Evaluation Summary

Ex-post Evaluation of AFD's Fiscal Reform Development Policy Loan (DPL Fiscal) Series 1, 2 & 3 to the Government of Indonesia, and accompanying technical cooperation

Country: **Indonesia** | Sector: **Fiscal**

Evaluator: Adelante Knowledge & Development
Date of the evaluation: Aug 2021 – Feb 2022

Key data on AFD's support

Project numbers: CID1064, CID1071, and CID1088

Amount: 100 M Euro, 150 M Euro, and 100 M Euro (loan) and 1,2 M Euros (TA – grant)

Disbursement rate: 100%

Signature of financing agreement: 8 Nov 2016, 13 Oct 2018, and 14 Jan 2020

Completion date: 20 Mar 2020

Total duration: 4 years

Context

Following the crisis in 1997/98, Indonesia embarked on a democratic transition and a series of structural reforms took place. President Joko Widodo first administration (2015-2019) sought to reinforce fiscal reforms to create fiscal space to increase spending and adjust the budget composition towards less subsidies, more social and infrastructure spending. AFD's role in Indonesia has grown with new commitments through Policy Based Loans (PBLs) becoming a strategic instrument for achieving change. The evaluated support consisted of (i) three consecutive and dependent PBLs disbursed as three tranches over the period 2016-2020,; (ii) two accompanying technical cooperation projects mobilising French expertise through Expertise France (French DG of Public Finance and the Institute for Climate Economics – I4CE) and (iii) the associated policy dialogue.

Actors and operating method

The Ministry of Finance was the lead and signatory, implementing the agreement through its DG Budget, DG Tax and its Fiscal Policy Agency (Badan Kebijakan Fiskal - BKF). BKF lead on dialogue and mobilising the technical cooperation (TC). The support provided by AFD was harmonised to World Bank Development Policy loans (programmatic series), as part of a fiscal reform effort started in 2015. AFD used the Policy Matrix elaborated by the GoI and the WB.

Objectives

These PBLs were provided in support to the Medium-Term National Development Plan (RPJMN) for the period 2015-2019 focusing on improving the quality of life of the population and reducing inequalities.

Expected outputs

The Policy Matrix that was negotiated for these PBLs focused on three pillars:

- Improving quality of spending: (i) the composition of spending; (ii) Budget execution and (iii) Efficiency of spending
- Strengthening revenue administration: (i) Tax administration efficiency; (ii) Compliance management and audit capability; (iii) Reduction of tax-paying process
- Enhancing tax policy: (i) Enhancing revenue potential; (ii) Enhancing economic efficiency of tax policy

AFD considered that one prior action of the policy matrix could be categorised as "pro-climate" insofar as it would enable a sustainable reallocation of fuel subsidies to the infrastructure sectors, including renewable energies and water and sanitation, while the new vehicle tax would have a significant environmental impact, encouraging investment in public transport, and eco-friendly vehicle exempt from the tax. The revision of the policy matrix for DPL3 included a new GoI commitment to better tag it climate related expenditures and to insure against disaster, pushed by AFD and supported by the TC with I4CE.

Performance assessment

Relevance

AFD's PBL in parallel to the WB's DPL Fiscal series was relevant with AFD's strategy. PBL is a relevant instrument for AFD and the GoI as it finances its budget deficit. The fiscal series, and other PBLs, are relevant to the key priorities of GoI's structural reforms, pushing the priorities established by GoI in its reform plan. As it seeks to improve overall the budget financing, the adequacy of the composition of both revenues and expenditures with Indonesia's long term development planning, including sustaining its low carbon development path, it includes an exit strategy.

Coherence

The AFD's PBL Fiscal series was also coherent with AFD's strategies and other interventions. The PBL increasingly reflected AFD's focus on green and inclusive growth through the support to Indonesia's green budgeting and low carbon path with the carbon tax. The PBL Fiscal series demonstrated how French expertise and AFD's financing could facilitate reform and establish long term partnerships between institutions. The final policy matrices were largely the result of long term dialogue, including diagnostics and driven by the MoF, in line with its Directorate General's priorities. This reform path was itself the result of the diagnostics shared between GoI and its partners over a protracted dialogue.

Effectiveness and sustainability

Indonesia's efficient selection of the matrices prior actions led to their full their implementation. Sustainability of the PBLs support cannot be assessed in the short term and need to be considered within the broader perspective of Indonesia's development plan, and sustained dialogue . The sustainability of changes is ensured by the content of the policy matrix that focuses on legal and regulatory changes more than institutional changes. The processes and structures established for coordinating the reform are bound to change and mutate.

The approach chosen for TC and the intermittent nature of its implementation were perhaps too complex, and formal. The PBLs (and the DPLs) did not have a framework for monitoring the results of the reform and thus the effectiveness of French expertise and technical know-how, while valued by Indonesian institutions, could not be well measured. However, AFD visibility is limited due to little scope of AFD inhouse expertise and EF to respond flexibly to emerging needs and respond with upstream support or re-adjust work plans.

Efficiency

The PBL modality is favoured by GoI (financing, matrix with agreed prior actions arising from the GoI's plan, TC chosen by the DGs), but not as the standard budget support approach that compounds the three inputs of money, dialogue and TC. The financial component is managed separately from the TC and dialogue; and the dialogue is not necessarily formal nor linked to the current TC. The dialogue happens at different levels, notably the higher level (Tim Reformasi) and may be preparing the ground for furthering the reform and new support. Mobilising TC is part of the approach for cooperation of each institution (DG) seeking support "as and when needed". This places the onus on the providers to be reactive. The low dimensioning of the TC programme placesd AFD in a situation where it does not have sufficient capacity in country to monitor progresses, engage in continuous, more flexible dialogue (informal) compared to other partners with the existing "TC supports" (in-house and experts). Indonesian institutions reported that not all TC impacts are tangible but contribute to internal processes that will lead to choices for further implementing reform (i.e., new taxes).

Added value of AFD's contribution

The influence of French expertise is achieved through TC, which role over the long term is critical to respond to needs of GoI in choosing reform path and pace. The various PBL series are creating trust across institutions. For business community, better taxation and governance should positively impact all firms, with more transparency and a level-playing field for all firms operating in Indonesia. On going reforms positioned Indonesia as a key partner of OECD and EU, which benefits from the EU Green Deal and the Carbon Border Adjustment Mechanism (CBAM). This will create additional value for French firms operating in Indonesia or working with Indonesian firms.

Conclusions and lessons learnt

The evaluation revealed that it is necessary for AFD to dedicate resources for developing a deep and operational understanding of the institutional set-up and of policy planning and development mechanisms, leading to diagnostics, reform plans and ultimately planned legal and regulatory changes for achieving results.

AFD should seized opportunities to become a lender to Indonesia and continue establishing itself as a robust, competitive and regular partner to finance budget and reforms and to provide sound technical cooperation and dialogue. AFD may explore possibilities to lead and continue establishing as a robust, competitive, and regular partner in Indonesia (and similarly in other emerging economies).

This may require new tools that allows flexible operations e.g Multi-Year Facility, cooperate early with multilateral institutions and think tanks like OECD to enter joint diagnostics and dialogue that better link three components of PBLs (funds, dialogue, and TC).

AFD would gain by increasing dimension of TC to cover the full cycle of PBLs starting upstream of the loan. This may be done through different supports and contracts. AFD would then gain being part of the dialogue processes at technical level, using insights for its strategic dialogue. Such a support would enable AFD connecting better the three components of its PBLs. This may enable deepening risk assessment with deep dive into the loan's thematic overcoming the limitations of a PEFA.

AFD should be able to mobilise in-group (AFD and EF) and outside expertise. The mobilization of the expertise, through local and informal dialogue, relying on flexible contractual mechanisms, is key.

AFD should set up its framework or guidelines for monitoring its budget support operations, PBLs or others, the dialogue and the TC. This would support AFD with analytical information and better appreciation of the linkages between policy matrices and sector reforms. AFD should delegate to its TC implementers the follow up of reforms and supporting AFD's dialogue with regular information and analysis.

It is suggested that the TC could include a component of knowledge management to structure the knowledge acquired and to ensure it is accessible by Indonesian institution and their staff within their policy planning and development and institutional culture. This would increase sustainability, and limit the impact of staff turnover.

The prior actions in the policy matrix are useful in so far as they enable push and dialogue with international partners of Indonesia and change in the legal and regulatory framework.