



# External finance for rural development

## Country case study: Indonesia

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### Key messages

- Agriculture and rural development are high priorities for Indonesia and are seen as critical for food, equity and economic growth.
- Government spending on agriculture has increased, but this may change as fertiliser subsidies are reduced. The government has also scaled up fiscal transfers at village level to boost rural development – funding that is expected to continue to increase.
- Official development finance (ODF) is not a major funding source for Indonesia, and most external funding comes from international private investors.
- ODF is still valued by the government, however, for the policy knowledge and project innovation it provides.
- Most ODF for agriculture and rural development is non-concessional, and is spent on irrigation. However, grants to the sector have risen significantly and are climate-related.
- Our research suggests an expected increase in government demand for concessional grants for rural development and agriculture in the future, but it is less clear whether there will also be increased demand for non-concessional finance.

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## Introduction

### Background

Rural development worldwide relies heavily on private funding. Yet the public sector has a key role to play in providing both investment and policy support to tackle persistent market failures. These include the under-provision of public goods (such as infrastructure, and research and development), negative externalities (such as the need to adapt to and mitigate the effects of climate change), informational asymmetries (e.g. the development of rural financial services) and the lack of protection for vulnerable people through, for example, social protection.

Far more finance is needed to achieve food security and promote sustainable agriculture in line with Sustainable Development Goal (SDG) 2. The United Nations (n.d.) estimates that an additional \$267 billion per year is needed to achieve every SDG 2 target: almost twice as much as total official development assistance (ODA) each year from all donors combined. Official development finance (ODF)<sup>1</sup> to agriculture and rural development rose slightly from \$10.2 billion in 2015 to \$10.9 billion in 2018. This is only a fraction of the total ODF disbursements of \$254 billion in 2018. Public expenditure on agriculture development also remains low: since 2001, governments have spent, on average, less than 2% of their central budgets on agriculture (FAO, 2019).

### Objectives, definitions and methodology of this country case study

This country case study summarises key findings from a country analysis of financing for rural development in Indonesia. It is one of 20 analyses that is synthesised for comparison in Prizzon et al. (2020).

The case study has two main objectives:

- to map demand from the Government of Indonesia over the next five to 10 years for external development assistance to support public investment in inclusive and sustainable rural development
- to analyse the financial and non-financial terms and conditions of such demand, its main preferences and the type of instruments that the government wishes to access or scale-up to support public investment in rural development.

### Definitions

**What we mean by public investment in inclusive and sustainable rural development** (see Prizzon et al., 2020, for more details): Our research has focused on six areas that contribute to such investment: access to agricultural technologies (research and development) and production services; agricultural value chain development (e.g. crops, livestock, fisheries); climate-resilient agricultural practices; rural basic infrastructure (e.g. water and irrigation systems, local roads, local energy generation and storage facilities); rural financial services; and rural investment environment (e.g. policy, legal and regulatory frameworks).

**What we mean by external assistance for inclusive and sustainable rural development:** We look beyond ODA to include government-to-government funds from bilateral and multilateral donors that do not meet concessionality criteria<sup>2</sup> (usually defined as other official flows, or OOFs). We call this official development finance (ODF). As a proxy for financing rural development, we examine data on external assistance to the agriculture sector and rural development (cross-cutting) based on an Organisation for Economic Co-operation and Development (OECD) definition. This is not a perfect measure, but given the lack of a sectoral definition or

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1 The sum of ODA and OOFs: the latter flow from bilateral and multilateral donors that do not meet the concessionality criterion for ODA eligibility.

2 The definition of concessionality is based on the share of the grant element. With the 2014 OECD reform, the grant element varies according to the income per capita of the ODA eligible country to be counted as ODA: at least 45% for low-income countries (LICs), 15% for lower-middle-income countries (LMICs) and 10% for upper-middle-income countries (UMICs). The International Monetary Fund (IMF) discount rate (5%) is also adjusted by income per capita group: 1% for UMICs, 2% for LMICs and 4% for LICs, including least-developed states (LDCs).

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attribution to rural development as such, it is the closest we can get to a consistent, cross-country mapping of external assistance from development partners. As a second-best option, we rely largely on quantitative and qualitative data on agricultural development. While the agriculture sector is a major component of rural development, data on agriculture alone cannot capture important non-farm activities.

### Research questions

This country case study reflects our four main research areas:

- the government's priorities for public investment in inclusive and sustainable rural development
- financing for public investment in inclusive and sustainable rural development
- borrowing (external development assistance) for this public investment
- the government's preferences in relation to external development assistance for public investment, including its demand for specific types of instruments.

As this project took place during the early stages of the Covid-19 pandemic, we also reflect the short- and medium-term implications of the crisis for government priorities and preferences for public investment, as well as the amount and type of external assistance demanded.

### Methodology

We used a qualitative case study approach, with the analysis of individual countries informed by a political economy framework, as developed by Greenhill et al. (2013) for aid negotiations (see Prizzon et al., 2020).

Our approach comprised a critical review of relevant policy literature<sup>3</sup> and data analysis,<sup>4</sup> which also helped us to identify country stakeholders. This was followed by interviews with key informants, informed by an electronic questionnaire submitted before

each interview. For Indonesia, we held 10 interviews between May and June 2020, and received six questionnaires (see Annex 1 for a list of those interviewees who agreed to their names being shared).

### Indonesia: country context

Indonesia's income status has fluctuated over the past 30 years. It was first classified as a lower-middle-income country in 1993, but the so-called 'Asian Financial Crisis' in 1997–1998 had such a severe impact on its economy that the country moved to low-income status for five years. In 2003, Indonesia regained its classification as a lower-middle-income country, and has been classified as an upper-middle-income country since July 2020.

Indonesia is not currently eligible for concessional assistance from international financial institutions (the World Bank and the Asian Development Bank), but still has access to concessional finance from bilateral organisations. The country has drawn heavily on resources from multilateral development banks since 2000 and is now the third-largest borrower of finance from the World Bank (World Bank, 2019b) and the fourth largest borrower from the Asian Development Bank (ADB, 2019a). Indonesia's demand for resources has been constrained at times over the past 20 years, as it has hit the borrowing ceilings set by these institutions to limit their exposure to larger borrowers (Prizzon and Rogerson, 2017).

Indonesia is the world's fourth most populous nation and its tenth largest economy (based on purchasing power parity) (World Bank, 2020a). The country has enjoyed sustained economic growth for nearly two decades since the 1997–1998 financial crisis, with the economy growing on average by 5.2% annually between 2000 and 2019 (World Bank, 2020e). This strong economic growth has been fuelled by a commodities boom (rubber, palm oil, coal and crude oil) in the 2000s (World Bank, 2015).

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3 Government strategies, IMF Article IV and World Bank diagnostic tools.

4 Spanning IMF, Food and Agriculture Organization (FAO), Asian Development Bank (AsDB), OECD and World Bank sources.

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However, commodity prices began to fall in 2012, dampening growth (ibid.).

Agriculture accounts for just 13% of Indonesia's GDP, while industry and manufacturing accounts for 59%, and services for 40% (World Bank, 2020e). The share of the economy based on the agricultural sector has declined over time. However, while the agricultural sector generates a small share of GDP, it accounts for 30% of all jobs in the country, with most of them in smallholder subsistence farming. In addition, just under half of Indonesia's people (45%) live in rural areas (World Bank, 2020e), of whom 34% live on less than \$3.20 a day (World Bank, 2020d).<sup>5</sup>

Indonesia's development has been highly uneven, with poverty concentrated largely in the eastern, coastal and rural parts of the country. Several provinces in eastern Indonesia, for example, have far lower per-capita income than Java and Bali (ADB, 2019b).

Food security remains a major issue in Indonesia. While progress has been made to reduce the number of undernourished people to just below the regional average (from 19% to 8% between 2004 and 2018), malnutrition rates remain very high, with 36.4% of children under the age of five stunted between 2016 and 2018. This is above the regional average, which stood at 25% over that period (FAO, 2019).

The country is also highly vulnerable to climate change and is particularly susceptible to the impact of rising sea levels, given that it is an archipelago made up of more than 6,000 inhabited islands. Indonesia was ranked as 105 out of 181 countries in terms of its vulnerability to climate change according to Notre Dame's Climate Vulnerability Country Index in 2018 (ND-GAIN, 2020), with a ranking of 1 indicating the lowest vulnerability and 181 the highest). Climate change is already having an impact on rural livelihoods, with erratic weather disrupting farming seasons, increasing pests and diseases, and reducing crop yields. Projections show that the impact is likely to get worse, with a fall in rice production of at least 20% unless adaptive measures are taken (IFAD, 2015).

## Government priorities for rural development

Indonesia's Long-Term National Development Plan 2005–2025 (Visi Dan Arah Pembangunan Jangka Panjang Tahun 2005–2025) (GOI, 2005) prioritises rural development and agricultural reform as a way to achieve food security and self-reliance, enhance equity across the country and drive economic growth. The delivery of this long-term vision has been supported by four five-year plans, with each plan emphasising the importance of agriculture and rural development. However, the relative importance given to the agriculture sector as a driver of economic growth has dwindled over time as Indonesia's economy has become less reliant on the sector.

The Fourth Medium-Term National Development Plan ('Rencana Pembangunan Jangka Menengah Nasional 2020–2024') (GOI, 2019) is built on seven pillars and includes a strong focus on improving human capital (which stresses the importance of nutrition), maintaining economic growth and strengthening infrastructure (which includes improving the value-added of agriculture, alongside other sectors), reducing regional disparities (which includes supporting villages and rural areas) and ensuring climate resilience.

The strategic plan of the Ministry of Agriculture ('Rencana Strategis Kementerian Pertanian 2020–2024') (GOI, 2020b) aims to improve food security and agricultural competitiveness by expanding the production of food commodities; maintaining the sustainability of agricultural resources and the availability of infrastructure and facilities; enhancing the capacity of human resources, competitiveness and innovation; and reforming public bureaucracy (FFTC-AP, 2020).

As part of its drive for greater equity across all regions and between rural and urban areas, the government introduced a new Village Law in 2014 to transform rural development by providing financial resources directly to Indonesia's 74,954 villages. The law has transferred significant resources from the

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5 Data on levels of extreme poverty in rural areas (that is, living on less than US\$1.90 per day) are not available.

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federal budget and from district-level revenues directly to village administrations that are now empowered to manage basic social services, rural infrastructure, agriculture development and community empowerment (World Bank, 2019a).

The Village Law is supported by the strategic plan of the Ministry of Villages, Disadvantaged Regions, and Transmigration ('Rencana Strategis Kementerian Desa, Pembangunan Daerah Tertinggal, dan Transmigrasi 2020–2024') (GOI, 2020c). This aims to improve the connectivity, infrastructure, value-chains, access to (and use of) innovation and technology, and human capacity of Indonesia's villages and key regions.

Our interviewees and survey respondents identified the development of agricultural value chains – the provision of services and inputs to add value to crops, livestock and fisheries and achieve greater economic returns – as the government's top priority for public investment in rural development and agriculture over the next five to 10 years. This was followed by support for rural basic infrastructure, and access to new technologies.

These three priorities resonate with the challenges identified by our interviewees as hindering rural and agricultural development in Indonesia. They noted, in particular, poor productivity and weak value-chains, attributing these challenges to poor access to markets, weak rural infrastructure and limited access to new agricultural technologies and innovation for farmers and rural communities.

According to our interviewees, institutional challenges present the biggest barrier to effective public investment in rural development and agriculture, rather than inadequate funding. They cited poor policy coordination between the central government and provincial, district and village levels, as well as weak capacity for policy implementation, as critical issues. Some interviewees also noted that overly bureaucratic government controls can lead to cumbersome and inefficient processes for decision-making.

Indonesia's rural development and agricultural policies are beginning to target specific groups and regions. Nearly all interviewees agreed that the government's rural development and agricultural policies included some targeting of smallholder farmers, women,

poor villages and regions that are isolated or that have been left behind by the economic progress seen elsewhere. The Village Law, for example, distributes varying amounts of funding to villages on the basis of their poverty rate and their geographic isolation.

Interviewees expect the Covid-19 pandemic to reinforce the government's existing priorities for rural development, according to most of our interviewees, with a heightened focus on food security and improving rural welfare. As of 1 July 2020, Indonesia had reported 57,770 confirmed cases of Covid-19 and 2,934 deaths (IMF, 2020b). The government introduced social and economic restrictions as a result of the pandemic and the IMF forecasts that Indonesia's economic growth will plummet to –0.3% in 2020 (IMF, 2020c) as a result of the crisis. The sectors most likely to be affected are manufacturing, trade (wholesale and retail) and tourism (WFP, 2020).

Unemployment is expected to rise as a result of the economic impact of the crisis. Increased food insecurity is also a concern, given the likelihood of falling supplies and imports, as well as a loss of income for many people as a result of unemployment (WFP, 2020). The government's initial policy response has been to provide a fiscal stimulus package amounting to 4.4% of GDP to support the country's economic recovery. The package aims to strengthen the health sector, provide social protection and support small and medium-sized enterprises (IMF, 2020b).

## Financing rural development

### Public finance

The Indonesian government's revenues and public expenditure are lower as a share of GDP than the average for the country's emerging market peers (World Bank, 2020b) and have been declining over time. In 2019, the government's revenues stood at 14% of GDP, while public expenditure was at 16%. Low public spending is viewed as preventing the government from making vital public investments to stimulate further economic growth (World Bank, 2020b; IMF, 2020a). The government has maintained a prudent fiscal stance, with a fiscal deficit of 1.8% in 2019.

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The share of public expenditure for agriculture has, however, increased over time and is close to the average for the region. According to the World Bank, the Indonesian government spent 3.3% of its public expenditure on agriculture in 2016, up from 2.8% in 2006 (World Bank, 2020b). This was actually above the global average of 1.6% for that year, and close to the average of 3.5% for Indonesia's regional counterparts (FAO, 2019).

According to data from the government,<sup>6</sup> the volume of spending on agriculture also increased between 2016 and 2019, mainly as a result of rising expenditure on fertiliser subsidies and infrastructure via the Ministry of Public Works (GOI, 2020a). However, the government's indicative spending plans on agriculture indicate a fall in the volume of financing for agriculture in the future. The government's 'Strategic plan for agriculture (2020–2024)'<sup>7</sup> shows that financing is set to fall and remain below 2019 levels between 2020 and 2024 (GOI, 2020b). This is due, in large part, to a shift in priorities with a significant fall expected in the amount of funding from the Ministry of Agriculture for fertiliser subsidies in the coming years. However, funding for agricultural infrastructure is expected to continue to increase via the Ministry of Public Works.

The volume of resources provided to Indonesian villages for rural development (including, but not limited to, agriculture) under the Village Law has also increased significantly. Annual fiscal transfers to villages rose from \$1.2 billion to \$8.4 billion between 2014 and 2018, accounting for approximately 6% of the national budget (World Bank, 2019a). At present, the budgets for 2020 to 2024 are not clear.

## External development assistance

The volume of ODF Indonesia received increased significantly – by 43% – between 2014 and 2018, from \$3.9 billion to \$6.9 billion (constant prices) (see Figure 1). This reveals an increased appetite for ODF on the part of the government, even though Indonesia is a middle-income country that has access to a range of external financing options.

The majority of ODF received between 2014 and 2018 was non-concessional, in line with Indonesia's middle-income status and lack of access to concessional finance from the multilateral development banks. The top three providers of ODF during this period, in order of volume, were the World Bank's International Bank for Reconstruction and Development, the Republic of Korea and the Asian Development Bank.<sup>8</sup>

It should be noted that these ODF figures do not reflect Indonesia's full access to concessional and non-concessional external development finance. They do not, for example, account for lending from providers like China, which is now a significant and growing provider of development finance to Indonesia. According to the Government of Indonesia, public lending from China rose from \$486 million in 2010 to \$1.78 billion in 2019 (GOI, 2020a).<sup>9</sup>

Indonesia is not an aid-dependent country, and concessional flows represented less than 1% of the country's gross national income and less than 1% of government expenditure in 2017. This is the result of strong economic growth over the past two decades and increasing access to private investments (World Bank, 2020e). The share of overall ODF provided as concessional finance fell from 49% in 2014 to 44% in 2018. Bilateral donors were the major providers of concessional finance between 2014 and 2016, with Germany,

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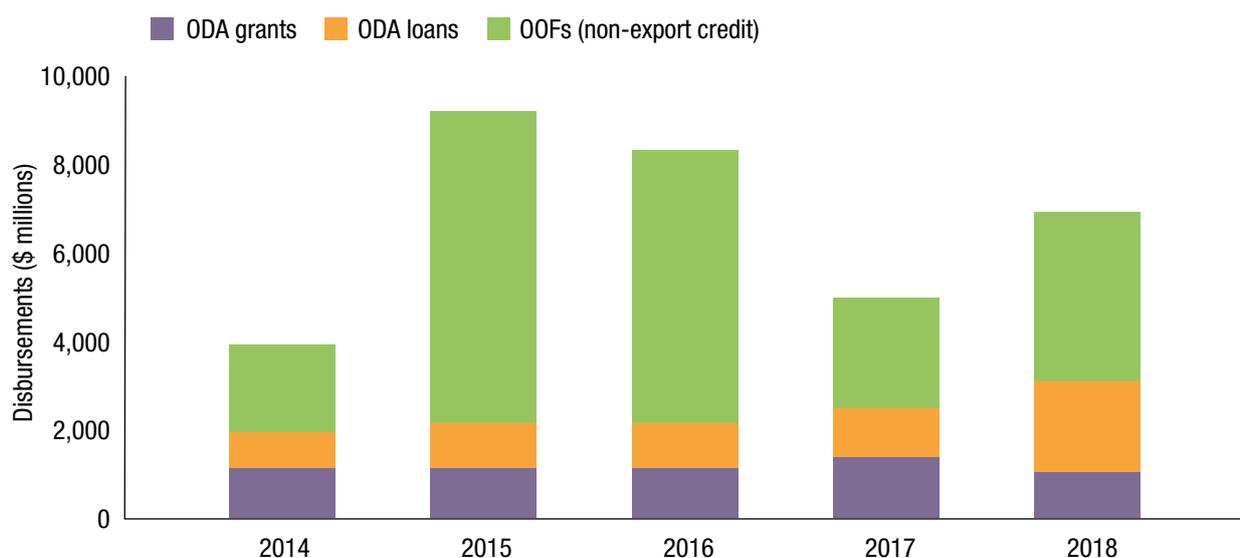
6 The government's classification for agricultural development needs includes funding to the Ministry of Agriculture, and funding to the Ministry of Public Works that is oriented to agriculture, fertiliser subsidies, rice reserves, reserve price stability for food and food security, and central government special grants transfers to the regions for irrigation and agricultural spending. It is based on the government's own classification identified in GOI (2020b): 94 (Table 8).

7 The government notes that the overall strategic targets set in its plan will not be fully met without additional domestic and foreign investment, beyond government resources.

8 Based on the volume of ODF disbursed between 2014 and 2018 (gross).

9 Figures are provisional for 2019.

**Figure 1 Official development finance disbursements to Indonesia across all sectors**



Note: constant 2018 prices. ODA, official development assistance; OOF, other official flow.  
Source: OECD (2020)

Japan and Australia the top three providers during this period.

The share of ODF received by Indonesia for rural development and agriculture has declined over time from 6.8% in 2014 to 2.7% in 2018 – below the global average of 5% – although this masks significant fluctuations over this period (Figure 2).

The majority of ODF for rural development and agriculture between 2014 and 2018 – 60% – was non-concessional. However, this average masks a significant increase in the volume and share of concessional grant financing over that period. In 2014, grant financing accounted for just 22% of ODF received for rural development and agriculture, but this rose to 56% in 2018. This contrasts markedly with the trend for ODF across all sectors, where the share of concessional grant financing has been declining marginally over time. This increase in concessional grant resources was driven by the significant scale-up of grants related to climate change from the United States in 2017 and 2018 to support the Green Prosperity Facility, which funds low-carbon rural development projects.

Most of the non-concessional ODF for agriculture and rural development between 2014 and 2018 was for infrastructure – primarily the maintenance and management of water resources – and was provided by the ADB and

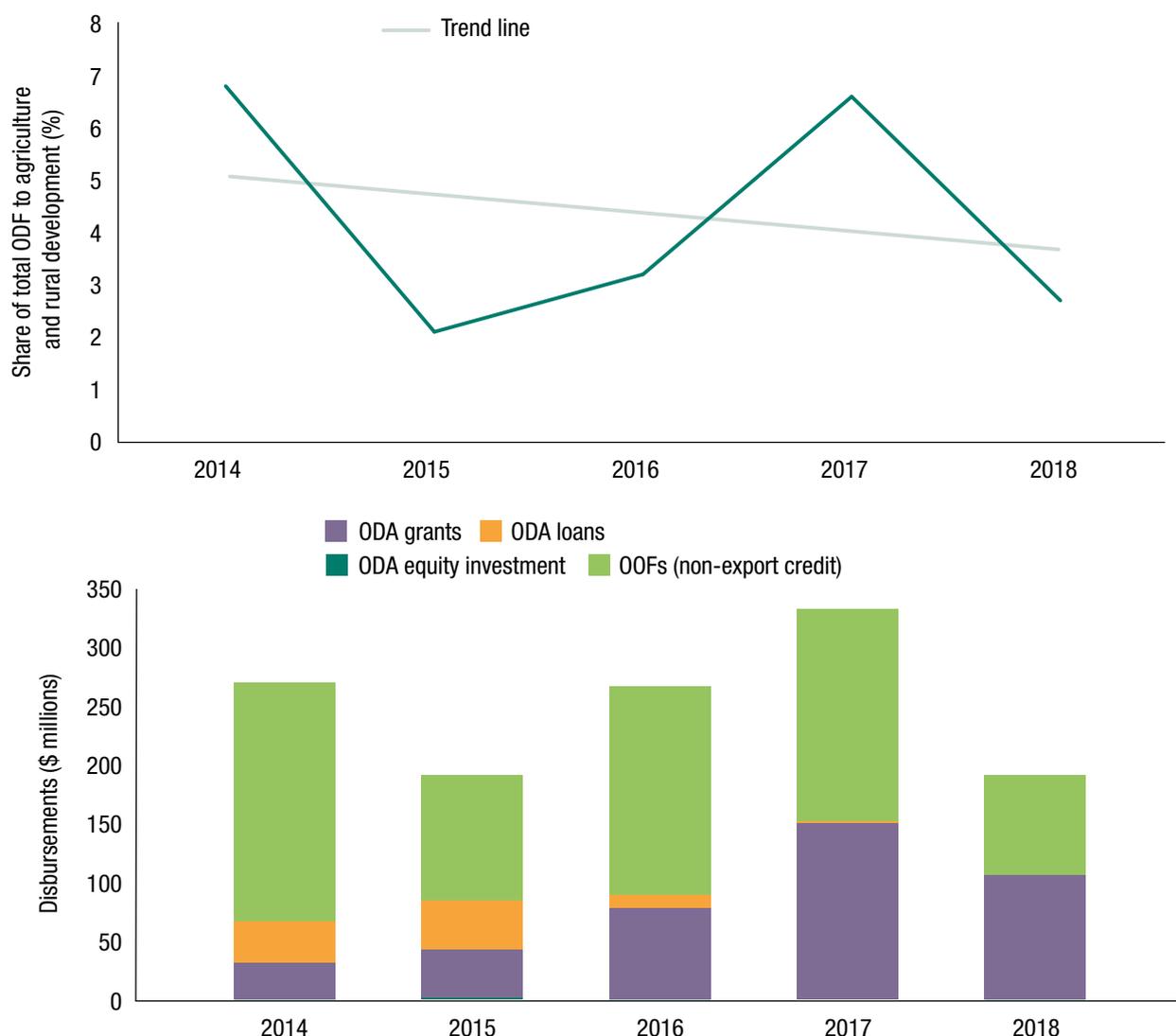
the World Bank. The World Bank also disburses the largest volume of non-concessional resources for rural development through a community empowerment programme that supports economic and social infrastructure and provides technical assistance to communities to help them plan and invest the funding received as a result of the 2014 Village Law.

Our interviewees and survey respondents were unanimous in their view that the government places a higher value on the technical expertise and innovation that comes with external assistance than on the amount of funding provided.

As already noted, external assistance flows – concessional and non-concessional – represent a very small finance flow for Indonesia and its strong economic performance. This, coupled with relatively low commercial interest rates, gives the government access to moderately cheap resources, beyond external assistance, to support its national development plans.

The government's continued and increasing use of external finance is seen as being driven by its desire to tap into the knowledge, project innovation and technical expertise offered by development partners. In particular, government officials noted that external assistance could help to pilot innovative projects that, if successful, could be scaled up by the government or private sector.

**Figure 2 Share and composition of official development finance to agriculture and rural development**



Note: ODA, official development assistance; ODF, official development finance; OOF, other official flow.  
Source: OECD (2020)

## Borrowing for rural development

### Debt trends and composition

Indonesia is considered to have moderate and sustainable public debt (IMF, 2020). In 2000, following the financial crisis in 1997/98, Indonesia's debt reached 87% of GDP, but through prudent fiscal management, the government managed to reduce it to 22.9% by 2011 (World Bank, 2020e). While Indonesia's public debt had increased to 30% of GDP by 2019, it still remains way below the government's debt threshold of 60%. The government's fiscal

deficit is also low, at 1.8% in 2019, and remains well within its threshold of 3% (IMF, 2020a).

However, the government has allowed central guarantees for project finance to count only partially against the government debt ceiling and large infrastructure loans are owned by state-owned enterprises without a sovereign guarantee. The IMF notes that this presents a risk along with the potential for weaker revenues for debt sustainability, and will need careful management (IMF, 2019: 56). Before the Covid-19 crisis, there were expectations that public debt would fall, at least marginally, in the near future.

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The majority of Indonesia's external public debt is to bondholders, rising from 27% in 2010 to 70% in 2019. This has overtaken the official (multilateral and bilateral) concessional and non-concessional debt, which once accounted for the bulk of the country's debt, but now stands at less than 24% (World Bank, 2020c). The government has gone directly to the market to fund its public investment programmes by issuing international bonds and *Sharia*-compliant government securities.

As expected, official non-concessional debt has increased as Indonesia's access to multilateral concessional debt has ended. The data also show that the government has taken on increasing amounts of multilateral non-concessional finance over the past 10 years as it has become more readily available, while bilateral non-concessional debt has decreased over time.

Public borrowing for the agricultural sector is relatively modest compared to other sectors, but has been rising since 2010. Government data and classifications indicate that the government borrowed the largest amount of financing for the human health and social work activities sector in 2019, followed by the construction sector and education sector (GOI, 2020c). It is important to note that the data do not reveal the type of debt taken out for each of these sectors, i.e. whether it is predominantly bond-based borrowing or from official creditors, or whether it was concessional or non-concessional.

The dominance of borrowing for social sectors is relatively unusual, as most countries borrow primarily for economic infrastructure. Agriculture ranked sixth out of 17 sectors in terms of the volume of public borrowing. However, while Indonesia's borrowing for agriculture is lower than for many other sectors, it has still increased four-fold since 2010 (GOI, 2020c).

### **Policies and preferences for borrowing and debt management**

Indonesia has laws and policies in place for the prudent management of debt and a clear set of debt thresholds. In 2003, following the 1997–1998 financial crash and the country's subsequent debt crisis, the government introduced a law on state finance (GOI, 2003) that adopts

Maastricht-inspired caps. This introduced constitutionally binding ratios of no more than a 3% fiscal deficit to GDP, with debt-to-GDP to rise no higher than 60% (Prizzon and Rogerson, 2017). The government also has a Medium-Term Debt Strategy that is regularly updated and that outlines specific targets for four years. The Government's 2018–2021 debt management strategy includes the following targets:

- a debt-to-GDP ratio that does not exceed 27.6% by 2021
- a share of foreign currency to total debt that does not exceed 37%
- a share of fixed interest rate loans that does not go below 91%
- a share of debt that matures in one year that does not exceed 10% of total debt
- an average maturity rate for loans of 7.6 years
- state guarantees that do not exceed 6% of GDP (GOI, 2018).

The government has a clear set of preferences about how to use different sources of funding. Indonesia's Fourth Medium-Term National Development Plan, for example, recognises that different sources of funding come with different characteristics that make them more or less suitable for financing particular sectors (GOI, 2019). Within the plan, the Government notes that:

- domestic revenues are suitable for funding government operations and public investments
- official grants are suitable for funding development programmes, natural and disaster relief and humanitarian support
- foreign loans are suitable to support state budget deficit and priority activities, which include economic infrastructure, the social transfer of technology, good practice and knowledge sharing
- domestic loans are suitable to support domestic industries and national development
- government securities are suitable to support government administration and operations
- *Sharia*-based securities are prioritised for infrastructure development (GOI, 2019).

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The government's use of resources for rural development and agriculture corresponds with this approach, with a focus on using less concessional loans for infrastructure and knowledge transfer to the sector.

Our interviewees and survey respondents noted that they expected the government to consider borrowing on less concessional terms for agricultural value-chain development, rural basic infrastructure and access to agricultural technologies. These areas reflect previous (less concessional) borrowing for the sector. Respondents expected that the government would have less of an appetite for borrowing at less concessional terms for climate change support or to enable a rural investment environment.

While most of our survey respondents expect increased government demand for concessional grants for the sector over the next five to 10 years, there was far less certainty as to whether there would be increased future demand for less concessional or commercial finance for the sector.

They also reported a government preference for borrowing in the local currency, with fixed, rather than variable, interest rates and long maturities to enable repayments over many years. These preferences reflect some of the key policies set by the Indonesian government in its Medium-Term Debt Strategy for 2018–2021, and are in line with its prudent macroeconomic stance.

## Preferences and instruments for rural development

The Indonesian government tends to develop individual, tailor-made relationships with each development partner and has no aid management policy or formal structures in place to coordinate dialogue among its partners (Prizzon and Rogerson, 2017). The development partners we interviewed noted the importance of long-term relationships with their government counterparts, and that an established and strong track record on delivery was vital to building trust.

The majority of respondents noted that the government has a strong preference for external assistance that is aligned to national priorities and is long-term, so that it can support durable and sustainable projects. Other preferences

include predictability and the presence of the donor in the country. This was seen as particularly important for building trust between the government and its development partners.

Survey respondents and interviewees indicated a strong preference for a broad set of financing instruments. These instruments include, in particular, more policy-based lending and project preparation facilities for rural development and agriculture. This chimes with the government's interest in utilising the policy and technical experience of development partners, as opposed to a sole focus on the additional financing offered by partners. Our survey respondents and interviewees also noted a preference for weather-based insurance instruments (which make it possible to make a claim in the event of objectively measured weather variables, such as rainfall) and catastrophe risk drawdown options, with credit lines opened to provide immediate liquidity following a natural disaster. This preference stems from Indonesia's high vulnerability to natural disasters and climate change as a result of its geography.

## Conclusions

Our analysis of the experience and perspective of Indonesia on financing public investment for inclusive and sustainable rural development, and particularly its demand for external assistance, is summarised as follows.

- Rural development and agriculture are identified as high priorities within Indonesia's long-term national development plan, and are viewed as critical for food security, equity across regions, and economic growth. Agriculture value-chain development is cited by our interviewees and survey respondents as the government's top priority for its investment in the sector over the next five to 10 years, followed by support for rural basic infrastructure and for agricultural technologies and production.
- These priorities reflect the key challenges facing the sector: low productivity, poor access to markets and limited opportunities to add value to produce. Interviewees and survey respondents expect the Covid-19 crisis

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to sharpen the government's focus on rural development and agriculture, rather than diminish it, and food security and support for rural livelihoods are seen as priority areas.

- The share of government expenditure on agriculture has increased over time (largely as a result of increasing fertiliser subsidies) and is just below the average for the region, standing at 3.3% in 2016. However, future government spending plans project a fall in the volume as fertiliser subsidies are reduced. The government has also scaled up its fiscal transfers to village-level administrations significantly to boost rural development, and a continued increase in these transfers is expected.
- ODF does not represent a significant source of external resources for the government, given that Indonesia is a middle-income country, and most external funding comes from international private investors via bonds. However, the government still values ODF for the policy knowledge and project innovation provided by development partners, and demand for ODF continues, with the volume of ODF received by Indonesia increasing by 43% between 2014 and 2018.
- Most of the ODF received by Indonesia for agriculture and rural development between 2014 and 2018 was non-concessional, and was spent on the maintenance of irrigation. However, the volume and share of grants to the sector has risen significantly over time, with grants accounting for 56% of ODF to the sector in 2018. This rise is attributed to an increase in climate-related grant financing from the United States.
- The majority of our interviewees and survey respondents expect this trend to continue, with government demand for concessional grants for rural development and agriculture anticipated to increase over the next five to 10 years. There was less certainty about whether there would be greater demand for non-concessional or commercial finance for the sector.
- The Indonesian government does not have an aid management policy or formal structures in place to coordinate dialogue with its multiple development partners, and opts instead for a more individual approach. The government is, however, perceived to value external assistance that is aligned to national priorities, long-term and durable.

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## Annex 1 List of interviewees

Name	Institution
Adi Budiarmo	Ministry of Finance
Ade Candradijaya	Ministry of Agriculture
Ivan Cortez Cossio	International Fund for Agricultural Development (IFAD)
Jan Joost Nijhoff	World Bank
Anissa Lucky Pratiwi	IFAD
Sergio Perez	Asian Infrastructure Investment Bank (AIIB)
Eric Quincieu	Asian Development Bank (ADB)
Joko Tri Haryanto	Ministry of Finance
Bito Wikantosa	Ministry of Village, Rural Development and Transmigration
Velix Wanggai	BAPPENAS/ Ministry of National Development Planning

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