



CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

In accordance with section 610(b)(1) of the Millennium Challenge Act of 2003, as amended, we wish to inform you that the Millennium Challenge Corporation (MCC) entered into a Millennium Challenge Compact with the Republic of Indonesia on November 19, 2011. We have included a detailed summary of the Compact and a copy of the text of the Compact.

We will publish the text of the Compact and the summary in the Federal Register and on MCC's website.

The attached notification is being sent to Congress on November 28, 2011.

Sincerely,

T. Charles Cooper
Vice President
Congressional and Public Affairs

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION
November 28, 2011**

In accordance with section 610(b)(1) of the Millennium Challenge Act of 2003, as amended (22 U.S.C. 7701 *et seq.*) (the “**Act**”), this notification is to advise that the Millennium Challenge Corporation (“**MCC**”) entered into a Millennium Challenge Compact with the Republic of Indonesia under sections 605 and 609(g) of the Act on November 19, 2011 (the “**Compact**”).

A detailed summary of the Compact and a copy of the text of the Compact follow.

SUPPLEMENTAL INFORMATION

MILLENNIUM CHALLENGE COMPACT BETWEEN THE UNITED STATES OF AMERICA, ACTING THROUGH THE MILLENNIUM CHALLENGE CORPORATION, AND THE REPUBLIC OF INDONESIA

The five-year, \$600 million compact with the Government of Indonesia (the “GOI”) is aimed at reducing poverty through economic growth (the “Compact”). To this end, the Compact’s three projects are intended to increase incomes of households in project areas through increased productivity of labor and enterprises, reduced household energy costs, and improved provision of growth-enhancing goods and services by the public sector.

I. Project Overview and Activity Descriptions

To advance the Compact goal of reducing poverty through economic growth, the Compact will fund three projects. The ***Green Prosperity Project*** aims to (i) increase productivity and reduce reliance on fossil fuels by expanding renewable energy; and (ii) increase productivity by improving land use practices and management of natural resources. These objectives are consistent with GOI development plans to support low carbon economic development and the protection of natural capital leading to increased household incomes in project areas. The ***Community-Based Health and Nutrition to Reduce Stunting Project*** aims to reduce and prevent low birth weight, childhood stunting, and malnourishment of children in project areas, and thereby increase household incomes through cost savings, increases in productivity, and higher lifetime earnings. Finally, the ***Procurement Modernization Project*** aims to (i) achieve significant government expenditure savings on procured goods and services; and (ii) improve the delivery of public services through expenditure of planned budgets.

Green Prosperity (GP) Project

The majority of Indonesia’s poor live in rural areas that are rich in natural resources, but the over-extraction and inadequate management of these resources threaten Indonesia’s ability to sustain high rates of economic growth and reduce poverty. It is estimated that over 10,000 villages in Indonesia (13 percent) do not have access to reliable and affordable electricity, and many more rely on expensive and dirty diesel generation. Illegal logging, conversion of marginal lands for agriculture, water pollution, and other unsustainable land use practices are adversely affecting the natural assets that people rely on for their livelihoods and wellbeing. The lack of clear data on land resource use and jurisdictional boundaries between villages and districts significantly hinders GOI agencies and land use planners from managing critical natural resources effectively. Ultimately, protecting Indonesia’s natural resource base in the face of demographic, social, and economic forces requires sustainable and equitable economic alternatives.

Indonesia is among the world’s top emitters of greenhouse gases. The majority of these greenhouse gas emissions result from deforestation and land use conversion; however, emissions from energy and industrial sources are growing rapidly. The GOI is committed to a more sustainable future, having set a target of reducing greenhouse gas emissions by 26 percent by

2020, while maintaining a target of seven percent annual economic growth. Increasing access to clean and reliable energy in rural areas and improving the stewardship of natural assets are critical priorities to achieving this goal.

The GP Project will promote high levels of environmentally sustainable growth as set forth in the GOI's medium to long-term development plans. The project will provide a combination of technical and financial assistance to support rural economic development that raises household incomes of Indonesians in a manner that reduces reliance on fossil fuels, improves land management practices, protects natural capital, and complements efforts to reduce emissions from deforestation and environmental degradation. The GP Project will involve local communities and governments in activities to improve the clarity and implementation of government policies and regulations.

The centerpiece of the GP Project is a funding facility that will support investments in two areas: (i) expansion of renewable energy; and (ii) sustainable management and use of natural resources (the "GP Facility"). These investments will enhance economic growth, reduce Indonesia's carbon footprint, and help align incentives and practices to foster improved environmental stewardship at the local level.

MCC and the GOI will start the GP Project in the provinces of Jambi and West Sulawesi. Based on program experience in the two start-up provinces, other eligible provinces will be added by mutual agreement. Districts will be selected based on a range of geographic, economic, environmental, and social indicators, including poverty levels, renewable energy potential, economic growth potential, governance, forest cover, and peat lands under threat of degradation or destruction. Districts must have government-approved spatial plans in place and agree to make land use information and licensing processes transparent and accessible.

Key implementing partners and project sponsors are expected to include local governments and institutions; private enterprises in the agriculture, forestry, water and energy sectors; financial institutions; small-holder farmers; and local and international civil society organizations. GP Project activities include:

- ***Participatory Land Use Planning Activity:*** The purpose of this activity is to ensure that projects funded by the GP Facility are designed on the basis of accurate spatial and land use data, and adhere to and reinforce existing national laws, regulations, and plans. This activity also will help strengthen the capacity of local communities and district level institutions to manage their own land and resources. MCC funding will support: (i) administrative boundary setting; and (ii) updating and integrating inventories of land and other natural resource use licenses and other relevant data.
- ***Technical Assistance and Oversight Activity:*** Technical assistance will be provided to district governments, project sponsors, community groups, and financial institutions to assist with the preparation of low carbon development work plans, project identification and design, preparation of business plans and funding applications, and capacity building, where necessary. The purpose of this activity is to develop a pipeline of projects for the GP Facility, while facilitating significant stakeholder consultations at the local level.

- **GP Facility Activity:** The GP Facility will finance projects in the renewable energy and natural resources management sectors. One or more independent facility managers acceptable to MCC will implement the GP Facility.

The GP Facility will contain at least two funding windows: (i) a window to finance commercial scale renewable energy investments reflecting the priority of the GP Project and private sector investments in natural resource management; and (ii) a grants window to support community-based, small scale renewable energy and other projects to promote sustainable natural resource management and improve land use practices.

The GOI will develop a comprehensive operations manual(s), subject to MCC approval, that governs operations of the GP Facility. The operations manual(s) will include detailed investment criteria and outline monitoring and reporting procedures to ensure that investment objectives are being achieved, and to verify compliance with other relevant criteria, including environmental and social safeguard requirements.

Proposals will be reviewed and recommended for approval in accordance with the operations manual. The operations manual will contain minimum project eligibility criteria reflecting: (i) a minimum economic rate of return (“ERR”) as defined by the MCC hurdle rate; (ii) a core objective of improving environmental stewardship; (iii) contribution (directly or indirectly) to the reduction of greenhouse gas emissions; (iv) equal access for women and other vulnerable groups to the project or its benefits; and (v) for commercially viable projects, suitable risk allocations to the parties.

- **Green Knowledge Activity:** The objective of this activity is to build local, provincial, and national capacity to advance Indonesia’s low carbon development strategy nationwide within the context of the GP Project. Specifically, MCC funding will support:
 - Capacity building for local and provincial stakeholders to stimulate a shift toward low carbon development policies in local and provincial governments, and to support the sustainability of MCC’s investment in the GP Project; and
 - Development and improvement of centers of excellence at selected Indonesian universities in science and technology related to low carbon development with an emphasis on renewable energy and closely related areas of natural resource management.

Community-Based Health and Nutrition to Reduce Stunting Project

Currently, 35.6 percent of children under 2 years old in Indonesia are severely stunted, as measured by international standards.¹ The consequences of the cumulative nutritional deprivation in a child’s early life include higher infant and child mortality, increased susceptibility to infection and illness, reduced adult physical stature, and impaired cognitive abilities, all of which result in long-term economic loss.

¹ Low height for age (as measured by two standard deviations below height for age).

The purpose of the Community-Based Health and Nutrition to Reduce Stunting Project is to reduce stunting and low birth weight in infants and children 0-2 years old in selected provinces. The project proposes an incentives-based scheme that facilitates community demand for tools to reduce stunting and improves the supply response and capacities of the Ministry of Health at the district and subdistrict levels.

This project builds on existing community engagement mechanisms already tested under a Ministry of Home Affairs community-driven development program pilot, *Generasi*, implemented with assistance from the national community empowerment program support trust fund (PSF) managed by the World Bank. *Generasi* successfully supported community efforts to improve targeted health, nutrition, and education indicators. With MCC support, the GOI will revise the program to obtain stronger nutrition and stunting outcomes. The “*Generasi Plus*” approach reinforces the community incentives system originally piloted under the *Generasi* program, and adds provider incentives to ensure that the supply of health services will meet communities’ demand. Project activities include:

- ***Community Projects Activity:*** MCC funding will be used by the PSF to finance block grants, participatory planning, and technical assistance to communities. To receive funding, villages participating in *Generasi* commit to improving 12 basic health and education indicators. Under *Generasi Plus*, stunting indicators (including a measure of children’s height for age) will be added to the existing 12 indicators. Facilitators, trained specifically in nutrition and stunting interventions, will work with local health and sanitation service providers to assist villagers in a participatory planning process to help identify problems and find local solutions to be funded using the block grant. In order to focus communities on the most beneficial interventions, the GOI will base the size of the villages’ *Generasi Plus* block grant for the subsequent year partly on their performance on each of the targeted health and education indicators.
- ***Supply-Side Interventions Activity:*** MCC funding will be used by the PSF (or other mechanism acceptable to MCC) to support: (i) the creation of an enhanced training program for all health and sanitation service providers in the designated project areas to encourage a focus on stunting reduction and related interventions; and (ii) testing various types of incentives to service providers based on their service delivery performance. MCC funding will also be used for grants to stimulate market-based responses to identified demand for nutrition and sanitation interventions.
- ***Communications, Project Management, and Evaluation Activity:*** MCC funding will be used by the PSF to support development and implementation of a national stunting awareness campaign with a focus on healthy families that emphasizes shared decision making between women and men within the household.

Procurement Modernization Project

Efficient and effective public procurement is a strategic public sector function and a fundamental component of good governance. Indonesia's existing public procurement systems are highly vulnerable to fraud, waste, and abuse resulting in significant loss of funds and diminished quality of services, with some studies estimating that the equivalent of over \$15 billion could be lost to corrupt and inept procurement practices in 2011 alone. Indonesia has issued two presidential regulations to modernize its public procurement system. These presidential regulations require the formation of Procurement Service Units (PSUs) at the national and local levels to serve as permanent, independent units where procurement professionals will provide a centralized procurement service. While approximately 150 PSUs have been established, most do not meet the requirements of a modernized procurement function and questions remain about how to organize and define the roles and responsibilities of the PSUs in local and national government. The National Public Procurement Policy Agency (LKPP) is eager to implement these modernization efforts and to promote international best practices in public procurement. Project activities include:

- ***Procurement Professionalization Activity:*** The next steps in the procurement reform agenda for Indonesia are to: (i) build a professional procurement workforce; (ii) create an institutionalized role and structure that provides sufficient authority to implement good practice; and (iii) provide a career path to incentivize adherence to best practices, while strengthening controls such as procurement and financial audits, which are needed to ensure improved institutional performance. To this end, the Procurement Modernization Project will implement the following mutually reinforcing subactivities:
 - *Institutional Structure and Professionalization of PSUs* to support PSUs at the various levels of government by: (i) determining standard staffing needs and strengthening operational modalities of PSUs; (ii) supporting LKPP's human resource development strategy by establishing a curriculum and recognizing training institutes through LKPP's accreditation process; and (iii) supporting development of training modules for GOI's auditors (inspectors general) to conduct compliance and performance audits of the procurement system.
 - *Procurement Management Information System* to support: (i) development of an information technology system to create a data warehouse to maintain complete records of procurement activity; (ii) testing of a procurement management information system module at pilot sites; (iii) establishment of a catalog purchasing system (commonly known as an e-catalog system) to ease the administrative burden and transaction costs related to purchasing routine commercial products and services; and (iv) the development of the procurement procedures and standard bidding documents for framework contracting.

This activity will be implemented in two phases. Phase one will pilot the program to test the core elements of the reform program across a variety of institutional settings in Indonesia to ensure that procurement reform generates the intended results. During phase one, up to 30 PSUs will be provided with assistance to build the capability of and provide professional credentials to the procurement workforce, and to institute improved

procurement practices. If certain conditions are met,² the successful models developed in phase one would then be rolled out to a larger set of existing or newly created PSUs under phase two, with a target to create a workforce of 500 procurement professionals working in permanent, full-time positions in established PSUs. It is estimated that this would provide permanent staffing for at least 100 PSUs.

- ***Policy and Procedure Development Activity:*** This activity consists of the following two subactivities that, together, address major gaps in the procedural framework and operation of the procurement system in Indonesia.
 - *Competitive Tendering for Public Private Partnerships (PPPs)* to support: (i) preparation of guidelines and standard bidding documents for competitive tendering of PPP projects and development of a toolkit with templates and model documents for procurement planning and project preparation; (ii) a pilot program to assist trained procurement officials to conduct a PPP infrastructure project in at least one line ministry or subnational administration; and (iii) implementation of recommended adjustments to the e-procurement system and a PPP project management system.
 - *Procedures for Sustainable Procurement* to support the development of processes and procedures to meet the GOI's commitment to purchasing environmentally-friendly goods and services. Developing the sustainable procurement framework will be implemented in three stages—discovery, establishment, and implementation—leading to a pilot program. MCC and the GOI will evaluate this subactivity's performance at the end of each stage and will move forward with the next stage only upon mutual consent.

² Conditions include: (i) conclusion of an assessment of phase one; (ii) achievement of agreed legal and policy changes; (iii) agreement regarding the final design of phase two; and (iv) demonstration that the projected ERR is at or above 10 percent for phase two.

II. Compact Budget

Projects and Activities	Millions (US\$)
Green Prosperity Project	332.5
<i>(A) Participatory Land Use Planning Activity</i>	25.0
<i>(B) Technical Assistance and Oversight Activity</i>	50.0
<i>(C) Green Prosperity Facility Activity</i>	242.5
<i>(D) Green Knowledge Activity</i>	15.0
Community-Based Nutrition Project	131.5
<i>(A) Community Projects Activity</i>	81.6
<i>(B) Supply-Side Activity</i>	36.0
<i>(C) Communications, Project Management and Evaluations Activity</i>	13.9
Procurement Modernization Project	50.0
<i>(A) Procurement Professionalization Activity</i>	46.4
<i>(B) Policy and Procedure Activity</i>	3.6
Monitoring and Evaluation	10.2
Program Administration and Control	75.8
<i>Program Administration</i>	70.8
<i>Targeted Gender Activities</i>	5.0
TOTAL COMPACT BUDGET	600.0

III. Administration

The Compact also includes program administration costs estimated at \$70.8 million over a five-year timeframe, including the costs of administration, management, auditing, and fiscal and procurement services. In addition, the cost of monitoring and evaluation of the Compact and integration of MCC's gender policy is budgeted at approximately \$15.2 million.

IV. Benefits and Beneficiaries

The **Green Prosperity Project** is expected to benefit households and businesses in targeted districts, primarily through expanded access to renewable energy and improved natural resource management. Improved land use practices may also indirectly benefit other public and private stakeholders downstream or adjacent to Green Prosperity Project provinces or districts. The Green Knowledge Activity is expected to benefit businesses and households at the national level. Economic rates of return are not currently estimated for this project because the future impact of subprojects will not be known until the investment facility is established and specific projects are identified, developed, and assessed. However, activities funded under the Green Prosperity Facility, will be required to have an ERR above 10 percent (MCC's hurdle rate). A subset of monitoring and evaluation indicators and targets for the Green Prosperity Project will be formulated as a condition to entry into force of the Compact.

The **Community-Based Nutrition Project** is expected to benefit up to 2.9 million children and their families in up to 7,000 villages by enhancing their human capital and lifetime income and

reducing health costs in several provinces.³ The preliminary estimated ERR on this project is 13 percent. ERR calculations are an estimate, using the best information available at the time. This figure represents a potential range of outcomes that account for the uncertainty of core parameters.

The ***Procurement Modernization Project*** is expected to support improved performance of up to 100 Procurement Service Units that are being established in local and central governments. Beneficiaries of this project will be residents and businesses located in and with economic relationships in the targeted districts, in addition to those benefitting from the public goods and services procured by participating national level ministries. Due to this project's groundbreaking nature, comparative data do not yet exist to calculate an ERR to quantify the benefits of the project. However, as outlined in the project description above, the project is structured in two phases. Phase one will help quantify the benefits and, in order to proceed with phase two, the Compact will require that planned activities have an ERR above 10 percent. A subset of monitoring and evaluation indicators and targets for the Procurement Modernization Project will be formulated as a condition to entry into force of the Compact.

³ West Java, East Java, Nusa Tenggara Timur, Nusa Tenggara Barat, Gorontalo, and West Sulawesi.