

CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

We wish to notify you that the Millennium Challenge Corporation intends to provide assistance to the Government of Indonesia to facilitate the development and implementation of a Millennium Challenge Compact.

If you or your staff would like to arrange a meeting to discuss this assistance, please contact Dan Petrie at (202) 521-3583 or PetrieDB@mcc.gov.

The attached notification is being sent to the Congress on August 31, 2020. The assistance may be provided and funds obligated on or after 15 days from the date of this notification.

In addition to the enclosed notification, we have attached supplemental information regarding the planned assistance.

Sincerely,

/s/

Emily Davis
Vice President
Congressional and Public Affairs

Enclosure: As stated

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

August 31, 2020

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| PROGRAM: | Eligible Countries |
| APPROPRIATIONS CATEGORY: | Fiscal Year 2020 Program Funds |
| OBLIGATION AMOUNT: | \$8,000,000 |

Pursuant to section 7015(c) of the Department of State, Foreign Operations, and Related Programs Appropriations Act, 2020, and section 610(a) of the Millennium Challenge Act of 2003, as amended (the “Act”), this is to advise that the Millennium Challenge Corporation (“MCC”) intends to obligate up to \$8,000,000 under section 609(g) of the Act for the purpose of facilitating the development and implementation of a Millennium Challenge Compact with the Government of Indonesia.

The funds are expected to finance compact development activities, including but not limited to assessing the expected impact of the proposed compact; furthering data collection, study, and design activities; and developing guidance documents and implementation strategies.

SUPPLEMENTAL INFORMATION - MCC 609(G) ACTIVITIES FOR INDONESIA

Background

Indonesia is the largest economy in Southeast Asia, spread across a sprawling archipelago of more than 17,000 islands. United by the national motto “Unity in Diversity,” the world’s largest Muslim-majority democracy and fourth most populous country is home to more than 270 million people from across 1,200 ethnic groups and subgroups. Indonesia has experienced steady rates of economic growth in recent decades—averaging 5.3 percent annually between 2000 and 2019—and has cut poverty by more than half over the same period, to 9.4 percent. However, beneath these positive trends lie persistent challenges and troubling disparities that may threaten continued growth and poverty reduction if not addressed.

While poverty rates have decreased, headcounts remain quite high—25 million Indonesians still live in poverty, and approximately 55 million are vulnerable to slipping back into poverty with incomes hovering slightly above the national poverty line. The benefits of growth have not been equitably shared, and disparities in income and opportunity persist between regions and population subgroups. These issues leave Indonesia vulnerable to shocks and are likely to be exacerbated by the global COVID-19 pandemic.

Compact Eligibility and Constraints Analysis

Indonesia signed its first MCC compact in November 2011. The compact, which closed in April 2018 after providing \$474 million in assistance, focused on modernizing government procurement, improving health and nutrition, and expanding sustainable energy and natural resource management. In December 2018, MCC’s Board of Directors selected Indonesia as eligible to develop a subsequent compact. The selection reflected the strong partnership MCC and Indonesia built during the first compact, Indonesia’s commitment to ensuring the sustainability of that compact, and the progress Indonesia has made on its policy performance. In FY 2020, Indonesia passed 15 of 20 indicators on the scorecard, including both the democratic rights and control of corruption “hard hurdles.”

Following its selection as eligible to develop a second compact, the Government of Indonesia (“Government”) appointed a panel of representatives from government, civil society, academia, and the private sector to work alongside MCC in analyzing the country’s most binding constraints to medium- and long-term economic growth. That analysis revealed three primary constraints: (i) barriers to export-oriented competitiveness, (ii) barriers to the productivity and innovation of non-tradable sector firms, and (iii) costly and underdeveloped financial intermediation. Preliminary analyses also showed that gender inequities and transport and logistics infrastructure are also important constraints that negatively impact Indonesia’s growth. MCC and the Government approved these findings in late 2019 and began work to identify the root causes of these problem areas. The Government also established and began staffing a professional compact development team to work closely with MCC throughout the remaining phases of program design.

In February and March 2020, MCC and the Government held a series of root cause analysis workshops and stakeholder consultations to diagnose and delineate the problems that contribute to the binding constraints. The Government also conducted a data-driven process—using metrics such as propensity for reform and impact on growth and poverty reduction—to evaluate and rank Indonesia’s provinces and select potential locations for the proposed program. While delayed due to COVID-19, the Government submitted a concept note in July 2020 that proposed two intervention areas that would address root causes of the financial intermediation constraint: (i) access to finance for infrastructure, particularly transport and logistics infrastructure, and (ii) access to finance for micro-, small-, and medium-sized enterprises (“MSMEs”), particularly those owned by women. MCC will work closely with the Government over the coming months to develop these concepts into full project proposals in the priority provinces of North Sulawesi, South Sumatra, and Riau.

Summary of Potential Project Interventions

Potential compact projects may focus on the following core objectives:

- **Strengthening financial intermediation for transport and logistics infrastructure.** Potential interventions include (i) increasing the funds available for quality transport and logistics infrastructure by encouraging the use of blended and diversified financing instruments and by developing and applying de-risking instruments; (ii) increasing the number of viable, demand-driven transport and logistics infrastructure projects through the creation of a regional project development facility that will improve project readiness, management, and delivery processes; and (iii) improving the availability of quality transport and logistics infrastructure through the implementation of demonstration project(s).
- **Strengthening financial intermediation for MSMEs, particularly those owned by women.** Potential interventions include (i) increasing the availability of MSME-appropriate financing through a credit guarantee program, credit registry, lending fraud detection systems, value chain financing, and regulatory reforms to accelerate the digital financial economy; (ii) improving MSME creditworthiness by building the capacity of businesses to meet the demands of formal borrowing and investment; and (iii) promoting women’s economic empowerment by providing need-based financial products, capacity building, and business upgrading support to increase access to finance for female entrepreneurs. To this end, MCC will explore ways to leverage financial technology solutions through blended finance.

MCC and the Government will continue to develop a program that supports Indonesia’s economic growth priorities. However, MCC also recognizes that the Government’s priorities to support medium- and long-term economic growth may be affected by COVID-19, and in that

case, MCC and the Government may consider modifications to program activities accordingly, within the context of the binding constraints identified through our joint analysis.

Assistance to Develop the Compact Proposal

In order to assist Indonesia to further develop the proposed compact, MCC intends to fund preparatory activities for each of the potential interventions listed above. Specifically, funds would be used to gather additional data, particularly at the provincial level and in the context of shifting priorities in light of COVID-19; develop guidance documents and frameworks to support the future implementation of potential interventions; conduct studies, including integrated feasibility studies and assessments of potential environmental and social impacts, gender and social inclusion considerations, economic benefits, and implementation arrangements; analyze the policy and institutional landscape and design potential reform activities; and examine opportunities to enhance women's economic empowerment. Funding these activities reflects MCC's commitment to preparing projects in a comprehensive manner, prior to compact signing, to reduce implementation risk and increase confidence in the economic justification and technical feasibility of the proposed projects.

Update on and Sustainability of the 2011 Indonesia Compact

The 2011 Indonesia Compact was designed to reduce poverty through economic growth by supporting three of the Government's growth and development priorities: better health and nutrition, procurement modernization, and sustainable energy and resource management. The compact included three projects in these priority areas and was designed and implemented with a focus on community ownership and innovative, scalable models that would allow for emerging opportunities.

Despite challenges, by the end of the first Indonesia Compact, MCC and the Government achieved many successful outcomes through this partnership and will incorporate key lessons learned into the design of the new compact program. For example, learning from the first compact program—which was both geographically and sectorally diverse—MCC and the Government are working to develop a more focused second compact to streamline implementation and ensure greatest impact.

Community-Based Health and Nutrition to Reduce Stunting Project. The \$120 million Nutrition Project was designed to reduce and prevent low birth weight, childhood stunting, and malnourishment of children in project areas, and to increase household income through cost savings, productivity growth, and higher lifetime earnings. When MCC's partnership with Indonesia began, more than one-third of Indonesian children under the age of five were chronically malnourished, stunting their physical and cognitive growth and causing lasting effects on their potential for learning and earning later in life. The Nutrition Project built upon a pre-existing Government initiative to combine interventions in health, sanitation, and nutrition, and targeted approximately 5,400 villages across 11 of Indonesia's 34 provinces where rates of stunted growth and low birth weight were higher than national averages. The Nutrition Project

trained over 17,500 service providers on proper feeding for pregnant mothers and infants, distributed over 35 million iron tablets for pregnant women, and conducted over 4,200 community sanitation behavior change meetings across 64 districts. Fighting stunting is now a national priority in Indonesia, and policy frameworks are in place to carry gains forward in the areas of infant and young child feeding, growth monitoring, and the integration of sanitation into nutrition efforts.

Procurement Modernization Project. The \$69 million Procurement Modernization Project was designed to assist the Government in achieving significant government expenditure savings while maintaining or increasing the quality of procured goods and services. Efficient and effective public procurement is a fundamental component of good governance. Before the compact, procurement was not recognized as a professional function for civil servants in Indonesia. Goods and services for government institutions were purchased by *ad hoc* committees of government employees with no relevant expertise, creating opportunities for error, misuse of funds, and diminished quality of goods, works, and public services. The Procurement Modernization Project trained over 1,000 individuals from national and local governments—24 percent of whom were women—in modern procurement and management skills to improve procurement practices, and established a modern e-procurement system. This organizational development program received strong support throughout the Government, and the Indonesian National Public Procurement Agency will maintain an online platform with training guides and materials to reach all Procurement Service Units in Indonesia. By working to reduce the misuse of government funds and promoting transparent, systematic procurements, the project aimed to unlock investment in infrastructure and public services that will directly benefit Indonesians, and foster a level playing field for businesses competing for public procurements.

Green Prosperity Project. The \$228 million Green Prosperity Project was designed to increase productivity and reduce reliance on fossil fuels by expanding renewable energy, and to increase productivity and reduce land-based greenhouse gas emissions by improving land use practices and management of natural resources. The majority of Indonesia's poor live in rural areas that are rich in natural resources but have generated low returns due to over-extraction and improper management of natural resources. The Green Prosperity Project was designed to promote sustainable management of these natural resources in order to help the Indonesian people unlock higher economic returns. The project established a market-responsive Green Prosperity Facility that provided grant funding to 66 grantees and leveraged an additional \$28 million in private sector investment, allowing grantees to pilot and scale up alternative approaches in on- and off-grid renewable energy, peatland restoration, sustainable agriculture, and improved natural resource management. Through these grants, the Green Prosperity Facility helped to install 12.73 megawatts of new renewable energy generation capacity; train over 127,000 farmers, including over 43,000 women, in climate-smart agriculture and natural resource management; and scale up sustainable production practices among nearly 74,000 cocoa-growing households and 12,000 independent palm oil farmers. The Green Prosperity Project also provided funding for updated

land use inventories and enhanced spatial plans in order to empower communities to make informed decisions about how best to manage natural resources.