COUNTRY BRIEF
TOWARDS SUSTAINABLE DEVELOPMENT FINANCING
IN INDONESIA
OCTOBER 2014
1. Indonesia has committed to 26% to 41% targets of reductions in greenhouse gas (GHG) emissions by 2020, set out in the National Action Plan for the Reduction of GHG Emissions (RAN-GRK). The government, in responding to negative climate impacts, has also developed the National Action Plan for Climate Change Adaptation (RAN-API).

2. In order to estimate expenditures to achieve the RAN-GRK, Ministry of Finance (MoF), through its Fiscal Policy Agency (FPA) and with participation from all key ministries, has developed the first “Mitigation Fiscal Framework” (MFF).

3. The MFF found that the total mitigation expenditures reached IDR 15.9 trillion (over USD 1.3 billion) in 2012, with the RAN-GRK central government expenditure amounting to IDR 7.7 trillion (over USD 640 million).

4. The MFF also demonstrated that a significant financing gap exists, of at least IDR 72-134 trillion/year (USD6 – 11 billion/year) potentially from public finance and IDR 91 – 171 trillion/year (USD7.5 – 14.2 billion/year) from private sources in order to achieve the RAN-GRK emission reduction target.

5. As part of Indonesia’s efforts in moving towards sustainable financing framework. The GoI has agreed to the Sustainable Development Financing (SDF) project supported by UNDP and UNEP to strengthen the fiscal frameworks for the implementation of the country’s environmental and climate commitments with sustainable financing and in a cost-effective manner. One of the objectives from The SDF project is to develop fiscal instrument options and strengthening performance-based budgeting system to support the implementation of Indonesia’s climate mitigation actions (RAN-GRK), adaptation (RAN-API), and Indonesia Biodiversity Strategic Action Plan (IBSAP).

6. For the beginning, the Ministry of Finance (MoF) developed a Low Emissions Budget Tagging and Scoring System (LESS) as recommended by the MFF, to identify the total budget allocation and actual expenditure on climate mitigation and further, in combination with the budget performance indicator, to assess the effectiveness of per unit of budget to achieve emission reduction targets. Based on the LESS, the MoF has issued the Ministerial Decree No.136/2014, introducing a Budget Tagging for Climate Change Mitigation system that is mandatory for seven key line ministries under the RAN-GRK.

7. An Online application has been developed by the Directorate General of Budget to track and tag climate mitigation, adaptation and biodiversity activities at the national level. Training has been conducted for the Fiscal Policy Agency as well as the line Ministries. Further training is envisaged for two key mitigation ministries (Ministries of Energy and Forestry).

8. Three provincial LESS studies have been developed and piloted in Central Java, Jambi and Yogyakarta since April 2014, and are expected to be completed in October 2014.

9. Climate expenditure and Institutional Reviews (CPEIRs) of adaptation and mitigation activities in provincial levels are also being carried out in East Nusa Tenggara province and Bangka Belitung province. These CPEIRs focus on climate mitigation and adaptation actions, including the gender responsive and poverty sensitive aspects of these actions.

10. Following a similar approach for the mitigation, the SDF programme will support the Ministry of Finance in developing a sustainable financing framework for adaptation and biodiversity in collaboration with two other projects, namely, the Biodiversity Finance Initiative (BIOFIN); and the Strengthening the Governance of Climate Finance to Benefit the Poor and Vulnerable funded by SIDA.
Indonesia Development Context

Indonesia has made significant progress towards poverty reduction and overall national development with solid 6% GDP growth annually since 2011 and the population living below national poverty line reducing to 11.36% in 2013 from 15.1% in 1990. However, several issues remain a challenge such as vulnerabilities to natural disasters, environmental degradation, discrimination against marginalized groups, increasing economic and gender inequality (Indonesia ranks 97 out of 135 countries in the World Economic Forum’s Gender Development Index (2011)) as well as limited capacities of highly decentralised local governments, etc. In particular, the current energy- and carbon-intensive economy of Indonesia is considered to inhibit sustainable development. In particular, Indonesia is both one of the major global emitter of greenhouse gases (GHG), and as a large archipelago is very vulnerable to the impacts of climate change. Therefore, it is critical for Indonesia to transit to an inclusive green economy, departing from the “business as usual” scenario. The Government of Indonesia (GoI) is already taking steps to address these challenges.

National Development and Climate Change Strategies

The Government of Indonesia (GoI) developed the Long-Term National Strategic Plan (2005-2025), establishing four key pillars for national development, namely: Pro-Poor, Pro-Growth, Pro-Jobs and Pro-Environment. Currently, a new Mid-Term Strategic Plan for 2015-2019 is being drafted, striving to explicitly incorporate an inclusive green economy, amongst other national priorities.

Complementary to the Green Economy agenda and recognizing the climate change threats to Indonesia and globally, the GoI is committed to making 26% (with domestic finance) to 41% (with international finance) targets of reductions in GHG emissions by 2020. The target of 26% GHG emissions reduction was translated into the Presidential Regulation on National Action Plan for the Reduction of GHG Emissions (RAN-GRK), setting out 50 mitigation actions across 5 broad sectors between 2011-2020, targeting 767 million tonnes of Carbon Dioxide (mtCO2) reduction in 2020.

In addition to mitigation efforts, recognizing the need in responding to negative impacts of climate change, the GoI has developed the National Action Plan for Climate Change Adaptation (RAN-API), identifying actions for adaptation of priority sectors in the short-term (2013-2014) whilst also mainstreaming adaptation in the Mid-term Strategic Plan 2015-2019. The RAN-API targets i) developing economic resilience, especially for the vulnerable, ii) developing climate resilient livelihoods, iii) maintaining sustainability of ecosystem services and iv) strengthening infrastructure. A mechanism for monitoring, evaluation, reporting and reviewing is also being established, strengthening the implementation of the RAN-API.

National Climate Mitigation Expenditures and Budget Tagging

Mitigation Fiscal Framework

In order to estimate the expenditures required to achieve the emissions reductions specified in the RAN-GRK, the Ministry of Finance (MoF), through its Fiscal Policy Agency (FPA) and with participation from key ministries, has developed the first “Mitigation Fiscal Framework” (MFF), - as its Climate Public Expenditure and Institute Review (CPEIR) - with support from UNDP. The MFF reviewed the climate mitigation policies and relevant institutional arrangements of Indonesia as well as assessed the existing levels of public expenditures on RAN-GRK actions, including different fiscal instruments such as investment financing and tax subsidy available for national mitigating actions\(^1\) (Figure 1).

\(^1\) Exclusive of international grants.
As shown in Figure 1, in 2012, the MFF found that the central government expenditure on RAN-GRK actions amounted to IDR 7.7 trillion (over USD 640 million), four times the expenditure in 2008. The total expenditures, including local government and off-budget allocations (investment financing, kerosene conversion and tax subsidy), reached IDR 15.9 trillion (over USD 1.3 billion) in 2012.

However the MFF found that by maintaining the RAN-GRK expenditure at IDR 16 trillion per annum will only reduce emissions by 116 mtCO2e by 2020 or 15% out of the national emission target to reduce by 767mtCO2. The MFF proposes a suite of different policies to bridge this emission gap and to reach the RAN-GRK target of 767 mtCO2e as well as assessing their indicative costs, as summarized in the table below.

### Table 1: MFF Indicative Annual Costs of Contributions to Emission Reductions

<table>
<thead>
<tr>
<th>Sources of Emission Reduction</th>
<th>Emission reduction (mtCO2e in 2020)</th>
<th>Indicative costs (IDR tr./year¹)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Public</td>
<td>Private</td>
</tr>
<tr>
<td>Maintaining RAN-GRK expenditure at 2012 levels</td>
<td>116</td>
<td>16</td>
</tr>
<tr>
<td>Additional RAN GRK expenditure in line with GDP</td>
<td>31</td>
<td>4</td>
</tr>
<tr>
<td>Improving cost effectiveness of existing expenditure</td>
<td>78</td>
<td>1-2</td>
</tr>
<tr>
<td>Power generation emissions 26% lower, incl. geothermal</td>
<td>104</td>
<td>15-45</td>
</tr>
<tr>
<td>Policies to limit deforestation to 450,000ha/year</td>
<td>260</td>
<td>1-2</td>
</tr>
<tr>
<td>Reductions required from new initiatives</td>
<td>121</td>
<td>6</td>
</tr>
<tr>
<td>RAN GRK target for forest, peatland, energy &amp; transport</td>
<td>710</td>
<td>45-75</td>
</tr>
<tr>
<td>Reductions from agriculture, industry &amp; waste water</td>
<td>57</td>
<td>Not covered in this first MFF</td>
</tr>
<tr>
<td>Total RAN GRK target</td>
<td>767</td>
<td></td>
</tr>
</tbody>
</table>

¹) Indicative costs expressed in 2012 prices.

Source: Mitigation Fiscal Framework (Indonesia, 2012)
As shown in Table 1, the MFF demonstrates that there is a significant financing gap of at least IDR 72-134 trillion/year (USD 6–11 billion/year) from public finance and IDR 91 – 171 trillion/year (USD 7.5 – 14.2 billion/year) from private sources to achieve the RAN-GRK emission reduction target.

This additional financial requirement highlights the need for the GoI to have a strategy and find ways to mobilize further resources to bridge the gap in mitigation funding, especially through the private sector and other non-state actions.

Through its reviews, the MFF proposes to further actions to the GoI in order to manage the mitigation fiscal framework, in particular:

i) Preparation of Annual MFF Report, to be coordinated by the Fiscal Policy Agency in MoF and prepared ahead of the budget cycle in order to influence the Medium-Term Expenditure Framework (MTEF)

ii) Integration of RAN-GRK in the budgeting process by identifying RAN-GRK actions, applying mitigation budget tag and costed prioritisation of mitigation activities

iii) Improving disbursement performance, especially in the Ministry of Forestry where only 75% of the budget from 2008-11 was actually spent.

Low Emission Budget Tagging & Scoring System (LESS)

Recognizing the findings from the MFF, the GoI is committed to the implementation of the framework. In particular, the Ministry of Finance, with support from UNDP and UNEP, has followed up on the recommendations from the MFF and developed a study on “Low Emission Budget Tagging and Scoring System (LESS)”. The study was prepared in close consultation with the Directorate General of Budget, Fiscal Policy Agency, National Development Planning Agency (BAPPENAS) and two key mitigation ministries (Ministries of Energy and Forestry).

The purpose of the LESS is to identify the total budget allocation and actual expenditure on climate mitigation and to assess the contribution of per unit of budget to achieve emission reduction targets, which would inform budget negotiations about the impact of per unit of emission reduction expenditure. The study provided two main outputs: i) definition and criteria to tag climate mitigation expenditures and the design of the tagging system and ii) a methodology to develop a mitigation scoring system. It was followed up by a Ministry of Finance decree.

Ministerial Decree on Budget Tagging for Climate Change

The Ministry of Finance approved the Decree No.136/2014 on Guidelines for Annual Planning and Budgeting of Line Ministry in July 2014. The Ministerial Decree introduces the Budget Tagging for Climate Change Mitigation system and makes it mandatory for seven key line ministries under the RAN-GRK, namely Ministries of Agriculture, Energy, Transport, Industry, Public Works, Forestry and the Environment. An online application and thematic budget coding system for tagging mitigation, adaptation and biodiversity activities have also been developed by the Directorate General of Budget (DG Budget).

\[2 \text{ The MFF did not cover reductions from agriculture, industry and waste water, suggesting an even higher financing gap than indicated here.}\]
**Capacity Building for Implementation of the Budget Tagging System**

Subsequently, two trainings on the online application of budget tagging system for climate change mitigation were conducted. The first training was intended for internal Ministry of Finance and to strengthen buy-in from the technical team of the DG Budget and the Fiscal Policy Agency (FPA). The second one was a technical training to line ministries. The latter training was conducted at the end of September 2014 under leadership of the DG Budget. All the seven line ministries representatives, who were responsible for planning and budget development, were invited. The training was designed to anticipate the final budget consultation of line Ministries for 2015 fiscal year as it is expected that the tagging system will be applied in the 2015 budget. Furthermore, in order to have higher level buy-in, the Echelon 1 meeting of senior public officers of the seven line ministries is planned to be hosted by the Minister of Finance in November 2014.

**Provincial LESS study for Climate Mitigation**

Following the same approach of the LESS study conducted at the national level, the LESS approach has been piloted in three provinces, namely Central Java, Jambi and Yogyakarta since April 2014 to October 2014. The provincial LESS study will review public expenditure (2010-2013) for mitigation actions in reference to the Provincial Action Plan for Emission Reduction (RAD-GRK) and RAN-GRK, analyze the priority of the activities and build policy recommendation for budget tagging system for climate mitigation activities to the Ministry of Home Affairs. The results of the provincial LESS study will be further used as feedback to the RAD-GRK/RAN-GRK monitoring system at Bappenas as well as input for developing fiscal policy to support implementation of climate mitigation at provincial level based on cost-effectiveness criteria.

**Pro-Poor & Gender Sensitive Adaptation Expenditure Review**

In addition to national efforts in integrating climate mitigation in the budgeting process, the GoI has also committed to climate expenditure reviews of adaptation activities in provincial levels. With support from UNDP’s Strengthening the Governance of Climate Finance to Benefit the Poor and Vulnerable project funded by Swedish International Development Agency (SIDA), Climate Public Expenditure and Insititutional Reviews (CPEIRs) are being conducted in Bangka Belitung province$^3$ and East Nusa Tenggara province$^4$ (NTT).

These provincial CPEIRs aim to improve the allocation of resources and management of finance to achieve the provinces’ emission reduction and adaptation commitments. The CPEIRs will also provide an understanding of existing climate policies and institutions in these provinces as well as understanding of the climate-related intergovernmental fiscal transfers. These CPEIRs focus on climate mitigation and adaptation actions, including the gender responsive and poverty sensitive aspects of these actions.

**Towards Sustainable Development Financing**

The financial requirements to address Indonesia’s environmental and climate change concerns is enormous. Therefore, the above-mentioned activities are to contribute to a larger national and subnational effort in enhancing the fiscal frameworks for climate mitigation, adaptation and biodiversity.

The GoI has agreed to the Sustainable Development Financing (SDF) programme supported by UNDP and UNEP to strengthening the fiscal frameworks for the implementation of the country’s environmental and climate commitments with sustainable financing and in a cost-effective manner.

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$^3$ As part of the Provincial Governance Strengthening Program (PGSP)

$^4$ As part of the Strategic Planning and Action to strengthen climate resilience of communities program (SPARC)
The government implementing partner of SDF project is the Fiscal Policy Agency of the MoF. The project is aimed to develop fiscal instrument options and to strength performance-based budgeting system to support the implementation of Indonesia’s climate mitigation actions (RAN-GRK), adaptation (RAN-API), and Indonesia Biodiversity Strategic Action Plan (IBSAP) to support the transition to an inclusive, green economy for sustainable development.

**Next Step**

“We are committed to a climate change blueprint, not only as an environmental issue but also for the national economy.”

(Joko Widodo’s Strategic Agenda, submitted during his presidential campaign, 2014).

On 20 October 2014, Indonesia sworn in Joko Widodo as the new president of one of the world’s largest democracies with high hopes to address many social economic issues of the country as well as for the national climate change agenda, according to many.

The President’s Nine Prioritized Programme or so called “Nawa Cita” was developed based on the identified problems in the current Indonesian economy that have resulted in continued high rate of poverty, welfare inequality, development gap between regions, environmental destruction as a result of natural-resource overexploitation, and too high a reliance on food, energy, finance and technology from outside the country. Thus, the President’s programme will be focused to address development issues from the periphery, starting from villages, coastal areas and marginalized groups by emphasizing Indonesia as a maritime nation. The President has also proposed that the Ministries of Forestry and Environment be combined in order to strengthen the national response to deforestation and haze. This vision includes the need for better development targeting and is supported by effective budget allocation. This vision for good governance and social justice, promoting transparency and further efficiency, provides optimism for climate actions and climate finance. It reinforces the work which Indonesia together with development partners has been doing in strengthening the fiscal framework for better mobilised and managed climate finance.
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