Report Number: ICRR0023351

## 1. Operation Information

| Operation ID | Operation Name |
|---|---|
| P172439 | Indonesia Investment and Trade DPL |
| **Country** | **Practice Area (Lead)** |
| Indonesia | Macroeconomics, Trade and Investment |

**Non-Programmatic DPF**

| L/C/TF Number(s) | Closing Date (Original) | Total Financing (USD) |
|---|---|---|
| IBRD-92440 | 31-Dec-2021 | 800,000,000.00 |
| **Bank Approval Date** | **Closing Date (Actual)** | |
| 15-Jun-2021 | 31-Dec-2021 | |

| | IBRD/IDA (USD) | Co-financing (USD) |
|---|---|---|
| Original Commitment | 800,000,000.00 | 0.00 |
| Revised Commitment | 800,000,000.00 | 0.00 |
| Actual | 800,000,000.00 | 0.00 |

| Prepared by | Reviewed by | ICR Review Coordinator | Group |
|---|---|---|---|
| Alma Pekmezovic | Jennifer L. Keller | Gabriela Chamartin Escobar | IEGEC |

## 2. Program Objectives and Pillars/Policy Areas

### a. Objectives

The program development objective (PDO) was to support the reform of Indonesia's investment and trade policies in support of economic recovery and transformation. For the purpose of this ICRR, the objectives of the operation (against which outcomes will be assessed) have been rephrased as follows:

**Objective One:** Improve the investment climate in support of economic recovery and transformation by opening more sectors to private investment, particularly FDI; (b) facilitating a more adequate supply of high-skilled professionals for labor market needs; and (c) stimulating private investment in solar energy.

**Objective Two**: Support trade policy reform to support competitiveness and the economic recovery by (a) increasing accessibility to and affordability of widely consumed food commodities and raw materials; and, (b) facilitating access to manufacturing inputs.

### b. Pillars/Policy Areas

The operation was structured around two pillars:

**Pillar A:** Attracting private investment, particularly foreign direct investment, (FDI) by (a) opening more sectors to private investment, particularly FDI; (b) facilitating a more adequate supply of high-skilled professionals for labor market needs; and (c) stimulating private investment in solar energy.

**Pillar B:** Reforming trade policy to support competitiveness and the economic recovery by (a) increasing accessibility to and affordability of 18 widely consumed food commodities and raw materials; and, (b) facilitating access to manufacturing inputs.

### c. Comments on Program Cost, Financing and Dates

The operation was approved on June 15, 2021. It became effective on October 7, 2021, and closed on December 31, 2021. The amount approved equaled the amount disbursed at US$ 800 million.

## 3. Relevance of Design

### a. Relevance of Objectives

**Background and Context.** At the time of the Development Policy Loan (DPL) approval, Indonesia was going through its first recession in two decades. With the onset of the COVID-19 pandemic, the Indonesian economy contracted by 2.1% in 2020. Both private consumption and investment fell sharply, and labor-intensive sectors, such as transport, hospitality, construction, and manufacturing, were severely hit.
The COVID-19 pandemic adversely affected employment and labor income. Between 2019 and 2020, unemployment rose from 6.3% to 7.1% and underemployment increased from 6.4% to 10.2%. According to the Indonesian Bureau of Statistics [Badan Pusat Statistik, BPS]), poverty based on the national poverty line increased from 9.4% to 9.8%.

**Alignment of PDO with Government's 2020-2021 Reform Agenda.** The PDO was closely aligned with the Government's agenda to attract investment and improve the competitiveness of the Indonesian economy. In response to the Covid-19 crisis, the Indonesian Government implemented a number of measures, including an emergency fiscal package consisting of increased Government spending of 3.6% of gross domestic product (GDP) in 2020, and 4.2% of GDP in 2021. The aim was to provide income relief to households and firms and support output.

The Government recognized that structural reforms, focused on improving competitiveness and the investment climate, were essential for improving productivity, growth and job creation, particularly in the post-pandemic economic recovery. Indonesia's moderate exposure to international trade and weak integration into global value chains (GVCs) had slowed the growth of manufacturing and other non-commodity tradable sectors. Indonesia had attracted little Foreign Direct Investment (FDI) relative to GDP compared to other countries in the region, thus missing a source of technology and knowledge transfer and external funding for the economy (PID, p. 3). Restrictive trade policies also contributed to high and volatile prices of staple food products and production inputs (PID, p. 3).

The operation was designed to help the Government address these structural challenges and implement priority reforms on investment and trade to aid the economic recovery. The operation sought to support relevant Government policy and legislative reforms such as the enactment of the Omnibus Law on Job Creation, which aimed to improve the investment climate (by amending various laws to allow more economic sectors to be open for foreign participation). Additionally, the operation aimed to promote competitiveness and sustainable transformation by: (i) relaxing work permit restrictions for skilled foreign workers, (ii) streamlining imports of basic goods, (iii) promoting renewable energy, and (iv) streamlining business licensing.

**Alignment with previous Government Reform Efforts and World Bank Interventions.** In addition to providing support to the Government for its 2020-2021 reform agenda, the operation provided an opportunity to build on previous assistance programs. The implemented reforms were long advocated in the World Bank's policy dialogue with and TA to the Indonesian Government. The 2020 Systematic Country Diagnostic Update emphasized the removal of investment restrictions, and the World Bank had provided technical assistance to Indonesia in prior years, in areas related to investment and trade policy reform. During the 2008–09 global financial crisis, the World Bank's 2009 Public Expenditure Support Facility to Indonesia sought to improve the investment climate by supporting the clarification of the rules and relaxing restrictions of DNI, i.e., the Negative Investment List (Daftar Negatif Investasi, DNI) regulation (Presidential Regulation No. 44 of 2016). (Indonesia's Negative Investment List included widespread foreign equity limits, sectoral reservations for MSMEs, and special licensing regimes, which had negative effects of the private sector). Nevertheless, in subsequent years, up until 2014, the drive to liberalize FDI was not sustained, and, in fact, foreign investment restrictions tightened in several sectors. Although some revisions to the Negative Investment List contained in Presidential Regulation No. 44 were undertaken in 2016, significant restrictions remained, and this operation addressed areas in need of further reform. With the COVID-19 pandemic acting as a catalyst, and after the reelection of the President in 2019, the Government responded by implementing one of the most ambitious investment, trade and investment liberalization reform programs in decades.

**Alignment of PDO with the World Bank Group's CPF FY21-FY25 for Indonesia:** The PDO was aligned to objectives outlined in the CPF FY21-FY25. That framework focused on the constraints identified in the 2020 Systematic Country Diagnostic Update and included four engagement areas: (a) strengthen economic competitiveness and resilience; (b) improve infrastructure; (c) nurture human capital; and (d) sustain management of natural assets, natural resources-based livelihoods, and disaster resilience.

The reforms seeking to remove restrictions on investment and trade supported the CPF through the engagement area 'Strengthening Economic Competitiveness and Resilience'. Facilitation of private investment in renewable energy supported the engagement area focused on improving infrastructure. Facilitation of the recruitment of high-skilled professionals not only supported the engagement area of strengthening economic competitiveness and resilience, it also supported the objective of nurturing human capital (due to potential for skill-transfer from foreign workers to domestic workers, thus contributing to "domestic human capital").

## b. Relevance of Prior Actions

### Rationale

There were five PAs, with PAs 1-3 supporting Objective 1, and PAs 4-5 supporting Objective 2. Most of the PAs, which comprised 9 distinct actions, had a strong link to the achievement of the PDO and were cast in a credible results chain.

**Objective 1 (Improve the investment climate in support of economic recovery and transformation by opening more sectors to private investment, particularly FDI; (b) facilitating a more adequate supply of high-skilled professionals for labor market needs; and (c) stimulating private investment in solar energy) had 3 Prior Actions (PAs):**

- PA1: To open more sectors to private investment, particularly FDI, the Borrower, through the Indonesia Investment Coordinating Board (Badan Koordinasi Penanaman Modal, BKPM), has reduced the number of business activities subject to at least one investment restriction from 813 to 260, as evidenced by Presidential Regulation No. 10/2021 (enacted on February 2, 2021).
- PA2: To facilitate a more adequate supply of high-skilled professionals for the labor market needs, the Borrower, through the Ministry of Manpower (MOM), has undertaken the following actions: (i) removed the requirement for an employer to have an expriate manpower employment plan (Rencana Penggunaan Tenaga Kerja Asing, RPTKA) to employ expatriate workers for a number of positions, and removed the requirement for an employer to obtain a written license from the MOM or any appointed officials to employ expatriate workers, as evidenced by Government Regulation No. 34/2021 (issued on February 2, 2021; effective from April 1, 2021); and (ii) extended the list of occupations eligible for work permits and removed the recommendation requirements of sectoral ministries for occupations outside of the eligible list, as evidenced by the MOM Decree No. 228/2019 (enacted on August 27, 2019).
- PA3: To stimulate private investment in solar energy and reduce the economy's dependence on fossil fuels, the Borrower has undertaken the following actions: (i) through the Ministry of Energy and Mineral Resources (MEMR) has removed the requirement to transfer ownership of plants generating electricity from renewable energy resources to the state electricity company (Perusahaan Listrik Negara, PLN) at the end of the term of the relevant power purchase agreements, as evidenced by MEMR Regulation No.

4/2020 (issued at the end of February 2020); (ii) through MEMR has exempted smaller power system owners from the requirement of operation license and certification of worthiness to operate, as evidenced by MEMR Regulation No. 13/2019 (issued on September 6, 2019); (iii) through MEMR has reduced capacity charges and eliminated emergency energy charges for on-grid industrial consumers who use behind-the-meter solar rooftop photovoltaic (PV) power plants, as evidenced by MEMR Regulation No. 16/2019 (issued on October 14, 2019); and (iv) through the Ministry of Public Works and Housing (MPWH) has allowed up to 5 percent of reservoirs' water surface to be utilized for floating solar Photovoltaics (PVs), as evidenced by MPWH Regulation No. 6/2020 (issued on April 7, 2020).

**Objective 2 (Support trade policy reform to support competitiveness and the economic recovery by (a) increasing accessibility to and affordability of widely consumed food commodities and raw materials; and, (b) facilitating access to manufacturing inputs) had 2 Prior Actions (PAs):**

- PA4: To support the economic recovery of households and firms from the COVID-19 crisis, the Borrower, through the Coordinating Ministry of Economic Affairs (CMEA), has increased accessibility and affordability of 18 widely consumed food commodities and raw materials by simplifying their import approval process and by waiving all technical requirements for imports in the event of: (a) urgent needs or price surges above normal price; (b) limited stock in domestic and/or international markets; (c) exceptional obstacles to the flow of trade and/or disruption in distribution, as evidenced by Presidential Regulation No. 58/2020 (signed on April 8, 2020).
- PA5: To facilitate access to manufacturing inputs, the Borrower, through the Ministry of Industry Agency for Standardization and Industrial Services Policy (Badan Standardisasi dan Kebijakan Jasa Industri) (MOI-BSKJI), has reduced the cost of compliance with national product standards (SNI) by removing compulsory SNI certification for steel, stove and wire products used by producers as evidenced by MOI Regulation no. 35/2019 (effective as of April 1, 2019).

**Objective 1: Improve the investment climate in support of economic recovery and transformation by opening more sectors to private investment, particularly FDI; (b) facilitating a more adequate supply of high-skilled professionals for labor market needs; and (c) stimulating private investment in solar energy**

**Prior Action #1.** Opening more sectors to private investment, including FDI, was important for the economic recovery. Prior to the adoption of the Presidential Regulation No. 10/2021, Indonesia's restrictions on FDI ranked third highest among high- and middle-income countries surveyed by the Organisation for Economic Co-operation and Development (OECD), and second highest among countries in the region (Malaysia, the Philippines, Thailand, Republic of Korea, and Taiwan). Indonesia's negative investment list included widespread foreign equity limits, sectoral reservations for MSMEs, and special licensing regimes, which had negative effects on the private sector (ICR, p. 14). By substantially reducing the number of business activities subject to at least one restriction, from 813 to 260, the PA made an important contribution to attracting FDI. Furthermore, the removal of restrictions to investment was intended to help Indonesia benefit from larger sources of technology, knowledge transfer and external funding for the economy. **(Relevance of PA1=S)**

**Prior Action #2.** Prior to the adoption of PA2, Indonesia's work permit system was highly restrictive compared to other countries in the region, as indicated by a relatively high score of 0.050 on the Work Permit Regulatory Restrictiveness Index for 2019 (PD, p. 22). This score was higher than those of countries such as Vietnam (0.020), the Philippines (0.015), India (0.008), and Malaysia (0.002), suggesting that Indonesia was less receptive to foreign workers with critical skills than its regional counterparts. Indeed, the restrictive work permit system limited the ability of firms to tap into the global skill markets relative to other countries in the region, where expatriates represent a much higher share of the skilled workforce. (PD, p. 22).

According to World Bank Enterprise data, nearly 80 percent of Indonesian companies were unable to fill managerial vacancies, the highest share in the East Asia and Pacific region (PD, p. 21). A Government of Indonesia-World Bank 2019 assessment highlighted that there was a critical shortage of skilled professionals in various white-collar positions, including Chemical Manufacturing Control, Biochemistry Supervisor, Microbiology Supervisor, Food Technologist, Chemical Engineer, Cloud Solution Architect, and UI/UX Designer (PD, p. 21). This skills' shortage resulted in lower productivity, limited employment growth, and innovation, leading to a low share of firms generating product or process innovation in Indonesia – crucial for sustained economic growth and economic recovery.

The high level of restrictiveness in Indonesia's work permit system was attributed to the cumbersome approval process that required endorsement from several entities, including the Expatriate Manpower Employment Plan and the Expatriate Manpower Employment License issued by the MOM, as well as approval from line ministries associated with particular sectors and occupations (ICR, p.15). To enhance the supply of high-skilled professionals for the labor market PA2 consisted of two distinct actions: (1) the removal of the requirement for an employer to have RPTKA to employ expatriate workers, as well as the removal of the requirement to obtain a written license from MOM or any appointed officials to employ expatriate workers; and (2) the extension of the list of occupations eligible for work permits and the concomitant removal of the recommendation requirements of sectoral ministries for occupations outside of the eligible list. These reforms were intended to provide more certainty to the approval process, eliminate the discretion of sectoral ministries, and expand the range of skill gaps that firms could fill through global markets. The policy actions were highly relevant for Indonesia's competitiveness in view of labor market and essential skills shortages. PA2 is rated as Satisfactory. **(Relevance of PA2=S)**

**Prior Action #3** sought to stimulate private investment in solar energy and reduce Indonesia' dependence on fossil fuels. Indonesia's investment in renewable energy (RE) in 2019 was US$1.7 billion. According to its National Energy Plan, Indonesia had set a target of achieving a 23 percent renewable energy capacity in its energy mix by 2025. However, with only US$1.7 billion invested in renewable energy (RE) in 2019, Indonesia's overall investment in RE was considered inadequate to meet this goal.

According to a World Bank-IFC analysis, Indonesia has the potential to install 47.2 GW of renewable energy capacity by 2030, with 30.4 GW from utility-scale solar, 14.7 GW from rooftop solar, and 2.1 GW from off-grid solar. However, the current government target for solar is only 9.3 GW, indicating a considerable gap in investment required to meet the potential capacity. The insufficient investment in renewable energy is a hindrance to Indonesia's transition to a more sustainable energy system.

The untapped potential of solar power in Indonesia is due to several obstacles. Build, Own, Operate and Transfer (BOOT) scheme obligates RE power producers to transfer ownership of plants generating electricity from RE to the state-owned electricity company Perusahaan Listrik Negara (PLN) at the end of the power purchase agreement. This obligation reduces the value of the project assets and deters investors due to uncertainties in land acquisition responsibility, collateral usage restrictions, and reduced commercial incentives.

Other obstacles to solar energy development include costly and time-consuming operational permits, capacity charges, and limitations on water reservoir use. Obtaining licenses and certificates required to build and install a Rooftop Solar Photo-Voltaic (PV) system is time-consuming and costly, which can discourage smaller projects due to increased fixed costs (ICR, p 16). Secondly, industrial customers installing on-grid, behind the meter generation are required to pay a capacity charge and emergency energy charge, which has a significant negative impact on the profitability of PV projects that generate power for less than 40 hours per week. Thirdly, limitations on the use and function of water reservoirs make it difficult to use their water surface for floating solar PV projects, which would be an ideal location for such projects.

The PA included four actions: (a) removing the requirement to transfer ownership of plants generating electricity from renewable energy resources to PLN at the end of power purchase agreements; (b) exempting smaller power system owners from operation license and certification requirements ; (c) reducing capacity and eliminating emergency energy charges for on-grid industrial consumers using behind-the-meter solar rooftop PV power plants; and (d) allowing up to 5% of reservoirs' water surface to be used for floating solar PVs. These regulatory reforms are well-aligned with the PDO of the operation, which aims to generate investment opportunities and tap into the vast potential of the solar PV sector in Indonesia. Moreover, they are critical to Indonesia's efforts to develop a sustainable and inclusive energy sector. Accordingly, PA 3 is judged as satisfactory. **(Relevance of PA3=S)**

**Objective 2: Support trade policy reform to support competitiveness and the economic recovery by (a) increasing accessibility to and affordability of widely consumed food commodities and raw materials; and, (b) facilitating access to manufacturing inputs**

**Prior Action #4.** PA 4 seeks to address the problem of inefficiently applied and unnecessary trade measures which raise the domestic prices of food and disproportionately affecting poorer households. A basket of food in Jakarta is more expensive than a similar one in Delhi (by 66 percent), Kuala Lumpur (17 percent), Beijing (13 percent) and Manila (8 percent) (PD, p. 25). High and volatile food prices are identified as one of the key drivers of malnutrition and slow poverty reduction in Indonesia. This became particularly evident during the COVID-19 crisis, which made it more difficult for households to purchase sufficient food. Food prices in Jakarta are more expensive than in other middle-income countries in the region and have been growing faster. A World Bank survey found that almost a third of Indonesian households experienced food shortages and 38 percent ate less than they should have in May 2020. By November 2020, 23 percent of households still reported food shortages and 29 percent reported eating less.

To support the recovery of households and firms from the COVID-19 crisis, PA4 supported the promulgation of a regulation, with the aim of waiving certain technical requirements for imports and hastening the procurement process of primary goods. The PA (Presidential Regulation No. 58/2020, signed on April 8, 2020) streamlined the import procedures for 11 essential food products and 7 input products, which were defined in a separate regulation (Presidential Regulation No. 59/2020. It simplified the import approval process for 18 widely consumed food commodities and raw materials, including rice, soybean, chili, and chicken meat, which make up 34 percent of food expenditures and 21 percent of total expenditures for households in the bottom 40 percent of the income distribution. Additionally, the list included inputs such as steel and cement, and together, these 18 products account for 6.1 percent of total Indonesian imports.

The streamlining was achieved through two key changes: (i) simplifying the import approval process by eliminating the need to obtain written validation from each participating ministry/agency to grant the import permit, and (ii) allowing for the waiving of technical requirements in urgent situations such as limited stock in domestic or international markets, exceptional obstacles to trade flow, or disruptions in distribution. **(Relevance of PA4=S)**

**Prior Action #5** to facilitate access to manufacturing inputs focused on reducing the cost of compliance with compulsory national product standards. Compliance with Indonesian National Standards (Standar Nasional

Indonesia, SNI) is associated with significant costs and delays for both importers and domestic producers, as the certification process for an imported input can take up to 5 months and can only be carried out by agencies mandated by the MOI to certify specific products (ICR, p. 17). WTO Trade Policy Reviews suggest that the widespread application of compulsory product standards certification is unique to Indonesia in south-East Asia (PD, p. 53). Indeed, SNI certification is equivalent to a tariff equivalent to up to 57 cents per dollar of imported goods in Indonesia (PD, p. 27). SNI certification is also a recurrent cost as the certification must be renewed every year against a fee and the certification process must be carried out again every 3 or 4 years depending on the product (PD, p. 27). Such barriers are particularly harmful for firms that require numerous individual inputs (which may all be subject to SNI compliance). PA5 resulted in the removal of 14 individual regulations, removing the mandatory certification with SNI for almost 10 percent of the intermediate imports to which the SNI certification is applied. The inputs covered by the 14 Ministry of Industry regulations comprised about US$ 3.9 billion, or 3.5 percent of total intermediate imports in 2019; and removed SNI certification for products such as steel, stove and wire products (PD, p. 28). The reform intended to increase the competitiveness of firms in manufacturing, as well as facilitate Indonesia's integration into global value chains (GVCs) by improving firms' ability to adjust their supply chains. PA5 is relevant for improving competitiveness and economic transformation and complementing investments. However, no additional evidence is provided regarding the relevance of the 14 regulations. PA5 is rated as Moderately Satisfactory. **(Relevance of PA5=S).**

### Rating

Satisfactory

## 4. Relevance of Results Indicators

### Rationale

**Objective 1** (attracting private investment, particularly FDI) had 3 RIs, with RI1a and RI1b associated with PA 1, and RI2 and RI3 associated with PA 2 and PA 3 respectively.

**Objective 2** (supporting trade policy reform to support competitiveness and the economic recovery) had three RIs, with RI4a and RI4b associated with PA4, and RI5 linked to PA5.

**Table 1: Results Indicators by Objectives and PAs, Baseline and Target Values, and Status**

| ***Results Indicator*** | ***Associated PA*** | ***RI Relevance*** | ***Baseline (2019)*** | ***Target (2021)*** | ***Actual (2021)*** | ***Actual as % of targeted change*** | ***RI Efficacy (Achievement) Rating*** |
|---|---|---|---|---|---|---|---|
| *Objective 1: Improve the investment climate in support of economic recovery and transformation by opening more sectors to private investment, particularly FDI; (b) facilitating a more adequate supply of high-skilled professionals for labor market needs; and (c) stimulating private investment in solar energy* | | | | | | | |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **RI1a**: Indonesia's share of manufacturing FDI inflows to regional comparators | PA1 | Moderately Unsatisfactory | 23.00% | 30.00% | 11% | -171.43% | Negligible |
| **RI1b (revised):** Difference in percentage change in growth in realized FDI between liberalized and non-liberalized non-commodity sectors (in the 2019-21 period): | PA1 | Moderately Unsatisfactory | n/a | 20.00% | 25.60% | n/a | Negligible |
| **RI 2:** Share of expatriates in total number of skilled workers | PA2 | Moderately Satisfactory | 0.53% | 1.00% | 0.63% | 21.28% | Negligible |
| **RI 3:** Share of solar power in national energy generation | PA3 | Satisfactory | 0.21% | 0.40% | 0.27% | 31.58% | Modest |
| ***Objective 2: Support trade policy reform to support competitiveness and the economic recovery by (a) increasing accessibility to and affordability of widely consumed food commodities and raw materials; and, (b) facilitating access to manufacturing inputs*** | | | | | | | |
| **RI 4a:** Yearly ratio between average domestic and international price of medium-quality rice | PA4 | Moderately<br><br>Satisfactory | 101.00% | 70.00% | 50.00% | 164.52%. | High |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **RI 4b:** Yearly ratio between average domestic and international price of soybean | PA4 | Moderately Satisfactory | 54.00% | 40.00% | 36.00% | 128.57%. | High |
| **RI 5:** Share of manufacturing inputs exempted from compulsory Indonesian National Standard (SNI) certification in total intermediate imports | PA5 | Moderately Satisfactory | 3.46% | 6.00% | 2.77% | -27.17%. | Negligible |

**RI 1a** was intended to capture the expected impact of PA1 toward increased FDI. The RI measured net manufacturing FDI inflows compared to its regional counterparts (which include the Southeast Asian countries that have not undertaken significant investment reforms in the past year, i.e., Malaysia, the Philippines, Thailand, Republic of Korea and Taiwan). The data sources and calculation used in the DPL baseline for the purposes of RI 1a were clear. While RI 1a was measurable with a clear baseline and target, the indicator's movement could not be uniquely attributable to PA1 and did not therefore constitute credible evidence of the impact of the prior actions. Not only were there country-specific factors which might influence FDI to Indonesia (beyond the reforms as part of PA1), the indicator was expressed relative to other regional economies, implying the indicator could be impacted by any number of policies and conditions in the other regional comparator countries. R1A is assessed as Moderately Unsatisfactory. **(R1A = MU).**

**RI 1b** attempted to measure the impact of liberalization on foreign direct investment by juxtaposing investment in sectors liberalized versus those not liberalized. The RI focused on the difference in percentage change in growth in realized FDI between liberalized and non-liberalized non-commodity sectors (in the 2019-21 period). The RI utilized actual FDI data. The sectors in which investment were liberalized were known. Actual FDI data on past growth (pre-reform) of both the liberalized sectors versus non-liberalized sectors prior to reforms allowed the team to calculate the baseline. FDI into liberalized sectors was measured as the FDI inflows in non-commodity sectors (secondary and tertiary sectors) in which all business activities were liberalized based on the Presidential Regulation 10/2021. While the data for the measurement was clear and readily available, the change in growth in FDI in the liberalized sectors could not be attributed to the reforms under PA1. Moreover, as a stand alone DPO, the short time period between baseline and target dates is vulnerable to idiosyncratic movements and not necessarily indicative of trend changes related to the investment climate. The measure was also impacted by FDI growth in the non-liberalized sectors, which could be affected by a range of external factors. The relevance of RI 1b is assessed as Moderately Unsatisfactory. **(R1B = MU).**

**RI 2** measured the share of expatriate workers in the total number of skilled workers. This was an output indicator aiming to measure the impact of PA2. The indicator sought to capture the greater ease in hiring for expat skilled workers, and to ensure that the indicator would not be impacted by business cycles (where hiring, both expat and domestic, might rise or fall), the indicator was expressed as a share of total skilled workers. RI2 was clearly defined and measurable, even though t he short time frame involved made it difficult to capture the full impact of the reform (the reform was enacted in 2019 and implemented during the COVID-19 pandemic when travel restrictions were still in place). That said, RI2 successfully captured the greater utilization of skilled foreign labor. The indicator is a stock measure; a more meaningful indicator would have focused on the flow of skilled expatriate labor. Overall, RI 2 is assessed as Moderately Satisfactory. (RI2=MS).
RI 3 (associated with PA3) measured the share of solar power in national energy generation. The RI was designed to capture the increase in investment in solar power expected to flow from project reforms. The RI was appropriate to monitor progress toward the PDO, given that an increase in the share of solar power in installed energy capacity would require an increase in investment in this sector. RI 3 was appropriate and measurable, defined with a clear data source. RI 3 is assessed as Satisfactory. **(RI3=S).**

**RI 4** consisted of two distinct indicators. RI 4a (associated with PA4) related to the yearly ratio between the average domestic and international price of medium-quality rice. RI 4b (also associated with PA4) related to the yearly ratio between the average domestic and international price of soybean. Owing to restrictions on imports, price gaps between domestic and international prices of rice and soybeans were substantial prior to the reforms. These price gaps for both rice and soybean were expected to decline as a result of PA4, and the implementation of Presidential Regulation No. 58/2020 (signed on April 8, 2020). The assessment period was 2019-2021. Rice and soybean (2 out of 18 products included in the policy) were chosen as products because of the importance of these commodities to Indonesia (ICR, p. 28). The PD notes that medium-quality rice is Indonesia's most important consumed commodity (PD, p. 26), and "rice is an important component of the food basket for all Indonesians, and especially so for the poor who spend around 24 percent of their food expenditure and 15 percent of total expenditure on this staple grain which is a key part of the diet." (PD, p. 32). The PD also notes soybeans are widely used in Indonesia as key inputs for tofu and tempeh (PD, p. 26).

RI4a and RI4b indicators were based on a clear data source and were measurable. However, they had some weaknesses in fully capturing the intended impact of PA4, which ultimately aimed to support trade reforms in order to improve the ability of households to afford basic foodstuffs and facilitate access to manufacturing inputs to support competitiveness and economic recovery. The focus on price differentials between domestic and international prices of rice and soybeans, two out of 18 products covered under the policy, did not (ii) account for external factors that affect international prices of the two commodities (and not having to do with the PA), and (ii) did not measure the impact of facilitated import procedures on firm competitiveness (that were to be achieved through the facilitated import procedures for raw materials). A better approach to capturing the impact on households' basic food affordability may have been through surveys on household food expenditure as a share of total spending. Therefore, the relevance of both RI4a and RI4b is assessed as Moderately Satisfactory **(RI4a= MS, RI4b=MS).**

**RI 5** (associated with PA5) was designed to measure the impact of exempting certain products from mandatory compliance with SNI (Indonesian National Standard). It measured the share of the value of manufacturing inputs that were exempted from mandatory SNI certification in total intermediate imports. The baseline for this measure was 3.46%, and the desired outcome was to increase this to 6% by 2021. The RI was well-defined and easily measurable using readily available trade data, though the timeline for measuring achievements might have been longer. RI 5 is assessed as Moderately Satisfactory. **(RI5=MS).**

### Rating

Moderately Satisfactory

## 5. Achievement of Objectives (Efficacy)

### OBJECTIVE 1

#### Objective

Improve the investment climate in support of economic recovery and transformation by opening more sectors to private investment, particularly FDI; (b) facilitating a more adequate supply of high-skilled professionals for labor market needs; and (c) stimulating private investment in solar energy

#### Rationale

Supported by PAs 1-3

Progress measured by RI 1a, RI 1b, RI 2 and RI 3

A key target **(RI 1b),** relating to an increased investment in fully liberalized non-commodity sectors) was met. Fully liberalized non-commodity sectors attracted more FDI and achieved a growth of 13.8% from 2019 to 2021. By comparison, FDI in non-fully liberalized sectors shrank by 11.8%. The difference between the percentage changes in FDI in the two categories of sectors was 25.6 percentage points. Thus, under the criterion of full liberalization based on Presidential Regulation 10/2021, the target of 20 percentage points difference in FDI growth in the two groups of sectors, set for RI 1b, was achieved. Furthermore, as of Q2 of 2022, FDI in fully liberalized sectors more than doubled compared to non-fully liberalized sectors. Indeed, FDI in fully liberalized sectors grew by 21.4% on average about a year before the policy in February 2021 and had a growth rate of 175% about a year after policy implementation. This represents a significant outcome under PA 1.

However, several other RIs were not met. This includes the following three RIs:

- RI 1a, Indonesia's share of net FDI in manufacturing relative to regional comparators;
- RI 2, the share of expatriate workers in the total number of skilled workers;
- RI 3, the share of installed capacity in solar energy production.

**RI 1a** measured Indonesia's share of net FDI in manufacturing relative to regional comparators. The aim was to achieve a target of 30%, compared to a baseline of 23%. However, this target was not achieved. RI 1a actually backtracked from its baseline value. At project completion, net manufacturing FDI fell to was 11 %. Even when alternate FDI data was used, the target set for RI 1a was not achieved. The ICR notes this was due to a short span of the assessment period (ICR, p. 19). The policy was enacted in February 2021 and the DPL approved in June 2021, with the assessment period for 2021 relatively short. Indeed, net FDI rebounded in 2021, compared to 2020 reaching 11% of manufacturing FDI to regional comparators. This was lower than the pre-pandemic FDI level in 2021 (23%). Early 2022 data (beyond the period of evaluation), however, suggests that manufacturing FDI increased.

Although RI 2 (on foreign workers) and RI 3 (on solar energy) made progress and moved in the direction of the target objectives, result targets were not achieved.

The target for **RI 2** was not achieved, despite some progress toward achievement of this target. As the ICR notes, the targets set for RI 1 was likely too ambitious (ICR p. 28), (nearly double the baseline), given that the reform was enacted in 2019 and implemented during COVID-19 when travel restrictions were still in place. Based on the number of work permits delivered by MOM (the Ministry of Manpower), the number of expatriate workers as a share of total skilled workers reached 0.63% in 2021 (outcome) and increased from 0.53% (baseline consisting of 15 million skilled workers in Indonesia) in 2019, against a target of 1%. The reforms associated with RI 2 were enacted in 2018 and implemented during the COVID-19 lockdowns, when travel restrictions were in effect, and many skilled workers from abroad could not travel to Indonesia. The number of work permits issued to expatriates increased from 81,000 in 2019, to 88,271 in 2021, and 110,833 in October 2022. The vast majority of expatriate work permits in 2022 were issued to workers from China (47 percent), followed by Japan, South Korea, and India. Nationals of these four countries represented 72 percent of the work permits issued to expatriate workers. The ICR notes that although hiring skilled expatriate workers has become less cumbersome and likely less costly than in the past, the screening remains quite intrusive with heavy reporting obligations (ICR, p. 26). Government Regulation 34/2021 removes the notification requirement but adds a requirement for RPTKA feasibility assessment, involving verification and payment of the Foreign Worker Utilization Compensation Fund by the applicant. Government Regulation 34/2021 obligates employers to submit an annual report, covering (a) employment of foreign workers, (b) education and training of Indonesian co-workers, and (c) transfer of technology and expertise from foreign workers to Indonesian co-workers.

The aim of **RI 3** was to double installed capacity from a baseline of 0.21% to a target of 0.40%. This target was not achieved. The share of solar energy reached 0.27 percent of total installed capacity in 2021 (74,532.94 MW), below the target of 0.40 percent. Installed capacity of solar power plants increased by nearly 40 percent in 2021 (201.09 MW), compared to 2019 (145.81 MW). According to PLN data, the new and renewable energy (Energi Baru Terbarukan EBT) mix was at 12.8 percent in June 2022, which is close to Ministry of National Development Planning (Badan Perencanaan Pembangunan Nasional, Bappenas)'s target of 15.7 percent for 2022, according to the updated national priority in the Government Work Plan (Rencana

Kerja Pemerintah). The ICR notes that “the solar market in Indonesia is still quite stunted due to other regulatory bottlenecks, which create a lack of incentives and restrict Indonesia’s power utility company (PLN) from signing new solar investments.” (ICR, p. 25). Overall, the share of solar energy is low compared to neighboring countries.

For both PA 1 and PA 2, the length of time between the implementation of the PAs (2019 and well into 2021) and the closing time of the DPL for the assessment period was relatively short. The DPL was approved in June 2021 and closed in December 2021, with assessment of indicators relying on 2021 data, with 2019 set as the baseline year. As such, the short assessment period likely prevented the achievement of some of the results sought by the operation, although this could have been factored in when setting the RI targets in the DPL monitoring and evaluation framework.

However, given that a key target was met (RI 1b), and some progress was made toward achieving RI 2 and RI 3, the overall rating for this objective is assessed as Moderately Satisfactory.

### Rating

Moderately Satisfactory

## OBJECTIVE 2

### Objective

Support trade policy reform to support competitiveness and the economic recovery by (a) increasing accessibility to and affordability of widely consumed food commodities and raw materials; and, (b) facilitating access to manufacturing inputs

### Rationale

Supported by PAs 4-5
Progress measured by RI 4a, RI 4b and RI 5

The reforms related to the second objective focused on trade policy reforms in order to improve the accessibility to key commodities and important intermediate manufacturing inputs. Trade policy reforms to increase the accessibility and affordability of key commodities were relevant in support of economic recovery.

**RI 4a** measured the yearly ratio between average domestic and international price of medium-quality rice (baseline 101%, outcome 50%, target 70%). RI 4b measured the yearly ratio between average domestic and international price of soybean (baseline 54%, outcome 36%, target 40%). The two RIs referred to the gaps between the domestic and the international price of rice and soybeans. Due to the restrictions on imports, these price gaps were substantial before the reforms supported by the DPL and were expected to decline as a result of the PA. The two RIs (both relating to strategic trade policy to remove restrictions on important key commodity foods and raw materials) were met. The difference between the domestic and international prices of rice decreased from 101% in 2019 to 50% in 2021. This indicates a reduction in the price gap, which was one of the goals of the reform supported by the DPL. The difference between the domestic and international prices of soybean decreased from 54% in 2019 to 36% in 2021.

Thus, between 2019 and 2021, the gap between the domestic and international prices of rice was more than halved, and the price of soybean in Indonesia also decreased compared to international prices. This is a positive outcome for consumers as rice and soybean prices relative to international prices became cheaper in Indonesia.

**RI 5** targeted the share of manufacturing Inputs exempted from compulsory SNI Certification in total intermediate imports (baseline 3.46%, outcome 2.77%, target 6%). The target for RI 5 was not met, and indeed regressed. Although the reforms enacted in 2019 led to the largest decline in SNI regulations since records began, intermediate imports exempted from SNI certification did not grow as strongly as expected, and their share in total intermediate imports declined to 2.77% (outcome), compared to the baseline (of 3.46%), well below the target of 6%.

Accordingly, achievement of the second objective is rated as Moderately Satisfactory.

### Rating

Moderately Satisfactory

### Overall Achievement of Objectives (Efficacy)
### Rationale

Efficacy is rated as Moderately Satisfactory. RIs 1b, 4a and 4b were met, with RI 1b representing a key target under the operation. However, some result targets were not met (RI 1a, RI 2, RI 2, RI 3 and RI 5).

### Overall Efficacy Rating
Moderately Satisfactory

## 6. Outcome

### Rationale

The overall outcome is rated as Moderately Satisfactory. The operation led to several reforms: most notably, investment reforms; trade reforms (to remove restrictions in in the import of key commodities, and supported the availability and affordability of widely consumed food commodities and raw materials), as well as reforms facilitating access to highly skilled professionals to address key human capital shortages.

Key targets associated with RI 1b, RI 4a and RI 4b were achieved. In this context, it is especially important to highlight the significant reforms achieved as part of RI 1b, as the investment reforms were comprehensive and led to a significant reduction in foreign investment restrictions. The implementation of the Omnibus Law significantly liberalized foreign investment and removed key restrictions to investments. Moreover, progress was made under RI 2, as, prior to the regulatory reform, the access of Indonesian firms to essential skills was problematic.

While the operation recorded progress on a number of indicators, there were some RIs that were not fully achieved. It should be noted, however, that some of the 2021 reforms under the DPL had a short assessment period, and those that were not achieved were enacted during the COVID-19 pandemic, which may have delayed the expected results from the reforms.

### a. Rating

Moderately Satisfactory

## 7. Risk to Development Outcome

There are two main risks to development outcomes including (1) macroeconomic risks; and (2) governance risks.

**Macroeconomic Risks.** Although they operation did not fully achieve targeted FDI levels, it led to improvements in Indonesia’s share of manufacturing FDI inflows, which reached 11 percent compared to regional comparators. Additionally, the operation facilitated growth in FDI for fully liberalized non-commodity sectors, with a growth rate of 13.8 percent from 2019 to 2021. However, these achievements are further put at risk due to macroeconomic factors such as global economic or regional deterioration. If the global economy experiences a significant downturn, investor confidence in emerging markets like Indonesia could decline, leading to a decrease in FDI inflows. Furthermore, domestic factors such as high inflation or political instability could also deter investors and negatively impact FDI inflows. Therefore, while the operation has made progress towards attracting FDI, the Indonesian Government will need to navigate macroeconomic risks in order to sustain and build upon achieved outcomes under the operation.

As a result of trade policy reform, project interventions have successfully decreased the relative price of medium-quality rice and soybeans in Indonesia compared to international prices, improving the affordability of key food commodities. However, the sustainability of these achieved outcomes is at risk due to increasing energy and food commodity prices (exacerbated by the war in Ukraine), which could undermine the objective of affordability of key food commodity prices sought by the trade policy. Global shocks and tightening financial market conditions may pose downside risks to Indonesia’s pace of economic recovery, potentially compromising the achieved outcomes of trade policy reforms. To mitigate this risk, the ICR notes it will be crucial for the Government to create fiscal space through tax reforms and greater spending efficiency. The June 2022-approved fiscal DPO supports reforms to increase tax revenue, improve the equity of the tax system, strengthen institutions for planning and budgeting, and enhance fiscal transfers. (ICR, p. 40).

**Governance Risks.** The operation led to the implementation of several Regulations, which are implementing regulations of the Omnibus Law on Job Creation.  These regulations supported reducing foreign investment restrictions (e.g., Presidential Regulation No. 10/2021, enacted in February 2021, reduced the number of business activities subject to at least one investment restriction from 813 to 260) and facilitated the supply of high-skilled professionals (with number of expatriate workers as a share of total skilled workers increasing from 0.53% to 0.63% in 2021). The regulations also simplified the regulatory framework and reduced the number of regulations for import approvals, potentially making it easier for private businesses to import products (e.g., animal products). However, the legality of the Omnibus Law that supports these regulations was conditionally declared unconstitutional by the Constitutional Court, which may reverse achieved outcomes under the regulations and impact investor sentiment. While this issue does not seem to be of significant concern to investors at present, it requires close monitoring by the World Bank (ICR, p. 44).

Finally, as Indonesia strives to increase its proportion of solar power in national energy generation, ongoing reforms are necessary to maintain and expand upon the progress made so far. As a result of project efforts, Indonesia has increased the proportion of solar power in its national energy generation, with the percentage rising from 0.21 to 0.27 between December 2019 and December 2021, through project targets were not fully achieved. The current regulatory bottlenecks pose a risk to the long-term feasibility of solar energy, and further reforms are needed to attract the level of investment necessary to achieve the Government's RE targets. In pursuit of solar energy development, the Government has implemented further reforms following the DPL and launched the 'One Million Solar Rooftops' initiative to encourage solar capacity growth, suggesting that the Government remains committed to continuous follow-up reform (ICR, p. 26).

## 8. Assessment of Bank Performance

### a. Bank Performance – Design

#### Rationale

The operation was underpinned by prior analytical work and long-standing World Bank assistance to Indonesia on investment and trade policy reform. In particular, the operation drew on the 2020 Systematic Country Diagnostic Update, the Country Private Sector Diagnostic, the 2020 World Development Report on GVCs, various analytical work on competitiveness in the design of the DPL. A PSIA (Poverty and Social Impact Analysis) and Environmental Impact Assessment was conducted to identify potential environmental and social risks. These provided mitigation measures and detailed recommendations.

Furthermore, the World Bank also consulted with a broad range of internal and external stakeholders, including the UK Embassy's Indonesia Bilateral Regulatory Reform Program and the Australia Indonesia Partnership for Economic Development, Prospera, which includes a workstream on better regulation for private sector growth.

The PAs covered a wide set of pertinent reforms and were well designed. Nevertheless, the results expected from some of the reforms supported by prior actions were likely unrealistically ambitious given the time frame of the operation. \

The ICR notes that Government officials from the Ministry of Finance (MOF) expressed the view that the preparation of the DPL, and similar operations more generally, could have been improved by engaging earlier to communicate more effectively with line ministries and agencies that may be concerned by the program. (ICR, p. 43). A more realistic time frame, therefore, would have made for more effective stakeholder engagement and project design.

### Rating

Satisfactory

## b. Bank Performance – Implementation

### Rationale

Earlier engagement with line ministries and agencies could have improved the implementation of DPL. The World Bank and IFC provided technical assistance through analytical work and preparation of follow-up operations in several reform areas supported by the DPO.
According to Government officials, World Bank support assisted in areas of poverty issues and the impacts of trade and investment reforms, as well as on environmental safeguards to business licensing. However, Government officials also requested more implementation support, better coordination, and timely sharing of information between the World Bank team, the MOF, and implementing agencies of the DPL program.. For instance, more support was requested at BKPM, who was operationalizing the key reform supported by the DPL, as well as more frequent check-ins in the implementation period and progress of RIs, even before ICR initiation.

### Rating

Satisfactory

## c. Overall Bank Performance

### Rationale

Overall bank performance is assessed as Satisfactory. The objectives and prior actions were highly relevant and selected based on extensive analytical work and prior technical assistance. However, there were flaws in project design, as noted above.

### Overall Bank Performance Rating

Satisfactory

## 9. Other Impacts

### a. Social and Poverty

The PSIA indicated that the overall poverty and social impact of the operation is likely to be positive. The DPO-supported reforms were expected to stimulate GDP growth by up to 0.2 percentage points per year and increase households' purchasing power. In turn, accelerated growth would enable Indonesia to reduce poverty and empower the middle class.

At the same time, PAs 1, 2, 4, and 5 were expected to exert adverse impacts on some segments of the population.  For example, the implementation of PA 2 and PA 5 may lead to displacement of some highly skilled national workers, although this could be mitigated by providing training opportunities for Indonesian employees. While PA 2 was expected to have a positive impact on the overall supply of workers in certain occupations, it could also affect the earnings of those in those jobs, as foreign workers may possess the requisite skills.

The Government undertook the following measures to mitigate some of these impacts:

- The Indonesian government has implemented regulations requiring compensation for land affected by investment projects, as well as a flagship Agrarian Reform Program supported by the World Bank. The country's safety net programs provide coverage for net sellers of rice who have social assistance, including food subsidies and conditional/unconditional cash transfer programs.
- To mitigate the potentially adverse effects of PA 5 and PA 2 on workers, the Government introduced an unemployment insurance program (Jaminan Kehilangan Pekerjaan, JKP).
- The Indonesia Human Capital DPL, approved by the World Bank in May 2022, supports the introduction of unemployment insurance (JKP).
- The World Bank is also supporting the development of social safety nets through an active Social Assistance Reform Project, and a Skills Project covering unemployment services and labor market intermediation, which is under preparation.
- The training program, Kartu Prakerja, supports the upskilling and reskilling of the population, and provides an e-voucher for short-term training for workers and jobseekers without higher education.

### b. Environmental

PA 3 (solar energy) and PA 4 (on import simplification for essential food items and raw materials) were found to have positive environmental effects. Investments in to solar (PA 3) will potentially reduce the role of fossil fuels in energy generation, with positive effects on the environment; whereas PA 4 is expected to reduce the pressure to convert forests and other types of land to agricultural use.

However, PA 1 (supporting the reduction of foreign investment restrictions) was found to have a possible negative impact, since land-intensive liberalized sectors include agriculture subsectors (such as, palm oil, soybean, sugarcane), mining (coal and mineral ores and onshore oil and gas), and real estate development. Some mitigating impacts have been taken, including application of a risk-based approach to business licensing for environmental permitting and regulatory requirements for wood-based industries.

### c. Gender

n/a

### d. Other

n/a

## 10. Quality of ICR

### Rationale

The ICR offers a thorough examination of the country context and rationale for the PAs, situating the operation's objectives within the broader framework of World Bank and government strategies, as well as Indonesia's long-term reform process. While the report identifies some weaknesses in operation design, such as the short closing period and the need to reconsider certain RIs, it also comments on future World Bank operations and their relevance. Despite these strengths, however, the ICR is not without flaws. Specifically, the report's language could have been clearer, and the outcomes achieved and discussed under the "Risk to Development Outcomes" section could have been more explicitly elucidated.

### a. Rating

Substantial

## 11. Ratings

| Ratings | ICR | IEG | Reason for Disagreement/Comments |
|---|---|---|---|
| Outcome | Moderately Satisfactory | Moderately Satisfactory | n/a |
| Bank Performance | Satisfactory | Satisfactory | n/a |
| Relevance of Results Indicators | --- | Moderately Satisfactory | |
| Quality of ICR | --- | Substantial | |

## 12. Lessons

This Review concurs with the lessons from the ICR, which are summarized below.

**Complementary policy actions with strong underlying evidence are a key strength, while setting targets needs assessment of the timelines**. Although several results were set at ambitious levels, the DPL closing may have been too short (6 months after approval). Accordingly, the time frame between DPO-supported reforms and the assessment period needs to be designed in line with implemented dates.

**A long-standing, continuous analytical engagement with the authorities is key for effective World Bank support to the reform process.** The World Bank had consistently provided technical assistance to Indonesia in previous years, in areas related to investment and trade policy reform. FDI liberalization had been flagged as a focus area in the policy dialogue with the authorities. By keeping a continuous analytical engagement and policy dialogue in these policy areas, the World Bank was able to build on previous assistance and swiftly align its support to the ambitious reforms undertaken by the Government in 2020–21. Moreover, technical assistance and other complementary World Bank operations are highly desirable to strengthen implementation support to limit the probability of future policy reversals.

## 13. Project Performance Assessment Report (PPAR) Recommended?

No