



## CONGRESSIONAL NOTIFICATION TRANSMITTAL SHEET

This Congressional Notification outlines the Millennium Challenge Corporation's intent to negotiate a Millennium Challenge Compact with the Government of Indonesia.

The attached notification is being transmitted to Congress on October 6, 2022 and negotiations with the Government of Indonesia may be started 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 compact.

If you or your staff would like to arrange a meeting to discuss the proposed negotiations with the Government of Indonesia, please contact Brian Forni at (202) 521-2631 or [ForniBJ@mcc.gov](mailto:ForniBJ@mcc.gov).

Sincerely,

/s/

Aysha House  
Vice President  
Congressional and Public Affairs

Enclosure as stated

**MILLENNIUM CHALLENGE CORPORATION**  
**CONGRESSIONAL NOTIFICATION**

October 6, 2022

Pursuant to Division B, Title I, Section 1101, and Title XI, Section 2108 of the Department of Defense and Full-Year Continuing Appropriations Act, 2011 ( P.L. 112-10); Division I, Title III under the heading “Millennium Challenge Corporation” of the Consolidated Appropriations Act, 2012 (P.L 112-74); Division K, Title III under the heading “Millennium Challenge Corporation” of the Consolidated Appropriations Act, 2014 (P.L 113-76); Division K, Title III under the heading “Millennium Challenge Corporation” of the Consolidated Appropriations Act, 2016 (P.L 114-113); Division F, Title III under the heading “Millennium Challenge Corporation” of the Consolidated Appropriations Act, 2019 (P.L 116-6); Division G, Title III under the heading “Millennium Challenge Corporation” of the Further Consolidated Appropriations Act, 2020 (P.L 116-94); Division K, Title III under the heading “Millennium Challenge Corporation” of the Consolidated Appropriations Act, 2021 (P.L 116-260); Division K, Title III under the heading “Millennium Challenge Corporation” of the Consolidated Appropriations Act, 2022 (P.L 117-103), as carried forward by the Continuing Appropriations and Ukraine Supplemental Appropriations Act, 2023 (P.L. 117-180); 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 Indonesia for a Millennium Challenge Compact (Compact) and (2) to initiate Congressional consultation before the start of negotiations.

The proposed Compact will seek to assist the Government of Indonesia in addressing the binding constraint to economic growth: costly and underdeveloped financial intermediation, by investing in needed infrastructure and project preparation for increased structured finance solutions and increased access to finance for micro-, small and medium enterprises. The Compact aims to unlock financing flows in a way that will catalyze economic growth and leverage Indonesia’s own resources.

**Economic Justification**

The Indonesia Compact aims to address key root causes of costly and underdeveloped financial intermediation by improving the financing of infrastructure, particularly transport and logistics infrastructure, and increasing access to finance for micro-, small and medium entrepreneurs. The Compact will support three projects to address the binding constraint of costly and underdeveloped financial intermediation: the Advancing Transport and Logistics Accessibility Services (“ATLAS”) Project; the Financial Market Development Project (“FMDP”) and the Access to Finance for Women-owned / Micro-, Small and Medium Enterprises Project (“MSME Finance Project”).

**Transportation and Infrastructure Management.** The **ATLAS Project** will support policy and institutional reform activities as well as improvements to transport and logistics services by implementing best practice planning and preparation processes. These investments will increase efficiency in the management and delivery of public investment as it relates to transport, and more specifically the quantity and quality of transport infrastructure investments, including but

not limited to: time savings for commuters, increased utilization of public transport modes, and reduced traffic congestion and emissions, as well as improved accessibility of transport services for women and disabled passengers. The economic rate of return (ERR) for the ATLAS Project is estimated at 10 percent.

**Increasing Capital Flows.** The **FMDP** will provide technical assistance, capacity building and blended finance grants to enhance the project finance and capital markets environment. These investments aim to increase the participation of private or commercially oriented infrastructure investments. Individual projects that fall under the FMDP will be evaluated for their ERRs and overall development impact throughout the Compact implementation process. An initial list of projects will be approved prior to entry into force of the Compact and the aggregate ERR of these projects will represent the estimated ERR of the FMDP as a whole.

**Investing in Medium and Small Businesses.** The **MSME Finance Project** will support digital, financial, and business capacity enhancement activities as well as a gender-inclusive value chain finance activity aimed to increase loans issued to W/MSMEs. The project aims to enhance access to financial and non-financial services and to increase investment. This project has an estimated ERR of 17 percent, and an expectation that over 48,000 MSMEs can benefit from MCC's investments.

MCC's engagement with Indonesia is a way to leverage Indonesia's own resources rather than simply adding to them. This Compact is heavily tied to strategic policy and institutional reforms with a range of government, semi-private, and private actors to catalyze economic growth. Instead of using a more traditional approach of fully grant- or publicly funded infrastructure, the Compact is designed with a view to sustainability and scalability in ways that will ultimately make use of the Government of Indonesia's own funding and revenue-generating models that can be taken up and expanded by private sector actors. The Compact addresses the costs of finance for the smallest firms in Indonesia—its MSMEs, which include a large population of even more credit-constrained female entrepreneurs—to the largest, in the form of the institutional investors whose long-term investments can and should be brought to bear to close Indonesia's formidable infrastructure gap, especially in the provinces outside Java. At each level of the economy, from small firms to local governments and companies, to infrastructure investors, the program aims to use the tools appropriate to the context to unlock financing flows in ways that will catalyze economic growth.

Each of the three proposed projects has a focus on increasing commercial investment, consistent with the original binding constraint of costly and underdeveloped financial intermediation. Specifically:

- The ATLAS Project is focused on strengthening mechanisms to identify, select, prepare, and bring to market well-designed infrastructure projects that are capable of attracting commercial finance, in accordance with the maximizing finance for development agenda. The projects in the Good Practice Infrastructure Projects Activity can also stimulate localized private sector activity, including by W/MSMEs.
- The FMDP will utilize a facility-like approach to mobilize commercial financing for sub-projects by providing blended finance grants that demonstrate the use of structured finance in infrastructure.

- The MSME Finance Project is focused on correcting a market failure of unmet demand by the smallest private sector firms in Indonesia, with the aim of leveraging formal financial service providers to make available more private funding for MSMEs.

## SUPPLEMENTAL INFORMATION

### Overview

The proposed Indonesia Compact seeks to assist the Government of Indonesia in addressing one major constraint to economic growth: the binding constraint of costly and underdeveloped financial intermediation. The Compact will address this constraint through three primary projects:

- 1) Advancing Transport and Logistics Accessibility Services (ATLAS) Project;
- 2) Financial Market Development Project (FMDP);
- 3) Access to Finance for Women-owned / Micro-, Small and Medium Enterprises (MSME Finance) Project.

### Background and Context

The largest economy in Southeast Asia, Indonesia—a diverse archipelago nation of more than 300 ethnic groups—has charted impressive economic growth since the Asian financial crisis of the late 1990s. Today, Indonesia is the world’s fourth most populous nation, one of the largest democracies and 10<sup>th</sup> largest economy in terms of purchasing power parity. Furthermore, Indonesia has made enormous gains in poverty reduction, cutting the poverty rate by more than half since 1999, to under 10 percent in 2019 before the COVID-19 pandemic hit. Indonesia assumed the G20 Presidency this year, encouraging all countries to work together to achieve a stronger and more sustainable recovery from the pandemic’s impacts. As Indonesia’s economy is now recovering, the country’s GDP growth is projected at 5.1 percent in 2022, supported by growing commodity exports and accommodative fiscal policy to weather the pandemic. Despite these positive trends, the Government of Indonesia estimates that over 30 percent of Indonesian households are either poor or near-poor.

On one hand, Indonesia is a market economy in which the state-owned enterprises (SOEs) and large private conglomerates play a significant role. Meanwhile, Indonesia’s micro-, small and medium sized enterprises, together accounting for 99 percent of the total number of private enterprises that are active in the country, are the focus of economic activity for the majority of Indonesians, engaging almost 97 percent of the nation’s workforce, and contributing around 62 percent of GDP. As Indonesia continues its transformation from being an economy that was highly dependent on oil, gas, coal, and agriculture into a more balanced economy with a rising share of manufacturing, the country has lessened its traditional dependency on primary exports, although it remains relatively high today, with a history of underinvestment in all infrastructure that does not directly support commodity exports. Given this context, the Government of Indonesia is committed to addressing the binding constraint of costly and underdeveloped financial intermediation.

MCC’s Board of Directors selected Indonesia as eligible to develop a subsequent compact in December 2018, following the closure of its prior compact in April 2018. The selection reflected the strong partnership between MCC and the Government of Indonesia. Indonesia passes the current, Fiscal Year 2022 scorecard, passing 14 of 20 indicators overall, including both the democratic rights and control of corruption hard hurdles.

MCC and the Government of Indonesia initiated the compact development process in early 2019. The Indonesia Country Team (CT) presented the Constraints Analysis to management in December 2019 and identified 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 were significant constraints that negatively impact Indonesia's growth. Following the Root Cause Analysis stage, the Government of Indonesia submitted a concept note proposing to narrow the focus of the Compact to two areas 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 approved this approach in August 2020.

In July 2021, the Government of Indonesia submitted two formal project proposals that focused on: (i) improving project planning and preparation capacity, and innovative financing for infrastructure and (ii) improving MSMEs' access to finance for increased productivity and inclusive growth. Following a data-driven selection process, MCC and the Government of Indonesia agreed on a geographical focus in five priority provinces—South Sumatra, Riau, North Sulawesi, Riau Islands, and Bali.

The COVID-19 pandemic has negatively impacted the timeline for Compact development and limited in-person consultations, particularly with provincial- and district-level stakeholders, and site visits on potential demonstration projects. MCC and the Government of Indonesia have continued to refine project design and complete feasibility work primarily via remote communication. Following the easing of Indonesian travel restrictions, MCC staff completed three visits to Indonesia from April-July 2022, covering all aspects of the proposed Compact. These missions were particularly vital for advancing scope decisions across the Compact and reaching understandings with provincial stakeholders on the sub-national components.

### **Compact Overview and Budget**

MCC engaged in a thorough Root Cause Analysis to fully explore the many root causes and systems dynamics underpinning the binding constraint of costly and underdeveloped financial intermediation. The proposed Compact includes three separate projects, each of which responds to a different set of root causes of that constraint while being firmly aligned with Indonesia's own development priorities, including the National Medium-Term Development Plan and the Sustainable Development Goals. The specific root causes the Compact projects are designed to address are as follows:

- The **ATLAS Project** aims to improve transport planning and preparation in the target provinces, responding to the root cause of inadequate infrastructure project preparation.
- The **FMDP Project** is designed to reach financial close on transactions using structured finance, including participation by institutional investors and with a focus on local currency transactions, which will address the root causes of underdeveloped project financing market and capital markets.

- The **MSME Finance Project** aims to increase lending by formal financial service providers to MSMEs and W/MSMEs in the target provinces to support their businesses, which will address the root causes of information asymmetry and borrowers' constraints.

Below is a summary describing the components of the proposed Compact with the Government of Indonesia. The budget and expected impacts are preliminary based on initial due diligence and project appraisal and are subject to change following Compact negotiations. The anticipated budget for the Compact is up to \$698 million, which includes MCC funding of approximately \$649 million and a Government of Indonesia contribution of approximately \$49 million.

## Indonesia Compact Budget

Component	Amount
<b>1. Advancing Transport and Logistics Accessibility Services</b>	<b>\$350,270,207</b>
Activity 1.1 Transport Planning Reform	\$27,021,409
Activity 1.2 Good Practice Infrastructure Projects	\$195,385,571
Activity 1.3 Public Investment Management Guidelines	\$18,707,129
Activity 1.4 Project Preparation and Delivery Facility	\$95,614,215
Activity 1.5 Support Services	\$13,541,883
<b>2. Financial Market Development Project</b>	<b>\$95,914,256</b>
Activity 2.1 Capacity Building / Technical Assistance	\$26,631,869
Activity 2.2 Transaction Advisory Services	\$15,437,809
Activity 2.3 Blended Finance Delivery Mechanism	\$53,844,578
<b>3. Access to Finance for Women-owned / Micro-, Small and Medium Enterprises Project</b>	<b>\$135,826,437</b>
Activity 3.1 Gender Inclusive Value Chain Finance	\$72,032,840
Activity 3.2 Digital and Financial Literacy Enhancements	\$25,044,897
Activity 3.3 MSME Capacity Enhancement	\$32,512,990
Activity 3.4 Augmenting Government Data on MSMEs	\$6,235,710
<b>4. Monitoring and Evaluation</b>	<b>\$7,000,000</b>
<b>5. Program Administration and Oversight</b>	<b>\$59,989,101</b>
<b>Total MCC Funding</b>	<b>\$649,000,000</b>

Total Compact Program Funding	Amount
Total MCC Funding	\$649,000,000
Government of Indonesia Contribution	\$48,675,000
<b>Total Compact</b>	<b>\$697,675,000</b>

### Proposed Projects

The projects and activities to be negotiated are:

**The objective of the ATLAS Project** is to improve transport planning and preparation in the target provinces, responding to the root cause of inadequate infrastructure project preparation.

The project includes four activities:

- *Transport Planning Reform Activity*: This activity will develop two proof-of-concept multi-modal transport planning projects to influence the Government of Indonesia to



- embrace the necessary institutional, legal, and regulatory reforms required to mandate and mainstream a multi-modal transport planning approach.
- *Good Practice Infrastructure Projects Activity*: This activity aims to support five infrastructure projects, which are intended to demonstrate innovative and strengthened approaches to project preparation, structuring and financing, and procurement and implementation, so that subnational governments endorse and promote PIMG principles.
  - *Public Investment Management Guidelines (PIMG) Activity*: This activity will create a public, online suite of Public Investment Management Guidelines for infrastructure, designed to improve the effectiveness and efficiency of public investment.
  - *Project Preparation and Delivery Facility Activity*: This activity will provide project preparation, structuring, procurement, and project delivery support to sub-national governments.

**The objective of the FMDP Project** is to reach financial close on transactions using structured finance, including participation by institutional investors and with a focus on local currency transactions, responding to the root causes of underdeveloped project financing market and capital markets. The project includes three activities:

- *Capacity Building/Technical Assistance Activity*: This activity aims to build capacity for institutional change within the financial market ecosystem, including in the area of green finance.
- *Transaction Advisory Services Activity*: This activity will provide transaction advisory services to originate approximately 10 proof-of-concept demonstration transactions.
- *Blended Finance Delivery Mechanism (BFDM) Activity*: This activity aims to mobilize commercial financing for sub-projects by providing blended finance grants.

**The objective of the MSME Finance Project** is to increase lending by formal financial service providers to MSMEs and W/MSMEs in the target provinces to support their businesses, responding to the root causes of information asymmetry and borrowers' constraints. The project includes four activities:

- *Gender-inclusive Value Chain Finance Activity*: This activity will provide non real property-based collateral financing to qualified W/MSMEs operating within growing sectors in the five target provinces.
- *Digital and Financial Literacy Enhancement Activity*. This activity will support and enhance the viability of W/MSMEs by providing technical assistance, digital and financial literacy training, and other demand driven business development support to W/MSMEs.
- *MSME Capacity Enhancement Activity*. This activity will support growth-oriented W/MSMEs that are in an earlier stage of their journey towards formalization and eventually towards formal finance. The activity will provide capacity enhancement training to eligible MSMEs to develop business skills, access markets, and increase sales.
- *Augmenting Government Data on MSMEs*. This activity will support the Government of Indonesia in gathering and analyzing MSME financial and technical performance MSME data.

The proposed Compact program also includes an \$11 million Strengthening Preparedness for Low Carbon Development and Climate Resilience Sub-Activity targeting decisionmakers in the Compact's five target provinces

### **Policy Reform and the Compact**

The ATLAS Project aims to strengthen environmentally friendly and gender-responsive inclusive infrastructure preparation and delivery processes at all stages of the infrastructure project lifecycle, and creation of the PIMG will require new regulations to mandate the use of the PIMG and significant adjustment of technical standards and operating procedures which are typically issued at Ministerial or Director General level. Similarly, the key policy, legal, regulatory, and institutional reforms which will be delivered through the Compact include fundamentally changing the approach to transport planning by replacing the current single-mode planning exercises carried out separately at the three levels of government (national, provincial, district/city) with a multi-modal integrated approach. This will require significant changes to the legal and regulatory framework including eventual adjustments to State Law 25/2004 on national development planning.

The policy and institutional reform approach of the FMDDP will be supportive of a multi-donor push to improve the policy environment for infrastructure finance, contributing to reform efforts at the national level, taking into account lessons learned from the ATLAS project's province-level engagement.

MCC is proposing that a condition precedent to entry into force of the Compact be the complete legal establishment and staffing of the accountable entity, expected to be called the Millennium Challenge Account Indonesia II (MCA-Indonesia II), including the issuance of all relevant ministerial instructions and decrees. The initial decree to establish the MCA has already been enacted by the Government of Indonesia, however several additional steps remain that will be critical to complete to ensure the MCA's ability to quickly and efficiently implement the proposed program.

### **Update on and Sustainability of the 2011 Indonesia Compact**

The \$474 million 2011 Indonesia Compact implemented from April 2013 and completed within the five-year time frame in April 2018 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, using scalable models that would allow for emerging opportunities. Despite challenges, by the end of the 2011 Indonesia Compact, MCC and the Government achieved many successful outcomes through this partnership and have incorporated key lessons learned into the design of the new compact program. For example, learning from the 2011 compact program—which was both geographically and sectorally diverse, covering 17 provinces and four major sectors—MCC and the Government have worked to develop a more focused subsequent 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 within 11 provinces, 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 5 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 has unlocked investment in infrastructure and public services that will directly benefit Indonesians and foster a level playing field for businesses competing for public procurements in the years to come.

*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 within 13 provinces. The majority of Indonesia's poor live in rural areas that are rich in natural resources but have generated low returns due to overextraction 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, which have empowered communities to continue to make informed decisions about how best to manage natural resources.