



## CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to inform the Congress of our plan to negotiate a Millennium Challenge Compact with the Government of the Republic of Indonesia.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of Indonesia, please contact Ellona Fritschie (for the Senate) or Jim Mazzarella (for the House of Representatives) at (202) 521-3850. This notification is being sent to the Congress on July 8, 2011, and negotiations with the Government of the Republic of Indonesia may be started on or after July 22, 2011.

Sincerely,

T. Charles Cooper  
Vice President  
Congressional and Public Affairs

Enclosure:  
As stated

**MILLENNIUM CHALLENGE CORPORATION  
CONGRESSIONAL NOTIFICATION**

July 8, 2011

Pursuant to the heading “Millennium Challenge Corporation” of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2010 (Pub. L. 111-117, Division F), as carried forward by Division B of the Department of Defense and Full-Year Continuing Appropriations Act, 2011 (Pub. L. 112-10), and section 610(a) of the Millennium Challenge Act of 2003, as amended, this notification is (1) to advise you that the Millennium Challenge Corporation (MCC) intends to start negotiations with the Government of the Republic of Indonesia for a Millennium Challenge Compact and (2) to initiate the 15-day consultation period before the start of negotiations.

Attached please find a summary of the objectives and mechanisms to be used for the negotiations of this Compact.

## SUPPLEMENTAL INFORMATION

### MCC COMPACT DEVELOPMENT WITH THE REPUBLIC OF INDONESIA

July 8, 2011

#### Overview

Indonesia was selected by MCC's Board of Directors as eligible for a compact in December 2008. The results of an interim constraints-to-growth analysis funded by the Asian Development Bank, the International Labor Organization and the Islamic Development Bank became available in November 2009, with the final report published in August 2010. To further guide the process for selecting priority areas for potential MCC investment, the Government of Indonesia (GOI) produced a foundational document called the "Grand Strategy Document". It combined the results of the constraints analysis with the priorities laid out in the 5-year National Development Plan (RPJM) and those described in the 100-day plan of the incoming Yudhoyono administration. After holding consultations in several regions across Indonesia in early 2010, the GOI formally submitted 13 concept papers to MCC on June 16, 2010. In late August 2010, MCC and the GOI agreed to move forward with the development of four projects within three themes that encompassed the best of what the concept papers had to offer: Access to Basic Services for Economic Growth (education and health), Green Prosperity (natural resource management, human and energy resource management) and Governance (procurement modernization). The resulting proposed projects are intended to respond to childhood stunting resulting from malnutrition and inadequate provision of healthcare services, Indonesia's efforts to protect its natural resource base, the need for skills training for youth employment, and the prevalence of corruption and low levels of government effectiveness in public procurement. All of these issues are constraints to economic growth and highlighted as priorities in Indonesia's national development strategies. Green Prosperity was conceived as a response to the GOI's goal for carbon emission reductions, which include reductions of 26% without foreign assistance and of 41% with foreign assistance. In addition, Green Prosperity responds to GOI commitments to pursue environmentally responsible development, which has featured prominently in consultations with local and international non-government organizations.

MCC now plans to enter into compact negotiations with the Government of the Republic of Indonesia.

#### Program Overview and Budget

Below is a summary describing the components of the proposed compact with the GOI. The budget is preliminary based on initial due diligence and is subject to change following project appraisal and compact negotiations.

PROJECT	Total
(A) Community-Based Health and Nutrition to Reduce Stunting	\$106,000,000
(B) Education and Professional Certification for Youth Employment (EPICS)	\$65,000,000
(C) Green Prosperity Facility	\$300,000,000
(D) Governance and Procurement Modernization	\$50,000,000
(E) Gender Equity Resources	\$5,000,000
(G) Program Administration, Monitoring and Evaluation, Audits	\$74,000,000
<b>TOTAL COMPACT BUDGET</b>	<b>\$600,000,000</b>

## **Community-Based Health and Nutrition to Reduce Stunting**

### ***Project Rationale and Description***

In Indonesia, 35.6% of children from birth to two years old are stunted (defined as 2 standard deviations below height for age for international standards). The consequences of the cumulative nutritional deprivation in a child's early life (indicated by stunting) include higher infant and child mortality, increased susceptibility to infection and illness and impaired cognitive abilities resulting in long-term economic loss. Chronic malnutrition is now recognized as a national development challenge by the highest policy levels, with Indonesia's current 5-Year National Development Plan describing the need for a prevention, rather than a treatment, approach for the first time.

The country's incidence of stunting is higher than that of many of its neighbors and is a legacy of a swiftly-decentralized health system that lacks capacity at the local level. The proposed project aims to work with communities and health services providers to strengthen both the demand for and supply of appropriate services to reduce chronic malnutrition among children from birth to three years old. The proposed project is the first of its kind in Indonesia and would include an incentives-based scheme that, on the one hand, facilitates community demand for tools to reduce stunting and, on the other hand, improves the supply response and capacities of the Ministry of Health (MENKES) at the district and sub-district levels. The Ministry of Home Affairs (MOHA), local governments, decentralized health services and communities would be engaged as critical partners to ensure access to nutrition, sanitation and hygiene information and services and motivating needed behavioral changes, particularly for poor families and women, at the client level. As a result, the proposed project would represent the first-of-its-kind partnership between the MENKES and the MOHA in addressing the childhood stunting problem.

The project would build on and utilize community engagement implementing mechanisms already tested under a MOHA community-driven development program pilot, *Generasi*, implemented with assistance of the World Bank managed PNPM<sup>1</sup> support fund (PSF). The *Generasi* program successfully supported communities in improving targeted health, nutrition and education indicators, but will be revised under the MCC-funded project to obtain stronger nutrition/stunting outcomes. This "*Generasi Plus*" activity would reinforce the community incentives system originally piloted under the *Generasi* program and would add provider incentives to ensure that the supply of health services is better poised to meet communities' demand. The *Generasi Plus* activity would aim to reduce stunting and low birth weight in infants and children birth to two years old in selected project provinces by strengthening community engagement, nutrition and sanitation services delivery and national awareness and advocacy. The proposed project is preliminarily anticipated to reach over 1,400,000 beneficiaries and has a preliminary estimated economic rate of return (ERR) of 23%.

## **Education and Professional Certification for the Youth Employment Toward Sustainable Economic Growth (EPICS)**

### ***Project Rationale and Description***

The economic and political crisis of the late 1990s sharply reduced Indonesia's real GDP and led to a rapid increase in under-employment. Since then, Indonesia has largely restored its macroeconomic and

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<sup>1</sup> Program Nasional Pemberdayaan Masyarakat (National Community Empowerment Program).

financial stability and has made a concerted effort to invest in education, doubling education spending in real terms between 2000 and 2006. Despite average economic growth of 5.9% between 2005 and 2008, unemployment and under-employment remain problematic<sup>2</sup>. Youth (15 to 24 years old) make up nearly two-thirds of the unemployed, with a rate two times higher than that of adults, and an even higher incidence of under-employment. Youths that do not complete senior secondary education are more likely to enter informal employment and face significant job insecurity and lower wages than their peers. Disadvantaged youth also have limited opportunities to gain job relevant skills once they leave formal education because of limited availability of training places and the upfront costs of attendance.

EPICS proposes to place private-sector demand at the heart of a revised approach to vocational and technical development. Starting with employer-generated training orders, private vocational institutions would recruit and train students in areas where skill deficits are constraining growth. Coupled with this demand-driven scheme would be an output-based aid incentive that would tie the private training provider's final payment to job placement or successful business start-up. This innovative approach would move workforce development away from the conventional supply-driven model that relies on state institutions to one that is built on private demand. The proposed project aims to create incentives at the systemic level to expand access to targeted, high quality vocational and technical skill development.

EPICS further aims to improve unemployed Indonesian youths' employment prospects by improving the quality and relevance of training opportunities available to them through two channels. First, the expansion of standardized competency based training will ensure a basic level of quality across different training providers and will permit ongoing systematic assessment and monitoring of training quality and outcomes. Second, by selectively offsetting the costs of training for disadvantaged students in sectors where a wage premium indicates greater demand for specific skills, there is an increased likelihood that this training will be linked to a formal job order from an employer. This condition serves as an incentive to training providers to focus on industries and occupations with immediate employment needs and promotes greater labor market efficiency through the improved match between potential workers, available training and employment possibilities. EPICS is preliminarily anticipated to target up to 74,000 unemployed Indonesian youth and has a preliminary ERR of approximately 15%.

## **Green Prosperity (GP)**

### ***Project Rationale and Description***

The majority of Indonesian's poor live in rural areas rich in natural resources but lacking in sustainable and equitable economic opportunities and effective natural resource management. As a consequence, illegal logging, land conversion for agriculture, forest fires, water pollution, over-extraction of resources, and other unsustainable practices have resulted in deforestation, food insecurity, desertification, flooding, increased incidence of disease, and the increased impoverishment of rural communities. The purpose of the proposed GP project is to encourage economic growth, recognizing the strong correlation between poverty and environmental degradation in rural Indonesia.

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<sup>2</sup> The total number of unemployed persons was 9.26 million (BPS, Feb 2009).

In particular, weak land governance and inaccurate spatial data/systems in Indonesia have led to tenure insecurity, degradation of land resources, overlapping concessions and land use rights claims, frequent conflict over land resources, significant loss of species and biodiversity, land speculation, and underutilization of land. Addressing these issues is a critical step to enabling sustainable land use practices and low carbon growth. It is anticipated that activities under the GP project will complement the GOI's efforts to reduce emissions from deforestation and degradation.

The primary objective of the GP project is to work with a select number of districts to create economic opportunities that alleviate poverty and improve management of Indonesia's natural capital. The selection of geographic areas is currently underway, based on a number of criteria including potential for economic growth and potential for carbon abatement. To date, MCC has worked closely with the GOI (in particular Bappenas and the REDD+ Task Force at the national level) and several international partners, and that coordination is expected to continue during the remainder of project development and through implementation.

To implement the proposed GP project, the GOI would work together with local governments and non-governmental actors to establish an enabling framework and a funding facility. The former would fund the creation of a framework for preserving Indonesia's environmental wealth and putting in place the institutional prerequisites for low carbon growth projects to be scalable and have sustained economic impacts. This activity would be done in coordination with the many actors already conducting work in this area. The enabling framework is expected to be underpinned by:

- Spatial certainty and equity, encouraging sustainable land management through accurate/updated spatial data and integrated land information systems/inventory on land cover, use, rights, and administrative boundaries, while enabling revised land use plans that take into account natural resource management and economic growth;
- Government commitment to and readiness for low-carbon development by strengthening existing policies and institutions and streamlining business licensing procedures; and
- Environmental and social safeguards, particularly with respect to protection of biodiversity and sensitive ecosystems, indigenous peoples, resettlement, and gender integration.

The creation of the framework would be carried out at the provincial level as part of the GP project's efforts to build on existing national laws, regulations and plans and to strengthen provincial capacity to adhere to a low-carbon development path. Although the geographic focus of GP investment implementation will be at the district level, important institutional linkages need to be established, in line with appropriate inter-institutional rights, responsibilities, roles and relationships at province level.

The proposed funding facility would promote low-carbon economic development activities, with a focus on three areas: improved land use practices, sustainable management of natural resources and clean energy. The facility would be structured to take advantage of emerging opportunities to finance projects in these priority areas. The facility would engage in the discovery of potential projects within these three areas at the local level, and in the technical development of those projects to ensure their adherence to GOI and MCC requirements, including MCC's statutory requirements to prevent or minimize adverse environmental and social impacts. Finally, the facility would aim to demonstrate the viability of projects consistent with a low carbon economy through the provision of financial support for the benefit



of other public and private investors. The GP project also includes a smaller activity to build Indonesia's human capacity in science and technology associated with sustainable economic development activities.

The GOI (actual) 2010 budget included 3.5 trillion rupiah (\$375 million) for all environment and climate change expenditures combined across Indonesia. In this context, MCC funding is intended to help catalyze Indonesia's transition to a sustainable low-carbon economy, and as such contribute to poverty reduction, and improved social welfare.

## **Procurement Modernization**

### ***Project Rationale and Description***

Public procurement is a strategic public sector function and efficient and effective public procurement is a fundamental component of good governance. Public procurement systems are also highly vulnerable to fraud, waste and abuse, costing governments and the public in significant loss of funds and diminished quality of services. A recent study by Indonesia's Corruption Eradication Commission (KPK) concluded that up to 40% of procurement value is lost due to fraud and abuse. If these findings are correct, it would mean that the equivalent of over \$15 billion could be lost to corrupt procurement practices this year alone in Indonesia. While Indonesia has recently passed two presidential regulations to modernize its public procurement system, much more needs to be done. The constraints to growth analysis prominently featured the need to prioritize strengthened public procurement processes because the adoption and implementation of these reforms has yet to take root in most central ministries and local governments. The proposed Procurement Modernization Project presents MCC with a unique opportunity to partner with the National Public Procurement Policy Agency (the national regulator for over \$50 billion of public procurements annually), an institution that is eager to adopt international best practices in public procurement.<sup>3</sup> Without diminishing the progress that has been made in reforming and modernizing public procurement in Indonesia, the procurement methods and procedures used in Indonesia currently are limited to the most basic, traditional procedures ill-suited to the needs of a public sector of the size and sophistication of the country.

The Procurement Modernization Project is designed to accelerate this procurement reform agenda and thereby transform the public procurement system in Indonesia. Reflecting the multifaceted nature of a public procurement system, the project would encompass six subactivities that address policy reforms, capacity development and institutional modernization, as well as work to strengthen LKPP's capacity to integrate gender concerns into the procurement realm. Each of the six subactivities is intended to address a significant gap in realizing an effective and efficient modern public procurement system serving the needs of a modern state. Given the size and depth of the public procurement system in Indonesia, meaningful reform is likely to be difficult. The scope of this project is intended to bring the procurement reform initiative that began more than a decade ago to the moment of critical mass that tips the system irreversibly towards real reform. While the project is national in scope, several subactivities to build capacity in local, pilot procuring units will be undertaken.

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<sup>3</sup> MCC originally provided support to LKPP through the Threshold Program to pilot e-procurement centers in four regions throughout Indonesia.

### **Dedicated Gender Equality Resources**

There are substantial gaps in ensuring equal economic opportunities for women and men in Indonesia, and women's legal and social status is highly problematic. To address these gaps, social and gender analysis will be integrated into each of the proposed projects and will inform their further design. In addition, dedicated Gender Equality resources will be available to focus on broader cross-cutting policy, regulatory and legal issues that inhibit women's full economic participation and ability to benefit from potential project benefits. While the proposed activities will complement the other compact themes, they will not be substitutes for gender integration into each project.