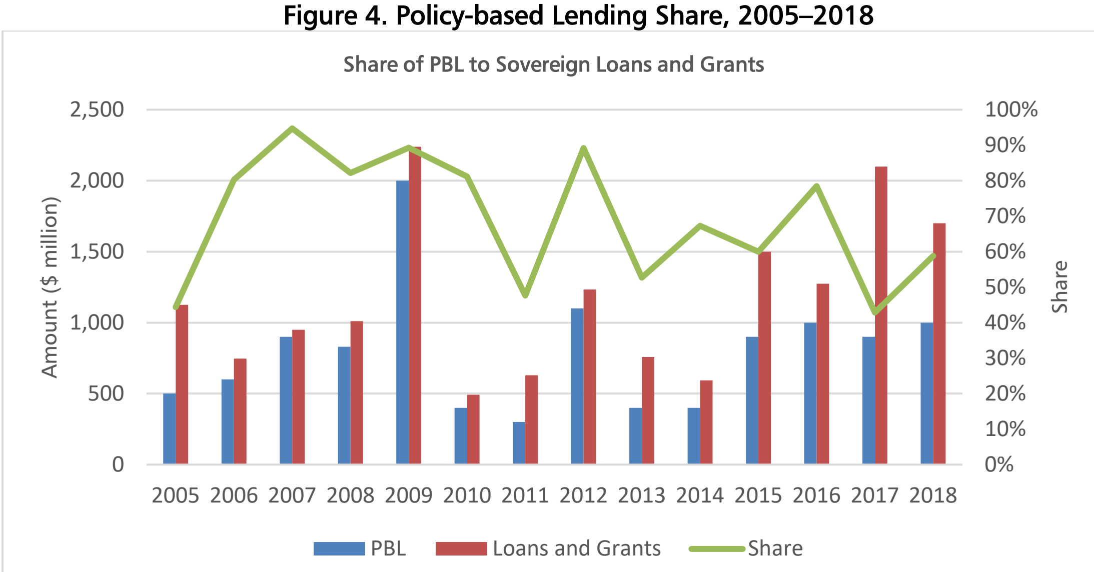
ADB = Asian Development Bank, DFI = development financing institution, MFF = multitranche financing facility, PBL= policy-based lending, RBL= results-based lending, TA = technical assistance.
Sources: Asian Development Bank databases.

Table 3. Approved Sovereign Loans and Grants, and Nonsovereign Portfolio, 2005–2018

	2005–2011		2012–2015		2016–2018		2005–2018	
	Amount ($ million)	Share (%)	Amount ($ million)	Share (%)	Amount ($ million)	Share (%)	Amount ($ million)	Share (%)
ANR	172	2	54	1	726	12	951	5
EDU	158	2	80	2	200	3	438	2
ENE	635	8	1,701	38	2,214	36	4,549	24
FIN	1,552	18	700	16	400	6	2,652	14
HLT	56	1	-	-	10	0	66	0
PSM	5,170	61	958	22	2,500	40	8,628	45
TRA	515	6	700	16		0	1,215	6
WUS	187	2	239	5	148	2	574	3
Total	8,445	100	4,431	100	6,198	100	19,074	100

ANR = agriculture and natural resources, EDU = education, ENE = energy, FIN = finance, HLT = health, PSM = public sector management, TRA = transport, WUS = water and other urban infrastructure and services.
Source: Asian Development Bank.

Figure 4. Policy-based Lending Share, 2005–2018



PBL = policy-based lending.
Source: Asian Development Bank.

65. **The large number of policy-based loans in the portfolio partly reflects the fact that the processing of investment projects became difficult in Indonesia over the evaluation period.** The problems arose mainly from land acquisition, coordination between different agencies and levels of government, differences in procurement regulations between ADB and government, and implementation of environment and social safeguards. Many of the projects identified for support in the COBP had to be dropped because of such problems. A related factor was the difficulty in meeting the project readiness conditions of the government that land must be acquired; resettlement and environment safeguards approvals must be in place; and detailed engineering design must be approved prior to loan negotiations. Projects involving foreign borrowing need to be included in the government planning process, which adds to the delays. Changes in land acquisition legislation over the period and uncertainties at local level over whether ADB's safeguard policy was to be upheld or the government's legislation added to confusion, and there has been a fear by some executing agencies and local governments that national auditors would not agree to safeguard measures taken in the context of ADB-supported projects. The government generally prefers to use country systems, dispensing with the need to pay attention to both government and ADB rules and requirements related to procurement and environmental and social safeguards.

66. **Approved amounts during the evaluation period differed significantly from the planned amounts.** The biggest differences were found in the ANR, education, health, and energy sectors where approved amounts were less than or equal to 50% of the planned allocations (Table 4). All sector programs spent less than planned in the CPSs except for the PSM program, which grew by 16%. The WUS and especially the transport programs were much smaller than in most other client countries of ADB and could not be expanded despite best efforts made by staff over the period. Loans approved but not planned in the CPS were mostly in the PSM sector (Appendix, Linked Document B). The unplanned support included support to counter the effects of global financial shocks and support to cover for unrealized investment projects. In particular, the dropping or replacement of MFFs affected the realization of planned allocations as most of the planned energy interventions were MFFs. From 2005 to early 2011, and even spilling over to the next CPS period, these were replaced by stand-alone projects with lower ADB funding. This could be attributed to lack of sector readiness to adopt the MFF modality, which was relatively new.

Table 4: Planned and Approved Sovereign Loans Allocations, 2005–2018 ($ million)

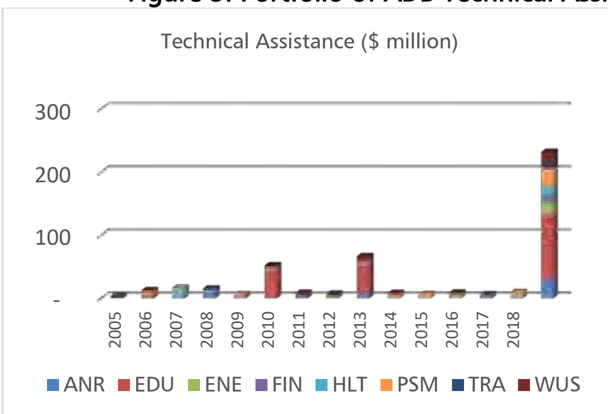
Sector	Planned (a)	Actual Allocations: Approved as planned (b)	Actual Allocations: Unplanned, but approved (c)	Total Allocations (d)	Percentage Deviation[a] (d-a)/a
Agriculture	2,736.9	802.2	100.00	902.2	-67.0
Education	1,725.0	325.0	80.0	405.0	-76.5
Energy	4,900.5	2,548.0	226.5	2,774.5	-43.4
Finance	2,080.0	1,400.0	400.0	1,800.0	-13.5
Health	100.0	50.0		50.0	-50.0
PSM	7,167.7	5,887.8	2,430.0	8,317.8	16.0
Transport	1,280.0	1,081.0	134.2	1,215.2	-5.1
WUS	504.4	437.6	40.00	477.6	-5.3
Total	**20,494.5**	**12,531.6**	**3,410.7**	**15,942.3**	**-22.2**

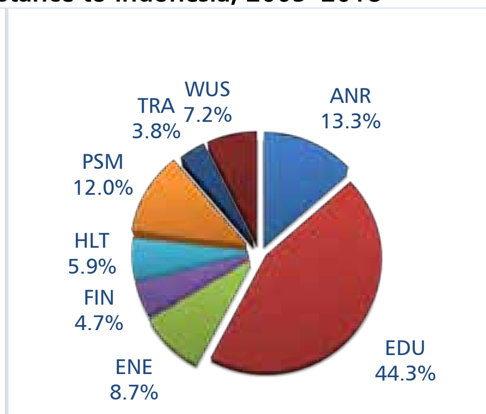
PSM = public sector management, WUS = water and other urban infrastructure and services.
Note: "Planned" allocations for purposes of this country assistance program evaluation were sourced from the country operations business plans (COBPs). "Unplanned, actual" were those not mentioned in the COBPs.
Source: Independent Evaluation Department.

67. **During 2005–2018, ADB approved 122 TA projects, amounting to $232 million.** ADB-administered TA cofinancing was $180.4 million, 80% of the total TA funding for the CAPE period. The funding sources were mainly Australia, Canada, France, Germany, the Netherlands, and financing partners such as the Asian Clean Energy Fund, Canadian Climate Fund, Department for International Development of the United Kingdom, the Global Environment Facility, and the

JFPR. Capacity development TA was most prevalent in the portfolio, representing 63% of the total approved amount. This focused mainly on institutional capacity building for the capital markets and banks, strengthening management capabilities, and enhancing finance sector governance. Advisory and operational TA constituted about 17.0% of the portfolio, and project preparatory TA projects 13.3%. The remaining TA projects were research development and policy advisory-related projects. Education had a sizable slice of the TA portfolio at 44% of the TA project cost, with a large chunk going to only two TA projects. This was followed by ANR and PSM, energy, health, and transport in decreasing order (Figure 5).

Figure 5: Portfolio of ADB Technical Assistance to Indonesia, 2005–2018





ADB = Asian Development Bank, ANR = agriculture and natural resources, EDU = education, ENE = energy, FIN = finance, HLT = health, PSM = public sector management, TRA = transport, WUS = water and other urban infrastructure services.
Sources: Asian Development Bank databases.

D. Focus Areas of Other Development Partners

68. **Multilateral and bilateral partners played complementary and unique roles in Indonesia.** However, the government has no formal partner coordination scheme—thus the development partners are mostly spread across all the major sectors. ADB, World Bank, Japan International Cooperation Agency (JICA), and KfW prioritized PSM-related support, having the bulk of their lending portfolio aimed at projects dealing with public expenditure and fiscal management reforms at national and local levels. Energy-related projects were mostly the focus of ADB, JICA, and KfW. The agriculture sector received investments from the IFAD, World Bank, and Australia while the transport sector received its support from ADB and JICA. Some of these development partners focused their support on certain sectors. Australia's efforts were concentrated on education, with the bulk of its investments in this area. The World Bank was the main partner for social protection and water supply, while KfW supported tourism.

69. Like ADB, the World Bank had a sizable share of its lending in the form of development policy loans (Table 5). For the period 2005–2018, 56% of the World Bank's financial support was through policy loans (compared with 69% for ADB). Development policy loans were used mainly to support PSM operations and to some extent finance sector reforms. ADB relied on the analytical work carried out by the World Bank in designing its own policy-based loans. For example, ADB's Development Policy Support Program made good use of its connection to the World Bank's development policy loans series for its design. Both ADB and the World Bank worked on some common areas, such as the development of a PPP framework and worked with other partners such as KfW, Department of Foreign Affairs and Trade of Australia (DFAT), AFD and the Government of Japan. Still, the sheer size of ADB's PSM program raises the question of why ADB did not itself produce more major knowledge work in this area; such as the very recent work of the Economic Research and Regional Cooperation Department (footnote 8). In the

finance sector, however there was not much overlap between ADB and the World Bank, which worked more on microfinance.

Table 5. Financing Volume through Policy-Based Loans ($ million): ADB and the World Bank

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2005–2018
ADB	500 (44)	600 (80)	900 (95)	830 (82)	2000 (89)	400 (81)	300 (48)	1100 (89)	400 (53)	400 (67)	900 (60)	1000 (78)	900 (43)	1000 (59)	11,230 (69)
World Bank	400 (30)	642 (51)	800 (62)	1359 (66)	1415 (37)	1735 (58)	1081 (44)	3174 (86)	300 (24)	679 (55)	500 (100)	1300 (70)	950 (66)	650 (38)	14,985 (56)

ADB = Asian Development Bank.
Note: Numbers in parentheses denote percentage of total financing.
Source: Independent Evaluation Department.

E. Summary

70. **ADB maintained pro-poor, inclusive and environmentally sustainable growth as its strategic objective over the different CPS periods covered in this evaluation**. It responded to Indonesia's changing development priorities over time by shifting the focus of its support. In the Medium-Term Development Plan, 2005–2009, the government sought to raise levels of sustainable economic growth, create jobs, and accelerate achievement of the MDGs. The 2010–2014 plan focused on reducing poverty through more rapid, more sustainable, and more inclusive economic growth; improving the quality of the public sector; fostering democracy; and strengthening the rule of law. The 2015–2019 plan prioritized scaling up of infrastructure investment, improvements to education and skills development, and policy reforms to improve competitiveness and service delivery. ADB responded to the changing country context by providing the necessary budget support even though CPS, 2012–2014 had anticipated a shift from program to project lending.

71. **The ADB program in Indonesia during 2005–2018 was guided by the strategic objective of higher economic growth that is also inclusive and environmentally sustainable.** However, there were strong differences between planned and actual investments. Through its support, ADB tried to advance the broad goals of improved infrastructure services, better economic governance, and enhanced human resource development. Total sovereign plus nonsovereign approved financing was $19.3 billion, with the bulk of the support (45% by volume) concentrated on PSM, the other major sectors being energy (24%) and finance (14%).

72. **PBL was preferred by the government over the evaluation period, although recently RBL has emerged as another preferred modality**. To a large degree, the World Bank faced a similar situation. The policy reform focus was mostly on financial, capital market development and PSM. PBL accounted for 69% of total sovereign lending volume during 2005–2018. The tilting of the lending program toward policy-based loans was partly due to difficulties in generating and implementing investment projects. Difficulties arose because of project readiness issues, the government's perception of the high transaction costs associated with investment loans, land acquisition problems; and the government's preference for the use of country systems to manage infrastructure projects. The use of country systems was not acceptable to ADB, leaving a more limited set of eligible programs.[51] All this went against the continuously stated objective of infrastructure development.

[51] ADB was, however, willing to consider the use of country systems at the agency level and did so in one of the projects with PLN.

3 Sector Program Performance

Highlights:

- Notwithstanding some weaknesses in design, most of the sector programs during 2005–2018 were rated *relevant* to country partnership strategy objectives. The transport, education, and health sector programs were rated *less than relevant*.
- The public sector management (PSM), finance, energy, and transport sector programs were rated *effective* whereas other sector programs were rated *less than effective*.
- The operations during the evaluation period were rated *efficient* largely due to the efficiency rating for the energy and finance programs. However, the PSM sector was not considered in this assessment largely because of the preponderance of policy-based lending and its occasionally unplanned character.
- In the PSM, energy, finance, and transport sector programs, outcomes were rated *likely sustainable* given the strong commitment and high degree of ownership from the government. The agriculture and natural resources, water and other urban infrastructure and services, and social sectors faced operations and maintenance issues due to capacity and financing problems and were rated *less than likely sustainable*.

73. **This chapter looks at the performance of the ADB program in each sector.** The assessment considers the relevance, effectiveness, and efficiency of ADB support. It also looks at the contribution of the ADB program to development impact and the likelihood that the outcomes of ADB support will be sustainable. The linked documents contain more detailed sector program assessments along with some recommendations (Appendix). The assessments at the sector level were guided by the objectives and goals specified for the sector in the CPS results framework. Favorable assessments at the project level may not automatically translate into favorable assessments at the sector level. Of the 93 projects in the scope of the evaluation 32 had evaluation reports, 10 of which had not yet been validated or evaluated by IED. The success rate of 81% is seen from this evaluated portion of the sovereign portfolio. The success rates at the sector and modality level as seen from the evaluations are discussed in the linked document on portfolio analysis (Appendix, Linked Document B).

A. Public Sector Management Operations

1. ADB Program

74. **ADB's country strategies during the evaluation period all supported PSM operations to some degree, though PSM was not central except perhaps in the first strategy program (2006–2009)** (Appendix, Linked Document C). The planned PSM portfolio was about $7.2 billion, while the actual approved PSM operations in Indonesia comprised 24 sovereign loans, 5 grants, and 27 TA operations totaling $8,656 million. The actual program approved included some projects that had PSM listed as one of several in the multisector designation. TA operations were mainly related to or attached to PBL although there were a few stand-alone TA projects in PSM. In addition, $1,111 million was provided by various development partners as cofinancing. PSM accounted for about half of the overall program. Within PSM, the subsectors of decentralization and public expenditure and financial management were the most visible. PBL was the dominant modality for PSM support (21 of 24 lending operations, accounting for 93% by value) and this was driven by reform considerations and the government's requests for budget support.

75. **The Indonesia program was far more reliant on PBL than programs in any other developing member country over 2005–2018.** The second highest user of PBL was the Philippines with $6.4 billion during the period. Authorities emphasized the PBL's role of providing a buffer against financial volatility, in addition to providing an opportunity for support for policy reforms. TA operations included Strengthening Knowledge Sharing in Indonesia, which supported the preparation of the government's long-term vision, Strategy 2045, and the government's Medium-Term National Development Plan, 2020–2024 in the area of PSM, and helped develop the PSM capacity of subnational governments. Strengthening Fiscal Risk Management of Accelerated Infrastructure Delivery supported the development of the MOF's capacity to analyze

the fiscal sustainability of the government's accelerated infrastructure program. In addition to such TA, consultation missions by the MOF's research department staff provided opportunities for knowledge exchange.

2. Assessment

76. **Relevance: the PSM program during the CAPE period was, on balance, *relevant*.** The CSP, 2006–2009 had a very large program of PSM reforms but, due to the global financial crisis in 2008, this became even larger with additional, appropriate, countercyclical support, leading to an allocation of over $5 billion. The CPS, 2012–2014 planned a few PSM interventions, although these were not indicated in the CPS results framework, leading to difficulties for IED in assessing the relevance of the PSM operations that were nevertheless undertaken. The CPS, 2016–2019 expanded support for PSM again, which led to another major emergency loan classified as PSM, an appropriate response to a crisis. By and large, PSM support was responsive to Indonesia's macroeconomic management and policy reform needs. ADB's program provided budget support at critical times to deal with budget deficits, through PSM operations and through PBL in other sectors, reflecting the external and internal economic environment, and aiming to deal with budget sustainability and macroeconomic stability. ADB was able to leverage its relationship with its development partners (see para. 68) to engage in a meaningful dialogue with government and to attract considerable cofinancing, amounting to an additional 12.8% of the PSM portfolio. This cooperation with development partners was evident in ADB's response to the tsunami disaster that struck Aceh and Nias in late 2004, and to other disasters. ADB offered post-disaster recovery and social protection support.

77. **The focus of PSM support varied with the government's changing needs over time.** Decentralization was the dominant subsector in the early years, due to efforts to maintain the integrity of the state. Early support for decentralization was focused on establishing a national framework for capacity development to enable regional governments to assess and address their own needs in relation to their new functions in human resources, financing, and organizational structures. Public expenditure and financial management were interwoven with decentralization, as can be seen in the Local Government Finance and Governance Reform Program; the emphasis was placed on financial management by regional governments, including regional government taxation and borrowing. The Development Policy Support Program series of loans, implemented from 2005 to 2011, focused on public financial management. The government's interest in ADB support for improving the investment climate and acceleration of infrastructure provision led to operations aimed at removing impediments and at spurring financing through PPPs (e.g., the Infrastructure Reform Sector Development Program), although the relationship with inclusive and environmentally sustainable growth, the central objective of the CPSs, was not clear. Toward 2018, the concern for the growing income inequality led to ADB support for the attainment of the Sustainable Development Goals (SDGs), in the Fiscal and Public Expenditure Management Program. The PSM program also responded to the need for countercyclical financing to overcome economic shocks such as the global financial crisis and the tapering of federal reserve's monetary easing (2008 and 2012).

78. **The design of results frameworks was weak, with outcome indicators in the program documents too optimistic or far from the government's or ADB's actions.** The absence of credible and useful indicators weakened the M&E framework of the program. In the CPS, 2012–2014 the PSM sector program was the second largest, yet it did not appear in the results framework, and hence its relevance to the CPS objectives was unclear to IED. The targeted outcomes for PSM were not always well selected or formulated, making it difficult to assess effectiveness and development impact. The design of PSM operations was in some cases inconsistent with the institutional and capacity challenges, hinting at the lack of backing from appropriate analytical work on the part of ADB. This was reflected, for example, in the work on municipal bonds and

PPP, where many different operations were taking time to achieve a breakthrough on the ground.[52] However, PBL was generally supported by TA for analytical and advisory support.[53] Within the PSM sector, the heavy reliance on policy-based loans (90%) might have come at the cost of investment projects for PPPs or of projects in internal audit, procurement, with an emphasis on regional governments.

79. **Effectiveness: considering the results achieved, the ADB support for PSM was *effective,* despite some deficiencies.** ADB's core lending related to decentralization and supporting TA projects was generally effective in supporting required policy reforms. The share of own source revenue in total regional government revenues, including transfers, increased from 18% in 2011 to 23% by 2014. The MDG-related program (Poverty Reduction and MDG Acceleration Program) was linked to increased social spending, although its effectiveness was limited when the program cluster was truncated after the first of three programs.[54] Important contributions related to service delivery included the application of minimum service standards for basic services in national and regional government planning, although this has stalled in recent years. Countercyclical operations (2009 and 2012) were effective in providing liquidity and confidence to the markets. The legal and institutional framework for PPPs was developed through the Infrastructure Reform Sector Development Program cluster. However, these reforms were unable to bring about the expected investments. The State Audit Reform Sector Development Program helped in professionalizing internal auditing and exceeded the training targets for degree and certificate programs. Currently 76% of regional governments received Supreme Audit Agency "unqualified" audit opinion, a significant increase from the 33% in 2013.

80. **Efforts related to local government financial management and PPPs did not yield the expected results**. Decentralization was not very effective in developing the institutions and processes needed to implement the required policies. The computerized financial management information system in 171 regional governments under the Local Government Finance and Governance Reform Program did not fare well, as procurement was delayed and eventually much of it was canceled. In the State Audit Reform Sector Development Program, the 14 centers of excellence were reduced to 8, as the Supreme Audit Agency minimized project risk. The efforts to generate bankable PPPs fell short of the targets set in the Infrastructure Reform Sector Development Program and the Stepping Up Investments for Growth Acceleration Program, particularly at regional government level. No new procurement law was issued as had been hoped for in the CPS, 2012–2014. However, in 2018 Presidential Regulation No. 16 was issued, allowing sector ministries to initiate procurement following the June estimated budget rather than the November determination of the budget. This regulation was a prior action for Fiscal and Public Expenditure Management Program II. While the regulation is an improvement, it continues the practice of embedding procurement regulations in presidential instruments, which have changed frequently.

81. It is too early to make a judgment on the achievement of other results, such as the CPS, 2016–2019 target of boosting local taxes. The relevant TA started in 2017 in Balikpapan. The Fiscal and Public Expenditure Management Program (2016–2018) assisted efforts to organize and mainstream efforts to achieve the SDGs, but it is too early to assess its results. PBL related to public financial management improved budget allocations and transparency to some extent, but

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[52] Municipal bonds are expected to be launched soon in Central Java, Jakarta, and then west Java with a targeted date of April 2020.

[53] ADB through a post-program partnership framework in PBL, engages with the government over the medium-term using TA support and policy dialogue.

[54] IED assessed this program *less than effective* overall in achieving its intended outcomes and outputs (IED. 2017. *Validation Report Indonesia: Poverty Reduction and Millennium Development Goals Acceleration Program*. Manila: ADB).

some governance indicators did not point to major improvements in this area. For example, the International Budget Partnership, in the crucial area of maternal health and child nutrition, found that "Between 2014–2016, the Directorate of Community Nutrition spent, on average, approximately 79% of their budget. Moreover, under-spending has worsened over this period; the execution rate fell from 89% in 2014 to 62 in 2016."[55]

82. **ADB has made significant efforts in the area of social and environmental safeguard policies in Indonesia.** Since 2007, it successfully helped the government enhance the legal and administrative framework for land through a TA project,[56] which contributed to the Law on Land Acquisition for Development in the Public Interest. This was closer to the ADB Safeguard Policy Statement of 2009 than the legal framework that preceded it, although significant gaps remained.[57] ADB received a request from Indonesia for Indonesia's safeguard system to be used in ADB-supported projects in four infrastructure sectors in 2013, which led ADB to approve another TA project[58] to conduct the necessary legal equivalence and implementation acceptability assessments on the possible use of country safeguard systems (CSS) in ADB-supported projects. After the initial assessment, it was decided to pursue CSS with one agency, PLN, for the energy sector. A paper proposing the use of CSS in ADB-supported projects with PLN is scheduled for discussion by the ADB Board of Directors in November 2019. The recent PLN safeguard experience through RBL was for low-risk projects. Given that issues of capacity, law, and policy remain, and that the PLN decree and guidelines have yet to be introduced, it is appropriate that ADB and PLN should proceed with low-risk operations. Use of CSS can be gradually rolled out in ADB-supported projects to ensure positive outcomes as staff capacity and experience with the new guidelines is gained. The anticipated introduction of a safeguards "center of excellence" supported by ADB together with the Word Bank and DFAT will help build national capacity for safeguard implementation.

83. **Efficiency: the PSM sector program was not rated in terms of its efficiency.** Most PSM operations were in the form of PBL and it was difficult to estimate the costs and benefits of the reforms they stimulated, making a proper economic analysis impossible. The choice of single-tranche policy-based loans avoided the usual issues found with second and third tranche approvals of multitranche loans and this could be seen as a positive aspect of the program. However, some policy-based loans were prepared only when sufficient approvals of investment project proposals failed to materialize in other sectors. The larger picture is not one of efficiency.

84. **Sustainability: ADB's PSM program is rated *likely sustainable*.** In general, supported policy reforms seem unlikely to be reversed and the government's capacity in certain areas has improved, which will enable it to sustain outcomes. Fiscal decentralization reforms supported by ADB have made progress and are unlikely to be reversed; the same is true for public expenditure and financial management. One exception was the recentralization of natural resource management functions of the government from the district and city levels to the central and provincial levels (Law 23/2014). This measure was seen by some as a needed correction, and by others as an unfortunate reversal of a progressive policy. The legacy of devolution reforms persists in the main. For instance, the devolution of collecting property taxes is expanding local own revenues as a proportion of total revenues (from 18% in 2011 to 23% in 2014) and it is making investments in local infrastructure and service delivery more accountable. Increased social sector spending as a proportion of GDP also seems to be firmly embedded in policy and budget practices; education and health spending have risen to 3.5% of GDP (2015) and 3.1% (2016)

[55] https://www.internationalbudget.org/wp-content/uploads/indonesia-budget-credibility-snapshot-ibp-2019.pdf
[56] ADB. 2007. *Enhancing the Legal and Administrative Framework for Land in Indonesia*. Manila.
[57] IED. 2016. *Real-time Evaluation of ADB's Safeguard Implementation Experiences Based on Selected Case Studies*. Manila: ADB.
[58] ADB. 2013. *Republic of Indonesia: Aligning Asian Development Bank and Country Systems for Improved Project Performance.* Manila.

from less than 3% each in 2009. ADB, with other development partners, helped Indonesia build capacity to maintain macroeconomic stability, for instance by identifying when to activate its crisis management protocols within the precautionary facility.

85. **Improvements in the PPP framework will continue to facilitate the use of PPP as a financing mechanism, although its use is contingent on building more capacity to generate transaction-ready PPPs.** Prospects for a conducive business climate are not fully satisfactory. Deregulation has eased investment procedures. Business formation and investment has been spurred by one-stop-centers at national and regional government level, but obtaining the necessary registration, permits, and licenses can still be a time-consuming and expensive affair.[59] Progress in financing and implementation to attain the SDGs is less likely to be sustained unless data systems and vertical reporting are strengthened and planning and budgeting are made performance-oriented. Increased accountability through internal auditing support is likely to last only if institutional development and additional reforms (e.g., greater independence of the audit function) are realized.

86. **The momentum of PSM improvement will probably be limited, given that there have been only tentative achievements in civil service reforms so far**. Support from ADB and other partners in this area may be difficult since the government wishes to have control over the pace and nature of these reforms.

87. **Development impacts: based on the weak contributions to CPS goals, the development impacts of the PSM program are rated *less than satisfactory*, despite the program's contributions to the decentralization of government and public financial management improvements in some areas.** PSM support, despite its large size, was unable to contribute directly to the more explicit goal of improving infrastructure services nor to the improvement of human capital development, or even to inclusive economic growth as a whole. Despite repeated attempts by ADB to promote investment projects overall and PPPs in particular, there was no remarkable increase in such transactions. Similarly, municipal bonds are taking longer than anticipated to take off (footnote 52). Efforts to expand taxation, a possible contributor to greater infrastructure spending that could also have had redistribution and inequality reduction effects, have been tentative at best. An adverse effect of the stagnation of local taxes is an overreliance on intergovernmental transfers that reduces public scrutiny and inhibits subnational government fiscal discipline.

88. The limited reach of reforms in the later part of 2005–2018 will make it difficult to achieve some of the CPS targets related to PSM. For instance, the target on the share of infrastructure investments financed by PPPs is likely to be missed by a long way. ADB has been involved in efforts to stimulate the pipeline of PPP projects. Bureaucratic reform will continue to be slow, particularly with respect to the civil service, making it difficult for Indonesia to attain some of the SDGs as targeted by ADB's PBL.

89. Nevertheless, there were also some positives. The influence of the ADB program is evident in, among others, fiscal decentralization, some aspects of financial management, and the framework for PPPs. PSM support has been instrumental in supporting the establishment of a more conducive framework for macroeconomic stability and investment. Timely countercyclical ADB support for deficit closing (around $3 billion) has helped to maintain macroeconomic stability in Indonesia. ADB's support sent calming signals to the market, and helped the government meet its spending commitments without resorting to inflationary financing or crowding out the private sector. The cost and size of its debt has been kept manageable since the first countercyclical operation in the CAPE period was approved in 2009. Debt as a percentage of GDP was 32.9% in 2014, 36.1% in 2015 and 34.2% in 2016,[60] far below the constitutionally

[59] World Bank. 2019. *Doing Business: Economy Profile Indonesia*. Washington, D.C.
[60] IMF. 2018. *Article IV Mission*. Washington, D.C.

set limit of 60%. Although the extent to which ADB support contributed to this result is perhaps small given the size of the economy, it is likely it made some contribution.

B. Energy Sector Program

1. ADB Program

90. **ADB support for the Indonesian energy sector included infrastructure projects to modernize and expand the power infrastructure, increase the use of renewable energy; lower emission generation, and support policy changes** (Appendix, Linked Document D). During 2005–2018, ADB provided 15 sovereign loans, 3 grants, 14 NSOs, and 19 TA operations in the energy sector. The sovereign operations funded distribution rehabilitation and strengthening. They included transmission projects in west Kalimantan connecting Indonesia with Malaysia and upgrading transmission facilities in Kalimantan to import hydropower from Malaysia, and the Java–Bali 500 Kilovolt (kV) Transmission Project intended to transfer excess Java power to Bali and reduce its reliance on expensive diesel generation. There were two policy-based loans in the energy sector: Sustainable and Inclusive Energy Program 1 and 2. These sought to (i) improve fiscal sustainability and energy sector governance, (ii) increase private participation in the power and gas markets, and (iii) improve the regulatory environment for increased access to clean energy. Two projects used the RBL modality: one for strengthening Indonesia's electricity grids in Sumatra to improve service quality, and the other for increasing access for consumers in more remote areas in the eastern regions of the country.

91. Nonsovereign lending included loans for three liquefied natural gas (LNG) trains at the Tangguh Development, two geothermal generating plants, a combined wind and solar project, and an LNG-to-power project. All nonsovereign loans were cofinanced by other multilateral and commercial lenders.

92. Of the 19 ADB energy TA projects in Indonesia, 9 were project preparatory TA, 5 were capacity building TA, 4 were policy and advisory TA, and 1 was an advisory and operational TA. Twelve TA projects of a TA cluster supported the Sustainable and Inclusive Energy Program. The other seven TA projects were for preparing the Java–Bali 500 kV Crossing Project, the geothermal power development, the Development of the West Timor Wind Power Project, and for capacity development support for RBL project implementation, implementing climate change adaptation, carbon capture and storage, and the Banten and South Sulawesi wind power development.

2. Assessment

93. **Relevance: ADB support for energy sector in Indonesia is rated *relevan*t.** ADB's energy program was aligned with Indonesia's development strategy as well as with ADB's Strategy 2020 and with country and sector strategies. The first three Medium-Term Development Plans in 2005–2019 emphasized increasing efficiency in the use of energy, rehabilitating the energy infrastructure, reducing subsidies, developing energy infrastructure in rural areas, significantly scaling up infrastructure investment (power generation) and renewable energy development, and policy reforms to improve competitiveness and service delivery. ADB loans and TA projects supported the government's development strategy for the energy sector. They were aimed at boosting access to energy, increasing energy efficiency in the public and private sectors, expanding the development of renewable energy and clean gas-fired generation through improved regulations and access for private investors, and improving the governance of the sector. The design and monitoring frameworks (DMFs) for sovereign loans, except for the Java–Bali Distribution upgrade, were well articulated and had clear, measurable outputs, including measurable disbursement-linked indicators and program action plan indicators in the RBL projects. Inclusive growth aspects of the program design included an expansion of the electricity

network in rural and remote parts of Indonesia. By supporting clean energy and operations aimed at energy efficiency, the program supported the objective of environmentally sustainable growth.

94. **There is good formal and informal coordination between ADB and other development partners**. Coordination meetings are held at least twice a year on geothermal development with the World Bank, and bilateral development organizations from France, Germany, Japan, New Zealand, and the United Kingdom. The Sustainable and Inclusive Energy Program 1 was cofinanced by AFD, World Bank, and KfW. There are no conflicting programs being supported by development partners. Many of the TA projects supporting the Sustainable and Inclusive Energy Program were funded through the Australian Agency for International Development, while other development partners provided complementary support to the regulatory reforms and improved governance. Other examples of cofinancing were: (i) joint cofinancing with AFD of the West Kalimantan Grid Strengthening Project; (ii) parallel cofinancing of the Sumatra RBL program with the World Bank's program-for-results financing, with closely coordinated results indicators and program actions, and a single independent verification agent administratively managed by ADB for both loans; and (iii) parallel cofinancing of the Eastern Indonesia RBL with KfW, with fully harmonized results indicators and program actions, and a single independent verification agent administratively managed by ADB for both loans.

95. **The modalities used suited the nature of the projects**. Most were investment loans appropriate for large infrastructure projects. The program also included two RBLs for the expansion of the State Electricity Company—Perusahaan Listrik Negara (PLN)—distribution network. This expansion involved multiple projects spread across wide geographic areas and was not suitable for standard project funding due to the dispersed nature of the work and small amounts of procurement. The funding for the Sustainable and Inclusive Energy Program projects was provided by a PBL, which was appropriate for the intended reforms, supported by TA for background analytical and advisory work, and for capacity development. In the nonsovereign sector, the loan maturities were longer than for commercial sources of finance. The development of a single fund by ADB to finance a mixture of several renewable energy projects enabled the projects to reach their required hurdle rate.

96. **Effectiveness: the energy program in Indonesia is rated *effective*.** The program achieved many of the expected outputs and outcomes. The Java–Bali Electricity Distribution Performance Improvement Project, which was the only completed sovereign loan project approved in the CAPE period, increased PLN's overall power distribution efficiency and the quality of power supply. However, outputs could be measured only on a grid basis and not for the project, as various subprojects were integrated across several locations in the Java–Bali network. Under the West Kalimantan Grid Strengthening Project, with over 78% of the loans disbursed as of March 2019, 150 kV transmission lines and a 150/20 mega volt amp substation have been completed. Up to 228 megawatts (MW) peak load has been registered on the connection with Malaysia and nearly 1,500 new households have been connected. This source of power replaced several diesel-fired generators and the average cost of electricity dropped from 2,342 Rp/kilowatt hour (kWh) to 1,315 Rp/kWh in the region.

97. **The policy-based loans and the result-based loans supported policy and regulatory changes and made significant contributions to the distribution sector.** The Sustainable and Inclusive Energy Program delivered 19 out of the 22 planned regulatory and policy changes envisioned during project preparation. It helped turn the public sector PLN from a loss-making institution requiring increasingly large subsidies, into a corporation with the ability to meet most of its revenue requirements and to service its debts. The accompanying TA projects have largely achieved their intended outcomes. The two ongoing RBLs have made significant contributions to improving PLN's distribution system and increased the number of new consumers connected in

rural regions. The targets for five out of six disbursement-linked indicators have been exceeded. The TA projects supporting the RBLs have significantly increased PLN's M&E capacity.

98. The Java–Bali 500 Kilovolt Transmission Project was unable to produce any results as it could not obtain permits in Bali at the point of the transmission crossing. The government canceled $228.1 million (92%) of the total loan amount of $249 million that was to be provided by ADB and the European Union's Asian Investment Facility.

99. **ADB nonsovereign projects have helped exploit natural gas for exports and to provide clean energy at a lower cost.** The Tangguh project that began LNG exports in June 2009 became a source of foreign exchange earnings, and generated revenues for both the central and regional governments. The project employed up to 10,920 workers during construction, with 97% of them hired locally. The extended annual review report indicated there had been an increase in household income in the project area of 168% since 2003.[61] The Sarulla Geothermal Project commissioned the last of its three units in May 2018 and will provide renewable energy that is cheaper than the average cost of the PLN-run plants in eastern Indonesia. The third completed project was the Vena Wind and Solar Project, the first phase of which, the wind farm, was commissioned in September 2018. The second phase, a 42 MW solar photovoltaic (PV) project, has been commissioned, and is awaiting PLN approval to commence operations. These wind and solar facilities will provide electricity cheaply than PLN-run plants in eastern Indonesia. In addition to providing employment and training to local people, Vena Energy has actively sought community support, and has invested significant funds in community infrastructure.

100. **Efficiency: ADB's portfolio in the energy sector is rated *efficient*.** The West Kalimantan Grid Strengthening Project has made good progress with few delays. The delivery of outputs under the ongoing RBL projects has been more efficient than standard project loans. However, other sovereign loan projects have suffered delays. For example, although the Java Bali Distribution Improvement Project had an economic internal rate of return (EIRR) at completion of 22.9% (as per the project completion report validation report), its design inefficiencies led to long delays and calls for additional management and supervision.[62] This project needed several changes in scope due to inexperienced project management unit (PMU) staff and an ineffective consultant firm. The cancellation of a major portion of the ADB and Asian Investment Facility loan for the Java–Bali 500 Kilovolt Transmission Project will lead to substantial delays, because the new alignments for the crossing are being finalized and construction contracts cannot be expected in the near term. Delays were also experienced in achieving most of the reforms targeted by the Sustainable and Inclusive Energy Program, some of which were due to the large number of policy changes and the many ministries and agencies involved in the process, making coordination and reaching agreement difficult. Several projects designed in the sector, including hydropower projects, did not proceed for one reason or another.

101. **NSOs were economically efficient.** The clients overcame first mover risks and addressed various technology and regulatory challenges (for wind and solar projects). The clients reached financial closure and began commercial operations that produced cheaper power than PLN-run plants (for geothermal projects). On balance, considering the implementation performance of both sovereign and nonsovereign operations, ADB's overall portfolio in the energy sector is rated *efficient*.

102. **Sustainability: the outcomes from the energy program are rated *likely sustainable*.** There are several factors that should help sustain the outcomes of ADB-supported energy operations.

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[61] The project, however, had not set a target for income increase.

[62] The project design did not allow enough time for delivery of procured materials, bidding for contractors had multiple rounds due to lack of experience, and contracts were awarded to firms with transmission experience but not distribution, which led to further delays.

ADB's sovereign operations contributed to PLN rationalizing tariffs and managing subsidies more efficiently. The current electricity tariffs are likely to provide PLN with enough funds to service its debts and meet its operational costs. ADB has increased PLN's staff capacity by providing on-the-job training for monitoring and evaluating projects, transmission planning, environmental management, social safeguard implementation, procurement, and financial management. PLN has enough qualified staff to maintain and operate the assets in a reliable manner, hence the achievements of the sovereign components are likely to be sustainable. The improved regulatory environment has enabled the private sector to participate in the development of renewable and low-emission gas-fired generation and the new tariff structure for renewables are likely to encourage further investment in areas where there are currently high-cost diesel plants. The Tangguh expansion supported through ADB's nonsovereign lending window will provide the needed supplies for PLN to expand its gas-fired generation needs, further contributing to environmental sustainability.

103. **ADB's NSOs supported several financially and commercially viable projects**. These are run by corporations with very high levels of experience. Operators are committed to long-term environmental management. Some have made commendable efforts to involve and support local communities for long-term operations.

104. **Development impacts: development impacts expected from ADB's energy sector portfolio are rated *satisfactory*.** By giving priority to energy infrastructure, ADB's country strategies promoted inclusive growth by creating employment and providing greater access to economic opportunities for women and the poor in secondary towns and rural areas. Reliable electricity enables working hours and productivity to increase and creates jobs. ADB's support to expand and improve generation, transmission and distribution systems has the direct impact of expanding electricity supply and access, including in rural areas. With support from ADB, the rehabilitation and extension of rural networks is now providing continuous supply to a section of rural customers and is likely to expand economic opportunities.

105. **ADB's energy program served the environmentally sustainable growth objective by focusing on renewable energy and energy efficiency**. Both the west Kalimantan project and the project in eastern Indonesia have led to measurable decreases in line losses and corresponding carbon dioxide reductions. ADB supported two geothermal projects, solar and wind power installations and gas-fired plants which will reduce carbon dioxide emissions per kWh of power produced by PLN. The expansion of the Tangguh field will lead to additional LNG use in Java and reduced emissions per kWh in the Java grid. Program action plans supported by one RBL included hazardous waste management in warehouses, which is being implemented.

106. **ADB's approach to the energy sector can be viewed as strategic and holistic, leading to improved sector performance.** ADB targeted policy changes for better sector governance and financial viability, and supported measures for further private and public sector investments. Complementary policy-based loans, RBLs, and TA provided by ADB have created significant synergies. The policy-based loans included a large TA component, which has, for instance, enabled the development of renewable energy policies and implementing guidelines. In turn, these policies have enabled the development of nonsovereign-funded renewable energy projects in the eastern regions of Indonesia. These projects are now being connected to end users through RBL-funded loans, completing a cycle of implementation in the energy sector. Projects are likely to lower carbon dioxide emissions, although this has not been measured. It is easier to measure the carbon impact in the case of the West Kalimantan Project where hydropower imported from Malaysia replaces diesel-fired generators. However, measuring carbon effects from the widely dispersed Java–Bali Grid Strengthening project is difficult. Measuring social impact was

hampered by a lack of baseline data in all the sovereign projects.[63] The Tengguh and Vena energy projects both collected extensive baseline data and are monitoring the impacts of their projects.

C. Finance Sector Program

1. ADB Program

107. **Indonesia was the second largest recipient of ADB support in the finance sector during the evaluation period**. Of the whole ADB sovereign finance sector portfolio during the evaluation period ($13.0 billion), 13.9% was approved for Indonesia, making it the second largest recipient of funds in this sector during 2005–2018, after India.

108. During the evaluation period, ADB approved six sovereign loans (of which five were policy-based loans) totaling $1.8 billion, one grant of $2 million, and five nonsovereign projects amounting to $525 million. However, one NSO was canceled, lowering the total NSOs to $225 million and the overall share of ADB's country support to the finance sector to 11.2%. Eleven TA operations were approved, amounting to $10.6 million, five of which were meant to support the policy-based loans.

109. **The portfolio focused on supporting the stability, deepening, and inclusiveness of the finance sector**. ADB's support to Indonesia's finance sector in the 1990s focused on banks. In light of the Asian financial crisis and Indonesia's decision to move gradually towards a single, integrated supervisory agency, ADB shifted its focus toward supporting the weaker part of Indonesia's finance sector: capital markets, non-bank financial institutions, and the regulatory and supervisory agency in charge of them. This institutional support was coupled with assistance to develop capital markets further, and with strengthening of non-bank financial intermediaries. Financial inclusion received little attention from ADB during the initial phase of the evaluation period, except for a grant given in 2005 for the restoration of microenterprises and microfinance in Aceh.

110. **ADB approved the Capital Market Development Program Cluster, Subprogram 1 ($300 million) in 2007**. This was followed by Subprogram 2 ($300 million) in 2009.[64] In 2009, ADB moved to address the constraints on infrastructure financing and approved the Indonesian Infrastructure Finance Facility ($100 million).[65]

111. **In 2012 ADB approved the Financial Market Development and Integration Program ($300 million)**.[66] The program introduced financial inclusion as one of ADB's policy objectives in Indonesia and consisted of Subprogram 1 ($400 million, 2015) and Subprogram 2 ($400 million, in 2017).[67] The key outcome was an increase in domestic participation in the non-bank finance

[63] Although ADB has claimed benefits from increased access (e.g., in terms of increased economic opportunities and better services), these were not measured; and, even if some local data are available the estimates do not reflect or refer to "before" and "after" situations.

[64] ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant to Indonesia for the Capital Market Development Program Cluster (Subprogram 1).* Manila; and ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to Indonesia for the Capital Market Development Program Cluster (Subprogram 2).* Manila.

[65] ADB. 2009. *Report and Recommendation of the President to the Board of Directors on the Proposed Loan and Equity Investment to Indonesia for the Indonesian Infrastructure Financing Facility*. Manila.

[66] ADB. 2012. *Report and Recommendation of the President to the Board of Directors on the Proposed Policy-Based Loan to Indonesia for the Financial Market Development and Integration Program*. Manila.

[67] ADB. 2015. *Report and Recommendation of the President to the Board of Directors on Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1 Financial Market Development and Inclusion Program*. Manila; and ADB. 2017. *Proposed Policy-Based Loan for Subprogram 2 and Technical Assistance Grant for the Financial Market Development and Inclusion Program*. Manila.

subsector through: (i) strengthening of regulatory oversight; (ii) deepening of the capital market, which provides expanded access to non-bank financing; and (iii) increasing the mobilization of long-term savings through a broadened investor base. The Financial Market Development and Integration Program supported the creation of the Indonesia Financial Service Authority—Otoritas Jasa Keuangan (OJK)—a single integrated regulator and supervisor. The program complemented these efforts with actions to promote the issuance of new instruments and boost long-term savings by strengthening institutional investors.[68]

112. **ADB approved five NSOs in the finance sector in the period**. Two were meant to promote the development of securitized assets—credits for motorcycles (2006), and mortgages (2010). The third and fourth were attempts to promote infrastructure financing, one through a large state-owned bank (2008), and the other through an equity investment for the Indonesia Infrastructure Finance (IIF) facility in 2009. It also included a loan to Indonesia Exim Bank in 2011. This operation was intended to support export financing and to pilot energy efficiency improvements at exporters' plants. The largest approval, however, was for a Housing Finance Program that was canceled.

2. Assessment

113. This assessment of ADB's support to the finance sector is based on the findings of a SAPE for the finance sector which covered the period 2005–2018 and was conducted at the same time as this CAPE.[69]

114. **Relevance**: **ADB's support to Indonesia's finance sector is rated *relevant***. The program's support for the stability, deepening, and inclusiveness of the finance sector was consistent with requirements of the Indonesian economy, and responsive to the needs of the times. ADB's decision to support the development of the Indonesia's finance sector was appropriate in the aftermath of the Asian financial crisis. The program was consistent with the country's priorities as well as with ADB's policies and strategies.

115. **ADB's choice of program modalities and sequencing was appropriate, but weaknesses in the design of the PBL affected the relevance of the program.** The analytical diagnostics conducted by ADB complemented the sector assessments done by the IMF through its Financial Sector Assessment Program. Despite the amount of diagnostic work produced, it is not easy to establish a clear causal pathway from the policy actions to the results chains in the DMFs or to define the contribution of the ADB's program to sector development. In this regard, as was also underlined by the evaluation on policy-based lending,[70] there were too many results indicators in the DMFs and they were generally not sufficiently attributable to the prior actions because they tended to be too broad or simply were not aligned with the policy actions of the PBL. This was the case, for instance, in the work on the insurance industry (life insurance, in particular), where not much of the analytical diagnostic on the bottlenecks of the industry was translated into policy actions and it was not, therefore, reflected in the result chain of the DMF.[71] Moreover, in some instances, indicators became too far-reaching; they were clearly affected by many other factors having little or nothing to do with the policy actions. In other cases where the causal pathway was more

[68] OJK's Board of Commissioners was first appointed on 1 June 2012. It assumed full authority over capital markets and non-bank financial institutions on 31 December 2012, and over banks on 31 December 2013 (Azis, Gonthor. 2013. *Otoritas Jasa Keuangan (OJK)—Indonesia Financial Service Authority*. Jakarta).

[69] IED. 2019. *Sector Assistance Program Evaluation on ADB Support to the Indonesia Finance Sector, 2005–2018*. Manila: ADB.

[70] https://www.adb.org/documents/policy-based-lending-2008-2017-performance-results-and-issues-design

[71] The analytical work on insurance included in the October 2011 back-to-office report, for instance, identified the quality of the distribution and sales channels and the restrictions on investment asset allocation as key challenges but these were adequately included in the program design and monitoring.

visible, as in ADB's efforts to support OJK to increase financial stability, the design of the policy-based loans did not include any higher-level indicators to measure ADB's contribution.

116. **Effectiveness: the finance sector program was broadly *effective, on the lower end of effectiveness.*** Sovereign operations contributed to institution building by supporting the establishment and governance of OJK. By 2012, as planned in the Financial Market Development and Integration Program, the government appointed the first Board of Commissioners of OJK and ADB worked with the board to prepare the first budget for OJK as a separate agency. ADB also supported the establishment of other institutions key for the stability and overall functioning of the financial system: the Financial System Stability Forum, the Bond Pricing Agency, and the Security Investment Protection Fund.

117. **Efficiency: ADB's finance sector program was *efficient*.** ADB's support to the finance sector was mostly in the form of PBL where there were fewer implementation issues than for other modalities and disbursement is straightforward, especially for the single-tranche programs. All the subprograms were completed on schedule and the policy actions were completed within the agreed timeframe. Loan effectiveness and disbursements were fulfilled as agreed in the financing agreements. ADB's support helped Indonesia move forward at crucial junctures, as when OJK was created. Other reforms, for instance in municipal bonds or financial inclusion, need longer to reach the intended outcomes, which brings into question the benefits of supporting the policy reforms considering the costs involved.

118. **Sustainability: the ADB program is rated *likely sustainable.*** The policies were adopted and implemented with a high degree of ownership by the government and the country. In addition, the government now has an institutional arrangement that will allow it to continuously monitor how its agencies are safeguarding macroeconomic and financial stability; the Financial System Stability Forum, the financial stability committee, is the main mechanism through which monitoring is taking place.

119. The development of OJK as a single, unified regulator and supervisor of Indonesia's financial system has become part of the government's institutional landscape and is likely to remain in place for the foreseeable future. OJK is now an independent institution, both politically and financially. It is regarded by the government and the sector as an essential element of Indonesia's finance sector governance framework, together with Financial System Stability Forum, Bank Indonesia, Indonesian Deposit Insurance Corporation, the Fiscal Policy Office of the MOF, and the self-regulatory organizations of the sector (Indonesia Stock Exchange, Indonesia Central Securities Depository, and Indonesian Clearing and Guarantee Corporation). The Bond Pricing Agency has put in place an effective system for credible pricing of bonds and timely dissemination of information to subscribers.

120. The sustainability of OJK will be affected by the return to Bank Indonesia of about one-third of the supervisors at the beginning of 2019, taking with them valuable supervisory skills and experience. A legacy issue associated with the creation of OJK is the potential overlap of supervisory activities between OJK, Bank Indonesia, and the Indonesian Deposit Insurance Corporation. This overlap is an ineffective use of resources and could adversely affect accountability and information sharing. More clarity on mandates and closer cooperation between Bank Indonesia and OJK regarding macroprudential oversight is needed. Moreover, the sustainability of the reforms for the supervision of financial conglomerates by OJK is dependent on further strengthening its capabilities.

121. **The actions that have been taken to widen financial inclusion are sustainable.** However, the interventions that were incorporated in the programmatic series of 2015 and 2017 are limited in scope and reach. The supervision of financial technology companies needs to improve and it

is very likely that the government's approach to financial inclusion will evolve much further as it makes further progress.

122. **The sustainability of the operations supporting infrastructure finance is unlikely.** IIF is now undercapitalized, marginally profitable, and unable to generate a reasonable return on equity. It is too small and a fringe player in infrastructure finance in Indonesia. IIF is unlikely to achieve sufficient scale of operations or level of profitability to ensure its long-term viability. As a small financial institution it is unable to take the lead in arranging major infrastructure projects because of its small balance sheet and single borrower and project limits. This will also constrain its ability to mobilize institutional investors through credit enhancement and risk participation products.

123. **Development impact: the development impact of the finance sector program is rated *less than satisfactory*.** While ADB's contribution to the stability of the sector was significant, its contribution to finance sector deepening was modest and to financial inclusion limited in scope and still to bear fruits. The contribution to stability was mainly through support for the development of a single, unified agency in charge of regulating and supervising the financial system (OJK). Establishing a single unified regulatory and supervisory agency for the system, with good governance standards helped the authorities address a major challenge stemming from the Asian financial crisis. It enhanced oversight of the finance sector which is essential for greater stability. This was a necessary condition for the sound deepening of Indonesia's financial system and Indonesia's development.

124. **Notwithstanding the progress, there are areas for improvement for OJK.** The evaluation mission's interviews highlighted the need to continue building the capacities of OJK staff. The OJK Law is currently being revised with the support of the World Bank, and this offers potential for further and more structured collaboration between ADB and the World Bank to enhance the oversight responsibilities of OJK in complex areas for which enhanced capabilities will be needed, such as in the supervision of financial conglomerates and financial technology companies.

125. **ADB's contribution to financial deepening was modest**. ADB contributed to the growth of the government bond market and the equity market, which are now deeper than at the beginning of the evaluation period. In the area of Sharia-compliant finance, Indonesia went from having virtually no sector at the beginning of the evaluation period to having a well-established Islamic financial system that is the seventh largest in the world. ADB work to support Sharia-compliant financial markets contributed to this progress.

126. However financial markets remain smaller than those in other countries in the region. As a percentage of GDP, Indonesia's local currency bond market is smaller than those of Malaysia, the Philippines, and Thailand. While the Indonesian bond market has increased in absolute terms, its size and depth has not kept up with those of peer countries in the region (Malaysia and Thailand in particular). The government recognizes the need for further progress in financial deepening especially by further developing capital market instruments such as derivatives and supporting the mobilization of finance from the insurance and pension industry. To this end it has started implementing the National Strategy for Financial Market Development, 2018–2024, which aims to create deep, liquid, efficient, inclusive, and secure financial markets. In this regard, ADB's further and more substantive and proactive involvement in capital market strengthening and deepening would be fully aligned not only with the priorities at the country level, but also with the ones highlighted in Strategy 2030.

127. **ADB's involvement in financial inclusion has been limited in reach and scope.** Moreover, the bulk of the interventions started recently so it is too early to see tangible results. The program started in 2015 and has supported financial inclusion policies, financial literacy, branchless

banking, and regulation of financial technology. However, the efforts made by the program did not improve financial inclusion significantly. Official data show that 49% of Indonesia's adult population and 37% of the poorest 40% of the population had a bank account in 2017, while only 12% of the 58 million SMEs had access to credit. Inclusion via financial intermediation, especially through NSOs, was very limited, with no clear financial inclusion results.

128. **ADB's support for financial inclusion was not underpinned by a strategic vision which could have paved the way to a more holistic approach to financial inclusion combining finance and private sector development with the most recent advances in the digital finance and financial technology industry.** The synergies between the sovereign and nonsovereign operations were not sufficiently explored. Moreover, the role of private sector participation in developing the finance sector was not adequately considered. Digital finance and financial technology's rapid evolution and their potential to reach remote areas and small businesses offer both opportunities and new challenges. For SMEs to be able to benefit from financial technology and to adapt to new ways of doing business, access to finance must be part of a more holistic approach which develops policies to support private sector development in tandem with the finance sector. ADB needs to support such a holistic approach to financial inclusion.

129. **Finally, ADB's NSOs in the financial sector were *less than successful*.** Especially in financial intermediation, nonsovereign interventions were scattered and opportunistic, and did not take advantage of the few windows of opportunity that existed. ADB played a countercyclical role in supporting state-owned financial institutions after the global financial crisis. However, these interventions did not have the needed replication and demonstration effects. Interventions to securitize motor vehicles and energy efficiency financing, among others, were premature and did not meet the market's current needs. ADB's contribution to financial deepening through NSOs was limited by the long lead time for project disbursement, changing market conditions, and the inability to price local currency transactions for a volatile market hesitant to take open currency positions.

D. Agriculture and Natural Resources Sector Program

1. ADB Program

130. **ADB provided 11 loan and grant projects in the ANR sector during 2005–2018, including 4 multisector loans, for a total approved amount of $982 million (5.2% of the total country portfolio)** (Appendix, Linked Document E).[72] These operations fell into three broad categories, poverty-reducing and income-generating, rural infrastructure CDD projects,[73] fisheries, marine resource and coastal management projects (hereafter fisheries projects), and integrated water resource management (IWRM) projects (although an important program, the Water Resources Management Investment Program, was canceled after 10 years). In addition, there is an ongoing project in social forestry.

131. **The CDD projects focused on rural infrastructure, providing essential relief, food security, and livelihood support to the population.** They helped to upgrade neighborhoods with transport links, water and sanitation, education, and health services. They also often attempted to bring behavioral changes to target groups, such as introducing hygienic practices or pursuing gender

[72] Of the four multisector projects covered under this ANR sector assessment, three were under the transport sector, and one under the WUS for the overall portfolio analysis in the CAPE. Aside from the 11 projects, the ANR sector assessment also examined earlier (approved before 2005, but ongoing during the CAPE period) relevant subsector projects to encompass a comprehensive review of the sector. These included two CDD projects, two fisheries and marine products, an irrigation project, and an agriculture project.

[73] CDD projects included a prominent component on transport under rural infrastructure, hence, some of these are revisited and discussed under the transport sector as well.

equality. Later in the cycle, a number of these projects were associated closely with the government CDD program—Program Nasional Pemberdayaan Masyarakat (PNPM Mandiri)—and were designed as interventions for only 2–3 years.

132. **Fisheries projects focused on fisheries, aquaculture, coral reefs, and coastal management.** These targeted poor fishing communities located in remote unconnected coastal regions; similar groups to those addressed by ADB's efforts in agriculture and rural development.

133. **ADB approved three projects in support of irrigation and IWRM between 2005 and 2018.** The first loan was an MFF, the Integrated Citarum Water Resources Management Investment Program, which did not last beyond the first tranche—the subsequent tranches were canceled because of high transaction cost and limited scope of works. The other two projects (Flood Management in Selected River Basins Sector Project and the Integrated Participatory Development and Management of Irrigation program RBL) were approved only recently in 2016 and 2017 and are in the early stages of implementation—assessing their effectiveness and sustainability and development impacts would be premature.

2. Assessment

134. **Relevance: the ANR portfolio is rated *relevant*.** The ANR sector objectives in the CPS were appropriate and responded well to the key challenges facing the Indonesian economy and ADB's corporate objectives. The CPS recognized the role of ANR in the archipelago, and the continued dependence of Indonesia's large population on these resources. The government's periodic development plans also consistently prioritized the sector. Investments in ANR were important for poverty reduction, assisting in gender and development, generating employment, and rendering economic development environmentally more sustainable.

135. **The ANR sector program was aligned with government priorities in the sector which followed a clear pattern**. After restoring a stable economic growth process after the Asian financial crisis, the government's emphasis shifted to rural infrastructure, especially transport links, and environmentally sustainability and climate change. It gave renewed emphasis to improving coastal management and marine resources, which would also reduce poverty among fishers, fish farmers, and fishing communities.

136. **The ANR program had certain design limitations**. While repeat projects such as poverty reduction and rural infrastructure, or IWRM pursued the subsector objectives through a series of investments, other projects, such as one addressing social forestry, were largely one-offs. Project-related M&E, especially setting baselines of projects and linking them with the CPS results framework, was not very systematic. The technical capacity in subnational offices and the support available from ADB staff were both limited.

137. **Effectiveness: the ANR portfolio is rated *less than effective,* despite some good performances in the multisector CDD projects.** Some of the outputs and outcomes of the CDD projects were innovative and promising in the sense that they introduced new practices and contributed to the achievement of project objectives. However, these projects formed a small part of the total ANR portfolio under assessment. In other types of projects, outcomes were often only partially achieved. Gender- and development-related activities provided useful opportunities to women beneficiaries. There is now much greater awareness among target groups about environmental sustainability.

138. **Some projects did not make full use of the financing and TA resources made available to them.** In some projects, efforts were abandoned, and loan accounts closed before full outputs

or outcomes could be achieved. Some entire areas of engagement have been neglected: the last CDD project was approved in 2011 and even fisheries projects are not in the current portfolio.

139. **Recent trends in ongoing projects in ANR do not promise an improvement in performance**. The recent projects Flood Management in Selected River Basins Sector Project and the Integrated Participatory Development and Management of Irrigation program are ambitious and complex. They require cutting edge technology and better implementation capability, which is not easily available in the sector. Achievement of non-physical outcomes (e.g., strengthening the policy-making capacity of government staff, private sector investment in ANR, and enhanced bank credit) has been hindered by several system-wide structural factors and the lack of institutional development. The government and ADB will have to make an extra effort to ensure that these large complex projects achieve their objectives.

140. **Efficiency: the ANR portfolio is rated *less than efficient*.** ANR projects have benefited many clients through relatively small investments. Investments in CDD projects were generally beneficial in terms of yielding larger incomes. These investments were instrumental in mobilizing community resources in the form of in-kind contributions and increased employment in rural areas. These broad cost and benefit effects are corroborated by the individual estimates of EIRRs for different ANR projects, although lack of baseline data, scope, and methodological issues revealed in several economic re-evaluations in PCRs continue to suggest weaknesses.

141. **There are several implementation and process efficiency concerns in ANR projects that need attention.** The large MFF for the Integrated Citarum Water Resources Management Investment Program was canceled. Smaller projects scattered across remote islands present a tremendous challenge. Small and fragmented investments increase coordination costs and reduce incentives for beneficiaries to exercise ownership. Many of the ANR projects reported that implementation was impeded by procedures related to financial devolution and the absence or irregularity of counterpart funding. Such impediments weakened absorption capacity, as can be seen in the unutilized funds under some projects.

142. **The limited technical capability in implementation agencies was a major constraint on process efficiency.** Project implementation had to be supported by many consultants, financed either by the loans or through TA grants. Apart from being inefficient, the arrangement increased coordination costs and weakened absorption of project expertise, requiring another round of consultants for the succeeding project. Opportunities to build expertise in the sector have been missed. The CSP, 2006–2009 noted that the agriculture sector was the "least efficient" sector.[74] Independent evaluation expressed a similar concern about the limited achievement of outputs and outcomes in ANR in its CPS final review validation.[75] Thus, a systematic lack of implementation capability seems to have persisted across projects.

143. **Sustainability: the ANR portfolio is rated *less than likely sustainable*.** The government is committed to investments in ANR. It has identified ANR investments that are consistent with its own medium-term development plans and has followed rigorous standards in selecting and negotiating project proposals with ADB. However, there have been operations and maintenance (O&M) financing difficulties related to the absence of capacity at provincial, district or lower levels in synchronizing financial flows with consulting services and material inputs on time.[76]

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[74] ADB. 2006. *Country Strategy and Program: Indonesia, 2006–2009*. Manila.

[75] IED. 2015. *Indonesia Country Partnership Strategy Final Review Validation, 2012–2014*. Manila: ADB.

[76] See the comment of a project evaluation report: "… effective roles of both the local governments and communities are required to sustain the O&M of completed project facilities" IED. 2014. *Indonesia: Community Water Services and Health Project.* Validation of Project Completion Report. Manila: ADB; and IED. 2015. *Indonesia: Rural Infrastructure Support to the PNPM Mandiri Project II.* Validation of Project Completion Report. Manila: ADB.

144. **ANR investments tried to reach out to too many remote communities and small habitats and were fragmented**. Similarly, the short duration (2–3 years) of a CDD project can hardly generate lasting impact. An appropriate balance between the long-term hardware and the short-term support are crucial for sustainable rural reconstruction. Despite the CPS attaching priority to them, interventions in the CDD and fisheries sectors have not been adequate.

145. **Development impacts: the ANR portfolio had *less than satisfactory* impacts.** The impacts of rural infrastructure CDD projects as well as marine resources projects were limited. These investments enhanced food security, improved nutrition and helped increase exports. However, because of the limited size of their investments and their wide coverage the benefits were thinly spread. Gains from earlier participatory irrigation projects have been significant, and the new IWRM projects are expected to have a major development impact upon completion.

146. **A notable aspect of some ANR projects has been the participation of local beneficiaries and nongovernment organizations (NGOs).** Residents have been involved in construction as well as the maintenance of project assets. This helps to prolong the benefits of investments. Otherwise, the use of loan funds for some short-lived investments (e.g., 10 years with O&M and 5 years without O&M) was not beneficial.

147. **The impact on gender equity and development was generally positive** and ANR investments contributed to the active participation of women in planning and managing natural resources but Indonesia has a long way to go before it achieves gender equality. As the ANR sector largely consists of independent small farmers, investments in the sector primarily benefited the private sector and created widespread employment opportunities.

E. Transport Sector Program

1. ADB Program

148. **ADB support for transport during the CAPE period amounted to $1,224 million, and was entirely focused on roads** (Appendix, Linked Document F). The portfolio included seven sovereign loans totaling $1.2 billion, which were all completed, and nine TA projects totaling $8.9 million. While before 2005 ADB support to the transport sector tended to be significant, the relative size diminished as the decentralization process slowed infrastructure investment and led to fewer funded projects.

149. **Of the seven loans in the transport sector, only two entailed rehabilitation and improvement**. The Road Rehabilitation II Project covered strategic national roads in 10 provinces of Sumatra and in all 4 provinces of Kalimantan. The Road Development Project, cofinanced by the IsDB with an amount of $65 million, covered strategic national roads in east and west Kalimantan and east and west Java. Both projects also included capacity building for the road agencies involved. The Road Rehabilitation II Project supported sector policy implementation. The Road Development Project included a road safety component, support for an integrated capacity development program for national, provincial, and district road agencies and a study on a strategic approach for prioritizing investments and transport sector planning. The second supported sector policy implementation

150. **The loan for the Rural Infrastructure Support Project and Rural Infrastructure Support to PNPM Mandiri Projects I and II were CDD multisector projects.** The transport component of these three projects accounted for about 80%, with the remainder being aimed at rural development, including irrigation and draining, and water supply and sanitation. Their themes, aside from enhancing inclusive and sustainable economic growth, also covered human development, civil society participation, and strengthening of governance of rural communities. Each village

received a block grant of $25,000 to $27,500 for improving village infrastructure. The second project focused more on the participation of women in this process. With these two projects, ADB enlarged the National Program for Community Empowerment (PNPM Mandiri), which was launched in 2007. This program provides a cohesive link to the many independent poverty reduction programs in the country and aims to cover all rural poor villages throughout the archipelago.

151. **Two policy-based loans, Inclusive Growth through Improved Connectivity, Subprograms 1 and 2, accounted for 58% of ADB's lending to the transport sector during the evaluation period.** These loans supported the domestic and international connectivity objective of the government's ambitious long-term Masterplan for the Acceleration and Expansion of Economic Growth (Masterplan Percepatan dan Perluasan Pertumbuhan Ekonomi Indonesia). The Inclusive Growth through Improved Connectivity program was parallel financed by the World Bank ($400 million in two loans), JICA ($200 million), and AFD ($100 million). The policy agenda focused on three areas: (i) strengthening coordination and the regulatory framework for connectivity and infrastructure development, (ii) improving intra-island and inter-island connectivity, and (iii) improving international connectivity. Policy actions enhanced the institutional capability for planning and implementation, increased competition and performance, providing opportunities for the private sector, and facilitated cross-border trade and progress on the legal framework.

152. **ADB's program of TA during the evaluation period consisted of nine TA projects totaling $8.9 million**. Two were project preparatory TA for the existing Regional Road Development Project and its next phase. Two were advisory and operational TA projects on the strengthening of environmental practices for the road network and support for infrastructure development. One policy and advisory TA, Improving Domestic Connectivity, was to strengthen the analytical capacity of the government ministries. Three others were capacity development TA projects and one was a regional TA project for facilitating regional cooperation between Indonesia and Timor Leste.

153. **Only one of the two project preparatory TA operations, for the Regional Road Development Project, led to the implementation of the investment project**. The project preparatory TA to prepare Regional Road Development Project Phase II was closed in 2017. The loan was delayed, because of postponements in environmental impact analysis consultations and the government's delayed approval of the environment assessment report. Moreover, the government decided to use its own funds for some road sections prepared under the TA, thus reducing the scope of the project. ADB decided not to process the loan. The difficulty in doing more in the transport sector came from the government's preference for using country safeguards and procurement systems. Moreover, ADB did not engage much with the SOEs in the transport sector. Other initiatives, such as an Australian-funded infrastructure project preparatory facility, were also unable to proceed.

2. Assessment

154. **Relevance: the transport sector program was rated *less than relevant*.** ADB's strategies and development directions were in principle supportive of the government's plan priorities, which attached high priority to transport, given Indonesia's inherent connectivity issues. However, ADB's transport program during the CAPE period was small and dominated by the two policy-based loans, which accounted for almost 60% of the portfolio. A further 15% of the portfolio was multisector CDD programs. While policy reforms in the transport sector were important, the relative size of the transport investment portfolio reflects diminishing ADB engagement in transport. The increased government budget for roads in 2008 combined with the dominance of SOEs in other forms of transport (air, water and rail transport) implied that ADB's support was too insignificant to make much of an impact at the country level. The fact

that several projects, including two planned maritime projects, did not materialize further indicated ADB's weakening presence. Given the restrictions placed by decentralization on infrastructure spending by the central government, only two of ADB's projects were traditional transport projects.[77] Financing through ADB investment projects is challenging because of ADB's stringent safeguard policies, which are not aligned with Indonesia's own safeguards, and the perception in the line ministries that BAPPENAS and ADB would prefer RBL and PBL. However, the CDD approach allowed ADB to work on roads at the local level.

155. **Planned and approved portfolio.** The country strategies and COBPs during 2005–2014 contained a series of transport projects that were eventually canceled. These included a Regional Roads Development MFF whose two tranches (total of $480 million) were converted into a stand-alone project of $180 million. Some projects were planned but were not delivered during the CAPE period. A second phase of the Regional Road Development Project was planned, and a project preparatory TA has been completed; however, the investment project has not been approved yet. Two maritime transport projects, an Interisland Transport Subregional Project and an Interisland Port Project, were planned but have not materialized.

156. **There is no formal development partner coordination mechanism**. BAPPENAS maintains responsibility for overall coordination. In practice, the government prefers bilateral discussions with individual development partners in the transport sector. Since different subsectors lie under different authorities, overall coordination is difficult.

157. **The two policy-based loans, for the two subprograms of the Inclusive Growth through Improved Connectivity Program, which accounted for 58% of sector lending, were originally categorized as multisector projects and had design weaknesses.** The three ADB country strategies during the period did not have clear and measurable targets for the transport sector, which made it difficult to assess ADB's performance and contribution. All the reforms supported by the operations were relevant, and individual reforms were necessary. However, as a sector program, they lacked cohesion, and suffered from a lack of a logical reform road map. Moreover, the necessary analytical work was lacking. There were almost no records available to the evaluation mission to illustrate the depth of the policy discussions that led to the selection of the policy actions, except for repeated lists of accomplished policy actions. However, the TA under the Inclusive Growth through Improved Connectivity Subprogram 1 did provide capacity building support to the newly established Committee for the Acceleration and Expansion of Indonesia's Economic Development under the Coordinating Ministry for Economic Affairs.

158. **Effectiveness: the program supporting the transport sector was *effective*.** Both the Road Rehabilitation II Project and the Road Development Project improved vehicular access on strategic roads. In addition, the Road Development Project supported regional cooperation by improving road connection with Malaysia (Sabah and Sarawak), while raising awareness for road safety. The socioeconomic M&E component of the Road Rehabilitation II Project reported that in the evaluated sections travel time was cut by about 30% for travel distances of more than 50 kilometers, and in one section, minibus fares decreased from Rp25,000 to Rp10,000. Assessing the effectiveness of the transport program in achieving results is made difficult by the weak results frameworks of the ADB country strategies. The indicators were neither specific nor measurable for the most part and provided little guidance on how the program's success could be gauged. Moreover, given the general nature of the indicators, attribution becomes an issue because ADB was not the only development partner supporting the transport sector in Indonesia during the evaluation period.

[77] As per information given to the CAPE mission, the World Bank also has had no new projects since 2006 and has only one active project. Like ADB, the World Bank also financed community roads under the PNPM Mandiri Program.

159. **Most of the targets set for the CDD projects were achieved.** CDDs proved to be a good way of getting women engaged and accepted in village planning, and participating in village committees, although the results varied substantially from village to village. Moreover, the infrastructure was delivered for the most part. In light of this success, it is not clear why some villages received only one block grant, while others received two. In particular, the villages of the first project have not been revisited. To some extent, the capacity developed with the first grant may have been lost in the absence of a follow-up grant.

160. **The policy reforms supported by the Inclusive Growth through Improved Connectivity Subprogram 1, suggest that outcomes were effective.** Investment in the transport sector increased by 18.2% in 2013 and a further 50.4% in 2015, while private sector investment rose by 53.0% and 35.8% in those years. PPP reforms enabled SOEs to attract private investments and seven projects were under construction in 2016. In addition, the newly introduced single-window system helped to reduce the dwelling time of ships in Tanjung Priok from 6.7 days in 2011 to 3.14 days in 2016.

161. **Efficiency: the ADB transport portfolio is rated *less than efficient* even though the two investment projects for transport approved during the CAPE period were assessed to be economically viable.** Higher than expected traffic resulted in higher benefits, offsetting the substantial higher investment cost. Regarding process efficiency, the Road Development Project experienced delays of 27 months because of several changes in the detailed design engineering, procurement, and land acquisition process. However, other projects experienced delays of less than 5 months. The PBL, Inclusive Growth through Improved Connectivity, was timely. The TA projects, on the other hand, experienced average delays of 25 months. Difficulties in recruiting suitable consultants and changes in scope were the common causes of delays. Several project preparation TA projects, often supported by ADB, did not lead to projects approved for funding by the government.

162. **About 81% of all the costs for the transport portfolio (excluding PBL) were for civil works.** For the CDD projects, about 77% of costs were for the road component and only 4.3% for consultancy, indicating the cost-efficiency of the CDD approach. By engaging local facilitators with hands-on guidance from consultants (train-the-trainer approach), CDD projects demonstrated their efficiency.

163. **Sustainability: the evaluation rated the transport program *likely sustainable.*** The government's commitment to the quality of roads will support the sustainability of outcomes. The increase in national roads classified as in "good" condition" from 37% in 2003 to 91% in 2016 indicates the resolve of the Directorate General of Highways to tackle this issue. The maintenance budget has increased regularly with the aim of fully meeting maintenance needs. Moreover, the quality of the construction components of the road projects has been good or satisfactory, but weak enforcement of axle load limits is taking its toll.

164. **The CDD project facilities have been implemented by the village communities themselves and they are taking care of their O&M for the most part**. Although the range of facilities includes roads, bridges, landing sites, irrigation channels, and retaining walls, these are simple to maintain. In villages where maintenance has fallen short, the Directorate General of Human Settlements is directing the provincial and district administration to provide the required support to the communities and to require them to participate regularly in community maintenance. The sustainability of women's empowerment will depend to a large extent on the continuation of CDD-type programs in those communities.

165. **The institutional reforms supported by the PBL persist, with a demonstrated change from the old institutional arrangements**. The government is pushing the agenda further, seeking more inclusive growth and more equal levels of development among the islands.

166. **Development impacts: the transport program produced some positive impacts.** The investments under Rural Infrastructure Support to PNPM Mandiri facilitated transport cost reductions of between 30% and 50% (Project I). The impact evaluation for Project I suggested that it had contributed to increases in the project village residents' incomes by 15%. The CDD projects strengthened the local capacity for community planning and good governance, and improved residents' livelihoods.

167. **It is difficult to attribute transport program impacts to the Inclusive Growth through Improved Connectivity program since other factors and other development partners also contributed to them.** Yet, after approving the policy-based loans, logistics costs as a share of the total cost of production dropped from 27% in 2011 to 25% in 2016, coupled with improved intra- and inter-island connectivity due to the increase in the number of pioneer services. Pioneer shipping services refer to services provided on routes stipulated by the government to serve areas or regions not yet served or not served by water transportation because it is not yet commercially viable. Pioneer shipping reduced transport costs for containers from Tanjung Priok to Merauke from Rp17 million in 2013 to Rp11 million in 2016. Overall, the development impacts of the small transport portfolio that materialized are rated *satisfactory.*

F. Water and Other Urban Infrastructure and Services Program

1. ADB Program

168. **ADB support for WUS during the CAPE period amounted to $591 million, 3.0% of ADB's total portfolio in Indonesia** (Appendix, Linked Document G). The portfolio consisted of six sovereign loans ($478 million), a grant ($2 million), 14 TA projects ($17 million), and a nonsovereign loan ($94.7 million). In addition, the multisector Integrated Citarum Water Resources Management Investment Program, which is classified under ANR, had among its planned outcomes improved water supply to Jakarta supplied by West Tarum Canal (WTC). This MFF was approved in 2008 but only the first tranche was completed with the remainder canceled.

169. **Loans and grants.** Of the six ADB loans, three were investment projects delivering wastewater treatment plants (WWTPs): the Metropolitan Sanitation Management and Health Project,[78] and two loans for the Metropolitan Sanitation Management Investment Project.[79] Both projects aimed to build new WWTPs in five cities, rehabilitate the existing WWTPs in two cities, and provide more than 300 community-based sanitation systems, with a combined investment of $155 million.

170. **Two loans supported the government CDD program, PNPM Mandiri.** The programs provided block grants for municipalities to finance small-scale, community-level infrastructure, of their choice, which were built by the community through a participatory process. The investments included rural roads, drainage, sanitation, and rehabilitation of village assets. The Neighborhood Upgrading and Shelter Project-Phase 2 ($74 million) provided support to improve

[78] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grants to the Republic of Indonesia for the Metropolitan Sanitation Management and Health Project*. Manila.
[79] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Metropolitan Sanitation Management Investment Project*. Manila.

slum neighborhoods in 20 cities,[80] while the Urban Sanitation and Rural Infrastructure Support Project ($100 million) provided block grants to 600 rural villages and 1,350 urban neighborhoods to implement community-based sanitation improvement activities.[81]

171. **Technical assistance.** The Accelerating Infrastructure Delivery Through Better Engineering Services Project ($148 million) TA loan was provided to improve the capacity of project design preparation and investment management of the Ministry of Public Works and Housing (MPWH), the main executing agency for most infrastructure projects.[82] A JFPR grant was provided for housing upgrade activities in the post-tsunami Aceh and North Sumatra ($2 million).[83] Most of the other TA projects were project preparatory or capacity development TA, which were part of investment projects. Three TA projects were stand-alone. The Supporting Water Operators' Partnership TA supported training, workshops and other capacity building for local water companies and wastewater treatment operators.[84] The Water Supply and Sanitation Sector Development Project helped BAPPENAS to prepare the National Medium-Term Development Plan, 2015–2019.[85] The Sustainable Infrastructure Assistance Program, Green Cities: A Sustainable Urban Future in Indonesia TA supported BAPPENAS in preparing the National Urban Development Strategy 2015–2025.[86]

172. **Nonsovereign loans.** ADB provided a $50 million nonsovereign loan to support capital expenditures of Palyja, one of the two water companies in Jakarta. The loan to Palyja was approved in 2007 and closed in 2012.[87] A second loan of $47 million to Aetra, the other water company in Jakarta, was approved in 2013, but canceled in 2015. The cancellation was due to the uncertainty of the Amended Restated Cooperation Agreement finalization following the new Jakarta provincial election in 2014 that could have led to several policy changes.[88]

2. Assessment

173. **Relevance: the ADB WUS program was rated *relevant*.** ADB's support was strategically well-positioned by focusing on sanitation. ADB produced solid analytical work on WUS in each of the CPSs evaluated, although this did not help much in terms of setting priorities in the CPSs. The focus on one subsector and one executing agency was relevant given the small size of ADB WUS program. Learning from the past, ADB avoided the multi-subsector, multi-agency approach which has been beset with coordination and other difficulties.[89] At least 60% of ADB investment

[80] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of Indonesia for the Neighborhood Upgrading and Shelter Project (Phase 2).* Manila.

[81] ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to the Republic of Indonesia for the Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project*. Manila.

[82] ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Technical Assistance Loan to the Republic of Indonesia for the Accelerating Infrastructure Delivery Through Better Engineering Services Project.* Manila.

[83] ADB. 2005. *Proposed Grant Assistance to the Republic of Indonesia for Seismically Upgraded Housing in Nanggroe Aceh Darussalam and North Sumatera (Financed by the Japan Fund for Poverty Reduction).* Manila.

[84] ADB. 2010. *Technical Assistance Report: Supporting Water Operators' Partnership*. Manila.

[85] ADB. 2011. *Technical Assistance Report: Water Supply and Sanitation Sector Development Project*. Manila.

[86] ADB. 2016. *Technical Assistance Consultant Report: Sustainable Infrastructure Assistance Program - Green Cities: A Sustainable Urban Future in Indonesia*. Manila.

[87] ADB. 2007. *Report and Recommendation of the President to the Board of Directors: West Jakarta Water Supply Development Project*. Manila.

[88] ADB. 2007. *Report and Recommendation of the President to the Board of Directors: East Jakarta Water Supply Development Project*. Manila. The memorandum on the loan termination was circulated in February 2015.

[89] IED. 2010. *Special Evaluation Study: Indonesia: Has the Multi-subsector Approach been Effective for Urban Services Assistance?* Manila: ADB. This study was influential in moving WUS away from multisectoral projects to "one project - one sector approach" followed in Indonesia. The multisectoral approach was regarded as too complex with insufficient impact. However, as Strategy 2030 requires ADB to develop more integrated projects, it will be interesting to see how similar challenges can be avoided moving forward.

in the CAPE period was allocated to sanitation. It was not clear whether the choice to focus on sanitation was by design, since in the first two country strategies (2006–2009 and 2012–2014) ADB planned to engage in both water supply and sanitation. Only in CPS, 2016–2019 did ADB specifically mention the focus on sanitation. Targeting urban sanitation projects may be justified, given that other development partners have worked intensively on the water and rural sanitation subsectors.[90]

174. **Given the absence of national leadership on sanitation, ADB could have played a more active role in leading the issue through policy dialogue and through the donor coordination forum**. ADB is widely regarded as a key supporter of the government's sanitation efforts. ADB could have leveraged this perception to influence policy decisions, including through ADB's knowledge products. ADB was flexible in its approach to suit the shifting priorities of the government. However, by adopting this approach it missed the opportunity to bring about more significant development impacts.

175. **The design of the WUS program supported the strategic agendas of inclusive and environmentally sustainable growth**. The CDD projects were targeted at relatively poor or marginal communities (less developed villages, urban slums, and poor neighborhoods) that lack basic services and infrastructure. Although the WWTP projects were not targeted specifically at the poor population, the projects were intended to minimize the financial burden for low-income households to install sanitation services. The WWTP projects supported the environmentally sustainable growth objective through the provision of better water supply and sanitation services. Piped water supply helps prevent ground water depletion and sanitation services improve the environment by disposing of household liquid waste. However, due to the cancellation of tranches after the first tranche, the major Integrated Citarum Water Resources Management Investment Program (classified under ANR) did not produce the desired outcomes of increasing the bulk water supply to Jakarta, reducing the potential contribution of the WUS program to environmentally sustainable growth. The CDD projects had women empowerment components, which were built into the Rural Infrastructure Support to PNPM Mandiri design. The TA projects supported governance and knowledge development.

176. **The program lacked clear and measurable WUS targets, which makes performance assessment difficult.** CSP, 2006–2009 did not have a target indicator for WUS. CPS, 2012–2014 and CPS, 2016–2019 used the government targets for water and sanitation as the sector outcomes. This was not appropriate, since the government targets were nationwide, while ADB support covered a limited area, and, for sanitation, only urban areas.

177. **Effectiveness: the WUS program was rated *effective*.** CSP, 2006–2009 did not have a target indicator for WUS. CPS, 2012–2014 contained a target that 69% of population had sustainable access to an improved water source, and 62% had sustainable access to basic sanitation. Both targets were achieved. CPS, 2016–2019 reflected the government's target of universal coverage of access to sanitation, an objective that was too ambitious for the government and unlikely to be achieved. Moreover, there were attribution issues. Under the Citarum project the WTC supplying water to Jakarta was rehabilitated to its original capacity of 31 cubic meters per second (m^3/s), and the delivery rate of water supply to Jakarta was increased

[90] The Canadian International Development Agency, DFAT Australia, United States Agency for International Development, JICA, the Netherlands, GTZ (Deutsche Gesellschaft für Technische Zusammenarbeit GmbH), United Nations Children's Fund, World Bank, along with PLAN International and CARE International are actively contributing to the improvement in rural water and sanitation. DFAT, Australia and the World Bank's approach to sanitation is a combination of sewer and on-site, community-based sanitation. JICA supports a sewer development in Denpasar, Bali.

from 16 m^3/s to 21 m^3/s. The more reliable water supply to Jakarta by WTC was one of the outcomes achieved under Tranche 1.[91]

178. **Most target performance indicators were achieved or exceeded in the case of the CDD projects**, **with village residents gaining access to better village infrastructure**. The Urban Sanitation and Rural Infrastructure Support to the PNPM Mandiri Project was rated *successful* by both its project completion and validation reports. The community nature of the project, and the fact that it supported an existing national government program, explains its success. Given this experience, the CAPE expects that Neighborhood Upgrading and Shelter Project (Phase 2), another CDD project, will also be effective.

179. **Targets under the wastewater treatment projects, Metropolitan Sanitation Management and Health Project and the Metropolitan Sanitation Management Investment Project, were only partially achieved.** The first WWTP project, the Metropolitan Sanitation Management and Health Project, targeted 14,700 new connections in Yogyakarta and 13,300 in Medan by 2014. By 2014, fewer than half of the targets had been achieved; however, by 2017, 15,031 new house connections in Yogyakarta, and another 9,280 in Medan, had been installed.[92] The largest investment project, Metropolitan Sanitation Management Investment Project, went through a scope change. The Cimahi WWTP was dropped due to a prolonged land acquisition process, reducing the number of WWTPs from five to four.[93] As a result, the overall proposed wastewater treatment capacity declined from 83.0 megaliters per day to 51.7 megaliters per day. Furthermore, the service area and the number of connections to the central (off-site) sewerage systems in the other four cities was reduced by 46% (from 82,900 to 44,300).

180. **TA projects made several useful contributions.** The TA on Supporting Water Operators' Partnership helped improve the financial performance of the participating water and wastewater operators through more efficient operations. They benefited from the training, workshops, knowledge exchange, and international partnerships supported by the TA. The Water Supply and Sanitation Sector Development Project has been effective in providing BAPPENAS staff with information and tools to improve their planning capacity, especially in preparing the National Medium-Term Development Plan, 2015–2019, as confirmed by the content of the plan. The TA projects included a project preparatory TA project for a water supply and sanitation investment, but no project has been approved so far. The Green Cities: A Sustainable Urban Future in Indonesia TA, a component of the umbrella Sustainable Infrastructure Assistance Program financed by the Australian government, provided inputs for BAPPENAS in preparing the National Urban Development Strategy, 2015–2025, which is a platform for further strategy and cooperation in the urban development sector.

181. **Efficiency: the WUS program was rated *less than efficient*, given the significant delays experienced by all investment projects and most TA projects.** For the Urban Sanitation and Rural Infrastructure Support Project, which is a CDD project, the EIRR at completion was 29%–75%, despite a 17-month extension. However, the EIRR for the other two WWTPs is expected to be low given the performance so far. The progress of the two WWTP loans was slow. The Metropolitan Sanitation Management and Health Project closing date has been extended by 5.5 years from June 2015 to December 2020. Meanwhile, the Metropolitan Sanitation Management Investment Project went through a major scope change that will likely impact its closing date. By May 2019, the ADB-financed portion of the project had disbursed only 3.6%. For the portion financed by the Asian Infrastructure Funds, 9% had been disbursed. The Neighborhood Upgrading and

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[91] ADB. 2018. *Indonesia: Integrated Citarum Water Resources Management Investment Program. Completion Report*, Manila https://www.adb.org/sites/default/files/project-documents/37049/37049-013-37049-023-pcr-en.pdf
[92] Aide Memoire: Metropolitan Sanitation Management and Health Project Review Mission. January 2019.
[93] ADB. 2016. *Major Change in Project: Metropolitan Sanitation Management Investment Project*. Manila.

Shelter Project, Phase 2 has been extended by 18 months. Various project preparatory initiatives did not come to fruition over the period, as in other sector programs.

182. **ADB's largest WUS project, the Metropolitan Sanitation Management Investment Project, was flagged as a project with an "actual problem" in the ADB project performance management system**. As of 2018, the project had not started civil works. The Cimahi WWTP was dropped in 2016 as the local government could not procure land on time. Other WWTPs in Makassar, Jambi, and Pekanbaru had to undergo design changes due to the government's new effluent standards. Prolonged recruitment of consultants, completion of detailed engineering designs, incomplete land acquisition, and budget increases have further delayed the implementation. The Metropolitan Sanitation Management and Health Project faced similar problems, which led to an extension of 5 years. The two projects received minimal support from the city governments, who saw them as the central government's instead of their own and therefore gave them a low priority.[94]

183. **The nine TA projects that have been closed experienced average delays of 20 months.** The project preparatory TA for the Metropolitan Sanitation Management and Health Project was closed almost 4 years later than its original closing date. Other TA projects experienced delays in closing of between 5 to 34 months.

184. **Sustainability: the WUS program is rated *less than likely sustainable*.** Some of the facilities built under the Urban Sanitation and Rural Infrastructure Support Project had quality issues. There was also no provision for major or periodic maintenance of facilities, and lack of clarity as to which entity would cover a possible shortfall in the O&M if user charges collected were less than required.

185. **Lack of clear policy and government leadership in the sanitation subsector poses a threat to the sustainability of investments.** Under decentralization, water and sanitation is a public service to be provided under city and district governments. However, it has been difficult to convince local governments to prioritize WWTP investments, because Indonesians are used to septic tanks. This translates into a lack of strong ownership for the O&M of WWTP investments, as evidenced by a general failure to comply with covenants such as those on wastewater tariff setting. There is also lack of clarity about who is responsible for operating the WWTP, providing household connections, and deciding on the tariff scheme. Indonesia needs a successful model for implementing sewage charges.[95] Households' willingness to pay for connections is also low.

186. **There is lack of clarity on how communities would finance O&M of the facilities built under the CDD projects Urban Sanitation and Rural Infrastructure Support Project and Neighborhood Upgrading and Shelter Project (Phase 2).** The government discontinued the PNPM Mandiri program in 2014. A new scheme, village fund (*Dana Desa*), was introduced, and the management of funds, in theory, applies the principles of CDD programs. While most village funds were used to build or rehabilitate village infrastructure, including community sanitation facilities, there has been no systematic monitoring of whether the funds were used to finance O&M of the existing facilities built under the two projects.

187. **The CAPE assesses the development impacts of ADB support to WUS *less than satisfactory*.** By focusing on one subsector, sanitation, ADB's small financial contribution had the potential to have a significant impact. However, ADB does not seem to have exercised leadership in helping the government take a more pro-active stance.

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[94] As revealed in an interview with BAPPENAS, one of the problems was minimal ownership of projects by the local government, which sees them as central government projects.

[95] While the Metropolitan Sanitation Management and Health Project is nearing completion, the borrower has yet to comply with the covenant related to wastewater tariff setting, which is still below the cost recovery level.

188. **Although ADB was not very involved in the water subsector, it supported regulatory and policy reforms through PSM PBL.** However, the support has yet to bring about a significant transformation. Access to piped water connections remains an issue. Local water companies generally suffer from poor governance and underinvestment.[96]

189. **Cross-cutting themes.** The two CDD projects helped improve basic services in the participating villages, which were targeted because of their high rates of poverty incidence (above 20%) and low levels of basic rural infrastructure. The gender action plan helped ensure that women participated in the community decision-making and labor works. The two WWTP projects have yet to be completed, and their contributions to inclusive and environmentally sustainable growth will depend on the progress made in providing connections, especially for the low-income households. Given that the Metropolitan Sanitation Management and Health Project took a while to deliver its household connections target, and the Metropolitan Sanitation Management Investment Project disbursed only 3.6% of its ADB-financed fund, their contributions were *less than satisfactory*.

G. Education and Health Sector Programs

1. ADB Program

190. **ADB's support for the social sectors during the CAPE period amounted to $614 million, 3.2% of total ADB financing in Indonesia during the period** (Appendix, Linked Document H). For education, ADB provided four sovereign loans (totaling $405 million.[97]). One of these was for Madrasah education and three were for skills development. It provided two grants (totaling $32.95 million), and nine TA projects (totaling $102.78 million). For the health sector, ADB provided one sovereign loan ($50 million)[98] and one nonsovereign loan ($10 million), three grants (totaling $5.75 million), and six TA projects (totaling $13.73 million) between 2005 to 2018. In the education sector, the Madrasah education development project and the vocational education strengthening project were closed in 2014. The ongoing polytechnic education development project will be closing in 2019 after being extended once. The delays were due to project administration issues such as lack of familiarity with ADB procurement processes and late budget revisions. The Advance Knowledge and Skills for Sustainable Growth Project was approved in November 2018, but at the time of IED's mission in April 2019 it was yet to be declared effective. Currently, ADB is thinly present in the education sector. ADB has remained out of the health sector after the closure of a nutrition improvement project in 2014. The government prefers that multilateral financing helps accelerate the implementation of its ongoing reforms in the social sectors while investing substantial amounts in both education[99] and health[100] from its own resources.

[96] IED. 2018. *Validation report: Infrastructure Reform Sector Development Program (Subprograms 1, 2, and 3, and an Infrastructure Project Development Facility).* Manila: ADB.

[97] ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Madrasah Education Development Project.* Manila; ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Vocational Education Strengthening Project.* Manila; ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Polytechnic Education Development Project*. Manila; and ADB. 2018. *Report and Recommendation of the President to the Board of Directors: Advance Knowledge and Skills for Sustainable Growth Project*. Manila.

[98] ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Nutrition Improvement through Community Empowerment Project*. Manila.

[99] The Law on National Education (No.20/2003) and the Constitution Amendment III emphasize that all Indonesian citizens have the right to education; that the government has an obligation to finance basic education without charging fees; and that the government is mandated to allocate 20% of its expenditure on education.

[100] The introduction of a coordination of benefits (COB) scheme, which according to the Ministry of Health Regulation No. 71/2014 (Clause 21) and Regulation No. 4/2016 allows patients to increase their entitled benefits by obtaining additional health insurance coverage from Indonesia's universal health care scheme. Available:

2. Assessment

191. **Relevance: the program in the education and health sectors is rated *less than relevant*.** The government's strategic priorities as defined in its long- and medium-term strategies, emphasized improving the quality of human resources, especially by building human capital in science and technology. In line with this, ADB's country strategies focused on human resource development. However, they did not really address the need to improve the low quality of human capital through reforms in the education and health systems. Of the three ADB interventions, the Madrasah and the two technical and vocational education and training (TVET) projects, only the latter two catered to the government's strategic objective. In these two projects the advanced equipment was not properly paired with training of teachers on the use of that equipment. Despite its impressive economic growth, Indonesia is still behind its peer countries in terms of the quality of its human capital and in terms of expenditures in health and education. Indonesia has a constitutional mandate to spend 20% of the national budget on education, and ADB could have helped devise innovative ways to make these resources deliver the needed results.

192. **Health sector interventions appeared in the CSP, 2006–2009 under the MDG acceleration program and nutrition improvement program**. However, no health sector projects were included in the CPS, 2012–2014 or the CPS, 2016–2019. There was no demand from the government, and the nutrition improvement program was not successful.

193. **Effectiveness: ADB social sector operations during the CAPE period are rated *less than effective*.** A monitoring framework at both the strategy and the program levels was wanting. The results information on some of the operations, especially those funded by grants, lacked relevant details. Focusing on the results on the ground, the project validation report of the Madrasah project noted the "Ministry of Religious Affairs (MORA) has understood the limited impact of the project on the wider national system." As for the two TVET projects, they faced significant delays in the procurement of the equipment, and, oddly, the training of the teachers was done without the benefit of the equipment on which the training was to take place. The result was that the teachers do not know how to operate the equipment properly, which affects their ability to teach the students effectively. The PMU was slow in recruiting consultants, and the projects' implementation remained categorized by the project performance management system as "at risk" for the first 3 years. Furthermore, another key objective of the projects was to establish links with model vocational centers run by multinational and international companies, in order to obtain international certification. This objective was not achieved.

194. However, ADB provided technical support and capacity development support through TA projects such as the Analytical and Capacity Development Partnership and the Minimum Service Standards Capacity Development Program. TA resources amounting to $92 million (95% of the total TA resources) were provided by the European Union and DFAT. The Analytical and Capacity Development Partnership TA provided a facility to conduct research, policy dialogue and capacity building for relevant government agencies (Ministry of Education and Culture; Ministry of Religious Affairs; BAPPENAS; and the Ministry of Research, Technology, and Higher Education) in the education sector and the Minimum Service Standards Capacity Development Program helped the government produce minimum service standards for quality learning and teaching and to build district level capacity for policy formulation. The NSO in the health sector is still at an early stage of implementation and hence too early to assess.[101]

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http://103.233.144.156/download/427241.%20Expanding%20market%20while%20improving%20health.pdf; and Law No. 40/2004 on National Health Insurance which also defined the role of its operating agency, known in Bahasa as BPJS-K. Available: https://www.tandfonline.com/doi/pdf/10.1080/23288604.2015.1020642

[101] The project was approved in April 2018. At the time of the mission, the project was still preparing to start up.

195. **Efficiency: the social sector portfolio was assessed *less than efficient*.** The three projects implemented in the education sector suffered from start-up delays and one of them was extended for 2 years. The two TVET projects used substantial amounts for the procurement of the latest equipment without realizing that teachers had not been trained properly to operate the equipment.[102] There is scant information on the efficiency of the other operations. Project management by executing agencies has generally been inadequate. A high turnover of project staff has been a constant feature of executing agency management. The program has not been able to tackle this challenge in an effective way. In the education sector, TA resources were used to produce a plethora of studies which did not translate into significant outcomes. These resources could have been used more efficiently and had a larger development impact.

196. **Sustainability: ADB investments in the social sectors are *less likely to be sustainable.*** The health sector project suffered from weak government ownership. The focus of the nutrition improvement project was consumable items that lasted only so long as the project funding was available. It consisted of raising mass awareness and a media campaign, thus maximizing disbursements, without the project being able, in its final phase, to deliver an essential supplement called *taburia*. By all accounts, this was not a government-driven program, and the ownership was very weak.

197. **Projects in the TVET sector focused more on the procurement of equipment than on improving the quality of content and service delivery**. The implementing agencies lacked O&M funds, which will affect the longer-term performance of these equipment. The design of the TVET project did not provide for definite plans for sustaining activities after project completion. Moreover, the implementing agencies had poor ownership of these projects, which also does not bode well for the sustainability of outputs and outcomes. The TVET institutions that the evaluation mission visited revealed that the teaching faculty had no incentives to generate revenue from the equipment provided by the project. Also, little effort was made by the beneficiary institutions to train the faculty to operate the newly procured and sophisticated equipment. The faculty at the institutes lacked initiative to enhance their knowledge and skills to improve the quality of education and service delivery.

198. **The sustainability of education sector projects is also affected by a lack of a clear vision for the sector.** The diversity of the population and the extent of Indonesia pose challenges that the government has not been able to tackle in an articulate and effective way. Indonesia needs a well thought-out strategy to improve its human capital through education and health. For instance, while some authorities emphasized vocational training, others focused on addressing illiteracy, and yet others on character-based learning. An additional challenge stems from decentralization, because some headmasters in schools are appointed by local government officials based on political patronage.

199. **Development impacts: the development impacts of ADB investments in the social sectors are *less than satisfactory.*** The impacts of the three education sector projects and the single health project were confined to the level of beneficiary institutions. To have sector-wide impact the social sector investments should be able to increase the capacity at the national and local levels to lead to more effective policies and reforms. However, all the projects were approved as investment projects without any policy reform requirements.

[102] The project completion report indicated that the Vocational Education Strengthening Project had an actual cost of $107.7 million (ADB financing was $75.7 million). Out of this, $93.4 million (87%) was used for the procurement of equipment and minor civil works. See ADB. 2015. *Indonesia: Vocational Education Strengthening Project*. Project Completion Report. Manila.

H. Summary

200. **ADB operations in Indonesia in energy, finance, PSM, and transport were rated *successful*; operations in ANR, WUS, and the social sectors were rated *less than successful*.** The performance in almost all the infrastructure sectors was affected by implementation difficulties, including coordination problems across various agencies and levels of government, safeguard issues, and land acquisition problems. The problems faced by infrastructure projects, such as those in water resource management and wastewater treatment, led to significant delays and changes in scope in some cases that limited the realization of expected outcomes. The exception was energy, because of the more effective SOE running electricity management.

201. **ADB operations in all sectors, other than ANR and the social sectors, were rated *effective* in achieving the program outputs and outcomes**. The PSM program contributed to improvements in regional government public financial management, government accountability through internal audit strengthening, and macroeconomic stabilization in the face of economic shocks. The finance program strengthened institutions and supported the establishment of OJK for integrated regulation and supervision of financial markets. The energy program helped improve transmission and distribution systems and renewable energy outputs in remote areas. Results were weaker in ANR and the social sectors. Sustainability was *less likely* in three sectors—ANR, WUS, and the social sectors. Development impact was rated *satisfactory* only in the energy and transport sectors.

4

Strategic Agendas and Drivers of Change

Highlights:

- The operations of the Asian Development Bank (ADB) to support its inclusive economic growth agenda in Indonesia during the period were *less than relevant.* Operationalization of inclusive economic growth in the public sector management and finance sectors was not satisfactory, although it was satisfactory in the energy, transport, and agriculture and natural resources (ANR) sectors. Impacts relating to inclusive economic growth were assessed *less than satisfactory*.
- ADB's operationalization of its environmentally sustainable growth agenda was *less than relevant* as its operations took place only in the energy, water and other urban infrastructure and services, and ANR sectors. The environmentally sustainable growth impact was *less than satisfactory* and visible mainly in the energy sector.
- The ADB program's contributions to regional cooperation and integration were *relevant* and had a *satisfactory* impact.
- The relevance and development impact of ADB's private sector development focus in Indonesia were *satisfactory*. ADB's support for gender equity was *less than relevant* but had limited development impact. The focus on governance and capacity development was *relevant*, and the associated development impacts were significant.

202. **ADB's three strategic agendas—inclusive economic growth, environmentally sustainable growth, and regional cooperation and integration—figured prominently in all the country strategies and COBPs covered by the evaluation, along with the Strategy 2020 drivers of change: gender equity, governance and capacity development, and private sector development.** This chapter assesses how well ADB incorporated each of these aspects into its program in Indonesia and the impacts achieved in these areas.

A. Inclusive Economic Growth

1. The Challenge and ADB's Interventions

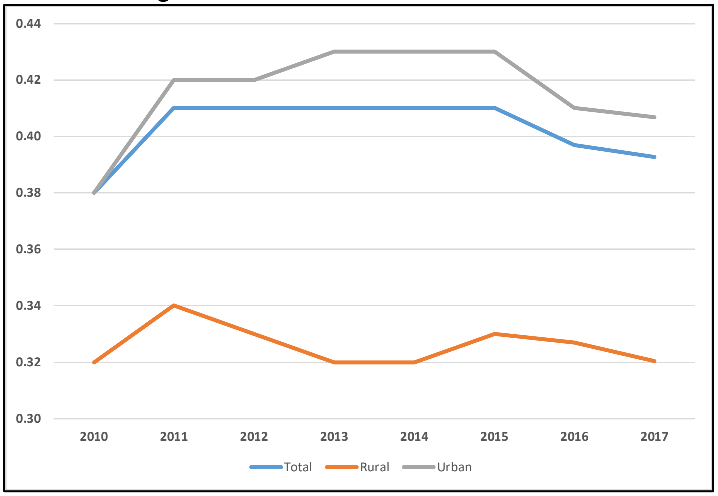
203. **ADB worked on improving the inclusiveness of economic growth, during a period when Indonesia's relatively rapid economic development was improving lives but increasing inequality and imbalanced regional growth.** After years of consistent real growth of about 5% per year, Indonesia's human development index as calculated by UNDP increased from 0.606 in 2000 to 0.694 in 2017, placing the country among the medium human development group together with the Philippines and Viet Nam. According to BPS, however, Indonesia's Gini coefficient worsened from 0.38 in 2010 to 0.41 in 2011–2015, only to recover slightly to 0.39 in 2017 (Figure 6). In addition, BPS shows that the average annual per capita GDP growth for provinces in the 2010–2017 period was uneven, ranging from 0.2% to 7.7%, with distribution tilted toward the lower end, with 14 provinces growing at below average rates (Figure 7).[103] Furthermore, youth unemployment has been high; 26.7% of the 15–19 age group, and 16.7% of the 20–24 age group were unemployed in 2018, as compared with 17.7% and 12.9%, respectively, for 2015. This is partly because young people are not being equipped with the foundational skills they need to contribute to development. Throughout the evaluation period, Indonesia had to endure several major disasters, including an earthquake in Sumatra in 2005; another earthquake in Yogyakarta as well as one in Pangandaran in 2006; the Padang earthquake in 2009; and, in 2018, the Lombok earthquake, and the Sulawesi earthquake that triggered a tsunami.

204. **However, ADB's work on inclusiveness in PSM operations was limited to supporting the recovery from disasters, and some social protection initiatives such as conditional cash transfers.** Most of the operations had indirect links to inclusiveness. Operations supported macroeconomic stability and were focused on decentralization and public financial management as a means of

[103] The fastest GDP per capita growth is in provinces located in Sulawesi. The provinces with slower rates of growth are in Sumatra, Kalimantan, and Papua.

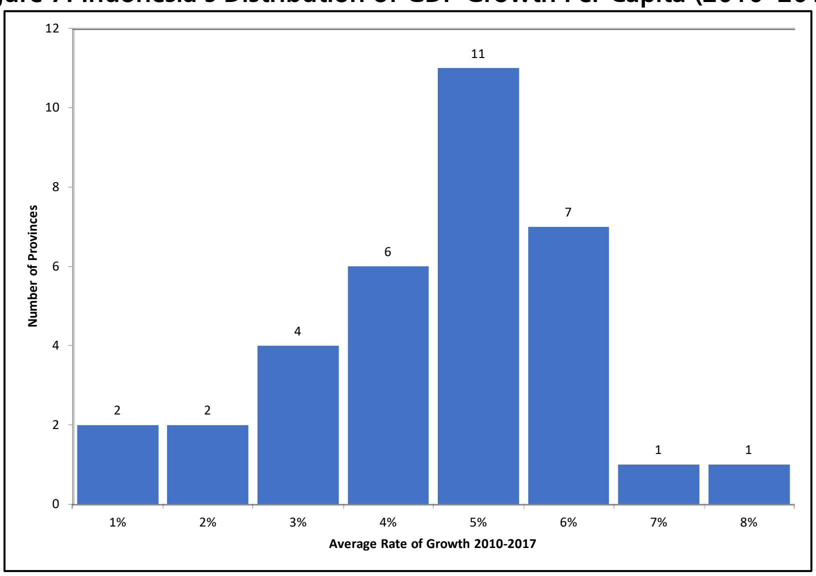
improving the use and efficiency of public resources. ADB also provided countercyclical support to dampen the impact of adverse external conditions on Indonesians and help sustain a relatively stable rate of economic growth. Toward the end of the evaluation period, the program also focused on the SDGs. But slow civil service reform made it difficult to attain some of the most challenging SDGs, such as those for maternal mortality and infant stunting.

Figure 6: Indonesia's GINI Coefficient



Sources: Statistics Indonesia (BSP) and evaluation team calculations.

Figure 7: Indonesia's Distribution of GDP Growth Per Capita (2010–2017)



Sources: Statistics Indonesia (BSP) and evaluation team calculations.

205. **ADB's energy sector operations were mostly located in provinces with below-average per capita GDP growth.** The projects supported the expansion and improvement of generation, transmission, and distribution systems in the west Kalimantan and in the rural areas of eastern Indonesia.

206. **ADB's program in the finance sector was not specifically designed to promote inclusiveness**. Except for the work promoting financial literacy and inclusion, which came toward the end of evaluation period, the rest of the program had an impact on the poor only through indirect channels. Support for customer and investor protection was not particularly aimed at

the poor although it may have benefited them. The same applies to support for Islamic finance and financial technology. The program supported a stable finance sector, which provided a necessary environment for sustained economic growth.

207. **In the transport sector, albeit on a limited scale, ADB reached out to poorer provinces outside Java.** The loans for road rehabilitation covered strategic national roads in 10 provinces of Sumatra and in all 4 provinces of Kalimantan, which were mostly poorer provinces.[104] A project cofinanced by the IsDB focused on strategic national roads in east and west Kalimantan and east and west Java. In addition, the CDD projects, which were coordinated with the government's PNPM Mandiri, aimed at rural poor villages throughout the archipelago. The transport program was, however, much smaller than those in most other developing member countries of ADB.

208. **ADB's work on ANR, also with limited resources, was for the most part delivered through CDD projects, which targeted the rural poor**. The marine and coastal management projects, which focused on fisheries, aquaculture, coral reefs and coastal management, targeted poor fishing communities located in the remote unconnected coastal regions. Besides giving alternatives to fishermen, these projects increased food security and promoted nutrition. On the downside, CDD projects were limited in scope, and covered only a small group of villages. ADB also administered two JFPR grant projects targeted at poverty reduction in the coastal communities of Sumatra.

209. **In WUS, ADB's work focused on WWTPs in five cities, rehabilitating the existing WWTPs in two cities, and providing more than 300 community-based sanitation systems**. The Neighborhood Upgrading and Shelter Project aimed to improve slum neighborhoods in 20 cities. In addition, ADB provided block grants to 600 rural villages and 1,350 urban neighborhoods to implement community-based sanitation improvements. Given the scale of Indonesia, all these numbers are small. Within WUS, ADB also administered a JFPR grant to provide housing upgrades in the post-tsunami Aceh and North Sumatra.

210. **ADB's program in the social sectors, education and health, was limited in resources and impact**. The work in the education sector was targeted for the most part at Madrasah education, and at skills development through TVET centers. The Madrasah project was inclusive in supporting Islamic education, but the project had a limited impact at the national level. In health, an ADB nutrition improvement project attempted to focus attention on the SDGs. In addition to its lending support, ADB provided TA relating to inclusive economic growth, such as the capacity development TA on updating and improving the Social Protection Index in Indonesia and a regional TA on assessing and monitoring social protection programs in Asia and the Pacific.

2. Assessment

211. **The overall ADB program in Indonesia was rated *less than relevant* to the government's inclusive growth strategy, as well as to ADB's corporate inclusive economic growth agenda.** The PSM and finance sector support was mostly indirectly oriented toward achieving inclusive growth. Most of the PSM support dealt with macroeconomic and governance objectives while the finance sector support focused mostly on providing a stable system. Some exceptions include support for post-disaster rehabilitation and for decentralization reforms where provincial and local governments were given greater expenditure autonomy and empowerment. ADB's support in

[104] The Socioeconomic Monitoring and Evaluation Program for Road Rehabilitation II Project reports that, in the evaluated sections, travel time was cut by about 30% for travel distances of more than 50 kilometers, and in one section, minibus fares decreased from Rp25,000 to Rp10,000. In addition, investments under Rural Infrastructure Support to PNPM Mandiri Projects I and II facilitated transport cost reductions between 30% and 50%. The impact evaluation for Rural Infrastructure Support to PNPM Mandiri Projects I suggested that the project had contributed to increase the project village residents' income by 15%.

the infrastructure sectors (energy, transport, and WUS) and in ANR was targeted at the poorer provinces and regions of Indonesia but resources allocated to these sectors were limited. ADB's program could have taken a more forward-looking and inclusive approach and addressed one of its most pressing development challenges: achieving a faster growth capable of absorbing a growing labor force and reducing Indonesia's high youth unemployment rate.

212. **Overall, given the relatively large size of the sectors that did not have specific elements of inclusiveness, the program had a *less than satisfactory* impact on inclusive economic growth.** While the development impact of ADB's work on inclusive growth in some of the PSM loans (such as social protection) and in some of the infrastructure sectors was noticeable, the rest of the lending had less of a direct impact. ADB's efforts in ANR fostered inclusive growth, but did so on a limited scale and, in the case of the finance sector, inclusion as an objective came toward the end of the evaluation period. Sanitation facilities could not be extended to the poor as the WUS projects did not take off. Transport sector projects were also at a limited scale to fulfill the needs of connecting the lagging regions with the advanced parts of the economy. Efforts in education and health were too few compared to the challenges and had weak results.

B. Environmentally Sustainable Growth

1. The Challenge and ADB's Interventions

213. **Indonesia, with many biodiversity hotspots, is seeing its vast environmental resources threatened by the country's growth process and increasing population.** Indonesia has the world's third largest area of rainforest, which is home to some of the highest levels of biological diversity in the world. Indonesia also accounts for a large part of the Coral Triangle, which contains three-fourths of the world's coral species and over a third of the world's coral reef fish species. However, the rate of degradation is high. Indonesia has lost an estimated 80% of its original forest habitat and deforestation practices threaten about half of the remaining forest. As for marine resources, some 70% of the Indonesia's coral reefs are moderately to severely damaged and threatened by destructive fishing practices. Mangroves are central to fish hatching.

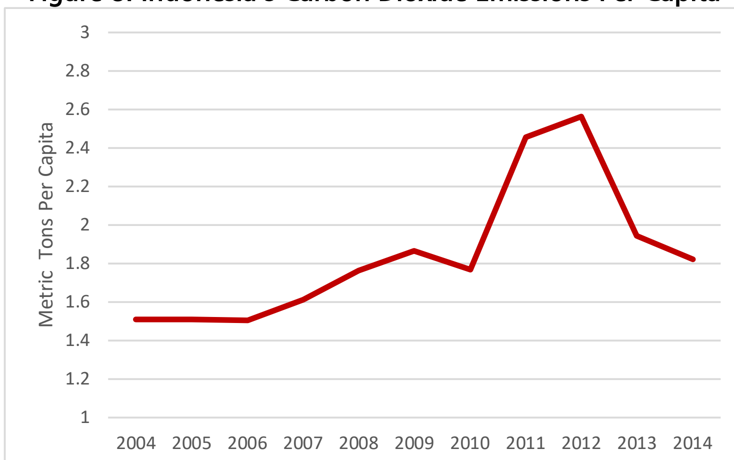
214. Climate change is causing extreme weather events such as droughts, and has increased the incidence of intense floods, forest fires, and storm surges. The average temperature in Indonesia, as reported by BPS, increased by an average of 0.31 degrees Celsius between 2011 and 2015. The country has made efforts to slow down pollution. According to the World Bank, Indonesia has been able to slow down the rate of carbon dioxide (CO_2) emissions per capita (Figure 8). Coal consumption for power generation continues to grow since it is the cheapest alternative. Septic tanks are the main type of improved sanitation even in urban areas where 98% of residents do not have access to centralized sanitation systems. Sewerage exists in only 11 of the country's 98 cities. While some progress is being made, environmental challenges still loom large. Jakarta is sinking gradually below sea level due to increased and unregulated extraction of groundwater. Indonesia seems to be at a phase where growth takes priority over the environment (the upward sloping part of the environmental Kuznets curve, where higher growth is initially achieved at the cost of the environment).[105]

215. **Throughout the evaluation period, environmental sustainability concerns were among the five main objectives of ADB's strategy**. In its three country strategies between 2005 and 2018, ADB expressed concern about environmental sustainability and, later, climate change and its impact on Indonesia. The slight change in emphasis did not take away from what should have been an unwavering commitment to help Indonesia face its environmental challenges and move to a phase corresponding to the downward sloping portion of the Kuznets curve.

[105] S. Kuznets. 1955. Economic Growth and Income Inequality. *American Economic Review.* 45 (March). pp 1–28.

216. **Despite the strong emphasis on environmentally sustainable growth in the strategies, ADB's program in PSM and the finance sector, two of the sectors receiving most support, did not include significant policy actions to pursue the goal of environmentally sustainable growth.** An exception was the support for mainstreaming SDGs in national and subnational budgeting in the 2016 Fiscal and Public Expenditure Management Program, which included elements needed for a good environmental policy. In the finance sector, there was a small and short-lived attempt to finance plant reconversions of exporters through Indonesia Exim Bank.

Figure 8: Indonesia's Carbon Dioxide Emissions Per Capita



Source: World Bank Sustainable Development Goals database.

217. **ADB's energy program focused on renewable energy and on increasing energy efficiency.** Both the west Kalimantan project and the project in eastern Indonesia aimed to reduce transmission and distribution losses, thereby reducing CO_2 emission reductions. ADB supported two geothermal projects, solar and wind power installations and gas-fired plants, which will reduce CO_2 emissions per kWh produced. Additional LNG from the expansion of the Tangguh field will also be used in Java, which has the potential to reduce emissions per kWh in the Java grid. Program action plans supported by one results-based loan also included hazardous waste management in warehouses, which is being implemented.

218. **In the transport sector, there were few environmental objectives.** Some environmental work related to sustainable growth was found in the climate proofing of roads, but this should now be part of standard design practice. ADB provided TA for strengthening environmental practices for road network development in Kalimantan, which centered on protecting the ecological integrity of a region that is considered a global center for biodiversity.

219. **ADB's ANR program touched both land and maritime environmental challenges through its CDD projects.** The projects that centered on rural areas upgraded habitats and neighborhoods, addressed water and sanitation, and promoted practices that were hygienic and environmentally friendly. The Integrated Citarum Water Resources Management Investment Program had to be canceled due to extended delays in the first tranche and the project could not produce the expected output of environmental protection. As the Citarum river basin provides 80% of the surface bulk water supply to Jakarta this may have implications for the excessive extraction of groundwater which is a cause of the gradual sinking of the city.

220. **In the WUS sector, the ADB sovereign program addressed environmental issues by focusing on WWTPs in five cities.** The program also rehabilitated existing WWTPs in two cities and provided over 300 community-based sanitation systems. ADB also backed improvements to

slum neighborhoods in 20 cities and provided block grants to 600 rural villages and 1,350 urban neighborhoods for community-based sanitation improvement activities. These efforts addressed the potential health problems stemming from the inadequate waste and the water infrastructure, with the majority of households resorting to both septic tanks and ground water. Environmental benefits from the piped water supply would accrue from lower reliance on groundwater by households. Almost 60% of households in Jakarta rely on groundwater.

2. Assessment

221. **Operations during the CAPE period were rated *less than relevant* to environmentally sustainable growth.** Despite having environmentally sustainable growth as a priority in its strategies, ADB mainly confined its environmentally sustainable growth elements to the energy, ANR, and WUS sector programs. In the transport and the finance sector programs, ADB's actions did not explicitly involve environmentally sustainable growth. The PSM and finance sector interventions did not address environmental and natural resource management issues, and to the extent they did it was only indirect or tangential. PSM support has not appreciably addressed the severe environmental governance issues facing Indonesia in the mineral and forestry resources sector. In the energy program, the focus on energy efficiency through reductions in line losses and energy-efficient appliances and renewable energy generation was geared to lowering carbon emissions. In sum, although addressing the environmental challenge was identified as a major objective in the CPSs, and rightly so, it received relatively little attention in terms of interventions and resources.

222. **The overall program impact on environmentally sustainable growth was *less than satisfactory* and the program's contribution has been modest in contrast to the high profile given to these issues in the country strategies.** This is especially so given the relevance of addressing environmental challenges in Indonesia and the importance of Indonesia's biodiversity to the world. While the projects in energy, ANR, and transport had discernable outcomes and some positive impact, this was not true for the rest of the program. The energy program improved efficiency, and ventured into clean energy, where it is succeeding. Contributions to the lowering of CO_2 emissions came through imports of hydropower from Malaysia, and solar and wind energy infrastructure that displaced diesel-powered electricity. However, this is unlikely to make much dent on carbon emissions as more coal-fired power plants are being built in Indonesia, this being the cheapest source of electricity. Similarly, the ANR and the transport support left a positive footprint, by changing environmentally damaging practices. Results in WUS, however, were limited, and there was no noticeable impact from the PSM or finance sector efforts. The targets under the WWTP projects were only partially achieved. As of 2017, 15,031 new house connections in Yogyakarta, and another 9,280 in Medan, had been installed under the first WWTP project, the Metropolitan Sanitation Management and Health Project, compared with a target of 14,700 new connections in Yogyakarta and 13,300 in Medan. The largest investment project, the Metropolitan Sanitation Management and Health Project, had a scope change. ADB's work in the water supply sector has not yielded noticeable results, because access to piped water connections did not improve as expected, and the supported policy changes have yet to bear fruit. Moreover, the potential benefits of applying ADB's safeguards were hampered by the limited scope of investment projects.

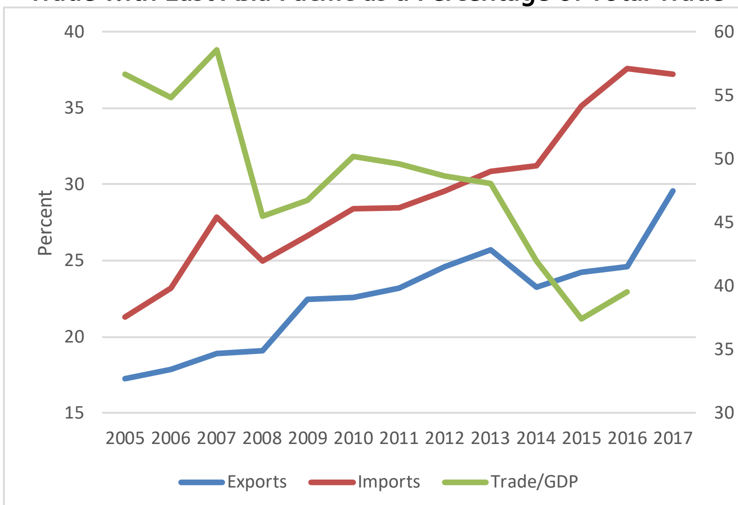
C. Regional Cooperation and Integration

1. The Challenge and ADB's Interventions

223. **During the evaluation period, Indonesia's external trade as a percentage of GDP gradually decreased, while its trade share with the East Asia and the Pacific region increased**. According to World Bank data, total trade (exports plus imports), as a percentage of GDP gradually declined

from 56.7% of GDP in 2005 to 39.5% in 2016 (Figure 9). Meanwhile, the share of Indonesia's trade with the region steadily increased for both imports and exports, with the share of imports from the region increasing from 21.3% in 2005 to 37.2% in 2017, and that of exports from 17.2% to 29.6% over the same period. The increase in the share of trade with the region has been boosted by the trade agreements reached within ASEAN, in particular the ASEAN Trade in Goods Agreement and the Agreement on Customs.

Figure 9: Indonesia's Trade as a Percentage of GDP and Trade with East Asia Pacific as a Percentage of Total Trade



GDP = gross domestic product.
Note: The right-hand scale denotes the trend in the trade to GDP ratio, whereas the left-hand scale is for exports and imports as a percentage of GDP.
Source: World Bank Sustainable Development Goals database.

224. **In financial markets, Indonesia has been part of regional efforts to boost domestic bond markets, particularly for government bonds**. ASEAN and the People's Republic of China, Japan, and the Republic of Korea—collectively known as ASEAN+3—have tried to develop local currency bond markets to mobilize domestic savings to finance long-term investment and strengthen the resilience of the financial system in the region. ADB has been the secretariat for this initiative. Beyond bond markets, the ASEAN countries have also been working toward more integrated financial markets, harmonizing their respective prudential regulations and supervisory systems. ASEAN intends to open banking borders starting in 2020.

225. **ADB support for regional cooperation and integration mostly took place within its programs in ANR, energy, the finance sector, and transport**. In the case of PSM, the only activity was to provide organizational support to the ASEAN secretariat. In the ANR sector the coral reef rehabilitation program was part of the Coral Triangle Initiative, which has implications for the multi-country program on sustainable management of coastal and marine resources in the region. ADB programs for WUS, education, and health did not have significant implications for regional cooperation and integration. In the energy sector, ADB supported cross-border gas and power connectivity and trade with neighbouring countries.

226. **ADB's finance sector program contributed to regional cooperation and integration by helping Indonesia adhere to the standards and markets that are being developed within ASEAN's framework for equities and bonds.** ADB supported Indonesia in joining the Basel Accord of the Bank for International Settlements, the International Association of Insurance Supervisors (IAIS), the International Organization of Securities Commissions (IOSCO), the Financial Action Task Force, and the Islamic Financial Services Board.

227. **As for ADB's transport program, the roads projects improved vehicular access on strategic roads, including for the road connection with the Malaysian states of Sarawak and Sabah.** The policy reforms supported by ADB, including the introduction of a single-window system, have reduced dwelling times for ships in a significant way. For instance, in Tanjung Priok, dwelling times in 2016 were on average 3.14 days, as compared with 6.7 days in 2011.

2. Assessment

228. **Support for activities related to regional cooperation and integration was rated *relevant*.** Unlike the inclusive economic growth and environmentally sustainable growth agendas, which were central to the country strategies, the regional cooperation and integration agenda was mentioned less frequently in those documents. However, some activities were undertaken, and some achievements made. ADB's work in regional cooperation and integration has followed both the government strategy, and the agreements reached within the ASEAN framework. This was particularly noticeable in the work in the ANR, energy, transport, and finance sectors. In ANR, ADB was focusing on regional public goods—coral and fisheries management, and in energy and transport, ADB was addressing the requests for greater connectivity. In the case of the finance sector, ADB supported the needed improvements in the soft and hard infrastructure of the equity and bond markets, as well as in the banking system, to pave the way for ASEAN financial integration.

229. **The impact of operations on regional cooperation and integration are rated *satisfactory*.** Regional cooperation and integration impacts can be seen in the energy, finance, and transport sectors. The energy and roads connections, as well as the improvement in port efficiency, are contributing to the growing volume of trade with the region. The West Kalimantan Project is importing clean hydropower from Malaysia, and the power purchase agreement with Malaysia has already been increased from a base load of 50 MW to 140 MW. Malaysia is actively assessing a further increase in supply, and PLN is likely to be able to take advantage of the revamped PPP framework to do the necessary works. The Indonesian finance sector is now better able to confront the competition that will come with ASEAN financial integration. While that integration is foreseen to be gradual, Indonesia has put in place most of the needed changes for it.

D. Gender Equity

1. The Challenge and ADB's Interventions

230. **Indonesia has made some progress in promoting gender equality, but challenges remain**. According to UNDP, Indonesia's gender development index value was 0.932 in 2017, behind the Philippines and Viet Nam, which are also classified as medium human development countries. Indonesia's index is also slightly below the East Asia and Pacific regional average of 0.957. These ratings reflect a human development index that shows a significant gender disparity, Indonesia had a value of 0.666 in 2017 for females and 0.715 for males. A more significant difference appeared in the GDP per capita in 2011 purchasing power parity terms: $14,387 for males and $7,259 for females. This significant difference reflected a low female labor force participation rate (50.7%, compared with 81.8% for males), as well as women's concentration in low–paid and low–skilled informal jobs. However, Indonesia's efforts have laid the groundwork for future improvements, since the country has now achieved virtual parity in education enrollment rates. Also, the World Bank reported that the maternal mortality ratio had declined from 212 deaths per 100,000 births in 2005 to 126 in 2015. Life expectancy had also improved from 68 years in 2000 to 72 in 2017.

231. **Most of ADB's infrastructure portfolio had implications for gender equity since it created better opportunities for the poor, including women**. The improvements in energy, transport, and WUS, as well as the infrastructure developed in most CDD projects across all sectors, provided a better living environment for all, including women. Similarly, many of the institutional and policy improvements supported by the PSM and finance sector programs are gender neutral. In the same vein, ADB's education and health program gave opportunities for all. Gender equity and empowerment was part of ADB's broader support for the mainstreaming of the SDGs in national and subnational planning. ADB's finance sector program, approved in 2015, had a specific focus on gender in its financial inclusion program, which gave prominence to finding out women's needs when carrying out consultations and surveys and when working on the design of the program. The financial inclusion program also stated that women should have equal access to credit and basic financial instruments.

232. **The CDD projects supported by ADB in transport, ANR, and WUS explicitly emphasized that women should be involved in the decision-making process and execution of projects.** These projects proved to be good at getting women engaged and accepted in village planning, and to participate in village committees, although the results on this aspect varied from village to village. All in all, the mere fact that special attention was devoted to women's participation in these projects helped bring attitudinal changes in the villages where they were implemented.

2. Assessment

233. **ADB work on gender equity was not articulated well in the country program even though since 2012 it is a CPS priority area and is rated *less than relevant*.** The main reason is that there were no specific interventions supporting gender equity until the end of the evaluation period, although some of the projects had indirect effects on women through gender mainstreaming work. In the finance sector program, gender elements were visible in the financial inclusion program. In the case of the CDD projects, ADB contributed to what the government was doing in this area, by lending its expertise, monitoring, and financial resources.

234. **ADB's support for gender equity under ADB's program had *less than satisfactory* development impact.** In the finance sector, gender came into focus only in 2015 through the financial inclusion program. In the energy sector, indirect effects on women came through increased employment possibilities due to transmission and distribution enhancements. In the case of the CDD projects, the resources devoted to women were small, and the degree of penetration in terms of the percentage of villages supported is not known to this evaluation. Anecdotal information suggests that ADB reached only a small proportion of villages. Nevertheless, PCRs noted some benefits, including women acquiring technical knowledge in areas related to agriculture and water resources, and an increase in the numbers of female teachers and students in vocational courses. The consultation with NGOs indicated appreciation for ADB's gender mainstreaming work. However, in the case of education and health projects, the absence of a gender action plan and limited gender-related targets in the loan agreement hampered the effectiveness of the project in ensuring that all activities were maximized for women's benefit.

E. Governance and Capacity Development

1. The Challenge and ADB's Interventions

235. **The Global Economic Forum's 2018 global competitiveness index noted that Indonesia's institutions have been improving.** Indonesia now has a score of 57.9 and a rank of 48 among 140 countries. Indonesia's score compares with an East Asia and the Pacific average score of 61.6. Indonesia scores well in social capital (63.0, ranked 10), but less well in budgetary transparency

despite the large ADB PSM program (53.8, ranked 57), and in the incidence of corruption (37.0, ranked 80). As for capacity, Indonesia scores 64.1 in skills, ranked 62. While Indonesia is improving in staff training (61.8, ranked 29) and vocational training (60.0, ranked 34), it is declining in the quality of the skill set of graduates (61.1, ranked 33), in digital skills among the population (62.2, ranked 39), and in the ease of finding skilled employees (61.1, ranked 35). Improving these indicators will require the poor quality of the basic education system to be addressed. Indonesia will also need to support the development of foundational skills in children, so that young people can easily acquire the skills needed in the labor market. Over a longer period, many indicators show improvements (e.g., political stability, anticorruption efforts, investment climate), but also some reversals, such as a decline in "democratic quality" that is rooted in discrimination against certain social groups.

236. **ADB's PSM program, which accounted for 45% of total resources, focused on many core elements of good governance, starting with public financial management.** ADB provided strong support for the decentralization process, and for creating a framework for institutional and capacity development at regional and local levels of government. The program focused on public financial management as well, and, at the government's request, ADB worked on the PPP framework, and on using minimum service standards focused on basic needs. Toward the end of the CAPE period, ADB's program paid special attention to the SDGs.

237. **ADB's energy program helped develop capacity in the electricity corporation PLN.** During 2011–2017, most of the capacity building was focused on safeguard assessment and monitoring. Other areas included policy assessment, resource assessment, tariff evaluation, technical monitoring, and financial management.

238. **ADB's finance sector program focused on institutional development, governance, and capacity building of OJK.** ADB also supported the development of intermediaries and markets with known conduct standards and greater transparency. Within OJK, ADB promoted a whistleblower protection system.

239. **In the transport sector, ADB's program had a policy component centered on improving governance and building capacity.** This included working on enhancing institutional capacity for planning and implementation, and on improving the legal framework. This work was framed within the government's Masterplan for the Acceleration and Expansion of Economic Growth (Masterplan Percepatan dan Perluasan Pertumbuhan Ekonomi Indonesia).[106]

240. **In the ANR sector, ADB's program governance work was related to the development of the integrated coastal zonal planning and management program**. This program was to be implemented in priority areas of 15 provinces and to provide guidelines for managing coastal areas in an integrated and sustainable way. Given its interdisciplinary and interagency mandate, support included building capacity to coordinate the approach successfully.

241. **In the WUS sector, ADB focused on improving governance through building capacity with TA**. ADB supported enhanced project design preparation and investment management at the MPWH, the main executing agency for the sector. Another TA project provided training, workshops, and other capacity building activities for local water companies and wastewater treatment operators. Two other TA projects supported BAPPENAS in dealing with the water and sanitation sector in the National Development Plan 2015-2019, and National Urban Development Strategy 2015–2025.

[106] Other development partners financing the masterplan included AFD, JICA, and World Bank.

2. Assessment

242. **ADB's program in terms of governance and capacity building is rated *relevant*.** The program was developed in close coordination with the government and it addressed significant challenges faced by the country. Indonesia's decentralization process was partly designed to tackle separatist sentiments by giving local governments greater authority, political power, and financial resources, but also to improve governance and service delivery that satisfied local interests. After the Asian financial crisis, Indonesia needed to create a unified, independent regulator and supervisor of the financial system that could govern it following the best standards. With ADB support, it did this by creating OJK.

243. **The ADB program had a *satisfactory* development impact on governance and capacity development.** Regional government revenues from own sources increased from 18% in 2011 to 23% in 2014. Audits have been professionalized, and regional auditors have helped 76% of reginal governments to be cleared by the Supreme Audit Agency, compared with only 3% in 2009. In the finance sector, OJK is now seen, both abroad and domestically, as a unified and single regulator and supervisory agency that has helped the financial system to weather external shocks, such as the global financial crisis and the gradual reduction in the United States' Federal Reserve's quantitative easing measures. Indonesia's finance sector regulation now follows world standards for the most part, including the Basel Accord, IAIS, and IOSCO. Capacity improvements in the energy sector helped PLN to become a financially stronger institution. Along similar lines, most of ADB's activities in governance and capacity building are well regarded. The exception was the training of the teachers in the use of sophisticated equipment in TVET centers, which was poorly planned and did not provide results.

F. Private Sector Development

1. The Challenge and ADB's Interventions

244. The Indonesian economy is split between a formal economy that is dominated by SOEs and an informal economy that accounts for a very large share of employment opportunities. SOEs tend to have a tight grip on their sectors and often hamper competition; according to the IMF, their assets amounted to 51% of GDP in 2016. By contrast, the smaller enterprises, mostly informal, are highly competitive, produce 60% of GDP, and employ 97% of the labor force. The Global Economic Forum's 2018 global competitiveness index showed Indonesia improving in business dynamism (69.0, ranked 30), above the average for East Asia and the Pacific of 65.7. Indonesia made improvements in the cost of starting a business (94.6, ranked 81) and the time taken to start a business (77.3, ranked 108); and it ranked highly in attitudes toward entrepreneurial risk (58.8, ranked 26).

245. **ADB's PSM program supported private sector development, with specific interventions such as developing a new framework for PPPs**. ADB also supported the development of a more conducive environment for investing in infrastructure, as well as a stronger framework for public procurement. These efforts could have been more fruitful had ADB also supported building implementation capacity in Indonesia for identifying and structuring PPPs that were attractive for investors.

246. **In the energy sector, ADB, with other development partners, worked on a private-sector-friendly regulatory framework.** In particular, ADB supported an enabling regulatory environment to promote competition and attract private sector investment; as well as to promote the increased use of renewable energy and energy efficiency, especially with private investment.

247. **In the finance sector program, efforts to strengthen the non-bank finance sector, and to develop markets for equities and government bonds, are central to private sector development.** The non-bank finance sector included insurance companies, pension funds, mutual funds, and finance companies. The equities market, which had collapsed with the Asian financial crisis, needed to adopt global standards and build the necessary infrastructure for trading and securities repositories. The government bond market mattered for the private sector since the price of this risk-fee asset was essential for the pricing of other financial papers. ADB supported the institutional framework for the development of financial markets, as well as for investor protection. ADB also supported the development of sharia-compliant finance, with both private and government securities. Through a private sector operation, ADB invested in IIF, together with IFC, the German government, and the Indonesian government.

248. **In the transport sector, ADB used its PBL to include actions that benefited the private sector.** ADB worked to increase competition and performance in the sector, as well as to create opportunities for private investors in this revamped system. The CDD projects in ANR, transport, and WUS also supported private sector development, albeit at a different level. In this case the private sector included independent workers, small farmers, and fishermen. In addition to the reviewed country program portfolio, two regional private sector agribusiness projects had an Indonesian component: (i) the High-Value Horticulture Development Project introduced a successful high-value horticulture business model in Indonesia for flowers, and (ii) the Agricultural Value Chain Development Project financed an increase in sugar refinery capacity.

2. Assessment

249. **Relevance: ADB's work related to private sector development is rated *relevant*.** ADB supported the government in moving forward with necessary reforms that removed obstacles for private sector development (e.g., improvements to the efficiency and transparency of equity markets, which were full of cumbersome requirements from an earlier age, such as trading with physical stocks), or that put in place the necessary conditions for such development to happen (e.g., the rules on PPPs or on mutual funds that create opportunities for investors).

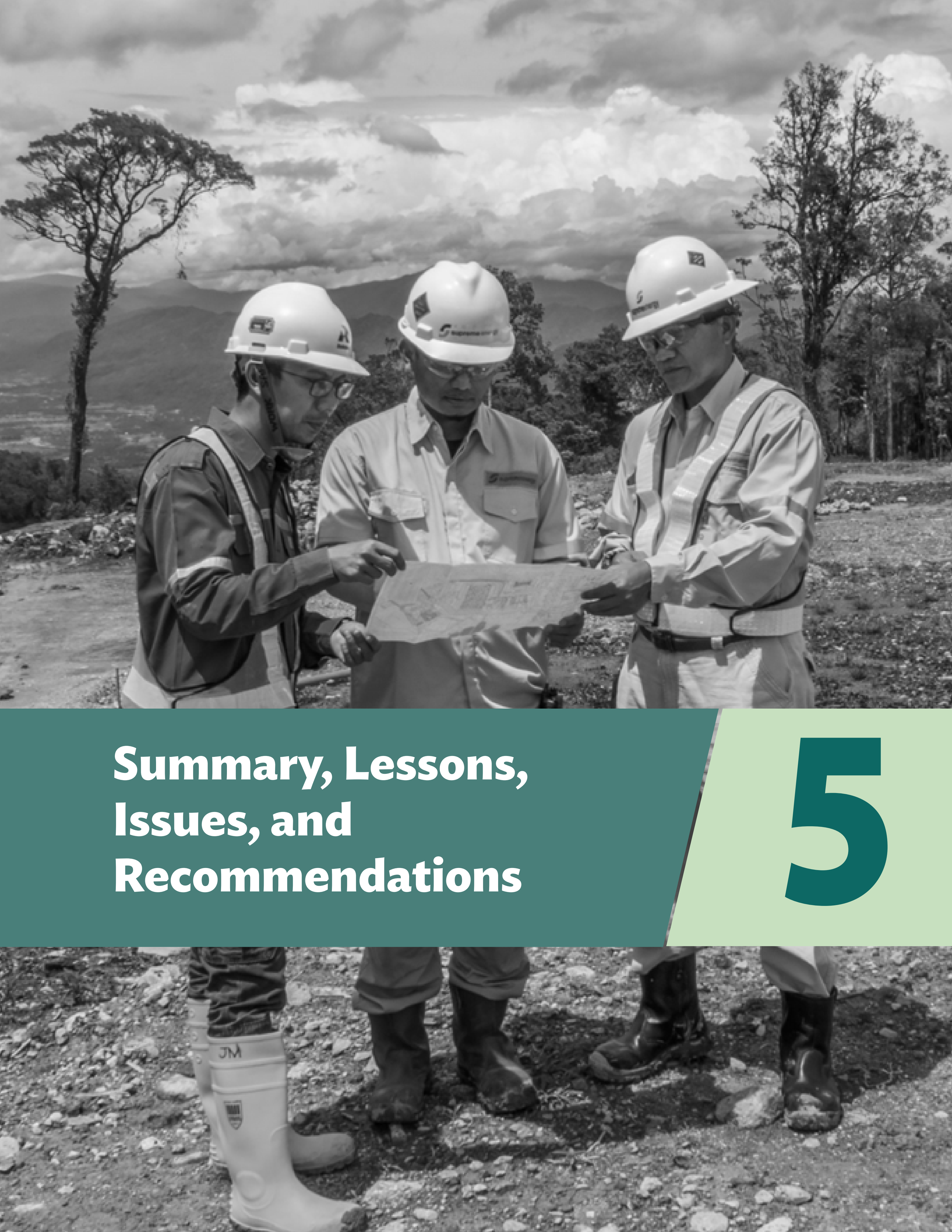
250. **The private sector development impact of ADB's work is rated *satisfactory*.** The work on PPPs, procurement, insurance companies, mutual funds, finance companies, equity markets, the government bond market, the opening of opportunities in the energy and transport sectors, and the improvement in the viability of village entrepreneurs were all positive to some extent. However, ADB did not succeed in areas such as pension funds. The decline in the pensions sector in Indonesia was due to the reform of the mandatory pension system in 2011 which extended the system to include independent workers in addition to salaried workers and placed the system under the Social Security Administration.

G. Summary

251. **Although inclusive economic growth and environmentally sustainable growth were the overarching goals of the various CPSs and environmentally sustainable growth was one of the objectives of the country strategies, they were not articulated or operationalized well in the ADB program.** ADB's support for the infrastructure sectors (energy, transport, and WUS) and ANR was targeted toward the poorer provinces and regions of Indonesia. The resources allocated to these sector programs were limited. Most of the huge amount of PSM financing dealt with macroeconomic and governance objectives. In the finance sector, ADB was focused on developing parts of the sector and on providing a stable system. ADB did no work on the fiscal side which could have helped address the rising inequality in the country and generated more resources for the severely under-resourced government; social protection was pursued to only a limited extent. ADB's work had some environmentally sustainable growth elements, mainly in

the energy, ANR and WUS sectors, but, given the huge issues in rural, urban, forest, and coral reef areas, this was not enough. ADB's work in regional cooperation and integration was most noticeable in the ANR, energy, transport, and finance sectors. ADB work on gender equity was not articulated well in the country program, although some of the projects had indirect impacts on women. ADB's program in governance and capacity building was *relevant* as it addressed significant challenges faced by the country, such as decentralization and the creation of a unified, independent regulator and supervisor of the financial system. ADB's program was *relevant* to private sector development as it focused on needed reforms and the necessary conditions for these to happen.

252. **Development impacts from ADB's work on inclusive growth and environmentally sustainable growth were limited.** Sanitation facilities could not be extended to the poor as the urban sanitation projects did not take off. The limited scale of transport sector interventions was not enough to meet the connectivity needs of the economy. The contribution of the ADB program to environmentally sustainable growth has been modest for a country with major environmental challenges. While the projects in energy, ANR and transport had discernable outcomes and some positive impact, the rest of the program did not have impacts that could be as clearly seen. Regional cooperation and integration impacts were noticeable in the energy, finance and transport sectors. The energy and roads connections, as well as the improvement in port efficiency, are contributing to a greater volume of regional trade. ADB's support for gender equity had limited development impact. ADB's program in governance and capacity development had a satisfactory development impact, especially in increasing regional government revenues, in professionalizing the audit function, and in establishing a better regulated and supervised non-bank finance sector.



5 Summary, Lessons, Issues, and Recommendations

253. **This chapter summarizes the performance and development results of the ADB program in Indonesia and makes recommendations based on the findings of the evaluation**. Recommendations are at both strategic and operational levels. The sector program assessments in the list of linked documents in the Appendix provide more detailed operational suggestions. The recommendations keep in mind the expectation that the new Indonesia CPS will need to cater to Indonesia's medium-term plan expected priorities for 2020–2024 and to be aligned with ADB's long-term strategic vision and operational priorities (addressing poverty and reducing inequalities, accelerating progress in gender equality, tackling climate change, building climate and disaster resilience and enhancing environmental sustainability, and strengthening governance and institutional capacity are among the seven operational priorities identified by ADB's Strategy 2030). National Medium-Term Development Plan priorities for 2020–2024 will likely include enhancing the quality and competitiveness of human resources; reducing inequalities and ensuring equity through regional development; strengthening Infrastructure to support economic development and basic services; and developing the environment, enhancing resilience towards disaster and climate.

A. Summary of Assessments

254. **ADB's strategy and support for Indonesia over the evaluation period were overall *successful on the borderline*.** This conclusion is based on assessments of sovereign and nonsovereign operations in ADB's main sectors of operation, and ADB's strategic agendas and special priorities. This assessment follows ADB's 2015 Guidelines for CAPEs, which aggregates ADB's sector and cross-sector thematic performance. A summary of the assessments follows.

255. **The PSM program, which had the highest lending volume, was rated *successful*.** The finance and energy sector programs were rated *successful*. Of the sector programs that received less support, the transport program was rated *successful* but the ANR, WUS, and education and health programs were rated *less than successful*. The overall success of each sector program is assessed by aggregating the scores under IED's standard criteria of relevance, effectiveness, efficiency, sustainability, and development impact, giving equal weights to each criterion. For relevance and development impact, the evaluation considered how well the strategic agendas and the drivers of change were reflected in the design of the program and what impacts were noticeable. The scores assigned to inclusive economic growth, environmentally sustainable growth, regional cooperation and integration, gender equity, governance and capacity development, and private sector development are summarized in Table 6. The overall rating for each criterion is obtained as a weighted average.

256. **ADB's program was rated *relevant* overall when compared with the strategic objectives set by the CPSs.** ADB support helped the government deal with budgetary problems and to achieve macroeconomic stability. It was timely during crisis situations such as the global financial crisis and during the tapering of the monetary easing by the Federal Reserve. ADB was able to leverage its relationship with development partners and to engage in a meaningful dialogue with the government. It also attracted substantial amounts of cofinancing, including for TA.

257. However, the program was biased toward the PSM program and less focused on inclusive economic growth, environmentally sustainable growth and infrastructure development, or even human development. The PBL modality was relevant to the objectives of improved governance and financial deepening, but less so to improving infrastructure services, developing human resources or addressing environmental challenges. The program also had design weaknesses in the PSM, transport, and health and education sectors. The weakness of the analytical and advisory work was seen in the deficient results frameworks. For the most part, this frustrated ADB's intentions of providing value addition and playing a catalytic role. In the transport sector, 60% of the portfolio was PBL. While the reforms supported by PBL were necessary and important,

there was lack of cohesion and no road map. Some planned projects in transport failed to materialize (some were canceled and others have yet to be delivered). Education and health interventions were not commensurate with the ambitious goals stated in the CPSs.

258. The government wanted ADB to bring innovative approaches and solutions to deal with emerging market economy issues. There could have been more and stronger analytical work by ADB to buttress the design and conditionality of the PBL operations. While some TA projects were successful in helping authorities move forward in critical junctures, as in WUS, in many cases it was difficult to tell how much the TA influenced policy reforms. Considering that all CPSs emphasized the importance of knowledge services, it was hard to discern the extent to which knowledge TA projects fed into the policy dialogue or the design of policy-based loans.[107]

Table 6: Rating of the Indonesia Country Program, 2005–2018

Sector	Relevance	Effectiveness	Efficiency	Sustainability	Development Impact	Overall Rating for sector program	
PSM	2.0	2.0	Not rated	2.0	1.0	**1.75**	*Successful*
Energy	2.0	2.0	2.0	2.0	2.0	**2.0**	*Successful*
Finance	2.0	2.0	2.0	2.0	1.0	**1.8**	*Successful*
Transport	1.0	2.0	1.0	2.0	2.0	**1.6**	*Successful*
ANR	2.0	1.0	1.0	1.0	1.0	**1.2**	*Less than Successful*
WUS	2.0	2.0	1.0	1.0	1.0	**1.4**	*Less than Successful*
Education and Health	1.0	1.0	1.0	1.0	1.0	**1.0**	*Less than Successful*
Overall Sector Scores	**1.9**	**1.9**	**1.7**	**1.9**	**1.3**		
Strategic Agendas							
IEG	1.0				1.0		
ESG	1.0				1.0		
RCI	2.0				2.0		
Drivers of Change							
Gender equality	1.0				1.0		
Governance and Capacity Development	2.0				2.0		
PSD	2.0				2.0		
Overall Thematic Scores	**1.5**				**1.5**		
Weighted Score	**1.7**	**1.9**	**1.7**	**1.9**	**1.4**	**1.72**	
Overall Rating for ADB Country Program	***Relevant***	***Effective***	***Efficient***	***Sustainable***	*Less than satisfactory*	***Successful on the borderline***	

ADB = Asian Development Bank, ANR = agriculture and natural resources, ESG = environmentally sustainable growth, IEG = inclusive economic growth, PSD = private sector development, PSM = public sector management, RCI = regional cooperation and integration, WUS = water and other urban infrastructure and services.
For each evaluation criterion, scores range from 0 to 3. For example, in effectiveness 3=highly effective, 2=effective, 1=less than effective and 0=ineffective.
Aggregation across criteria for each of the sectors and overall is made using equal weights. Under each criterion the sector scores are aggregated using weights proportional to financing volume. Equal weights are used to aggregate scores for cross-cutting themes. Equal weights are used to aggregate overall sector score and thematic score.
Performance assessment is deemed *highly successful* if the aggregate score is <=3.0 and >=2.5; *successful* if it is <2.5 and >=1.6; *less than successful* if it is <1.6 and >=0.8; *unsuccessful* if it is <0.8. If the score falls in the range 1.6 and 1.75 the performance is termed *successful on the borderline* and if it falls between 1.45 and 1.59 it is termed *less than successful on the borderline*.
Source: Independent Evaluation Department.

[107] The evaluation team did not have sufficient access to the materials showing ADB's support through knowledge products, with limited information relating to the most recent years.

259. **ADB's work on regional cooperation and integration, governance and capacity development, and private sector development was rated *relevant,* while its support for inclusive economic growth and environmentally sustainable growth and gender was assessed *less than relevant*.** A substantial part of ADB's efforts in PSM were directed toward improving public financial management and the ease of doing business. In the energy sector, the policy support facilitated private sector participation in clean energy. However, there were no specific design elements in the program for inclusive economic growth or environmentally sustainable growth.

260. **ADB support was rated *effective*.** This was due to the effective outcomes in the PSM, finance, energy and transport sectors, although the outcomes were weaker in the ANR, WUS, and social sectors. The assessment of effectiveness was based for the most part on observed developments, because the results frameworks of the strategies and those of many operations were poor. Accordingly, this evaluation focused on what was achieved on the ground. The program succeeded in some areas, for example in advancing public financial management in local governments; in improving the financial performance of the electricity corporation PLN; in helping develop a single, independent regulator and supervisor for the finance sector (OJK); in improving the road connection with Malaysia; and in developing soft and hard infrastructure at the village level through the CDD projects. Yet in some other areas, ADB's efforts succeeded only partially or not at all. Examples include the dropping of the computerized financial management information system for regional governments, the failure to bridge energy transmission between Java and Bali, the stagnation of the pensions finance sector, the failure of NSOs in the finance sector, the significant scaling down of the project financing WWTPs, the cancellation of a troubled major program (Citarum) in water resource management of crucial importance to Jakarta, and the failure to couple the purchase of sophisticated equipment at TVET centers with training of the teaching staff to use it.

261. **The evaluation rated ADB's support *efficient* overall, although implementation efficiency was weak in the sectors that received the smallest allocations.** The share of PBL was sizable in the PSM sector, but its efficiency was not considered for the efficiency assessment.[108] Efficiency in projects financed with RBL was higher than that of projects financed using investment loans—that advantage can be seen in the projects to strengthen the electricity grid. Similarly, projects using the CDD modality also tended to be efficient.[109] However, traditional investment loans and TA projects in almost all sectors were often delayed, requiring extensions; many projects did not materialize, despite design work having started. One impact of these processing and implementation delays was that ADB lost its competitive edge over commercial lenders. The extensions in loans and TA projects in many cases were between 1 and 2 years, but in one particular case, the Metropolitan Sanitation Management Investment Project, the extension was for 5.5 years. Two factors contributed to lower efficiency in some of the projects. One was the scale and dispersion of projects, which made their implementation costly (as in the ANR sector). The other factor was the capacity limitations of the implementing agency. Efficiency was also low in some NSOs, such as the investment in IIF, which did not yield the desired result even after many years due to management failures.

262. **ADB sovereign operations are rated *likely sustainable* overall, although the program was *less than likely sustainable* in ANR, WUS, education, and health sectors.** The government was clearly driving the agenda, and ADB was attentive to the government's requests. Most policy reforms supported by ADB are likely to remain in place and to be resilient to a wide array of risks

[108] With PBLs it is difficult to estimate the costs and benefits of policy reforms in an economic analysis. In terms of process efficiency there are no issues with timely disbursements especially with single-tranche PBLs; however, there were clear signs that a lot of the PBL in PSM began in part as a response to infrastructure projects that did not materialize and regular requests for budget support from the government.

[109] In the case of transport, in CDD projects, about 77% of the resources were for the road component and only 4.3% for consultancy, a proportion that shows efficiency.

such as change in governments. The policy reforms adopted were implemented with a very high degree of ownership by the government and the country, with stakeholders at home and abroad having an interest in furthering those reforms instead of reversing them. This is the case with the devolution of property taxes to local government that expanded their own revenues; with the improvements in the tariffs, expertise and operations of PLN; with the creation of OJK, the sole, independent regulator and supervisor of the financial system; with the Directorate General of Highways taking over maintenance of roads; and with the empowerment of villages, and of women within the villages, through the CDD projects. The tepid approach to civil service reforms will probably slow down PSM improvements; the limited scope and reach of the efforts on financial literacy will likely lead to a revamping of the approach; and the fragmented approach to rural reconstruction will be challenged until ADB determines how to balance the long-term infrastructure and short-cycle support. In the WUS sector, there is no provision for major or periodic maintenance of facilities, nor is there a delineation of responsibility and identification of resources for O&M. In projects such as those covering TVET, no plans were included for sustaining activities after project completion.

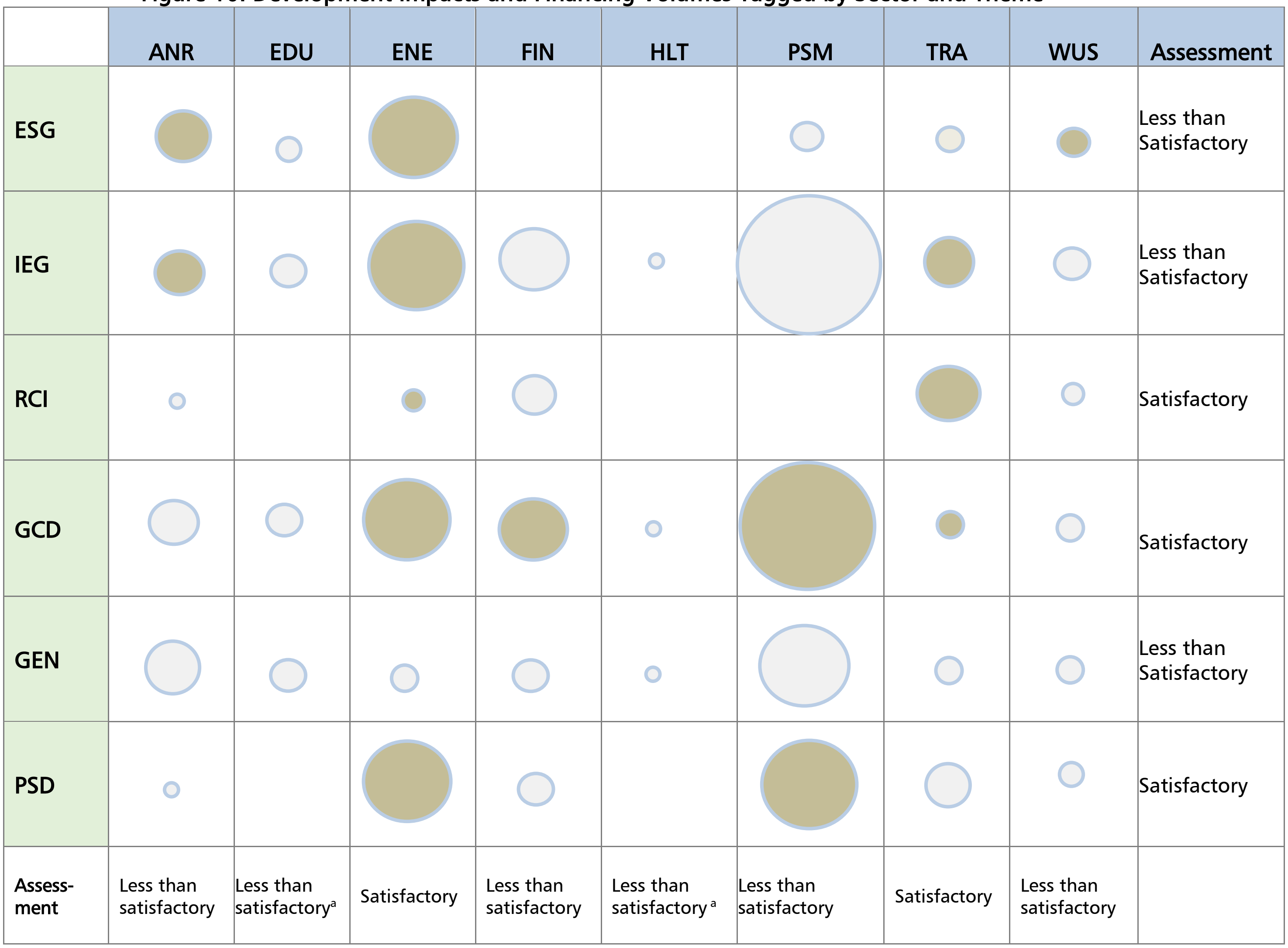
263. **The development impacts of ADB's program were overall *less than satisfactory*, although there were some positive impacts.** Sector programs other than energy and transport had a less than satisfactory development impact as determined by their contribution to CPS objectives. The strategic agendas of inclusive economic growth and environmentally sustainable growth were rated as having *less than satisfactory* impact. However, there were positive results in some sectors. The advances in the environmental sustainability and inclusive growth agenda were made through reductions in CO_2 emissions and greater access to electricity in remote areas; ADB's work on regional cooperation and integration had positive developments in hard and soft infrastructure that improved connections between Indonesia and its neighbors. ADB's work relating to gender equity was *less than satisfactory*. The work in the other two drivers—governance and private sector development—had *satisfactory* impacts. The financing volumes tagged under a particular theme for each sector are depicted in Figure 10.

264. **The evaluation set out to assess the extent to which ADB program from 2005 to 2018 contributed to the objectives contained in the country strategies during the period.** It concluded that the contribution of the ADB-supported program to inclusive and environmentally sustainable growth objectives was limited. The program as it materialized was *less than relevant* to these strategic objectives and overall had *less than satisfactory* development impacts. This was mainly because new investment projects in the sectors that mattered most for these objectives did not materialize. This was particularly the case in the infrastructure sectors but the same could be seen in the social sectors. The findings in relation to the subsidiary evaluation questions were mixed. Those questions were, to what extent did the ADB program lead to (i) improved infrastructure services, (ii) improved economic governance, (iii) progress in developing human resources, (iv) better tackling of environmental challenges, and (v) finance sector deepening and increased access?

265. **ADB's contribution was limited by the size of the lending to the infrastructure sectors, as well as by the limited success of some of the policy actions.** The PSM program improved the efficiency of subnational spending, although available information suggests that the increase in services was not accompanied by an increase in the quality of those services. As for PPPs, ADB's support could have resulted in PPP projects if the government had been guided on how to structure these contracts. Support for PPPs started almost at the beginning of the evaluation period in different projects, but the regional governments are still in early stages of using PPP. The energy program succeeded in improving the provision of energy services by developing projects in some of the poorest regions. The transport program was limited in size and scope and efforts to expand it failed. The ANR and WUS programs had relatively limited scopes and ended up making only a limited contribution to infrastructure, partly because important WUS projects

were scaled down and a number of initiatives to prepare new projects did not lead to projects. The education and health programs had negligible impacts. The only finance sector operation to supporting infrastructure services directly, the IIF facility, has yet to yield satisfactory results.

Figure 10. Development Impacts and Financing Volumes Tagged by Sector and Theme



ANR = agriculture, EDU = education, ENE = energy, FIN = finance, ESG = environmentally sustainable growth, GCD = governance and capacity development, GEN = gender equity, HLT = health, IEG = inclusive economic growth, PSD = private sector development, PSM = public sector management, RCI = regional cooperation and integration, TRA = transport, WUS = water and other urban infrastructure and services.
Notes: (1) Education and health are rated together as the social sector. (2) The size of the bubble is proportionate to the volume of ADB financial support. A darker shade denotes a more direct impact and a lighter shade more indirect. The assessment row and column are based on the scores in Table 6.
Source: Asian Development Bank Independent Evaluation Department assessment.

266. **Several aspects of ADB's program contributed to good results in the area of economic governance.** The PSM program helped the country carry out the decentralization process, including by strengthening the subnational audit function. The program also supported Indonesia to establish a more conducive framework for macroeconomic stability and investment, while also supporting the country in challenging times, such as post-disasters caused by natural hazards and during the global financial crisis. The energy program's contribution to economic governance is reflected in the improvement to PLN's fiscal performance. The finance sector program supported the creation and development of OJK, a step that has helped fend off adverse

developments in the system, such as external crises. The program also supported Indonesia in adopting financial regulations that are generally aligned with world standards. In transport, the policies supported by ADB improved the legal framework, and helped create an environment for increased competition and performance. In the three remaining sectors, ANR, WUS, and education and health, ADB's program contributed little to improving economic governance.

267. **ADB's program made very little progress in developing the human resources, especially of the disadvantaged although it helped build capacity in several government sectors**. ADB's policy-based support contributed to an increase in subnational spending in education and health to 3.5% (2015) and 3.1% (2016), up from less than 3% each in 2009. However, the impact of these increases on improving the population's human capital will depend on how funding and improved teaching quality and learning outcomes are prioritized. Outcomes in education and health were weak in both the Madrasah education and the TVET programs.

268. **The environmental components of the program were in sectors that received small allocations, or, as in the energy sector, were a small part of the program.** Despite the small allocations, the energy sector results-based loans and nonsovereign loans called for stringent environmental conditions and provided significant training in environmental management planning and implementation. The two sectors that received most support through PBL (PSM and the finance sector), touched only marginally on the environmentally sustainable growth objective. The SDGs were included in the PSM program toward the end of the evaluation period, and only in a lukewarm way. As for the finance sector, the only operation related to environmental sustainability was a project preparatory TA, Global Climate Partnership Fund-Indonesia Investment Program, which aimed to establish a solid deal flow for renewable energy and energy efficiency investments through banks in Indonesia. However, there was very limited investment appetite by local banks in Indonesia for any of the projects presented.

269. **Limited improvements were seen in the area of financial deepening and access to finance**. The program contributed to a stronger regulatory and supervisory framework that has helped Indonesia maintain macroeconomic stability, and promoted the insurance and mutual fund sectors, as well as the equity and public bond markets. Yet progress in financial deepening was hampered to some extent by cultural factors. For instance, Indonesians tend to prefer saving and borrowing from closed groups, as evidenced by the World Bank's Findex data. This tendency is much higher than in Indonesia's peers and neighbors. These preferences have fostered the development of a relatively large financial market that is not regulated or supervised by the authorities, and that caters to about 10% of Indonesians. Indonesians seem suspicious of certain Western financial products and are still hurting from the losses suffered with the collapse at the time of the Asian financial crisis. Not surprisingly, contracts such as insurance are not widely accepted, perhaps because Indonesians, even those with higher education, do not appreciate their benefits and risks.

270. **The development impact of the ADB program was challenged in many sectors by three main factors.** First, ADB allocated insufficient resources to sectors that were critical for the achievement of the strategy's objectives, as was the case with the small allocation to improving human capital through health and education. The failure to identify and prepare investment projects in several sectors was also part of this. Second, ADB failed to exploit synergies by promoting needed sector reforms in tandem with projects. This can be seen in ADB operations in the WUS, education and health sectors, where the program did not address the poor governance and underinvestment in these sectors. Third, ADB did not adequately back up policies with analytical work. This could be seen in the finance sector, where some policies ignored the ways in which most Indonesians go about their payments, savings, and credit needs, such as cooperatives, or the needs of the people and regions that are most remote from Jakarta.

271. The report benefitted from feedback received from key authorities during the consultation mission conducted on 26–27 September 2019. The consultations have confirmed the findings, issues, and recommendations offered by it generally and key stakeholders have expressed their appreciation for the support of ADB.

B. Lessons

272. **ADB's support is effective when a country has strong ownership of the ADB programs and when operations are grounded on a deep understanding of the country's realities, geography, diversity, cultural factors, legal system, and preferences.** In Indonesia, programs that had good ownership and where there was strong implementation capacity moved ahead steadily, e.g., improvements in the audit function. By contrast, the program to stimulate municipal bonds is taking a long time to show results. Local governance improvements are only possible when there is adequate capacity, and this has to be ensured before ADB moves forward to support more sophisticated reforms. Most PSM reforms in Indonesia were hindered by a civil service incentive system that is still awaiting much-needed reforms. Similar problems can also be seen in other sectors, notably health and education, where ADB's assumptions about capacity did not take account of the need for civil service reform. The very strong Indonesian culture of social and family solidarity also posed a challenge to traditional products in the insurance and pension industries. A deeper insight into these areas is needed to develop financial products that would work.

273. **Sustained demand for ADB support is more likely if ADB can build on progress made in previous projects, including the relationships that were established in the process**. In the case of PSM, ADB has established a good working relationship with provinces and large cities, which gives it a comparative advantage. However, ADB needs to be prepared to bring to the table the level of knowledge and innovation that the government demands. When this does not happen, as was the case in the WUS sector, inconsistencies arise between the national and the subnational level, leading subnational governments to lose interest. In the case of investment loans, the closure of projects without greater engagement or dialogue does not bode well for ADB's future operations in the particular sector. For instance, with the closure of the Regional Roads Development Project, ties with the Department of Highways on road projects will end, and re-engaging will be difficult.

274. **Working with SOEs on infrastructure projects is an attractive option given the difficulties of working with subnational governments with limited capacities.** Working with SOEs helps speed up the process since it involves fewer approvals and can be an effective way of proceeding until project readiness and other related issues of working with government are resolved. ADB was able to proceed only with a few infrastructure projects, and it is significant that these involved SOEs (e.g., PLN). Moreover, with SOEs, making necessary arrangements to ensure availability of resources for O&M was not an issue in operations during the period.

275. **The CDD approach was a cost-effective way of delivering small, community-based projects to build soft and hard infrastructure at the village level.** Cost-efficiency was achieved by engaging local facilitators and providing them with hands-on guidance by consultants (the train-the-trainer approach). By empowering villagers, including women, and involving them in different phases of the project, these operations delivered strong results. Aside from improving livelihoods, the CDD project allowed these communities to address their physical infrastructure needs, while improving the way they interacted with their environment, including forests and coral reefs. Although community involvement boosted the likelihood that infrastructure would be maintained properly, not all these projects had well-defined arrangements for financing post-project O&M. In addition, performance was better in those projects where the government and ADB tried to target measurable results and gather enough data to assess their achievement.

Another success factor was the quality and commitment of the facilitators, suggesting that taking special care in their selection, and providing them with appropriate training and advice will enable them to face any contingencies.

276. **Lack of coordination between national and regional planning levels can affect project implementation.** For instance, water and sanitation are central to public health, but they are the responsibility of city governments that do not always show the interest that these issues deserve and often do not have the political will to move forward with projects. This has affected the land acquisition process, which is the responsibility of the local governments, leading to inefficiencies in implementation.

C. Issues

277. **The challenges to inclusive and environmentally sustainable growth in Indonesia remain significant.** Income distribution worsened during most of the evaluation period, as did the disparities between different provinces and regions. Youth unemployment has been gradually increasing, highlighting the urgent need for significant work on the economic growth model that Indonesia is developing and that may include an industrial policy and absorption of young people into the workforce. Indonesia's environmental resources such as the rainforest and its large biodiversity are being threatened by the country's growth process. Disasters resulting from natural hazards have become more damaging and more frequent. Given this, it is essential that the CPS, 2020–2024 for Indonesia incorporates the operational priorities under ADB's Strategy 2030, including: addressing poverty and inequalities through improved access to opportunities, quality jobs, education, health care and social protection; accelerating progress in gender equality; and tackling climate change and disaster resilience and environmental sustainability.

278. **Subnational governments have limited capacity for project preparation and implementation**. This was a problem during the period as decentralization has shifted the implementation responsibilities to lower levels of government. The limited capacity of regional government staff to address finance issues (including alternative financing such as PPPs) for development and technical preparation acted as a constraint to infrastructure development. Coordination problems arose because of the multiplicity of agencies with overlapping functions and oversight, across national, provincial, district, and lower levels. This made it difficult for ADB to work effectively in infrastructure projects to connect the lagging regions with the more prosperous ones. Given that ADB's Strategy 2030 prioritizes strengthening the quality and capacity of public institutions for a country's development, ADB should highlight this aspect in its forthcoming CPS for Indonesia.

279. **ADB's extensive use of PBL, while responsive to government requests and useful in supporting government budgets and needed policy reforms, did not produce the much-needed capacity development and institutional strengthening.** This was the reason for the weak development impact in terms of achieving CPS goals. Given the weak financial management of several executing agencies and local governments, and the less than ideal harmonization of procurement systems, investment projects that contain adequate safeguards against these risks are more likely to be effective.

280. **Many of ADB's planned infrastructure investment projects failed to materialize or ran into significant implementation problems.** This was partly because of project readiness issues involving land acquisition problems, discrepancies with the country systems, and the poor quality of detailed engineering design. As a result, sector resource allocations did not follow the spirit of the main objectives defined in the country strategies. Most sector programs did not materialize as planned, with slow start-ups and large proportions remaining unutilized. While allocations to PSM and the finance sector were high, and the objectives of improved governance, financial

deepening, and greater financial access were more than adequately covered, the allocations to develop infrastructure, improve human capital, and address environmental challenges were low. Many of the projects identified for support through the COBPs had to be dropped, partly due to difficulties in meeting the project readiness conditions of the government that land must be acquired, resettlement and environment safeguards approvals must be in place, and detailed engineering designs must be approved before loan negotiations. Several projects under implementation ran into significant problems due to insufficient harmonization of procurement rules between ADB and government systems. Differences between the ADB safeguard policy and national regulations caused confusion and led to delays and cancellations, also because of insufficient handholding by ADB or fears by executing agencies that government auditors would not agree to the ADB mandated safeguard measures.

281. **The design of results frameworks was weak at both the strategy and the program levels in several sectors.** The absence of credible and useful indicators weakened the ability to monitor and evaluate the program. Often, outcome indicators in both the strategy and program documents were too optimistic or far from the government's or ADB's actions. While PBL can be a good tool to support reform programs, especially within a programmatic framework, its effectiveness needs to be assured by hands-on implementation support through TA and strong backing from analytical work to establish a clear link between policy actions, outputs, and outcomes.

D. Recommendations

282. Based on the issues identified in this evaluation and keeping in view the expectation that the Indonesia CPS, 2020–2024 will need to cater to Indonesia's medium-term plan priorities for 2020–2024 and to be aligned with ADB's Strategy 2030 operational priorities, the evaluation has two strategic and three operational recommendations. ADB should:

Strategic Recommendations

Recommendation 1. Focus on boosting Indonesia's path to inclusive growth and environmentally sustainable and climate resilient growth, two of its most pressing development challenges, in the context of high inequality and growing environmental challenges. Rebalancing ADB's policy-based and investment-related support should also help the government address the income inequalities across households and between different provinces and regions. ADB should help Indonesia adjust the economic growth model, respond to environmental degradation, and make gender equity a more explicit feature in its assistance programs.

Recommendation 2. Strengthen local government capacity by working selectively with provinces, districts, and large cities to enable local governments to provide support for infrastructure development in various sectors. ADB should pursue a phased approach by focusing on selected provinces to simplify oversight and to enable it to scale up after learning from experience. Developing capacity for project preparation and implementation is best done through investment projects and by building on relationships from previous projects.

Operational Recommendations

Recommendation 3. Tackle project readiness issues and offer better and more innovative project designs to improve the quality and implementation of ADB-supported investment projects. ADB should accelerate the harmonization of procurement guidelines between ADB and government systems and provide more hands-on assistance on resolving safeguard issues, given the continuing differences between government and ADB social safeguard policies. ADB should improve the capacity of executing agencies, particularly to prepare detailed engineering designs, carry out government procurement, and implement safeguard systems, so its projects can meet the government's project readiness conditions.

Recommendation 4. Diversify financing modalities, to ensure that policy reforms supported by PBL are complemented by other modalities, including RBL and investment projects, to achieve the targeted development outcomes. ADB should sequence reforms supported by PBL or RBL carefully and complement them with other instruments to provide appropriate capacity development and institutional strengthening and to ensure the effectiveness of ADB strategies.

Recommendation 5. Improve the framing of operations by providing strong analytical underpinnings and results frameworks to support policy reforms and capacity building and institutional strengthening. There is a continuing need for reforms, given the need to tackle persisting critical constraints such as low levels of productivity, lack of competitiveness, and limited human capital. Reforms need to be based on sound diagnostics and analytical foundations, based on in-depth knowledge work. ADB should provide knowledge services with a wider reach, going beyond supporting projects.

Appendix

APPENDIX: LIST OF LINKED DOCUMENTS

A. Indonesia Loans, Guarantees, and Technical Assistance Portfolio Covered by the Evaluation, 2005–2018
https://www.adb.org/sites/default/files/linked-documents/A-Portfolio-2005-2018-INO.pdf

B. ADB Portfolio Analysis, 2005–2018
https://www.adb.org/sites/default/files/linked-documents/B-Portfolio-Analysis-INO.pdf

C. Public Sector Management Operations Assessment
https://www.adb.org/sites/default/files/linked-documents/C-PSM-Assessment-INO.pdf

D. Energy Sector Program Assessment
https://www.adb.org/sites/default/files/linked-documents/D-Energy-Assessment-INO.pdf

E. Agriculture and Natural Resources Sector Program Assessment
https://www.adb.org/sites/default/files/linked-documents/E-ANR-Assessment-INO.pdf

F. Transport Sector Program Assessment
https://www.adb.org/sites/default/files/linked-documents/F-Transport-Assessment-INO.pdf

G. Water and Other Urban Infrastructure and Services Sector Program Assessment
https://www.adb.org/sites/default/files/linked-documents/G-WUS-Assessment-INO.pdf

H. Education and Health Sector Programs Assessment
https://www.adb.org/sites/default/files/linked-documents/H-Education-and-Health-Assessment-INO.pdf