INVESTMENT CONCEPT NOTE

Investment Concept Title: New Indonesia Economic Governance Investment (Prospera 2.0, including Katalis 2.0)	
Start date: January 2026	**End date:** December 2035
Total proposed DFAT funding: up to AUD550 million	

A. Development Context (What is the problem?)

Indonesia is a rapidly growing middle-income economy, with rising per-capita incomes and broad-based improvement across various health and social indicators over the past thirty years. Its economic and budgetary performance during the COVID-19 pandemic was one of the region's best and it was one of the first economies to return to its pre-pandemic size.

Indonesia's economic institutions are now more resilient to economic shocks and can lead the development of increasingly complex policy reforms. During the COVID-19 pandemic, reformist Indonesian Ministers, led by Sri Mulyani Indrawati, took the opportunity to pursue structural reforms. These included omnibus laws on tax, financial services, subnational financing, health, and job creation. Several reforms positively impacted gender equality by increasing access to services and promoting financial inclusion.

Indonesia's economic success masks complex gender, regional and social inequalities. Whilst per capita income in Jakarta is on par with many developed economies, incomes in some Papuan provinces are similar to low-income countries. Around 20 per cent of the population live just above the poverty line. Women are underrepresented in the economy and the labour market and overrepresented in the lowest-paid and informal jobs. Intersections between gender, power dynamics, socio-economic structures and norms drive economic disadvantage.

Indonesia's Vision 2045 paints a picture of the structural reforms the country needs to become a high-income country by 2045: strengthened institutions, improved public finances, and government services that build human capital. To achieve the 2045 goal, Indonesia must rapidly accelerate annual economic growth from 5 to 7 per cent. Regardless of whether the goal is achieved by 2045, Indonesian policymakers have coalesced around this national vision by laying down a pathway through middle-income status. Financial risks will need to be managed.

To achieve the 2045 vision, Indonesian policymakers must navigate increasingly complex policy problems and vested interests. Indonesian leaders must build and sustain the political will to implement structural reforms that drive productivity growth, unlock investment and raise per capita incomes. Experience from other Asian middle-income countries shows that this won't be easy. Indonesia's track record on macroeconomic reforms is solid, in part because macroeconomic stability supports elite interests. Sectoral, microeconomic, and competitive reforms cut across elite interests and will be more difficult to pursue.

Climate change and digitalisation will be among Indonesia's defining challenges and opportunities. Policymakers must enact whole-of-society measures to avoid the risks and capitalise on the opportunities. This will require strong leadership and coordination, reform to institutional arrangements, and leveraging the best global knowledge and practice to drive policy outcomes. The scale of the energy transition is massive, but the opportunities from the green transition are even greater if Indonesians can be convinced that the opportunities can be realised.

While dealing with the new digital and climate change issues, Indonesia will need to transform its economic and service delivery institutions to deal with the rising demands of a middle-income society. Human capital needs to be prioritised to better equip the future workforce, including improving the participation of the female labour force, which has remained stuck around 50 per cent for the past three decades (with a 28-percentage point gap to male rates), and quality of participation also remains low. Additionally, approximately 80.5 percent of Indonesians with moderate to severe disability are out of the workforce, and the gap between men and women working in the formal sector persists. Indonesia's digital divide remains and will hold back economic growth and worsen the social gap. Nearly 40 per cent of the adult population remains without access to the internet, and it is worse for those in rural areas and those with lower levels of education.

Expanding two-way trade and investment is a key bilateral priority and will help Indonesia meet its growth trajectory goals towards the 2045 vision. The opacity of the business-enabling environment and the weakness of domestic institutions restrict the ability for the potential benefits of greater trade and investment to be realised in Indonesia. Encouraging open and freer trade -- in tandem with regulatory reform to address protectionist policy settings – will bring about broader impacts, with outcomes benefitting not just the immediate stakeholders, but also opportunities to the wider industry and community. Increasing Indonesia's two-way trade and investment with Australia also helps Indonesia build out its global trading relationships to support its development goals and growth trajectory.

Indonesia's low national savings rate constrains investment and growth. Deepening the financial sector is critical so that savings can be efficiently channelled into productive investments. Lifting the tax-to-GDP ratio from the current 11 percent to above 15 percent would give the Indonesian Government the funds needed to invest in human and physical capital. Additionally, financial inclusion and literacy has not expanded equally, with many segments of the population, including rural women, facing barriers in accessing formal financial services.

The transformation vision of 2045 will remain the guidepost, but Indonesia still needs to navigate risks. Financial and economic stability has improved but cannot be taken for granted, mainly as risks still exist in the financial sector, especially around insurance. Indonesia is ranked in the top third of countries globally regarding climate risk, with high exposure to all types of flooding and extreme heat. People with disabilities are disproportionately represented among populations most at-risk of climate-driven hazards and already represent 15 per cent of the population, a number that is expected to grow as Indonesia's life expectancy improves.

B. Strategic Intent and Rationale (Why should Australia invest?)

Australia has a strong and growing interest to continue to support Indonesia's economic development and economic prosperity. The Indonesia-Australia Comprehensive Strategic Partnership (CSP) agreed to enhance our economic and development partnership to forge a stronger economic partnership for mutual prosperity and target sustainable and inclusive economic growth for our peoples. The **Australia-Indonesia Development Partnership Plan 2024 - 28** supports Indonesia's efforts to achieve equitable and sustainable economic transformation including in trade, investment and innovation, as well as better integrating our two economies for mutual benefit.

Indonesia's rise to become an economic powerhouse means more economic opportunities for Australia. The *Indonesia-Australia Comprehensive Economic Partnership Agreement* (IA-CEPA) and ***Invested: Australia's Southeast Asia Economic Strategy to 2040*** aim to capitalise on these opportunities, including by stepping up Australian private investment into Indonesia. Investment dollars are a vote of confidence in Indonesia's development trajectory and economic stability. This investment (Prospera 2.0 including Katalis 2.0) will reinforce these efforts by supporting reforms that improve the Indonesia's regulatory environment for traders and investors.

Alongside our private sector investment drive, this investment, **Prospera 2.0 (including Katalis 2.0)** will serve as the vehicle for Australia to **maintain our role as Indonesia's technocratic partner of choice for economic reforms.** This means preserving Australia's close and trusted role supporting Indonesia's economic institutions in the development and implementation of the country's economic reforms needed to achieve its long-term economic development ambitions and prosperity.

This investment will also help manage the risks of economic and financial market instability. Indonesia remains concerned with averting another financial crisis, given the impact of the Asian Financial Crisis on political stability. This has driven Indonesia to adopt stringent lending practices, giving it a low debt-to-GDP ratio that has made the country attractive to investors. Energy transition and climate risks pose new challenges including for the financial sector globally. Indonesia's banking sector and financial regulators have a key role to play in ensuring Indonesia can take advantage of new industries resulting from energy transition while mitigating against the financial impacts of climate risk including extreme weather events.

Indonesia's ambition to become a high-income country by 2045 means that it will continue to seek knowledge partners to navigate increasingly complex policy reforms. This advice will be particularly relevant as Indonesia navigates accession to the Organisation for Economic Co-operation and Development (OECD) and contemplates a bid to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Efforts to become an OECD member also create momentum and a framework for Indonesia's future economic reforms and economic development. Adoption of OECD standards and best practices will help Indonesia further integrate into the global economy, important for our economic and regional security interests.

Locally led development

Building on the successful approach of Prospera and Katalis in their current phases (see details below), Prospera 2.0 (including Katalis 2.0) will place a strong emphasis on locally-led development through the extensive use of Indonesian advisers, local evidence and knowledge, by prioritising areas of policy focus that are requested by Indonesian Government entities, and by delivering policy advice tailored to the Indonesian context. The design will also consider options to institutionalise advisory support within the Indonesian Government system. See Section D below for more detail. APS partnerships will also continue to explore partnership models that move beyond capacity development and training delivery to focus on mutual benefit and cooperation, including in international fora and supporting Indonesia’s ambition to engage as a development partner outside of Indonesia, including through trilateral development cooperation in the Pacific.

Key lessons from the current phases

The Australia Indonesia Partnership for Economic Development (Prospera) is a $259m facility (2018 – 2026), which contributes to Indonesia’s strong, sustainable and inclusive economic growth. Prospera currently delivers the policy and regulatory pillar of KINETIK (the Australia-Indonesia Climate and Infrastructure Partnership), aimed at deepening bilateral cooperation on reducing emissions and promoting clean energy systems and industries to accelerate the net zero transition.

The Mid-term Review of Prospera (2021) found the current program to be highly effective, efficient and relevant. Prospera provides Indonesia with diverse, high-quality advisory services that have helped make it a trusted 'internal' adviser within a complex political and bureaucratic context. GoI views Prospera as the development partner of choice in shaping economic reforms. Its effectiveness is also due to its ability to mobilise high-quality technical assistance quickly compared to Indonesian systems and other development partners that face lengthy procurement processes. Indonesia can always access 'first best' policy advice from multilateral development banks, but Prospera's politically informed 'best possible' advice is more relevant for policymakers that need to navigate technical, political and budgetary constraints.[1]

Prospera's integrated model of APS partnerships and advisory services drives its effectiveness. Many of the twenty APS partners have partnered with Indonesian counterparts for over 20 years. APS partnerships have forged strong people-to-people and institution-to-institution links that complement Prospera's advisory support by allowing Indonesia to learn about Australia's institutional experience. Integrating APS partners and advisory support into a single program has led to better policy coherence and complementarity across APS partners and advisory activities.

The design will also be informed by an independent evaluation of Prospera to be completed by end-2024.

The IA-CEPA Economic Cooperation Program (ECP) (Katalis) is an investment worth A$40 million over 5 years (2020-2025) designed to support strong, sustainable and inclusive trade and investment between Australia and Indonesia.

A Mid-term Review of Katalis was completed in May 2024. It found that Katalis had performed exceptionally well in difficult circumstances and was on track to deliver some important outputs to enhance two-way trade and investment between Indonesia and Australia. However, the review recognised that Katalis has had to evolve significantly from its original design and recommended that for any future phase of Katalis it would be necessary

[1] MDB advice is theoretically sound but cannot be informed by political constraints to the same degree. See this paper by Stefan Dercon (ex DFID Chief Economist) for an explanation of these concepts: The Political Economy of Economic Policy Advice (ox.ac.uk).

for a rethink of Katalis' purpose, to reflect lessons learned, the changing context, and to address limitations in the original design.

ODA eligibility

The ODA Eligibility Flowchart confirms the proposed investment is ODA eligible. The design will also explore a mechanism to enable use of non-ODA funding by the investment.

C. Proposed Outcomes and Investment Options (What?)

The goal of this investment is to support Indonesia's economic transformation, enabling greater investment, including from Australia, and to support stronger, more inclusive economic growth in-line with Indonesia's ambition to reach high-income status by 2045. This goal supports Australia's ambitions to deepen our economic relationship with Indonesia, including through increased two-way investment. This investment, Prospera 2.0 (including Katalis 2.0), will contribute to a stronger, less discretionary regulatory environment that provides greater certainty to investors. Stronger, more inclusive growth provides more opportunities for trade and investment and supports human development.

The drafting of this ICN has been completed in parallel with a portfolio planning process in the Indonesia program, covering all major economic, trade, climate and infrastructure development programs. This planning proposes two main investments for the Portfolio: Prospera 2.0 (including Katalis 2.0), focused on economic policy and economic cooperation and incorporating the policy and regulatory pillar of KINETIK; and an investment focused on infrastructure and financing, which takes on the financing components of KINETIK.

The Prospera 2.0 (including Katalis 2.0) design will examine how to best integrate the next phases of Prospera and Katalis including to maximise the ability of Katalis to benefit from linkages to Prospera. In particular, it should focus on enabling greater synergy between the work Prospera does on policy reform to support economic growth in Indonesia and Katalis' goal to improve market access and increase two-way trade and investment. Katalis will continue its work to find new opportunities to bring together the complementary strengths and ambitions of Australia and Indonesia to realise greater trade and investment, while leveraging Prospera's parallel work on policy reform.

The investment will be structured to both retain the Katalis brand and to preserve Prospera's trusted advisor status. This will involve a separately procured Katalis component that supports Australia's economic cooperation program obligations under the IA-CEPA free trade agreement. The design will develop a combined investment level program logic, as well as component program logics for both Prospera 2.0 and Katalis 2.0. The design will also consider management mechanisms that ensure appropriate feedback loops and cross pollination on policy and regulatory issues across all components of the investment. This will include considering how Prospera and Katalis work together to enable broader trade and investment reforms that impact inclusive economic growth.

This investment, Prospera 2.0 (including Katalis 2.0), will continue to deliver the policy and regulatory pillar of KINETIK, the Australia-Indonesia Climate and Infrastructure Partnership. This will ensure that we can report on that 5-year AUD200 million government commitment (mid-2022 to mid-2027). Beyond that, the investment's work on climate and energy transformation and on the private sector will continue to complement and draw on insights from our efforts to crowd-in Australian and other private sector investment into Indonesia's clean energy transition through the blended finance mechanisms established and capitalised under KINETIK (these investments – through Australian Development Investments (ADI) and Private Infrastructure Development Group (PIDG) – will remain active beyond mid-2027 and are proposed to be incorporated into the infrastructure and financing investment).

End-of-program outcomes are proposed for the Investment across three key areas across its implementing mechanisms and with a 10-year horizon. These will be refined through the design process.

1. Economic transformation: macroeconomic, financial sector, budget, and revenue policies, with a focus on gender and disability in policy outcomes.
2. Private sector transformation: micro-economic, trade and investment, competition and innovation, labour market and digital economy, focusing on female labour force participation.
3. Energy and climate transformation, including issues of a just transition.

In formulating the EOPOs, Post considered the trade-offs between Indonesian Government needs, whether or not to continue long-running activities, including the need to preserve Australian influence, and how Indonesia will evolve as a middle-income country.

- Prospera (and AIPEG before it) began as an economic policy program focused on economic stability, building budget, and PFM capacity. Over its lifetime, the program has evolved to take on a wider set of complex policy reforms, including climate and energy, digital transformation, and institutional transformation in the health sector.
- Although demand still exists from MoF for technical assistance in core macroeconomic, financial sector, budget and PFM, DFAT assistance in these areas has been longstanding. Good development practice demands we evaluate this assistance and encourage Indonesia to build its capability.
- Experience from other middle-income countries shows that issues captured in EOPO 1 are central to the next growth phase. Indonesia will need to generate higher productivity growth from competition, innovation and open trade and investment as growth from factor accumulation slows.

Balancing the trade-offs between the above, this concept note combines Prospera's current EOPOs 2 and 3 into a single EOPO. Doing so reduces the level of support in these areas. In the 10-year time horizon for Prospera 2.0, some activities supported in the current phase (in public financial management and macroeconomic policymaking) should be gradually transferred, potentially to an Indonesian Government think tank that would be seed funded by Prospera (see delivery approach for further details).

The design will also explore how the investment intersects with DFAT's human development programs in health, education and other areas. For example, consider whether Prospera 2.0 should focus on public sector transformation and whether this focus is restricted to central/economic agencies or works with service delivery agencies.

Prospera 2.0 will work towards outcomes in these three areas by delivering:

- High-level, responsive policy advice.
- Institutional transformation through support for selected longer-term change efforts.
- Effective partnerships between Australian and Indonesian institutions.
- Economic cooperation program activities.

APS partnerships will be embedded across each of the three EOPOs. APS capability is described in Section D.

Economic policy and institutional transformation

EOPO 1: Strong macro-economic, financial sector, budget and revenue policies are developed and implemented by capable institutions, and drive stable, inclusive and sustainable growth in Indonesia. This EOPO will include macro-economic, financial sector, budget, public financial management and revenue. The work of relevant APS partnerships such as for Treasury, ATO, ANAO, Department of Finance and other economic agencies will contribute to this EOPO.

What does success look like?

Indonesia continues to remain resilient to economic and financial shocks, and macro-financial stability underpins long-term growth. Increasingly, Indonesia enacts the economic reforms to enable transformation to high-income status. Indonesia continues to develop its institutional capability to deliver better policies and services.

Private sector and digital transformation

EOPO 2: Targeted ministries are implementing microeconomic, trade, investment, and digital policies that are unlocking key economic transformations required to move Indonesia beyond middle-income status, including on female labour force participation, digital economy and private sector competition.

This EOPO will include microeconomics, trade and investment, competition and innovation, labour market, and digital economy. It will also focus on lifting female labour force participation. The work of relevant APS partnerships, such as with the DTA, CSIRO, ACCC, and others, will contribute to this EOPO.

This EOPO retains Prospera's current focus on this set of policy issues, anticipating that these issues will become increasingly important. Compared to the current program, this EOPO will focus more on the digital economy. It will position lifting female force participation as a key driver of supply-side economic growth.

Indonesia's policy settings under this pillar directly impact Australia's trade and investment interests. Indonesia's openness to trade impacts Australian firms' ability to export to Indonesia; Indonesian regulations impact Indonesia's attractiveness as an investment destination and the profitability of Australian investment in Indonesia; digital policy settings will shape the growth and direction of the digital economy and shape digital trade between Indonesia and Australia. Katalis 2.0 will deliver economic cooperation activities under this pillar, linking to systemic reforms pursued under Prospera 2.0. The design will continue to refine this EOPO, including to ensure it captures outcomes relevant to Katalis 2.0's objectives.

What does success look like?

Success for Indonesia is a private sector that delivers middle-class jobs and contributes to the 2045 goals. This will require higher firm and labour productivity growth, underpinned by competition and innovation, open trade and investment settings, higher female labour force participation and a vibrant digital economy. Success for Prospera 2.0 (including Katalis 2.0) will be the Indonesian Government increasingly delivering economic reforms in this area, including in ways that support bilateral trade and investment, and with more robust institutional capabilities to devise and implement policies and regulations.

Energy and climate transformation

EOPO 3: Macro-level policies are enabling a just and affordable transition to a sustainable economy, including through increased investment in decarbonisation and renewable energy.

Initially at least, this EOPO will be framed as Prospera 2.0 delivering the policy and regulatory pillar of KINETIK (per fourth paragraph of Section C above). Prospera will likely focus on macro climate and energy policies. The delineation between this investment and the infrastructure and finance successor investment, which will include a focus on some of the technical aspects of energy transition and renewable energy, will be further elaborated during concurrent design processes.

APS partnerships, such as with DCCEEW, DISR, BoM, CSIRO, the CEFC and other agencies, will contribute to this EOPO.

What does success look like?

Transitioning energy systems and dealing with the increasing impacts of climate change will be one of the defining policy challenges of the next decade. The success of Indonesia's transition will depend on strong national leadership, policy coordination and implementation of macro-level energy, climate, fiscal, economic, and social policies. These macro-level policies will continue to be driven by the central agency actors with whom Prospera has built up its reputation as a trusted partner. Women and girls, who will experience this transition differently from men and boys, will have a more active voice in transition policymaking and more gender-equal access to economic opportunities.

GEDSI

Gender equality will be a significant objective of Prospera 2.0 (including Katalis 2.0). An emphasis of this investment is also to improve economic participation and social life, for women and people with disabilities, through access to resources, opportunities and decision-making processes.

The investment will take a twin-track approach to GEDSI with outcomes firmly embedded in the program logic and the programs outcomes. GEDSI will be a mainstreamed consideration across all areas of work, for example, analyses underpinning policy reform activities will need to consider how women, men, girls and boys, including those with disabilities and/or dimensions of social disadvantage will be impacted by a policy. In addition to this, targeted interventions will be delivered, which actively seek to improve the ability of various groups to access the benefits of economic policy reforms and the programs EOPOs.

The design will consider areas where targeted interventions could assist the achievement of GEDSI outcomes in the early years of the program. It will also consider the GEDSI dimensions of the program logic and EOPOs.

D. Implementation Arrangements and Delivery Approach (How will DFAT deliver it and engage?)

Prospera 2.0 (including Katalis 2.0) will be deployed towards supporting the Indonesian Government to tackle complex policy problems that require high levels of technical knowledge, multi-sectoral or inter-ministerial coordination and where the political economy is challenging. A key to success will be the ability to leverage opportunities when the political economy is favourable by bringing fast and responsive technical expertise behind institutions and reform leaders.

Government-to-Government partnerships (G2G): continue the longstanding successful APS partnerships with activities that include peer-to-peer technical advice to support and influence policy reforms, the long-term deployment of Australian officials into Indonesian counterpart institutions, short-term/periodic FIFO partnership arrangements to support the provision of advice on specific reform initiatives, as well as other forms of capacity building, two-way twinning, and exchange programs. Under this investment we would also seek to draw on expertise from industry bodies, specialist think-tanks and Australian state and territory agencies. The design will examine the composition of APS partners to determine which should be incorporated into Prospera 2.0. The design will work closely with the new SEA G2G program to ensure complementarity and exchange of lessons learned.

Technical assistance: use high quality technical assistance, targeted at providing context appropriate 'best possible' advice on economic policies, and delivered in-concert with the activities under the G2G partnerships. The design will consider the best modalities to broaden out the reach and to further institutionalise partnerships with economic institutions and key personnel/interlocutors.

Economic cooperation activities: activities delivered by Katalis to support enhanced two-way trade and investment between Indonesia and Australia. These activities may include business partnerships, training or technical assistance that are geared towards bilateral trade and investment outcomes but also enable a broader impact on inclusive economic growth in Indonesia.

Options for delivering the investment

Option 1: Programmatic (development) facilities - preferred (same as current Prospera modality)

DFAT procures Managing Contractor(s) (MC) to implement Prospera 2.0 (including Katalis 2.0). Under this option, we would procure and contract separately the Prospera and Katalis components under the investment (with the Prospera component structured to help ensure activities under Katalis can have broader/systemic impacts). As per the current model, the MC(s) would develop a strong program strategy for each component, but also retain the flexibility of a facility model. The MC(s) would develop an overall implementation strategy for including clear approach to harnessing the collaboration opportunities between technical assistance in both Katalis and Prospera components and APS partners. The MC(s) would also provide coordination and oversight; and deliver monitoring, evaluation, and learning processes, reporting and communications for its technical assistance activities, as well as the APS partners. APS partners would enter into ROU agreements with DFAT under this investment.

Option 2: Fully programmed - not preferred

Prospera 2.0 (including Katalis 2.0) is delivered through a traditional program model. This would be similar to Option 1 but with less flexibility and with programming designed from commencement, with built-in adjustment points. The investment could also be structured as a series of smaller, finite investments for the different mechanisms with clear, pre-agreed inputs, deliverables and outcomes. This option would enable easier management and oversight of program implementation and could allow greater diversity of implementing partners and contractors. However, it would come at the expense of the flexibility and responsiveness that makes the current phase of Prospera a partner of choice for GoI.

Option 3: Multilateral Delivery - not preferred

DFAT delivers the bulk of the funding through a multilateral partner/s, for example, the World Bank and the OECD. This option would draw on these partners' expertise and reputation with technical assistance and would minimise resourcing at required at Post, compared to a facility. This option would not be favoured by GoI, have less effective Australian branding and would not be based on the lessons learned from Prospera's current phase.

Preferred option

Option 1 is the preferred delivery model. This option will continue many of the existing (and highly valued) activities and be better positioned to quickly start new activities. The continued responsiveness will underpin Prospera 2.0's comparative advantage with key GoI counterparts.

Opportunities to leverage other ODA and non-ODA investments

Prospera 2.0 (including Katalis 2.0) will continue to work alongside the portfolio of ODA and non-ODA investments deployed by Australia to enhance our economic engagement with Indonesia. The investment's focus is on the policy and regulatory environment. The design will document the creation of two-way feedback loops to and from the broader economics portfolio. This includes documenting how Prospera 2.0 (including Katalis 2.0) will work with Export Finance Australia, the Jakarta Deal Team and DFAT's blended finance portfolio.

The design will also explore how this investment will work alongside other investments in the Australia Indonesia development partnership to identify potential intersections and ensure complementarity.

Proposed Monitoring, Evaluation and Learning

A robust MEL system will be in place to capture learning across the investment to enable DFAT and the Managing Contractor to make informed choices about when to adapt, expand or exit from specific lines of effort. Structured processes of shared learning and reflection will provide lessons to enhance effectiveness and efficiency. The MEL system will also aggregate results from program components and APS partner interventions to enable analysis of how the investment, as a whole, is progressing toward outcomes that deepen our bilateral economic engagement.